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Invitation to Trouble:

The Hidden Costs Associated With Settlement

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FOR THE INSURER or corporate defendant, the decision to settle litigation is often made by a simple, seemingly rational formula: How much will the plaintiff accept, compared to the cost of defense? If a settlement can be achieved within the budget, and the risk of a major adverse award avoided, then the decision to settle is considered a "prudent" business decision. It feels good to "get that one behind us," as one CEO remarked recently about a multi million dollar settlement he recently approved. If the plaintiff will settle for more or less the cost of defending the case, then why *not* settle?

The reasoning rings so true that few have seriously questioned it. On closer inspection, however, this simple equation becomes, not a formula for reducing risk--although it does so in the short run--but rather a formula for increasing the number of lawsuits and the subsequent risk to the corporation in the long run. Plaintiff attorneys count on the fact that the vast majority of cases settle and that the cost of an adequate defense sets a floor for settlement discussions. If defendants would reserve settlement for cases that cannot be won, many plaintiff firms would cease to exist.

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Short-Term Factors

Of course, a focus on short-term financial considerations is understandable and, in many instances, justified. The problem lies in the indiscriminate use of the settlement equation. Many corporate counsel, confronted with the risk of an adverse verdict at trial and nightmares about runaway punitive damages, decide to settle without a fight, no matter how unfounded the complaint might be. This reaction is often understandable. A trial is expensive and anxiety-provoking. Risk can never be totally eliminated. The possibility of settling a case for 10 percent or 25 percent of the theoretical risk can look attractive when one is making decisions on the basis of educated hunches and intuition--not facts. And many cases should settle. Sometimes they involve injuries or losses that should be compensated. In other instances, the law makes a successful defense nearly impossible, as is the case in many jurisdictions with strict liability statutes that do not permit the state-of-the-art defense.

Many cases, however, should not be settled because they have no merit and can be won. One out of three settlement dollars ends up in the accounts of plaintiff attorneys and is used to identify new situations, often involving the same firm, where any significant loss has occurred. One major computer manufacturer on the West Coast, for example, has been sued by the same plaintiff attorney at least six times in the last five years, and has settled each time. These settlements have transferred millions of dollars to this particular plaintiff attorney, resources which were used to fuel his next case.

Long-Run Factors

The law is flexible and ambiguous enough that the mere fact of a significant loss, combined with creative lawyering, is usually sufficient to survive summary judgment and that is usually enough to get settlement talks moving. By identifying such cases and confronting plaintiffs at trial, a corporation will be much better off financially in the long-run. Companies that routinely settle marginal cases develop a reputation among plaintiff counsel as sources of revenue. Companies that stand up and fight against suits that can be won send a powerful message to the plaintiff's bar: settlement is not automatic anymore. If you do not have a strong case, we will make sure you walk away empty-handed.

In addition to the pressures within the corporation to settle litigation, the pressure from the court system is also immense. Underfunded and overwhelmed by an ever-increasing caseload, few judges have time for a lengthy trial and most do everything they can to encourage litigants to settle. In some jurisdictions, the law is being bent toward settlement without regard to justice. The Supreme Judicial Court of Massachusetts, for example, ruled in 1983 that it was appropriate for a trial judge to use the threat of treble damages to promote settlement irrespective of a defendant's involvement in the underlying action.

Inviting Trouble

The stampede to settle, combined with the increasing number of lawyers, is a sure-fire formula for more and more suits. This is especially true in situations where there is a strong possibility of serial litigation or class actions. Settlement encourages plaintiff counsel to file marginal suits, assured that

earlier settlements and the costs of defense set a minimum value for the case. While attempts to place restrictions on punitive damages and joint and several liability may help stem the tide of litigation, such efforts are meeting considerable political resistance. Since mostly state laws are at issue, success is unlikely to be uniform or complete.

Most plaintiff attorneys have a standard complaint on computer disk that can produce a 100-page document in a day. That leaves a great deal of time for ambitious plaintiff counsel to search for the inevitable loss that is bound to occur with a wealthy corporation in the causal chain--so long as they have sufficient settlement funds from prior cases to fuel their efforts. Many plaintiff counsel made wealthy by asbestos settlements are now gearing up for their next attack: multi chemical sensitivity claims. Imagine the number of lawsuits that will be generated by the nearly $4 billion settlement of the breast implant cases. That case alone represents over a billion dollars that will be used to generate complaints paid for by the very defendants who are likely to be targets of the next suit.

There is an alternative to this current situation: Take the cases that can be won to trial. The technology to assess risk is available through pretrial jury research that empirically identifies cases that can be won and establishes a reasonable value for those cases which should be settled. Using empirical research to help manage litigation will not increase and can decrease costs even in the short-run. By identifying the key issues upon which the case will be decided, a more limited and well-focused discovery process can be developed.

Bottomless Pit

If pretrial research was used routinely, more companies would experience the jubilation that DuPont recently did when it won its first Benlate case. Speaking after the victory, John F. Schwartz, Senior Vice President and Special Counsel, expressed the attitude that will ultimately save that corporation millions: "DuPont is not a deep pocket, a bottomless pit or an underground well ready to be tapped dry." As a result of this victory, the plaintiff attorney involved has fewer resources to go on to the next "situation." The defendants had the courage to confront the inevitable short-term risk of trial in favor of the long-term corporate, financial and social benefits that accrue when justice--not settlement--takes priority. ■