

# Damages in Settlement Negotiations and Mediation

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Damages represent a powerful tool in negotiation for settlement of employment disputes. Here are some of the ways in which damage questions are vital to the process:

**Pivotal Anchoring Device.** The “best alternative to a negotiated agreement” in an employment case is a trial on the merits, the outcome of which will be a judgment for one side or the other. For most employment disputes, this will be a money judgment—whether for nothing (defense verdict) or some amount of cash (typically, from an employee’s verdict, but on occasion an award for counterclaim damages). The usual way to value an employment case consists of calculating the damages the employee will recover if successful and discounting that amount based on the probability of a defense verdict.

These are exceptions to this principle:

- One side or the other may have a vulnerability known to the other (the case may be media-worthy and the employer may be highly adverse to unfavorable publicity, or the employee may be unable to sustain the cost of litigation), and that vulnerability may drive the settlement amount.

- Before litigation or early in the process, the parties may look to severance pay concepts (either specific to the employer or according to some supposedly customary formula) to calculate what will be sought or paid
- In situations where the claimant is a current employee, even an at-will employee, the settlement amount may be driven by the value to the employer of avoiding the continuation of the employment relationship because doing so eliminates an irritant and future exposure to liability for retaliation claims.
- Generally, the element of damages associated with attorney's fees to which the parties look is not the amount that is likely to be awarded after success at trial, but the amount of legal fees accrued to the date of settlement.

Aside from these situations, potential damage recovery and probability of success are the touchstones to which the parties and counsel will look in determining the settlement amount, or the "value" of the case.

In any negotiation, the range in which the parties are negotiating has a profound impact on the ultimate outcome. Our common negotiating culture calls for the parties to begin at opposite ends of the range of potential outcomes (zero or the maximum potential recovery) or some concession from the extreme edge of the range, impliedly demanding a corresponding concession. By a series of moves away from the extremes (note: this is not the same thing as

moving towards a center), the parties eventually arrive at a figure on which they can agree.

Nothing has a greater impact on the final settlement figure than the starting points. One of them will almost always be zero; the other one is driven by a damage calculation.

**Adjusting Expectations Through The Damage Calculation.** Each side has an opportunity to affect the other's frame of reference for negotiation through damage calculations. Astounding, parties tend to be fixated almost exclusively on liability—which controls the amount of the discount—to the exclusion of damage issues.

### **Why Lawyers Focus on Liability**

There are several reasons for this tendency. First, attorneys absorb their clients' emotional need for vindication, to which the liability determination is essential. This is exacerbated by the fact the focus in employment law on matters that generate emotional reactions. A discrimination case requires an accusation of anti-social behavior (discriminatory intent) and even a breach of contract case is often accompanied by efforts to show an improper motive that impeaches any legitimate basis for termination. Jury appeal of a defense case is greatly aided where there has been improper or incompetent conduct by the plaintiff, and employees universally have their egos tied up in their work.

Second, liability issues are associated with the drama of the events that led to the termination, adverse employment action or employee mistreatment on which the case is founded. The deterioration of the employment

relationship is usually a much more interesting story than the employee's post-termination mitigation efforts.

Third, lawyers are competitive people engaged in a competitive process, and their attention is riveted on winning at trial. Invested as they are in their client's causes, they overlook the range of potential outcomes other than total victory. This is the consequence of two human failings that cognitive psychologists studying "heuristics" have identified: *representativeness error* and *affective error*.

Representativeness error refers to the tendency we all have to discount the probability of less probable potential outcomes. It is simply part of how human beings respond to uncertain situations. If you doubt this, compare the outcomes of the last five cases you tried to verdict to what you expected either at the outset of the case or at the time of trial. (If you believe you accurately predicted each, you are falling victim to the well-documented tendency of people to believe that their former opinion was something different from the one they actually held once it has been contradicted).

Affective error refers to the way our objective judgment is distorted by our desire to obtain an outcome that fits with our personal emotional preferences. This is why people bet on the home team when it is not favored, or why I believe that the candidate I favor in an election will somehow prevail long after disinterested observers have concluded that it will not happen. Lawyers are emotionally tied to their clients and have powerful emotional and

financial reasons to want their clients to get what they want. None of us exercises the cold-blooded judgment with which we credit ourselves.

There is one more factor worth mentioning: pure ego. Trial lawyers want to believe that their own efforts and superior skill make a profound difference to the outcome of the case. I cling to the prediction of total victory because it is consistent with how I wish to see myself: as the all-powerful champion of my client who can control the outcome of a case through my own talent and actions.

### **Using Damages To Change The Playing Field: Employee's Counsel**

The problem of overlooking damage issues is so obvious that the Advisory Committee on Federal Rules included a provision in the disclosures mandated by the Federal Rules of Civil Procedure to force parties to focus on damages at the very outset of the case. The plaintiff is called upon to quantify and support the specific damages claimed. All too often, this requirement is disregarded by plaintiff's counsel.

Damage claims are much less persuasive when they are obvious "back of the napkin" calculations. One of two things will happen, and perhaps both. First, the calculation will be inflated because it will rely on estimated figures rather than specific, documented data; it is so much in the interest of the employee's attorney to come up with a large number that all manner of error will be found in the calculation: double-counting, generous rounding up, and unsupported estimates based on wishful thinking (assuming that the maximum bonus would have been awarded to the employee) are common.

Second, the calculation can overlook meaningful elements of damage that do not instantly come to mind (job search expenses, moving costs to take a new job, value of fringe benefits, prejudgment interest, the impact of probable future increases in pay from the former employer). The casual approach to damages leaves money on the table that is there for the taking.

Employee's counsel can extend the negotiating field by identifying every possible element of damages and providing a well-documented calculation of each early and often. Such calculations are most persuasive if they are not founded on unreasonable assumptions. Along the way, there will be plenty of opportunities to make reasonable assumptions that increase the potential recovery. If the defense is provided with a detailed spreadsheet calculation listing all the elements and showing how each is calculated, referenced to documentation, those numbers will sink in and affect the employer's valuation of the case. If defense counsel is less than thorough, those calculations may go essentially unchallenged, which is the one way that an attorney for the employee actually can add value to the case through his or her own talent and actions.

### **Using Damages To Change The Playing Field: Employer's Counsel**

The usual "back of the napkin" calculation by management's counsel is likely to be inaccurate because it omits elements of damage that have been ignored or dismissed out of hand. It is also likely to be based on figures that capture less than the full claim; for instance, employer's generally omit bonus

or incentive compensation and rely on base salary to calculate damages, and thereby close their eyes to the actual exposure.

Employer's counsel can change the playing field by carefully dissecting each of the elements of damage claimed by the employee and seeking out facts and figures that drive down the recovery. Highlighting the impact of an offset for severance pay, showing the probability of a later reduction in force affecting the fired employee and making a good record of inadequate mitigation are among the tools to be considered. Unmasking a less-than-obvious double-counting in plaintiff's calculation at a crucial moment can dramatically affect the negotiation.

**Starting With The Damage Calculation.** A skilled mediator will begin the process by harmonizing the parties' view of the damages. If this step is not taken, the parties will be applying their discounts based on the chances of a defense verdict to different numbers. The plaintiff's numbers will invariably be higher, usually significantly higher, than those being used by the defense.

Unlike the liability questions, the damage questions (except for punitive damages) rarely touch the emotional nerves liability issues irritate. Unlike the liability questions, many are susceptible of objective determination: the plaintiff's annual compensation can be ascertained from company records and tax returns, benefits and compensation calculations can be verified with reference to terms of the applicable compensation structure or benefit plan, and so on. Many mediations begin with a detailed examination of these kinds

of questions which, surprisingly often, the parties come to the table without having examined closely and critically.

This process provides an ideal opportunity to surface and discuss damage issues on which the parties are likely to disagree. Each, however, must consider the other's points and incorporate a reasoned evaluation of the impact of the issue on its position. It is much easier to modify one's position in response to a demonstrated error in calculation or assessment based on misinformation than in response to an argument that the theory of the case is legally or factually unfounded.

But once a party has adjusted its position in response based on a mistake relating to damages, the demonstration of flexibility can favorably affect the potential for settlement. If the defense recognizes an element of damage not been considered before, this opens the door to more general reconsideration of the merits of the case. Confronting a strong damage defense that has not been recognized or given credence before the mediation, the employee side will be more open to reconsidering its position and may begin to show flexibility.

Just as important, when either party makes a concession, even due to an obvious mistake, the other party is under greater pressure to make concessions in response. This is part of the normal give-and-take of negotiation: when one side makes a concession, our negotiating culture permits that side to demand a similar concession in response.



Finally, damage issues require a more complicated calculus that pushes parties, especially plaintiffs, to recognize the variety of potential outcomes that could occur if the case goes to trial. If the employee's attorney believes there is a 75% chance of establishing liability, the collateral costs of litigation (impact on employee's career) and the benefits of settlement (eliminating uncertainty, immediate availability of cash) may lead the employee to agree to a discount over 25%. But if the employee considers damage defenses, each of which could result in an award that is 50% lower than the full recovery expected, even greater flexibility is required.

Some examples of areas where damage arguments should be considered by both sides are:

- “Soft” damages such as emotional distress and punitive damages. The presence of caps on recovery serves to provide an anchor. Defense counsel's thinking often begins with the cap amounts and then discounts in recognition of weak points in the plaintiff's case, even to the point of eliminating consideration of these elements of damage. The employee side is actually benefited by the cap, in that it establishes an order of magnitude in the mind of defense counsel. Plaintiff's counsel normally assumes that every case will result in the maximum recovery permitted by the caps, which is not in keeping with actual experience in the courts. The defense said can benefit from presenting examples of other cases that

seemed equally compelling but resulted in recovery well below the caps.

- Mitigation of damages is a fertile area for discussion. Respecting job search issues, the case law is fairly forgiving, but plaintiff and plaintiff's counsel may be sensitive to the argument that a relatively lame effort was undertaken. This is an issue that, if allowed to go to the jury, opens the door to virtually any figure the jury selects that is below full recovery of losses.
- The impact of post-termination events on the employer's practices in compensation and bonuses, as well as post-termination reductions in force, present the opportunity to argue that less than full back pay will be available for recovery.
- Fringe benefits and bonuses are areas in which plaintiff's counsel often includes damages that are based on inaccurate assumptions. Where accurate information requires consideration of different damage amounts, this can require reducing expectations.

While these matters mostly operate to reduce the potential for recovery by the employee, consideration of them based on an analysis of the evidence tends to modify the former employer's position because elements of damage that had been dismissed and unavailable become part of the arithmetic in arriving at a figure that represents the employer's exposure and tend to increase that figure. The analysis of evidence also provides greater confidence that the exposure is real.

## **Focusing Parties On The Future**

## **Where Damage Issues Get Emotional: Attorneys' Fees**

### **Conclusion**

The parties' expectations about settlement are significantly affected by their assessment of damages, but usually they have different assessments which invariably push their settlement positions away from one another. Reviewing and challenging the damage issues avoids the more emotional, and therefore more difficult to resolve, differences over liability questions. Where the parties begin from a common frame of reference, and identify the vulnerabilities they face beyond the merits, greater flexibility is engendered that may allow the parties to reach a settlement.