The Importance of Quantifying Intangible Litigation Costs
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CPR members know that intangible costs of litigation – not just potential liability and legal expenses – are extremely important to clients. CPR's excellent Early Case Assessment (ECA) Toolkit provides a good list of intangible business concerns that lawyers and clients should consider in assessing cases.

How many lawyers and clients actually conduct ECAs and how many actually quantify the value of the intangible costs of litigation? Our research suggests that many lawyers shy away from giving clients clear, explicit assessments of readily quantifiable aspects of litigation – liability and litigation expenses. They are even less likely to value intangible consequences, which are much harder to quantify but can be extremely important to clients. Without a careful assessment of intangible as well as tangible costs, an organization's decision-makers can underestimate the impact of litigation and thus make poor litigation decisions.

This article describes several major intangible costs – organizational dysfunction, opportunity costs, and damaged reputations – and suggest ways that lawyers and business clients can quantify such costs so that they can make better litigation decisions.

ORGANIZATIONAL DYSFUNCTION

Companies are composed of individuals who may suffer litigation stress, which can degrade people's cognitive functioning because stress depletes mental resources, stimulates fight-or-flight reactions, and increases the risk of cognitive and motivational biases. When companies are parties in litigation, their board members, executives, managers, and other employees may have a lot at stake and are especially likely to be stressed.

Employees may worry about continued employment in the company or with other potential employers. If employees' actions are challenged in litigation, they may become defensive and try to justify their actions. They may provide inaccurate information about events at issue, which could create problems for their employers.

While litigation is pending, networks of internal relationships may suffer. Different employees and organizational units may have conflicting perspectives and interests in the handling of the cases, which can cause internal discord in addition to conflict with the other side.

Weakened Organizational Morale. Litigation can undermine identification with the companies by their stakeholders, including company officials, employees, customers, and contractors. Lawsuits can tarnish companies' images in stakeholders' eyes, creating crises for stakeholders who have strong bonds with the companies. This can reduce their motivation, satisfaction, and willingness to cooperate with others in the company. The tendency to closely identify with the companies is magnified for front-line ambassadors—individuals responsible for publicizing the companies' positive values. Some may resign to avoid the pain involved.

Companies can have identity crises similar to those experienced by individuals. Like humans, companies try to preserve their self-esteem and avoid psychological pain. Adverse publicity from litigation that damages companies' reputations can become internalized by their stakeholders. This affects the companies' "internal brand": perceptions of their fundamental purpose, integrity, and accountability.

Litigation can disrupt the social atmosphere within companies, eroding morale and destabilizing their culture. It can affect employee absenteeism, physical health, productivity, and decision-making.

The adversarial nature of litigation can poison the workplace environment by creating a "win or lose" dynamic. Individuals may suffer social and psychological harm from the companies by being perceived as "losers," which can result in antisocial workplace behavior of displaced aggression within the companies.

Faulty Organizational Decision-Making. In reaction to the pressure of lawsuits, decision-makers can experience high levels of uncertainty, emotion, and pressure, causing them to misperceive crises and make decisions that are not in the companies' best interests. Self-serving cognitive and motivational biases can impair their decision-making. When they get information challenging their perspectives, they may reject or discount the information, causing them to overestimate the strength of their legal cases. They are particularly susceptible to attribution bias, planning fallacy, and escalation of commitment.

Attribution bias can lead decision-makers to attribute success to internal factors, such as their personal abilities, and attribute failures to external factors, such as bad luck. This can cause people to be overconfident which can lead them to overestimate their chances of success in litigation.

Planning fallacy occurs when managers make decisions based on excessive optimism. This is particularly common in companies that encourage optimism and interpret pessimism as disloyalty. Related to this process, companies may develop "groupthink," as mutually reinforcing biases are validated by the group. Real or imagined gossip and criticism "at the watercooler" can produce strong emotions, causing decision-makers to override their own good judgment and focus on short-term rather than long-term goals.

Decision-makers sometimes maintain or intensify commitment to a flawed strategy when people criticize a strategy they developed or advocated. As a result, they may favor continued litigation or trial to justify past actions, protect their reputations, and secure their positions, even when it would be better for the companies to settle cases promptly. They may prefer to go to trial to avoid responsibility for accepting an unfavorable settlement. In those situations, the employees can blame the judge or jury for adverse decisions. On the other hand, employees who are risk averse may arrange unfavorable settlements to avoid the risks of trial. In both these situations, employees make decisions to protect their individual interests, which may conflict with the company's interests in litigation.

LOSSES OF OPPORTUNITIES

Litigation can prevent or delay achievement of companies' goals because of the diversion of time and energy of key stakeholders. Rather than spending time on core business matters, they must spend considerable time helping lawyers to prepare their cases and acting as witnesses in depositions and trials. In addition to the loss of managers' time engaging with lawyers or in court, companies can lose a lot of productive potential as employees gossip about the latest developments in litigation.

Lost time spent on litigation can eat into a company's profits. In an extreme example, analysts said that management distraction and reduced productivity during litigation between Texaco and Pennzoil resulted in a $2 billion reduction of combined equity by the two companies.

The diversion of companies' time and energy can disrupt their "innovation agendas." During major ongoing litigation, managers have a harder time making long-term plans. Anticipating possible adverse litigation outcomes, they may shift into "survival mode" to preserve scarce resources. For example, litigation over Merrell's Benedectin drug diverted employees from developing new drugs. In a U.S. Senate Commerce Committee survey of approximately 2,000 CEOs about the impact of litigation, 36% said that it caused their companies to discontinue selling certain products, 15% said that they laid off workers due to litigation, and 8% said that they closed plants because of it. Thirty percent of firms that had been sued decided against introducing new products. A U.S. secretary of commerce identified a "fear to innovate" as an indirect cost of product liability litigation.

DAMAGE RELATED TO PUBLIC IMAGE

Reputations are vital assets for all types of organizations, especially in the age of social media. Although people generally recognize the significance of reputations in litigation, they often don't understand the ways that litigation can harm reputations or how much organizations can suffer as a result.

Financial analysts use reputation metrics as important investment criteria, so damage to reputations can have a direct financial impact by depressing companies' valuations. Positive reputations help secure and maintain positive relationships with stakeholders, enhancing economic performance. Reputations often are linked to community and institutional support, the quality of employee recruitment pools, and employee commitment and satisfaction. Damaged reputations can threaten these interests.

Stigmatizing of Companies' Brands and Reputations. Brands are companies' most vulnerable assets, reflecting customers' images of their products or services, differentiating them from others, and sometimes justifying higher prices. Litigation can quickly create crises for companies by reducing the value of their brands.

Brands reflect the long-term relationship between companies and the public. Brands have great narrative power to tell stories about companies. Companies strategically develop their brands to portray certain qualities, such as family values and security. A "brand personality" is the set of human characteristics associated with a brand. For example, brands such as Harley-Davidson, Marlboro, and Levi's display the brand personality of "ruggedness," glamorizing ideals of strength and masculinity. Brand personalities can increase consumers' emotional bonds with products and thus increase customer loyalty and sales. Litigation can seriously damage companies' bottom line when it contradicts stories reflected in their brands and undermines consumers' trust.

Companies' reputations reflect public perceptions of their value systems. Companies generally are expected to act legally and ethically, operate based on values of integrity and trust, and contribute to the public good. Companies' success and survival are related to perceived fulfillment of their economic, ethical, and social responsibilities. Stakeholders may abandon companies when they believe that institutional actions do not align with the stakeholders' values. One study found that 59% of subjects believe that if a company has been sued, it probably is culpable. Litigation can become a battle for the stakeholders' "hearts and minds" as companies try to retain their loyalty.

Negative Media Coverage. In our world of ever-expanding dissemination of mainstream and social media messages, litigation can be extremely dangerous to companies' health and survival. Legal victories may not protect companies from reputational damage. Even a legal victory can be a public relations disaster, as illustrated by the *Monsanto v. Schmeiser* case. Monsanto sued Saskatchewan farmer Percy Schmeiser after its patented Roundup Ready® canola seed was found in his fields. The Supreme Court of Canada upheld Monsanto's patent, but the ruling alienated farmers, who feared they could be sued if Roundup Ready® genes happened to drift into their crops.

The risk to companies' reputations is complicated by the tension between their legal and public relations strategies. Lawyers generally focus on identifying legal problems and minimizing risks, whereas public relations professionals generally focus on promoting favorable public communication. The very openness and honesty that can favorably affect public opinion can be highly damaging in litigation. Pending litigation can limit public relations opportunities because public statements can undermine companies' credibility in court and be considered as admissions of liability.

Social media communications magnify companies' reputational risks from litigation, as social media are prone to spreading exaggeration and misstatements. It is easy to spread fabricated "expert" opinions, which readers may accept at face value. Once damaging information is disseminated through the internet, it may be impossible to remedy the damage. Indeed, attempts to limit access can further damage companies' reputations.

When business litigation becomes a media event, the harm to the companies can increase substantially. Journalists use narrative devices to craft their stories, often casting corporate defendants as villains with deep pockets, and plaintiffs as the "little guy" fighting against power and privilege. While companies have some control of their messaging through press releases for the mainstream media, social media communication—such as blogs, websites, social networking sites, and mass e-mails—increasingly influence public perceptions.

Reputational damage can last a long time, even after companies' efforts to rehabilitate their images. For example, after a lawsuit against Nike disclosed that some of the company's Asian subcontractors were forcing children to work in poor conditions, it re-examined its entire supply chain and published a list of its suppliers. Although Nike increased its transparency, it suffered lingering reputational damage.

Cost of Rehabilitating Reputations. To effectively address public image issues during litigation, companies may assign their public relations and legal teams to jointly develop public communication strategies. They need to simultaneously promote positive images and advance the litigation strategies, which can be difficult in the midst of contentious litigation. Such additional efforts increase the companies' costs.

Managing reputations related to major litigation may require much more than simply developing effective legal and public relations strategies. Companies' leadership at the highest levels may need to undertake new initiatives that recognize contemporary social mores, business ethics, and norms of business responsibility. These efforts are likely to require a substantial amount of time because of the complex interrelationship between business ethics, brand, and litigation strategies.

When companies suffer reputational losses from litigation, they may incur additional expenses to rehabilitate their image and make any necessary behavioral changes. For example, they may need to rebrand their companies with both internal and external stakeholders. Internally, rebranding may involve recasting the company's core mission and values. This can require a substantial amount of expense and employee time to reflect on the problems, develop new approaches, and communicate them effectively within the companies. Externally, companies may develop a new name or logo and implement a major public relations campaign to build a more positive image.

VALUING INTANGIBLE COSTS

Whereas damage awards and legal fees and expenses are quantifiable (albeit hard to estimate accurately), it is especially hard to quantify intangible costs of litigation. There aren't clear and accepted methods or metrics for valuing these types of intangible costs. As a result, it is easy for companies to ignore them when weighing the likely costs and benefits of litigation. Many decision-makers are aware of intangible costs and use gut reactions about them in making litigation decisions. Even in these situations, they may not carefully consider all the intangible costs and they may underestimate their value.

There is no magic formula for estimating intangible costs accurately. So decision-makers must do their best to assess the costs in each case. Lawyers may not feel qualified to make these estimates, so this provides an opportunity for lawyers and company decision-makers collaborate in setting valuations.

These estimates should focus only on *prospective* costs of continued litigation, *not sunk costs* that already have been incurred. Also, decision-makers should try to separate the effects of the litigated issues themselves from the anticipated effects of future litigation and adjudication. This is a difficult task because some intangible costs, such as reputational damage, can be due to the underlying issue in the case. If that damage has already been suffered, then it is a sunk cost. For example, a defendant in a product liability case may suffer reputational damage due to a product defect. In making litigation decisions, parties should consider the extent to which the litigation process itself would produce *additional* reputational damage.

Despite the difficulties in estimating intangible costs, decision-makers in litigation should do their best, recognizing that the values are rough estimates. It can help to estimate *ranges* of the costs, which may provide more confidence. For example, one can estimate the costs to be between $100,000 and $200,000 instead of making a single estimate of $150,000.

Methods for Valuing Intangible Costs. Some experts have developed methods to estimate intangible costs. For example, decision-makers can estimate the cost of the diversion of employees by estimating the amount of employees' time that would be devoted to the litigation and multiplying it by an hourly rate of compensation. Various employees have different rates of compensation, which may be combined into a single average. Alternatively, estimates can be made for individual employees or different categories of employees. Compensation rates should include non-salary compensation such as bonuses and fringe benefits.

Costs also should be included for overhead, such as administrative time, directors' time, in-house counsel time, and time wasted due to disrupted routines. This could also be estimated as some multiple of the amount of liability attributed to the litigation. As an example, the intangible costs could be estimated as 50%, 100%, 200%. If a decision-maker estimates the amount of the liability to be $200,000, the intangible costs would be $100,000, $200,000, or $400,000 in this example.

Corporate defendants understandably worry about the risk and cost of motivating potential plaintiffs to sue them in the future. There are risks both in settling and losing at trial. Although these risks are hard to quantify, defendants can assess the probability of additional litigation resulting from decisions in the present case and decide how much it is worth to reduce or avoid the risks of stimulating additional claims in the future. There can be an intangible benefit of winning at trial, so decision-makers should consider this value as well.

One approach is to assess an intangible factor as a percentage of a tangible cost, such as 5% to 15%. For example, reputational loss can be estimated as a percentage of the company's market value or tangible litigation costs.

The simplest—and perhaps best—way to estimate the intangible costs is for decision-makers to decide how much they would pay to avoid the costs. Parties can think of this as a form of insurance premium to avoid these costs. After identifying the various categories of likely intangible costs in a case, decision-makers can determine how much more they would pay (or how much less they would accept) to avoid these costs by promptly settling the case instead of continuing in litigation.

To produce the greatest value, this assessment should occur as early as reasonably possible in the litigation—or optimally even before litigation begins. The earlier that decision-makers and their lawyers conduct these assessments, the more they can save in litigation costs.

CONCLUSION

Litigation creates major risks of attracting huge intangible as well as tangible costs. Intangible impacts can dwarf the potential liability and tangible costs of litigation in some cases, as well as its benefits. In particular, litigation can disrupt companies' internal dynamics, prevent them from pursuing opportunities, and harm their public image. For companies to make wise litigation decisions, they must assess these risks as accurately as possible.

Sophisticated decision-makers are generally aware of intangible interests affected by litigation. They should not ignore intangible factors just because these assessments are difficult and uncertain. If they fail to assign a numerical value to those interests, they risk making poor litigation decisions because they ignore or undervalue these interests. Our book includes detailed checklists of questions to help lawyers and mediators work with clients to identify and value intangible interests and a simple framework to help companies make good decisions that consider values of intangible litigation costs.

For the research underlying this article and its associated chapter in the book, see Keet, Heavin and Sparrow, *Indirect and Invisible Organizational Costs: Making Informed Decisions About Litigation and Settlement*, 20 Cardozo Journal of Conflict Resolution 49 (2018).

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