

**USING DECISION TREE ANALYSIS TO MANAGE
LITIGATION (AND OTHER) RISK
HOUSTON ASSOCIATION OF CORPORATE COUNSEL**

PRESENTED BY
TOM FULKERSON, WES LOTZ & JERRY MITCHELL
FULKERSON LOTZ LLP

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DOES THIS SOUND FAMILIAR?

- “For 18 months I was told we were right and our case was defensible. Now I’m being told we have to settle.”
- “We had a budget of \$200,000 for the litigation. Now I’m at \$400,000 and we’re only half way done. Management is furious.”
- “Do we really have to ‘turn over every rock?’ The cost is killing us.”
- “I have no idea where this case is going. It changes from week to week. We don’t seem to have a clear strategy for getting this resolved.”

ALL THESE PROBLEMS ARE SYMPTOMS OF THE SAME FAILURE

Outside counsel should be expected to:

- 1) jointly *investigate* the pertinent facts with you;
- 2) *distinguish* important facts from trivial ones;
- 3) *assess* the likely outcomes at key decision points, and
- 4) *give an opinion* for which they are held ***accountable***.

GOOD DECISIONS TREES LEAD TO GOOD DECISIONS

“The best practical advice then is: try to maximize your expected payoff, which is the sum of all payoffs multiplied by probabilities.”

“Each party tended to view its own chances in court as better than the other side.”

“It is amazing to see how wide a spectrum of results can be obtained from replicating an identical negotiation with different principal actors, it makes no difference whether the subjects are inexperienced or whether they are senior executives and young presidents of business firms. That is an important lesson to be learned here.”

- **Howard Raiffa, Frank P. Ramsey Professor of Managerial Economics, Harvard University.**

CONSTRUCTING A HYPOTHETICAL DECISION TREE IN A THEFT OF TRADE SECRETS CASE

- Our Client, a manufacturer of medical devices, signed a Joint Development Agreement with a long time Customer (Customer-1) to develop a new surgical instrument in a \$2.5 Billion per year market.
- The JDA provides: **“Notwithstanding any other provisions of this Agreement to the contrary, neither party shall be liable to the other for indirect, special, incidental, consequential or punitive damages or loss, including but not limited to loss of profits or revenue, loss of opportunity or other like loss or damage.”**
- Two years and \$4 million later, no new product emerged and the Joint Development Agreement was terminated.

RISKS INVOLVED IN THE CASE

- One year later Client discovers a Solo Improvement and begins selling to Customer-2, eroding Customer-1's market share and profitability. Eight months ago Customer-1 bought our product to reverse engineer it.
- Customer-1's attorney emails you a "courtesy copy" of a lawsuit, telling you he is at the Courthouse to obtain a TRO barring all sales.
- If the injunction is granted the Client will lose \$30MM of sales a month.
- The Client anticipates adding \$165 MM to its profit line from sales of the New Product this year.
- Client insists the Solo Improvement is based on different research and rejects the approach taken in JDA research, but admits we "may not be completely clean."

MANAGEMENT ASKS YOU TWO QUESTIONS

“How bad is it?” and

“How much is this going to cost us?”

This program provides the tools to accurately answer those questions, without losing your mind while doing it.

STARTING OUR HYPOTHETICAL DECISION TREE

- Decision tree analysis breaks a complex problem into manageable parts, assigning each a probability and outcome.
- Instead of asking “how bad is this case?” we ask...
 - What is the risk we will lose the preliminary injunction hearing?
 - What is the risk we will lose at trial?
 - What is the cost of losing at the preliminary injunction stage and at trial?
 - Does the contract disclaimer protect us from a large runaway verdict?
 - How much will this cost in attorneys’ fees (through P.I., through trial)?
 - How much in opposition attorneys’ fees could we be liable for?
 - How much will it cost in employee time and effort to defend?

USING OUR HYPOTHETICAL DECISION TREE

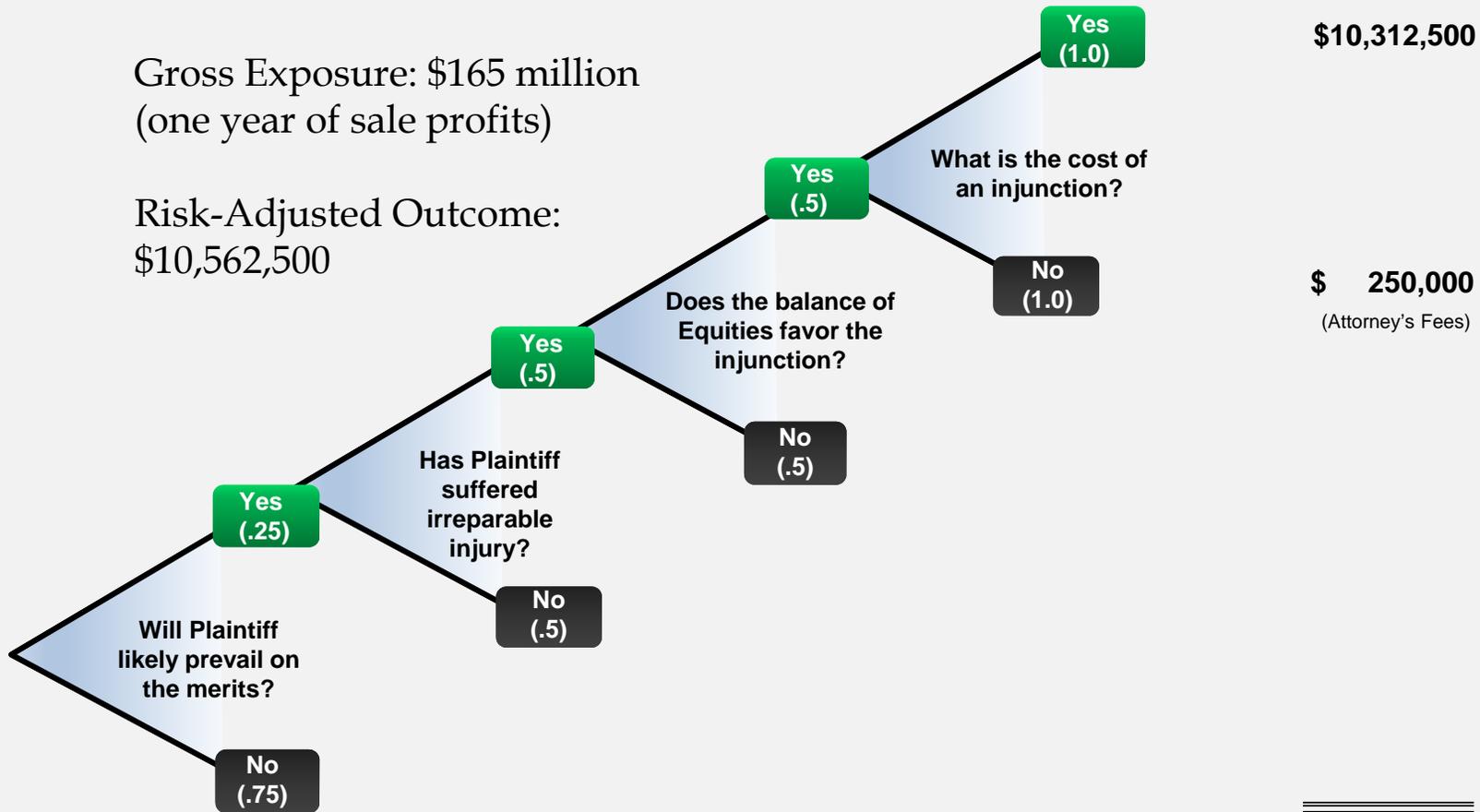
Once decision tree analysis is finished, we can test our conclusions and answer more critical questions:

- Settle or Fight?
- How do we best improve the odds of success?
- Is there a better way out?

DT1 – THE NEGATIVE EXPECTANCY FROM A PRELIMINARY INJUNCTION

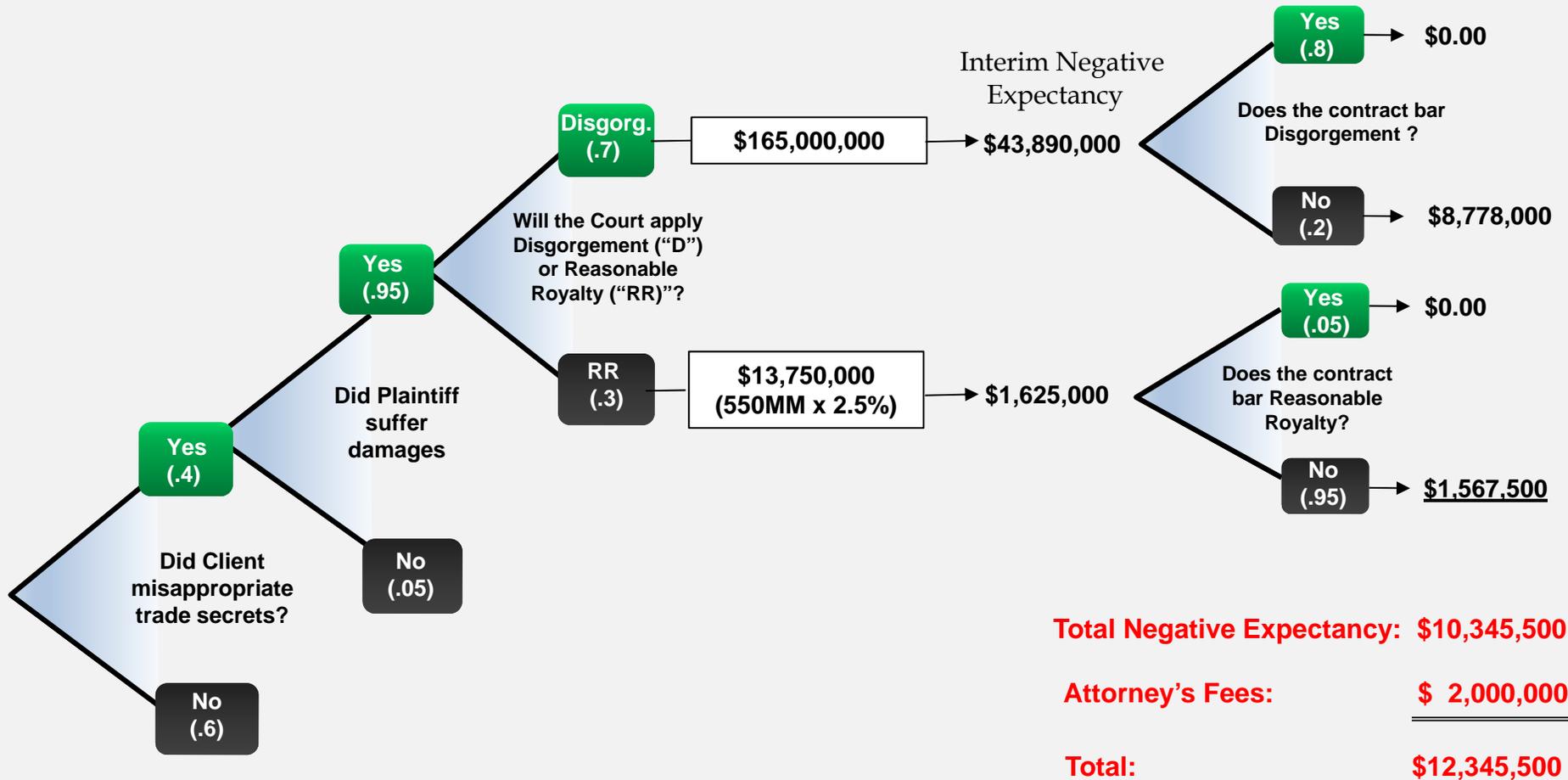
Gross Exposure: \$165 million
(one year of sale profits)

Risk-Adjusted Outcome:
\$10,562,500



Total Negative Expectancy: \$10,562,500

DT2 – TRIAL NEGATIVE EXPECTANCY



TOTAL NEGATIVE EXPECTANCY

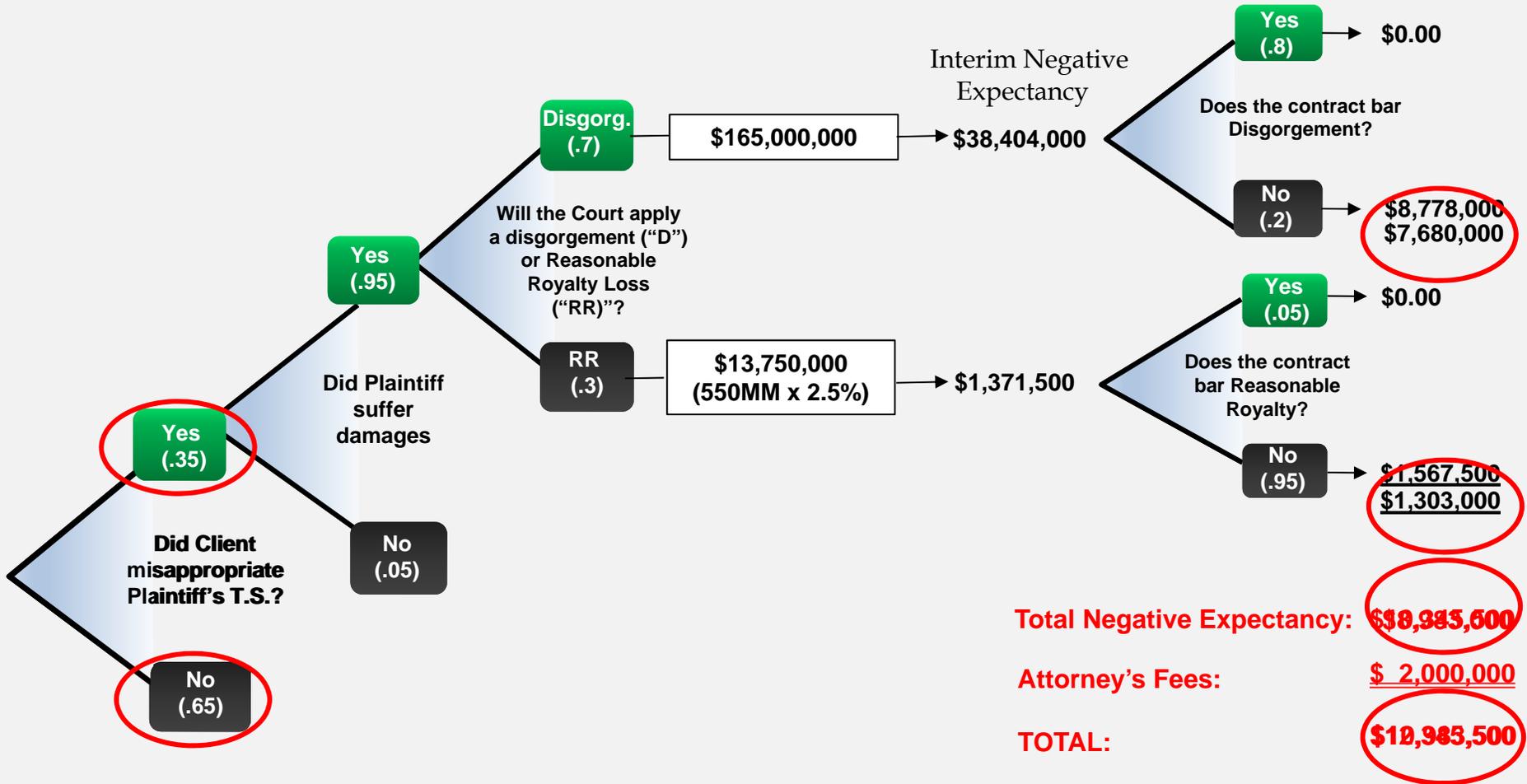
- Negative expectancy from the preliminary injunction phase: **\$10,562,500**
- Plus the negative expectancy at trial: **\$12,345,500**
- Total negative expectancy from completed litigation **\$22,908,000**

**We intentionally inserted flaws in these
two decision tree analyses.
Find them first and you win a \$100 Amazon™ gift card!**

DON'T STOP: USE THE DECISION TREE

TO IDENTIFY OPPORTUNITIES TO CUT RISK

DT3 – TRIAL NEGATIVE EXPECTANCY WITH IMPROVED LIABILITY CHANCES

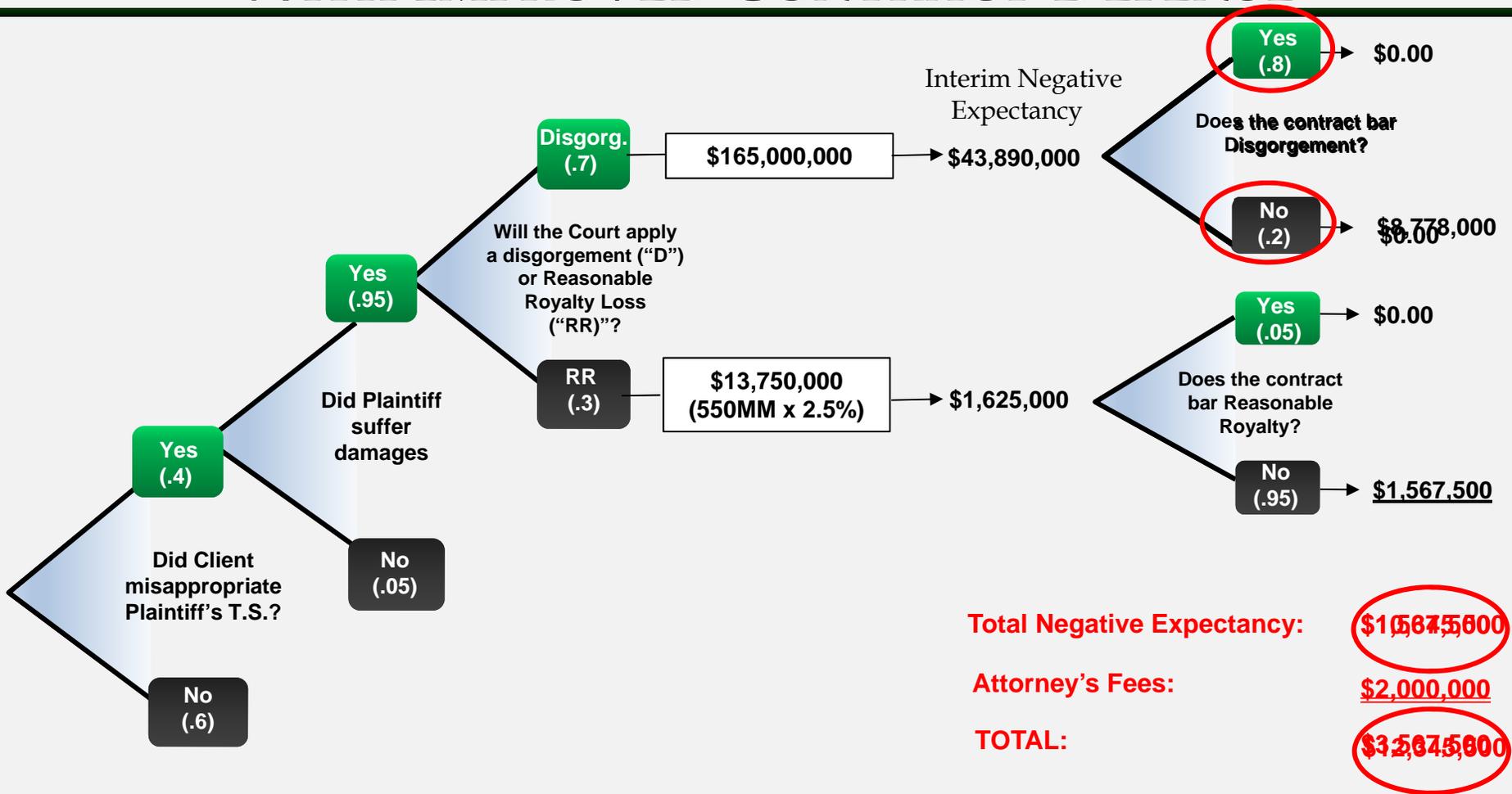


ASSESSING LIKELY OUTCOMES DRIVES IMPROVED STRATEGY

- In Texas, direct damages are those that “flow *naturally* and *necessarily* from a breach of contract such that they can conclusively be presumed to be within the contemplation of the parties.” *El Paso Marketing L.P. v. Wolf Hollow I, L.L.P.*, 383 S.W.3d 138, 144-145 (Tex.2012).

- Establish testimony by the plaintiff’s representative before it understands how critical the information is....
 - Q: Would you agree that even if my Client used the IP that doesn’t mean with any reasonable certainty that my Client would have produced a profitable device?
 - A: I guess so.
 - Q: A lot of things can go wrong between when a new product is developed and successful marketing of the tool, right?
 - A: Sure, I guess.
 - Q: For example, we might have built a device the market didn’t like or want, right?
 - A: Sure, I suppose.
 - Q: I mean, we could have built a device that didn’t even turn a profit, right?
 - A: Yeah, but you didn’t.

DT4 – TRIAL NEGATIVE EXPECTANCY WITH IMPROVED CONTRACT DEFENSE



THE RIGHT DECISION TREE TELLS US WHERE TO PUT OUR TIME AND MONEY

	Improved Liability Defense	Improved Contract Defense
Cost in Attorneys' Fees	\$750,000	\$75,000
Cost in Expert Fees	\$350,000	0
Cost savings/risk avoided	\$1,362,000	\$8,778,000
Net Gain in Risk Avoidance	\$262,000	\$8,703,000

DON'T STOP THERE! USE THE ANALYSIS TO ENGINEER A BETTER OUTCOME

- Conventional wisdom is “the person who makes the opening offer loses.” This is a “prevarication, a pure canard.”
- “But we’ll look *weak!*”
- Try this written offer:
 - “This is a worthless claim. You will end up paying not just your lawyers, but ours too.
 - We offer to sell you up to 200,000 new laparoscopic units at a \$250 per unit discount.
 - Over the next year and a half or so you make \$3,000,000 in attorney fees, make up to \$5,000,000 in product sales over the next five years and get immediate entry into the market.
 - The offer is off the table when we start the P.I. hearing.”

WHY MAKE AN EARLY OFFER?

- 1) It sets the tone and range of negotiations. The first offer is the extreme low end of bargaining outcomes.
- 2) It shifts the focus from whether JDA software was copied to the market value of the I.P.
- 3) The cost is in the worst case 25% of your expected negative outcome.
- 4) If it is accepted, the discounted sales may actually *add* to net revenue and profit.

YOU DO NOT HAVE TO DEVELOP THE DECISION TREE FROM SCRATCH

- There are a host of software packages that help with decision tree analysis. But be careful in your selection--- many are oriented to special purpose projects. Here are a few, all of which come with online free tutorials.
 - Decision Pro™: <http://www.decisionpro.biz/business-users/software/demo-download>
 - Precision Tree™ <http://www.palisade.com/precisiontree>
 - Free online tools: <http://www.butleranalytics.com/10-free-decision-tree-software/>
- Use the human capital available to you. Most corporations have extensive expertise in decision tree analysis and individuals who can perform it. Search them out. The added benefit is that management will see a presentation in a familiar format.

DID YOU FIND THE FLAWS?

- The Preliminary Injunction losses are incomplete. If your Client is forced out of the market it not only hurts in year 1, but for years to come.
- What if the trial is continued to 18 months?
- Preliminary Injunction damages and trial losses trade off.
- The trial damages calculation fails to consider game changers:
 - The figure covers only past damages.
 - The model does not consider whether the Client can engineer-around the trade secret.
 - Complex decision tree analysis might also consider other steps like chance of winning a summary judgment, a motion to dismiss or strike a key expert.

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We are not your daddy.

WE WELCOME ALL QUESTIONS

FOR MORE INFORMATION, PLEASE CONTACT:

THOMAS M. FULKERSON - (713)654-5888

WES LOTZ - (713)654-5830; OR

JERRY MITCHELL (713)654-5837



FULKERSON LOTZ LLP

4511 YOAKUM BLVD, SUITE 200

HOUSTON, TX 77006