

# LAW SUIT DEFENCE STRATEGY

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*Using Decision Tree Analysis*

**John Doe**

**3/24/2013**

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## **1. Executive Summary**

### **Preamble :**

The case relates to decision by an Insurance company in a claims case. John Cambell claims to have hurt himself while working on the roof of Eastview Aprtments, owned by Doug Raynolds. John has claimed a compensation of \$ 1.5 million but has made an offer to settle the claim at \$ 750,000. The company officials feel that John has a sound case. The Insurance Company has to determine whether it is better to accept the offer or make a counter offer of \$ 400,000. The risk associated with this decision is that if John reject the counter offer, he may either make a counter offer of \$ 600,000 or go for jury trial.

### **Analysis and Recommendation :**

The outcome of the jury trial is uncertain and the insurance company may have to pay anywhere between \$ 0 to \$ 1.5 million with the likely costs being \$ 825,000. However, in case John either accepts the counter offer or makes another offer of \$ 600,000, the insurance company stands to gain. The likely costs of the strategy to make the counter offer of \$ 400,000 is \$ 670,000 which is less than the other option of settling the claim at \$ 750,000.

Hence it is recommended that the company should make the counter offer of \$ 400,000. Should John make a counter offer of \$ 600,000, the Company should accept that offer instead of going for a Jury trial.

## 2. Background/Introduction

The case relates to decision by an Insurance company in a claims case. John Cambell, an employee of Manhattan Construction Company claims to have hurt himself while working on the roof of Eastview Apartments, owned by Doug Reynolds. The basis of John's claim is that John or his Company had been made aware of the rotten sections in the roof, the accident and injury could have been prevented. He has claimed a compensation of \$ 1.5 million.

Allied Insurance, the insurer of Mr. Reynolds, must defend Mr. Reynold failing which they will have to pay up the compensation amount. The officials of Allied Insurance have investigated the case and have found John's claim to be strong.

Allied must decide whether to accept John's offer or to make a counter offer of \$ 400,000. The risk Allied faces in the case of making the counter offer is that John may either reject the offer and the case may go for Jury Trial or make a counter offer of \$600,000. If John either accepts the counter offer or makes another offer, Allied will be better off. However, it may end of spending more money if John decides to go for a Jury trial. The possibility of the Jury awarding John either \$ 750,000 or \$ 150,000 is much stronger than they rejecting his claim.

### Payoff Table

Decision Alternative (i)	State of Nature (j)		
	<b>S1 = John Accepts Offer</b>	<b>S2 = John Makes a Counter Offer</b>	<b>S3= John Decides to go for Jury Trial</b>
D1 = Make An Offer	V11= -\$400,000	V12=-\$600,000	V13=-\$825,000
	<b>Jury Rejects John's Claim</b>	<b>Jury Accept John's Claim</b>	<b>Jury approves lower amount</b>
D2= Go for Jury Trial	V21=\$0	V22=-\$1,500,000	V23= -\$750,000

### 3. Decision Tree

The following facts are available about the case.

- If Allied makes a counter offer of \$ 400,000, John may accept the offer, reject the offer or make a counter offer of \$ 600,000. The probability of these events are 0.1, 0.4 and 0.5 respectively. If John rejects the offer, the case will be decided by Jury Trial
- If the case goes for Jury trial, the probabilities of the Jury rejecting John’s claim, accepting a lower amount of \$ 750,000 and awarding full claim of \$ 1.5 million is 0.2, 0.5 and 0.3 respectively.

Based on the above scenarios and decision points available to allied, the following decision tree has been constructed:

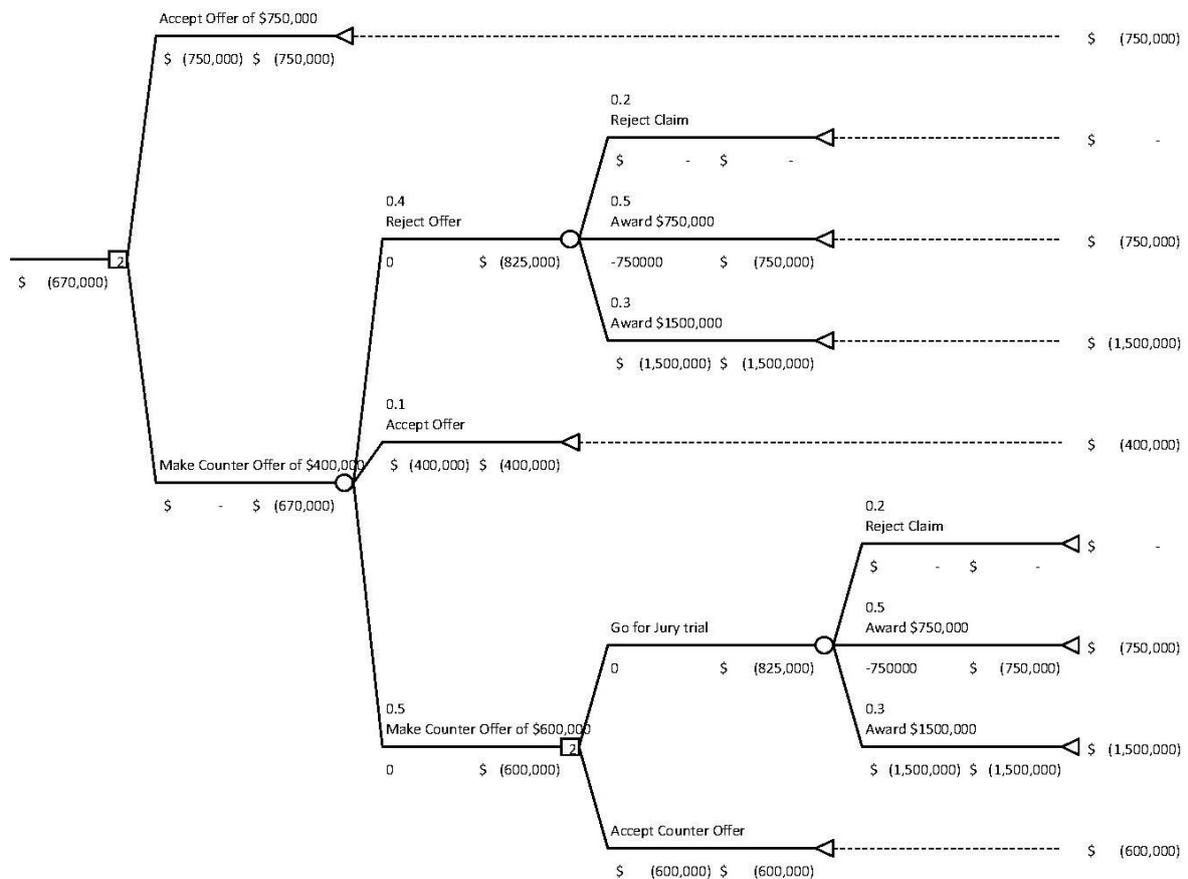
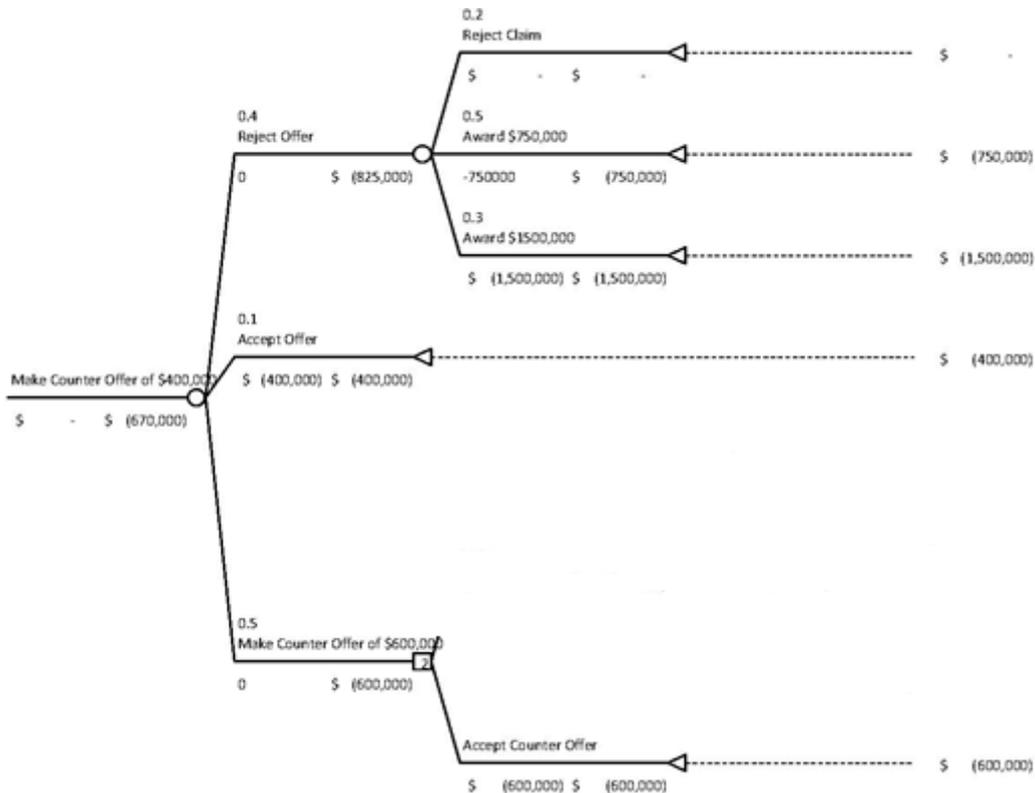


Figure 1 : Decision Tree For Lawsuit Problem

**Decision Strategy**



**Figure 2 : Decision Strategy**

**4. Recommendations**

**(I) Whether Allied should accept John Campbell initial offer to settle the claim for \$750,000**

The expected cost of the decision to make counter offer to John is \$ 630,000. This is less than the cost of accepting his offer of \$750,000. Further, there is an 88% possibility that Allied will end up paying less than or equal to \$ 750,000 if it decides to make a counter offer and hence it should definitely consider this option favorably.

**(II) Formulate the decision strategy that Allied should follow if they decide to make John Campbell a counteroffer of \$400,000**

Upon receipt of the counter offer, if John makes another offer of \$ 600,000 to settle the claim, Allied should accept the offer and close the matter because if Allied goes for Jury trial, the expected cost is \$ 825,000 (0 x 20% + 50% \* \$ 750,000 + 30% \* \$1,500,000).

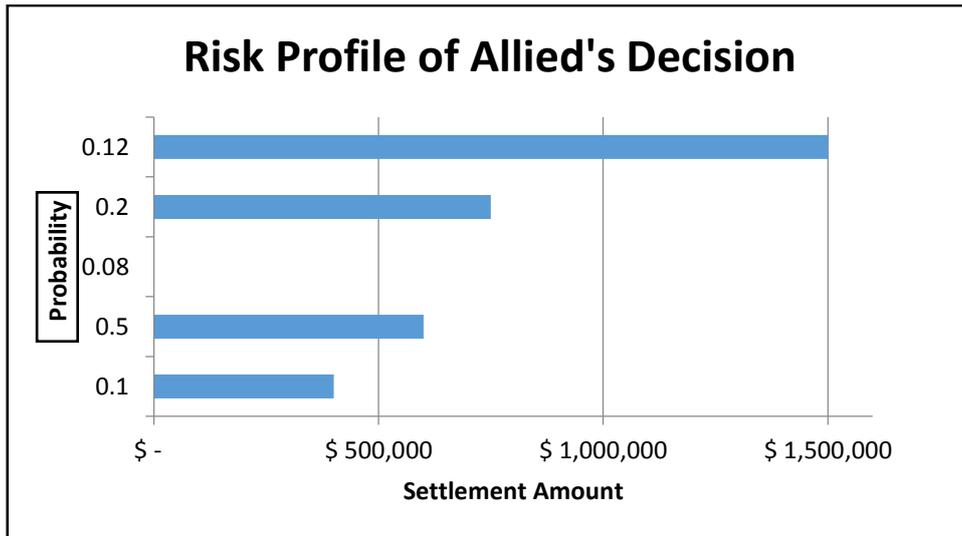
**5. Risk Profile of Allied’s Decision**

Allied’s decision to make an offer to John may have the following outcomes:

<b>Event</b>	<b>Probability</b>	<b>Cost</b>
1. John Accepts offer of \$ 400,000	0.1	\$400,000
2. John makes counter offer of \$ 600000	0.5	\$600,000
3. John Rejects the Offer and Case goes for Jury trial		
(a) Jury Rejects the case	0.08	\$0
(b) Jury Awards \$ 750000	0.2	\$750,000
(c) Jury Awards\$ 1.5 mn	0.12	\$1,500,000
<b>Total</b>	<b>1.0</b>	<b>\$670,000</b>

**Table 1 : Possible Outcomes and Probabilities**

The risk profile is graphically presented below: It may be seen that there is an 88% possibility that Allied will end up paying less than or equal to \$ 750,000 if it decides to make a counter offer and hence it should definitely consider this option favorably.



Appendix

