

Loss Aversion in Settlement Negotiations

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Settlement negotiations regarding legal claims can generally be successful only if discussions lead to a compromise which leaves both parties fearful that litigation may lead to a result potentially far worse. When there are strong competing arguments that make it difficult to judge who will win at trial this is especially true. After all, why settle if the other side has only offered something that barely covers your expense or only compensates a plaintiff with a minimal amount after costs and attorneys fees.

As noted in an [article](#) by Floyd J. Siegal, an Encino area mediator, a settlement is “the functional equivalent of purchasing insurance against an uncertain risk.”

If the outcome of litigation is more certain because, for instance, you consider your side to have a strong legal case that is likely to win, your incentive to settle based on uncertainty goes down and impacts how much it will take for a settlement to make sense. The reverse holds true for a weak case.

Of course, attorneys and their clients must be able to see the strengths and weaknesses of their positions clearly in order to make rational judgments in this regard. This is an area in which a neutral mediator can assist.

Complicating matters, the Siegal article referenced above notes that people (and clients) tend to be “loss averse”, meaning that people are less willing to commit themselves to a known loss, than a known gain.

A 2008 study from the Journal of Empirical Legal Studies analyzing 2054 California civil cases is noteworthy in this regard. [[Let's Not Make A Deal: An Empirical Study of Decision Making in Unsuccessful Settlement Negotiations](#), vol. 5, issue 3] As the Siegal article notes, the study includes two interesting facts:

1. Plaintiffs failed to do better in 61.2 percent of cases when rejecting the defendant's best offer and proceeding to trial/arbitration.
2. But when defendants failed to do better than the lowest demand made by plaintiff (24.3 percent of cases) the result was much worse for defendants, who paid on average \$1.14 million more than the lowest demand at settlement. By comparison, when plaintiffs did worse at trial/arbitration, they recovered on average only \$43,100 less than the best offer they rejected at settlement.

This study regarding loss aversion may assist you in your next settlement negotiation.

Link to original article: <http://commercialcounselor.com/loss-aversion-in-settlement-negotiations/>

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