

Chicago Daily Law Bulletin®

Volume 161, No. 56

Decision-making in negotiating settlements: the overconfidence bias

Sometimes clients make decisions in negotiations that are not in their best interest. They do this without realizing that they are falling victim to cognitive biases, neurological shortcuts and cognitive illusions, that have evolved to support the activities of a primitive hunter-gatherer encountering the dangers of the savannah, rather than a modern human being negotiating a settlement.

As human beings, lawyers are often subject to the same mental pitfalls.

A degree of familiarity with decision science, which refers generally to the many recent discoveries in the fields of behavioral economics, cognitive psychology and neuroscience, can be helpful when advising clients about negotiation.

Daniel Kahneman, the Nobel laureate in economics and author of "Thinking, Fast and Slow," would have us all be so familiar with these biases and heuristics (unconscious mental shortcuts) and the limitations they place on our decision-making that we would stand around at the end of meetings saying things like, "Let's not fall for the outcome bias. This was a stupid decision even though it worked out well" or "His System 1 constructed a story and his System 2 believed it." (System 1 is the unconscious automatic part of our thinking that controls most of our actions, while System 2 involves the more recently evolved analytical parts of the brain.)

While we may eventually get to the point where we can casually refer to these cognitive biases knowing we will be understood, many practitioners are still trying to take it all in.

As Kahneman himself said when speaking at Loyola a

couple of years ago, most people do not tell him they have read his book, they say they are reading his book. There's a lot of information from Kahneman and other scientists in these fields to digest.

For this series of columns I will try to describe just a few of the cognitive limitations that come up on a regular basis for lawyers and clients in negotiations, starting with the overconfidence bias.

The widespread nature of the overconfidence bias among lawyers is demonstrated by the books and articles of Randall Kiser of DecisionSet which explain how frequently lawyer-client teams make mistakes in deciding whether to settle cases.

For example, in one instance, Kiser compared settlement offers and trial results from 2,054 cases that failed to settle. By comparing rejected settlement offers with verdicts, he found that plaintiffs were wrong in thinking that they would do better at trial 61.2 percent of the time and defendants were wrong 24.3 percent of the time.

When defendants were wrong, however, they were spectacularly wrong. While verdicts for plaintiffs averaged \$43,100 less than the last offer, defendants paid on average more than \$1.1 million more by going to trial. (These results were independent of costs and attorney fees.)

Not only are we often wrong, we are often sure our wrong answers are correct.

As explained by Barry Goldman in "The Science of Settlement," scientists such as Edward Russo and Paul Schoemaker have repeatedly shown that if you give people a test asking them questions — ranging from the length of the Nile River to the gestation period (in days) of an Asian elephant —



Teresa F. Frisbie is the director of the Loyola University Chicago School of Law Dispute Resolution Program; a mediator and arbitrator at ADR Systems of America; a member of the National Academy of Distinguished Neutrals; and of counsel to DeGrand & Wolfe P.C.

most people give wildly inaccurate answers that they are overwhelmingly confident are correct.

Goldman posits that this overconfidence is deeply rooted in our evolutionary biology and "even if it might be helpful today, in that moment just before a fight breaks out in a bar, it is not an adaptive strategy (for lawyers trying to value cases)."

Kahneman describes a Duke University study where CFOs of large corporations were asked to estimate the next year's Standard & Poor's index performance. More than 11,000 forecasts were collected and the CFOs' estimates came in at less than zero correlation to reality. Just like the rest of us, their reported confidence in their wrong answers was "grossly" overconfident.

Overconfidence bias happens because rather than considering all possible information when estimating a quantity, the brain takes a shortcut and relies on the information that comes to mind easily (i.e., the last case, the cases the office has handled in the past few years, perhaps a recent article in the newspaper).

The brain constructs a coherent story in which the estimate makes sense.

One way to address the overconfidence bias is to make sure that one has fully researched all available information impacting a settlement as early in the case as possible.

Of course, this is easier for injury cases where there is jury verdict and settlement data than for business disputes, but there are helpful early case assessment tools for other types of cases such as the CPR International Institute for Conflict Prevention & Resolution's Corporate Early Case Assessment Toolkit at cpradr.org/Portals/0/Home/CPRECAToolkit2010.pdf.

Another suggestion comes from psychologist Gary Klein. As described by Kahneman in "Thinking, Fast and Slow," Klein proposes that when an organization reaches an important decision, but has not yet formally committed, the leader should convene a group of individuals who are knowledgeable about the decision and say, "Imagine that we are a year into the future. We implemented the plan as it now exists. The outcome was a disaster. Please take five to 10 minutes to write a brief history of that disaster."

This kind of a pre-mortem could also be helpful in a negotiation or mediation preparation session.

Inside and outside counsel and client representatives could be asked to imagine the case just after a losing verdict and take a few minutes to write down the reasons for such an outcome.

This exercise could overcome the powerful forces (need to appear loyal, etc.) that, as Kahneman put it, "favor a collective blindness to risk and uncertainty."