The Psychology Of Settlement

Barry Goldman

When we understand how the brain operates, we can work with it instead of against it to settle cases.

BACKGROUND • We humans have never had enough time or energy to think carefully about every decision we have to make. We need rules of thumb we can apply quickly and without much mental effort to the majority of our decisions. Over the millennia, evolutionary pressure caused the species to develop these “heuristics” and the process of natural selection determined which of them survived.

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THIS ARTICLE is intended as a practical guide to the psychological aspects of the settlement process. The human brain processes information in certain identifiable, predictable ways. If we understand a few basic concepts from behavioral economics, social psychology, and decision theory, we can package our proposals in ways that make it more likely that our opponents will agree to them.

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The problem comes about because the environment we lived in when these heuristics were wired into how we think is not the environment we now inhabit. Strategies that were adaptive in the ancestral environment are likely not to be adaptive anymore. The easiest way to see this is to consider the heuristic, “always eat as much as you can.” In the ancestral environment, the African Savanna during the Pleistocene, “always eat as much as you can” was a good idea, an adaptive strategy. Populations that adopted the heuristic were able to survive periods of food scarcity better than populations that didn’t. In suburban America in 2006, when there is a fast food restaurant on every corner, “always eat as much as you can” is not an adaptive strategy. But it is so deeply wired that many of us have difficulty resisting it, with well known and serious consequences.

Recent work by psychologists and economists has uncovered a number of similar heuristics at work in the way we process information and make decisions. Evolutionary psychologists have come up with theories to explain why these heuristics were adaptive in the environment of evolutionary adaptation but that is not what concerns us here. What we care about for purposes of settling lawsuits is identifying the heuristics that are at work in the minds of our clients, our opponents, and ourselves. If we can identify the rules being used to process information, we can predict the decisions that will result. To the extent we can frame the presentation of information so that it triggers the use of preferred heuristics, we can influence those decisions.

THE ENDOWMENT EFFECT • One of the most robust of the habits of mind discovered by behavioral economics researchers is the “endowment effect.” It is the tendency for human beings to overvalue anything perceived as “mine.”

An easy way to see the power of the endowment effect is to pick something that belongs to you and ask yourself two questions about it. Pick your house, your car, or your laptop, any non-trivial object will do. Ask yourself, “What is the least amount of money I would accept to sell this thing?” Then ask yourself, “If I didn’t already own it, what is the greatest amount of money I would pay to buy it?”

Classic economics says the answer to the two questions will be the same. The value of an object to you is the price at which you would be equally willing to buy it or to sell it—the “indifference point.” It is related to the way we ensure that the division of one cookie between two children is fair. If one child cuts the cookie and the other chooses first, the cutter will divide the cookie at the point where he is indifferent to which piece he winds up with. The indifference point is the fair point of division. But that isn’t the way people actually think about objects that belong to them. The way we actually think, an object increases in value if it is mine.

If you are like most people, there is a difference between the amount you would sell your laptop for and the amount you would pay to buy it. The smallest amount you would accept to sell it is greater than the largest amount you would pay to buy it. Because of the endowment effect, you would not be able to make a deal with yourself!

This is not rational. A rational economic actor places a value on an object. He does not first have to ask, “Is it mine?”

We can do some speculative evolutionary psychology and provide an explanation for why this heuristic exists. In the ancestral environment it was likely an adaptive strategy to care deeply about your stuff and to resist forcefully anyone who wanted to take it from you. Given a population that cared deeply about its stuff and another population who was more
blasé, the blasé folks likely did not survive long enough to reproduce and become our ancestors.

But please note, just because the behavior produced by the endowment effect is irrational doesn’t mean it is random or unpredictable. Almost no one says they would pay more to buy the object than they would take to sell it. Like the rest of the biases and heuristics discovered by behavioral economics, the endowment effect produces quite predictable results.

LOSS AVERSION AND FRAMING EFFECTS • Suppose you are about to leave the room. I meet you at the door and make the following offer: I will give you a choice between A or B. If you choose A, I will promptly hand you $20. If you choose B, I flip a coin and you call heads or tails. If you win the flip, I will give you $40. If you lose, I will give you nothing. Which would you choose?
• A—Take the $20; or
• B—Flip double or nothing.

Next case. Same set-up. To leave the room, you have to make a choice. Choose A, you must pay me $20. Choose B, I flip a coin, you call heads or tails. If you win, you owe me nothing. If you lose you owe me $40. Which would you choose?
• A—Pay the $20; or
• B—Flip double or nothing.

Again, classic economics provides a theory and a prediction. It says that you have a certain level of risk tolerance. Either you like to take a gamble or you don’t. Because $20 is $20 whether you gain it or you lose it, the classical answer is that whichever choice you make—to flip or not to flip—you will make it in both cases. And again it turns out this is not the way people actually behave.

Most people treat the two cases differently. We tend to take the sure thing when the question is posed in terms of a gain and to take the risk when the question is posed in terms of a loss. We change our decisions depending on whether we perceive ourselves to be ahead or behind, playing with our own money (in a loss frame), or playing with the house’s money (in a gain frame). The rule is that we tend to be risk-averse in a gain frame and risk-seeking in a loss frame. We will take risks to avoid losses that we would not take to secure equivalent gains.

This framing effect is related to another important concept for our purposes called “loss aversion.” Losers cry, it is said, louder than winners sing. Losses loom larger than gains. A gain of $1,000 does not make us as happy as a loss of $1,000 makes us sad. The economic fact that $1,000 is $1,000 is overcome by the psychological fact that we hate to lose.

REGRET AVERSION AND THE STATUS QUO BIAS • Imagine two brothers, Alphonse and Bocephus. Imagine that their Great Aunt Carlotta died and left them each 1,000 shares of Amalgamated Consolidated valued at $50,000. Suppose Alphonse left the money in Amalgamated Consolidated but the stock went down in price and he lost $25,000. Suppose Bocephus sold his Amalgamated Consolidated and bought United Affiliated stock instead. Suppose United Affiliated also went down in price and he also lost $25,000. Who do you think feels worse?

Once more, the classical economics answer is that both brothers feel exactly the same. They feel like people whose investment decisions lost them $25,000. But the behavioral economics answer is different. It turns out most people think Bocephus feels worse. This is because most people place a different value on a case in which I do nothing and it turns out badly and a case where I do something and it turns out badly. It is hard to explain why this should be so, but most of us feel it is true.