

## **Setting a Course to Mediation Success: The Sunk Cost Fallacy**

*Charles Platt*

Our previous articles have discussed how Navigator can help parties use more rigorous financial and behavioral analysis to achieve mediation success.<sup>i</sup> This article reviews how Navigator can help parties address the “sunk cost fallacy.”

### **The Sunk Cost Fallacy**

People confronting a loss on an investment have a bias to continue with that investment, not abandon it. This bias even causes us to try to recover our loss by incurring further losses or taking greater risks.<sup>ii</sup> This bias, which grows stronger for larger investments, is called the “sunk cost fallacy.”<sup>iii</sup>

Research shows that losses or costs we have already incurred on an investment should *not* influence our decision-making. Sunk costs should be irrelevant from an economic perspective in our decisions to continue with or abandon an investment. Instead, economically rational decisions should be made based on the prospective benefits and costs of the alternative courses of action.<sup>iv</sup>

This sunk cost fallacy arises in mediation where substantial attorneys’ fees and other litigation expenses have been incurred by lawyers and their clients (the “Parties”) in discovery and other pre-trial proceedings.<sup>v</sup> These sunk costs can create a bias for Parties to continue with litigation instead of accepting a settlement, in an attempt to either recover the litigation investment or at least justify legal expenses incurred, rather than abandoning the litigation to avoid further losses or risks.<sup>vi</sup> This inclination is heightened by the Parties’ cognitive bias of “risk aversion,” discussed in an earlier article, that causes them to be more likely to avoid losses than seek out gains.<sup>vii</sup>

As a result, in deciding whether a settlement proposal is within an acceptable range, Parties are influenced not just by how the settlement option compares to the expected outcome of the litigation and the prospective cost of achieving that outcome, which is the standard economic analysis. The Parties’ judgment about a

settlement proposal can also be influenced by the amount of litigation costs already incurred in the litigation, even though those costs cannot not be recovered and their judgment should be based solely on future costs and benefits.<sup>viii</sup> This bias occurs *even when* the settlement proposal compares favorably to the expected outcome of the litigation at hand *and* not accepting the settlement proposal could be characterized as irrational behavior from an economic standpoint.<sup>ix</sup>

### **Addressing The Sunk Cost Fallacy**

This sunk cost fallacy can be mitigated if the Parties enter into settlement negotiations as soon in the litigation process as reasonably possible before non-recoverable litigation costs get too high.<sup>x</sup> The lower the investment already made, the less the perception will be that a settlement will result in a “loss” of money already incurred in litigation expenses.

In the event that such early settlement negotiations do not occur, and large litigation costs are incurred, the sunk cost fallacy may create real challenges for the mediation process if not confronted directly by all the Parties. Their analysis of whether a settlement proposal is in an acceptable range should consciously *disregard* the amount spent already on litigation and focus instead on expected present and future costs and outcomes of continuing with litigation and how those compare to the settlement option. Sunk costs already incurred should be considered only as a guide as to what future litigation costs will be required if settlement is not achieved and litigation is pursued.

### **Conclusion**

Navigator can help you set a course to mediation success by identifying how the sunk costs in litigation may be affecting the settlement analysis, and how focus on present and future costs and benefits will achieve the best return in mediation.

This article is for marketing purposes only, does not constitute legal advice,  
and should not be relied upon as legal advice.

- 
- <sup>i</sup> Setting-a-Course-for-Mediation-Success.pdf (navmas.com); <https://www.navmas.com/wp-content/uploads/2024/05/Navigator-Accounting-for-Risk-Aversion.pdf>; <https://www.navmas.com/wp-content/uploads/2024/05/Excessive-Optimism-In-Litigation-Outcomes.pdf>; <https://www.navmas.com/wp-content/uploads/2024/06/Information-Asymmetry-in-Mediation.pdf>; [Navigator-Framing-and-Anchoring-in-Mediation.pdf \(navmas.com\)](#).
- <sup>ii</sup> Jeffrey J. Rachlinsky and Andrew J. Wistrich, *How Lawyers' Intuitions Prolong Litigation*, 86 Southern California Law Review, 101, 143 (2013) ("*Rachlinsky and Wistrich Article*"); Maya Steinitz, *How Much Is That Lawsuit In The Window? Pricing Legal Claims*, 66 Vanderbilt L. Rev. 1889, 1914 (2013); Samuel Issacharoff & George Lowenstein, *Second Thoughts About Summary Judgment*, 100 Yale L.J. 73, 113 (1990) ("*Issacharoff and Lowenstein Article*"); Hal R. Arkes and Catherine Blumer, *The Psychology of Sunk Cost*, Organizational Behavior and Human Decision Processes (February 1985) ("*Arkes and Blumer Article*"); <https://the-decisionlab.com/biases/the-sunk-cost-fallacy>.
- <sup>iii</sup> *Rachlinsky and Wistrich Article, supra*, at 143; *Arkes and Blumer Article, supra*, at 124.
- <sup>iv</sup> *Id.*; Robert J. Rhee, *A Price Theory of Legal Bargaining: An Inquiry into the Selection of Settlement and Litigation Under Uncertainty*, 56 Emory Law Journal 619, 622 and n. 5, 659 (2006); *Issacharoff and Lowenstein Article, supra*, at 113; Richard A. Posner, *Economic Analysis of Law*, 8 (4<sup>th</sup> Ed. 1992); *Arkes and Blumer Article, supra*, at 125-126.
- <sup>v</sup> *Rachlinsky and Wistrich Article, supra*, at 146.
- <sup>vi</sup> *Id.*; *Issacharoff and Lowenstein Article, supra*, at 113-114.
- <sup>vii</sup> <https://www.navmas.com/wp-content/uploads/2024/05/Navigator-Accounting-for-Risk-Aversion.pdf>.

---

viii *Rachlinsky and Wistrich Article, supra*, at 147, 143; *Arkes and Blumer Article, supra*, at 124, 132; <https://the decisionlab.com/biases/the-sunk-cost-fallacy>.

ix *Id.* at 148; <https://the decisionlab.com/biases/the-sunk-cost-fallacy>.

x *Id.* at 149.