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Overconfidence and risk (mis)management in settlement decisions

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Imagine a wrongful death case where a bicyclist dies after colliding into a trailer that was parked behind a landscaping truck. The deceased rider suffered trauma to the top of his head and his helmet was cracked down the middle, suggesting he wasn't looking where he was going. Apparently the truck did not stop suddenly, and the trailer was probably parked legally. Jury research indicates these points will be important.

The defendant has two insurance policies, one for $2 million dollars in primary coverage and another for $10 million in excess coverage. Assume a comparative fault jurisdiction where any award to the plaintiff may be reduced by a percentage if she or he is found partially at fault for the accident. As defense counsel or claims professional, would you reject a settlement demand made by the surviving family to settle within the limits of the primary coverage?

This was a real case in Texas. Unfortunately for the defense team, which rejected three demands to settle for $2 million or less, the jury awarded the surviving family almost $28 million dollars. Ultimately, the surviving family accepted almost $10 million in order to avoid an appeal. But that's not all. Because it failed to accept reasonable settlement demands from the plaintiff, the primary carrier was liable under Texas law for the entire settlement amount.

Some might say the jury's verdict of $28 million dollars is a good example of a "nuclear verdict" or "social inflation." Carriers and the defense bar have been talking about these phenomena for a number of years, so it seems to me the defense team in the Texas case knew a socially inflated verdict was possible but seemed remote enough to reject three demands to settle for $2 million or less.

Of course, plenty of cases go the other way. Sometimes plaintiffs walk away from decent settlement offers only to get less or nothing at trial. Talented lawyers on both sides can be blinded by confirmation bias and overconfidence.

These biases, or mental shortcuts called heuristics, may be invisible but they are powerfully real and handicap our ability to make good decisions. The famous physicist, Richard Feynman, said "The first principle is not to fool yourself – and you are the easiest person to fool."

When something bad happens to us, we blame our environment, such as social inflation or a biased judge (who may or may not have been "plaintiff friendly" in the Texas case). But when we see bad things happen to others, we think there's something wrong with their character or personality.

Consider this

Over a decade ago, researcher Randall Kiser documented how often attorneys did better or worse at trial compared to their opponents' last settlement proposal. Generally, Kiser found that plaintiffs' attorneys did worse at trial almost 60% of the time at a cost of about $40,000 per error.

On the defense side, Kiser found that they did worse at trial in about 25% of cases at a cost of approximately $1.1 million dollars per error.

Because most cases settle at some point, perhaps these findings have resonated with the bar. On the other hand, some cases really need to be tried by a judge or jury; some fights are worth having. As Kiser's research shows, a bad outcome at trial for one side is a great outcome for the other.

My point is not that counsel should default towards settlement. Instead, consider practices that might improve decision-making.

First of all, recognize the possibility that unexpected factors may substantially interfere with your assessment. Although we feel empowered when we say "no" to a settlement offer or demand, does that feeling of satisfaction make us blind to what may lie ahead?

Second, defense litigators seem to ignore a powerful cognitive bias leveraged by the plaintiff's bar when its members ask juries to make awards: anchoring (decisions are biased in favor of a reference point that can be suggested in advance of a decision). You can read more about anchoring elsewhere but I wonder why defense litigators don't counter this bias more often during their closing arguments.

It may be unorthodox and scary at times but you could say the same thing about trials in general and the Texas case in particular.

Third, can your team talk about how its evaluation may be off? Granted, some teams have no interest in lawyers who recommend settlement; they want counsel to focus on winning the case – period. But I wonder whether the defense team in the Texas case permitted or encouraged its members to challenge the assumption that a verdict above $2 million may not be so remote. Considering what's at stake in some cases, it's too risky not to have that discussion.

Lady Justice may uphold the scales of justice in one hand, but don't forget she carries a large sword in her other hand, while blindfolded.

Jeff Trueman is a commercial mediator. He can be reached at jt@jefftrueman.com