

# Overcoming The Sunk Cost Fallacy and Its Untoward Impact on Settlement Dynamics

By Christopher Nolland  
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“You just don’t get it,” the client explains. “I have great claims and I’ve spent over \$300,000 in legal fees and two years of my life to get here. Obviously, my lawsuit must be worth more than my investment in money, time, energy, stress, and opportunity costs. How can you possibly suggest I should consider settling for less than what I have into the case or, even worse, write a check to resolve counterclaims that are a bunch of BS?”

That in a nutshell, is the Sunk Cost Fallacy: the idea that there is necessarily some relationship between one’s past investment in an asset and the current value of that asset – and in this case the “asset” is the claims in the lawsuit. Of course, the asset does not “remember” how much you have invested in it. \$20,000 investments at the \$20 per share that both Enron and Amazon were trading for in 1998 would result in vastly different values for each of those assets/investments today – with today’s values having no relationship whatsoever to the amount previously invested.

Essentially, the irrelevance of Sunk Costs demands that you ignore your past investment and focus only on what your asset is worth today. Stated another way, a rational economic player must fully embrace and understand that their past investments – their “Sunk Costs” – are irrelevant to a rationale decision about the value of that asset now.

The inability to ignore Sunk Costs when making decisions about whether to continue with an endeavor or investment is what leads to staying in unrewarding (or worse) business or personal relationships because of “all of the years already invested”; continuing to pour money and time into losing business or professional endeavors (such as litigation) in the hope that somehow it will all ultimately work out in your favor; and not cutting your losses and moving on. It ignores a primary rule of life. To paraphrase Will Rogers: “The first step to getting out of a deep hole is to stop digging”.

Most reasonably intelligent people can logically understand that the amount previously invested in a lawsuit does not inform the determination of the current settlement value of the case. Why then do even highly experienced, rational, and smart litigants (and their counsel) often fall prey to the Sunk Cost Fallacy and let their past investment in a lawsuit largely drive case valuation and settlement decisions?

The evil enabler of the Sunk Cost Fallacy is the classic psychological concept of Cognitive Dissonance – the mental discomfort or conflict that occurs when a person’s behaviors and beliefs do not align or when their actions contradict their beliefs. In this case, the cognitive dissonance syllogism leading to poor settlement decisions is : 1) I am a smart person (Belief #1); 2) A smart person would not invest \$300,000 and two years into a lawsuit that wasn’t worth that much (Belief #2); I invested \$300,000 and two years into this lawsuit (Undisputed Action); 4) Therefore the lawsuit must have a value of at least \$300,000 or otherwise I am not a smart person – which would create a conflict with Belief #1 above.

The error in the above syllogism is that one of the Beliefs is incorrect and leads to an erroneous conclusion about the value of the case. Assuming their Belief #1 (“I am smart”) is either correct or that you are unlikely to convince them otherwise, how do you help litigants make a sound decision that is not

in conflict with Belief # 1 – that they are smart? The answer is to help them understand that their Belief #2 is erroneous. Very smart people make losing investments all the time based upon the information available when they invested. Warren Buffet has made many losing investments – some involving losses of hundreds of millions or even billions of dollars – yet no one would seriously dispute that he is brilliant and one of the most successful investors of all time.

The question is not whether every decision or investment works out well but whether your portfolio of decisions/investments works out well overall. Not every investment, endeavor, or decision by even the smartest and most sophisticated folks will be successful. That failure does not mean it was an unwise decision made by an unwise person. Rather, it is simply a good decision made by a smart person utilizing available information and appropriate risk/reward metrics that happened not to work out well. Once your clients (or you in the case of contingent fee attorneys) understand and truly internalize that they are still very smart even if this particular lawsuit was not a successful economic endeavor, you and your clients can begin the journey of defeating the enemy of logical case valuation and rational settlement decisions – the decision distorting Sunk Cost Fallacy.

## Biography

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**Christopher Nolland** has been a mediator and arbitrator since 1993. He has conducted over 2,900 mediations and numerous arbitrations, primarily in business and commercial matters and fiduciary cases. Nolland's mediation and arbitration practice is national in scope and focuses on large, complex, multifaceted disputes. Nolland is an Adjunct Professor of Law at SMU Law School and for the past 25 years has taught a full semester course on Negotiation to 2nd and 3rd year law students and LLM candidates.

In addition to his neutral ADR practice, over the past 20 years Nolland has established a national practice as Special Negotiation Counsel in significant, complex disputes and litigation, acting as the primary negotiator and point person for settlement strategy on behalf of one party (in a non-neutral role). Nolland's Special Negotiation Counsel activities account for a substantial portion of his practice. In that role Nolland is typically the primary point of contact with the mediator. He can be reached at [chris@nolland.com](mailto:chris@nolland.com) or through his website [www.nolland.com](http://www.nolland.com)