Overcoming the Loss Aversion Obstacle in Negotiation

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The cognitive bias of loss aversion—the phenomenon that losses loom larger than gains—poses an obstacle in negotiation. Each party's own concessions loom larger than those of the other party, which makes it difficult to reach an agreement by trading concessions. This Article suggests ways to overcome this obstacle. Two types of solutions are presented: substantive solutions, which focus on features in an agreement that may counter loss aversion; and tactical solutions, which focus on presentation strategies to counter loss aversion. This Article also considers whether several well-known but undertheorized negotiation practices owe their effectiveness to their capacity to counter loss aversion bias.

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I. The Loss Aversion Cognitive Bias

When making decisions, most people, most of the time, give more weight to the risk of suffering a loss of a given magnitude than to the chance of gaining a benefit of the same magnitude.[1] This preference seems irrational,[2] and it is considered a cognitive bias. This bias is known as loss aversion.[3]

Loss aversion "refers to the asymmetry in the evaluation of positive and negative outcomes, in which losses loom larger than the corresponding gains."[4] In other words, a person is more deterred by the idea of losing a particular sum of money than excited by the idea of gaining the same sum: "[f]or most people, the fear of losing $100 is more intense than the hope of gaining $150."[5]

A. *The Status Quo Bias, Endowment Effect, and Offer-Asking Gap*

Loss aversion affects whether we find it desirable to change our situation. If the change is expected to change some things for the better and some for the worse, loss aversion makes us give more weight to the changes for the worse than to the ones for the better, thus inducing a bias towards rejecting the proposed change and preserving the status quo.[6] This is the "status quo bias"[7]—people's tendency to prefer the existing situation over changing it even when the expected benefits of such change outweigh the risks.[8]

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1. *See* Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263, 279 (1979); *see also* DANIEL KAHNEMAN, THINKING, FAST AND SLOW 282–83 (2011).

2. DANIEL KAHNEMAN & AMOS TVERSKY, *Conflict Resolution: A Cognitive Perspective*, *in* BARRIERS TO CONFLICT RESOLUTION 45 (Kenneth J. Arrow et al., eds., 1995). For a discussion of whether loss aversion is actually irrational, *see* EYAL ZAMIR, LAW, PSYCHOLOGY AND MORALITY: THE ROLE OF LOSS AVERSION 205–07 (2014). For the view that loss aversion is actually rational, see Giuseppe Ciccarone & Enrico Marchetti, *Rational Expectations and Loss Aversion: Potential Output and Welfare Implications*, 86 J. ECON. BEHAV. & ORG. 24, 25 (2013) (arguing that loss aversion is a rational response aimed at reducing variances in future consumption when full information is not available to the consumer).

3. Loss aversion is a tenet of prospect theory, a broader behavioral economics theory of decision-making. Kahneman & Tversky, *supra* note 1.

4. KAHNEMAN & TVERSKY, *supra* note 2, at 45.

5. Kahneman & Tversky, *supra* note 1, at 284. Guthrie states that "the available empirical evidence suggests that losses generally loom at least twice as large as equivalent gains." Chris Guthrie, *Prospect Theory, Risk Preference, and the Law*, 97 NW. U. L. REV. 1115, 1119 (2003).

6. KAHNEMAN, *supra* note 1, at 292; KAHNEMAN & TVERSKY, *supra* note 2, at 54.

7. William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 J. RISK & UNCERTAINTY 7, 8 (1988).

8. *See* ZAMIR, *supra* note 2, at 17–21; Deepak Malhotra & Max H. Bazerman, *Psychological Influence in Negotiation: An Introduction Long Overdue*, 34 J. MGMT. 509, 517 (2008).

The status quo bias is related to another concept, the endowment effect,[9] which is the phenomenon that people value things more if they already own them.[10] Often, the price one agrees to pay in order to purchase an item is much lower than the price she demands in order to part from it once it is already in her possession. The endowment effect results in the offer-asking gap[11]—a gap between the price one is willing to offer for an item (i.e., willingness to pay) and the asking price she will demand for it once she has it (i.e., willingness to accept).[12]

In this Article, our central concern is loss aversion, and the possibility that the status quo bias, endowment effect, and the offer-asking gap may have a partial basis in loss aversion.[13]

B. *Loss Aversion in the Legal Field*

In the past forty years, loss aversion has been thoroughly studied and researched, including its various implications for the legal field.[14] The obstacle that loss aversion poses to conflict resolution has been thoroughly explained,[15] and some possible ways to tackle this obstacle have been presented.[16] However, there is still no complete answer to the question of how a negotiator can overcome loss aversion, nor a discussion of whether the effectiveness of some known negotiation practices can be explained by the fact that they address the

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9. Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. ECON. BEHAV. & ORG. 39, 44 (1980).

10. *See* ZAMIR, *supra* note 2, at 21–28.

11. Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 625 (1998).

12. ZAMIR, *supra* note 2, at 21–22.

13. Whether loss aversion is the sole root of these phenomena is beyond the scope of this Article, Likewise, the relationships between the status quo bias, endowment effect, and offer-asking gap are also outside the scope of this Article. With that said, however, it does seem that perhaps the endowment effect underlies particular instances of the broader phenomenon of status quo bias, that perhaps the endowment effect partially underlies the offer-asking gap, and that the offer-asking gap might contribute to or feed into a status quo bias. *See* Russell Korobkin, *The Endowment Effect and Legal Analysis*, 97 NW. U. L. REV. 1227, 1228–29, 1250 (2003). There is also an argument that loss aversion does not provide a full account of the status quo bias, since it does not explain *why* people are loss averse and since status quo bias also appears in settings that do not entail gains or losses. *See* Korobkin, *supra* note 11, at 657; Samuelson & Zeckhauser, *supra* note 7, at 36.

14. *See* Jeffrey J. Rachlinski, *Gains, Losses, and the Psychology of Litigation*, 70 S. CAL. L. REV. 113 (1996); Korobkin, *supra* note 13; Korobkin, *supra* note 11; Guthrie, *supra* note 5; Malhotra & Bazerman, *supra* note 8; Eyal Zamir, *Loss Aversion and the Law*, 65 VAND. L. REV. 829 (2012); ZAMIR, *supra* note 2.

15. KAHNEMAN & TVERSKY, *supra* note 2.

16. *See id.* at 57; Rachlinski, *supra* note 14, at 171.

loss aversion obstacle. These two issues will be addressed in this Article.

II. The Loss Aversion Obstacle in Negotiation

Loss aversion poses an obstacle to reaching an agreement via negotiation.[17] In negotiation, the parties close the gap between their respective demands by mutual concessions. But there's a problem with making these mutual concessions. Party A, of course, views her concessions as losses and her adversary, Party B's concessions as gains.[18] Since losses loom larger than gains, Party A's concessions loom larger than Party B's to her, even if they are exactly matched. From Party B's perspective, however, the exact opposite is true: Party B's concessions loom larger to her than Party A's.[19] Consequently, even where both parties would stand to benefit from trading concessions, the exchange may seem insufficient to both of them. Each side's evaluation of possible solutions is biased, and so is their comparison of possible solutions to the status quo; the mutual biases

17. *See* Kahneman & Tversky, *supra* note 2, at 54; Korobkin, *supra* note 11, at 656. Galinsky and Mussweiler state that the uncertainty that dominates many negotiations makes negotiators more prone to cognitive biases. Adam D. Galinsky & Thomas Mussweiler, *First Offers as Anchors: The Role of Perspective-Taking and Negotiator Focus*, 81 J. Personality & Soc. Psychol. 657, 657 (2001). Zamir explains that in conflict situations, loss aversion poses an obstacle to even engaging in ADR, since doing so feels like the loss of the litigation option to which one feels entitled, and he shows how this aversion relates to reactive devaluation, another obstacle to reaching agreement. Zamir, *supra* note 2, at 91. In this Article, we focus particularly on loss aversion within the negotiation process, not the loss aversion involved in the decision to negotiate.

18. *See* Kahneman, *supra* note 1, at 304.

19. Research shows that negotiators tend to devalue concessions made by the opponent. Margaret A. Neale & Max H. Bazerman, Cognition and Rationality in Negotiation 12, 75–77 (1991).

bring the parties further apart from each other,[20] diminishing the probability of eventually reaching an agreement.[21]

III. Overcoming the Loss Aversion Obstacle

Identifying and understanding the loss aversion in negotiation enables us to consider possible methods to counteract it. Some of these methods emerge explicitly from an understanding of how loss aversion works.[22] Other potentially valuable methods to counteract loss aversion are known negotiation practices[23] that developed without explicit reference to loss aversion but whose effectiveness can be explained, at least in part, by their success in diminishing the effect of loss aversion.

This section discusses methods to counteract loss aversion as an obstacle to reaching a negotiated agreement. It proceeds in two parts: first, methods to structure an offer or proposed agreement; and second, methods to present such an offer to an opposing party.

A. *Substantive Aspects: Designing an Offer in Light of Loss Aversion*

Awareness of loss aversion can help negotiators to design their offers in ways that will diminish the effect of loss aversion on the opposing party. Specifically, negotiators can counteract or reduce the effect of loss aversion on an adversary by offering concessions that

20. *See* Carsten K.W. de Dreu et al., *Effects of Gain-Loss Frames in Negotiation: Loss Aversion, Mismatching, and Frame Adoption*, 60 Organizational Behav. & Hum. Decision Processes 90, 103–06 (1994) (arguing that parties to a negotiation misinterpret the other side's demands and concessions because of their biased perceptions about the other side's behavior). *See generally* Chase Foster et al., *Negotiation Myopia*, *in* Political Negotiation A Handbook 121, 121–40 (Jane Mansbridge & Cathie Jo Martin eds., 2016) (discussing a host of cognitive biases that drive this mutual misunderstanding of alternative solutions and the other side's position). For an account of the bargaining impasse created by another kind of cognitive bias—the self-serving bias of considering what benefits us to be also what is fair—see Linda Babcock & George Loewenstein, *Explaining Bargaining Impasse: The Role of Self-Serving Biases*, 11 J. Econ. Persp. 109 (1997).

21. *See* Kahneman & Tversky, *supra* note 2, at 56 (discussing "Concession Aversion"). *Compare with* Zamir, *supra* note 2, at 87–90 (showing an aspect of loss aversion that favors settlements - regret aversion); and Thaler, *supra* note 11, at 51-54 (discussing regret aversion).

22. Kahneman & Tversky, *supra* note 2, at 57; Malhotra & Bazerman, *supra* note 8, at 515–16.

23. For example, searching for items that are of high benefit to one side yet low cost to the other. *See* Roger Fisher & William Ury, Getting To Yes: Negotiating Agreement Without Giving In 75 (Bruce Patton, ed., 2011). See discussion of the power of value asymmetry, *infra* in Section III.A.3.

decrease an adversary's losses rather than increase their gains, by making demands that reduce an adversary's gains rather than increase their losses, by leveraging asymmetric valuations between parties, and by delaying or minimizing their counterpart's concessions when they are not central to the negotiator's desired outcome.

1. *Making Effective Concessions: Decreasing an Adversary's Losses Adds More Value than Increasing Their Gains*

When considering a concession in a negotiation, loss aversion bias makes increasing the other side's gain by a specific amount less effective than decreasing their loss by the same amount, since losses loom larger than gains.[24]

Thus, in a multi-part project or a long-term contract about ongoing business dealings, and assuming all else is equal, loss aversion counsels in favor of making a concession in a part of the deal where the other side stands to lose ground, rather than making a concession on a term that already stands to improve the other party's position compared to the status quo.[25]

Because of loss aversion, the value function of gains and losses is an asymmetrical S-shaped graph.[26] The steepest segment of the value function—the zone where a gain or loss of a given magnitude will create the largest change in value—is the segment just below the reference point.[27] Therefore, the most effective concession—the one that will add the most value to the other party for a given size of concession—is that which cancels a specific loss (that is, elevates the outcome to zero on the value function). The outcome for that issue becomes not a loss but preservation of their reference point (that is,

24. *See* KAHNEMAN & TVERSKY, *supra* note 2, at 57.

25. *See, e.g.*, Kuiran Shi & Tiaojun Xiao, *Coordination of a Supply Chain with a Loss-Averse Retailer under Two Types of Contracts*, 1 INT'L J. INFO. & DECISION SCI. 5, 11–15 (2008) (discussing how an optimal design of buyback and mark-down money contracts can enhance the relationship between manufacturers and retailers by focusing on mitigating retailer losses caused by unsold inventory); Fabian Herweg & Konrad Mierendorff, *Uncertain Demand, Consumer Loss Aversion, and Flat-Rate Tariffs*, 11 J. EUR. ECON. ASS'N 399, 425–26 (2013) (discussing how loss averse consumers prefer flat-rate electricity tariffs to minimize their losses during the few scenarios where they may incur losses if they had relied on a dynamic market-based tariff).

26. *See* Kahneman & Tversky, *supra* note 1, at 279; Kahneman, *supra* note 1, at 283. This S-shaped graph is essential to prospect theory; Kahneman states that "[i]f prospect theory had a flag, this image would be drawn on it." *Id.* at 282.

27. *See* Kahneman & Tversky, *supra* note 1, at 279; Kahneman, *supra* note 1, at 283.

zero on the value function) regarding a specific term or issue at hand.[28]

2. *Making Effective Demands: Decreasing Gains Costs Less Value Than Increasing Losses*

Loss aversion has implications not only for which concession a negotiator should offer, but also for how a negotiator should structure a demand. People don't like demands, of course; but the S-shaped value function of gains and losses suggests that a demand may be less off-putting to an opposing party if it decreases gains rather than increases losses.[29] An opposing party may have the strongest reaction to a demand that brings them "below zero" on the value curve—thus incurring a loss as relates to a particular term.[30] Loss aversion counsels in favor of targeting demands to areas in which the other side stands to gain (and preferably gain a lot), avoid areas in which they are losing, and especially avoid areas in which a demand will turn a neutral outcome into a loss.[31]

3. *The Power of Value Asymmetry*

Exploiting value asymmetry is a well-known and widely recommended negotiation technique.[32] A concession that is cheap to the

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28. *See, e.g.*, Yinghao Zhang et al., *Contract Preferences and Performance for the Loss-Averse Supplier: Buyback v. Revenue Sharing*, 62 MGMT. SCI. 1734, 1740–41, 1745–48 (2016) (discussing how risk averse retailers prefer a revenue-sharing contract over a buyback contract, although both impose similar losses and gains on retailers over the long term, because a revenue-sharing contract does not create temporary losses); Paul Heidheus & Botond Koszegi, *Competition and Price Variation When Consumers are Loss Averse*, 98 AM. ECON. REV. 1245, 1246, 1254–55 (2008) (discussing how loss aversion by consumers may contribute to higher market prices because consumers are averse to a temporary loss of utility while searching for an identical new product at a lower price, despite this search yielding a higher total utility over the long term).

29. See discussion of the value function *supra*, Section III.A.1 and note 26.

30. *See* Amos Tversky & Daniel Kahneman, *Loss Aversion in Riskless Choice: A Reference-Dependent Model*, 106 Q. J. ECON. 1039, 1039–40 (1991) (discussing how the perception of the value of a transaction tends to change faster as the transaction gets closer to the point of shifting from a gain to a loss); Robert Jarrow & Feng Zhao, *Downside Loss Aversion and Portfolio Management*, 52 MGMT. SCI. 558, 561–65 (2006) (discussing how loss aversion is particularly pronounced when portfolio managers are faced with a downside risk rather than an upside one).

31. The value graph is S-shaped, meaning decreasing marginal value—that is, the added value of an additional gain decreases with the growth of the gains. *See* Kahneman & Tversky, *supra* note 1, at 279; Kahneman, *supra* note 1, at 283. Therefore, demanding a concession of a given magnitude will cost the other party less value if the concession is located in their high-gains area.

32. *See, e.g.*, FISHER & URY, *supra* note 23, at 75; WILLIAM URY, GETTING PAST NO: NEGOTIATING IN DIFFICULT SITUATIONS 118 (1991); DEEPAK MALHOTRA AND MAX

side making it and valuable to the other side can result in efficient outcomes for the parties.[33] An obvious and powerful way to overcome the loss aversion obstacle is to focus on items that one side values more than the other.[34] A concession that is cheap to the side making it and valuable to the other side is not only efficient but also powerful enough to overcome the loss aversion obstacle.[35]

This technique is usually recommended for its effect of creating value for both sides and "increasing the pie," hence increasing the chance of reaching an agreement and the value each side will get from that agreement. My discussion here implies that there may be another reason for the effectiveness of the practice of looking for asymmetry in value: its ability to overcome the loss aversion obstacle.

4. *Minimizing the Decision Burden: Separating the Current Decision from the Concession*

Loss aversion makes it hard to decide on a concession. A party will have difficulty deciding to accept a suggested agreement if it includes a concession on her part. Sometimes it is possible, however, to design the solution in a way that separates the current decision from a later concession. Such separation, when possible, makes it easier for the side that will need to make the concession to accept the currently suggested agreement, relieving them from most of the decision burden involved in deciding to make a concession. There are at least

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H. BAZERMAN, NEGOTIATION GENIUS: HOW TO OVERCOME OBSTACLES AND ACHIEVE BRILLIANT RESULTS AT THE BARGAINING TABLE AND BEYOND 77 (2007); STUART DIAMOND, GETTING MORE: HOW TO BE A MORE PERSUASIVE PERSON IN WORK AND IN LIFE 141 (2010).

33. *See* Lyle Brenner et al., *On the Psychology of Loss Aversion: Possession, Valence, and Reversals of the Endowment Effect*, 34 J. CONSUMER RES. 369, 374–76 (2007) (discussing how parties to a negotiation place different subjective values on a negotiation issue and how focusing on the exchange of negotiation items from the party that places a lower value on it to the other side can overcome loss aversion obstacles); *See generally* Eyal Ert & Ido Erev, *On the Descriptive Value of Loss Aversion in Decisions under Risk: Six Clarification*, 8 JUDGEMENT & DECISION MAKING 214, 225–29 (2013) (summarizing factors influencing subjective valuation and the associated loss aversion).

34. *See* David A. Lax & James K. Sebenius, *Interests: the Measure of Negotiation*, 2 NEGOT. J. 73, 87–91 (1986) (discussing how parties to a negotiation place differing values on items and issues that are being negotiated and how negotiation parties can rely on these varying valuations to create optimal negotiation offers); Jared R. Curhan et al., *What Do People Value When They Negotiate? Mapping the Domain of Subjective Value in Negotiation*, 91 J. PERSONALITY & SOC. PSYCHOL. 493, 506–09 (2006) (summarizing the results of multiple controlled experiments that highlighted how negotiation parties valued a negotiation issue subjectively and how this subjective valuation changed the outcome of negotiations).

35. *See* Brenner et al., *supra* note 33.

two possible ways to design such a separation between the decision and the concession: deferring the concession to a later stage, and deferring the concession to another decisionmaker.

(a) *Setting Exit Points: Deferring the Need for a Concession to a Later Contractual Stage*

Exit points in a contract are pre-determined times or circumstances in the lifetime of the contract on which one or both sides will have the legal power to relieve themselves of their contractual obligations. Various considerations are involved in deciding whether or not to set exit points in a contract, and one can rightly decide that in a specific case, all things considered, it is better not to set exit points. But when we consider loss aversion in isolation, setting exit points might present a way to overcome the loss aversion obstacle. If the side that is asked to make a concession knows that they will have an exit point prior to the concession, it will be easier for them to agree. If their concession is of a continuous nature—that is, their loss happens not all at once but gradually over the life of the contract—it will be easier for them to agree if they know they have an exit point after only a small portion of the continuous loss has already occurred. This way the decision burden they feel will be proportional only to the inevitable loss that will occur until the exit point, and not to the full loss.

Of course, the full loss does not disappear for the conceding party just because it has been deferred to a later stage. And loss aversion will still exist when the parties arrive at the exit point and each must decide whether or not to end the contract. But when the parties reach that point, loss aversion works the other way: now the contract already exists, and thus continuing the contract is the default. Now, the decision that has to overcome the loss aversion obstacle is the decision to end the contract. Each side is aversive of losing the benefit it is getting from the contract. The status quo has changed: now the status quo is the existence of the contract, and any bias or tendency preferring the status quo now works in favor of continuing the contract and against using the exit point to end it. The table has been turned: Loss aversion has transformed from an obstacle to signing the contract into the glue that holds it together.

Once the contract is signed and its actual execution has begun, another powerful psychological mechanism begins working in favor of continuing the contractual relationship and against ending the contract: commitment and consistency.[36] In the present context, commitment and consistency means that where a party has signed the contract and started working under it, the party will want to feel and appear consistent, which creates a strong tendency to act consistently with her previous conduct—that is, with the contract that is already underway. The desire for consistency is strong enough to compel decisionmakers to do things that they ordinarily would not want to do;[37] it is definitely strong enough to reduce dramatically the effect of loss aversion.[38]

Deferring the actual concession to a later stage is consistent with the known and recommended negotiation technique of "baby steps"—that is, avoiding asking the other side to swallow "too much too fast"[39] and instead "go[ing] slow to go fast."[40] Perhaps one reason that this technique is effective is its power to counter and overcome the loss aversion obstacle.

(b) *Deferring the Actual Concession to Someone Else's Decision*

Often the other side to the negotiation is not a single person but a group of people (e.g., a corporation, or a state, or a family). Decision mechanisms for groups of people can be complex, and sometimes flexible. The actual negotiator you face can have more or less decision power. Their mandate can vary. This complexity can create difficulties, but it can also create another way to tackle the loss aversion obstacle. If the negotiator for the other side is having a difficulty deciding on a concession, it is possible to defer that concession to another person's (e.g., the counterparty's manager's) decision. Doing so will make it easier to the negotiator to accept the rest of the structure. The manager may see things differently; for example, she may consider the structure as a whole rather than just this specific concession, or she may be less emotionally involved since she doesn't have the personal involvement in the negotiation that the negotiator

36. Robert B. Cialdini, Influence: The Psychology of Persuasion 43 (1984).

37. *Id.* at 44.

38. *See* David A. Hoffman & Tess Wilkinson-Ryan, *The Psychology of Contract Precautions*, 80 U. Chi. L. Rev. 395, 419–26 (2013) (arguing that the status quo bias and a desire to maintain the relationship and trust contribute to contracting parties accepting more losses and taking fewer precautions once the execution of a contract has already started); Erick Zacks, *Shame, Regret, and Contract Design*, 97 Marq. L. Rev. 695, 705–18 (2014) (discussing how the desire to avoid inconsistency and the shame of breaching a moral promise is a factor to continuing with the execution of a contract despite higher than expected losses or lower than expected gains).

39. Ury, *supra* note 32, at 108.

40. *Id.* at 124–25.

has. In any case, when someone is reluctant to agree to a concession, deferring the concession to another person gives the negotiator another chance, and relieves the other side of the loss aversion decision burden, making it easier for them to accept the rest of the offer.

B. *Tactical Aspects: Presenting the Solution*

Not only can a solution be designed in many different ways; once designed, a given solution can also be presented in many different ways. These different presentations create different loss aversion reactions, even where the solution remains the same. Following are ways to present the solution and design the messages in a manner that can help to overcome the loss aversion obstacle.

1. *Focusing on What A Counterpart Might Lose Rather Than What They May Gain*

Since losses loom larger than gains, an argument showing the other side what they might lose if they reject the offer might be more persuasive and convincing than an argument showing them what they stand to gain if they agree.[41]

Note that this line of reasoning uses loss aversion as a means to convince the other side to agree to the suggested solution and change the status quo. Interestingly, loss aversion works here against the status quo bias; indeed, against the loss aversion obstacle itself. The power of loss aversion, which regularly functions as a barrier to change, is turned here against itself and is working as a motive to promote change.[42] Focusing on what the other side might lose turns on their loss aversion, and directs their aversion towards that potential loss; and their aversion to that potential loss makes the negotiator's offer—which enables the other side to avert that loss—more attractive compared to the alternative of rejecting the offer and suffering the loss. This way, focusing on a counterpart's potential losses uses the power of loss aversion to make an offer look more attractive. This in turn improves the chances of the other side accepting it, thus actually bringing the parties closer to reaching an agreement.

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41. Malhotra & Bazerman, *supra* note 8, at 516; MALHOTRA & BAZERMAN, *supra* note 32, at 160.

42. *See, e.g.*, Itamar Simonson et al., *Choice in Context: Tradeoff Contrast and Extremeness Aversion*, 29 J. MARKETING RES. 281, 282–89 (1992) (arguing that consumers compare an offer not only with other tradeoffs available through the negotiation, but also with past experiences and what they currently have to determine if rejecting the offer may leave them worse off).

2. *Adjusting the Reference Point*

Losses and gains are relative terms.[43] A result that is considered a loss in one situation can be considered a gain in another.[44] Whether a given result is considered a gain or a loss is determined by the reference point to which it is compared.[45] Receiving $100 sounds like a gain, but if you expected to receive $200, receiving $100 feels like a loss.[46] And if you expected to receive $120, receiving $100 would still feel like a loss, but a smaller one.

Since both the very perception of a result as a loss and the magnitude of the loss are determined by the reference point, changing the reference point can change the evaluation of a given result from a loss to a gain, or from a large loss to a small one.[47] And since loss aversion exists only when the possible result is considered a loss, and its severity is proportional to the size of the loss,[48] a change in the reference point can dramatically influence loss aversion. Changing the other side's reference point can be a powerful way to diminish their loss aversion and thus overcome the loss aversion obstacle.[49]

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43. KAHNEMAN, *supra* note 1, at 282.

44. *See* NEALE & BAZERMAN, *supra* note 19, at 45.

45. KAHNEMAN, *supra* note 1, at 282; *see* ZAMIR, *supra* note 2, at 11("There can be no loss aversion without a reference point.")

46. *See* ZAMIR, *supra* note 2, at 8; *see also* MALHOTRA & BAZERMAN, *supra* note 32, at 122; Zamir, *supra* note 14, at 837.

47. Zamir, *supra* note 14, at 833.

48. KAHNEMAN, *supra* note 1, at 282–83.

49. Neale and Bazerman showed that changing negotiators reference point and thus changing the framing of a suggested solution from a loss to a gain increases willingness to make concessions and thus increases probability of reaching an agreement. *See* NEALE & BAZERMAN, *supra* note 19, at 45–47. They conclude that "[t]he framing effect suggests that to induce concessionary behavior from an opponent, a negotiator should create referents that lead the opposition to a positive frame and couch the negotiation in terms of the other's potential gains." *Id.* at 47. In court settlement negotiations, the difference in reference point between the plaintiff and the defendant - the settlement is in the gains zone for the former and in the losses zone for the latter - results in different approaches and risk attitudes, that affects even the judges. *See* Rachlinski, *supra* note 14; Guthrie, *supra* note 5, at 1122–27. Zamir shows that in non-negotiation contexts, framing effect was found in some cases (e.g. contract default rules) but not in others (e.g. tax payments and several specific health care decisions), and states that the overall data seems to indicate that framing effects do exist although their significance is sometimes overstated, and that their effectiveness may be less due to the existence of some general framing effect and more dependent on the specifics of the situation. *See* ZAMIR, *supra* note 2, at 7, 207–12. A clear and overwhelming framing effect was found for organ donations, where a default of donating ("check the box if you wish to not donate") resulted in donation percentage of over 85% while a default of not donating ("check the box if you wish to donate") resulted in donation percentage of less than 15%. KAHNEMAN, *supra* note 1, at 373. Framing effect was also found effective in convincing people to get tested for HIV, skin cancer and breast cancer. Malhotra & Bazerman, *supra* note 8, at 515.

Influencing the other side's reference point is actually a common practice in negotiation, although most negotiators probably don't refer to it as such.[50] Many known and popular negotiation practices influence the other side's reference point; and although some of these practices are usually recommended without scientific explanation of their effectiveness, and some are recommended with explanations that do not refer to reference points, one likely reason for the effectiveness of those techniques is their effectiveness in changing the other side's reference point, which diminishes their loss aversion and brings the negotiation closer to an agreement.

How do negotiators influence the reference point of the other side? By directing the content of the discussion.[51] Reference point is context-dependent;[52] thus, influencing the context can influence the reference point. Basically, a negotiator directs the attention of the other side to a certain aspect of the situation—the aspect that the negotiator wants to set as their counterpart's reference point[53]—emphasizing two things: its relevance, and its facts and numbers. Usually this is best done by asking questions:[54] "How much would this car cost if it was new?" "How much time will it take you to complete this project if we don't reach an agreement?" "What is your current salary?" It can also be done in other ways, such as storytelling:[55] "Last week I was in Dallas and they offered me $73,000 for a similar project."

A negotiation scene offers many possible reference points,[56] some of which we will discuss below. In a given negotiation, some of these potential reference points help make our offer more appealing to the

50. *See, e.g.*, Jack S. Levy, *Loss Aversion, Framing, and Bargaining: The Implications of Prospect Theory for International Conflict*, 17 INT'L POL. SCI. REV. 179, 180–81, 186–89 (1996) (discussing the importance of the reference point to international negotiation along with various approaches to adjusting and working with the other side's reference point); Malcolm Baker et al., *The Effect of Reference Point Prices on Mergers and Acquisitions*, 106 J. FIN. ECON. 49, 55–63, 68–70 (2012) (discussing how shifts in reference points about expected stock market growth and share prices impact merger & acquisition prices and contribute to the formation of merger waves).

51. KAHNEMAN, *supra* note 1, at 304.

52. Korobkin, *supra* note 13, at 1275.

53. Directing attention to specific aspects of the negotiation situation was proved to alter ones perception and decrease or even eliminate the cognitive bias of anchoring effect. *See* Galinsky & Mussweiler, *supra* note 17, at 659.

54. *See* FISHER ET AL., *supra* note 23, at 113; CHRIS VOSS, NEVER SPLIT THE DIFFERENCE: NEGOTIATING AS IF YOUR LIFE DEPENDS ON IT 141, 151–56 (2016).

55. VOSS, *supra* note 54, at 200.

56. *See e.g.*, NEALE & BAZERMAN, *supra* note 19, at 47; *see also* ZAMIR, *supra* note 2, at 9 (discussing multi-reference point scenarios).

other side; others do the opposite. Which reference point to use depends on the merits and numbers of the specific negotiation at hand. In general, a reference point should both be relevant in the context of the specific negotiation and make one's offer look good (that is, describes a situation that is worse for the other side than other potential reference points). If multiple reference points meet these criteria, using more than one may be effective.

Adjusting the reference point can bring us closer to an agreement not only when a negotiator adjusts a counterparty's reference point, but also when adjusting the reference point of internal stakeholders—constituents, managers and partners, and even the negotiator herself. Opposition on one's own side can be as tough an obstacle to agreement as opposition from a counterparty. Internal negotiation—convincing our own people to authorize and agree to a possible solution—can be as important to the success of the negotiation and as difficult as the external one (and sometimes even more).[57] The same tactics that can effectively adjust the other side's reference point can be used to adjust the reference point of internal stakeholders.[58] Reducing this internal loss aversion thus reduces the tendency of a negotiator's team to reject possible solutions and increases the chances of reaching an agreement.

(a) *The Current Situation*

Usually, the current situation is the default reference point.[59] People compare what they may get or might have to give to what they currently have. But sometimes people refer to a different reference point. For example, if they see what someone else has received, it may become their reference point. Now they expect to receive the same, and they will consider anything less a loss.[60] Alternatively, if they may set a goal, that goal may become their reference point, making it hard for them to accept anything less even if it is still above their reservation value.[61] In such cases, it can be effective to turn their reference point back to the current situation.

57. *Cf.* Shivan Sarin, *Strategizing the Two-Level Negotiation: How a Level I Negotiator Deals with a Level II Agitator*, 21 HARV. NEGOT. L. REV. 143, 146 (2015); *see also* Robert H. Mnookin, Ehud Eiran & Sreemati Mitter, *Barriers to Progress at the Negotiation Table: Internal Conflicts Among Israelis and Among Palestinians*, 6 NEV. L. J. 299 (2005-2006).

58. *See, e.g.*, Rachlinski, *supra* note 14, at 171.

59. KAHNEMAN, *supra* note 1, at 282; ZAMIR, *supra* note 2, at 8.

60. KAHNEMAN, *supra* note 1, at 282.

61. NEALE & BAZERMAN, *supra* note 19, at 49–50.

The current situation is specifically effective as a reference point when we can show that what we offer is not that different from it. If a comparison between the suggested solution and the current situation shows that they are not that different in their relevant elements, this is a powerful argument that can dramatically decrease loss aversion. Sometimes people are loss averse just because they fail to see that the losses are small (or even that there are no losses).[62] If we can show that the requested change is not far from the current situation, it can make it much easier for the other side to consent.

It has been noted that one of the primary obstacles to reaching an agreement in negotiation is the other side's feeling that a negotiator is asking "too much too fast."[63] When possible, showing the other side that what we offer is not far from the current situation is an effective way to overcome this obstacle; and a possible explanation for its effectiveness is that such a move redirects the other side's attention to the current situation, thus resetting it as their reference point and consequently diminishing their loss aversion.

(b) *The Adversary's Own Offer*

When an offer obviously differs a lot from the current situation, using the current situation as the reference point will not eliminate the other side's loss aversion. It is better to find a different reference point—one that is still perceived as relevant, and that more closely resembles the offer. This reference point will diminish the other side's loss aversion. One such potential reference point is the other side's own offer. If we can show that our offer is not that different than theirs, it can substantially decrease their loss aversion and their resistance.

Using the other side's offer as the reference point is related to the common recommended negotiation practices of building on the other side's ideas and suggestions[64] and engaging them in designing the solution.[65] Here also, it is possible that the effectiveness of those

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62. *See* Peter Brooks & Horst Zank, *Loss Averse Behavior*, 31 J. Risk & Uncertainty 301, 313–17 (2005) (summarizing the results of a controlled study that highlighted the presence of loss aversion in the context of a small potential loss paired with a larger potential gain such as the purchase of a lottery ticket). *But see* Eldad Yechiam & Guy Hochman, *Loss-Aversion or Loss-Attention: The Impact of Losses on Cognitive Performance*, 66 Cognitive Psychol. 212 (2013) (finding that the existence of a potential loss actually improved the selection rate of a choice that had a higher potential gain despite the potential for loss being present only in that specific choice).

63. Ury, *supra* note 32, at 108.

64. *Id.* at 111–12.

65. *Id.* at 110–114.

ideas has to do with their effect in reducing loss aversion by narrowing the gap between what we ask and their reference point.

(c) *What Would Happen Anyway*

A third possible reference point is what would happen anyway—what we can reasonably assume will happen in the absence of an agreement.

There is an important difference between this reference point and the "current situation" reference point. Here, we emphasize that the situation is dynamic. One cannot expect the situation to remain the way it is. Things are bound to deteriorate. If a negotiator can make a plausible argument showing that the loss the counterpart fears will happen anyway, or perhaps will be even greater than the one the negotiator wants to impose, the other side will be much less averse to our proposal.

Referring to the natural course in which things will probably develop (or deteriorate) is a powerful way to detach the other side from the reference point of the current situation (and the status quo bias), since it practically tells them that their hope to hold on to the current situation is an illusion. The current situation will not remain the same, and refraining from action will not result in staying at the current situation, but will have much worse results. A credible argument along these lines can be extremely effective in pulling a stubborn party out of their trenches and into the dynamic of mutual concessions towards agreement.

(d) *The Possibility of a Greater Loss*

When the other side sees a potential loss—say, a $1,000 loss—they are loss averse. They don't like this option. They reject it. But if they become aware of the possibility of a greater loss—say, a $2,000 loss—it can diminish their aversion to the $1,000 loss option.

Below I discuss several ways of directing a counterpart's attention to the possibility of a greater loss for them than the one included in an offer. Some are basic and familiar negotiation techniques. Their effectiveness and popularity may be due, at least in part, to their effect in influencing the other side's reference point, thus diminishing their loss aversion and making them more receptive to reaching an agreement in general and to accepting our offer in particular.

The first and most common way to direct the other side's attention to the possibility of a greater loss—a way as ancient as negotiation itself—is by making an extreme demand, or a first offer that is extremely biased in our favor.[66] Probably every negotiation book and course refers to this practice: recommending it, discussing it, arguing against it, warning from it, and defending from it.[67] For our purposes, the important thing is the effect such an offer has on the other side's reference point. It shows them the possibility of a greater loss. Future options will be compared to it, and they will look more plausible since they are not as bad as this one.

As ancient as extreme offers may be, the scientific discussion of their effect is relatively new. One account of the effectiveness of extreme offers comes from the concept of anchoring:[68] the extreme number functions as an anchor,[69] either by setting a base point from which adjustment is made[70] or by creating a priming effect that brings to mind numbers that are related to the anchor number;[71] either way, putting an anchor on the table pulls the outcome of the negotiation closer to the anchor number than if the anchor did not exist.

As mentioned earlier, and wholly consistent with the anchor explanation, it is possible that the effect of extreme offers can also be explained, at least in part, in the effect they have on the other side's reference point, and thereby on their loss aversion. The extreme offer functions as a reference point; and once it is established as the reference point, a subsequent offer is automatically compared to it. The subsequent offer may still be outrageous, one that would be immediately rejected if presented alone. But if the subsequent offer is even slightly moderated compared to the extreme first offer, it can appear

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66. *See, e.g.*, CHARLES B. CRAVER, EFFECTIVE LEGAL NEGOTIATION AND SETTLEMENT § 10.02[3] (7th ed. 2011) (discussing the propensity to make an extreme offer at the onset of discussions as an established negotiation tactic); Bruce Barry & Raymond A. Friedman, *Bargainer Characteristics in Distributive and Integrative Negotiation*, 74 J. PERSONALITY & SOC. PSYCHOL. 345, 347 (1998) (arguing that an extreme first offer can help the offeror with framing the range of acceptable outcomes).

67. *See, e.g.*, FISHER & URY, *supra* note 23, at 14; MALHOTRA & BAZERMAN, *supra* note 32, at 31, 33, 34; VOSS, *supra* note 54, at 198–208; DIAMOND, *supra* note 32, at 378; HERB COHEN, YOU CAN NEGOTIATE ANYTHING 120–21 (1980).

68. KAHNEMAN, *supra* note 1, at 119.

69. *See* Galinsky & Mussweiler, *supra* note 17, at 655; Gregory B. Northcraft and Margraret A. Neale, *Experts, Amateurs, and Real Estate: An Anchoring-and-Adjustment Perspective on Property Pricing Decision*, 39 ORG. BEHAV. & HUM. DECISION PROCESSES 84, 94–95 (1987); Jingjing Yao, Li Ma & Lin Zhang, *From Lab Experiments to Real Negotiations: An Investigation of International Iron Ore Negotiations*, 34 NEGOT. J. 69, 81–82 (2018); *see also* Najung Kim & Hun-Joon Park, *Making the Most of the First-Offer Advantage: Pre-Offer Conversation and Negotiation Outcomes*, 33 NEGOT. J. 153 (2017).

70. NEALE & BAZERMAN, *supra* note 19 at 48–50; KAHNEMAN, *supra* note 1, at 120.

71. KAHNEMAN, *supra* note 1, at 122.

reasonable, because it is compared to an even worse reference point: the first offer.

Although the effectiveness of extreme first offers has been demonstrated experimentally, a question remains as to what causes that effect: whether it is created by the setting of a reference point, or by anchoring, or by mutuality, or by other mechanisms. Research seems to support the idea that reference points have some role in the effectiveness of first offer anchors. It can be reasonably expected that if part of the effectiveness of extreme first offers is because they set a reference point, then changing the reference point will influence the effectiveness of the first offer. And indeed, the research bears this out: A focused effort to set a different reference point successfully countered the effectiveness of anchors in negotiation, which may be an indication that the effect of first offers can be connected to setting a reference point.[72]

Making an extreme first offer is not the only way to set the other side's reference point on the possibility of a greater loss. Another closely related way to do so is the technique described by Cialdini as the "door-in-the-face"[73] or "rejection-then-retreat" technique:[74] asking for something completely different than what we want, which will (a) cause the other side a much greater loss, and (b) most probably be rejected by them. Cialdini shows that such a move greatly increases compliance with a second, much moderated request;[75] one account of this effect, at least in part, is the role of the reference point and loss aversion. The first extreme request set the reference point on a potential great loss for the other side; and as a result, the second request seemed more reasonable, and created less loss aversion, than would be the case if the second request would be presented alone and not after the first request.

A third way of setting the other side's reference point on the possibility of a greater loss is by referring to an external standard or a third-party price tag that is much worse for the other side than the negotiator's offer.[76] If the standard or price tag is perceived by the

72. Galinsky & Mussweiler, *supra* note 17, at 659; Douglas N. Frenkel & James H. Stark, *Improving Lawyers' Judgment: Is Mediation Training De-Biasing?*, 21 HARV. NEGOT. L. REV. 1, 40–41(2015); KAHNEMAN, *supra* note 1, at 126–27.

73. *See* Robert B. Cialdini et al., *Reciprocal Concessions Procedure for Inducing Compliance: The Door-in-the-Face Technique*, 31 J. PERSONALITY & SOC. PSYCHOL. 206 (1975). *See also* MALHOTRA & BAZERMAN, *supra* note 32, at 163–65

74. CIALDINI, *supra* note 36, at 28.

75. Cialdini et al., *supra* note 73, at 213–15.

76. *See e.g.*, VOSS, *supra* note 54, at 200 ("If you go to Harvard Business School, they're going to charge you $2,500 a day per student.").

other side as relevant to their situation, it becomes a relevant reference point. And if this reference point represents a greater loss for the other side than our offer, this move can diminish their loss aversion and increase the chance of accepting our offer.

Another way to remind the other side of the possibility of a greater loss is to remind them of the previous offers they received from the negotiator (or from others) and rejected, and to show them that the current offer is an improvement compared to the previous ones.[77] The comparison to previous offers sheds positive light on our current offer, by setting the other side's reference point on offers that represent greater loss for them.

(e) *Gradual Adjustment*

A reference point can also be adjusted gradually, step by step. When the needed adjustment is significant, it may be difficult to cross the chasm in one leap. In such case it can be efficient to adjust the reference point one step at a time.

In his book *Getting Past No*, William Ury suggests that one of the most common obstacles to agreement is the other side's feeling that we are asking too much too fast,[78] and that a solution is to guide them step by step.[79] A similar concept was described by Cialdini as the "foot-in-the-door" technique[80]—asking for something small in order to increase the likelihood of compliance to the first request, and then launching follow-up requests (one or more) that gradually get us closer to what we want.[81] Similar advice can be found in other sources.[82] The effectiveness of these techniques can be accounted for, at least in part, by the fact that they create gradual adjustments of the other side's reference point. These adjustments accumulate to a significant change in their reference point—a change that may not have been possible to achieve in one step. The change in reference point results in a decline in loss aversion, thus increasing the likelihood of reaching an agreement.

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77. Rachlinski, *supra* note 14, at 171.

78. Ury, *supra* note 32, at 108.

79. *Id.* at 125.

80. Cialdini, *supra* note 36, at 54.

81. *See* Malhotra & Bazerman, *supra* note 8, at 516; Malhotra & Bazerman, *supra* note 32, at 165–67.

82. *See* Diamond, *supra* note 32, at 115.

(f) *Their Best Alternative To a Negotiated Agreement (BATNA)*

The other side's alternatives are the ways in which they can advance their interests other than by an agreement with us. Their best alternative to a negotiated agreement (BATNA) is what they will probably do if the two parties fail to reach an agreement.[83] Referring to the other side's BATNA can sometimes be effective in adjusting their reference point. If their BATNA is not attractive, then setting it as a reference point can make an offer and requested concessions appear less off-putting.

Setting the reference point to their BATNA is not the same as setting it to what would happen anyway: the latter is the expected way in which things will develop, while the former is what they can do. Both are relevant aspects of the negotiation situation, and thus both are possible reference points that can be considered.

(g) *Objective Standards*

Another aspect of the situation to which we can direct the attention of the other side is objective standards.[84] Such standards can include official price lists, market conventions, and relevant precedents.[85] If the standard is closer to our offer than the current situation or other potential reference points, referring to it and setting it as the reference point can diminish loss aversion and improve our offer's acceptance prospects.

Using standards is a common recommendation to negotiators, and is indeed a powerful negotiation technique.[86] It is possible that part of its effectiveness is that its relevance enables it to serve as a reference point; and in those cases in which this reference point is close to our offer, using it can diminish loss aversion and bring us closer to reaching an agreement.

83. FISHER & URY, *supra* note 23, at 102. For a contemporary account of the concept of BATNA, see James K. Sebenius, *BATNAs in Negotiation: Common Errors and Three Kinds of "No"*, 33 NEGOT. J. 89 (2017).

84. *See* FISHER & URY, *supra* note 23, at 82.

85. For precedents as standards in negotiation, see Larry Crump, *Toward a Theory of Negotiation Precedent*, 32 NEGOT. J. 85 (2016); Larry Crump & Don Moon, *Precedents in Negotiated Decisions: Korea–Australia Free Trade Agreement Negotiations*, 33 NEGOT. J. 101 (2017). For an example of negotiation in the shadow of a precedent, see Jonathan G. Odom, *A Modern-Day Pentagon Paper in a Post-Pentagon Papers World: A Case Study of Negotiations Between The Washington Post and the U.S. Government Regarding Publication of the 2009 Afghanistan Assessment*, 23 HARV. NEGOT. L. REV. 215 (2018).

86. *See, e.g.*, FISHER & URY, *supra* note 23, at 82; DIAMOND, *supra* note 32, at 105; Wesley MacNeil Oliver & Rishi Batra, *Standards of Legitimacy in Criminal Negotiations*, 20 HARV. NEGOT. L. REV. 61, 64–65 (2015).

(h) *The Whole Picture*

Sometimes a concession we demand may seem to the other side significant relative to the size of the specific item that is directly connected to the concession. In such cases it may be useful to direct the attention of the other side to the whole picture, the whole contract or project, compared to which the concession may look smaller.[87] Setting the reference point on the whole picture can put a concession into proportion and thus diminish loss aversion.

3. *Diminishing the Decision Burden*

As mentioned earlier, loss aversion makes it hard for a negotiator to decide to accept an offer that entails a loss. As discussed, it is possible to take steps to diminish this difficulty when designing the solution; it is also possible to take such steps when planning how to present the solution. Here are some presentation tactics to ease the decision burden without changing the proposed solution.

(a) *The Loss Would Have Happened Anyway*

The essence of the decision burden, in the context of loss aversion, is the difficulty of the decision maker to take responsibility for creating the loss. Even if the loss is accompanied with gains, the loss itself is still a loss, and responsibility for it is still a burden. If we can show the other side that this specific loss would have happened anyway, this can be a significant relief for them. If the loss would have happened anyway, then it is not a result of their decision; they are not to be blamed for it. When possible, showing the other side that the loss would have happened anyway can significantly diminish their loss aversion and increase the chances of reaching an agreement.

(b) *Reversibility*

If we can show the other side that their decision on a concession is reversible, it can significantly diminish their loss aversion regarding that concession. It is much easier to accept an arrangement that contains a concession if the concession is perceived as not final. The other side can tell themselves that the final decision will be made later, when more information is available, and perhaps even by someone else. This way the other side is relieved from the decision burden, or at least some of it. Directing the other side's attention to the fact

87. Malhotra & Bazerman, *supra* note 8, at 514, 519; MALHOTRA & BAZERMAN, *supra* note 32, at 172–73.

that the concession is not final can diminish the loss aversion obstacle and make it easier to reach an agreement.

(c) *Baby Steps*

When possible—when the suggested arrangement occurs in phases—it can be useful to try to focus the attention of the other side on one phase at a time. This way the concession in sight is only the one contained in that phase, and since the loss aversion is proportional to the size of the perceived loss, the result is a diminished loss aversion.

(d) *Exit Points*

When the suggested arrangement contains exit points, directing the other side's attention to their existence can be an effective way to diminish loss aversion. Whenever hesitation appears or second thoughts surface that can be attributed to loss aversion, reminding the other side of the existence of exit points can be an effective neutralizer.

4. *Considering Other Cognitive Biases*

Loss aversion is not the only cognitive bias that exists in the context of a negotiation and can affect the dynamic and results of the negotiation. We already discussed the use of one such cognitive bias, the anchoring effect, and its influence on the other side's reference point.[88] Several other cognitive biases are relevant in the negotiation context and can be used to minimize or to counter the resistance created by loss aversion.[89] There are several possible applications of such biases.

(a) *The Certainty Effect*

The certainty effect is the name given to the phenomenon that people give extra weight to sure things compared to things that are not sure.[90] For example, most people would pay more to go from a 99 percent chance that a desired event happens to 100 percent than from 37 percent to 38 percent, although the improvement in expected utility is the same.[91] The very difference between certainty and uncertainty seems to have weight.

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88. See Discussion, *infra*, section III.B.2.d.

89. *See* KAHNEMAN & TVERSKY, *supra* note 2; *see also* NEALE & BAZERMAN, *supra* note 19, at 41–60.

90. *See* Kahneman & Tversky, *supra* note 1, at 265.

91. *See* KAHNEMAN & TVERSKY, *supra* note 2, at 50.

In the context of loss aversion as an obstacle to a negotiated agreement, the certainty effect is relevant in two ways. First, it clarifies that sure losses and gains loom larger than uncertain ones.[92] Hence, if one can design the agreement such that the benefits for the other side are certain and the losses are not, it can diminish their aversion to those losses and thus diminish the loss aversion obstacle to reaching an agreement.

Second, when the other side considers whether to prefer their alternative over reaching an agreement with us, if one can show them that the costs of their alternative are certain while the benefits are not,[93] this can make the alternative seem less attractive and thus increase the chance of reaching an agreement.[94]

(b) *Optimistic Overconfidence*

Optimistic overconfidence refers to the common tendency to overestimate one's ability to predict and control future outcomes.[95] In the context of a negotiation, and specifically dispute resolution negotiation, optimistic overconfidence can appear in the honest belief that if the case is not settled in an agreement, one has a good chance to win it in court, where the actual prospects are far less promising.[96] Optimistic overconfidence can create a severe obstacle to reaching an agreement.[97]

An interesting way to diminish the obstacle to reaching an agreement created by optimistic overconfidence is apparently by introducing people to the world of mediation: it seems that mediation training is de-biasing, at least regarding the specific bias of optimistic overconfidence.[98]

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92. *See* RICHARD DE NEUFVILLE & PHILLIPE DELQUIE, *A Model of the Influence of Certainty and Probability "Effects" on the Measurement of Utility*, *in* 9 RISK, DECISION AND RATIONALITY 189, 185–89 (Bertrand Munier ed., 1988) (discussing the results of an experiment showing how the certainty effect influenced participants to choose options that did not have the highest expected net gain). *See generally* Simone Cerreia-Vioglio et al., *Cautious Expected Utility and the Certainty Effect*, 83 ECONOMETRICA 693, 693–95 (2015) (discussing the theoretical foundations of the certainty effect).

93. *See* Rachlinski, *supra* note 14, at 171.

94. Aversion to sure losses is considered one of the main reasons to the phenomenon of escalation of commitment, basically since sunk costs are sure losses. See ZAMIR, supra note 2, at 29–31. For information on sunk costs, see also Thaler, *supra* note 9, at 47–50.

95. KAHNEMAN & TVERSKY, *supra* note 2, at 45.

96. NEALE & BAZERMAN, *supra* note 19, at 12, 53–55.

97. KAHNEMAN & TVERSKY, *supra* note 2, at 46.

98. Frenkel & Stark, *supra* note 72, at 21; Randall L. Kiser, Martin A. Asher & Blakely B. McShane, *Let's Not Make a Deal: An Empirical Study of Decision Making*

Assuming that within the context of the one specific negotiation in which we are involved sending the other side to mediation training may not be practical, a shortcut can be used. A negotiator can direct them to try techniques such as considering the opposite[99] and perspective taking[100] by asking questions about the aspects of the situation that they may prefer not to consider—those that may weaken their case should it come to court. Such questions could refer to legal precedents, behavioral morality, or limited availability of key witnesses. Interrupting their dreams with reality check questions can bring them closer to realistic assessment of their chances, thus decreasing the perceived value of their alternative and bringing it closer to its actual size, and diminishing the obstacle that optimistic overconfidence creates to reaching an agreement.

From a loss aversion analysis perspective, letting the other side dwell on an extremely overoptimistic imagined alternative sets them a reference point that will make it very hard for them to accept concessions, even when those concessions are actually justified in terms of serving their interests. The reality check questions can help them switch to a more realistic reference point, thus diminishing loss aversion and increasing the chance of reaching an agreement.

IV. Conclusion

In negotiation, the cognitive bias of loss aversion creates an obstacle to reaching an agreement by trading concessions, since each party's own concessions loom larger than similar concessions from the other party. Analyzing the mechanism and dynamics of loss aversion in negotiation can direct us to ways to diminish the obstacle it creates to reaching an agreement.

Overcoming the loss aversion obstacle in negotiation can be done using two sets of negotiation tools. The first set contains tools for designing our offer, our suggested solution and agreement. When we understand how loss aversion makes it difficult for the other party to accept our offer, we can design our offer in ways that would diminish their loss aversion and thus will make it easier for them to accept our offer. Such design tools include locating our offered concessions where they will be most effective in diminishing the other party's loss

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in Unsuccessful Settlement Negotiation, 5 J. Empirical Legal Stud. 551, 588–89 (2008).

99. *See* Frenkel & Stark, *supra* note 72, at 22–27. The method of considering the opposite was also proved successful in diminishing the anchoring effect. *See* Galinsky & Mussweiler, *supra* note 17, at 666.

100. See Frenkel & Stark, *supra* note 72, at 34–42.

aversion—where they will diminish their losses and not where they will increase their gains, and locating our demands where they will create the least loss aversion for the other party—where they will decrease their gains and not where they will increase their losses. Other design tools are making use of the power of value asymmetry and minimizing the decision burden by deferring the actual concession to a later stage (by setting exit points) or to someone else's decision.

The second set of negotiation tools contains tools for presenting our offer. Different ways of presenting the same offer can create different levels of loss aversion, and presenting our offer in ways that will diminish the other party's loss aversion can increase our offer's acceptance chances. Such presentation tools include focusing on what the other party might lose rather than on what they may gain; adjusting their reference point to minimize the loss aversion (by referring to or reminding them of relevant possible reference points in the negotiation, such as the current situation, their own offer, what would happen anyway, the possibility of a greater loss, their BATNA, objective standards, the whole picture, and gradual adjustment); diminishing the decision burden, by showing them that the loss would have happen anyway or is reversible, showing them that there are exit points, or advancing in baby steps; and making use of other relevant cognitive biases such as the certainty effect and optimistic overconfidence.

Some of the negotiation tools discussed in this Article are commonly recommended, and some have been thoroughly researched, but a discussion as to the psychological mechanisms which make them effective was generally lacking. Our discussion suggests that the effectiveness of these tools can be accounted for, at least in part, by their effect of diminishing the other party's loss aversion, thus weakening the loss aversion obstacle and bringing the parties closer to an agreement.