



Studying Transactions in the Laboratory

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Why Conduct Laboratory Experiments?

Immediate Goal:

Descriptive

Ultimate Purpose:

Normative

Prescriptive

Two Experimental Approaches

– Between-Subject Experiment

- *The Status Quo Bias and Contract Default Rules*
83 Cornell L. Rev. 608 (1998)
- *Inertia and Preference in Contract Negotiation*
51 Vand. L. Rev. 1583 (1998)

– Controlled Simulation

- *Who Wins in Settlement Negotiations?*
Am. L. & Econ. Rev. (2009); doi:10.1093/aler/ahp004

Rational Choice View of Contract Preference

- Preferences reflect goal of wealth maximization
- Preferences are independent of context
 - Legal Rules
 - Negotiation dynamics



“Preference exogeneity assumption”

The Status Quo Bias

Evidence in other contexts

- Property rights/endowments

Question: Is the same effect caused by:

- Contract default rules?
- Other contract terms?

Hypothesis:

Identifying a particular contract term as the “status quo” term will positively affect bargaining parties’ preferences for that term.

Experimental Design

Subjects: 187 Univ. of Illinois Law Students

Stimulus: Contract negotiation scenarios

- Subjects place value on specific terms
- Terms are presented as part of the “status quo” to some subjects and as not part of the “status quo” to other subjects

Comparison: “Between subjects”

Consequential Damages Scenario

All subjects:

- Gifts, Inc. prefers NextDay be liable for *all damages*
- NextDay prefers liability limited to *foreseeable damages*
- Differential cost to NextDay of full damages term:
\$0-\$10 per package (95% probability)
- Calculated by NextDay's accountants using Gifts, Inc. historical shipment data

Condition 1: Legal default = limited liability

Condition 2: Legal default = full liability

Consequential Damages Scenario Results

Condition 1 (N=26)

Limited liability → Full Liability

\$6.96 per package

Condition 2 (N=28)

Full liability → Limited Liability

\$4.46 per package

Preference for Defaults, or for Inaction?

Condition 1: (Limited liability → Full liability)

\$6.96 per package

Condition 2: (Full liability → Limited liability)

\$4.46 per package

Condition 3 (N=33):

Limited liability (form K) → Full liability (default)

\$7.36 per package

Condition 4 (N=25):

Full Liability (form K) → Limited liability (default)

\$4.10 per package

Impossibility Excuse Scenario

Issue: Will NextDay be excused from performance due to unforeseen contingencies?

Condition 1 (N=22):

Excuse → No Excuse
\$188,000

Condition 2 (N=25):

No Excuse → Excuse
\$56,000

Implications

Prescriptive (for negotiators):

- Control reference points in negotiation

Normative (for lawmakers):

- “Tailored” defaults
- Non-enforcement defaults

Background Assumptions

Many settlement negotiations are purely distributive and have a non-trivial bargaining zone

Even when integrated tradeoffs are possible, nearly all have a distributive element

Legal merits have large impact on outcomes, but they are not the only factor

Few (if any) simultaneous tests of the power of many potential variables

Methodology

Law students randomly assigned to represent plaintiff or defendant

Pre-negotiation questionnaire followed by 30 minute negotiation

Purely "distributive" (only issue is size of cash payment from D to P)

Subjects' reservation prices ("bottom lines") held constant

Dependent variable = plaintiff's share of cooperative surplus

Subjects compensated with probabilistic "contingent fee"

N=55 (dyads) after manipulation checks

Simulation Facts

Defendant Electec Corp. fires plaintiff Henry Smith, Age 60

Smith sues for illegal age discrimination

Lawsuit seeks \$100,000 in damages

Legal standard permits “indirect evidence” of discriminatory motive
Hazen v. Biggins (1993)

Some facts favor each party and no facts are private information

Plaintiff’s reservation price = \$10,000 (private information)

Defendant’s reservation price = \$60,000 (private information)

Reservation Price Instructions

Plaintiff's Instruction:

[I]n other words, you should not leave settlement negotiation without an agreement if it is possible to get at least \$10,000. If you cannot convince Electec to pay Smith at least \$10,000, you should decline to settle the case. If there is no settlement, Smith will retain a specialist in employment law litigation to represent him in court in this matter, notwithstanding the costs and risks of trial.

Defendant's Instruction:

In other words, Electec has instructed you that you should not leave the settlement negotiation without an agreement if it is possible for you to secure a settlement by agreeing that Electec will pay Smith \$60,000 or less. If you cannot convince Smith's lawyer to accept \$60,000 or less, then you should decline to settle the case. If this occurs, Electec will hire a litigator and take its chances in court.

Hypotheses

The following variables will predict surplus:

Estimate's of other negotiator's "bottom line"

(Maximum amount he will pay to avoid trial)

Relative patience

(Enjoyment of negotiation)

(Enthusiasm for litigating case)

Targets (aspirations)

("Goal" in \$\$, as distinguished from bottom line)

Perceptions of a fair settlement

(Fair to both sides from neutral perspective)

Subject gender

Identity of initial offeror

Amount of initial offer (or demand)

Relative self confidence

(Rating of skill level relative to peers)

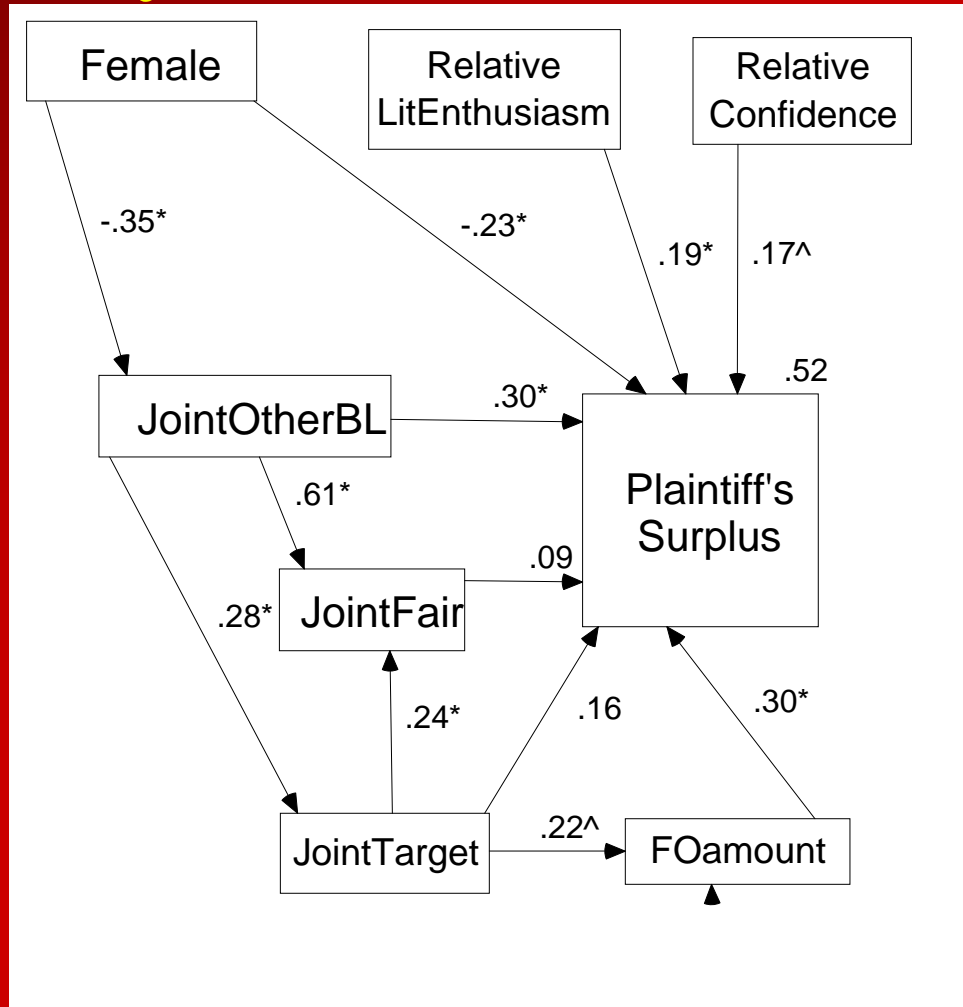
(Rating of "success" in last negotiation)

Bivariate Correlations

	Surplus	Female	Joint OtherBL	Joint Fair	Joint Target	FO Amount	JRE
Female	-.404***						
Joint Other BL	.599***	-.353**					
Joint Fair	.474***	-.156	.675***				
Joint Target	.382**	-.025	.281*	.409**			
First Offer Amount	.440**	-.171	.232	.083	.223		
Relative Enthusiasm	.375**	-.053	.252	.378**	.268*	.098	
Relative Confidence	.266**	-.085	.216	.082	.007	-.002	.100

***p < .001, **p<.01, *p<.05

Path Analysis (Direct and Indirect Effects)



* $p < .05$, $^\wedge p < .10$

Fit statistics: Chi-square = 17.838 (df = 16, n=55, $p = .333$),
CFI = .980, TLI = .964, R-squared = .52.

Path Analysis: Standard & Unstandardized Effects

	Unstandardized Effects			Standardized Effects
	Direct	Indirect	Total	Total
JointOtherBL	.088	.038	0.127	.425
Female	-4661	- 2985	- 7646	-.384
FOamount	.147	0	0.147	.301
JointTarget	.083	.045	0.128	.253
Relative LitEnthusiasm	.611	0	.611	.190
Relative Confidence	.975	0	.975	.175
JointFair	.031	0	0.031	.095

Path Analysis

	Dependent and Intermediate Variables				
	JointOtherBL	JointFair	JointTarget	FOamount	Plaintiff's Surplus
Female	-23561** (8510)				-4660* (2003)
JointOtherBL		0.545*** (0.089)	0.165* (0.077)		0.088* (0.039)
JointFair					0.031 (0.045)
JointTarget		0.363* (0.152)		0.232^ (0.138)	0.083 (0.053)
Relative LitEnthusiasm					611* (303)
FOamount					0.147** (0.047)
Relative Confidence					974^ (524)

Chi-square = 17.838 (df = 16, n=55, p = .333), CFI = .980, TLI = .964, R-squared = .52.

^p<.10 *p < .05, **p < .01, ***p < .001

Possible Limitations

Bargaining zone was very large

If bargaining zone were smaller...

- positive correlations might be weaker
- risk of impasse might be greater

Subjects had no settlement data for similar cases

- positive correlations could be weaker with other focal points



Factors that were assets could be less important or liabilities in other contexts