

The Art & Science of Persuasion



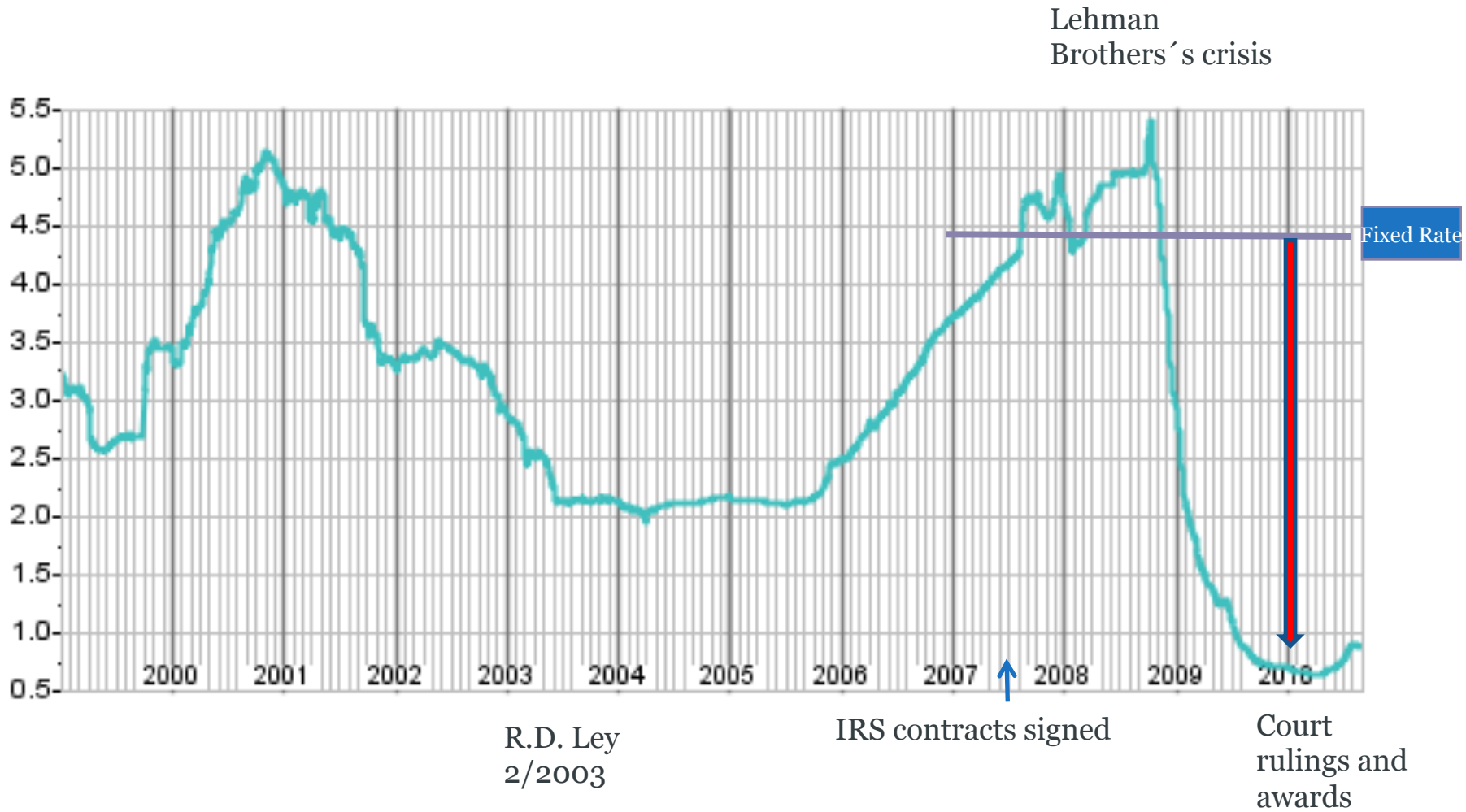
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Recent disputes on Interest Rate Swaps (IRS)

(3 month-Euribor vs. fixed rate)



Recent disputes on IRS

Typical claim by client (borrower): IRS is null and void, since its was mis-sold to me and I thought it was an insurance policy.

Key issue:

- Is the client trying to walk out from a valid long term contract, just because of the unexpected drop in Euribor following Lehman's crisis?

Vs.

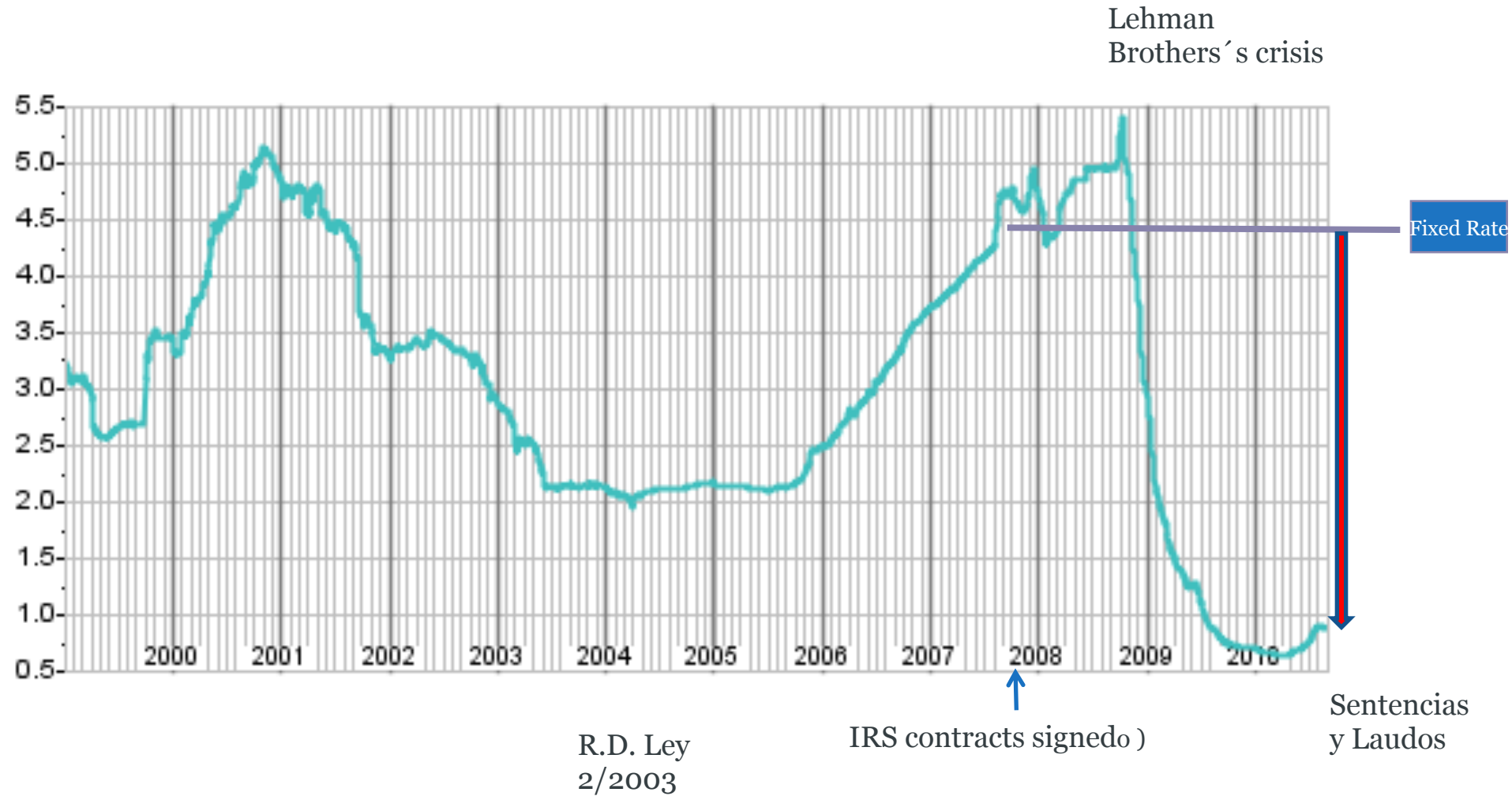
- Did the bank take advantage of an uneducated, unsophisticated client to mis-sell him/her a complex financial product which the client did not fully understand?

Recent Spanish court rulings on IRS

Regional Court	Swap declared void?	Rationale
Asturias	Yes	“El banco tenía una prognosis más o menos fiable del futuro , que no puso en conocimiento del cliente”
Pontevedra	Yes	“[Había una] expectativa para los entendidos , a la postre convertida en realidad, de un desplome en la evolución del Euribor . Los clientes no profesionales [eran] ajenos a a tales previsiones bajistas”.
Ávila	No	“ Un contrato no puede ser válido cuando favorece y nulo cuando perjudica ”.

Recent disputes on Interest Rate Swaps (IRS)

(3 month-Euribor vs. fixed rate)



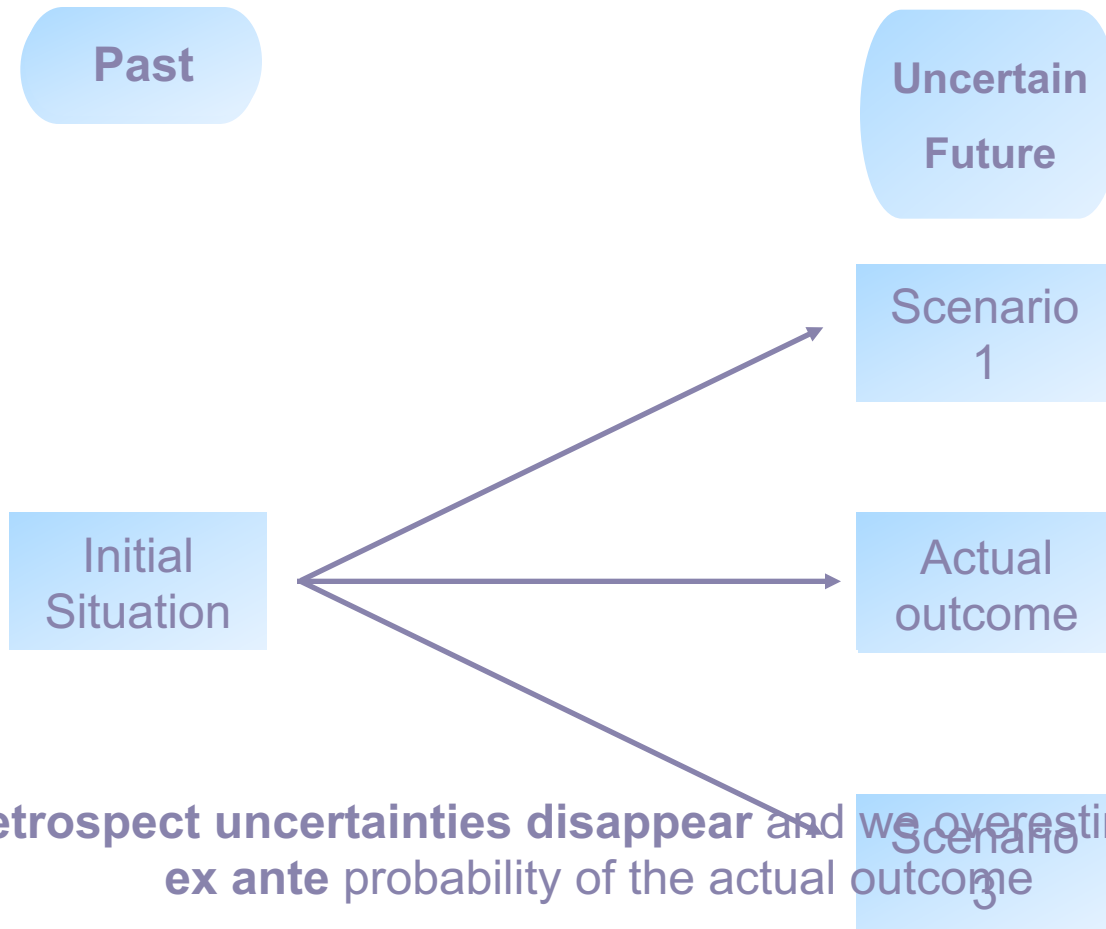
Hindsight bias: definition

= **ex post**, once something has happened, we spontaneously tend to exaggerate its **ex-ante** predictability

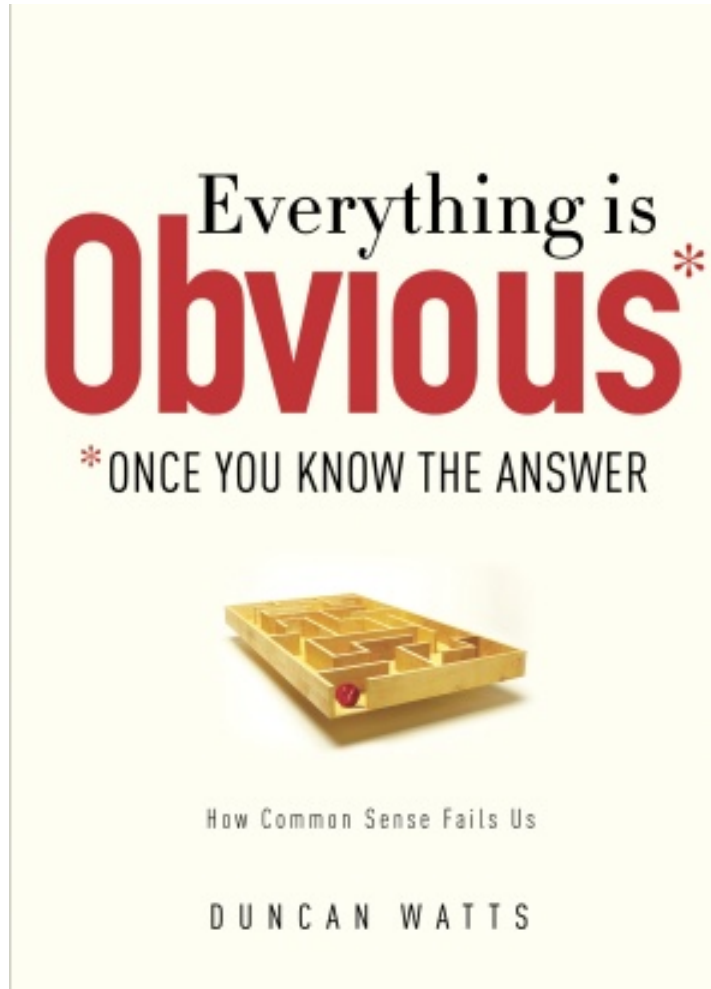
USA: *“I knew it all along”, “Monday morning quarterback”, “20/20 hindsight vision”...*

Argentina: *“Con el diario del lunes, siempre se acierta el caballo ganador”*

Hindsight bias: explanation



Hindsight bias in daily life



Hindsight bias in Law

Patents: once something has been discovered or invented, its novelty may be underestimated.

Tort litigation: defendants may be declared negligent even if they applied reasonable care (e.g. radiologist who missed a tiny tumor).

Market abuse: a speculative trading strategy may be considered abusive (e.g. “*pump and dump*”) even if it was just lucky.

Financial mis-representation/mis-selling: after an unexpected crisis, financial institutions may be accused of inadequate disclosure of risks or even fraud.

Reverse hindsight : a tiny disclaimer, hidden in a long document, may be claimed to have alerted a client or risks (even if all verbal information understated those risks)

Hindsight bias in FDI: the “obsolescing bargain”

Raymond Vernon, “*Sovereignty at Bay*” (1964)

- A risky project will only be undertaken if its potential profitability is high enough.
- Scenario 1: project fails.

No problem (except for investor and maybe some stakeholders)

- Scenario 2: project succeeds and becomes very profitable.

Problem: “*ex post*” host country may claim that the initial contract was a “rip-off” and may either renegotiate its terms or expropriate the project.

Ex post, unrealized risks will become invisible

Hindsight bias in Law...and Politics!



September 29, 2010

“Iceland’s Parliament voted to press **negligence charges** against former prime minister **Geir Haarde**, for the mishandling of supervision of banks prior to the 2008 bank crisis that left the economy in ruins”

April 23, 2012

Criminal charges dismissed, except for a minor one.

Hindsight bias: debiasing techniques

- Doctrine “*Fraud by Hindsight* (FBH)”

Formulated by Judges Henry Friendly (*Denny v. Barber*, 1978) and Richard Easterbrook (*Di Leo v. Ernst&&Young*, 1990).

= when claiming fraudulent non-disclosure of material information, plaintiffs should provide **contemporaneous** evidence of defendants’ scienter.

- Counterfactual thinking

= imagine deliberately plausible alternative scenarios which might have led to different outcomes

A “prospective bias”?

Today, April 26, **2012**, an Arbitral Tribunal in the Republic of TORVIA determines that company C suffered damages in **2008**, in the amount of X dollars.

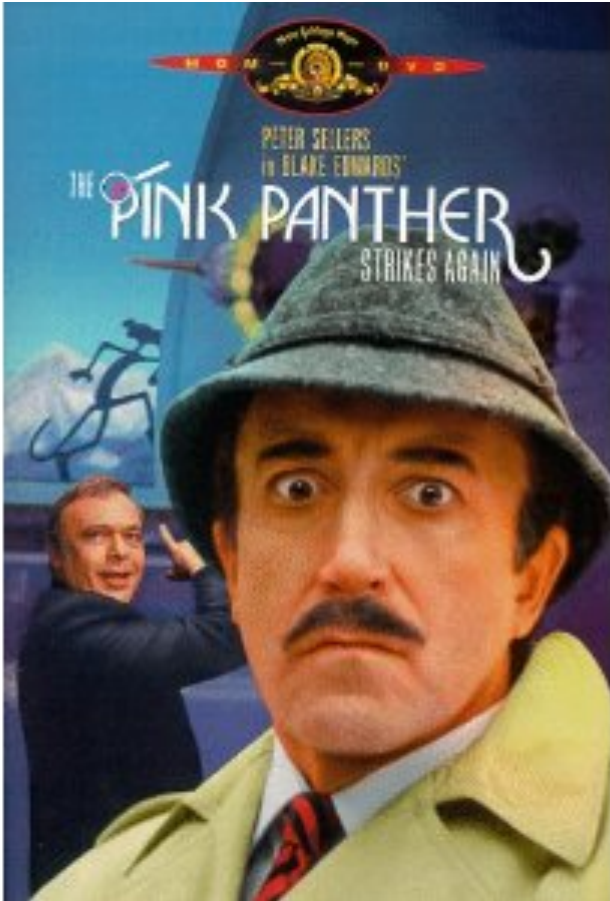
What interest rate to use to calculate “*pre-award interest*” on X, for the period **2008-2012**?

A: Company C’s WACC (“weighted average cost of capital”), to reflect its opportunity cost.

B: A risk-free interest rate (e.g. Toravia’s T bill rate)

C: “*The arbitrator shall exercise his or her judgement*” (Mark Kantor, “*Valuation for Arbitration*”).

Inspector Clouseau and the dog



“The Pink Panther Strikes Again” (1976)

Clouseau: *Does your dog bite?*

Hotel Clerk: *No.*

Clouseau: *[Bowing down to pet the dog]*

Nice doggie...

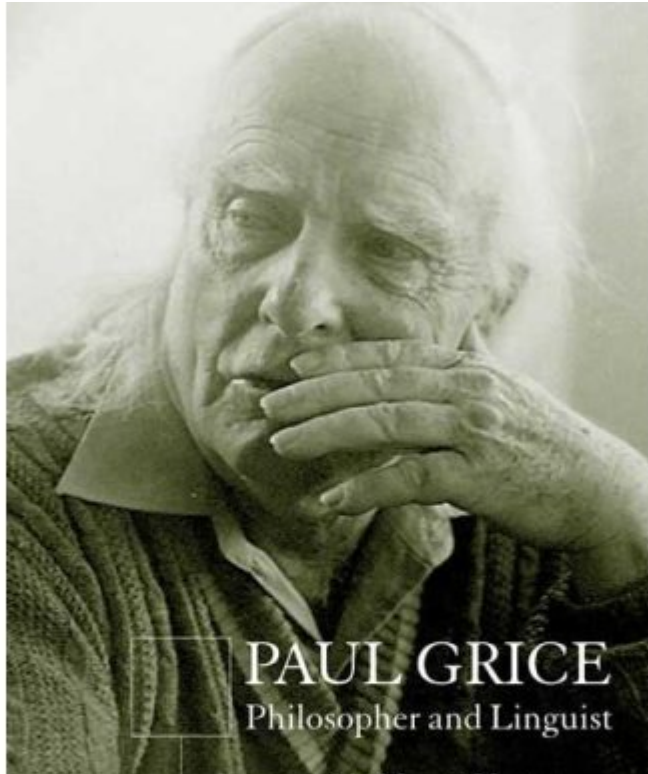
[Dog barks and bites Clouseau!]

Clouseau: *I thought you said your dog did not bite!*

Hotel Clerk: *Yes. But this is not my dog!*

“Implicatures” & Relevance Theory

(H.P. Grice, and Dan Sperber & Deirdre Wilson)



Herbert Paul Grice (1913-1988)

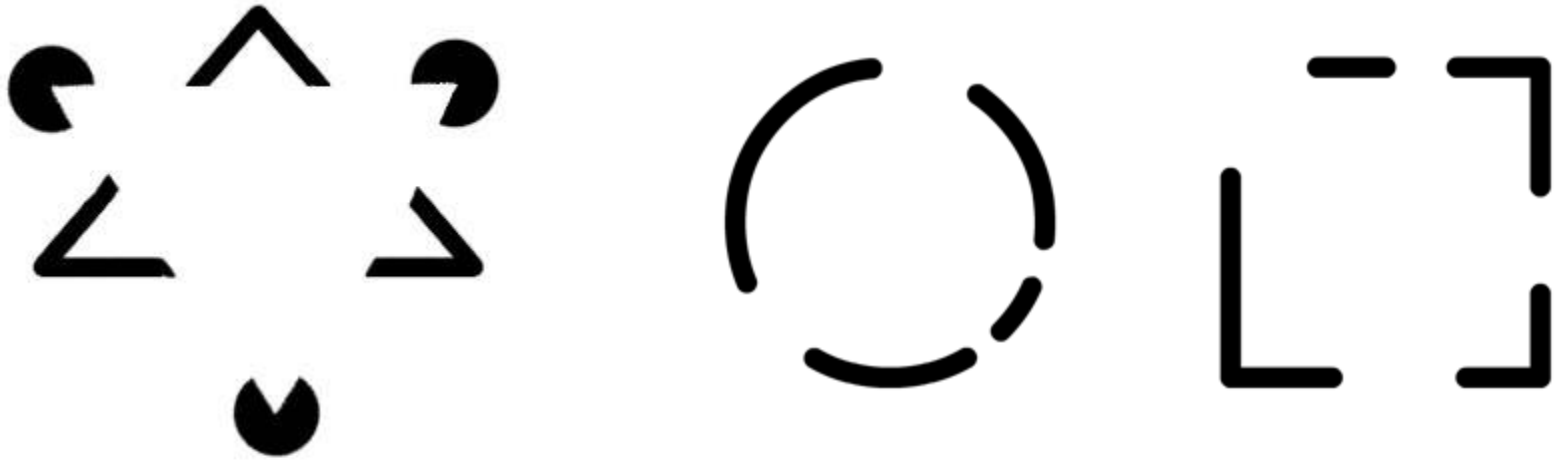
- We ascribe concrete meaning to utterances in light of their **context**.
- We implicitly assume that responses to questions are **relevant** (“*Relevance Theory*”)
- Thus, we spontaneously draw “**implicatures**” (i.e. contextual inferences) which go beyond purely logical “**implications**” from available evidence.

e.g. Clouseau’s erroneous “implicature” that the dog is the innkeeper’s

Typical biases or “cognitive illusions”

1. “*Hindsight bias*” (or “*creeping determinis*”)
2. Story-based perception (“*story model*”, “*creative perception*”
“*implicatures*”)

Gestalt theory: “Law of Closure”

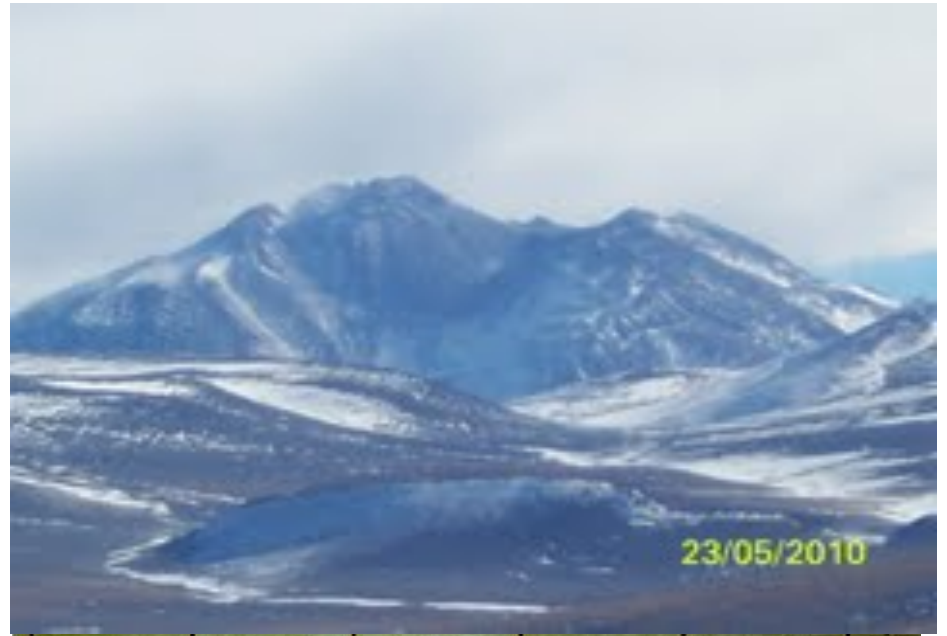


- Our brain is a pattern (*Gestalt*)- recognizing machine
- We ignore gaps and “**fill-in blanks**”, taking into account the context
- We discard information which does not fit into the pattern
- We “see” things which are not there!

Optical illusions: “Pareidolia”



Face on Mars (Viking, 1976)



Nevado “El Muerto” 6486 m Atacama range
Domain of Arnheim, René Magritte (1938)

Story-telling: a “weapon of mass persuasion”

Area	Instrument	Illustration
<ul style="list-style-type: none"> • Religion 	<ul style="list-style-type: none"> • Parables 	
<ul style="list-style-type: none"> • Management 	<ul style="list-style-type: none"> • Story-telling 	<ul style="list-style-type: none"> • <i>Where is my cheese?</i>
<ul style="list-style-type: none"> • Politics • International conflicts 	<ul style="list-style-type: none"> • National foundational myths • Political metaphors (Lakoff) • <i>Spin doctors</i> 	<ul style="list-style-type: none"> • “<i>Empire of evil</i>” (Reagan) • “<i>Axis of evil</i>” (Bush) • “Armas de persuasión masiva: retórica y ritual en la Guerra del Pacífico” (Carmen Mc Evoy)
<ul style="list-style-type: none"> • Marketing & Advertising • Fundraising • News & media 	<ul style="list-style-type: none"> • Testimonials • “<i>Viral marketing</i>” • “<i>Daily news, eternal stories</i>” (Jack Lule) 	<ul style="list-style-type: none"> • “<i>If I look at the mass, I will not act. If I look at the one, I will</i>” (Mother Theresa)
<ul style="list-style-type: none"> • Financial bubbles 	<ul style="list-style-type: none"> • Financial myths (Robert Shiller) 	<ul style="list-style-type: none"> • “<i>House prices will never fall</i>” • “<i>This time is different</i>” (Reinhart & Rogoff)

Traditional legal pleading: the “IRAC model”

- “Good judges pride themselves on the **rationality of their rulings** and the suppression of their personal proclivities, including most especially their emotions...The most rigorous form of logic, and hence the most persuasive, is the **syllogism**” .

(Antonin Scalia & Brian A. Garner, *“Making your case: the Art of Persuading Judges”*, 2008).

- Hence, the traditional approach to pleading (“IRAC”):
 - Issues
 - Rules
 - Analysis/Application
 - Conclusion

Legal pleading: the “story model”

(Nancy Pennington & Reid Hastie, *A Cognitive Theory of Juror Decision Making: The Story Model*, 13 *Cardozo L. Rev.* 519, 520 (1991))

Cognitive process of individual jurors:

- Stage 1: Story construction
- Stage 2: Representation of potential alternative verdicts
- Stage 3: Selection of verdict which best matches the story

Identical witnesses’ testimony more persuasive for jurors when presented chronologically (i.e. in story terms) than by witness.

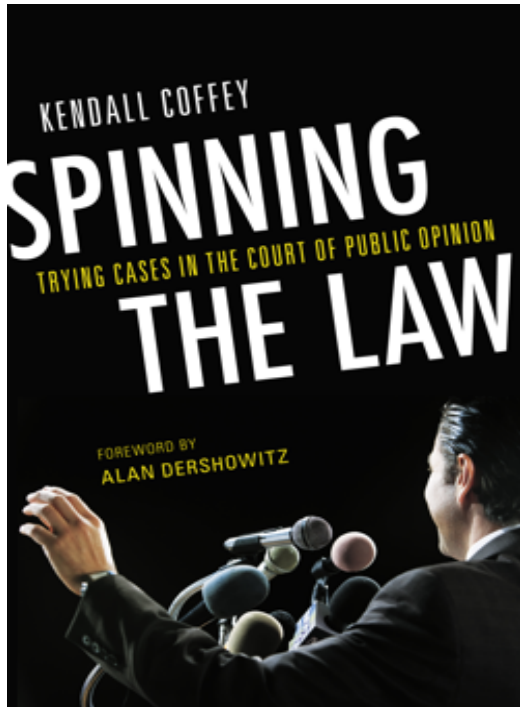
Jurors disregard that part of the evidence which does not fit into their story

Stories: cognitive role

- **Stories** are the main knowledge category (*Gestalt*) we use to understand the world
- We fill-in blanks (“Law of closure”) in non-visual perception, and spontaneously leverage limited evidence into full-fledged stories.
- Stories more convincing if they draw on the “stock of social knowledge” and social stereotypes.
- Stories may be implicitly “planted” or “primed” through the use of metaphors.
- Once a story is accepted, it gets reinforced by “confirmation bias”.

“Stories”: emotional role

- We use the emotional part of our brain when making decisions (Antonio Damasio, “*Descartes’ Error*”)
- Stories may “prime” emotions and lead us to see evidence from the perspective of the story’s main character.



The story of Mr. Simpson’s lawyers (Dershowitz, Cochran...):

A bigoted white police officer in LAPD resented that O.J. Simpson was a successful black celebrity

Story-based perception: conclusions

- Stories fill-in (factual) blanks and help interpret & retain ambiguous evidence (cognitive role)
- Prime favorable feelings & emotions (emotional role)
- Should be plausible (e.g. resonate with pre-existing beliefs/stereotypes), coherent and simple

Lucy Reed's rule: stories should fit into one single page

- Should not be too overt, so as to let feelings emerge spontaneously and prevent audience from feeling manipulated.
- Need to appear early (e.g. in opening statement), so as to condition subsequent perception (“confirmation bias”).

This is why counsels ask for interim measures even when they know that they will not be granted

The “**Double helix**” (DNA) approach”: Sound Legal Argument + Strong Story

Young Woody Allen's story



“When I was kidnapped, my parents snapped into action...”

(By now you have probably constructed your own story of what happened next)

“They rented out my room!”