

Multimedia: Conveying Lessons in Economics and Law

By Dr. John F. Sase

Fiorello (Chico Marx): Hey, wait, wait. What does this say here, this thing here?

Otis B. Driftwood (Groucho Marx): Oh, that? Oh, that's the usual clause that's in every contract. That just says, uh, it says, uh, if any of the parties participating in this contract are shown not to be in their right mind, the entire agreement is automatically nullified.

Fiorello: Well, I don't know...

Driftwood: It's all right. That's, that's in every contract. That's, that's what they call a sanity clause.

Fiorello: Ha-ha-ha-ha-ha! You can't fool me. There ain't no Sanity Clause!

--Quoted from *A Night at the Opera* (MGM, 1935)

Multimedia communication—some combination of written word, audio and video recordings, projected software presentations, live performance, and other forms--has emerged as a popular means to reach colleagues, staff personnel, and students in business, government, and academia. Those who have been out of the educational system for more than a few years may not comprehend the proliferation of media in and beyond the classroom. Here, multimedia online course offerings flourish in the distance-learning environment. These courses and their media content have grown greatly in popularity. They reach learners who face physical and time constraints that make it too difficult or expensive to attend a brick-and-mortar institution.

Of course, the use of media for communication and learning is nothing new. It has advanced over time. Film and some electronic multimedia for learning and education in offices and shops have been known available since the Second World War. At that time, government-training films helped viewers learn how to assemble components intended for military hardware as well as how to prevent contracting certain social diseases.

Film and audio discs (78rpm and 33 1/3rpm records) were carried forward into the school systems of the 1950s. In one notorious example about dating produced by Coronet Instructional Films in 1950, Nick Baxter takes Kay to the high-school scavenger hunt and they have lots of fun! In addition, Nick discovers that he and Kay share a passion for miniature golf, taffy pulls, and weenie roasts. Mmm! Pass the relish. Though some advancement was made throughout the 1950s and 60s, phonograph records and 16mm film remained the status quo for multimedia (well before the term was widely used) for the next few decades. As a result, production of audio and video materials remained prohibitively expensive for the average individual or small business due to the high cost of the technology.

However, this situation changed rapidly with the introduction of portable video recorders, recordable audio discs, and other devices in a new generation of media. During the past quarter-century, the technology has advanced while the cost to users has plummeted. Through computerized digital technology, most of us can produce high-quality audio and video content for business and educational applications for an investment of a few hundred dollars or less.

Currently, PowerPoint and its rivals remain the most used--and most abused--multimedia tools in the classroom, conference room, and courtroom. Too often, presentations in the form of "slideuments" (documents embedded into presentation slides) leave many viewers as victims of

Death by Bullet-Point. However, there are many good books by presentation gurus to help us defeat this beast. A simple and free place to begin the transformation to good PowerPoint is at Pecha Kuccha 20x20 (www.pecha-kucha.org), an international organization dedicated to using twenty PowerPoint slides that last twenty seconds each. The idea is to create a story and tell it with graphically relevant slides. These 20x20 slides contain six to ten words each to form a presentation of six minutes and forty seconds.

The most recent quantum leap in multimedia has come in the form of short videos that are viewable on computer screens and are shared with others on social-media Web sites such as YouTube.com. Professors make videos to integrate into their lecture materials. Small businesses and professional practices (including law offices) use this media to help to market their services and to communicate with peers. One of a few books that we recommend on this topic for professional use is *YouTube and Video Marketing: An Hour a Day* by Greg Jarboe (2nd. ed., John W. Wiley & Sons, 2012).

No longer is YouTube just a venue to view silly backyard stunts or the antics of cute kittens. Today, more than 100 million people take social action on YouTube every week. In the U.S., nearly two-thirds of YouTube viewers are between the ages of twenty-five and sixty-four, with the largest group—28%--being between thirty-five and forty-nine. The most popular type of online content remains news and current events. Recent studies indicate that 70% of YouTube viewers visit the site to find information or to learn how to do something. By the way, if you communicate best through PowerPoint (PPT), there are a number of inexpensive or free software programs that allow you to convert a PPT presentation to video easily. I, Dr. Sase, use Wondershare PPT2Video (www.wondershare.com) for the animated portions of many of my own videos.

Though the technology of creating communication videos has grown relatively inexpensive and easy to use, the major challenge remains how to develop engaging content. Producing a good video for use in the courtroom could delight a jury whose eyes have glazed over from the events of the day. If that video helps an attorney to communicate the argument of his/her side of the case more effectively, then that video becomes demonstrative evidence on steroids.

Explaining technical evidence often presents the most daunting challenge in professional communication. As with many fields, Economics can be understood best when explained in plain, common language. We find some of the best examples of this approach appearing in feature films. Dr. Laura Jean Bhadra of North Virginia Community College has compiled a list of movies that she uses in her Economics courses and has shared them online with other economists (<http://www.nvcc.edu/home/lbhadra/>).

One of my all-time favorite clips from a film is a scene from *Miracle on 34th Street* (20th Century Fox, 1947). This classic monologue by screenwriter George Seaton takes place in the chambers of Judge Henry X. Harper (portrayed by Gene Lockhart). It demonstrates what economists call the multiplicative effect of negative externalities. In this scene, the judge's political manager, Charlie Halloran (played by William Frawley), is giving a tongue lashing to Judge Harper about the consequences that will befall the judge if he returns to the courtroom and rules that there is no Santa Claus. Halloran says "[I]f you go back in there and rule that there's no Santy Claus,...we won't even be able to put you in the primaries." Judge Harper responds "[L]isten to

reason. I'm a responsible judge. I've taken an oath. How can I seriously rule that there is a Santa Claus?"

Halloran retorts by saying, "All right. You go back and tell 'em that the New York State Supreme Court rules that there's no Santy Claus. It's all over the papers. The kids read it and they don't hang up their stockings'. Now what happens to all those toys that are supposed to be in those stockings'? Nobody buys 'em. The toy manufacturers are going to like that. So, they have to lay off a lot of their employees—*union* employees! Now you got the CIO and the AF of L against you. And they're going to adore you for it. And they're going to say it with votes. Oh, and the department stores are goin' to love you, too. And the Christmas-card makers and the candy companies. (chuckling) Henry, you're going to be a very popular fellow." In addition to providing an eloquent example of a difficult economic principle, this passage underscores the value of starting a media production with a well-written script.

TARP, HARP, and *Margin Call*

Over the past few years, economists have been grappling with the task of how to explain exactly what happened in the economic debacle that killed two Bear Stearns hedge funds in 2007 and led to the Lehman Brothers collapse, the Wall Street Confidence Crisis of 2008, and the Troubled Asset Relief Program (TARP) bailout of 2009. This has been a tough one to explain because of the obtuse technical complexity of derivative hedge funds. However, when we watched the film *Margin Call* (Lionsgate, 2011), we were mightily impressed. Although, at moments, the dialogue gets a bit dicey for the financially uninitiated, we found that director/writer J.C. Chandor nails the matter on its head. The drama involves the day that the "music stopped" on Wall Street and how the decision of one firm to pull the plug caused the hedge-fund market to tumble. At the end of the 7.5 minute climax scene in chapter eight of the DVD, CEO John Tuld (portrayed by Jeremy Irons) decides to open the floodgates and sell off all of the Mortgage-Backed Securities owned by his company (which Chandor describes in the Director's Commentary as an amalgam of actual Wall Street houses and investment bankers).

In this scene, the board of directors is holding a middle-of-the-night emergency meeting. Peter Sullivan, a young analyst (played by Zachary Quinto), is called into the boardroom. He must explain to CEO Tuld that the firm is at grave risk of bankruptcy if the value of sub-prime mortgages that make up the bulk of their hedge funds drops by 25%. (Within the dialogue of this key scene from *Margin Call*, I, Dr. Sase, have placed my annotations within brackets.)

Tuld begins his interview with Sullivan by saying "Maybe you can tell me what you think is going on here. And, please, speak to me as you might to a young child (pause) or to a golden retriever." Sullivan responds, "As you probably know, over the last thirty-six to forty months [since 2004], the firm has been packaging new MBS [Mortgage-Backed Security] products that combine several differentiated tranches of rating classifications in one tradable security" [in other words, layers of low-, medium-, and, mostly, high-risk mortgages bundled together. Imagine a foot-high Dagwood sandwich with layers comprised of lots of low-quality bologna that is beginning to spoil and a few slices of high-quality corned beef on top].

Next, Sullivan says, "The firm is currently doing a considerable amount of this business every day. Now, the problem... is that it takes us, the firm, about a month to layer these products correctly.... We have to hold these assets on our books longer than we might ideally like to. But

the key factor here is these are essentially just mortgages.” [This means that they were expected to pay a constant flow of returns over a long period of time and that their value is backed by home values. However, these values started to fall in July 2006.]

Sullivan continues by saying, “So that has allowed us to push the leverage considerably beyond what you might be willing or allowed to do in any other circumstance, thereby pushing the risk profile without raising any red flags.” [In other words, because the bond-rating agency over-rated these decaying, cheap-bologna sandwiches as it would a fresh, high-quality deli beef sandwich, the unknowing market believed them to be of high quality, even though they were not. Due to this erroneous belief, the firm was able to borrow heavily against the inflated, perceived value of these funds. However, as sub-prime mortgages began to go into default and the homes attached to them became abandoned and plummeted in value, the cheap bologna was beginning to stink and the market was catching on to the scam. In this perspective, it was primarily leverage that precipitated the failure of these funds.]

Sullivan concludes by stating, “If these assets decrease by just 25% and remain on our books, that loss would be greater than the current-market capitalization of this entire company.” [Therefore, a decline in the actual value of the assets of this one division of the firm—hedge funds over-loaded with sub-prime mortgages of degenerating value--would be large enough to drive down the entire company into negative worth. The company would owe more than it could pay off and hence would be bankrupt.]

As a result of Sullivan’s information, Tuld decides to sell off all of these toxic assets as quickly as possible in the hope of stemming the losses to his company. However, this course would destroy the reputation of the firm for years to come while knowingly putting the other companies that are buying these now-toxic assets out of business. In order to accomplish this, Tuld must pay off his key people to keep them incommunicado until the “Fire Sale” is over. If a successful fire sale is to happen, 40% of the sell-off must occur by 10:15AM. The sale must be done by 11:00AM because the word will be out on the street by lunchtime. In order to get his salespeople to sell a month’s worth of inventory in less than half a day while destroying their own jobs and reputations, Tuld offers to pay them huge performance-based bonuses (potentially more than \$2 million per person). In effect, the merry-go-round has broken down. The music on Wall Street has stopped. Tuld concludes, “And standing here tonight, I’m afraid that I don’t hear a thing. Just silence.”

Now is a good time to summarize the specifics of the actual Bear Stearns case: This investment bank/brokerage house got burned from using leveraged-credit investment, a common strategy in the hedge-fund universe. In leveraged-credit investment, a company purchased a special form of Collateralized Debt Obligations (CDOs) that paid an interest rate greater than the cost of borrowing. In the Bear Stearns case, the CDOs were Mortgage-Backed Securities (MBS), containing large percentages of risky, low-rated, subprime mortgages. However, these MBS had been rated erroneously as AAA securities by Moody’s Investor Service.

Next, the firm leveraged—borrowed against the MBS just purchased—at a lower interest rate than the additional securities that they would purchase would pay out. Since the new MBS would pay out interest in an amount greater than the cost of borrowing against the present holdings, every incremental amount of leverage increased the total expected return at Bear Stearns. This can be compared to an automobile jack. A person repeatedly pushes down on a lever in order to

turn a ratchet that incrementally raises the car higher and higher. In other words, the more leverage that the firm uses the greater its expected return.

By borrowing against its current holdings in order to buy more Mortgage-Backed Securities, Bear Stearns became highly leveraged. The company had exposed itself to an enormous amount of risk. Therefore, the firm sought out insurance to protect itself in case the value of their MBS fell. In the institutional investment market, this kind of insurance comes in the complicated form of what is called Credit-Default Swaps (CDS). Bear Stearns planned to “watch the money roll in!” However, their profit margin was thin. This was due to the interest paid on money borrowed for the purchase of additional MBS and to the cost of the insurance that came in the form of Credit Default Swaps. The latter was obtained to cover possible minor losses in the market value of holdings of Bear Stearns.

Under normal conditions and the assumption that the Mortgage-Backed Securities had been rated fairly in terms of their value, Bear Stearns probably would have been protected. However, the market learned about the scam of over-rating the MBS, which should have been rated initially around BBB rather than AAA. Then, the MBS should have had their rating lowered after underlying home prices began to decline around July 2006. As a result, the market value of the Mortgage-Backed Securities held by Bear Stearns plummeted and put the company into the red. This was the tragic end of a story with aftershocks that continue to spill out into Main Street America and beyond.

For additional information on the Bear Stearns case, see *Dissecting the Bear Stearns Hedge Fund Collapse* (posted on www.investopedia.com, 6 September 2007). View an informational video of the Mortgage-Backed Securities crisis and related events at www.youtube.com/saseassociates and look at *Mortgage Markets*, or enter <http://youtu.be/wpwSMnMKIj4>.

When looking at complex issues such as the collapse of an institution on Wall Street or elsewhere, the facts become easier to understand and to digest when a balance of different media are used together effectively. People learn best when their different senses—especially visual and aural—are fed. Therefore, attorneys may be wise to use a mix of sensory inputs that include projected audio and video along with physical demonstrative evidence. When presenting to a jury, it is important to remember that many potential jurors have grown up either as part of the MTV Generation or as members of the iDevice Legion. Consequently, multimedia communication could be a deciding factor in winning or losing a case. One walloper of an example is *Ernst v. Merck*, a Wrongful-Death case involving Vioxx. The plaintiff attorneys won a \$253 million verdict because their engaging PowerPoint trumped the Death-by-Bullet-Point presentation by the defense. Enough said.

A PDF copy of this article is posted at <http://www.saseassociates.com/legalnewscolumn.html>. We continue to post videos related to our monthly column on www.YouTube.com/SaseAssociates.

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