

Law & Games Conference, November 13-15, 2003.

**Supreme Court Exchange: Introducing the Game
By Daniel Egger,
Managing Partner, Eno River Capital
Contact: e-mail: degger@enorivercapital.com - Tel. (919) 680-4511.**

[October 21, 2003 Draft]

FREQUENTLY ASKED QUESTIONS

I. Introducing the Supreme Court Exchange Game

1. What is the Supreme Court Exchange Game?
2. How Do I Play?
3. How Do Litigation-Outcome Derivatives (“LOUDs”) Pay Off?
4. What LOUDs Can I Trade?
5. Do LOUD Prices Accurately Reflect Real-World Litigation Risks?
6. How Can I Make Money Trading LOUDs?
7. Can I Cheat to Win?
8. What Do I Get If I Win?
9. Are There Other Ways to Win the Game Besides by Maximizing the Annualized Return of my Hedge Fund?
10. What Other LOUDs Will be Traded in the Future?

II. The Supreme Court Exchange Game Generates the Best Risk-Assessments Possible

1. What Factors Make the Price of a Particular LOUD Fluctuate Over Time?
2. Is LOUD Price-Fluctuation a “Random Walk?”
3. With Time, Will it Be Possible to Prove Whether or Not Supreme Court Exchange is an “Efficient” Market?

4. You Claim that Supreme Court Exchange Prices Provide the “Best Possible” Risk-Assessment Information, Yet the Game Still Rewards Skill. What Else Can I Read About The Theory Behind Whether Game Performance is a Result of Skill or Luck or Some Combination of the Two?

III. The Supreme Court Exchange Game Supports Hypothesis-Testing Regarding What Real-World Factors Impact Litigation-Outcomes

1. What is a “Rational” Trading Strategy?
2. What Are Some Specific Examples of Rational “Fundamental” Trading Strategies?
3. My Relative Trading-Advantage Lies in “Normative” Analysis of Statutes and Constitutional Provisions, Lower Court Opinions, Appellate Arguments, and Supreme Court Precedents. What Trading Strategies Should I Pursue?
4. My Relative Trading-Advantage Lies in Knowledge of the Supreme Court as a Result-Oriented Political Institution. What Trading Strategies Should I Pursue?
5. I’m a Political Scientist, Sociologist, Economist, or Quantitatively-Oriented Law Professor. Can I Exploit Features of the Supreme Court Exchange Game to Formulate and Test My Own Hypothesis About the U.S. Legal System?

IV. The Supreme Court Exchange Game Enables New Forms of Litigation Risk-Management

1. My Own Case is Currently Pending Before the U.S. Supreme Court. Can the Exchange Help Me to Manage My Risk?
2. Does Information About the Price of LOUDs Have Economic Value in the “Real-World”?
3. Does the Supreme Court Exchange Game Change Supreme Court Practice?

The End

1. What is the Supreme Court Exchange Game?

Supreme Court Exchange is a new online multi-player game that tests players' skill in predicting the outcome of pending Supreme Court cases, by applying the metaphor of portfolio investment management.

The Game harnesses competition – the profit motive - to develop collectively a good that would be otherwise be impossible, or prohibitively expensive, for individual players to obtain: specialized information.

This specialized information consist of the most accurate possible, up-to-the moment consensus of the world's legal experts as to the *likelihood of any particular outcome* in any particular case pending at the U.S. Supreme Court.

This information can:

Enable statistically valid testing of both academic and commercially-motivated hypothesis regarding what identifiable real-world factors impact litigation outcomes – including factors the parties or their lawyers may have the power to change.

Enable statistically-valid determinations of what portion of a Supreme Court litigation-outcome is predictable, and what portion is random, or attributable to chance.

Prove the value of new kinds of Information Technology for more effective litigation and better litigation risk-management.

2. How Do I Play?

To play, simply register on-line to become a “Fund Manager” and receive your own Hedge Fund, initially capitalized at \$10 million (100% for your own account).

Fund Managers seek to increase the amount of money in their Fund by successful investing in the actual outcomes of pending real-world Supreme Court cases.

The “Exchange” makes investment in litigation-outcomes possible by matching willing buyers and sellers of specialized financial derivatives. These derivatives are a form of future that either expire worthless or pay off at a profit depending upon how the Supreme Court resolves a particular case.

Once the real-world Supreme Court's year ends and all derivatives pay off or expire, the Fund with the best annualized Internal Rate of Return (“IRR”) wins.

3. How Do Litigation-Outcome Derivatives (“LOUDs”) Pay Off?

Once the Supreme Court releases its opinion in a particular case, holders of LOUDs that correspond with the actual outcome receive \$100,000 per LOUD from the seller, while LOUDs that predicted a different outcome expire worthless. LOUDs can be thought of as futures on a particular litigation-outcome.

4. What LOUDs Can I Trade?

The Exchange initially matches buyers and sellers of three Litigation-Outcome Derivatives (referred to as “LOUDs”).

For appellate cases on which the Supreme Court has granted *certiori*, and which continue to be pending before the Supreme Court on the merits:

- 1) “Reversed LOUDs” (R-LOUDs) paying \$100,000 per unit;
- 2) “Affirmed LOUDs” (A-LOUDs) paying \$100,000 per unit; and
- 3) “Push LOUDs” (P-LOUDs) paying \$100,000 per unit.

LOUDs are generally priced at a fraction of their face, or “par” value: for example, an “R-LOUD asking 0.20” means an R-LOUD for sale for \$20,000; and “A-LOUD bidding 0.60” means a buyer is offering to pay \$60,000.

“Affirmed” and “Reversed” LOUDs are self-explanatory. “Push” is adapted from Blackjack, where it refers to a hand that neither the player nor the dealer wins. (“Push LOUDs” or “P-LOUDs” are defined by the Exchange as outcomes where: a) The lower court decision is formally “affirmed in part and reversed in part”; b) Although there may be a plurality-driven outcome that appears to affirm or reverse the lower court, the Supreme Court issues no definitive majority opinion on the merits; c) The case is dismissed without prejudice for jurisdiction improvidently granted; or d) Procedural changes, including request for re-argument in the next term, a settlement reached between the parties while the case is pending, etc., result in no final ruling on the merits in that year). Note that whenever the price of an R-BLOD + A-BLOD + P-BLOD for a particular case fails to equal \$100,000, there is an obvious risk-free profit (arbitrage) opportunity that will immediately be traded away.

5. Do LOUD Prices Accurately Reflect Real-World Litigation Risks?

Yes. Assuming all players are playing to win, as the day when the Supreme Court will issue its opinion approaches, the price of an R-LOUD should closely approach the percentage likelihood that the opinion of the lower court will be reversed; A-LOUD prices that it will be affirmed, and P-LOUD prices that the Court will do a little of both, or neither.

For example, “last *Amalgamated Drilling* R-LOUD trade at 0.90” means that supply and demand on the Exchange balance when the R-LOUD price reflected a 90% chance that the lower court will be reversed. Just as an R-LOUD on *Amalgamated Drilling* at \$90,000 means a 90% chance of reversal; an A-LOUD at \$6,000 means a 6% chance the lower court decision will be affirmed, and a \$4,000 P-LOUD means a 4% chance that no definitive decision will issue.

(These prices will of course require minor adjustment under Black-Scholes to reflect the anticipated remaining time to expiration, the volatility of pricing on the exchange, and the available alternative risk-free rate of return; and, just as real-world derivatives do, may vary substantially from the price predicted by the Black-Scholes model due to other supply-and-demand issues).

6. How Can I Make Money Trading LOUDs?

As with any security, you must disagree with “the market” as to what the “right” or “future” price should be – then cash out when the market moves sufficiently far in the “right” direction to cover your transaction costs and beat the risk-free rate of return.

Assume for example that you believe it very likely that the Supreme Court will reverse the, in your view, obviously flawed decision of the lower court in *Amalgamated Drilling*. Given your level of confidence, you would happily take on substantial risk if the Exchange was offering “even money” odds that the Court will reverse. In other words, you would happily pay \$50,000 to buy one “R-LOUD” from the Exchange, because although it will expire worthless if you are wrong, it will pay out \$100,000 if you prove right.

Of course, most informed players of the Game probably agree with you that the Court of Appeals’ tortured reasoning in *Amalgamated Drilling* misapplies settled Supreme Court precedent. The price offered on the Exchange (which, incidentally, simply matches demand between willing buyers and sellers, like NASDAQ, rather than “making a market” by providing additional liquidity as the NYSE specialist system claims to do) is therefore not \$50,000 but \$90,000.

If you think that there is a less than 90% chance that you are right, then on a “fundamental” analysis you should still not buy the R-LOUD now. To be a “fundamental” buyer, you must decide that “the market” is under-pricing the R-LOUD – in other words, underestimating the risk of reversal by the Supreme Court – and will move in the direction of the actual risk – and by a sufficiently large amount to cover your transaction costs, as well as reward you for the increased volatility over the risk-free rate of return.

7. Can I Cheat to Win?

Yes – if by cheating you mean “Insider Trading.” The Exchange wants the price of its derivatives to reflect all possible information, including information possessed by “insiders.”

For example, feel free to buy P-LOUDs on your own case pending before the Supreme Court, and make a killing on the Exchange by voluntarily and unexpectedly settling out of Court.

The Exchange reserves the right to define other forms of cheating as it sees fit, and bar Managers from the Exchange that it believes to be cheating according to its definitions – but until the Exchange proclaims something to be cheating, go right ahead. Caveat emptor. By the way, if you suspect the Exchange itself of “cheating” (front-running, trading on prices before releasing them to the Web site, offering certain Funds more favorable trading conditions in return for inside information, etc.) well, this is, after all, a completely unregulated market – perhaps you should band together with some other Fund Managers and create a “Regulator.”

8. What Do I Get If I Win?

Games are played for fun. But this year’s winning Fund Manager will also receive a substantial cash award, the opportunity to author the “Litigation-Risk Annual Review” for the prestigious *Journal of Risk Management & Behavioral Economics*, and the exclusive right to use the title “Supreme Portfolio Manager 2004” and add the honorific “SPM” after his or her name.

9. Are There Other Ways to Win the Game Besides Maximizing the Annualized Return of my Hedge Fund?

Yes -- maximize your absolute profits as Fund Manager instead! You can do this not only be reinvesting profits from previous years to manage for your own account (where 100% of the profits belong to you) but also by managing money for third parties -- where 20% of *their* profits, and 1% of *their* total Funds under your management go to you *each year*.

Why will they give you their money to invest? Given enough players with enough incentive to win, the market should deviate only in non-obvious ways from an “efficient” market, meaning that it will be rare to beat consistently a “random walk” investment performance comparable to a volatility-adjusted equivalent of the risk-free rate of return. So some Managers may be best off throwing a few darts at the Supreme Court docket – or hiring someone else to manage their Fund’s money for them.

To facilitate “Manager Selection” between Players, the Exchange will provide track-record Statistics, including, for each year and from inception, annualized Internal Rates of Return (absolute and risk-adjusted), and total funds under management, along with comparative performance rankings, for all active Managers. At the end of the Year, in

addition to the Supreme Portfolio Manager IRR Award, the Exchange will announce prizes for Hedge Funds that were most profitable for their Managers that year.

10. What Other LOUDs Will be Traded in the Future?

That depends on demand from Fund Managers.

Two obvious LOUDs to add next would be:

1) “cert. denied” or CD-LOUDs. These would become available for all lower court cases as soon as a Petition for *Certiori* is been filed with the Supreme Court. In addition A-, R-, and P-LOUDs could be made available from the time the petition for *Certiori* is first filed, instead of, as now, only when a Petition for *Certiori* is granted.

2) “Overruled,” or “O-LOUDs” that pay off only when a particular named precedent (*Bakke*; *Roe v. Wade*) is overruled during the current Year.

II. The Supreme Court Exchange Game Generates the Best Risk-Assessments Possible

1. What Factors Make the Price of a Particular LOUD Fluctuate Over Time?

If the Supreme Court Exchange *were* an efficient market, LOUD prices would reflect the consensus of the entire market, including all relevant information available at that time, as to the likelihood of a particular litigation-outcome at the Supreme Court. New information – the filing of an amicus brief, a decision in different but potentially-related case, the decision of the Solicitor General to argue a case, etc. – will impact the market for a brief period, subsequently reflected in a new equilibrium price – but only to the extent *the new information was unanticipated or differed materially in form from consensus expectations and is considered capable of influencing the outcome.*

Of course, prices also fluctuate in the absence of any apparently relevant new information – possibly because investors are modifying other investments, and committing to or withdrawing cash from them, which can then impact supply and demand. Note that this factor (the net change in cash available to invest) can be measured and controlled-for on the Exchange much more precisely than in real-world markets (where net inflows to or redemptions from mutual funds, for example, is often used as a proxy for net changes in demand).

In addition, Black-Scholes factors (anticipated time remaining until the event occurs at which the LOUD will either pay off expire, the anticipated volatility of LOUDs, and the alternative, risk-free rate of return) mean that LOUD prices will tend to converge fully on a “fundamental” market assessment of risk only as their expiration date approaches.

2. Is LOUD Price-Fluctuation a “Random Walk?”

Games of skill are exempted from U.S. Online Gambling laws. The Exchange may wish to offer large cash prizes to keep players motivated. Therefore, the Exchange is a game of skill until proven otherwise.

Behavioral economics teaches that even relatively efficient markets such as the Exchange continue to contain inefficiencies -- due in large-part to irrational aspects of human behavior -- that can potentially be exploited by less irrational market participants so long as transaction costs are kept low.

Of course, it should be acknowledged that informed and motivated players of the Game will quickly learn to trade-away any obvious inefficiencies, and will then turn their attention to exploiting subtler ones, so that the Exchange should grow relatively more efficient over time.

If the Supreme Exchange were eventually to *become* an efficient market, then by definition LOUD price-fluctuation would be a random walk (that is, a stochastic path with a “drift” that over time should equal the volatility-adjusted risk-free rate of return available within the Game). Any Game performance better than average would be due solely to luck; performance of Fund Managers, good and bad, would tend to revert to the mean from year to year; and track records would be meaningless, as Manager performance in prior years would not correlate positively with performance in the current year.

3. With Time, Will it Be Possible to Prove Whether or Not Supreme Court Exchange is an Efficient Market?

Yes. If the Exchange *becomes* an “efficient market” as that term is generally understood, it will begin to be obvious once the Game is played actively by a sufficient number of informed, motivated players for two or three years.

First: the performance of all Fund Managers, not just most, will tend to revert to the mean over time.

Second: Manager performance in any one year will not correlate with performance in other years.

Third: the distribution of all annualized Fund returns will be “normal” in shape, lacking any significant “skew.”

Given the Exchange’s nominal transaction costs, the lack of a “long-bias” in the market overall, the Exchange’s ability to control for total money supply and define exactly the risk-free alternative rate of return at any time, explaining away these three phenomena by some cause other than market efficiency will become very difficult.

4. You Claim that Supreme Court Exchange Prices Provide the “Best Possible” Risk-Assessment Information, Yet the Game Still Rewards Skill. What Else Can I Read About The Theory Behind Whether Game Performance is a Result of Skill or Luck or Some Combination of the Two?

The academic disciplines of behavioral economics in general, and behavioral finance in particular, have recently focused on a number of ways in which markets such as the Exchange appear to deviate from pure efficiency – suggesting avenues for superior investment. Evaluating statistical methods that may help determine whether a “winning” Fund Manager’s unusually good performance is due to skill, or is simply a string of luck, is a primary topic in Nassim Taleb’s “Fooled By Randomness: The Hidden Role of Chance in Markets and In Life” (Texere, 2001). The basic ideas of behavioral finance regarding how and why markets may differ from “efficient market” models are introduced very clearly for the lay person by Robert Shiller in “Irrational Exuberance” (Broadway Books, 2000).

For a deeper exploration, Taleb’s “Dynamic Hedging: Managing Vanilla and Exotic Options” (Wiley, 1997) and Shiller’s “The New Financial Order: Risk in the 21st Century” (Princeton 2003) explain how to design financial derivatives that can track real-world events, adjust their prices dynamically to achieve a market in which the market-maker can control its own exposure, and use derivatives to hedge risks.

The novelty of the present exploration, such as it is, arises first, from using an online multi-player Game to generate collectively real-world price-information that would otherwise be impossible or prohibitively expensive to obtain; and second, in pointing out the practical value of this new information in a number of contexts – academic research, development of better electronic research and litigation-support tools for lawyers, and better management and hedging of real-world litigation risks.

III. The Supreme Court Exchange Game Supports Hypothesis-Testing Regarding What Real-World Factors Impact Litigation-Outcomes

1. What is a “Rational” Trading Strategy?

For discussion here, rational trading strategies are defined as strategies that can be:

- 1) Articulated as a hypothesis about changes in LOUD-prices over time,
- 2) Reduced to an objective algorithm or algorithms,
- 3) Applied, individually or in conjunction with other strategies, to screen for potential trades or inform individual decision whether or not to trade,

- 4) “Back-tested” – that is, established to have positive statistical correlation with a large set of past outcomes so that, had it been applied over some historical time period, it would have resulted in superior returns over that period,
- 5) Implemented cost-effectively in real-time on a going-forward basis, and
- 6) Demonstrated to generate prospective returns that are clearly superior to the “next-best” algorithmic model available.

2. What Are Some Specific Examples of Rational “Fundamental” Trading Strategies?

Various Technical and Arbitrage Strategies (for example buying and selling LOUDs for a risk-free return whenever the price of an A-LOUD + R-LOUD + P-LOUD does not add up to 1.0) can be rational, and may well succeed.

However, we focus here on “Fundamental” strategies – those based on identifying an exploitable difference between the individual Fund Managers’s informed expectation of the actual probability of various outcomes for a Supreme Court case, and the market’s current pricing of those outcomes.

The two basic categories of “Fundamental” analysis are:

- 1) Reading the lower court opinion(s), Supreme Court briefs, and the precedents cited in them, in order to evaluate the persuasiveness of their arguments and form a view of what the “Correct” decision of the Supreme Court should be. This could be called “Normative” Fundamental Analysis.
- 2) Calculating the probabilities of reversal, affirm, or a non-decision in the group of cases that share identifiable procedural posture with the current case over an appropriate period of time. For example, it may be that, ignoring subject matter completely, over the last ten years only 25% of all cases in which *certiori* is granted from the 9th Circuit after it has ruled *en banc* have led to a reversal by the Supreme Court – so that 25% would be a reasonable starting point for calculating risk. This could be called “Procedural” Fundamental analysis.

2. My Relative Trading-Advantage Lies in “Normative” Analysis of Statutes and Constitutional Provisions, Lower Court Opinions, Appellate Arguments, and Supreme Court Precedents. What Trading Strategies Should I Pursue?

If your expertise lies in evaluating the persuasiveness of arguments before the Court, you are probably very well situated to win the Game! Most observers believe that the strength of relevant precedent and its applicability account for a large part of how the Court rules. On the other hand, if it turns out that you can’t beat most other strategies, it may imply that the Court’s rulings contain a larger random component than generally expected.

Normative analysis comes in many flavors, and your strategy should be based upon knowing what style of Normative Analysis you practice:

“Blackstone,” or “Traditional” Normative Analysis, holds that the common-law is always “discovered” through historical or legal research rather than invented by judges on an *ad hoc* basis. Every Supreme Court case therefore has a “right” outcome based on the holdings of pre-existing case-law. Other outcomes are simply “wrong” – and “should” be overruled in subsequent years as “not the law.” This view, once a common “Whig” trope, is of course now rare.

“Modern” Normative Analysis holds that the obvious uncertainty around the outcome of pending Supreme Court cases is due primarily to unarticulated, but principled, “policy” differences among the Justices --- differences that can be modeled as differences regarding which “meta-rules,” including rules of constitutional interpretation, they each believe they should apply in particular situations, and how each Justice prioritizes, or ranks, their own meta-rules when two of their meta-rules might otherwise conflict. Therefore, knowing the case law and the arguments, and *who is sitting on the Court* (assuming that they have written enough that their individual meta-rules and prioritization rules can be modeled) should be sufficient to predict the “right” outcome.

“Stochastic” Normative Analysis holds that while pre-existing case-law and arguments, as well as the sitting Justices’ individual meta-rules and prioritization rules, influence litigation-outcomes substantially, Supreme Court outcomes in particular (perhaps because they often raise “new” fact patterns) retain an element of uncertainty, or chance, that is not caused by any “error.” There may be no single “correct” outcome based on precedent, argument, or the Justices’ policies – but the outcome is still largely predictable.

3. My Relative Trading-Advantage Lies in Knowledge of the Supreme Court As a Result-Oriented Political Institution. What Trading Strategies Should I Pursue?

Basing your strategy on the observation that the Court at times seems “result-oriented” in certain of its decisions should allow you to perform well if you can identify with confidence situations when the Court will deviate from a Normative “right” result.

For example, you could back-test the hypotheses that the Court is more likely to take a position other than precedent, argument, and principled application of meta-rules would predict (whether under a Traditional, Modern, or Stochastic Normative View) when: 1) it is advocated by the Solicitor General serving a President the Court majority shares a political affiliation with, 2) the lower court judge is known to share political views or was nominated by a President of the same Party as the majority of the Court, or 3) the plaintiff is a large corporation with huge amounts of money at stake (or conversely, an indigent individual with only the law to protect him or her).

In summary, litigation outcome “Fundamentals” should be modeled completely by three determinative inputs: Procedural, Normative and Result-Oriented -- plus a Stochastic, or random, element. (The author of the Game suspects that Supreme Court outcomes may

prove to have a significant stochastic component – poetically speaking, the Court itself may be engaging in a “Random Walk” through history).

4. I’m a Political Scientist, Sociologist, Economist, or Quantitatively-Oriented Law Professor. Can I Exploit Features of the Supreme Court Game to Formulate and Test My Own Hypothesis About the U.S. Legal System?

Yes. First, formulate your academic hypothesis as a “trading-hypothesis,” that is, something that that will contribute to accurate prediction of Supreme Court outcomes.

For example, you may suspect that, even controlling for all known “Normative” and “Procedural” Fundamentals, and limited to cases where standing has been established, challenges to Agency Action under the Administrative Procedure Act tend to be won by plaintiffs who have large amounts of money at stake and lost by plaintiffs who have suffered more “subjective” harms, such as destruction of a wilderness where they hike. This could be characterized as a “Result-Oriented” factor and modeled.

First, back-test. Add a new “cash at stake for plaintiff” factor to your current model containing all previously validated outcome-predictive factors, and see if the addition improves your basic model’s net predictive power against historical time-series.

Second, if these historical results look good, play the Game: run a prospective test by “investing” your stake based on your new model.

Third, evaluate your new results frequently. If your new results are merely comparable to results from applying your earlier model, you may have identified a legitimately correlating, but non-orthogonal (ie, non-additive) predictive factor. On the other hand, if your new results are worse over significant time periods, you should consider modifying or abandoning the new hypothesis. If your new results are better, keep chalking up superior returns for a long enough period of time that the likelihood that they are due to a run of luck becomes vanishingly small. You have now tested and proven a falsifiable hypothesis!

IV. The Supreme Court Exchange Game Enables New Forms of Litigation Risk-Management

1. My Own Case is Currently Pending Before the U.S. Supreme Court. Can the Exchange Help Me to Manage My Risk?

Yes. Consider the following Two Examples:

Q1. I am Executive Director of a Union that just won a \$500 million class action lawsuit at the trial level and the award was upheld at the Court of Appeals. The defendant was granted certiori at the Supreme Court and the case is currently pending. Our lead attorney insists that we will win again – but I see that our R-LOUDs are trading at 0.80 and our A-

LOUDs at only 0.10. The defendants are offering to settle for \$250 million. What should I do?

A1. First of all, the LOUD gives a much more realistic assessment of risk than your own lawyer! Be aware that your attorney probably doesn't want to lose his chance to get up and argue a Big Case in front of the Supreme Court Justices and see his name immortalized in a published Supreme Court opinion; it will be difficult for him to give you objective advice in favor of settling at this point. In general, for this and other reasons, too few Supreme Court cases settle. But the "market," to the extent it reflects all available information, is telling you that have an 80% chance of losing this year, plus a further 10% chance of an indeterminate result, such as a remand for fact-finding on damages, that could drag on for years more. Taking 50% of what you "won" contingently at the trial court is objectively attractive. Basing your decision on the market price of LOUDs will also give you a basis to persuade your Board of Directors and your membership that you are doing the objectively correct thing by settling.

Q2. I'm CEO of a Global 1000 Company, Toxic-Process, Inc. We were just granted *certiori* before the US Supreme Court. We're appealing an environmental liability claim we self-insured above our "cap." We already lost at the Court of Appeals. If we lose again it will cost us at least \$1 Billion. The uncertainty around the case is hurting our credit rating, depressing our stock price, and rattling our customers. It is also making my Board of Directors question my decision to fight this issue rather than settle. I see that the Exchange is currently offering *Toxic Process* A-LOUDs at 0.25, and R-LOUDs at 0.70. Can I hedge our exposure 100% by buying \$1 billion par value of A-LOUDs from the Exchange for \$250 million?

A2. Today the Exchange itself accepts and distributes only virtual money. But Exchange prices should reflect what your Company should pay, after adding a reasonable profit to the intermediary, to Lloyd's of London or an investment vbank that provides you with a custom derivative. However, while you are correct that A-LOUDs currently trade at 0.25, or \$25,000, you need to bear in mind that that is the asking price for *one* unit today -- but at the volumes you seek to buy, the asking prices will no doubt rise considerably. Perhaps you could buy 10,000 Units -- which would give you the \$1 billion par value you seek -- for an average price of \$40,000, or \$400 million. That would make sense only if eliminating another year of uncertainty is worth an additional \$150 million to your Company (because the difference between the \$400 million cost of the hedge and the estimated "value" of the outcome predicted by current prices or $(\$1 \text{ billion})(0.25) + (0)(0.75) = \250 million is \$150 million).

2. Does Information About the Price of LOUDs Have Economic Value in the "Real-World"?

Yes. Consider a Corporation facing the prospect of paying a \$500 million judgment now, or hanging on another year, absorbing additional appellate costs, and then losing at the Supreme Court and owing \$1 Billion. The Company lost at the Court of Appeals and the

Supreme Court granted *certiori*. Company lawyers and the Board of Directors are insisting that because the Company is in the right (“Normative” thinking) it will ultimately win – but meanwhile the Company’s A-LOUD is selling for 0.90 and has never sold for less than 0.85. The rational CEO settles – saving his company (\$1 billion)(.80) – (\$500million) = \$300 million and a year of further uncertainty.

Without the availability of objective LOUD-pricing on the Exchange, a decision by the Company’s CEO to settle would likely be politically untenable and perceived as unreasonably defeatist – even a breach of duty to shareholders. Here LOUD price-information is not only accurate, but because it comes from an objective source, it can be acted-upon.

On a “make or buy” analysis, how much should a LOUD price-quote sell for when used for hedging risk? If the above Company decided to perform its own litigation-risk assessment, it could hire a range of objective and un-conflicted experts in Supreme Court appellate practice and/or the substantive areas of this particular case, ask them each to review the relevant materials and score the Company’s probable outcomes at the Court, and then combine the resulting advice into a single probability score. Such a project might easily cost \$250,000 and take weeks or months – and is virtually certain to result in a prediction less accurate than the Exchange’s

3. Can the Supreme Court Exchange Game Influence Legal Practice?

Yes, if it makes litigants more comfortable pricing and hedging their chances of success, or leads to a reduction in emotional decisions by litigants and counsel on both sides to “Hang on and hope for the best” and increases the number of out-of-court settlements prior to an opinion being issued.

Yes, if it helps to identify additional “Fundamental” Normative factors that correlate with desired outcomes. If it turns out that algorithms that “score” the *precedent* found in rival appellate briefs can distinguish algorithmically patterns of precedent-use that correlate positively with winning (for example, one could imagine that briefs with precedent that is on average more recent, is more tightly clustered with other key cited precedent, represents more strong majority or unanimous opinions rather than plurality or bare majority opinions, etc., might be both identifiable algorithmically, and shown to correlate with the winning side).

Practitioners will almost certainly respond to the discovery that certain uses of precedent correlate with winning by consciously adopting those precedent-structures into their briefs whenever possible.

Similarly, automated precedent-scoring (and/or argument-scoring) software used to help win the Game by comparing rival appellate briefs and using them as a factor in estimating litigation-outcomes can also be modified to assist attorneys in research and preparation of better real-world appellate briefs.

(Note that technologies for precedent-scoring and precedent-recommendation have in the past been a major research interest of the present author – who considers himself a Stochastic Normative Fundamentalist who also takes procedural and Result-Oriented factors very seriously. Software that can analyze networks of cited precedent in large collections of written judicial opinions, plot such precedent-structures as a network or graph, and then use various statistical techniques to partition that graph, sort it into clusters of greater and lesser density, etc. -- holds out great promise as a key tool to use in predicting the relative effectiveness of the litigant's briefs, and so in predicting outcomes and winning the Game. Such software can also help litigants strengthen their use of precedent against their rivals, identify weaknesses in their opponent's precedent-structures, etc. The process of argument-formation may be subtly but fundamentally altered -- like playing a game of chess that appears normal to observers, but where both sides are running alternative scenarios on a supercomputer between manual moves).

One can even imagine that the Court itself, with its strong policy of respecting “settled expectations,” particularly in commercial matters, may, when made aware that LOUD-pricing suggests that its chosen result is highly unexpected (for example the Court is drafting an opinion with outcome that the “informed market” anticipates with only a 10% probability) may make a special effort to explain, justify, or even soften the economic impact of its unexpected -- and likely un-hedged -- decision.

THE END