

**TESTIMONY OF A. ROBERT PISANO
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**BEFORE THE SUBCOMMITTEE ON GENERAL FARM COMMODITIES AND RISK
MANAGEMENT
COMMITTEE ON AGRICULTURE
U.S. HOUSE OF REPRESENTATIVES**

**ROOM 1300, LONGWORTH HOUSE OFFICE BUILDING
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Thank you, Chairman Boswell and Ranking Member Moran, for the invitation to provide testimony before the Subcommittee on General Farm Commodities and Risk Management of the House Committee on Agriculture, regarding proposals to designate contract markets that will provide a mechanism for trading futures and option contracts in motion picture box office numbers. My name is Robert Pisano. I am appearing today and providing oral testimony on behalf of the Motion Picture Association of America, Inc. ("MPAA"). However, these prepared remarks are submitted as the collective views of The Directors Guild of America, Inc. ("DGA"), the Independent Film & Television Alliance ("IFTA"), the International Alliance of Theatrical Stage Employees ("IATSE"), and the National Association of Theatre Owners ("NATO"), as well as the MPAA and its member companies, Paramount Pictures Corporation, Sony Pictures Entertainment Inc., Twentieth Century Fox Film Corporation, Universal City Studios LLLP, Walt Disney Studios Motion Pictures, and Warner Bros. Entertainment Inc., which represent perspectives from all corners of the motion picture industry.

I have spent virtually my entire career in the film business, first as a partner of a major law firm working on entertainment matters before joining Paramount Pictures as executive vice president and general counsel in 1985. At Paramount, I was responsible for all legal and legislative affairs, as well as labor relations and business development. I was a member of the Office of the Chairman and the Operating Committees of the studios' international theatrical, video, and pay television distribution and exhibition joint ventures. I left Paramount and joined Metro-Goldwyn-Mayer in 1993 as Executive Vice President and then became Vice Chairman, when I had the responsibilities of chief operating officer. Immediately before joining MPAA, I was National Executive Director and CEO of the Screen Actors Guild. My views, my opposition to futures trading in box office receipts, reflect not only the views of the MPAA and its members, and the film industry coalition allied with MPAA on this matter, but also my long experience engaged in the financial and business aspect of the film industry.

The Commodity Futures Trading Commission ("CFTC") currently has before it applications to approve or deny two proposed commodity futures contracts and a commodity option contract that are designed to allow the contracts' users to bet on the level of gross motion picture box office numbers for single and unique motion pictures ("the proposed contracts" or "the contracts"). We strongly oppose approval of these proposed contracts because they are nothing more than gambling contracts that lack any of the characteristics of legitimate futures contracts,

fail to serve any public interest, and will harm all parts of the motion picture industry. Descriptions of the terms of the proposed contracts are included in Attachment A to these remarks.

Legitimate commodity futures contracts invariably are designed to serve the interests of the industries that use the underlying commodities by providing a means to discover prices and hedge commodity price risks. Consistent with this, Congress has declared in Section 3(a) of the Commodity Exchange Act (“CEA”), 7 U.S.C. § 5(a), that transactions covered by the CEA “are affected with a national public interest by providing a means for managing and assuming price risks, discovering prices, or disseminating price information.” CEA Section 3(b), 7 U.S.C. § 5(b), further declares that it is the “purpose of this Act to serve the public interests described in subsection (a)” It is service of these public interests that distinguishes legitimate, lawful futures contracts from gambling contracts that are either proscribed as crimes by the federal Wire Act or regulated by state gaming authorities.

The proposed contracts, which are sponsored by Media Derivatives, Inc. (“MDEX”) and The Cantor Futures Exchange L.P. (“Cantor”), serve no public interest and, to the contrary, can significantly harm the motion picture industry and impose new, substantial costs that do not exist today. A Cantor affiliate currently operates a website known as The Hollywood Exchange that lets users of the site engage in make-believe, non-monetary bets on the success of particular motion pictures. The request for CFTC approval of the proposed futures contracts is a transparent device to convert such make-believe, online betting into a for-profit wagering service, thereby circumventing the criminal proscriptions of the federal Wire Act.

The CEA, however, does not authorize the CFTC to license gambling contracts that fail to serve the public interests required for every lawful futures contract. And, in light of the existing significant strains on the CFTC’s scarce resources in regulating legitimate futures and derivatives markets, those resources should not be diverted now to policing gambling on motion picture box office numbers.

A. The Proposed Contracts Provide No Price Discovery or Hedging Service to the Motion Picture Industry; They Are Simply Betting Instruments

The motion picture industry is distinctly different from industries that have use for legitimate futures contracts. First, in the motion picture industry, there is no cash market in any “commodity” – no articles or interests are traded among buyers and sellers for which a futures market is needed or desirable for price discovery.¹ Second, the product of the industry is an ar-

¹ Motion picture box office numbers are outside of the legal definition of a “commodity” under the CEA because (a) no rights or interests are traded in motion picture box office numbers, (b) such numbers (as announced by *Variety*) do not value any other traded article, good, right or interest, and (c) such numbers are not beyond the control of certain industry insiders. All of the commodities specifically enumerated in CEA Section 1a(4), 7 U.S. C. § 1a(4), are traded in cash markets, and the requirement that futures prices reflect the legitimate forces of supply and demand of an underlying cash market further requires that futures contracts be permitted only to the extent that they reflect the valuation of articles, rights and interests that are traded. In addition, box office numbers are not within the CEA’s definition of “excluded commodity” because they are within the control of or, at a minimum, highly influenced by, a small group of entities (*i.e.*, producers, distributors and exhibitors) that control, among other things, the number and loca-

tistic or entertainment product that derives its value not from any intrinsic utilitarian use, but from emotional sentiment. Whether a motion picture will connect with an audience has proven quite difficult to predict, and in some instances sentiment for a motion picture can prove to be quite fleeting. There is no set formula for success, which depends on the totality of such things as artistic intangibles, marketing, release date, opening locations, and the national mood, fears, and fascinations at a particular time. Significantly, studios must invest virtually all of their capital up front. Accordingly, post-production, studios have natural incentives to avoid any action that can threaten an audience's interest in or reception of a motion picture.

Third, unlike most other products that are the subject of futures contracts, the value of an individual motion picture is not priced in open bidding among a large contingent of interested parties. Rather, a relatively small number of entities (the studio, the exhibitors, and marketers) have inordinate impact on the potential for box office numbers in the opening weekend and beyond for any particular motion picture. Their private decisions as to release dates, opening locations, number of theaters, number of screens, size of screens, and marketing budgets can significantly impact box office numbers in the early weeks of showings. Those decisions can be in flux up to the opening release and beyond, and much of the information regarding those decisions is closely held and protected from public dissemination. Fourth, unlike all other industries that use futures contracts, the motion picture industry has no constituents that would be natural long hedgers – no one has a risk of loss if a motion picture is wildly successful. Accordingly, there is no natural price competition in any purported “market” for box office numbers.

Neither of the sponsors contends that their proposed contracts offer any price discovery function. Studios receive information on box office numbers directly from exhibitors and others, including Rentrak Theatrical (“Rentrak”), a private company that compiles information on box office numbers from many, but not all, exhibitors. The public generally receives estimates of gross box office numbers from reading stories in the general press based on figures announced by the studios and Rentrak.

Moreover, the bets made on the proposed contracts would not be a reliable indicator of box office numbers, because much of the material information affecting such numbers is non-public. Bettors would not have access at any time to much of the material information affecting a motion picture's box office performance (*e.g.*, marketing budgets, distribution agreements), because it generally is not publicly available. Trying to forecast box office numbers prior to a motion picture's release without the benefit of the non-public information that is closely held by studios and other motion picture industry insiders is arbitrary.² Significantly, none of the means used to assess the legitimacy of futures pricing based on supply and demand would exist for the proposed contracts. Prior to the publication of estimates of box office numbers for the first

tion of theaters in which a motion picture is shown, the number of screens and size of screens on which a motion picture is shown, and the marketing budgets for a motion picture. *See* CEA Section 1a(13)(iv)(I), 7 U.S.C. § 1a(13)(iv)(I).

² Marketing and distribution plans are never made public. Prior to release, traders could see trailers, TV spots, and print, online, and outdoor advertisements. However, the marketing spend itself and the breakdown of spend by media are not public and would be difficult to determine as an outside observer, particularly as marketing varies by location.

weekend release, there is no cash market pricing, no additional months of futures market pricing, and no actual cash market transactions against which to measure the legitimacy of the futures price.

Further, non-public business decisions regarding motion picture marketing and distribution plans that affect box office numbers can and do occur up to and throughout the release of the motion picture, with studios constantly adjusting their distribution patterns and marketing spend to take account of consumer acceptance of a film. Although a preliminary plan is prepared in advance of approving a motion picture for production (*i.e.*, well before a release date is scheduled), the plan remains subject to change and in fact is continually adjusted until the motion picture is released and beyond. Marketing changes generally can be made within a day and in some cases almost immediately, in terms of changing marketing materials, their placement, or their relative frequency of use.³

The proposed contracts have no appeal or use with respect to the public interest criterion of hedging. Studios mitigate their financial risk at the pre-production stage or early in the production stage by a host of techniques, including partnering with other companies to share the risk, diversifying projects across different segments of the viewing audience, selling downstream rights early to cover costs, and raising capital in private and public markets to effectively syndicate the risks. Studios further mitigate their financial risk by balancing their slate of motion pictures with a variety of types of pictures (new films and remakes; low budget and high budget; teen and adult; comedy and drama and horror, etc.).

Although it may appear in theory that establishing a short position in a futures contract could be a “hedge” against poor box office performance, in the reality of the marketplace, selling a motion picture “short” after production would invite catastrophic collateral consequences, both for the particular film’s success and future relationships with financiers, directors, actors, exhibitors and others. Commercial interests involved in a motion picture will not run the risk of negative publicity by creating even the potential for accusations or rumors that it was “betting against” the success of its own picture by “shorting” it in a futures market. Moreover, there is a legal concern that such shorting transactions could generate claims of violating standard mutual covenants in industry contracts with exhibitors, directors, actors and others that prohibit disparagement of the work.

For independent producers, whose films are often released in the U.S. by the major studios, which control marketing and release plans, mitigating financial risk may be even more difficult. Independent producers secure financing on a film-by-film basis with different investors for each film and rely heavily on the distribution commitments of foreign distributors before production of the film even begins. Those minimum commitments, along with any government incentive programs, are collateralized by financial institutions and other investors, which loan the producer the production budget. Independent producers rely on the proceeds of foreign distribu-

³ The press does report the number of screens on which a motion picture will be released (but usually only within a week of release) and may report changes in screen count earlier if it becomes known that the scope of release has been significantly increased or decreased for a motion picture, but this information alone, without knowledge of other material, non-public information, is wholly inadequate to reasonably predict box office numbers.

tion to pay back the production loan, and therefore any hedging by U.S. distributors could harm not only independent producers, but also the dozens of financial and commercial partnerships they must build worldwide to secure financing for each film.

Theater owners similarly have no incentive to bet against a motion picture. They do not want to be perceived as betting against the product they will be offering and they have other means to mitigate risk. By virtue of the Paramount Antitrust Consent Decrees entered into with most of the major motion picture studios about 60 years ago, the studios license on a theater-by-theater and picture-by-picture basis. Motion picture licenses are *not* tied one picture to another. Doing so would be a violation of the Paramount Antitrust Consent Decrees and, in any case, also would raise antitrust considerations. Therefore, *no exhibitor is obligated* to license *any* motion picture. If an exhibitor *chooses* to license a motion picture, the rental for that license is negotiated separately, and any concern that the exhibitor may have regarding the public's interest in the motion picture (*i.e.*, potential success) will be reflected by the percentage of the rental the theater owner agrees to pay based on those negotiations. Motion picture rental is paid as a *percentage* of the gross numbers of tickets sold.

Significantly, underscoring the fallacy that the proposed contracts are even close to being legitimate futures contracts, the sponsors' contract rules effectively and, for Cantor's contracts, expressly, prohibit trading by studios and other insiders, thus precluding any potential for hedging whatsoever.⁴ These rules are unique among all futures contracts. They bear witness to the fact that the proposed contracts, unlike legitimate futures, do not in fact price "commodities" that are traded in a market, but, rather, are bets on the value for *a single product* (the motion picture), which can be substantially influenced through the actions of relatively few insiders. The sponsors' rules suggesting the use of an "Information Barrier" as a means to avoid the proscription of insider trading provide no assistance in permitting hedging. Such a barrier requires futures traders for a studio to be cordoned off from any information within the studio that would provide the basis for determining hedging needs and strategy. Studio and other industry insiders who have the ability to materially affect the level of box office numbers also likely would be wary of trading in the proposed contracts in any event, because doing so increases the potential of incurring significant legal costs in having to respond to inquiries from governmental investigations and/or private claims if futures prices gyrate.

As a practical matter, any decisions by a studio to hedge any risk would need to be cleared with senior management, who necessarily have intimate knowledge of all financial and contractual information relating to a motion picture and under the sponsors' rules would not be permitted to interact with traders. In this connection, box office numbers data are very important and sensitive information that is shared within a studio with, among others, key mid-level mar-

⁴ Cantor's filing on April 14, 2010 with the CFTC of a proposed contract based upon "The Expendables" expressly prohibits any person in possession of material, non-public information from trading in the contract until the information has become public. Examples of such information cited in Cantor's rules include, but are not limited to, changes in release date or the promotion or advertising budgets, number of theaters showing the film, and actual box office receipt statistics following release. Cantor's rules purport to require studios and other entities to adopt policies to ensure that their officers, directors, employees, and agents, including authorized traders, do not trade on the basis of material, non-public information.

keting personnel, the General Counsel's Office, and senior management. No studio is arranged or intends to reorganize itself so as to separate the management and reporting lines of persons with access to the box office numbers data and the persons who compile or compute those figures. It makes no sense to do so and would prevent a studio from utilizing the box office numbers data in the most efficient manner.

B. The Proposed Contracts Will Harm the Motion Picture Industry

Currently, studio estimates of box office numbers do not impact anyone; they are of no consequence to the public's interests. However, the CFTC's approval of the proposed contracts will *create*: (a) burdens for motion picture financing by creating new, but unreliable and non-economic, prognostications of a motion picture's success, (b) conflicts of interest for studio employees and independent contractors by creating a means to bet against the success of motion pictures, and (c) new legal risks for studios in, among other things, announcing estimates of box office numbers and having to police the use of inside, non-public information affecting box office numbers that could be material to bettors' trading decisions.

The pricing on the proposed contracts creates a greater risk of depressed box office numbers because such pricing, although lacking any reliable economic basis, could harm a motion picture's prospects by negatively affecting financiers' and audiences' perception of it. Because the ultimate breadth of distribution can be revised up to the time of release and afterward, the proposed market could affect distributors' ability to secure screens if the pricing of contracts signals a sentiment of negative box office results. The harmful effect of negative publicity is not limited to theater showings. Many prices for downstream licenses and other sources of revenue are driven in part by actual box office receipts. Motion pictures slated to open in limited theaters (which can easily meet the threshold requirements of the proposed contracts of 600 theaters for MDEX and 650 for Cantor) and then broaden based on word of mouth could be ruined by futures pricing that casts them in the false light of a "failed" opening.

The impact of piracy could be amplified by these contracts because trading in the proposed contracts also creates a new means to try to profit from theft of studios' confidential motion picture materials, thereby increasing the likelihood of such theft and exacerbating our industry's existing widespread motion picture piracy problems. For example, a person who steals a motion picture or motion picture creative materials, in finished or unfinished form, before its release could short the contract and then post it on the Internet to hurt box office numbers. Similarly, a person armed with critical inside information might use it to profitably trade in the proposed contracts. Nothing in the sponsors' publicly available materials about their contracts begins to suggest how either will be able to detect and prevent such manipulative conduct. Given the rise of the Internet and other technologies, piracy and leaks of confidential information are growing threats to the motion picture industry. The CFTC should not provide any additional incentives for motion picture piracy and stealing intellectual property by approving the proposed contract applications.

Approval of the contracts also creates a whole host of new financial and legal costs and burdens that do not now exist. Once a contract is traded in box office numbers estimates, the announcement of such estimates has consequences for bettors. This, in turn, creates legal risk for

studios in announcing their estimates – where none exists now – because mistakes that are currently meaningless could now be portrayed as impacting bettors’ financial results from their contracts, thus giving rise to private claims for damages for negligence, misrepresentation, or even, given the minimal pleading requirements for commencing actions, manipulation. The cost of litigating even unmeritorious claims could be substantial and cause studios to cease or significantly alter the practice of public announcements.

Approval of the proposed contracts also will require studios and all other industry participants that have the power to affect futures pricing to institute and police anti-insider trading compliance regimes for the proposed contracts. It is problematic whether any prohibition on insider trading would need to take into account inside information held by persons who are not subject to the control of the studios. In the event that the studio is distributing an independent film, the potential for many more insiders outside of the studio’s control is enormous. There are many industry participants who have access to material, non-public information and could try to use that information to profitably bet on the proposed contracts. There are many insiders, for example, in studio marketing and distribution departments and upper management and in exhibitors’ finance, marketing and contracting departments, who have access to such material, non-public information as actual box office data, internal forecasts, advertising strategies and spending, and release patterns.⁵ Exhibitors also have a right to see a motion picture prior to licensing it in the U.S.⁶

Even if a studio’s compliance system is designed and executed to perfection, it is possible that, at some point, the CFTC or the Department of Justice will investigate a suspicion of possible manipulation of the proposed contracts, causing large legal expenses for the industry. The studios would be put to great expense to comply with the investigation. Moreover, studios and other industry insiders would be natural targets for strike suits by disappointed traders. Further, the negative publicity that could flow from rumors or announcements of an investigation and from strike suits would be damaging to the industry parties involved. These are risks and costs that do not now exist and the industry will receive no benefits from the contracts to offset these substantial risks and costs.

⁵ Other insiders who could possess material, non-public information range from financiers and their advisors, potential distribution partners, talent, crew, agents and other representatives, special effects and other post-production vendors, trailer houses, festival screening committees and the employees, families, and friends of all these people. Insider trading also could implicate insider trading proscriptions of the federal securities laws, where a movie’s box office success could be material to the market value of its producer’s publicly traded securities. Also, the rise or fall of an independent production company’s release could have a material impact on its future ability to function; trading in such a picture’s prospects could doom not only that picture, but future pictures and, in the worst case, the entire company. The proposed contracts thus could be used by insiders as surrogates for their companies’ securities in order to profit from inside information.

⁶ Although certain members of the public may see a motion picture prior to its theatrical release, and their reactions may become public through social media and social networking technologies, much of this information remains non-public.

These essential public interests reflect a legislative intent that futures contracts provide economic value beyond pure speculation. Consistent with this, the contract market designation criteria and core principles requiring that contracts not be readily susceptible to manipulation and that a designated contract market (“DCM”) prevent manipulation are founded on the principle that futures contracts are tied to legitimate cash markets, serve an economic purpose for those markets, and that futures prices should reflect, in the CFTC’s oft-used words, the “legitimate forces of supply and demand” in an underlying cash market. The Appendices to the CFTC’s rules governing contract market designation specifically require, among other things, that a board of trade applying to be approved as a DCM shall submit a “description of the cash market on which the contract is based” and the “designated contract market should collect data in order to assess whether the market price is responding to the forces of supply and demand.” Similarly, CEA Section 4(a), 7 U.S.C. § 6(a), expressly condemns “excessive speculation” and authorizes the CFTC to prohibit it.

These features of the CEA unambiguously demonstrate Congress’s intent that, for futures contracts to be lawful, they must provide price discovery and hedging functions and not simply be an outlet for speculation. The Commodity Futures Modernization Act of 2000 may have relaxed the procedures for designating contract markets, but it did not extinguish or even change the statute’s central requirement that regulated futures contracts meet those criteria.

The proposed contracts cannot serve these public interests. It is undisputed that they will not provide a means of price discovery; indeed, MDEX and Cantor do not even argue that their contracts serve this public interest. Nor, as discussed below, will the proposed contracts in fact be used for hedging. Rather, they are simply a means by which the sponsors of the contracts seek to serve their own private interests and the private interests of persons who would like yet another outlet for speculative pursuits. Such activity should not receive the sanction of the federal government or take up any of the government’s scarce regulatory resources especially where, as here, the contracts would be harmful to the industry they purport to serve.

C. Reports of Box Office Numbers Are Not Free from Error

Box office estimates largely have been a marketing tool; they were not created to support financial trading. The practice in the motion picture industry is to report *estimates* of weekend gross box office numbers on Sunday, based on projections informed by numbers received for Friday and Saturday showings. *Variety* publishes those estimates on Monday, as do many major newspapers and media sources. Those estimates, which are generated by the studios, are based in part on non-public and undisclosed projections and assumptions that can vary from motion picture to motion picture and from studio to studio. *Variety* provides this disclaimer about the information it publishes:

“Variety publishes data compiled by Rentrak Theatrical, which collects *studio reported data* as well as box-office figures from North American theatre locations. Any information provided by Rentrak has been obtained from sources believed to be reliable.

However, Rentrak does not make any warranties as to the accuracy, completeness or adequacy of this information and data. The user of this data agrees Rentrak, its officers and employees will have no liability arising from the use or disclosure of this information and data. To submit any questions to Rentrak, please email: boxofficeinfo@rentrak.com.”

See: http://www.variety.com/index.asp?layout=b_o_layout&dept=Film (emphasis added). Those estimates, as with estimates of all types, can be flawed, although traders rely on them – see the articles from *Variety* about errors in estimates of weekend box office numbers for the past two consecutive weekends in April 2010, which are attached hereto as Attachments B and C.

The box office receipt information Rentrak compiles from the exhibitors that have agreed to provide that information to Rentrak is itself incomplete, and we understand that the percentage of the total box office numbers that is reported by exhibitors to Rentrak can vary materially from motion picture to motion picture depending on how many exhibitors within its universe of reporting exhibitors are showing a particular motion picture. We understand that many exhibitors record box office numbers electronically and then provide the aggregate information to Rentrak through an electronic feed, but also that many exhibitors tabulate their numbers manually. However, *some exhibitors never report to Rentrak, either automatically or manually.*⁷

Typically, studios, upon receiving Rentrak exhibitor-based figures, in turn conduct their own information gathering and analysis to develop their estimates that may be publicly announced in the press. As *Variety's* disclaimer indicates, the studios' Sunday announcements of weekend motion picture box office numbers information in *Variety* include the studios' estimates. The studios' information gathering and analysis may vary from one company to another and is closely held proprietary information, but it can include, for example, communicating with some of the exhibitors that are not included in the Rentrak figures and even those exhibitors that are included in the Rentrak figures if their information appears to be potentially inaccurate or incomplete.

Even the studios' box office estimates announced subsequent to the Sunday estimates are unaudited and never capture 100 percent of box office numbers. None of the data reported to *Variety*, the Rentrak compilations, or the studio estimates are used to settle transactions between exhibitors and distributors. Those transactions are settled by reporting of actual gross box office receipts between the contract parties, on a non-public basis, and subject to their contractual accounting and audit rights and obligations. In addition, it should be noted that neither Rentrak nor studio figures adjust for U.S./Canadian exchange rates. Further, studio-announced figures may

⁷ Our understanding is that not all exhibitors provide information to Rentrak and, therefore, the completeness of Rentrak's tabulations for any particular motion picture for any particular period, as measured against the entire universe of box office numbers for a motion picture for that period, can vary based upon the number of screens on which it is shown by exhibitors that provide their information to Rentrak.

include data reported to the studio by a third-party distributor where U.S. and Canadian theatrical rights are held by different entities.

D. The Proposed Contracts Are Susceptible to Manipulation and Price Distortions

In the first instance, the lack of any legitimate economic measure of valid pricing before the Rentrak numbers are announced prevents any ability to even identify a manipulated price. Further, the potential box office numbers for a single motion picture can be materially affected by individual industry participants in a variety of different ways that would be exceedingly difficult to detect. Exhibitors that contribute to the Rentrak numbers could, either intentionally or accidentally, misreport their data. A distributor could determine within the period following a motion picture's release to reduce or increase the number of theaters that would show the motion picture. A distributor for a variety of reasons could determine to substantially reduce or expand its marketing budget, which can materially affect box office numbers. A major exhibitor could decide to show the motion picture on smaller or larger screens, which can materially affect audience interest and capacity. We respectfully submit that the sponsors have no effective means to detect or prevent such conduct or to determine whether it was undertaken for valid business reasons, rather than to manipulate futures prices.

Futures prices for individual motion pictures also are susceptible to manipulation by false market rumors. In the unique circumstances of the motion picture industry, it would be virtually impossible to identify the sources of such rumors or to prosecute any alleged manipulation by false rumors, because such rumors would typically be based on opinions relating to a motion picture's artistic or entertainment merit rather than verifiable facts. There already are plenty of rumor mills with respect to the quality of motion pictures and many of them are in the online environment. These range from reviews by members of the public who have attended screenings, professional reviewers, press reports relating to rumored or perceived "trouble" on motion pictures (multiple writers, talent defections, re-shoots, postponed release dates, etc.), and reports of the quality of footage that have leaked pre- or post-release. There is no effective way to police such rumors or reliably determine their source. These sorts of rumors can depress or increase box office performance. Therefore, the ability to profit from rumors by trading in the proposed contracts would intensify any incentive to spread false rumors in a manner that the sponsors could neither detect nor control.

I wish to thank once again Chairman Boswell and Ranking Member Moran for the invitation to provide testimony, and I will be happy to respond to questions from Members of the Subcommittee.

ATTACHMENT A

THE PROPOSED CONTRACTS' TERMS

A. The Cantor Contracts

The Cantor contracts are complicated, and to some degree uncertain, trading instruments, and their material terms can vary from one motion picture title to another and even without notice to traders at the time trading commences.⁸ Generally, however, the Cantor submission states that its contracts would provide a means to bet on gross domestic box office numbers of select motion pictures released in the United States and Canada, “as compiled by Rentrak Theatrical and/or Nielsen EDI and published in *Variety Magazine* (or such other publicly available source or sources *as may be designated* by the Exchange from time to time).”⁹ This description is confusing because the information about gross box office numbers *as published by Variety Magazine* is not the same as the information “compiled by Rentrak” *from exhibitors*. (Rentrak’s compilations from exhibitors do not account for 100% of gross box office numbers, and the percentage of the total box office numbers reflected in the figures it collects from exhibitors can materially vary from motion picture to motion picture.)

The Cantor submission states that each motion picture will be the subject of its own separate contract, and Cantor will decide in its discretion the motion pictures for which it will list futures contracts on its platform.¹⁰ The Cantor contracts will call for traders to bet on the gross Domestic Box Office Receipts (“DBOR”) over the “DBOR Determination Period.” The DBOR Determination Period runs from the date of the motion picture’s opening until four weeks after the motion picture first qualifies for “wide release” status as defined by the Cantor rules.¹¹ Those rules define “wide release” status to occur once a motion picture is shown simultaneously on the same day in 650 theaters.¹² The “Final Settlement Price” will be a fractional equivalent of the gross DBOR over the DBOR Determination Period.¹³

⁸ See Cantor Rule I-1, Definition, “First Trading Day” (noting First Trading Day “will be specified in each DBOR Contract”); Cantor Rule II-3(b) (discussing fluid DBOR Determination Period).

⁹ See Cantor Rule I-1, Definitions, “DBOR” and “Rentrak Theatrical.” (Emphasis added.) Rentrak Theatrical is a unit of the Rentrak Corporation. See www.rentrak.com. Nielsen was acquired by Rentrak and no longer separately reports motion picture box office numbers. Accordingly, our comment will address reporting by Rentrak only.

¹⁰ Cantor Rule II-10.

¹¹ If the motion picture fails to achieve wide release status prior to the end of the 12th Release Week, the DBOR Determination Period will conclude at the end of the 12th Release Week. Cantor Rule II-3(b).

¹² Cantor Rule I-1, Definition, “Wide Release.”

¹³ Each contract will be settled at the equivalent of one millionth of the gross DBOR for the United States and Canada showings over the DBOR Determination Period – *i.e.*, if the gross DBOR over the DBOR

When trading on any particular Cantor contract will commence is not clear from the Cantor rules; it appears that, at Cantor's discretion, it could commence anytime between a year and one day before a motion picture's release and presumably start dates could vary from contract to contract.¹⁴ The time period of the DBOR Determination Period might not be knowable at the time trading commences – that period could span from four to twelve weeks, depending on if and when a motion picture first qualifies as a “wide release.”¹⁵ Accordingly, at the time trading commences, traders would not even have notice of the terms of their bets. It also is unclear when trading will end. The chart accompanying the latest Cantor contracts submission (for “The Expendables”) states that “The longest trading period for a DBOR contract is a period of four Release weeks.” If trading must cease no later than four release weeks after the opening, trading could be limited to a shorter time period than the DBOR Determination Period. For example, theoretically, trading would end *four weeks* after the opening, but the DBOR Determination Period could be the first *six weeks* following release, if a motion picture fails to qualify as a “wide release” until the third week after its release. This can cause substantial uncertainty for pricing and perhaps invite gaming. In contrast, the definition of “Last Trading Day” in the Contract Terms and Conditions states that “the Last Trading Day shall under no circumstances be any earlier than the Tuesday following the close of the DBOR Determination Period.” Pursuant to this

Determination Period are \$56 million, the Final Settlement Price of the contract would be \$56. Cantor Rule II-3(a). Upon settlement, each buyer of Cantor contracts who holds them to maturity will be entitled to receive, and each seller will be obligated to pay, one millionth of the gross DBOR for the DBOR Determination Period. Cantor provides the following example in Rule II-13(a): If an underlying motion picture title has earned a DBOR of \$56,455,000 during the DBOR Determination Period, the Final Settlement Price would be calculated by dividing \$56,455,000 by 1,000,000 (equaling \$56.455), and then rounding such amount to \$56.46.

A trader's profit or loss on a long position held until contract expiration will equate to the difference between the contract price when the contract was entered into and the Final Settlement Price. Using the example above, if the buyer enters into a futures contract at a price of \$50 and holds the contract until expiration, the buyer's profit would be the difference between \$50 and \$56.46. The seller of such a contract at the price of \$50 would lose the difference between \$56.46 and the \$50 contract price. If a trader liquidates his or her contract position prior to contract expiration, his or her profit or loss will be the difference between the opening and liquidating contract prices.

¹⁴ It is not clear when trading will commence in relation to the opening release, but it appears that there will be an Opening Auction on the first trading day to determine an “Equilibrium Price” for the commencement of trading. Cantor Rule II-11. The description of the Opening Auction has changed during various iterations of the DBOR Contract, and it is unclear exactly how the auction will work. While a contract is open for trading, traders will be permitted to execute trades 24 hours a day, seven days a week. Cantor Rule II-12.

¹⁵ See Cantor Rule II-3(b). For example, if a motion picture is released in 500 theaters in Week 1, but is shown in 650 theaters in Week 2, the DBOR Determination Period will be six weeks long, because “wide release” status will not have occurred until the second week, and the Determination Period will conclude at the end of the fourth week after wide release is achieved. If a motion picture never achieves “wide release” status, the DBOR Determination Period will be the full first twelve weeks following the opening, and the Final Settlement Price will be based on the DBOR over the full 12-week period.

definition, trading could last as long as 12 weeks for a motion picture that fails to achieve wide release status. Significantly, under this definition, trading potentially could extend beyond the DBOR Determination Period – *after the settlement price is known publicly or by those with inside information.*

B. The MDEX Contracts

MDEX's proposed Opening Weekend Motion Picture Revenue Contracts ("the MDEX Contracts") include a binary option and collared futures contract. The MDEX contracts are designed to provide a means to profit from bets on the box office numbers of the opening weekend for "major releases." MDEX's proposed binary option contracts would be issued over a series of strike prices (tied to the level of first weekend box office numbers as reported by Rentrak) that would be exercisable only upon expiration (European style) and only if the strike price for the reported first weekend box office numbers is reached. Upon successful exercise, the purchaser would be entitled to receive \$5,000 per option contract.

MDEX's proposed "collared futures" contracts also would offer exposure up to \$5,000 to the outcome of a particular revenue period, but are not binary and, therefore, offer a range of exposure for each contract from \$0 to \$5,000. Instead of the strike price present in the binary option contracts, collared futures contracts are based on a range of Rentrak's tabulations of box office numbers, with any payouts based on numbers falling below that range (paying nothing), within that range (paying according to a preset formula), or above that range (paying \$5,000). If a movie's box office revenue comes within the range of a collared futures contract, the revenue number is converted into a revenue unit by dividing that range into one-quarter increments, from 0 to 100, and then multiplying by \$50.



April 13, 2010

'Titans' victorious at weekend box office

Final figures put 3D epic on top of 'Date Night'

By ANDREW STEWART

When the dust settled on Monday, Warner Bros.' 3D epic "Clash of the Titans" had edged out 20th Century Fox's "Date Night" domestic B.O. debut.

Preliminary estimates had "Date Night" winning the weekend, with \$27.1 million; Fox revised the figure downward to \$25.2 million.

Meanwhile, "Clash" earned a revised \$26.7 million, down slightly from Warner's \$26.9 million estimate. The 3D epic dropped 56% in its sophomore weekend and has cumulated \$110.2 million.

Paramount and DreamWorks Animation's "How to Train Your Dragon" followed closely, with \$24.9 million. The toon slipped only 14% in its third frame, for a total haul of \$92.1 million.

"Dragon" scored 65% of its weekend take from 2,165 total 3D locations, while "Clash" saw approximately 50% from 1,632 3D runs. "Clash," which isn't playing on Imax 3D screens, was able to top the box office even with a substantial number of filmgoers opting for the 2D version.

Fox originally had predicted a 34% drop for "Date Night" from Saturday to Sunday, but said the comedy ended the weekend with a steep 49% decline. Studio attributed the drop to the final day of the Masters on Sunday, saying the golf tourney siphoned audiences from the comedy's targeted older demo.

Most of the frame's other adult-oriented films, including Lionsgate's "Why Did I Get Married Too?" and "The Bounty Hunter" also took steep hits on Sunday.

The Masters played heavily to older audiences, skewing toward male viewers, but also with a surprisingly strong female audience. The "Date Night" demo was similar, with 52% females to 48% males, and about 60% of the audience over 25.

Despite its second place finish, "Date Night" is off to a solid start, with the popularity of stars Tina Fey and Steve Carell helping it exceed "The Bounty Hunter's" \$20.7 opening weekend on March 19.

Family pics like "Dragon" fared best on Sunday, with the toon slipping 38% that day. "Dragon" may lose auds as kids head back to school after spring break, but Par said it expects the toon to hold steady until the studio launches 3D "Shrek Forever After" on May 21.

Attachment C

'Kick-Ass' slays 'Dragon'

Another swap at B.O. top

By [ANDREW STEWART](#)

For the second consecutive week, the top two spots at the domestic box office have swapped places, with this week's No. 1 position going to Lionsgate's superhero comedy "Kick-Ass."

Pic's revised weekend figures held steady on Monday at \$19.8 million, while Paramount and DreamWorks Animation's 3D toon "How to Train Your Dragon" dropped from its estimated \$20 million to a revised \$19.6 million.

The B.O. shuffle comes a week after Warner Bros.' "Clash of the Titans" was renamed the B.O. champ with its weekend actuals, ousting 20th Century Fox laffer "Date Night."

In its soph sesh, "Date Night" saw a solid hold of 34%, claiming the No. 3 spot with \$16.7 million, while actuals for "Clash" totaled \$15.5 million. Cume for "Date Night" stands at \$48.7 million; "Clash" has reached \$132.6 million in its third frame.

Without any major tentpole releases entering the market in the past two weeks, solid holdovers have been pitted against aud-specific debuts like "Date Night" and "Kick-Ass."

"Kick-Ass," about an average teenager who dons a superhero persona, played best among young males, with a 60%-40% male-female split. The pic's healthy launch could bode well for "Kick-Ass" in repeat frames, as Lionsgate hopes fanboy enthusiasm will help fuel strong word of mouth among wider demos.

" 'Kick-Ass' is fantastic, highly original entertainment, and our marketing and distribution teams have brilliantly positioned it for a long and successful run," Lionsgate prexy Joe Drake said in a statement. "That kind of run is precisely what we are seeing on the international front, where 'Kick-Ass' has demonstrated a very strong hold at the box office."

The film has grossed some \$13.8 million internationally, since its early bow overseas April 2.

Meanwhile, "Dragon" saw a strong hold in its fourth frame, slipping just 21%. The toon's 3D component helped boost holdover potential, which accounted for 65% of the weekend take on 56% of the total location count.

"Dragon," whose cume reached \$158.3 million as of Monday, should have a clear playing field until Par/DWA's "Shrek Forever After" is released May 21.