

## BACK TO THE FUTURE[S]: A CRITICAL LOOK AT THE FILM FUTURES BAN ♦

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## INTRODUCTION

Imagine, for a moment that two highly-anticipated, big-budget Hollywood films are about to premiere, both of which are helmed by famous, highly-respected directors: “Movie 1” and “Movie 2.” Movie 1 is a historical war epic about a legendary commander. It will feature big, bloody battle scenes and an even bigger cast, starring award-winning Hollywood royalty Anthony Hopkins, Angelina Jolie, and Colin Farrell. Movie 2, on the other hand, is a dramatic science-fiction action adventure based on an original screenplay, with a relatively unknown cast, that was produced with a brand-new, expensive development process shrouded in secrecy. There are a number of similarities between these two films—they are both large, highly “buzzed” action-heavy projects by directors with great reputations—but nonetheless, these movies have one, glaring difference: Movie 2—James Cameron’s *Avatar*—will net over \$1.1 billion worldwide,<sup>1</sup> while Movie 1—Oliver Stone’s *Alexander*—will lose more than \$70 million.<sup>2</sup> So where does this enormous discrepancy come from? How could we predict that *Avatar* would be a massive hit, but that *Alexander* would be a tremendous flop?

Movie studios across Hollywood and the rest of the country have chased the answers to these questions with incredible persistence, but as *Avatar* and *Alexander* demonstrate, there is no known key to a surefire hit.<sup>3</sup> In their search for a blockbuster, studios have found a number of different techniques that help reduce the likelihood of an unexpected flop, but nonetheless, history suggests that some elusive, unpredictable ‘X-factor’ often remains the master of a film’s commercial success.<sup>4</sup> In these

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<sup>1</sup> See Movie Budget Records, THE NUMBERS, <http://www.the-numbers.com/movies/records/budgets.php> (last visited Oct. 26, 2010).

<sup>2</sup> See *id.*

<sup>3</sup> As Robert Pisano, President and Interim CEO of the Motion Pictures Association of America (“MPAA”), explained, “there is no set formula for [motion picture] 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.” Robert Pisano, Interim CEO, MPAA, Test. before the H. Subcomm. on Gen. Farm Comm. and Risk Mgmt (Apr. 22, 2010), *available at* <http://agriculture.house.gov/testimony/111/h042210/Pisano.pdf> [hereinafter Pisano Testimony]. See also Robert Pisano, Interim CEO, MPAA, Statement before the U.S. Commodity Futures Trading Comm’n (May 19, 2010), *available at* [http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/publicmeeting051910\\_pisano.pdf](http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/publicmeeting051910_pisano.pdf).

<sup>4</sup> Studios often try to reduce the likelihood of a flop by advertising heavily; locking in big name actors, directors, and producers; sticking to generic, but reliable plot devices; creating sequels or films based on well-known pre-existing material; and highlighting favorable connections between unrelated films. See Patrick Topf, Examining Success at the Domestic Box-Office in the Motion Picture Industry (2010) (unpublished manuscript, on file with Illinois Wesleyan Univ. Econ. Dep’t), *available at* [http://digitalcommons.iwu.edu/cgi/viewcontent.cgi?article=1109&context=econ\\_honproj](http://digitalcommons.iwu.edu/cgi/viewcontent.cgi?article=1109&context=econ_honproj) (finding that a motion picture’s box office success was most significantly determined by its star power, genre, distributor, MPAA rating, and whether it was part of a franchise). A

instances, the techniques that studios use to reduce the *chance* of an unexpected flop<sup>5</sup> are useless, since they do nothing to offset the impact of a flop when it actually occurs.<sup>6</sup>

Many large industries in the United States use commodity futures<sup>7</sup> markets to offset the impact of unexpected price changes that are harmful to their business.<sup>8</sup> The motion picture industry does not. Moreover, when the Commodity Futures Trading Commission (“CFTC”) authorized futures trading in domestic box office receipts,<sup>9</sup> many people within Hollywood<sup>10</sup> quickly lobbied Congress to ban the trading of futures contracts for box office revenue receipts (“film futures”). Shortly after the CFTC’s approval, Congress banned the trading of film futures.<sup>11</sup>

This Note proposes that Congress should not have banned film futures trading. Although proponents of the ban argued that film futures trading would lead to market manipulation and gambling that would destabilize the motion picture industry—much like what subprime mortgage-backed securities did to the real estate industry—the reasoning behind these concerns is

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good example of these techniques in practice is Ridley Scott’s *Robin Hood*, starring Russell Crowe, which is the same duo responsible for the critically acclaimed and commercially successful *Gladiator*. See *Robin Hood*, IMDB, <http://www.imdb.com/title/tt0955308/> (last visited Oct. 26, 2010). Despite using these risk-reducing techniques and having the ninth largest production budget in motion picture history, *Robin Hood* was not the huge hit that Universal Pictures expected. See *Movie Budget Records, THE NUMBERS*, <http://www.the-numbers.com/movies/records/budgets.php> (last visited Oct. 25, 2010). “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.)” Pisano Testimony, *supra* note 3.

<sup>5</sup> See Topf, *supra* note 4.

<sup>6</sup> Furthermore, most of these risk-reducing techniques—such as signing well-known actors and running large advertising campaigns—are costly, which only contributes further to the detrimental impact of a flop.

<sup>7</sup> For a detailed explanation of commodity futures trading, see *infra* Part II.B.

<sup>8</sup> In 2007, the farming and oil and gas industries—two industries that extensively use futures exchanges—were responsible for 1.34% and 1.19% of private Gross Domestic Product (“GDP”), respectively. The entertainment industry was relatively comparable, occupying 0.43% of private GDP in 2007. 2007 U.S. GDP by Industry, ARIZONA WORKFORCE INFORMER, Dec. 15, 2008, [http://www.workforce.az.gov/admin/uploadedPublications/2100\\_gdp.xls](http://www.workforce.az.gov/admin/uploadedPublications/2100_gdp.xls).

<sup>9</sup> On June 14, 2010, the CFTC authorized Media Derivatives to begin film futures trading. See Michael Cieply, *Trading in Film Futures Contracts Approved*, N.Y. TIMES, June 15, 2010, at B2. Roughly one week later, on June 28, 2010, it gave the same authorization to Cantor Fitzgerald. See *Cantor Exchange Receives Regulatory Approval, but Contracts are Banned by New Law*, CANTOR EXCHANGE, <http://www.cantorexchange.com/getdoc/2d929de7-c59b-4ab1-841d-d5487af7f3da/Market-Launch-Announcement.aspx> (last visited Oct. 25, 2010).

<sup>10</sup> Most significantly, this included: 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.; as well as 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”). See Pisano Testimony, *supra* note 3.

<sup>11</sup> Congress amended section 1(a) of the CEA to exclude film futures from the definition of a “commodity,” thereby preventing its trade on any commodity futures exchange. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 721(a)(4), 124 Stat. 1376.

questionable, particularly in light of the rushed and reactive nature of the Congressional ban.

Part I of this Note briefly describes the events that led to the film futures ban and highlights some of the forces that may have been at work behind-the-scenes. Part II of this Note establishes a working understanding of commodity futures trading in general, defines film futures, and provides a brief illustration of who may want to invest in film futures. Part III identifies the reasons why Congress banned film futures, analyzes their merits, and discusses the persuasiveness of each. Part IV argues that the CFTC's approval of film futures trading verified the legitimacy and ability of a film futures exchange to help, not harm, the motion picture industry and specifies the significant national public benefits that trading would provide. Part V acknowledges that although a ban on film futures trading may be appropriate in the future, the large potential benefits of a film futures exchange warrant a repeal of the ban for at least a probationary period to allow for the CFTC to collect sufficient film futures data, such that a careful, more-informed analysis of the benefits and concerns of film futures trading could be performed.

#### I. THE HISTORY OF FILM FUTURES: FROM *INCEPTION* TO *ARMAGEDDON*

The story of film futures begins in 1996, when two Wall Street traders—Max Keiser<sup>12</sup> and Michael Burns<sup>13</sup>—created The Hollywood Stock Exchange (“HSX”),<sup>14</sup> an online multiplayer game that enabled hundreds of thousands of users to buy or sell ‘moviestocks’ of upcoming motion picture projects for fictional dollars.<sup>15</sup> The goal of users who trade on the HSX is to maximize their returns on investment, which is identical to the goal of all investors on real world stock exchanges.<sup>16</sup> Traditionally, the

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<sup>12</sup> Although Keiser was a stock broker and options trader at the time, he is now primarily a television broadcaster on financial news programs. ABOUT MAX KEISER, <http://maxkeiser.com/about/> (last visited Nov. 22, 2010).

<sup>13</sup> As a trader, Burns specialized in raising equity for the entertainment and media industry. In 1999, he joined Lionsgate Entertainment and is currently its Vice Chairman. Michael Burns, LIONSGATE, <http://corporate.lionsgate.com/ExecutiveBio.asp?ExecutiveBioId=9> (last visited Oct. 26, 2010).

<sup>14</sup> See Daniel Frankel, *The Rise & Plunge of Movie Futures Trading*, THE WRAP, Aug. 15, 2010, <http://www.thewrap.com/movies/article/rise-plunge-movie-futures-trading-20094?page=0,1>.

<sup>15</sup> Each ‘moviestock’ is tied to the expected box office success of the movie it represents in the first four weeks of its release. See HSX GLOSSARY, <http://www.hsx.com/help/?page=glossary> (last visited Oct. 26, 2010).

<sup>16</sup> See Bill Stanley, *Buy Low, Sell High: A Strategy for Stock Market Investors*, ASSOCIATED CONTENT, July 14, 2010, [http://www.associatedcontent.com/article/5565748/buy\\_low\\_sell\\_high\\_a\\_strategy\\_for\\_stock.html](http://www.associatedcontent.com/article/5565748/buy_low_sell_high_a_strategy_for_stock.html) (stating that “the goal when investing in anything is to buy it when the price is

success of an investor's efforts to maximize its return on investment is closely tied to its ability to accurately estimate the 'true' value of a potential investment.<sup>17</sup> These individual valuations are significant because investors will only buy or sell a given share if they believe its market price does not accurately reflect its 'true' value.<sup>18</sup> When trading occurs, each unique appraisal of a given film share is naturally and dynamically reflected in the share's current market price. Thus, when thousands of individual users trade on the HSX every day, this price-determining relationship creates a synergy that is the driving force behind why the current price of an HSX film share has historically<sup>19</sup> and empirically<sup>20</sup> proven itself to be a reliable indicator of an underlying film's actual performance at the box office. Keiser and Burns created the HSX precisely for this valuable forecasting function, and more specifically, its potential application to real world motion picture financing.<sup>21</sup>

In the spring of 2001, this dream looked to become a reality when an investment brokerage firm, Cantor Fitzgerald, L.P.,

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low and sell when the price is high").

<sup>17</sup> See Dave Berkus, *How do Investors Place a Value upon Your Business?*, CONNECT, Feb. 2002, <http://www.connect.org/resources/docs/CompanyValuationGuide.pdf>.

<sup>18</sup> Investors will only invest if they believe that the current market price of an asset is not representative of its 'true' value. Thus, an investor's success depends solely on the accuracy of its present value estimations.

<sup>19</sup> In the last twelve years, the HSX reliably predicted Oscar winners across all award categories 82.1 percent of the time. See *Hollywood Stock Exchange Announces its 12<sup>th</sup> Year of Trading Nominees for the Academy Awards*, CANTOR FITZGERALD, Dec. 16, 2009, [http://www.cantor.com/press\\_releases/Hollywood\\_Stock\\_Exchange\\_Announces\\_Its\\_12th\\_Year\\_Of\\_Trading\\_Nominees\\_For\\_The\\_Academy\\_Awards.html](http://www.cantor.com/press_releases/Hollywood_Stock_Exchange_Announces_Its_12th_Year_Of_Trading_Nominees_For_The_Academy_Awards.html). Additionally, the HSX correctly forecasts many surprise hits and unexpected flops. For example, the HSX predicted the enormous commercial success of the original *Pirates of the Caribbean* movie well before audiences met Johnny Depp's Captain Jack Sparrow. Prior to its release, the HSX expected that *Pirates of the Caribbean: Dead Man's Chest* would earn between \$110.7 and \$138.6 million in its opening weekend—at the box office; it earned \$135.6 million in Domestic Box Office Receipts ("DBOR"). One month after the film's release, 21,641 unique HSX users owned shares of the *Pirates* stock. See Rachael King, *Hollywood Games People Play*, BLOOMBERG BUSINESSWEEK, Aug. 7, 2006, [http://www.businessweek.com/technology/content/aug2006/tc20060804\\_618481.htm?chan=top+news\\_top+news](http://www.businessweek.com/technology/content/aug2006/tc20060804_618481.htm?chan=top+news_top+news). The HSX also had the foresight to expect that Robert Pattinson's *Remember Me* would be an enormous flop—earning only \$38 million in its first weekend—even though the HSX was correct too, in its prediction that his superstardom at the center of the *Twilight* teen-craze would, only three months later, earn almost \$280 million in the opening weekend of its third installment, *The Twilight Saga: Eclipse*. See Mandy, *Hollywood Stock Exchange Predicts Rob's Movies Box Office Intake*, ROBERT PATTINSON LIFE (Jan. 19, 2010, 5:10 AM), <http://robpattinson.blogspot.com/2010/01/hollywood-stock-exchange-predicts-rops.html>.

<sup>20</sup> See David M. Pennock et al., *The Power of Play: Efficiency and Forecast Accuracy in Web Market Games*, 291 *Science* 987-88 (Feb. 9, 2001), <http://artificialmarkets.com/am/pennock-neci-tr-2000-168/> (finding that the HSX correctly predicted actual DBOR 93.1% of the time).

<sup>21</sup> Indirectly, major studios such as MGM and Lions Gate Entertainment already use the HSX DBOR estimates to inform their marketing and advertising decisions. See Rachael King, *Hollywood Games People Play*, BLOOMBERG BUSINESSWEEK, Aug. 7, 2006, [http://www.businessweek.com/technology/content/aug2006/tc20060804\\_618481.htm?chan=top+news\\_top+news](http://www.businessweek.com/technology/content/aug2006/tc20060804_618481.htm?chan=top+news_top+news).

purchased the HSX with the specific intent to translate the HSX model into a real world futures market, ‘The Cantor Exchange.’<sup>22</sup> But tragically, these plans were halted by the September 11 terrorist attacks, which crippled Cantor Fitzgerald and were responsible for the loss of 658 Cantor employees.<sup>23</sup> As a result of this catastrophe, Cantor Fitzgerald did not return to its film futures endeavor until 2007, when it hired futures expert Richard Jaycobs to lead its regulatory approval efforts.<sup>24</sup> Coincidentally, Robert Swagger, the Chairman and CEO of Veriana Networks, Inc., began making similar plans for the regulatory approval of ‘The Trend Exchange,’ the film futures endeavor led by Veriana’s subsidiary, Media Derivatives.<sup>25</sup>

Unfortunately, both Cantor Fitzgerald and Media Derivatives chose to pursue their film futures exchanges in a financial and regulatory climate that was very different from the *laissez-faire* atmosphere that existed in 2001.<sup>26</sup> Nonetheless, in 2009, with the nation still reeling from the 2007 subprime mortgage crisis, the CFTC began the regulatory approval process for film futures, hosting ‘commenting periods’ to serve as public fora to discuss the issues and concerns of a film futures exchange.<sup>27</sup> Most significantly, the CFTC hosts these commenting periods as part of its application process to provide a futures exchange applicant with the opportunity to work with any critics of the proposed exchange to address and accommodate material concerns before it is too late for an applicant to adjust the rules and mechanisms of

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<sup>22</sup> See Andrei Narcis, *The Hollywood Stock Exchange*, REFERAT, May 29, 2004, [http://www.referat.ro/referate/The\\_Hollywood\\_Stock\\_Exchange\\_5624.html](http://www.referat.ro/referate/The_Hollywood_Stock_Exchange_5624.html).

<sup>23</sup> See CANTOR FITZGERALD CHARITIES, <http://www.cantor.com/public/charities> (last visited Mar. 21, 2011).

<sup>24</sup> See *id.*

<sup>25</sup> See *id.*

<sup>26</sup> In 2001, concerns about regulatory approval did not exist, since Congress had just passed the Commodity Futures Modernization Act of 2000, which adopted a very broad approval process that led to the authorization of credit default swaps and other ‘exotic’ financial devices. See Daniel Frankel, *The Rise & Plunge of Movie Futures Trading*, THE WRAP, Aug. 15, 2010, <http://www.thewrap.com/movies/article/rise-plunge-movie-futures-trading-20094?page=0,0>. Moreover, in 2007, the subprime mortgage crisis devastated the United States economy and destroyed consumer confidence and public opinions of Wall Street investment banking. E.g. Jim Brown, *Public Outcry Continues Over AIG Greed, Wall Street Bailout*, ONENEWSNOW, Oct. 13, 2008, <http://www.onenewsnow.com/Politics/Default.aspx?id=281986>. Today, the United States is still recovering from the damage that the crisis caused. See *The Financial Crisis: A Timeline of Events and Policy Actions*, FEDERAL RESERVE BANK OF ST. LOUIS, <http://timeline.stlouisfed.org/pdf/CrisisTimeline.pdf> (last visited Oct. 26, 2010).

<sup>27</sup> See Daniel Frankel, *The Rise & Plunge of Movie Futures Trading*, THE WRAP, Aug. 15, 2010, <http://www.thewrap.com/movies/article/rise-plunge-movie-futures-trading-20094?page=0,1>. The Trend Exchange and Cantor Exchange commenting periods were open from Sept. 25, 2009 to Nov. 5, 2009, and Nov. 28, 2008 to Jan. 28, 2009, respectively. See Dan M. Berkovitz, General Counsel, CFTC, Test. before the H. Subcomm. on Gen. Farm Comm. and Risk Mgmt (Apr. 22, 2010), available at <http://agriculture.house.gov/testimony/111/h042210/Berkovitz.pdf>.

its exchange.<sup>28</sup> Unlike most areas of investment banking, the devastation of the financial crisis did not materially harm futures markets.<sup>29</sup> Thus, even amidst the public outrage and condemnation of financial institutions, film futures were not criticized by the public or government.<sup>30</sup> In fact, Swagger and Jaycobs used these commenting periods as a platform to emphasize and clarify the need for a film futures exchange amidst uncertain financial times. For example, Swagger explained that “Hollywood financing deals, which traditionally are murky propositions, have become especially difficult to obtain after the economic meltdown.”<sup>31</sup>

Perhaps what is most curious about these public commenting periods is the silence of the MPAA,<sup>32</sup> who in 2010—well after the CFTC-sponsored commenting periods on film futures had expired—would become one of the most vocal critics of film futures.<sup>33</sup> The MPAA’s silent acceptance of film futures in 2009 could largely be attributed to its Chairman and CEO from 2004 to early 2010, Dan Glickman,<sup>34</sup> who both Cantor Fitzgerald and Media Derivatives perceived as an advocate of film futures, or at

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<sup>28</sup> See Dan M. Berkovitz, General Counsel, CFTC, Test. before the H. Subcomm. on Gen. Farm Comm. and Risk Mgmt (Apr. 22, 2010), *available at* <http://agriculture.house.gov/testimony/111/h042210/Berkovitz.pdf>. DCM applications are available at Industry Filings, CFTC, <http://services.cftc.gov/sirt/sirt.aspx?Topic=TradingOrganizations> (last visited Nov. 14, 2010). Public comments are available at Public Comments, CFTC, <http://comments.cftc.gov/PublicComments/ReleasesWithComments.aspx> (last visited Nov. 14, 2010).

<sup>29</sup> See *Futures Industry Association Encourages Fair Treatment of Movie Futures*, FIA, Apr. 8, 2010, <http://www.futuresindustry.org/?i=1503> (explaining that “one of the principal lessons of the recent financial crisis is that futures markets performed flawlessly under the highest levels of stress”).

<sup>30</sup> See *Richard Jaycobs Comments: Movie Futures Trying to Make Their Way to Trading Screens*, CANTOR FITZGERALD, Nov. 9, 2009, [http://www.cantor.com/press\\_releases/Richard\\_Jaycobs\\_Comments\\_Movie\\_Futures\\_Trying\\_To\\_Make\\_Their\\_Way\\_To\\_Trading\\_Screens\\_-\\_The\\_Chicago\\_Tribune.html](http://www.cantor.com/press_releases/Richard_Jaycobs_Comments_Movie_Futures_Trying_To_Make_Their_Way_To_Trading_Screens_-_The_Chicago_Tribune.html) (stating that the 2009 commenting periods were “uneventful”).

<sup>31</sup> *Id.* Media Derivatives also discussed that “the U.S. recession has reduced financing [by studios] for movies, which cost an average of \$107 million each to make in 2007.” Todd Shields, *Film Futures Market Approved Over Studio Objections*, BLOOMBERG LAW, Apr. 16, 2010, <https://www.bloomberglaw.com/link/load/document/LOZNV0D9L35>. Nonetheless, Swagger observed, “every other segment has had a means to offset risk . . . [but] the entertainment industry [does] not.” *Id.*

<sup>32</sup> The MPAA “serves as the voice and advocate of the American motion picture.” MPAA ABOUT US, <http://mpaa.org/about> (last visited Oct. 26, 2010). Six major motion picture studios are members of the MPAA: Walt Disney Studios; Paramount Pictures Corporation; Sony Pictures Entertainment Inc.; Twentieth Century Fox Film Corporation; Universal City Studios LLLP; and Warner Bros. Entertainment Inc. *Id.*

<sup>33</sup> See Daniel Frankel, *The Rise & Plunge of Movie Futures Trading*, THE WRAP, Aug. 15, 2010, <http://www.thewrap.com/movies/article/rise-plunge-movie-futures-trading-20094?page=0,1> (stating that Pisano “vigorously oppos[ed] [film futures] markets”).

<sup>34</sup> Prior to his position at the MPAA, Glickman was the United States Secretary of Agriculture from 1995 to 2001. Dan Glickman (1995-2001): Secretary of Agriculture, MILLER CENTER OF PUBLIC AFFAIRS, <http://millercenter.org/academic/americanpresident/clinton/essays/cabinet/721> (last visited Oct. 26, 2010).

least someone who would not object to the existence of such an exchange.<sup>35</sup> Unfortunately, in an ironic twist of fate, this likely supporter of a film futures exchange was replaced by a critical adversary and strong voice against the trading of film futures, MPAA COO Robert Pisano.<sup>36</sup>

Once Pisano officially became the MPAA's interim CEO, the MPAA took every opportunity to speak in opposition to the CFTC's regulatory approval of the Cantor Fitzgerald and Media Derivatives film futures exchanges.<sup>37</sup> But at the end of March, despite the MPAA's efforts, the CFTC's approval of film futures trading seemed imminent.<sup>38</sup> In response, the MPAA shifted its focus away from the CFTC, and instead, embarked on an extensive campaign to lobby Congress for a statutory ban of film futures trading that would effectively supersede the CFTC's anticipated approval.<sup>39</sup>

Unlike its discussions with the CFTC, the MPAA's lobbying efforts quickly succeeded in drawing the bipartisan attention and support of Congress, who was concerned that the authorization of

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<sup>35</sup> See Daniel Frankel, *The Rise & Plunge of Movie Futures Trading*, THE WRAP, Aug. 15, 2010, <http://www.thewrap.com/movies/article/rise-plunge-movie-futures-trading-20094?page=0,1> (highlighting that “[u]nder Glickman's watch, two CFTC public commenting periods on the proposed futures markets came and went in 2009 without MPAA opposition”).

<sup>36</sup> On April 1, 2010, Pisano became the President and Interim CEO of the MPAA. See Sharon Waxman, *Glickman Leaves MPAA, Pisano Interim Chief*, THE WRAP, Jan. 22, 2010, <http://www.thewrap.com/deal-central/column-post/glickman-leaves-mpaa-pisano-interim-chief-13371>. Prior to joining the MPAA, Pisano was National Executive Director and CEO of the Screen Actors Guild from 2001-2005. See MPAA ABOUT US—PRESIDENT AND INTERIM CEO, <http://mpaa.org/about/ceo> (last visited Oct. 26, 2010).

<sup>37</sup> The MPAA spoke out against film futures on behalf of: itself; the DGA; the IFTA; the IATSE; and NATO in meetings on Apr. 22, 2010, with the House Subcommittee on General Farm Commodities and Risk Management, and again on May 19, 2010, with the CFTC. Pisano Testimony, *supra* note 3. Scott Harbinson, International Representative of the IATSE, also opposed a film futures exchange at these meetings. House Committee on Agriculture Opening Statements, <http://agriculture.house.gov/hearings/statements.html> (Apr. 22, 2010). See also *Public Meeting to Consider the Trading of Contracts Based on Motion Picture Box Office Receipts and Gather Views of Interested Parties*, CFTC, May 19, 2010, <http://www.cftc.gov/PressRoom/Events/agenda051910.html> [hereinafter “Meetings”]. Speaking in favor of a film futures exchange were: Richard Jaycocks, Robert Swagger, Michael Burns, Schuyler M. Moore, Partner at Stroock & Stroock & Lavan LLP, and a number of other speakers with experience in motion picture financing and futures markets. *Id.* At both meetings, the MPAA extensively criticized film futures exchanges for being nothing more than legalized gambling that had no resemblance to a legitimate futures market that—if authorized—would only serve to create new, material risks in the motion picture industry that speculators could easily manipulate. Pisano Testimony, *supra* note 3. See also Robert Pisano, Interim CEO, MPAA, Statement before the CFTC (May 19, 2010), [http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/publicmeeting051910\\_pisano.pdf](http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/publicmeeting051910_pisano.pdf).

<sup>38</sup> See Daniel Frankel, *The Rise & Plunge of Movie Futures Trading*, THE WRAP, Aug. 15, 2010, <http://www.thewrap.com/movies/article/rise-plunge-movie-futures-trading-20094?page=0,1>.

<sup>39</sup> Since 2006, the MPAA has spent \$2 million annually on its Congressional lobbying efforts creating a “suction” over Congress on issues regarding MPAA interests. See Nick Baumann, *Hollywood's Big Wall Street Smackdown*, MOTHER JONES, Apr. 26, 2010, <http://motherjones.com/politics/2010/04/big-hollywoods-wall-street-smackdown>.

a film futures exchange could conflict with the primary objectives of its impending financial reform legislation, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Wall Street Reform Act”).<sup>40</sup> On April 16, 2010,<sup>41</sup> as a result of the concerned voices of the MPAA and its constituents, former Sen. Blanche Lincoln (D – Ark.) –a film futures critic and Chairman of the Senate Agriculture, Nutrition and Forestry Committee<sup>42</sup>–wrote a provision into the latest draft of the Wall Street Reform Act that effectively banned all domestic trading of film futures.<sup>43</sup> The majority of Congress rose in support of this provision.<sup>44</sup>

<sup>40</sup> At the time, Congress was in the final stages of completing the Wall Street Reform Act, a sweeping financial reform legislation that focused primarily on increasing accountability and decreasing investment risk, particularly with regard to the “exotic instruments such as derivatives” that fueled the financial crisis. *Dodd Praises House Passage of Wall Street Reform*, June 30, 2010, <http://dodd.senate.gov/?q=node/5701>. In April 2010, Sen. Dianne Feinstein (D – Calif.) and Sen. Barbara Boxer (D - Calif.) wrote a letter to the CFTC urging the CFTC to delay its approval of film futures trading until Congress could complete this legislation. See Nick Baumann, *Hollywood’s Big Wall Street Smackdown*, MOTHER JONES, Apr. 26, 2010, <http://motherjones.com/politics/2010/04/big-hollywoods-wall-street-smackdown>; see also Daniel Frankel, *New Opposition to Movie Futures Trading: Congress*, THE WRAP, Apr. 6, 2010, <http://www.thewrap.com/movies/article/new-opposition-movie-futures-trading-congress-16013>. The CFTC agreed to extend its review of film futures by one week, but ultimately approved both exchanges prior to the completion of Congress’s financial reform legislation. See Daniel Frankel, *10 Key Moments in the Life of Movie Derivatives*, THE WRAP, Aug. 13, 2010, <http://www.thewrap.com/movies/article/10-key-moments-life-movie-derivatives-20122>; Todd Shields, *U.S. Agrees to Extend Review of Box-Office Futures Contracts*, BLOOMBERG BUSINESSWEEK, June 7, 2010, <http://www.businessweek.com/news/2010-06-07/u-s-agrees-to-extend-review-of-box-office-futures-contracts.html>.

<sup>41</sup> See Ben Fritz, *Legislation Proposed to Ban Box-office Futures*, L.A. TIMES, Apr. 16, 2010, <http://latimesblogs.latimes.com/entertainmentnewsbuzz/2010/04/legislation-proposed-to-ban-box-office-futures.html>.

<sup>42</sup> BIOGRAPHY OF BLANCHE LAMBERT LINCOLN, <http://lincoln.senate.gov/about/Biography.cfm> (last visited Oct. 26, 2010). Sen. Lincoln’s sister, Mary Lambert, is a movie director, writer, and producer. Mary Lambert, IMDB, <http://www.imdb.com/name/nm0005116/> (last visited Oct. 26, 2010). Swagger and Jaycobs criticized Sen. Lincoln for writing the ban without sufficient knowledge as both a “Hollywood handout,” and a favor to Sen. Feinstein that was motivated by Sen. Lincoln’s difficulty gaining support for her unsuccessful 2010 re-election. See Daniel Frankel, *The Rise & Plunge of Movie Futures Trading*, THE WRAP, Aug. 15, 2010, <http://www.thewrap.com/movies/article/rise-plunge-movie-futures-trading-20094?page=0,1>; Bruce Drake, *Blanche Lincoln’s Prospects for Re-Election Look Dim in Arkansas Senate Race*, POLITICS DAILY, Feb. 2, 2010, <http://www.politicsdaily.com/2010/02/02/blanche-lincolns-prospects-for-re-election-look-dim-in-arkansas/>. See also Jon Walker, *In Re-election Bid, Blanche Lincoln Getting Crushed By John Boozman, Says New Poll*, FDL, Feb. 2, 2010, <http://elections.firedoglake.com/2010/02/02/in-re-election-bid-blanche-lincoln-getting-crushed-by-john-boozman-says-new-poll/>.

<sup>43</sup> Mechanically, Congress banned film futures in the Act by amending the CEA definition of a ‘commodity’ to explicitly exclude motion picture box office receipts. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 721(a)(4), 124 Stat. 1376.

<sup>44</sup> Addressing the most widespread concern of film futures trading, Sen. Patrick Leahy (D – VA) and Sen. Orrin Hatch (R – UT) warned Congress that the CFTC’s anticipated authorization of a film futures exchange will encourage “risky and manipulative behavior” that, as Rep. Collin Peterson (D – Minn.) clarified, would “basically authoriz[e] gambling.” Todd Shields, *Film Futures Market Approved Over Studio Objections*, BLOOMBERG LAW, Apr. 16, 2010, <https://www.bloomberglaw.com/link/load/document/L0ZNKV0D9L35>. Members of

Swagger and Jaycobs met individually with over one hundred representatives of the House to request additional time to properly analyze and discuss the concerns regarding film futures before Congress decided on the ban, but these efforts were fruitless.<sup>45</sup> Jaycobs and Swagger explained that, while the House representatives agreed that film futures shared no similarities with the risky instruments that caused the financial crisis, most were hesitant to take action because of the negative political implications they would inevitably face in an election year by standing in support of a new, obscure financial exchange that was being compared to gambling and the financial crisis.<sup>46</sup> Furthermore, Jaycobs and Swagger criticized Lincoln for adding the film futures ban as a “last minute line item” that she did not truly understand.<sup>47</sup>

Nonetheless, the Congressional authorization of the Wall Street Reform Act went along as planned, with the film futures ban still in place. The House passed the Act in a 237-192 vote on June 30, 2010,<sup>48</sup> followed by the Senate on July 15, 2010 (60-39).<sup>49</sup> Shortly after—on July 21, 2010—President Obama signed the Wall Street Reform Act into law,<sup>50</sup> effectively halting all current domestic film futures exchange endeavors for the foreseeable future.<sup>51</sup>

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Congress also questioned the ability of DBOR to meet the CEA’s definition of a ‘commodity.’ See Nick Baumann, *Hollywood’s Big Wall Street Smackdown*, MOTHER JONES, Apr. 26, 2010, <http://motherjones.com/politics/2010/04/big-hollywoods-wall-street-smackdown>.

<sup>45</sup> At that point, Swagger and Jaycobs suggested that film futures were guilty by association to credit-default swaps. See Daniel Frankel, *The Rise & Plunge of Movie Futures Trading*, THE WRAP, Aug. 15, 2010, <http://www.thewrap.com/movies/article/rise-plunge-movie-futures-trading-20094?page=0,2>.

<sup>46</sup> See *id.*

<sup>47</sup> Swagger accused the MPAA of using its political clout to add this “last-minute line-item.” Bob Strauss, *Firms Want to Bet on Movie Futures, but Studios and the MPAA Say it Won’t Work*, L.A. DAILY NEWS, Apr. 26, 2010, [http://www.dailynews.com/news/ci\\_14959368](http://www.dailynews.com/news/ci_14959368). Senator Lincoln was also criticized for a separate issue regarding the Wall Street Reform Act by other financial experts, who, like Jaycobs and Swagger, criticized Lincoln for making a hasty decision on a complex derivatives issue she did not fully understand. See Damian Paletta, *Dodd, Lincoln Try to Quell Derivatives Fury*, WALL STREET JOURNAL BLOGS, July 1, 2010, <http://blogs.wsj.com/washwire/2010/07/01/dodd-lincoln-try-to-quell-derivatives-fury/>.

<sup>48</sup> U.S. House of Representatives Final Vote Results for Roll Call 413, Agreeing to the Conf. Rep. on the Wall Street Reform Act, June 30, 2010, <http://clerk.house.gov/evs/2010/roll413.xml>.

<sup>49</sup> U.S. Senate Final Vote Results for Vote Number 208, Agreeing to the Conf. Rep. on the Restoring American Financial Stability Act of 2010, July 15, 2010, [http://www.senate.gov/legislative/LIS/roll\\_call\\_lists/roll\\_call\\_vote\\_cfm.cfm?congress=111&session=2&vote=00208](http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=111&session=2&vote=00208).

<sup>50</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 721(a)(4), 124 Stat. 1376 (the “Wall Street Reform Act”). See also Jesse Lee, *President Obama Signs Wall Street Reform: “No Easy Task”*, THE WHITE HOUSE BLOG, July 21, 2010, <http://www.whitehouse.gov/blog/2010/07/21/president-obama-signs-wall-street-reform-no-easy-task>.

<sup>51</sup> Media Derivatives has shifted its film futures efforts to foreign markets. See Michael White, *Movie Futures May be Revived as Promoter Eyes Foreign Markets*, BLOOMBERG

## II. BACKGROUND AND DEFINITIONS

### A. *A Brief History of Futures Trading*

Contrary to what its name may suggest, trading in futures has ancient roots that can be traced back to Aristotle's renowned work, *Politics*, in which Aristotle described the first known futures contract as a "financial device [that] involve[d] a principle of universal application."<sup>52</sup> Since then, cultures around the world have used futures contracts throughout history to hedge and speculate.<sup>53</sup> In the 1800s, the Chicago Board of Trade approved the first official futures contract in the United States.<sup>54</sup> Today, the trading of futures continues to flourish in the United States, and now encompasses a wide range of asset classes.<sup>55</sup>

### B. Commodity Futures Trading, Generally

A 'futures contract' is a standardized contract between two parties to buy or sell a specific asset in the future (of identical quality and quantity) at a predetermined price and date.<sup>56</sup> All

BUSINESSWEEK, Aug. 2, 2010, <http://www.businessweek.com/news/2010-08-02/movie-futures-may-be-revived-as-promoter-eyes-foreign-markets.html>. *But see* Rutam Vora, *Hollywood Futures on, Bollywood Says No*, COMMODITY ONLINE, <http://www.commodityonline.com/news/Hollywood-Futures-on-Bollywood-says-no-27499-3-1.html> (stating that key figures in India's Bollywood have raised concerns about a film futures exchange that are analogous to those raised by the MPAA and Congress). Cantor Fitzgerald, on the other hand, abandoned The Cantor Exchange prior to Obama's signage. *See* Ira Teinowitz, *Cantor Exchange Backs Away from Hollywood*, THE WRAP, June 28, 2010, <http://www.thewrap.com/movies/column-post/cantors-movie-futures-trading-gets-ok-18803>.

<sup>52</sup> In *Politics*, a philosopher, Thales, speculated that the olive crop would be particularly large, and acted on his estimation by taking a 'long' position in olives, buying every olive press in Miletus. When Thales' predictions proved to be correct, he made a considerable profit. Aristotle, *POLITICS* Book 1, Part 11 (Benjamin Jowett trans.), *available at* <http://classics.mit.edu/Aristotle/politics.1.one.html>.

<sup>53</sup> For example, in the late 17<sup>th</sup> and 18<sup>th</sup> centuries, members of the Japanese Samurai class engaged in extensive futures trading on the D jima Rice Exchange. Since the samurai were paid in rice, not coin, the samurai used the D jima Rice Exchange to hedge against unexpected price fluctuations in rice to stabilize the coin value of their salaries. *See* Ulrike Schaeede, *Forwards and Futures in Tokugawa-period Japan: A New Perspective on the D jima Rice Market*, 13 J. OF BANKING & FIN. 487, 487-513 (1989), *available at* [http://www.sciencedirect.com/science?\\_ob=MIimg&\\_imagekey=B6VCY-46R0F48-2-4&\\_cdi=5967&\\_user=1683300&\\_pii=0378426689900289&\\_origin=search&\\_coverDate=09%2F30%2F1989&\\_sk=999869995&view=c&wchp=dGLbVzb-zSkzS&md5=87c72a94a12652ea5609071a48ff4795&ie=/sdarticle.pdf](http://www.sciencedirect.com/science?_ob=MIimg&_imagekey=B6VCY-46R0F48-2-4&_cdi=5967&_user=1683300&_pii=0378426689900289&_origin=search&_coverDate=09%2F30%2F1989&_sk=999869995&view=c&wchp=dGLbVzb-zSkzS&md5=87c72a94a12652ea5609071a48ff4795&ie=/sdarticle.pdf).

<sup>54</sup> On April 3, 1848, the Chicago Board of Trade approved a futures contract for grain. HISTORY OF THE CFTC, <http://www.cftc.gov/About/HistoryoftheCFTC/index.htm> (last visited Nov. 14, 2010).

<sup>55</sup> There are currently thirteen major futures exchanges in the United States. *See* List of Futures Exchanges, ACADEMIC DICTIONARIES AND ENCYCLOPEDIAS, <http://en.academic.ru/dic.nsf/enwiki/1270653> (last visited Nov. 22, 2010). Some of the most popular asset classes exchanged on these markets include: agriculture, energy, and metals. *See* Most Commonly Traded Commodities, INVESTORGUIDE.COM, <http://www.investorguide.com/igu-article-1139-investing-basics-what-are-the-most-commonly-traded-commodities.html> (last visited Nov. 22, 2010).

<sup>56</sup> Futures Contract Definition, INVESTOPEDIA, <http://www.investopedia.com/terms/f/futurescontract.asp> (last visited Oct. 26, 2010).

futures contracts are traded on a commodity futures exchange and can be completed either by physical delivery or in a cash settlement.<sup>57</sup> Unlike a ‘traditional’ market, where actual commodities are bought and sold; a futures market only deals with the purchase and sale of *contracts* for actual commodities.<sup>58</sup> Thus, no immediate transfer of ownership occurs when an investor buys or sells a futures contract. In practice, this means that an investor can participate on a futures exchange even if they do not own the actual underlying commodity they plan to trade.<sup>59</sup> Since futures exchanges are characterized by this unique quality of *pseudo-ownership*,<sup>60</sup> it is not surprising that nearly all futures contracts are settled in cash, not physical delivery.<sup>61</sup>

Futures contracts serve two related functions: (1) hedging and (2) speculating.<sup>62</sup> Although hedging and speculating are closely related, the differences and interaction between the two are noteworthy to understand the mechanics of a futures exchange.

Hedging—the primary reason for futures trading—is a stabilizing tool that offsets risk.<sup>63</sup> People who hedge in a commodity futures exchange (“hedgers”) have a stake in the underlying asset, and hedge to shield that stake from harmful, unpredictable price changes.<sup>64</sup> In exchange for using this risk-blocking shield, hedgers forfeit their opportunity to reap the rewards of a favorable, unexpected price change.<sup>65</sup>

Speculating, on the other hand, can be characterized as an

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<sup>57</sup> A commodity futures exchange is a public market where futures are bought and sold through a broker at a standardized price, quantity, and delivery date. See ROBERT L. LERNER, THE MECHANICS OF THE COMMODITY FUTURES MARKETS: WHAT THEY ARE AND HOW THEY FUNCTION 1 (Timothy J. Rudderow ed., Mount Lucas Mgmt. Corp. 2000) (2000), available at [http://www.turtletrader.com/beginners\\_report.pdf](http://www.turtletrader.com/beginners_report.pdf).

<sup>58</sup> See *id.*

<sup>59</sup> See *id.*

<sup>60</sup> In that owners of a futures contract do not own the actual commodity, but rather just a contract to buy or sell it at some specified future date.

<sup>61</sup> In fact, less than two percent of all futures contracts are settled by physical delivery. See ROBERT L. LERNER, THE MECHANICS OF THE COMMODITY FUTURES MARKETS: WHAT THEY ARE AND HOW THEY FUNCTION 1 (Timothy J. Rudderow ed., Mount Lucas Mgmt. Corp. 2000) (2000), available at [http://www.turtletrader.com/beginners\\_report.pdf](http://www.turtletrader.com/beginners_report.pdf).

<sup>62</sup> See *id.* at 4-5.

<sup>63</sup> See *id.* at 4.

<sup>64</sup> See *id.* at 4.

<sup>65</sup> For example, suppose that it is currently May, where the price for wheat is \$4.00 and the futures price for wheat in August (“August Wheat”) is \$4.10. In this situation, a wheat farmer who wants to sell 20,000 bushels of wheat in August could hedge against the risk of August Wheat falling below \$4.10/bushel by selling 20,000 bushels of August Wheat futures today (in May) at the \$4.10 futures price. In doing so, the wheat farmer has secured a \$4.10/bushel revenue stream for August Wheat. Thus, if the true price for August Wheat is only \$3.90, the wheat farmer will have protected itself from an unexpected \$0.20/bushel loss. However, if the true price for August Wheat appreciated to \$4.60, the wheat farmer must still sell its wheat at \$0.50/bushel below the market price because in removing its risk of August Wheat falling below \$4.10, the farmer forfeited its chance to reap the unexpected \$0.50 reward.

investment mechanism to assume the risks that hedgers look to offset.<sup>66</sup> Unlike hedgers, who are risk-averse, people who speculate on a commodity futures exchange (“speculators”) are typically risk-*welcoming* investors who do not have a pre-existing interest in the underlying asset.<sup>67</sup> ‘Welcoming’ risk may appear to be somewhat of a misnomer, but it is important to keep in mind that not all risks are ‘bad’ risks; a ‘risk’ is simply the chance of some event happening in the future.<sup>68</sup> Speculators closely examine each risk that hedgers may want to offset to determine whether that risk is ‘good’ or ‘bad.’<sup>69</sup> Thus, speculators will only choose to assume the ‘good’ risks that they believe will likely result in a favorable return on investment.<sup>70</sup>

Another way of understanding futures hedging and speculation is in terms of exposure to a particular market. A hedger has a pre-existing interest in a particular underlying asset, which exposes it to the risks and rewards of that asset’s market. Hedgers are concerned about this risk, and aim to reduce their exposure to it in order to secure a more stable, predictable income.<sup>71</sup> Speculators, on the other hand, are more interested in the potential rewards of a particular market; they are not as concerned with the inherent risk of the market because they have little to no pre-existing exposure to it. In sum, speculators invest in futures to expose themselves to the potential rewards that accompany the uncertainties that hedgers want to avoid.

### C. *Film Futures, Specifically*

A film future is simply a commodity futures contract for the

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<sup>66</sup> See ROBERT L. LERNER, *THE MECHANICS OF THE COMMODITY FUTURES MARKETS: WHAT THEY ARE AND HOW THEY FUNCTION* 5 (Timothy J. Rudderow ed., Mount Lucas Mgmt. Corp. 2000) (2000), available at [http://www.turtletrader.com/beginners\\_report.pdf](http://www.turtletrader.com/beginners_report.pdf).

<sup>67</sup> See *id.* at 5.

<sup>68</sup> BLACK’S LAW DICTIONARY 626 (9th ed. 2009) (defining “risk” as the uncertainty of a result).

<sup>69</sup> Since speculators are independently responsible for their determinations of ‘good’ and ‘bad’ risks, they are often experts on the industries they invest in, and are finely tuned to relevant current events.

<sup>70</sup> Consider the position of a wheat speculator who exists in the same world as the hedging farmer. See *supra* note 65. Unlike the farmer, who invested in futures to hedge against unexpected drops in the value of his crop, here, the wheat speculator has no initial exposure to the wheat industry. As such, a wheat speculator who expects that the price of August Wheat will rise above the \$4.10/bushel futures price could speculate on this price expectation by purchasing 20,000 bushels (or any other amount) of August Wheat futures; a position that would then expose the speculator to the risks and rewards of the wheat industry. Accordingly, if the true price for August Wheat appreciated to \$4.60, the speculator would be able to settle its wheat futures contracts for a favorable cash settlement (or physical delivery) and enjoy a net gain of \$0.50/bushel. Conversely, if the true price of August Wheat was only \$3.90, the speculator would face a \$0.20/bushel loss, since it would now have to settle its contracts—to investors like the wheat farmer and others who *sold* August Wheat futures—for an amount below the speculator’s initial \$4.10/bushel investment.

<sup>71</sup> See *supra* note 24.

DBOR of a motion picture's theatrical debut.<sup>72</sup> Unlike the various physical commodities that trade on futures exchanges, such as corn, oil, and wheat, the relevant commodity in a film futures contract is an intangible financial instrument—DBOR—whose final value is tied directly to the domestic box office revenue from ticket sales of the underlying motion picture. Thus, any film futures contract is an agreement to buy or sell DBORs at the agreed-upon price, regardless of its market value at the time that cash settlement is due. In this respect, film futures are akin to futures contracts for stock indexes,<sup>73</sup> United States treasury bonds (“T-bonds”),<sup>74</sup> and other ‘nontraditional’ commodities<sup>75</sup> that are commonplace on most futures exchanges.

Since the interest and scope of motion picture projects vary greatly,<sup>76</sup> the financial company in charge of the film futures exchange—either Cantor Fitzgerald or Media Derivatives—determines which films are eligible to be traded as a future. To ensure a fluid, transparent market that will attract many investors, eligibility requires that films have “sufficient economic interest.”<sup>77</sup> To further enhance trading stability, the film futures exchange has a unique rule that limits the maximum day-to-day price variance of

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<sup>72</sup> Prior to Congress's film futures ban, the CFTC authorized trading for two film futures exchanges: The Cantor Futures Exchange, L.P., owned by Cantor Fitzgerald, and The Trend Exchange, Inc., owned by Media Derivatives, Inc. and privately financed by Veriana Networks. CANTOR EXCHANGE – ABOUT CX, <http://www.cantorexchange.com/About-CX/Cantor-Exchange.aspx> (last visited Oct. 26, 2010); THE TREND EXCHANGE FREQUENTLY ASKED QUESTIONS, [http://www.veriana.com/images/stories/pdf/the\\_trend\\_exchange\\_faqs\\_august\\_2010.pdf](http://www.veriana.com/images/stories/pdf/the_trend_exchange_faqs_august_2010.pdf) (last visited Oct. 26, 2010). Futures on the Cantor Exchange are based on the DBOR from the first four weeks of a motion picture's theatrical debut, while Trend Exchange futures are based only on the DBOR from a film's opening weekend. HSX GLOSSARY, <http://www.hsx.com/help/?page=glossary> (last visited Oct. 26, 2010); THE TREND EXCHANGE FREQUENTLY ASKED QUESTIONS, [http://www.veriana.com/images/stories/pdf/the\\_trend\\_exchange\\_faqs\\_august\\_2010.pdf](http://www.veriana.com/images/stories/pdf/the_trend_exchange_faqs_august_2010.pdf) (last visited Oct. 26, 2010). These exchanges are not materially different. Therefore, for the purpose of this Note, the Cantor Exchange and the Trend Exchange will be discussed as a single, collective film futures exchange, except where otherwise provided.

<sup>73</sup> See *Mallen v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 605 F. Supp. 1105 (D.C.Ga. 1985).

<sup>74</sup> See *Messer v. E. F. Hutton & Co.*, 847 F.2d 673, 674 (11th Cir. 1988) (stating that “treasury bonds and Treasury bills are among the most active new contracts currently traded”).

<sup>75</sup> Nontraditional commodities include commodities based on cash-settled financial instruments. *Conroy v. Andeck Res. '81 Year-End Ltd.*, 484 N.E.2d 525 (Ill. App. Ct. 1985).

<sup>76</sup> In 2009, the motion picture with the largest production budget was *Harry Potter and the Half-Blood Prince*, which cost \$250 million. See Movie Budget Records, THE NUMBERS, <http://www.the-numbers.com/movies/records/budgets.php> (last visited Oct. 26, 2010). This production budget was \$249.085 million greater than that of the 2009 ‘ sleeper ’ hit, *Paranormal Activity*, which cost only \$15,000. See *id.*

<sup>77</sup> The Cantor Futures Exchange (CX) will take into account factors such as “sufficient economic interest” in a film, how far into production a film might be, and whether it has been designated for release on more than 650 domestic theatres by a major box office tracking service. See Jeremy Juuso, *From Beginning to End: The Life Cycle of a Future on the Cantor Exchange*, THE A.K.A. INDIE FILM BLOG (Apr. 20, 2010, 7:27 PM), <http://jeremyjuuso.blogspot.com/2010/04/from-beginning-to-end-life-cycle-of.html>.

a film future to ten percent (10%).<sup>78</sup> This limit helps mitigate the transitory price volatility that is motivated by panic or excitement, but would still allow for legitimate changes in expectations to take effect over a matter of days.

#### D. Who Would Invest in Film Futures?

As with any market, investment in film futures necessarily involves some element of risk.<sup>79</sup> However, there are a number of reasons why investors might find value in a film futures exchange. For example, suppose the film futures exchange authorizes futures trading for *Avatar II*, the direct sequel to *Avatar*, the most commercially successful film of all time.<sup>80</sup> A few things are known about the film so far: *Avatar II* is in production, currently slated for a 2014 release,<sup>81</sup> and all the stars of the original film are expected to sign on. Furthermore, James Cameron recently announced that he plans travel to The Challenger Deep – the deepest known location in the world<sup>82</sup>—to film parts of *Avatar II* using the signature 3D technology from the original film. While this decision could create tremendous footage, the expedition will be dangerous, incredibly expensive,<sup>83</sup> and is not guaranteed to produce any usable material.

A large theater chain who anticipates a record-breaking turnout for *Avatar II* could benefit by using *Avatar II* film futures to hedge against the risk that the film is not as successful as

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<sup>78</sup> The 10% price change is based on the price a film future settled at 5 PM on the previous day. *See id.* It is debatable whether this ceiling merely delays the inevitable, since a 50% price change may simply take a few days longer for the same end result to be reflected on the exchange. However, particularly in an industry where key negotiations and disputes between actors and directors are often resolved as quickly as they arise, such a ceiling may sufficiently ebb unwarranted, fleeting panic or excitement to ensure a more stable price. For example, Christian Bale's *Terminator: Rise of the Machines* meltdown, which was widely broadcast on the internet, may have raised concerns about turmoil on the set for a day or two, but resolved itself quickly and filming resumed without further issue. *See* Korin Miller, *Holy Audio Tape, Batman! Bale's 'Terminator Salvation' Rant Released*, N.Y. DAILY NEWS, Feb. 2, 2009, [http://www.nydailynews.com/gossip/2009/02/02/2009-02-02\\_holy\\_audio\\_tape\\_batman\\_bales\\_terminator\\_-2.html](http://www.nydailynews.com/gossip/2009/02/02/2009-02-02_holy_audio_tape_batman_bales_terminator_-2.html). *But see* Nadine Shubailat, *McG Defends Christian Bale's 'Terminator' Rant*, ABC NEWS, May 21, 2009, <http://abcnews.go.com/Entertainment/Movies/story?id=7634132&page=1> (defending Bale's rant).

<sup>79</sup> *See* Clayton Reeves, *Introduction to Risk and Return*, GAEBLER, <http://www.gaebler.com/Introduction-to-Risk-and-Return.htm> (last visited Oct. 27, 2010).

<sup>80</sup> *See* All Time Worldwide Box Office Grosses, BOXOFFICEMOJO.COM, <http://boxofficemojo.com/alltime/world/> (last visited Oct. 26, 2010).

<sup>81</sup> *Avatar 2*, IMDB, <http://www.imdb.com/title/tt1630029/> (last visited Oct. 26, 2010).

<sup>82</sup> The Challenger Deep is roughly 36,000 feet deep, which is over a mile deeper than Mt. Everest is tall. Deepest Place in the Ocean – Challenger Deep, EXTREME SCIENCE, <http://www.extremescience.com/zoom/index.php/oceanography/45-deepest-ocean> (last visited Oct. 26, 2010).

<sup>83</sup> To film in The Challenger Deep, Cameron will need a cutting-edge deep-sea submarine that is custom-built to facilitate his filming crew, talent, and 3D filming in the sun-deprived, high pressure ocean bed. *See* Jim Vejvoda, *Avatars of the Deep*, IGN, Sept. 16, 2010, <http://movies.ign.com/articles/112/1121099p1.html>.

expected, either because of The Challenger Deep project, or simply to avoid some unforeseeable risk.<sup>84</sup> Regardless of the specific concerns, the theater chain can shield its revenue stream from any unforeseeable price changes by selling *Avatar II* futures (proportionate to its market share of DBOR) to secure a stable, yet still desirable revenue when *Avatar II* debuts.

A single investor could also find value in trading *Avatar II* futures. For example, an investor who is confident that *Avatar II* will exceed expectations and become an even bigger hit than the original could benefit by purchasing *Avatar II* futures. Conversely, a speculator who is convinced that *Avatar II* will fail to meet expectations—perhaps because he or she expects that the allure of 3-D technology will fade by 2014<sup>85</sup>—could choose instead to sell *Avatar II* futures. In either circumstance, the investor whose speculations are accurate would receive a positive return on investment, while the other could face a loss.<sup>86</sup>

For instance, suppose that the Cantor Exchange lists the price of an *Avatar II* film future at \$100, indicating the current market expectations that *Avatar II* will earn \$100 million in DBOR over its first four weeks of release. Investor A contracts to purchase 10

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<sup>84</sup> The motion picture industry is susceptible to many risks beyond its control that are not unique to the motion picture industry. For instance, the production of a motion picture could easily be materially damaged by a catastrophic natural disaster, such as what occurred during the production of *Waterworld*, starring Kevin Costner, when a large hurricane destroyed a multi-million dollar set. See Bobby Roberts, *The Five Most Pointless Ways Big Budget Movies Blew Millions*, CRACKED, Mar. 20, 2010, [http://www.cracked.com/article\\_18484\\_the-5-most-pointless-ways-big-budget-movies-blew-millions.html](http://www.cracked.com/article_18484_the-5-most-pointless-ways-big-budget-movies-blew-millions.html). Furthermore, there are risks inherent to the motion picture industry, such as the chance of a human error that ruins an expensive ‘one-take’ shot, or the chance of a star being unable to work for some other reason that studios cannot reliably foresee. For example, Warner Brothers could not have foreseen the potential impact of Heath Ledger’s untimely death on its filming of *The Dark Knight* if he had passed away before completing the scenes for his character, The Joker. See Sara Kugler, Amy Westfeldt, & Adam Goldman, *Actor Health Ledger, 28, Found Dead in New York*, U.S.A. TODAY, Jan. 24, 2008, [http://www.usatoday.com/life/people/2008-01-22-heath-ledger-obit\\_N.htm](http://www.usatoday.com/life/people/2008-01-22-heath-ledger-obit_N.htm).

<sup>85</sup> Following *Avatar*’s release, many films quickly converted its footage into 3-D. Some, like Paul Anderson’s *Resident Evil: Afterlife*, even used the same high-tech cameras that *Avatar* made famous. *Resident Evil: Afterlife-Upcoming movies uses James Cameron’s Avatar technology*, CALCUTTA TUBE, <http://caltuttatube.com/resident-evil-afterlife-upcoming-movie-uses-james-camerons-avator-technology/78461/> (last visited Oct. 26, 2010).

<sup>86</sup> As a brief aside, *Avatar II* film shares are, in fact, being actively traded on the HSX. On October 19, 2010, *Avatar II* film shares were trading fairly low on the HSX, at \$229.29, compared to the original *Avatar*’s shares, which closed at \$430.85 on January 11, 2010. *Avatar II* Profile, HSX, <http://www.hsx.com/security/view/AVAT2> (last visited Oct. 26, 2010); *Avatar* Profile, HSX, <http://www.hsx.com/security/view/AVATR> (last visited Oct. 26, 2010). Furthermore, James Cameron recently announced that he will film *Avatar II* and *Avatar III* in a single large production period, which further underscores the importance of risk management though hedging since *Avatar III* will finish filming before the DBOR performance of *Avatar II* is known. See Jim Vejvoda, *Cameron on Avatar’s Future*, IGN, Oct. 20, 2010, <http://movies.ign.com/articles/112/1129216p1.html>. Cameron himself implicitly acknowledged this heightened need for eliminating risk through hedging when he acknowledged the “need to future-proof [those involved in *Avatar II* and *III*] out five or six years to the end of the third film.” *Id.*

*Avatar II* futures, while Investor B contracts to sell 10 *Avatar II* shares, creating a contractual obligation that requires Investors A and B to buy or sell, respectively, 10 *Avatar II* shares for \$100 each at the time that performance is due, regardless of the final market value of an *Avatar II* share. Thus, if *Avatar II* earns \$100 million in DBOR, both investors will break even. However, if *Avatar II* earns \$150 million, then Investor A will receive \$500, since she will purchase 10 *Avatar II* DBOR contracts for \$100 each<sup>87</sup> from investors like Investor B, who will lose \$500 because of her contractual obligation to sell 10 *Avatar II* DBOR contracts for \$100 each, even though they are actually worth \$150.<sup>88</sup>

These examples are but a small sampling of the wide range of potential investors who would enjoy great value from a film futures exchange, using it as a shield against the dangers of the inherently risk-laden motion picture industry. So why did the MPAA and its constituents fight so hard for Congress to outlaw the practice?

### III. *IRON [B]AN*—WHY CONGRESS BANNED FILM FUTURES TRADING

Congress banned the trading of film futures in the Wall Street Reform Act by amending the definition of a “commodity” in Section 1a(4) of the Commodity Exchange Act (“CEA”)<sup>89</sup> to explicitly exclude “motion picture box office receipts” and “any [related] indexe[s], measure[s], value[s], or data.”<sup>90</sup> In its declaration that motion picture box office receipts were no longer commodities, Congress effectively removed all DBOR-related financial instruments and exchanges from the jurisdictional reach of the CFTC, who cannot authorize or regulate the trading of a futures contract that does not actually involve a legitimate commodity.<sup>91</sup>

Congress’s decision to exclude motion picture box office receipts from the definition of a “commodity” reflected the genuine concerns held by many critics of film futures that DBOR did not constitute a legitimate “commodity” for the purposes of trading on a commodity futures exchange.<sup>92</sup> Although this was the only concern that Congress explicitly reflected in its ban of film futures in the Wall Street Reform Act, a number of other factors materially contributed to the demise and decisive ban of film futures trading.

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<sup>87</sup>  $(\$150 - \$100) * 10 = \$500$ .

<sup>88</sup>  $(\$100 - \$150) * 10 = -\$500$ .

<sup>89</sup> 7 U.S.C. § 1a (1936).

<sup>90</sup> The Wall Street Reform Act, *supra* note 50.

<sup>91</sup> 7 U.S.C. § 2 (1936).

<sup>92</sup> See Pisano Testimony, *supra* note 3.

This section will identify, analyze, and discuss the merits and persuasiveness of each key criticism that was responsible for the film futures ban, chiefly: (1) the argument that motion picture box office receipts are not a “commodity;” (2) the concern that a film futures exchange would be easily manipulated and ‘gamed’ by investors; (3) the accusation that film futures trading is essentially legalized gambling; and (4) the damaging comparisons of film futures to the exotic financial instruments that contributed to the present financial crisis.

A. “*Motion Picture Box Office Receipts are not a ‘Commodity’*”

Prior to its Wall Street Reform Act amendment, the CEA defined a “commodity” as:

[W]heat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, [potatoes], wool, wool tops, fats and oils . . . cottonseed [], peanuts, soybeans[], livestock[], and frozen concentrated orange juice, and all other goods and articles, except onions [], and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in.<sup>93</sup>

As the MPAA and other entertainment entities became uncomfortable with the notion of film futures trading, many challenged the ability of motion picture box office receipts to satisfy the requirements of the “commodity” definition; a sentiment that Congress ultimately concurred with and effectuated it into law.<sup>94</sup> More specifically, film futures critics argued that DBOR were not a “commodity” because motion picture box office numbers did not: (1) trade or value “rights or interests,” or (2) have a price-determining function that “reflect[ed] the valuation of articles, rights, and interests that are traded.”<sup>95</sup> Since Part IV will establish that the second critique—the ability of a film futures exchange to provide a price-determining function—is unconvincing,<sup>96</sup> the following analysis will focus exclusively on the inadequacy of the first argument’s reasons for denying the inclusion of DBOR in the definition of a “commodity.”

The first critique proposed that the CFTC should not have authorized film futures trading on a commodity futures exchange because DBOR are not “rights[] [or] interests” under the CEA’s

<sup>93</sup> 7 U.S.C. § 1a(4) (1936).

<sup>94</sup> The Wall Street Reform Act, *supra* note 50. See Nick Baumann, *Hollywood’s Big Wall Street Smackdown*, MOTHER JONES, Apr. 26, 2010, <http://motherjones.com/politics/2010/04/big-hollywoods-wall-street-smackdown>.

<sup>95</sup> *Id.* See also Pisano Testimony, *supra* note 3.

<sup>96</sup> See *supra* Part IV.

definition of a “commodity” since they have no underlying cash market and do not value any other good, right, or interest with an underlying cash market.<sup>97</sup> Although the CEA has no explicit requirement for a commodity to have an underlying cash market, the MPAA argued that this requirement should be inferred, since every commodity that is specifically enumerated in the CEA has an underlying cash market.<sup>98</sup>

This argument is flawed because the CEA explicitly recognizes that not all commodities possess an underlying cash market.<sup>99</sup> Furthermore, Congress specifically intended that the CEA’s definition of a commodity be broadly construed in order to ensure that the valuable public economic functions of futures trading would not be hampered by technicalities.<sup>100</sup> In part, Congress’s comfort with its broad interpretation of a “commodity” can be viewed as a reflection of its confidence in the CFTC to monitor, detect, and remedy any fraud, manipulation, or bad faith that could occur on a commodity futures trading exchange.

Additionally, it is well established that specific enumeration in a statutory provision is not exhaustive when its language indicates otherwise.<sup>101</sup> Here, the language of the CEA indicates that the commodities specifically enumerated are not an exhaustive list because it contains a catch-all provision that includes “all other goods and articles . . . services, rights, and interests in which contracts for future delivery are presently or in the future dealt in.”<sup>102</sup> This residual provision demonstrates that Congress did not intend the enumerated list of commodities to be exhaustive because the provision allows “all other goods and articles,”

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<sup>97</sup> 7 U.S.C. § 1a(4) (1936). Since this branch of § 1a(4) was the only viable route for DBOR to achieve “commodity” status—in that DBOR are not “goods” or “articles”—if DBOR were not legitimate “rights[] or “interests,” the CFTC’s authorization of film futures would be improper and film futures trading would be prohibited.

<sup>98</sup> Pisano Testimony, *supra* note 3. *See also* 7 U.S.C. § 1a(4).

<sup>99</sup> 7 U.S.C. § 1a(13)(ii)(II) (1936) (stating that an “excluded commodity” is a commodity “with no cash market”).

<sup>100</sup> S. REP. NO. 93-1131 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5848, 5859 (stating that the provision granting exclusive jurisdiction to the CFTC incorporated a broad definition of commodities specifically to recognize the value of an expanding futures market). *See also* S. REP. NO. 95-405 (1978), *reprinted in* 1978 U.S.C.C.A.N. 2087, 2101-02 (acknowledging that “the comprehensive framework for exchange-related futures contracts on an ever-expanding number of commodities established in the [Act] of 1974 has worked well”). *See, e.g.,* Conroy v. Andeck Res. ’81 Year-End Ltd., 484 N.E.2d 525 (Ill. App. Ct. 1985) (explaining that Congress amended the CEA precisely to encompass futures markets to cover nontraditional commodities, such as stock index futures).

<sup>101</sup> *See* Chevron U.S.A. Inc. v. Echazabal, 536 U.S. 73, 80-81 (2002) (finding that expressing one item of an associated group does not exclude another left unmentioned). *See, e.g.,* Pearson v. Component Tech. Corp., 247 F.3d 471, 478 (3d Cir. 2001) (finding that the enumerated factors for determining an employer’s liability under 29 U.S.C. § 2101 were not an exhaustive list). *See also* SER Solutions, Inc. v. Masco Corp., 103 Fed.Appx. 483, 489 (4th Cir. 2004) (explaining that the enumerated factors in the fee-shifting provision of 17 U.S.C. § 505 were not intended to be an exhaustive list).

<sup>102</sup> 7 U.S.C. § 1a(4) (1936).

including those not specifically enumerated, as well as any “services, rights and interests,” even though no commodities of that nature are specifically enumerated.<sup>103</sup> Furthermore, it is worth noting from a practical standpoint that the mere fact that Congress amended the CEA’s definition of a “commodity” to *explicitly* enumerate DBOR demonstrates that Congress at least acknowledged the possibility that DBOR would have satisfied its unamended definition.

Based on the foregoing, Congress should recognize DBOR as a legitimate commodity.

B. “*Speculators will ‘Game’ the Futures Exchange*”

Perhaps the most insidious argument raised by advocates of the film futures ban is the concern that, despite the CFTC’s seal of approval, a film futures exchange would nonetheless be readily susceptible to manipulation and abuse, which speculators could ‘game’ for personal profit by influencing consumer behavior to depress box office revenues.<sup>104</sup> This legitimate fear deserves careful consideration, and is particularly poignant in light of how oil speculators were able to influence oil prices in 2008.<sup>105</sup> If film speculators could manipulate futures prices to materially influence the purchasing behavior of movie-goers, this alone would certainly justify a film futures trading ban, since the existence of such a dynamic between investors and movie-goers would directly conflict with the primary purpose of a futures exchange to provide economic benefits to the public. Furthermore, the feared ability of speculators to influence DBOR would risk the financial security of middle-class workers in the motion picture industry who rely on residual income tied to DBOR.

However, the legitimacy of this grave concern rests entirely on the single, shaky presumption that film futures speculators could manipulate box office success. This presumption begs the more fundamental question: “Would movie-goers be influenced

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<sup>103</sup> *Id.*

<sup>104</sup> Pisano Testimony, *supra* note 3; Scott Harbinson, International Representative, Int’l Alliance of Theatrical and Stage Employees, Test. before the H. Subcomm. on Gen. Farm Comm. and Risk Mgmt (Apr. 22, 2010), *available at* <http://agriculture.house.gov/testimony/111/h042210/Harbinson.pdf>.

<sup>105</sup> In the summer of 2008, the price of oil reached a record high of \$147 per barrel. See Melinda Peer, *Speculators Drive Up Oil Prices*, FORBES, Aug. 28, 2009, <http://www.forbes.com/2009/08/28/oil-market-speculation-markets-commodities-cftc.html>. At a June 17, 2008 Congressional hearing on the energy industry, the assembled panel of experts unanimously agreed that oil speculation was responsible for the artificially-high oil prices. See Herman K. Trabish, *How Oil Speculators Drive Oil Prices Up, and Why*, NEWENERGYNEWS BLOG (June 30, 2008, 6:19 AM), <http://newenergynews.blogspot.com/2008/06/how-oil-speculators-drive-oil-prices-up.html>.

by, or even aware of what film futures speculators have to say about the films they might see?” Although the knee-jerk response to this question is “no,” an in-depth analysis is still needed in light of the substantial harm that could occur if this unsubstantiated reply is incorrect.

For all intents and purposes, film futures speculators could essentially be described as film critics who review motion pictures before they actually viewed the final product. Whereas a film critic’s review is their expert opinion of the actual motion picture, the futures price of a film is simply a ‘review’ of how the aggregate expects the film to perform. Thus, since the film futures price is based only on the evaluations of speculators, who are less-informed than movie critics,<sup>106</sup> the influence that a film’s futures price has on movie-goers will be diminished compared to that of critic reviews.<sup>107</sup>

The public perceptions of motion pictures often conflict with the opinions of film critics. For example, the 2006 blockbuster hit *Pirates of the Caribbean: Dead Man’s Chest*—which made \$423.3 million—received a Rotten Tomatoes<sup>108</sup> user score of eighty-six

<sup>106</sup> In that, unlike film critics, film speculators have not viewed the final product of a motion picture project.

<sup>107</sup> It is worth noting, however, that some proponents of the film futures ban have argued that speculators could act in a role that is unlike that of film critics by fabricating ‘negative’ buzz about a particular motion picture project or the actors involved in its filming. Pisano Testimony, *supra* note 3. Although this point may be legitimate in theory, it is unreasonable to expect that, in practice, speculators could generate the type of ‘negative’ buzz that would *reliably* deflate commercial success. Instead, the reality of our society strongly suggests that the old adage, “any news is good news,” more aptly characterizes the true impact of ‘bad’ news, *particularly* in the realm of media and entertainment. For a timely example, consider the Charlie Sheen media circus that began in late 2010, wherein a constant stream of live news and interviews documented the offensive (and often felonious) conduct of Charlie Sheen. Charlie Sheen: Pictures, Video, Breaking News, HUFFINGTON POST, <http://www.huffingtonpost.com/news/charlie-sheen> (last visited Mar. 22, 2011). Here, supporters of this argument would likely predict that the ‘bad’ news of Charlie Sheen’s odious conduct would result in commercial harm to his entertainment endeavors. Sadly, this was not the case. In fact, Charlie Sheen’s misconduct (to date) has significantly *increased* ratings for his television show, *Two and a Half Men*. See James Hibberd, *Ratings Rise for Sheen’s ‘Men,’* HOLLYWOOD REPORTER, Nov. 2, 2010, <http://www.hollywoodreporter.com/blogs/live-feed/ratings-rise-sheens-men-34524> (reporting that recent ‘bad’ news about Charlie Sheen increased ratings for *Two and a Half Men* by 7%); see also David Amerland, *The Charlie Sheen Show: Unfolding Live and Uncut on Social Media Everywhere,* TECHNORATI, Mar. 3, 2011, <http://technorati.com/entertainment/celebrity/article/the-charlie-sheen-show-unfolding-live/page-2/> (stating that “[Sheen] he has become a people magnet helping TV shows increase their ratings and websites boost their traffic”).

<sup>108</sup> Rotten Tomatoes is a review website that rates motion pictures using two main scores, the “critic score” and the “user score.” The critic score of a particular film represents the aggregate opinion of professional film critics (calculated as the percentage of established critics who recommended the film). Tomatometer & Average Rating, ROTTEN TOMATOES, <http://flixster.zendesk.com/entries/436270-tomatometer-average-rating> (last visited Mar. 22, 2011). If the critic score of a film is ‘good’ (60% or greater), it is designated as “FRESH.” *Id.* Films that are not “FRESH” are “ROTTEN.” *Id.* Similarly, the user score of a film represents the aggregate opinion of average movie-goers who “liked” the film (where a “liked” designation constitutes a user review of at least 3.5/5 stars). *Id.*

percent (86%), but a “Rotten” critic score of only fifty-four percent (54%).<sup>109</sup> More recently, this same phenomenon appeared in *Battle: Los Angeles*, which made \$60.5 million domestically in its first two weeks of release and enjoyed a Rotten Tomatoes user score of sixty-two percent (62%), even though its critic score was an extremely poor thirty-three percent (33%).<sup>110</sup> As New York Times film critic A. O. Scott explained, “Movies . . . are understood to be common cultural property, something everyone can enjoy, which makes any claim of expertise suspect.”<sup>111</sup> However, despite this apparent discrepancy between the opinions of movie-goers and film critics, empirical research has proven that critic reviews are statistically significant determinants of box office success.<sup>112</sup> However, the financial impact of this influence is extremely small, especially when compared to the influence of other determinants of box office success, such as star power, genre, and MPAA ratings.<sup>113</sup> The juxtaposition of the high significance but low magnitude of critic reviews have led to considerable debate among academics as to whether critic reviews are truly determinative, or if they are instead merely predictive of box office success.<sup>114</sup> While this issue is still unresolved, the summation of research suggests that the high accuracy but small fiscal impact demonstrate the predictive, not determinative character of critic reviews.<sup>115</sup>

In light of the small effect that critic reviews have on box office success, it is unlikely that the price of a film future would

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<sup>109</sup> Review of *Pirates of the Caribbean: Dead Man's Chest*, ROTTEN TOMATOES, [http://www.rottentomatoes.com/m/pirates\\_of\\_the\\_caribbean\\_dead\\_mans\\_chest/](http://www.rottentomatoes.com/m/pirates_of_the_caribbean_dead_mans_chest/) (last visited Mar. 22, 2011). The HSX also correctly forecasted the blockbuster success of *Pirates*. See Rachael King, *Hollywood Games People Play*, BLOOMBERG BUSINESSWEEK, Aug. 7, 2006,

[http://www.businessweek.com/technology/content/aug2006/tc20060804\\_618481.htm?chan=top+news\\_top+news](http://www.businessweek.com/technology/content/aug2006/tc20060804_618481.htm?chan=top+news_top+news); see also Alex Carlson, *Top 10 Most Critic Proof Movies of All-Time*, FILM MISERY, <http://www.filmmisery.com/?p=666> (providing other examples of commercially successful films that had positive user reviews, but low critic reviews).

<sup>110</sup> Review of *Battle: Los Angeles*, ROTTEN TOMATOES, <http://www.rottentomatoes.com/m/battle-los-angeles/> (last visited Mar. 22, 2011).

<sup>111</sup> A. O. Scott, *Avast, Me Critics! Ye Kill the Fun: Critics and the Masses Disagree about Film Choices*, N.Y. TIMES, July 18, 2006, [http://www.nytimes.com/2006/07/18/movies/18crit.html?\\_r=3](http://www.nytimes.com/2006/07/18/movies/18crit.html?_r=3). See also Alex Billington, *Does Anyone Care About Critics' Opinions Anymore?*, FIRST SHOWING, May 8, 2007, <http://www.firstshowing.net/2007/05/08/does-anyone-care-about-critics-opinions-anymore/> (stating that the purchase of a movie ticket is a deeply personal experience).

<sup>112</sup> See Suman Basuroy et al., *How Critical are Critical Reviews? The Box Office Effects of Film Critics, Star-Power, and Budgets*, 67 J. MARKETING 103 (2003); Patrick Topf, *Examining Success at the Domestic Box-Office in the Motion Picture Industry (2010)* (unpublished manuscript, on file with Illinois Wesleyan Univ. Econ. Dep't), available at [http://digitalcommons.iwu.edu/cgi/viewcontent.cgi?article=1109&context=econ\\_honproj](http://digitalcommons.iwu.edu/cgi/viewcontent.cgi?article=1109&context=econ_honproj); Jehoshua Eliashberg & Steven M. Shugan, *Film Critics: Influencers or Predictors?*, 61 J. MARKETING 68 (1997).

<sup>113</sup> See *supra* note 112.

<sup>114</sup> See *id.*

<sup>115</sup> See *id.*

have any impact box office success. While there exists a minority argument that film critics serve a determinative role in box office success, the application of this academic argument to the film futures setting is inappropriate. More specifically, the key explanations for this determinative effect—such as consumer trust in famous film critics or the ease and simplicity with which movie reviews can be referenced in a newspaper—cannot be applied to a film futures exchange.<sup>116</sup>

Based on the foregoing, the argument that film futures speculators could influence movie-goers by manipulating the exchange to materially harm a film's DBOR is unconvincing.

### C. "Film Futures Trading is Just Legalized Gambling"

Since the emergence of commodity futures trading in the United States, the trading of futures has been the target of sweeping accusations<sup>117</sup> that such trading serves no public interest because it is essentially legalized gambling that will do nothing but increase volatility in the underlying market of the commodity.<sup>118</sup> Despite these accusations and the facial similarity of gambling and speculation, the trading of commodity futures is permitted because it is widely accepted that, when complying with the CEA and CFTC, a futures exchange behaves nothing like a casino.<sup>119</sup>

When gamblers place a bet, they create a new risk that has a random or nearly-random chance of occurring.<sup>120</sup> This bet is motivated purely by the prospect of personal gain and cannot serve any price determination or risk offsetting public function.<sup>121</sup>

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<sup>116</sup> For instance, a movie-goer would not be able to see how a particular speculator 'reviewed' a film or learn what factors motivated the determination of the film's current futures price. Furthermore, from a purely practical standpoint, it is extremely unlikely that the average movie-goer would understand or have any interest in analyzing what a particular futures price implied about a film's underlying merits, particularly since the futures price is based on the aggregate evaluations of people who have not seen the film yet.

<sup>117</sup> See *Gambling in Futures: the Real Meaning of the Phrase and the Part Played by the Speculator in the Business Life of the Nation*, N.Y. TIMES, Jan. 9, 1910, <http://query.nytimes.com/mem/archive-free/pdf?res=F00C13FA3E5D11738DDDA00894D9405B808DF1D3>.

<sup>118</sup> See Pisano Testimony, *supra* note 3; Scott Harbinson, International Representative, Int'l Alliance of Theatrical and Stage Employees, Test. before the H. Subcomm. on Gen. Farm Comm. and Risk Mgmt (Apr. 22, 2010), *available at* <http://agriculture.house.gov/testimony/111/h042210/Harbinson.pdf>.

<sup>119</sup> See Board of Trade of the City of Chicago v. Christie Grain & Stock Co., 198 U.S. 236 (1905) (establishing the legitimacy of futures trading despite arguments that the predominantly cash-settled nature of futures trading constituted gambling); *see also* Board of Trade of City of Chicago v. Olsen, 262 U.S. 1 (1923) (upholding the constitutionality of grain futures despite comparisons of futures trading to gambling).

<sup>120</sup> See Peter Greenfinch, *Gambling vs. Speculation: What Differences?*, KNOL, <http://knol.google.com/k/gambling-vs-speculation#> (last visited Nov. 22, 2010); Matt Phillips, *Buffett: "Gambling" and "Speculating," Here's the Difference*, WALL STREET JOURNAL BLOGS, June 3, 2010, <http://blogs.wsj.com/marketbeat/2010/06/03/buffett-gambling-and-speculating-heres-the-difference/>.

<sup>121</sup> *See id.*

Furthermore, once a wager is placed, the gambler is locked in until they either win or lose; gamblers cannot choose their risks or exit their position without penalty. Conversely, when speculators ‘bet,’ they invest in a pre-existing risk that they have researched in detail. While speculators, like gamblers, usually hope that their ‘bets’ result in a personal gain, the ‘bets’ made by speculators also provide valuable price determining and hedging functions that serve the public interest.<sup>122</sup> Unlike the rigid odds in gambling, where “the house always wins,”<sup>123</sup> speculators can choose their own risks and only select those that they believe are more likely than not to result in a favorable outcome. Furthermore, if at some point a speculator becomes dissatisfied with their investment position, they are not married to it; a speculator can simply “zero-out” its position by either selling the contracts it initially purchased, or purchasing the contracts it initially sold.

Thus, the argument that film futures trading should be banned since it is essentially legalized gambling is unconvincing because: (1) the characteristics of commodity futures trading do not resemble those of gambling, and (2) film futures critics raise no reasons to construe the trading on a film futures exchange any differently, with respect to gambling, from the trading that occurs on all futures exchanges.<sup>124</sup>

D. *“Film Futures Resemble the Risky Financial Instruments that Caused the Financial Crisis”*

Some film futures critics have argued that the trading of film futures should be prohibited because DBOR contracts are substantially similar to the deadly subprime mortgage-backed securities of the Financial Crisis.<sup>125</sup> Many members of Congress who supported the film futures ban were also motivated to voice this concern, since the key objective of the impending Wall Street Reform Act was to increase accountability and promote stability by restricting the authorization of any “exotic” financial instruments that resembled mortgage-backed securities.<sup>126</sup> However, the analogy of film futures to mortgage-backed securities is attenuated

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<sup>122</sup> See *supra* Part IV.

<sup>123</sup> Robert C. Hannum, A Guide to Casino Mathematics, UNIV. OF NEV. CENTER FOR GAMING RES., [http://gaming.unlv.edu/subject/pdf/casino\\_math.pdf](http://gaming.unlv.edu/subject/pdf/casino_math.pdf) (last visited Nov. 14, 2010).

<sup>124</sup> See Robert S. Swagger, Chairman and CEO, Media Derivatives, Inc., Test. before the CFTC (May 19, 2010), *available at* [http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/publicmeeting051910\\_swagger.pdf](http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/publicmeeting051910_swagger.pdf) (explaining that a gambling argument could be made of any futures exchange, including those dealing in government T-bonds).

<sup>125</sup> See Cyrus Sanati, *Movie Time at the CFTC Draws Heated Debate*, N.Y. TIMES DEALBOOK BLOG (May 19, 2010, 4:04 PM), <http://dealbook.nytimes.com/2010/05/19/heated-debate-during-movie-time-at-the-c-ft-c/>.

<sup>126</sup> See *id.*

at best. In fact, DBOR contracts are only similar to subprime mortgage-backed securities to the extent that both were “innovative” financial instruments intended to diversify risk.

Unlike DBOR contracts, subprime mortgage-backed securities are securities, not commodities, which are duly regulated by the United States Securities and Exchange Commission (“SEC”), and not the CFTC.<sup>127</sup> Furthermore, subprime mortgage-backed securities are not futures contracts; they are securities whose value is tied to the mortgage payments of homeowners with risky, subprime, adjustable rate mortgages who were unable to qualify for traditional mortgages because of their high likelihood to default on payments.<sup>128</sup> Unlike the trading of subprime mortgage-backed securities—which was a key source of the financial crisis<sup>129</sup>—the trading of futures contracts had no role in fueling the crisis, and in fact, was one of the few stable financial markets that performed without issue during the high-stress of financial crisis.<sup>130</sup> Most significantly, film futures run no risk of creating a ‘bubble’ that would artificially raise price expectations above their true value because DBOR contracts, unlike mortgage-backed securities, are tied directly to the *actual* value of DBOR.<sup>131</sup>

Based on the foregoing, the comparison of film futures to subprime mortgage-backed securities was not a valid reason to prohibit the trading of film futures.

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<sup>127</sup> See *Messer v. E. F. Hutton & Co.*, 847 F.2d 673, 674 (11th Cir. 1988).

<sup>128</sup> A mortgage-backed security is an investment device whose value is tied to the mortgage payments and default risk on a commercial or residential property. Mortgage-Backed Security, INVESTOPEDIA, <http://www.investopedia.com/terms/m/mbs.asp> (last visited Oct. 26, 2010). *Subprime* mortgage-backed securities were tied to the incredibly risky class of homeowners who had adjustable rate mortgages because of their high likelihood to default on payments. Subprime Mortgage, INVESTOPEDIA, [http://www.investopedia.com/terms/s/subprime\\_mortgage.asp](http://www.investopedia.com/terms/s/subprime_mortgage.asp) (last visited Oct. 26, 2010). Despite this large risk, investors in mortgage-backed securities collectively viewed these financial devices to be much less risky and more valuable than they truly were, based on the flawed assumption that housing prices would continue to rise indefinitely. See John W. Diamond, Ph.D., Speech to River Oaks Women’s Breakfast Club at the Rice University James A. Baker III Institute for Public Policy (Oct. 15, 2008), article based on presentation, available at <http://www.bakerinstitute.org/publications/TEPP-pub-financialcrisis-speech-103008.pdf>. This investing behavior steadily inflated the housing ‘bubble’, such that the traded value of a mortgage-backed security was well above its actual value. See *id.* at 7-8. When investors eventually realized how unreliable the subprime mortgage-backed securities were, the housing ‘bubble’ burst and rapidly destroyed the value of these securities. See *id.*

<sup>129</sup> See *id.*

<sup>130</sup> See *Futures Industry Association Encourages Fair Treatment of Movie Futures*, FIA, Apr. 8, 2010, <http://www.futuresindustry.org/?i=1503> (explaining that “one of the principal lessons of the recent financial crisis is that futures markets performed flawlessly under the highest levels of stress”).

<sup>131</sup> See Joe Weisenthal, *The Creator of Movie Futures Thinks He Invented the Next Atomic Bomb: Here’s Why He’s Wrong*, BUSINESS INSIDER, May 25, 2010, <http://www.businessinsider.com/why-max-keiser-is-wrong-about-box-office-futures-2010-5>.

IV. *TO KILL A MOCKINGBIRD*—WHY FILM FUTURES TRADING  
WOULD HELP, NOT HARM, THE MOTION PICTURE  
INDUSTRY

As Part III outlined, Congress's ban on film futures was motivated by a number of speculative arguments, many of which could equally describe government-sponsored T-bond futures. But more broadly, these criticisms underscored the deep fears of the MPAA and others that a film futures exchange would destabilize the motion picture industry by subjecting it to gambling, fraud, and other abusive manipulations. This section will demonstrate that Congress should not have given credence to these concerns because the sole government authority on futures trading, the CFTC, addressed and answered these key concerns weeks earlier when it chose to authorize the first film futures exchange on June 14, 2010. Furthermore, this section will identify and describe the valuable public benefits and positive externalities that a film futures exchange will provide if Congress repeals its ban.

A. *The CFTC's Authority and the Significance of its Authorization of Film Futures Trading*

1. The CFTC's Authority

Under the CEA, the CFTC has exclusive jurisdiction over the regulation and trading of commodity futures contracts.<sup>132</sup> Currently, the CFTC oversees sixteen designated contract markets ("DCMs") and fourteen clearinghouses, which are financial institutions that reduce the systematic risk in DCMs by guaranteeing the performance of all cleared trades of futures contracts.<sup>133</sup> These DCMs include a wide range of underlying commodities,<sup>134</sup> some that are 'traditional' commodities—including oil, wheat, and soybeans—while others are 'nontraditional' commodities, such as stock indexes and T-bonds.<sup>135</sup> However, regardless of the nature of a DCM's underlying commodity, all DCMs must uniformly comply with the CEA and the regulations of

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<sup>132</sup> 7 U.S.C. § 2 (1936).

<sup>133</sup> See Dan M. Berkovitz, General Counsel, CFTC, Test. before the H. Subcomm. on Gen. Farm Comm. and Risk Mgmt (Apr. 22, 2010), available at <http://agriculture.house.gov/testimony/111/h042210/Berkovitz.pdf>. In 2009, CFTC-regulated facilities managed the trades of nearly 3 billion futures contracts. See *id.*

<sup>134</sup> See CME GROUP, <http://www.cmegroup.com/> (last visited Nov. 14, 2010).

<sup>135</sup> Commodity futures contracts are typically 'nontraditional' when the underlying commodity is a financial instrument, such as a derivative. See S. REP. NO. 850 (1978), reprinted in 1978 U.S.C.A.N. 2087, 2101. More specifically, "Congress was aware in 1974 that . . . futures trading in financial instruments and Government securities were being developed." *Id.* at 2109-10.

the CFTC.<sup>136</sup>

The mission of the CFTC, as designated by the CEA, is to promote and enable futures exchanges to provide the valuable economic functions of: (1) price discovery and (2) price risk management.<sup>137</sup> To best promote these functions, the CFTC has a statutory duty to encourage the competitiveness and efficiency of commodity futures exchanges by protecting market participants from fraud, manipulation, and other abusive trading practices.<sup>138</sup>

Given the CFTC's dual purpose to promote economic value and protect against foul play, an entity who wishes to become a DCM must first apply to the CFTC for designation and demonstrate that it complies with the requirements set forth in the CEA.<sup>139</sup> More specifically, the rigorous DCM application process involves a careful and substantial review<sup>140</sup> by the CFTC that assesses: (1) the capacity of the proposed exchange to serve the national public interest by providing the economic functions of price discovery and risk assumption, and (2) the applicant's ability to act in accordance with the core values of the eight "designation criteria"<sup>141</sup> and eighteen "core principles"<sup>142</sup> that are described in the CEA. Furthermore, even after the CFTC approves a DCM application, the concentration of its inspection and regulatory efforts does not dissipate. In fact, the Division of Market Oversight's 'Market Compliance Section' regularly conducts rule enforcement reviews of every DCM—a process that nearly mimics the intensity of the initial application process—to ensure that a DCM continues to comply with the CFTC's core principles and police its exchange for market manipulation and abuse.<sup>143</sup>

Most significantly, the CFTC's evaluation of an applicant's ability to comply with the designation criteria and core principles mirrors the concerns that film futures critics raised in support of

<sup>136</sup> 7 U.S.C. § 2(a)(1)(A) (1936). See *Messer v. E. F. Hutton & Co.*, 847 F.2d 673, 674 (11th Cir. 1988) (stating that all commodity futures are regulated by the CFTC and governed by the CEA).

<sup>137</sup> 7 U.S.C. § 5 (1936).

<sup>138</sup> Missions and Responsibilities, CFTC, <http://www.cftc.gov/About/MissionResponsibilities/index.htm> (last visited Nov. 14, 2010).

<sup>139</sup> How to Become a DCM, CFTC, <http://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/dcmhowto.html> (last visited Nov. 14, 2010).

<sup>140</sup> See Dan M. Berkovitz, General Counsel, CFTC, Test. before the H. Subcomm. on Gen. Farm Comm. and Risk Mgmt (Apr. 22, 2010), available at <http://agriculture.house.gov/testimony/111/h042210/Berkovitz.pdf> (stating that the CFTC's review of new DCM applications is "a key element" of its organization).

<sup>141</sup> 7 U.S.C. § 7(b) (1936); 17 C.F.R. § 38, App. A. (2006).

<sup>142</sup> 7 U.S.C. § 7(d) (1936); 17 C.F.R. § 38, App. B. (2009).

<sup>143</sup> See Ongoing Compliance with Core Principles, CFTC, <http://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/index.htm> (last visited Nov. 14, 2010).

the ban.<sup>144</sup> For example, the designation criteria require that all potential exchanges have systems in place that will ensure fair and equitable trading, prevent market manipulation, and arrange for a registered clearing organization to clear transactions.<sup>145</sup> Correspondingly, the core principles stress the importance of an exchange's ability to provide an open, competitive, and efficient market, whose contracts are not readily susceptible to manipulation, fraud, or abuse, where price distortions and disruptions of delivery or cash settlement can be effectively monitored.<sup>146</sup> Thus, it is apparent that any authorization by the CFTC of film futures trading necessarily involved a critical evaluation of the core concerns complained of by film futures critics. As such, the CFTC significantly marginalized the apparent materiality of the arguments against film futures when it authorized film futures trading not once, but twice, on June 14, 2010, and June 28, 2010.

In light of the CFTC's confidence that a film futures exchange would help, not harm, the motion pictures industry, Congress should have deferred to the CFTC's judgment instead of yielding to the critical voices of the MPAA and its constituents. To further corroborate this conclusion, Congress should have also looked inward to the suboptimal track record of its prior attempts to ban a particular commodity futures contract.

## 2. The Failure of Congress's Ban on the Trading of Onion Futures

An action by Congress to restrict the definition of a "commodity" in the CEA is unusual. This is due in large part to the legislative history of the CEA, which suggests that Congress intended to construe its definition of a "commodity" broadly.<sup>147</sup> In fact, prior to the film futures ban in the Wall Street Reform Act, there has been only one other instance in which the definition of a "commodity" was explicitly constrained by Congressional action.

On August 28, 1958, Congress passed the Onion Futures Act, which barred the trading of onion futures contracts because "onions" were no longer a valid "commodity" under the CEA.<sup>148</sup> Just as with the recent prohibition of film futures contracts, Congress's ban was motivated primarily by the "intense political pressure" of lobbyists and participants in the onion industry,<sup>149</sup>

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<sup>144</sup> Namely, to ensure that film futures trading would not promote manipulation, fraud, or the creation of risk.

<sup>145</sup> 17 C.F.R. § 38, App. A (2006).

<sup>146</sup> 17 C.F.R. § 38, App. B (2009).

<sup>147</sup> See *supra* pp. 196-197.

<sup>148</sup> 7 U.S.C. § 13-1 (1958).

<sup>149</sup> Craig Pirrong, *Shameless Self-Promotion (and a History Lesson)*, STREETWISE PROFESSOR

who blamed onion futures for the increasing volatility and falling prices in the market for onions.<sup>150</sup> However, contrary to the expectations of these critics, it is now a statistical certainty that onions futures *decreased* price volatility, which is demonstrated by the markedly higher instability of the onions market both before and after the brief period that onion contracts were permitted to trade on a futures exchange.<sup>151</sup> For example, between October 2006 and April 2007, onion prices climbed by 430%, then crashed between May 2007 and October 2007 by 92%; this volatility was far greater than the price volatilities of corn, wheat, and oil over the same periods.<sup>152</sup> Furthermore, volatility in the onion industry has been so astronomical since the onion futures ban, that many of those who had originally lobbied Congress for the ban now believe that an onion futures exchange would be beneficial to the stabilization of the onions market.<sup>153</sup> For instance, Debruyn Produce—a large onion grower and key lobbyist in the passage of the onion futures ban—recently stated that “there probably has been more volatility since the [onion futures] ban . . . a futures market for onions would make some sense today.”<sup>154</sup> Similarly, Congress also acknowledged the failure of its ban by denying other bills that have proposed similar provisions to prevent a particular commodity from trading on a futures exchange.<sup>155</sup>

Thus, Congress should have simply relied on its unpleasant experience with the onion futures ban to understand that, despite

BLOG (Dec. 6, 2007, 9:45 AM), <http://streetwiseprofessor.com/?p=175>.

<sup>150</sup> See Jon Birger, *What Onions Teach Us About Oil Prices*, FORTUNE, June 30, 2008, [http://money.cnn.com/2008/06/27/news/economy/The\\_onion\\_conundrum\\_Birger.fortune/](http://money.cnn.com/2008/06/27/news/economy/The_onion_conundrum_Birger.fortune/). Among those Congressman most lobbied by onion farmers, was future President Gerald Ford. *See id.*

<sup>151</sup> See Jonathan Hoenig, *Save Our Speculators!*, SMARTMONEY, Sept. 3, 2009, <http://www.smartmoney.com/Investing/Options/Save-our-Speculators/> (stating that “economists found more cash market volatility in onion prices before and after the period of futures trading than there was while the onion futures market was operating . . . futures markets respond to and decrease volatility”); Roger Gray, *Onions Revisited*, 45.2 J. FARM ECON. 273 (1963), available at [http://chla.library.cornell.edu/cgi/t/text/pageviewer-idx?c=chla;cc=chla;rgn=full%20text;idno=5033566\\_4125\\_002;didno=5033566\\_4125\\_002;node=5033566\\_4125\\_002%3A6.3;view=image;seq=0019](http://chla.library.cornell.edu/cgi/t/text/pageviewer-idx?c=chla;cc=chla;rgn=full%20text;idno=5033566_4125_002;didno=5033566_4125_002;node=5033566_4125_002%3A6.3;view=image;seq=0019) (proving that onion futures helped stabilize onion prices despite the widespread concerns of onion farmers). These findings are not surprising considering the nearly-universal applicability of futures trading. *See* Letter from Robert J. Shiller, Professor of Economics, Yale Univ., to Gary Gensler, Chairman, CFTC (May 14, 2010), available at <http://www.cantorexchange.com/getdoc/f08d8bc9-de77-4ad5-9bbb-145ec4b1c325/Shiller-Letter-to-CFTC.aspx> (stating that hedging “makes it possible for any industry to enhance overall performance and societal value”).

<sup>152</sup> *See id.*

<sup>153</sup> See Jon Birger, *What Onions Teach Us About Oil Prices*, FORTUNE, June 30, 2008, [http://money.cnn.com/2008/06/27/news/economy/The\\_onion\\_conundrum\\_Birger.fortune/](http://money.cnn.com/2008/06/27/news/economy/The_onion_conundrum_Birger.fortune/).

<sup>154</sup> *Id.*

<sup>155</sup> In 1972, Congress denied a bill that proposed a ban on potato futures, relying on its experience with the onion futures ban as a guide for its decision. *See* Craig Pirrong, *Shameless Self-Promotion (and a History Lesson)*, STREETWISE PROFESSOR BLOG (Dec. 6, 2007, 9:45 AM), <http://streetwiseprofessor.com/?p=175>.

the lobbying efforts and reluctance of the MPAA, a ban of DBOR contracts was not prudent, especially since the CFTC was well-suited to keep film futures trading under its watchful regulatory eye and take action if necessary.

### B. *Potential Benefits of a Film Futures Exchange*

Contrary to the CFTC's analysis and repeated authorization of film futures trading, critics of film futures—particularly MPAA President and interim CEO Robert Pisano—nonetheless contended that a film futures exchange would not serve any national public interest. More specifically, film futures critics alleged that the CFTC should not have permitted film futures trading because such an exchange would serve no price discovery<sup>156</sup> or hedging functions.<sup>157</sup> These allegations are inaccurate. In fact, as explained below, the trading of film futures would not only provide valuable price discovery and hedging functions, but may also benefit the national public interest by reducing unemployment in the motion picture industry, and promoting creativity and innovation in motion picture projects.

#### 1. Price Discovery

Critics of film futures trading argued that a film futures exchange would not serve a price discovery function because: (1) DBOR contracts have no underlying cash market in any “commodity,” and (2) motion picture success is difficult to predict. As Part III Section A of this Note explained, the argument that DBOR contracts have no underlying cash market has no bearing on the eligibility or capability of a futures exchange to provide a valuable price discovery function. Furthermore, while it is true that “there is no set formula for [the ultimate] success [of a motion picture],”<sup>158</sup> the CFTC's analysis of the film futures DCM applications accepted that a film futures exchange could accurately and reliably measure the current market *expectation* of a motion picture's box office success, which at its core, is a determination of the ‘price’ for a particular film's domestic ticket sales, if it were released today. The legitimacy of the price determining capabilities of film futures trading has also been demonstrated by the historical success of the HSX, which provides no financial incentive or risk, yet nonetheless has reliably predicted the DBOR of major motion pictures.<sup>159</sup> For example,

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<sup>156</sup> An exchange serves a price discovery function when its trading mechanism accurately reflects the market value of its underlying asset.

<sup>157</sup> See Pisano Testimony, *supra* note 3.

<sup>158</sup> *Id.*

<sup>159</sup> See sources cited *supra* note 19.

the HSX accurately forecasted the DBOR of Paramount Pictures' recent release, *Paranormal Activity 2*. On the eve of its release, *Paranormal Activity 2* shares were trading on the HSX at \$79.50; in its first four weeks of release, the film made \$77 million at the box office.<sup>160</sup>

## 2. Hedging

Detractors of a film futures exchange also claimed that the CFTC should not permit the trading of DBOR contracts because "the proposed contracts have no appeal or use with respect to the public interest criterion of hedging."<sup>161</sup> Specifically, these critics declared that since most studios make partnership agreements for risk-sharing and investment during the infancy stages of a motion picture project, no one will have an incentive to hedge on a film futures exchange.<sup>162</sup> However, this argument is also flawed. Despite the front-ended investment structure of motion picture projects, there still exist a wide variety of ways in which hedging on a film futures exchange could substantially offset an entity's exposure to risk. The following illustrations provide two such examples.

For instance, consider the annual occurrence of competing studios that each plan to release a big budget horror film on Halloween weekend. Since these films all cater towards the same demographic, there is a very high likelihood that a shared release date would split viewership and damage the DBOR of each horror film.<sup>163</sup> Any studio who is concerned that its motion picture will lose viewership because it shares a release date with a substantially similar project could hedge on a film futures exchange to offset its release date risk by buying shares of the competing film(s).<sup>164</sup> Thus, if a competing film steals viewers away from the studio's project, the studio's DBOR loss would be offset by the gain it would enjoy on the film futures exchange.<sup>165</sup>

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<sup>160</sup> *Paranormal Activity 2* Profile, HSX, <http://www.hsx.com/security/view/PNAC2> (last visited Nov. 14, 2010).

<sup>161</sup> Pisano Testimony, *supra* note 3.

<sup>162</sup> *Id.*

<sup>163</sup> Without the availability of futures trading, studios that are currently in this position typically distance release dates in an attempt to secure more exclusive access to horror film movie-goers. For example, in 2010, *Paranormal Activity 2* was released on October 22, while *Saw 3D* was released on October 29. *Paranormal Activity 2* Profile, IMDB, <http://www.imdb.com/title/tt1536044/> (last visited Nov. 14, 2010); *Saw 3D* Profile, IMDB, <http://www.imdb.com/title/tt1477076/> (last visited Nov. 14, 2010).

<sup>164</sup> See Richard Jaycobs, President, Cantor Futures Exchange, Test. before the CFTC (May 19, 2010), *available at* [http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/publicmeeting051910\\_jaycobs.pdf](http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/publicmeeting051910_jaycobs.pdf).

<sup>165</sup> As Richard Jaycobs identified, film futures could have been useful when this same dilemma arose in 2008, when Paramount and Warner were each concerned that their respective comedies, Paramount's *The Love Guru* and Warner's *Get Smart*, would

Not unlike large Hollywood production studios, a single movie theater chain could also find significant value in the hedging opportunities of a film futures exchange.<sup>166</sup> For example, suppose that a theatre chain had a two percent (2%) market share in 2007, but now in a post-*Avatar* world, only occupies a one and one-quarter percent (1.25%) share because its theaters are not equipped with the 3D technology that is required to show an increasingly large number of big budget motion pictures.<sup>167</sup> Here, this theatre chain could offset its revenue loss by purchasing film futures in the big budget 3D films that it cannot exhibit. Thus, when a big budget 3D film such as *Avatar II* shifts the theatre chain's consumer base to another provider, its losses could be offset on a film futures exchange by the DBOR success of *Avatar II*.<sup>168</sup>

Furthermore, even if it was temporarily presumed that the concern that no one would hedge on a film futures exchange was legitimate, this argument would remain an unconvincing justification for the Congressional action that superseded the CFTC's authorization because of the fundamental dynamic that is present in all futures exchanges. A futures market requires the participation of both hedgers and speculators in order to sustain itself; without both categories of investors, the lack of incentives to participate would cause the exchange to naturally extinguish over time.<sup>169</sup>

Perhaps most notably, the CFTC has the exclusive jurisdiction to regulate and ensure the statutory compliance of its commodity futures exchanges, which includes the need for all DCMs to serve a hedging function.<sup>170</sup> Thus, if a film futures exchange *did* fail to provide an adequate hedging function, the CFTC would be well-equipped to act within its exclusive statutory duty to prohibit film futures trading or otherwise discipline the exchange without any need to lobby Congress for an explicit ban.

### 3. Other Benefits in the Public Interest and Positive Externalities

One of the most significant public policy concerns surrounding film futures is the theory that an exchange based on box office receipts would increase volatility in the industry and significantly endanger the incomes of middle-class workers in the entertainment industry, who are independent contractors that are compensated between jobs by 'residual' income tied directly to the

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underperform because they shared the same release date and target audience. *Id.*

<sup>166</sup> *See id.*

<sup>167</sup> *See id.*

<sup>168</sup> *See* 7 U.S.C. § 5(a) (1936).

<sup>169</sup> For further discussion on this relationship, *see supra* pp. 189-190.

<sup>170</sup> 7 U.S.C. § 1 et seq. (1936).

box office success of their previous project(s).<sup>171</sup> However, as Part III explained,<sup>172</sup> a film futures exchange would *decrease* volatility in the motion picture industry. Furthermore, middle-class employees in the entertainment industry stand to benefit indirectly from film futures trading. As Robert J. Shiller, Professor of Economics at Yale University, explained to Gary Gensler, Chairman of the CFTC, “[a film futures] market is exactly the kind of thing that we need . . . if film producers can manage the risks of their productions better, by trading in such markets, more film industry entrepreneurs would be encouraged to start new businesses and compete.”<sup>173</sup> In 2009, 134 movie distributors released motion pictures in the United States.<sup>174</sup> However, 81% of the market share belonged to only six of these distributors.<sup>175</sup> Not coincidentally, these six studios constitute the entire membership of the MPAA.<sup>176</sup> This oligopoly,<sup>177</sup> by definition, creates a barrier to entry that restricts the production of motion picture projects—such that the demand for movies exceeds the supply—and allows oligopolies to receive “supernormal” profits.<sup>178</sup> As a result of this oligopolistic market structure, the supply of jobs in the motion picture industry—particularly those performed by middle-class independent contractors—is kept artificially below its demand. Thus, by encouraging film industry entrepreneurs to start new businesses, film futures trading would lessen the motion picture industry’s barrier to entry, thereby increasing the number of projects in production and, in doing so; increase the supply of jobs in the motion picture industry.

Finally, the trading of film futures could also benefit the public interest by creating large positive externalities that would encourage creativity, innovation, and originality in motion picture production.<sup>179</sup> The ability to take risk-offsetting positions on a film

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171 See Scott Harbinson, International Representative, Int’l Alliance of Theatrical and Stage Employees, Test. before the H. Subcomm. on Gen. Farm Comm. and Risk Mgmt (Apr. 22, 2010), *available at* <http://agriculture.house.gov/testimony/111/h042210/Harbinson.pdf>.

172 *Supra* pp. 197-201.

173 Letter from Robert J. Shiller, Professor of Economics, Yale Univ., to Gary Gensler, Chairman, CFTC, (May 14, 2010) (on file with author), *available at* <http://www.cantorexchange.com/getdoc/f08d8bc9-de77-4ad5-9bbb-145ec4b1c325/Shiller-Letter-to-CFTC.aspx>.

174 See Market Share for Each [Motion Picture] Distributor in 2009, THE NUMBERS, <http://www.the-numbers.com/market/Distributors2009.php> (last visited Nov. 14, 2010).

175 See *id.* (aggregating the market shares of the top six distributors).

176 MPAA ABOUT US, <http://mpaa.org/about> (last visited Nov. 14, 2010).

177 The mere fact that these studios encompassed 81% of all motion picture projects in 2009 strongly suggests an oligopolistic market character.

178 Oligopoly, TUTOR2U, [http://tutor2u.net/economics/content/topics/monopoly/oligopoly\\_notes.htm](http://tutor2u.net/economics/content/topics/monopoly/oligopoly_notes.htm) (last visited Nov. 14, 2010).

179 See Letter from Robert J. Shiller, Professor of Economics, Yale Univ., to Gary Gensler, Chairman, CFTC (May 14, 2010), *available at*

futures exchange would lessen the risk aversion of movie entrepreneurs and studios, thereby broadening the financing opportunities for motion pictures. In particular, these financing opportunities will encourage studios and other movie financiers to take *creative* risks more often, which will benefit society by promoting innovation and originality in the motion picture industry.<sup>180</sup>

### CONCLUSION

In 1982, long-time President of the MPAA, Jack Valenti, spoke out on behalf of the MPAA and its constituents against the recent introduction of a new device that the MPAA believed would instead cause an “avalanche” or “tidal wave” that would do nothing but destabilize the motion picture industry, causing it to “bleed and bleed and hemorrhage.”<sup>181</sup> Although proponents of this product claimed it would promote the growth and financial success of the motion picture industry, the MPAA nonetheless proclaimed to the House of Representatives that “[this product] [was] to [] American film producer[s] and the American public as the Boston strangler [was] to [] wom[e]n home alone.”<sup>182</sup> This ‘doomsday’ device was the video cassette recorder (“VCR”).<sup>183</sup>

Nearly three decades later, despite the enormous benefit that the advent of the VCR has provided the motion picture industry, the MPAA nonetheless raised similarly catastrophic allegations here with regard to the trading of film futures. However, unlike VCRs—which had the time to overcome the MPAA’s initial criticisms and prove its worth after the Supreme Court of the United States did not prohibit its use<sup>184</sup>—the trading of film futures may never be given a similar opportunity to reveal its potential

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<http://www.cantorexchange.com/getdoc/f08d8bc9-de77-4ad5-9bbb-145ec4b1c325/Shiller-Letter-to-CFTC.aspx> (stating that film futures trading would encourage “more adventurous” motion picture projects).

<sup>180</sup> While there have been instances of innovative and original movies succeeding in today’s economic climate without access to film futures, such as *Avatar*, *Once*, or *Paranormal Activity*, these films have done so under very unique circumstances. *Avatar*’s innovative production technology was incredibly expensive, but thanks to James Cameron’s infallible track record and deep pockets, was able to see the light of day in a film that took roughly ten years to complete. Conversely, the low budget indie hits *Once* and *Paranormal Activity* were likely only financed in today’s economic climate because of their extremely low cost and high upside. See Most Profitable Movies, Based on Return on Investment, THE NUMBERS, <http://www.the-numbers.com/movies/records/budgets.php> (last visited Nov. 14, 2010). A film futures exchange could encourage investment in innovative projects that are more costly than *Once* or *Paranormal Activity*, but not backed by a James Cameron-esque figure.

<sup>181</sup> Seth D. Schoen, *Valenti’s “Boston Strangler” Testimony*, SLASHDOT, May 31, 2002, <http://news.slashdot.org/article.pl?sid=02/05/31/1622232>.

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417, 417 (1984) (holding that using VCRs for time-shifting constituted a “fair use”).

value.

A film futures exchange could greatly benefit the American public and motion picture industry by providing valuable price determining and risk offsetting economic functions, as well as promoting employment, creativity, and innovation in the motion picture industry. While critics raise some legitimate concerns regarding the trading of film futures—namely the possibility that speculators could ‘game’ a film futures exchange or that such an exchange would serve no public function—these concerns do not justify Congress’s statutory ban of film futures trading because the CFTC, under its statutory authority, is well-suited to monitor, detect, and remedy precisely these kinds of material issues that may arise in commodity futures trading. Additionally, many of the arguments that fueled the film futures ban—such as the arguments that a film futures exchange should be prohibited because it has no underlying cash market and would merely function as a forum for gambling—can be raised of any futures exchange, including T-bond futures, which are run by the United States government.

Furthermore, Congressional action to supersede the CFTC’s authority was inappropriate because the fierce, reactive criticism of a new futures exchange by a group associated with the underlying commodity is a common occurrence for nearly all commodity classes, many of which now benefit from thriving futures markets; a trend that dates as far back in United States history as 1910, when grain farmers lobbied Congress to ban the trading of grain futures to stop the “criminal oppressors of the farmer [in the] Chicago wheat [futures exchange].”<sup>185</sup> Moreover, Congress should have deferred to its experience with the onions ban, which led to unexpected and undesirable results for all parties involved and inadvertently demonstrated the undeniable aptitude of futures trading to stabilize price volatility.

Based on the foregoing, Congress should remove its ban and relinquish its control over the existence of a film futures exchange to the watchful regulatory eye of the CFTC, at least for some probationary period, to provide film futures trading the reasonable and well-deserved opportunity to demonstrate its potential to provide significant social and economic benefits to the motion picture industry and to the American public.

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<sup>185</sup> *Gambling in Futures: the Real Meaning of the Phrase and the Part Played by the Speculator in the Business Life of the Nation*, N.Y. TIMES, Jan. 9, 1910, <http://query.nytimes.com/mem/archive-free/pdf?res=F00C13FA3E5D11738DDDA00894D9405B808DF1D3>.

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