

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

PUBLIC MEETING TO CONSIDER THE TRADING OF
CONTRACTS BASED ON MOTION PICTURE BOX OFFICE
RECEIPTS AND GATHER VIEWS OF INTERESTED PARTIES

Washington, D.C.

Wednesday, May 19, 2010

1 PARTICIPANTS:

2 Commission Members:

3 GARY GENSLER, Chairman

4 BART CHILTON

5 MICHAEL V. DUNN

6 SCOTT D. O'MALIA

7 JILL E. SOMMERS

8 Panel 1:

9 CLARK HALLREN
Clear Scope Partners10 RICHARD JAYCOBS
11 Cantor Exchange12 ALICE NEUHAUSER
Complete Rights Management13 ROBERT PISANO
14 Motion Picture Association of America

15 Panel 2:

16 MICHAEL BURNS
Lionsgate17 SCOTT HARBINSON
18 International Alliance of Theatrical and
19 Stage Employees/Directors Guild of
America20 SCHUYLER MOORE
Stroock, Stroock and Lavan21 ROBERT SWAGGER
22 Media Derivatives

1 P R O C E E D I N G S

2 (9:36 a.m.)

3 CHAIRMAN GENSLER: Good morning. I call
4 to order the public meeting of the Commodity
5 Futures Trading Commission to consider issues
6 relating to the trading of futures and binary
7 options based on motion picture box office
8 receipts. I would like to start by thanking
9 today's panelists, my fellow commissioners, the
10 CFTC staff for being here today. This is our
11 fourth public meeting this year, and I hope to
12 continue, as I know my fellow commissioners do as
13 well, these public meetings to consider important
14 matters before the Commission.

15 I wanted to pause also and just give a
16 thanks to the staff of the CFTC and the staff of
17 the SEC in putting out a joint preliminary set of
18 staff findings on the events around -- the market
19 events on May 6. They've worked tirelessly. The
20 cooperation between the SEC and CFTC was really
21 what you would hope for from public servants in
22 this nation, and it was reams of data, and there's

1 still much to do in the future, but I just wanted
2 to pause a moment and thank the staff here and at
3 the SEC for that.

4 Last month, the CFTC approved the
5 applications at Cantor Futures Exchange and Media
6 Derivatives for designation as contract markets.
7 The Commodity Exchange Act requires the Commission
8 to approve such applications if the applicant
9 meets criteria that are enumerated in the Act.
10 Given the novel nature of the contracts that the
11 Cantor and MDEX have proposed trading, however,
12 the CFTC requested and both of the designated
13 contract markets agreed that all new classes or
14 category of media-related contracts that these
15 contract markets plan to list must be submitted
16 for approval to the Commission. This is actually
17 in distinct contrast to how most futures contracts
18 on existing contract markets can be self-certified
19 in one day, and so that's why we're seeking to
20 learn more information here.

21 Today we'll hear from the views of eight
22 panelists on whether the Commission should approve

1 the Cantor and MDEX first contracts or deny those
2 contracts. The Commission actually will not vote
3 today, but the purpose of the meeting really is to
4 allow the Commissioners and the public to learn
5 more about these contracts. We are interested
6 primarily in fact finding, and given the interest
7 of the public as expressed in the particular
8 contracts, we thought together that it would be
9 good to have a public hearing. It's the most
10 transparent way to do this. It's also most
11 efficient for the five commissioners rather than
12 have the individual meetings with various parties
13 behind closed doors.

14 So, the Commission and the public will
15 hear from two panels. Both Cantor and MDEX are
16 here. We chose to ask one to be on one panel and
17 one to be the second just to spread that out, but
18 we also have a number of other parties that will
19 be speaking to us.

20 Before we do that, Rich Shilts, who's
21 the head of our Division of Market Oversight,
22 hasn't gotten a lot of sleep these last 10 days --

1 Rick -- so I thank you particularly for pulling
2 together some thoughts here.

3 We'll go through and present the actions
4 taken so far by the Commission with regard to
5 Cantor and MEDEX's application and some of the
6 statutory considerations. We've asked our general
7 counsel, Dan Berkovitz, to sit at the table in
8 case there are questions, but -- also, the record
9 for this morning's meeting will stay open I think
10 till May 26. My, one year since my swearing in.

11 Instructions for mailing the comments
12 can be found at our website, www.cftc.gov.
13 Comments can also be transmitted by fax to
14 202-418-5521 and emailed to us. All comments
15 received and a copy of the transcript of the
16 hearing will be on our website, and all of the
17 testimonies today of course can be brought by --
18 seen by live webcast.

19 Before I turn to Director Shilts, each
20 of my commissioners will have some thoughts to
21 share, and I turn to Commissioner Dunn.

22 COMMISSIONER DUNN: Thank you, Mr.

1 Chairman, and an interesting year it has been for
2 you as well.

3 Predicting the success or failure of a
4 futures contract is possibly more difficult than
5 predicting whether or not a motion picture will be
6 successful. Most new future contracts fail. An
7 estimated 70 to 80 percent cannot attract and
8 sustain a profitable level of trading volume.
9 Despite the fact that creating successful and
10 sustainable futures contracts appears to be
11 against all odds, exchanges are continually
12 working to bring new products to the market in the
13 hopes to finding successful contracts.

14 Future contracts based on the box office
15 receipts are new products. I applaud the new
16 exchanges that have created these innovative
17 products and look forward to hearing what they
18 have to say, particularly how their contracts
19 would be useful to the market and how they comply
20 with the Commodity Exchange Act. I understand
21 that box office contracts have also caused some of
22 the motion picture industry to raise objections to

1 their trading. Noting that contracts will not be
2 useful and are susceptible to manipulation, I am
3 very interested to hear the evidence that supports
4 these assertions.

5 In determining whether to approve
6 contracts for trading, the Commission is bound by
7 the rules and regulations set forth by the
8 Commodity Exchange Act. Staff has worked very
9 closely with all interested parties regarding
10 these contracts, and I await their recommendation
11 on whether or not they should be approved for
12 trading or violate the Act in some way. Until
13 that time, I will keep an open mind on this
14 subject and look forward to listening to today's
15 panelists, and I want to thank all of you for your
16 participation.

17 CHAIRMAN GENSLER: Thank you,
18 Commissioner Dunn. Commissioner Sommers.

19 COMMISSIONER SOMMERS: Mr. Chairman.
20 Last month the Commission approved the
21 applications of Media Derivatives and Cantor
22 Futures Exchange to become designated contract

1 markets conditioned on a requirement that the
2 exchanges submit all new classes or categories of
3 Media-related contracts for approval instead of
4 using the self-certification process. We imposed
5 this condition due to concerns regarding the
6 nature of the contracts MDEX and Cantor initially
7 intended to list for trading, which were based on
8 motion picture box office receipts.

9 There are a number of questions I have
10 regarding whether these contracts can serve as a
11 useful hedging tool, how they will be settled, and
12 whether they are susceptible to manipulation. As
13 I stated in my concurrence to the Commission's
14 approval of the Cantor application, I also have an
15 overarching concern as to whether the contracts
16 these DCMs intend to list for trading raise
17 broader policy issues related to information
18 aggregation markets.

19 Two years ago, the Commission published
20 a concept release seeking comment on the
21 appropriate regulatory treatment of financial
22 agreements offered by markets commonly referred to

1 as event, prediction or information markets.
2 Commission staff has received numerous requests
3 over the years for guidance on the types of
4 contracts that should be allowed in this category.
5 Unfortunately, the Commission has not yet
6 established a framework for resolving this issue.
7 I would prefer that the Commission address the
8 broad policy issues raised in the concept release
9 rather than approving or rejecting requests to
10 establish information markets on an ad hoc basis,
11 which is where we find ourselves now.

12 That being said, our governing statute
13 and regulations require us to act on requests for
14 approval of contracts within a specified time
15 frame. The deadlines for the MDEX and Cantor
16 contracts are fast approaching. Section 5c(c) of
17 the Commodity Exchange Act mandates that we
18 approve these contracts unless we find they
19 violate the Act. We have no discretion in this
20 regard. Based on the record developed so far, I
21 do not yet know the answer to these questions.
22 Hopefully the information we gather today will

1 assist us in making appropriate determinations.

2 I thank all the panelists for being here
3 today, and I look forward to hearing their
4 testimony. Thank you.

5 CHAIRMAN GENSLER: Thank you,
6 Commissioner Sommers. Commissioner Chilton?

7 COMMISSIONER CHILTON: Thank you, Mr.
8 Chairman. Since you've commented on the study, I
9 just want to say, you know, I associate myself
10 with your remarks, but I also was thinking about
11 this amendment that came up last night that
12 concerns me on regulatory reform, and let me
13 actually speak a little more on this as to the
14 chairman. I mean, this bill, I think, was stalled
15 significantly on the Hill and in no small measure
16 Gary Gensler has helped move it forward, and he's
17 done a lot of behind-the-scenes work, and the
18 staff has done a lot of behind-the-scenes work.
19 It's been critical.

20 I'm not a hundred percent sure it would
21 have gone forward without your work, so we're in
22 agreement on a lot of these issues, and I thank

1 you. I don't know if we're in agreement on the
2 Dodd Amendment that I saw last night that concerns
3 me greatly, and that's for a two-year delay and a
4 study before they would implement the OTC
5 provisions. If there's anything we've learned
6 from the financial calamity, it's that getting a
7 view into these dark markets is critical for
8 consumers, so I really appreciate the bill that
9 Senator Lincoln and Senator Dodd have come forward
10 with. I want to see it passed, and I want to see
11 it passed now.

12 On this issue, I want to commend the
13 Cantor folks and MDEX folks for coming up with
14 something that's neat and novel, and in general I
15 hate to be, you know, a regulator that holds back
16 innovation, because I think it is pretty cool, and
17 we all have sort of a common experience of sitting
18 in a movie theater maybe before the film and being
19 treated to or subjected to various previews over
20 your popcorn -- oh, that's neat or I want to see
21 that or you couldn't pay me to see that, whatever
22 it is -- and so I find it sort of cool in general.

1 But I'm not so sure that "cool" means it's a
2 business, although I'm open to, you know, looking
3 at it.

4 Now, these are critical markets and
5 they're important. They discover pricing for
6 consumers, and these are really serious markets
7 that we work on every day and sometimes all day
8 every day and all weekend. So, I'm not making
9 light of them, but I want to make sure that they
10 pass the legislative -- the legal test, which is
11 what -- no matter how cool or neat one of might
12 think it is it's got to pass the legal test.

13 In that regard, I'm concerned about
14 three things, and we'll be talking about it today
15 -- I'll be talking about it today. What is the
16 underlying commodity? Are these subject to
17 manipulation and how would we surveil those
18 markets that have -- can have an impact on it?
19 And is it a viable hedging mechanism? Is it a
20 viable hedging mechanism for the folks who would
21 be most affected by this? I mean, if it's not a
22 viable hedging mechanism, we can't approve it.

1 That's sort of the core of our act. So, I look
2 forward to that.

3 I also want to commend the chairman for
4 the transparency in general. You know, having
5 these meetings I think is very good. It adds
6 sunshine and in that vein, not for now but
7 whenever feels chairman feels comfortable I would
8 like to have some sort of, you know, comment on --
9 I'd like some transparency on this vote. I'd like
10 to make sure that people know about the vote or
11 the seriatim when it occurs. So, we don't have to
12 do that now but whenever it's appropriate.

13 So, with that I thank you all for being
14 here. Appreciate your time and, again, appreciate
15 the work of the staff.

16 Thank you, Mr. Chairman.

17 CHAIRMAN GENSLER: Thank you,
18 Commissioner Chilton. Thank you for the kind
19 remarks.

20 I'm thinking, Dan, if you can direct
21 with your little BlackBerry somebody to look at
22 this amendment that Commissioner Chilton

1 mentioned, just to see what it says. I know it's
2 reported in the newspapers, but thank you.

3 Commissioner O'Malia.

4 COMMISSIONER O'MALIA: Mr. Chairman,
5 thank you for calling this hearing. I appreciate
6 the participation of our witnesses on this panel
7 and the other panels.

8 Today's hearing will give the Commission
9 the opportunity to learn about a potentially
10 innovative product in the film industry. This
11 industry has advanced at a rapid pace to bring us
12 technological wonders like Avatar, and at least
13 two entities are trying to innovate the way movies
14 are financed. I intend to use this hearing to
15 better understand whether or not these contracts
16 fit into our regulatory scheme and if they meet
17 the core principles mandated by Congress. While
18 there's no statutory requirement that these
19 contracts be universally accepted, I'm also
20 curious to learn from our witnesses whether they
21 believe these contracts will be effective in
22 managing commercial exposure.

1 Innovation in both technology and
2 financing is inevitable, and as regulators we must
3 stay on top of the way markets innovate. I'm very
4 pleased that the Commission will vote this week to
5 reestablish the CFTC Technology Advisory
6 Committee, especially given the market events of
7 May 6 and the integral role that technology
8 appears to have played in those events.

9 Technology is now the foundation of the
10 derivatives industry. Market information, trade
11 strategies and execution, risk management,
12 clearing, and settlement are all dependent on
13 technology. In our time, we have seen an
14 unprecedented shift from trading in physical pits
15 to trading in the virtual pit that spans the globe
16 24/7. Unfortunately, here at the Commission we
17 struggle to keep pace with the technological
18 advances as we continue to receive account data
19 via facsimile and enter data manually. I fully
20 expect that Congress will provide new authorities
21 to the Commission to oversee the OTC markets,
22 which are estimated to be ten times the size of

1 the regulator markets. This agency is about to be
2 hit with a tsunami of trade data, and a fax
3 machine will not provide any assistance
4 whatsoever. We must do a better job to automate
5 all our forms and systems to handle the massive
6 amount of data that will be sent to this
7 Commission under the new authorities. As
8 regulators, we must understand and embrace
9 technology in order to be effective.

10 The Advisory Committee will bring
11 together the best and the brightest to discuss how
12 technology is being deployed across the industry;
13 how the CFTC should oversee such technology; and
14 what the future holds for technological
15 advancements in our markets so the CFTC can stop
16 playing catch-up for as long as it has.

17 The Committee will include
18 representatives from academia, exchanges, and
19 clearinghouses; trade repositories; technology
20 traders, otherwise known as algorithmic and the
21 high-frequency traders; FCMs; end users; and
22 banks. The Committee will hold its first meeting

1 hopefully on July 14th, which will specifically
2 focus on high-frequency trading. The hearing will
3 include a presentation from the Office of the
4 Chief Economist on recent research into
5 high-frequency trading, including a model that
6 shows how these high- frequency traders affect the
7 market. Other hearings will address co-location,
8 automation of CFTC data, trade repositories, SWAP
9 execution facilities, and technological
10 surveillance and security systems just to name a
11 few. Members of the Committee will be expected to
12 provide papers on a number of topics so the
13 Committee and the Commission can have informed
14 discussions on these important issues.

15 I'll look forward convening this hearing
16 in the near future and for this Committee to make
17 a valuable contribution to our technology debate.

18 CHAIRMAN GENSLER: Thank you,
19 Commissioner O'Malia, and I thank you also for
20 your leadership since you've come here on
21 reestablishing the Technology Committee, because I
22 think it is a big plus to this Commission and this

1 Agency.

2 COMMISSIONER O'MALIA: Let me just say I
3 know that everybody has had a roll in this, and
4 this was not a hard sell for anybody on this
5 Commission, and I appreciate your support of that.

6 CHAIRMAN GENSLER: No, but it usually
7 takes one person to pick up the ball and run with
8 it, so thank you.

9 With that, Director of Market Oversight
10 Rick Shilts.

11 MR. SHILTS: Thank you, and good
12 morning. As you noted, the purpose of this
13 hearing today is to provide the Commission with
14 additional information related to pending contract
15 approval requests submitted by two Exchanges --
16 Media Derivatives, which I'll refer to as MDEX,
17 and Cantor Futures Exchange. The settlement
18 prices of the contracts submitted for approval are
19 based on the level of box office receipts from
20 theaters for particular movies. These contracts
21 are often referred to as movie futures or box
22 office receipt futures.

1 As Chairman Gensler noted, the
2 designation orders for both MDEX and Cantor
3 require them to submit to the Commission for prior
4 approval any new class or category of
5 media-related products before listing them for
6 trading. In conditioning these designations, the
7 Commission recognized that Media contracts may
8 require special review to ensure, among other
9 things, that they are consistent with the
10 Commodity Exchange Act and the Commission's
11 regulations considering the unique nature of these
12 contracts.

13 On March 9th, MDEX, or Media
14 Derivatives, requested approval of its collared
15 futures and binary option contracts based on the
16 open weekend motion pictures revenues for the film
17 called Takers. A collared futures contract is a
18 contract that caps each trader's possible gains
19 while limiting potential losses. The caps and
20 floors will establish trading ranges of a hundred
21 million dollars with each one million dollars of
22 revenue equal to \$50. For example, MDEX can list

1 a contract for Takers that has a floor of 200
2 million and a cap of 300 million. If a buyer and
3 seller enter into a contract at initial revenue of
4 250 million, then the seller would collect \$2,500
5 from the buyer. This figure is arrived at by
6 subtracting the floor, 200 million, from the
7 initial contract value, 250 million, resulting in
8 a revenue level of 50 million. Since each million
9 dollars of revenue is valued as \$50 as set by the
10 Exchange, the initial contract value would be \$50
11 multiplied by 50, or \$2500. If the actual gross
12 box office revenues for the film are below 200
13 million, then the buyer would lose 2,500 and no
14 more than 2,500. The purpose of the cap and floor
15 is to ensure that maximum gains and losses are
16 known in advance so that the contracts can be
17 fully collateralized.

18 With respect to position limits, MDEX
19 has proposed a position limit of 25,000 contracts,
20 net long or short, for its Takers collared
21 features contract. MDEX also intends to list
22 binary call options with strike prices of \$20

1 million again based on that same movie. A binary
2 call option contract is an option in which the
3 purchaser either receives nothing or receives a
4 fixed amount if the box office receipts are at or
5 above a specified strike price. An option is in
6 the money if the opening weekend picture revenues
7 are greater than that strike price. The value of
8 an in-the-money option would be \$5,000. For that
9 contract, MDEX has proposed a position limit of
10 25,000 contracts for all strike prices combined.

11 Both MDEX contracts are settled based on
12 the reported opening weekend motion picture
13 revenues. The opening weekend is defined as the
14 time that the motion picture is released through
15 the following Sunday. The contracts are then
16 settled on the following Thursday. The MDEX
17 contract's 45-day fast-track review period would
18 have ended on April 23rd, but staff extended its
19 review to the full 90-day statutory review period.
20 The statutory review period ends June 7, 2010.

21 On March 30th, Cantor requested approval
22 of its domestic box office receipt futures

1 contract based on the movie The Expendables.
2 Cantor intends to list futures on domestic box
3 office receipts covering revenues for the first
4 four weeks that a motion picture has been
5 released. The four-week period is defined as the
6 time that the motion picture is released through
7 the fourth weekend following release. The
8 contract size is determined by dividing the box
9 office receipts number by \$1 million. Therefore,
10 total box receipts of 100 million would translate
11 into a contract size of 100. For this contract,
12 Cantor has proposed a position limit of 10,000
13 contracts. As I noted with respect to the MDEX
14 contracts, staff also extended the review period
15 for the Cantor contract to the statutory deadline,
16 which is June 28th.

17 The box office receipt numbers used for
18 cash settlement for all these contracts are
19 calculated by the distributor of the motion
20 picture. Staff understands that the vast majority
21 of motion picture revenues are reported from the
22 theaters to distributors through Rentrak

1 Corporation. Rentrak is a media measurement and
2 research company that, among other things,
3 provides audience measurement services to the
4 entertainment industry. It is essentially a
5 third-party data aggregator and has no direct
6 interest in any particular motion picture.

7 A small amount of box office receipts
8 are not reported through Rentrak. They are
9 reported directly from the theaters to the
10 distributor. This data is referred to as
11 call-around data. Once the distributor sums the
12 Rentrak and the call-around receipt data, that
13 number is reported back to Rentrak, which in turn
14 distributes it to Variety magazine, Box Office
15 Mojo, and other news organizations and interested
16 parties.

17 The Exchanges have created processes to
18 validate the gross box office revenue data
19 disseminated by the studios that would be used to
20 calculate the final settlement values. The
21 objective is to ensure that the Rentrak raw data
22 comprises a very high percentage that is usually

1 about 98 percent of the gross box office revenues
2 that are reported publicly by the distributing
3 studios. If publicly reported data varies from
4 the raw data in a manner that is statistically
5 significant, the Exchanges will initiate
6 additional procedures to validate the Rentrak and
7 call-around data.

8 Both of the contracts -- or all three of
9 the contracts have been posted on the Commission's
10 website for public comment. The comment period
11 for the MDEX contracts ends on May 14th. The
12 comment period for the Cantor's contract ends May
13 21st. As of yesterday, five comment letters
14 relevant to contracts have been submitted. Two
15 comment letters were from members of Congress:
16 One dated April 22nd from a group of senators and
17 a second dated April 28th from a group of
18 congressmen. Both of these letters expressed
19 concern about the CFTC's possible approval of
20 movie box office revenue contracts citing pending
21 financial legislative efforts that may prohibit
22 such contracts; the opposition of a segment of the

1 movie industry to the listings of these contracts;
2 possible trading restrictions on studios; and
3 whether such contracts can serve as a hedging
4 function and a possible diversion of CFTC
5 resources.

6 The other comment letters were written
7 in support of these contracts. One commenter
8 stated that the success of the contracts was
9 critical to fostering growth in the U.S. Film
10 industry and in creating efficiency and
11 transparency in the financing phases of films,
12 while another letter stated support for regulated
13 and transparent box office receipt futures
14 exchanges.

15 With respect to our review, the
16 Commodity Exchange Act specifies that the
17 Commission must take action on a proposed contract
18 within 90 days of its request for approval. The
19 relevant provision particularly provides that the
20 Commission shall approve any such new contract or
21 instrument unless the Commission finds that the
22 new contract or instrument would violate the act.

1 If no action is taken at the end of the 90 days
2 under Commission regulations, the contract is
3 deemed approved.

4 Under the Commodity Exchange Act, the
5 primary focus of staff's review of new contract
6 filings is to ensure that the contract is not
7 readily susceptible to manipulation -- Core
8 Principle 3 -- and that the contract has
9 speculative limits or position accountability
10 rules that would minimize the susceptibility
11 manipulation. That's Core Principle 5. In
12 addition, staff considers any comments received
13 related to the approval request.

14 Under Core Principle 3 for cash-settled
15 contracts such as these, staff carefully evaluates
16 the cash price series that would be used for cash
17 settlement. In particular, we will consider the
18 manner in which the Rentrak number is generated;
19 the data calculation methodology and data release
20 procedures; the mechanisms and procedures in place
21 by Rentrak and the distributors to ensure its
22 reliability that it's not readily susceptible to

1 distortion to manipulation; and the specific rules
2 and procedures adopted by the Exchanges to
3 mitigate against manipulation and inappropriate,
4 premature access to the numbers.

5 Also as a part of this review and
6 pursuant to the provisions of Guideline No. 1,
7 which relates to new contract approvals, staff
8 will consider whether the box office receipt and
9 revenues are reliable, verifiable, publicly
10 disclosed, and available on a timely basis.

11 Finally, we will consider whether any
12 contract design specifications, trading
13 restrictions, and other protections should be in
14 place to minimize the potential for price
15 distortion and manipulation.

16 Under Core Principle 5, all Exchanges
17 are required to reduce the potential threat of
18 manipulation or congestion, particularly during
19 spot months by adopting position limits or
20 position accountability. Staff will review each
21 Exchange's position limit and accountability rolls
22 to ensure that the limits are appropriate to

1 reduce the incentive for a trader to attempt to
2 distort the cash settlement price to profit on a
3 large future's position. We will also review the
4 procedures adopted by the Exchanges for granting
5 exemptions from any of these limits.

6 I'd like to note that the core principle
7 requirements for DCM contracts were added to the
8 Commodity Exchange Act in 2000 by the Commodity
9 Futures Modernization Act, or CFMA. At that time,
10 the CFMA also repealed the section of the Act
11 which embodied a public interest requirement that
12 in turn included the Economic Purpose Test. Under
13 the Economic Purpose Test, Exchanges could only
14 list for trading contracts that could be used on
15 more than an occasional basis for hedging or price
16 basing. As a result of the changes at the CFMA,
17 staff has not routinely considered the economic
18 purpose served by proposed contracts in its
19 reviews. However, in view of the comments
20 expressed by interested parties and several
21 commissioners related to the potential hedging
22 uses of these contracts, staff will consider the

1 potential hedging utility of the contracts in its
2 review. The comments of the panelists here today
3 would be of much interest to staff in our
4 analysis.

5 Finally, in conclusion, with respect to
6 the contracts submitted for approval, staff review
7 is ongoing. Our review will fully consider the
8 relevant statutory and regulatory requirements, as
9 well as the comments submitted. In particular, we
10 look forward to the views provided today at this
11 hearing, which should help inform staff about this
12 issue so that the ultimate decision is based on a
13 full consideration of all applicable statutory
14 criteria and other relevant considerations. Thank
15 you.

16 CHAIRMAN GENSLER: Thank you, Mr.
17 Shilts. I'm going to try to keep ourselves to a
18 timeline to ask you quick questions and then get
19 to our other panels, but I'm sure each of my
20 fellow commissioners have some questions on what
21 you see and what the law is.

22 I understand from your testimony that

1 you highlighted three considerations: The
2 manipulation, Core Principle 3; that they have
3 position limits, Core Principle 5 if I recall --
4 and then you mentioned -- it's not a core
5 principle but then you mentioned this issue of
6 economic purpose or whether the contracts that are
7 available are used for hedging. So, my question's
8 really around the third point. I'm sure we'll
9 have a lot of debate on the other panels whether
10 Rentrak numbers work and whether these things can
11 be manipulated and so forth. But it's the third
12 point maybe for Mr. Berkovitz as well. How do the
13 five of us conduct our business? Is there an
14 economic purpose test that's in here? If it was
15 repealed in 2000, is it a little bit there because
16 of -- I can't recall -- Section 3? You know, how
17 does that influence our decision making? Either
18 one of you.

19 MR. BERKOVITZ: Mr. Chairman, you've
20 noted the other section that comes into play here,
21 and as Rick described in his testimony the Public
22 Interest Test was repealed in the Commodity

1 Futures Modernization Act, so there's no longer an
2 explicit requirement of an explicit finding that
3 this not be contrary to the public interest as
4 there was, which set up an actual test and a
5 process for review. However, the law still
6 requires that the Commission either approve or
7 disapprove the contract, and if the Commission
8 finds that would violate the Act, then it can
9 disapprove the contract. So, in the "would
10 violate the Act" is implicit rather explicit, as
11 it used to be, that the Commission is now finding
12 that the contract is somehow contrary to the
13 findings and purposes and whole purpose for which
14 the futures contracts are trading. So within that
15 Section 3, the Findings and Purposes is an
16 implicit authority for the Commission to make a
17 determination of whether the contract would
18 accomplish something consistent with the purpose
19 of the Act, such as managing and assuming price
20 risks.

21 CHAIRMAN GENSLER: But is it that it
22 violates the Act or is it just -- I mean, is this

1 one of those, you know, 50/50 -- a 51 percent sort
2 of if you think it's this way then -- or is it got
3 to, as you say, violate the act?

4 DR. BERKOVITZ: Well, I think that's up
5 for the Commission's judgment as to whether indeed
6 what the degree of how the Commission concludes in
7 terms of whether it would violate the Act. I
8 think that's one of the judgments that's reserved
9 for the Commission.

10 CHAIRMAN GENSLER: Well, I'm sure others
11 will ask you further questions on it. Can I ask
12 you a couple more questions that actually --
13 because they're kicked up by the testimony later,
14 testimony by the Motion Picture Association of
15 America, so I thought I may as well just ask you
16 as our General Counsel. But they have in their
17 testimony that the Commission should disapprove --
18 they're recommending -- you know, I think
19 everybody knows that this be disapproved -- but
20 that think that it's "outside" the Commission's
21 jurisdiction. Do you think these contracts are
22 outside? I mean, there may be other reasons.

1 They have five or six other reasons to disapprove
2 it, but do you think these things are outside the
3 Commission's jurisdiction?

4 DR. BERKOVITZ: There's -- there'll be
5 the -- there's the threshold jurisdictional
6 question of whether these are contracts for future
7 delivery, and I think if the Commission concludes
8 and based upon the staff's recommendations that
9 they are indeed contracts for future delivery,
10 then they would be within the Commission's
11 jurisdiction. Now, the testimony of the
12 participants today and the written testimony
13 indicate why in their view they're not contracts
14 for future delivery and the staff analysis, as Mr.
15 Shilts can explain, is examining those issues as
16 to whether that goes to the jurisdictional
17 question of whether they're futures contracts or
18 whether these futures contracts are susceptible to
19 manipulation or meet the criteria. So, there's --

20 CHAIRMAN GENSLER: No, no, I understand,
21 and on the manipulation or other things, I'm not
22 asking that right now. I'm just trying to

1 understand. They say it's outside of jurisdiction
2 because it's not associated with the financial,
3 commercial, and economic consequence. I tend to
4 think it is probably is, so I'm not asking that.
5 So, that's just one Commissioner's view. But then
6 they say it's beyond the control of the parties to
7 the relevant contract or agreement. You know,
8 this is out of our statute they're quoting.

9 DR. BERKOVITZ: I believe -- and Mr.
10 Shilts can also answer on this -- I believe as a
11 preliminary threshold matter the staff's
12 conclusion is that these indeed are contracts for
13 future delivery and, therefore, they would be
14 within the Commission's jurisdiction.

15 CHAIRMAN GENSLER: Let me just see. I
16 think my time might be up, so I was just seeing if
17 there was any other question. I'm going to turn
18 to Commissioner Dunn.

19 COMMISSIONER DUNN: Thank you, Mr.
20 Chairman. Let me take up where you left off with
21 Mr. Berkowitz. You thought you were going to be
22 the potted palm here, didn't you? Not quite so

1 easy.

2 Mr. Chairman, Mr. Berkovitz in his
3 capacity as our General Counsel testified in front
4 of the House Agricultural Committee, and I would
5 like to insert that testimony as part of this
6 record, because I thought it was an excellent
7 procedural piece.

8 CHAIRMAN GENSLER: All right, so done.

9 COMMISSIONER DUNN: Thank you, Mr.
10 Chairman. Without getting into how the
11 bureaucracy works, but would you enlighten maybe
12 the Commission but the public on when these types
13 of applications come through what is the role of
14 the Office of General Counsel in these requests?

15 DR. BERKOVITZ: The Office of General
16 Counsel has two basic functions. One is to
17 function as the Commission's legal advisor to
18 provide legal advice on questions of law to the
19 Commission. Also the Office of General Counsel
20 works very closely with the divisions, with the
21 Division of Market Oversight, with Mr. Shilts and
22 his staff, and in analyzing the legal questions

1 that come up during the Division of Market
2 Oversight's review, as reviewing the staff's work
3 for legal sufficiency hopefully with the goal of
4 -- so when the Division of Market Oversight would
5 provide a recommendation to the Commission that
6 any legal issues would have been resolved and the
7 staff could present a recommendation to the
8 Commission and the legal -- any legal issues would
9 have been either resolved or presented clearly for
10 the Commission to determine.

11 COMMISSIONER DUNN: So, if the
12 recommendation coming from the Division of Market
13 Oversight to the Commission would have the
14 assurance of the Office of General Counsel, that
15 is in compliance that is in with the statute.

16 DR. BERKOVITZ: That would be the goal
17 of both our offices, yes.

18 MR. SHILTS: That's correct.

19 COMMISSIONER DUNN: Ah, Mr. Shilts, just
20 so don't feel left out, some of the things that
21 we're looking for under the new Exchanges on
22 those, they are what is called a self-regulatory

1 organization, an SRO. But I believe in your
2 testimony you point out that they do contract out
3 with the -- with an entity for some of that
4 regulatory oversight. Could you amplify on that a
5 bit?

6 MR. SHILTS: Yes. The primary
7 responsibility for oversight of all contracts --
8 or by -- is -- by the Exchange -- some of this
9 responsibility would be contracted out to the
10 National Futures Association. Ultimately, the
11 Exchange has final responsibility for making sure
12 that it carries out all of its self-regulatory
13 functions, and of course the Commission also
14 through its oversight is a surveillance, and
15 compliance functions would be also looking at the
16 Exchanges to make sure that they carry out their
17 responsibilities.

18 COMMISSIONER DUNN: And how do you
19 assure yourself, the division that those core
20 principles that you talked about are in fact being
21 met?

22 MR. SHILTS: As I mentioned, with

1 respect to contract approvals as well as looking
2 at contracts that have been filed under
3 certification provisions, the primary focus is
4 really susceptibility to manipulation, and again
5 there's a Core Principle 5 on spec limits, but
6 it's essentially to serve that same purpose, that
7 there's limits in place that would minimize
8 susceptibility to manipulation. So, in looking at
9 a particular contract and, again, if it's
10 physically delivered, obviously there's different
11 procedures and things that we'd be looking at, but
12 when we're talking about a cash-settled contract,
13 fundamentally we're looking at the nature and the
14 process for deriving the cash settlement price
15 areas, and if it's, in this case, an independent
16 third party, it's not something that's been
17 developed by the Exchange. Some cash-settled
18 contracts are. This would not be. We would look
19 to the nature of the -- as to how that particular
20 price series is developed -- the reputation,
21 the -- you know, the history of the entity that's
22 actually compiling the number.

1 For example, you look at, like,
2 something -- whether, you know, like, for euro
3 dollars the British Bankers' Association prepares
4 that. There's a long history. In this case,
5 we're looking at a Rentrak. What procedures do
6 they have in place? What mechanisms are there to
7 ensure that the price that they come up with is
8 meaningful, representative, reflects actual box
9 office receipt numbers? We'd also be considering
10 any other mechanisms or procedures that the
11 Exchange may have adopted that might go to trying
12 to minimize the susceptibility to manipulation --
13 you know, prohibitions on entities, like at the
14 studio or Rentrak, that they would not be allowed
15 to trade the contract. So, it's -- the essential
16 focus is on the nature of that price series.

17 And something else I think that's
18 important to note is that in general when
19 Exchanges pick a cash price series for a contract,
20 in some cases it's something new that's designed
21 for the contract, but in most cases, they're using
22 a price series that's already in existence, and

1 that's the case here where the Rentrak numbers
2 have been out there and the ultimate numbers that
3 they combine with the small amount of information
4 gathered from the studios and that that's
5 published and used for other purposes, you know,
6 in settling various contracts in the film
7 industry, and that is generally widely viewed as
8 being -- at least our initial examination -- as
9 being representative of actual box office receipt
10 numbers. So, it's a number of factors that we
11 would be considering but all going to the ultimate
12 reliability/acceptability of the number.

13 COMMISSIONER DUNN: I'm curious then --
14 how would the Commission investigate and prosecute
15 possible movie futures manipulations attempts?

16 MR. SHILTS: I think that the process --
17 and the Director of Enforcement may want to
18 comment -- would be probably similar in the sense
19 that if we -- if there's some evidence that a
20 particular number that's been released seems to be
21 inappropriate through our surveillance function or
22 through information we receive in the industry

1 combined with our large trader data because,
2 again, these are fully regulated markets, we will
3 have on a daily basis information about all large
4 traders. So, if there's some information that
5 would come in that would suggest some sort of --
6 something inappropriate, we could quickly look to
7 see if that matched up with the positions of
8 traders in the market and then, you know, conduct
9 further examination, talk to the parties involved,
10 the exchanges, Rentrak. That information, the
11 Rentrak data, is all available to the Exchanges to
12 assess the completeness and the accuracy of the
13 numbers. It's auditable, so.

14 COMMISSIONER DUNN: So, we can in fact
15 take a look at the numbers that were presented and
16 we determine whether or not those are correct
17 numbers in Rentrak and I guess in variety as well?

18 MR. SHILTS: No, I don't think that's
19 necessarily what we can do. I mean, the ultimate
20 objective here in looking at a third-party index
21 is that are there procedures and mechanisms in
22 place such that we could have confidence that the

1 number that's used is reliable and representative
2 of what it's trying to measure -- in that case,
3 box office receipt numbers. We would not
4 contemplate and would have the capability to
5 actually go and survey every theater, every
6 reporting, you know, theater throughout the
7 country to actually tabulate that and make sure
8 that that number is correct. But that's why it's
9 important to look at the reputation, the history,
10 the nature of the price series -- in this case,
11 the Rentrak data -- to get comfort that this
12 third-party price series is represented if it has
13 the proper procedures and protections in place to
14 ensure that it is a representative, meaningful
15 number. The people in the industry do look to it
16 as being reliable.

17 COMMISSIONER DUNN: I'm curious. How
18 much resources are you going to develop on the
19 division to oversee this and do rural enforcement
20 reviews, etc.? Are you going to do this on each
21 contract?

22 MR. SHILTS: Fortunately, for most --

1 well, maybe unfortunately, as has been mentioned
2 -- most -- many new contracts don't succeed, so
3 we'll have to see what happens. But fortunately,
4 for those that do, they tend to generate volume
5 and open interest at a somewhat slow pace, so it
6 gives us an opportunity to start devoting
7 resources to looking at the particular contracts,
8 having a surveillance economist, for example,
9 become familiar with the industry that -- either
10 reporting the -- you know, looking at the large
11 traders. Ultimately, as far as the commitment of
12 staff resources, it's just -- it's hard to say
13 now, because it's -- you don't know ultimately
14 whether these will succeed and how large the
15 markets will be. I mean, if they don't achieve,
16 you know -- I mean, if they trade at some, you
17 know, fairly small level, there may never -- not
18 be any traders of any size that would really ever
19 pose any significant concern if they do become
20 quite widely used, and obviously you'd have to
21 devote more resources to that. I know that the
22 chairman has worked tirelessly to try to get us

1 additional staff, which we attended to vote to -
2 not just to these markets but to any new
3 contracts.

4 COMMISSIONER DUNN: Sucking up won't get
5 you any more resources.

6 MR. SHILTS: Can't hurt.

7 COMMISSIONER DUNN: Mr. Chairman, I
8 think my time's expired.

9 CHAIRMAN GENSLER: All right. Thank
10 you, Commissioner Dunn.

11 He's probably right about the last
12 comment, but we thank you.

13 Commissioner Sommers.

14 COMMISSIONER SOMMERS: I'm going to
15 follow up with regard to some of the questions
16 that we have regarding Core Principle 3 and the
17 contracts being susceptible to manipulation and
18 ask you if you can talk about other contracts that
19 are traded on other DCMs that we have experience
20 with that are based on industry estimates, that
21 are based on numbers from these third-party
22 vendors, and what our experience is with

1 surveilling markets that have these kind of data
2 sources.

3 MR. SHILTS: Yes. I think there's
4 probably a number of contracts that have been
5 either approved or traded or currently trading
6 that were settled as based on some sort of a
7 third-party number. For example, you know, euro
8 dollars have settled to a third-party index. You
9 know, the feeder cattle contract is settled to an
10 index created by USDA. The CME has developed a
11 number of real estate index contracts, which --
12 and also some insurance contracts, which I think
13 to some extent are similar to the ones that are
14 talked about here, because you're talking about

15 contracts that are based on transaction prices for
16 various real estate in different cities. It's a
17 number that's developed by S&P, again, not for
18 futures trading but separate, and the CME
19 developed a futures contract to use that number.

20 But, again, it's -- in a sense, when we
21 looked at that it was a matter of looking at S&P,
22 the neck of the procedures in place, to kind of be

1 comfortable that well, at least this series, this
2 price series they used to value real estate in
3 various cities is meaningful, representative.
4 Again, not that we would have the capability to go out
5 and do some sort of an audit of all the, you know,
6 the transactions. But, again, it looks to the
7 nature of the entity that's -- you know, S&P is
8 the business of doing this, that, you know, their
9 reputation and what -- and also the specific types
10 of mechanisms and procedures they have to actually
11 go out and develop the index.

12 So, in a sense, this is somewhat
13 parallel to that in that we're kind of looking at
14 well, who is Rentrak and what is their reputation,
15 their history, and all in the industry, and the
16 nature of the price in the sense that it wasn't --
17 this isn't something that was developed for these
18 contracts. It preexisted. They chose to use this
19 as a -- and Exchange can explain in more detail --
20 but they chose to use this price because of their
21 view that it is representative, meaningful, and,
22 you know, the industry generally views it as an

1 acceptable number that's not prone to distortion.

2 COMMISSIONER SOMMERS: And with these
3 other contracts, how is the contract -- how are
4 the contract terms and conditions stipulated for
5 the final settlement? Are they based on an
6 estimate? They're based on whatever this real
7 estate number is regardless of whether or not
8 anyone is validating that number?

9 MR. SHILTS: Yes. It's based on the
10 actual number that this third party would put out,
11 you know, if it's the real estate index, the
12 number the S&P would put out; if it's the, you
13 know, euro dollars, it's the number the British
14 Bankers' Association puts out; if it's, you know,
15 like I mentioned, like, feeder cattle, it's the
16 number the USDA puts out. Again, because the
17 focus -- I mean, we -- is how the settlement price
18 is actually determined and the reputation and
19 reliability of that number so that we -- because
20 we can't go back for each month and do some sort
21 of analysis to say -- you know, on all these
22 contracts -- and say, well, we duplicated the

1 effort and, yes, we think it's accurate. It
2 really has to go to we think the provider of the
3 price has -- you know, is reputable and has
4 procedures and mechanisms in place to ensure that
5 it is a meaningful price.

6 COMMISSIONER SOMMERS: And with these
7 other contracts, what are the Exchanges'
8 obligations to verify that these prices are right,
9 and have the Exchanges had any problems in the
10 past with validating these numbers and making sure
11 that these numbers are actually reliable?

12 MR. SHILTS: In a sense, the Exchanges'
13 obligations are similar to ours, because when
14 they're designing a new futures contract -- I
15 mean, you may be looking whether you do cash
16 settlement or physical delivery and for many of
17 these physical delivery is possible, so if you're
18 doing cash settlement you have two options. You
19 can either develop your own price series, or you
20 can look to something that's generally considered
21 to be reliable that's already preexisting. So, in
22 that sense, they are -- by choosing a particular

1 index, they are making kind of the same type of
2 calculation that I'm saying. They're not -- they
3 are not -- and they don't have essentially
4 capability to go out and actually verify that, you
5 know, that all the numbers that go into
6 calculating the index are bona fide. It's, in a
7 sense, you're relying on the third party to do
8 that. So, it's kind of the same type of approach.

9 COMMISSIONER SOMMERS: My other line of
10 questioning is under Core Principle 5 with regard
11 to either position limits or accountability levels
12 that the Exchanges may impose and how we decide
13 whether those are appropriate based on a new
14 contract that we don't know a lot about the
15 traders, incentives to -- we're not familiar with
16 the industry yet, how do we know that those levels
17 are appropriate at this point?

18 MR. SHILTS: For cash-settled contracts,
19 unlike physically delivered where you kind of base
20 the spec limit on deliverable supplies, at least
21 for the spot month. For cash-settled contracts
22 the real focus is on what you had mentioned,

1 trying to set numbers that would tend to minimize
2 the potential for a trader to want to distort the
3 underlying price to the extent they have that
4 ability, and I think here would be some of the
5 unique characteristics of these contracts, you
6 know, the fact that it's based on a single movie,
7 that kind of a narrowness. We would want to focus
8 on a number that is, you know, appropriately
9 tailored to the nature of the particular
10 contracts.

11 I can't tell you there's a specific
12 formula or some rule of thumb -- not just for this
13 but for any cash-settled contract -- but it's
14 something that we're looking at in the sense of
15 trying to assess what numbers, what levels would
16 make sense to minimize that potential, and then
17 presumably we would try to set those as something
18 that's relatively low, at least at the start, and
19 then the Exchanges, of course, can grant hedge
20 exemptions but also be looking carefully at the
21 nature of those and how they would relate to
22 whether -- that particular, you know, trader's

1 interest in the industry so that it doesn't create
2 some sort of untoward incentive towards distortion
3 of the prices.

4 CHAIRMAN GENSLER: Thank you,
5 Commissioner Sommers. Commissioner Chilton.

6 COMMISSIONER CHILTON: Thank you. I
7 want to follow up a little bit on the first part
8 of Commissioner Sommers' questions. I had
9 concerns, as people have talked with me about
10 these issues initially, about the Rentrak numbers,
11 and I became, you know, less concerned from the
12 standpoint that they are generally accepted. I
13 still had some questions about them and still do
14 but have less concern now than I did. But I like
15 the sort of poignant questions you were asking,
16 and it made me think that, you know, I mean,
17 nobody regulates Rentrak. And so they can tell
18 us, you know, well, we look at this many theaters
19 and we select them and -- but nobody looks at them
20 to -- you remember, you know, Reagan said "Trust
21 but verify"? So, the only time we really come to
22 look at Rentrak's numbers, it seems, is if there

1 was an enforcement problem -- I mean, if we
2 thought there was a problem.

3 And, you know, what I'd like to say is
4 we should be more like, you know, the police
5 department, sort of looking at everything, instead
6 of the fire department coming in to, you know,
7 hose down the charred remains of damage. So, I
8 guess I am a little bit concerned. You know, we
9 have this issue, and I know it gets me into
10 trouble a little bit, but -- you know, with
11 Platts, where, you know, there's a number that's
12 out there for energy prices and it's generally
13 accepted, but we don't know how it's come up with
14 or whom we ask. I mean, they won't tell us. So,
15 this seems like this could fall into the same sort
16 of bailiwick, and I just raise it as a point, Mr.
17 Shilts, if you have any comment on it, but
18 Commissioner Sommers got me thinking about that.

19 MR. SHILTS: Well, first, I don't want
20 to make it sound like we've definitely formed
21 conclusions yet. That's the whole Rentrak number
22 and the process is something we are looking at.

1 But, again, the points you raised are things that
2 we definitely are considering, and we do want to
3 know exactly how this number is generated, the
4 mechanisms. As I said, we have some, you know, a
5 lot of additional -- I mean, initial information
6 that most of this is automated, coming directly
7 from the theaters. There's protections in place
8 presumably that would prevent, you know,
9 generating numbers that are false. But, again,
10 those are the types of thing that we do want to
11 look at to make sure that it isn't just some sort
12 of, you know, an estimate that someone can easily
13 --

14 COMMISSIONER CHILTON: All right. I
15 mean, we're not surveilling the Rentrak system.

16 MR. SHILTS: That's correct.

17 COMMISSIONER CHILTON: The only time --
18 if we saw -- if we suspected a problem, I mean --

19 MR. SHILTS: If we suspected -- I guess
20 with any contract, if we saw evidence that the
21 cash price series no longer seemed to meet the
22 requirements, you know, that we would look at,

1 that it's not reliable or accepted or it's been
2 manipulated is to -- we would go back to the
3 Exchange and tell them that they need to either
4 not trade the contract or to look for another cash
5 price series.

6 COMMISSIONER CHILTON: Yeah, or we --

7 MR. SHILTS: For any contract.

8 COMMISSIONER CHILTON: Or we go to our
9 enforcement people --

10 MR. SHILTS: Yes.

11 COMMISSIONER CHILTON: -- and get a
12 subpoena and we go figure out --

13 MR. SHILTS: But you have to deal with
14 the, you know, some evander problem that occurred.

15 COMMISSIONER CHILTON: Right.

16 MR. SHILTS: But I'm saying going
17 forward we wouldn't just let it stand.

18 COMMISSIONER CHILTON: Okay. The reason
19 why -- Am I over my time. We're not using it
20 anymore, okay.

21 CHAIRMAN GENSLER: We're going to try to
22 -- we'll try to do it on the next round.

1 COMMISSIONER CHILTON: We'll try to
2 oblige the Chairman but I see we have no lighting
3 assistance.

4 So, Mr. Berkovitz, I want to go back to
5 what I said in my statement was what I want to
6 look at, you know, what's a commodity? Is there
7 manipulation? And is it a legitimate hedging
8 vehicle? All those three things.

9 So, to follow up on the chairman's
10 question, and excuse me for just looking at the
11 Act itself but, Mr. Berkovitz, you said, you know,
12 as far as jurisdiction that we have over contracts
13 for the sale of commodities for future delivery;
14 and, you know, I think -- well, you know, I'm
15 willing, for the sake of this question, to say
16 okay, they're futures. But, you know, is it
17 actually a commodity? I mean, is there an
18 underlying commodity here, or what would that be?

19 MR. BERKOVITZ: The commodity would be
20 the service rights and interest in which the
21 contracts for future delivery are dealt in, which
22 would be the box office receipts as defined in the

1 contract that is subject to approval -- these box
2 office receipts.

3 MR. SHILTS: I think it's the -- yeah,
4 it's the box office receipt number, and I guess in
5 a sense it would be similar to the S&P real estate
6 price index number or the Consumer Price Index
7 number that's used to settle some futures
8 contracts.

9 COMMISSIONER CHILTON: Okay, so we look
10 at 1a(13)(iv). You know, it says, "an occurrence,
11 extent of an occurrence, or contingency." The
12 occurrence would be the box office receipts,
13 correct, Mr. Berkovitz?

14 MR. BERKOVITZ: (inaudible)

15 MR. SHILTS: You might want to push your
16 mic.

17 COMMISSIONER CHILTON: Yeah, okay. Yes,
18 okay, so the occurrence would be the box office
19 receipts, and it said that it has to be the big
20 "I" below that, Mr. Berkovitz, says, "beyond the
21 control of the parties to the relevant contract,
22 agreement, or transaction." So you know, you

1 could, I guess it's debatable, but, I mean, movie
2 studios are all about producing movies. They're
3 all -- I mean, their goal is -- you know, if they
4 had a mission statement, my guess is it's, you
5 know, box office returns. So, that's really their
6 focus, is box office returns. So, it would seem
7 to me that they would be able to control, to some
8 extent, the occurrence. And, therefore, I wonder
9 whether or not these would be just susceptible to
10 manipulation by the studio just on its face,
11 hypothetically, because they are a party to the
12 contract, and the contract is based upon the
13 occurrence.

14 MR. SHILTS: That's a, you know, good
15 question and something that we had looked at in
16 connection with the reviews at the Exchanges and
17 is ongoing with respect to this, and I think
18 there's maybe two ways of looking at it. One is
19 kind of the focus on the susceptibility and
20 manipulation of the cash settlement and price
21 areas, which I talked about, and, you know,
22 whether there's, you know -- that the numbers that

1 are generated actually reflect the number of
2 people that went to the movies and what they paid
3 for it. Then -- and it -- and looking at does
4 anybody really, whether it's the studio or
5 whatever, have any way to control that number to
6 influence it, or is it just, you know, an
7 automated procedure that just feeds data?

8 I think probably more what you're
9 focusing on maybe is, you know, trading prior to
10 that where, you know, a studio can maybe, through
11 it's marketing budget or whatever, influence what
12 the ultimate -- you know, the number of people
13 that actually go see the movie. And that's
14 something that we want to look into, too, and I
15 guess we've heard different things.

16 On the one hand, I mean, someone said
17 that well -- that as much as they would like,
18 studios generally don't have this much of control.
19 Otherwise, there would be no flops. I mean, that
20 to some -- so that it's -- and I -- you know, I
21 don't know, there's some -- like I know what the
22 answer is, but to some extent it's, you know, it's

1 -- do they -- how much control do they really
2 have? And I guess also to look at in the sense of
3 is that -- to the -- you know, if they do adjust
4 their budgets, whatever, put out press releases or
5 whatever, is that in the sense of manipulation, or
6 is it really more just influence and something
7 part of their normal business operations? But I
8 understand, you know, your comments.

9 COMMISSIONER CHILTON: But I mean, they
10 have some impact on the price. I mean, they pull
11 the movie. They can do the things you're talking
12 about. They can have Russell Crowe go on Jimmy
13 Kimmel. I mean, they can do things that have an
14 impact really up to the very last minute. So, I
15 mean, I see, you know, again, I guess that's
16 debatable. But I see no way that they're not
17 impacting the price. If they are not a party that
18 has control, it cannot be beyond the control of
19 the party and they're a party to the occurrence.

20 Now, Mr. Shilts, you said at one point I
21 think you said these are really based upon what,
22 you know, consumers do. The prices are controlled

1 by what they do, and maybe not by the studios, but
2 what consumers do at the box office, is that
3 correct?

4 MR. SHILTS: Yes, that's the -- I think
5 that's why people -- I mean, not for these futures
6 contracts but in general -- why other parties have
7 various contractual obligations that kind of go to
8 these box office receipt numbers. So.

9 COMMISSIONER CHILTON: So, they sort of
10 look at the value generated in cash by the actual
11 ticket window sales.

12 MR. SHILTS: Right, yes, and that
13 they're viewed -- you know, we understand at least
14 preliminarily that they're viewed as a reliable
15 indicator what actually occurred, you know, what
16 -- that people -- how many people went to see the
17 movie and, you know, and the price.

18 COMMISSIONER CHILTON: Okay, so this --
19 and this finishes my line, Mr. Chairman.

20 So, there's another part in the Act
21 there, Mr. Berkovitz, that if you didn't accept my
22 original -- it's going to be 2I(a)(13)(iv) -- but

1 if you didn't accept my contention that the
2 studios are a party that can have an influence
3 that has control over the price of the occurrence
4 and therefore they can't be involved in it -- if
5 you didn't accept that whole argument -- then you
6 have this other one, the ii -- there's another
7 possibility for determining that there's an
8 underlying commodity here, and that's a commercial
9 rate of return. But that would require, as you
10 see down there in II, that it would require -- it
11 says "based solely on one or more commodities that
12 have no cash market," right? So -- but Mr. Shilts
13 just said that there is a cash market. I mean,
14 that's people buying at the box office -- that's
15 how we're making these determinations. So, what
16 section of 1a(13) could we rely on to determine
17 that this actually is a commodity? And that's my
18 last question. I'll be quiet after that for a
19 little bit. Thanks for your indulgence.

20 MR. SHILTS: Could I just make one
21 comment before he answers? I think my view at
22 least would be that there really isn't an

1 underlying cash market here when you're just
2 looking a number, that I think what we
3 historically viewed as a cash market where there's
4 an actual physical commodity that people are
5 buying and selling something whether it be, you
6 know, Treasury Bills or corn or crude oil, and
7 that where you -- you know, whether it's prices of
8 real estate or the Consumer Price Index or
9 domestic box office receipt numbers, that there
10 really isn't a cash market per se where people are
11 buying and selling some specific commodity.

12 COMMISSIONER CHILTON: What are the -- I
13 mean, what are box office receipts? I mean, we're
14 paying cash to buy a ticket to a movie. They're
15 aggregating that and reporting it. What sort of
16 market is that?

17 MR. SHILTS: It's a revenue number.

18 COMMISSIONER CHILTON: Revenue number,
19 okay. Berkovitz, you want to comment?

20 MR. BERKOVITZ: Yeah. I think the
21 question of the cash market would relate to the
22 cash market for the number that is the box office

1 receipts index, not whether there's a cash market
2 for tickets, but it would be the index that's
3 produced by Rentrak and released by the studios.
4 Nobody's buying or selling that index. Like the
5 S&P 500 Index, you don't -- you don't own that.

6 The other question I would say is that
7 whether something is an excluded commodity or not,
8 we're looking here as to whether this fits in the
9 definition of an excluded commodity, which would
10 help -- okay, we would analyze and say if it's
11 under this 13(i)(2) or (3) or (4) and it fits in,
12 oh, it's an excluded commodity; therefore, it is a
13 commodity. But if it's not an excluded commodity,
14 that just means it's not an excluded commodity.
15 It doesn't mean it's not a commodity. So, you
16 could still have a commodity even though it's not
17 an excluded commodity.

18 COMMISSIONER CHILTON: I mean, it's got
19 to fit into law. Where -- how's it -- what's --
20 it's got to be a commodity. It's got to be a
21 commodity, right? I mean, it's got to be a
22 commodity. So, which commodity is it?

1 MR. BERKOVITZ: Well, there are several
2 types of commodities. There are excluded
3 commodities, so there's exempt commodities and --

4 COMMISSIONER CHILTON: There are Ag's,
5 excluded, and exempts.

6 MR. BERKOVITZ: -- (inaudible)
7 financials.

8 COMMISSIONER CHILTON: So, which one is
9 it?

10 MR. BERKOVITZ: Well, if it's not an
11 excluded commodity, it would be an exempt
12 commodity. Commodity -- there's not an excluded
13 commodity or an agricultural commodity.

14 COMMISSIONER CHILTON: Sort of like
15 metals?

16 MR. BERKOVITZ: That's right. Metals is
17 another --

18 COMMISSIONER CHILTON: Okay, I'll chew
19 on that for a while. Thank you.

20 CHAIRMAN GENSLER: I'm going to turn to
21 Commissioner O'Malia, but that was very helpful,
22 that back and forth maybe, but at least for this.

1 Commissioner.

2 COMMISSIONER O'MALIA: I agree that that
3 was helpful, and I'd like to kind of go along that
4 -- down the line of questioning a little bit and
5 maybe ask some more comparisons to specific
6 contracts that have been traded.

7 I assume this is not the first contract
8 that has generated some opposition or concerns
9 from within the industry or at least one aspect of
10 the industry. How does this compare to other
11 specific contracts you've looked at in your tenure
12 here at the Commission, and one contract that was
13 raised -- it was a Head Street contract regarding
14 -- which traded, and I don't think it trades
15 anymore, but the corporate earnings future, that
16 seems to be similar, kind of an opinion of
17 corporate earnings in the information controlled
18 specifically by a corporate entity: Coca-Cola or
19 General Electric. They seem to have all the
20 information about what the future will be about
21 that product. Can you kind of answer that
22 two-part question?

1 MR. SHILTS: Yeah. I guess on the first
2 one, I think in the introduction of futures
3 contracts in most new commodity areas, at least
4 from my experience, has generated a lot of
5 opposition by -- and in -- I think ultimately many
6 members of the industry ultimately come to use
7 them. I mean, even going back I think to the --
8 originally, the stock index contracts were opposed
9 strongly by the SEC, but of course now they're
10 widely integrated into risk management. Same
11 thing I think with some of the Treasury futures
12 and energy futures. So, I think -- and -- so I
13 think that, you know, to answer your question, I
14 think generally that it's -- there tends to be a
15 view that people don't really understand how
16 contracts can be used for risk management, and
17 they -- you know, there's an opposition to that.
18 And in many cases, the contracts never succeeded,
19 as I had mentioned. But those that do, the
20 industry generally comes on board and trades them,
21 and that's actually probably why they succeed.

22 With respect to some other contracts

1 like I mentioned and, you know, whether it's
2 corporate earnings or something like that or
3 another, you know, index of, you know, whatever,
4 you know, whether it's a macroeconomic index, like
5 I said, or insurance -- head contract based on
6 insurance, real estate, and other things, I think
7 that there is some analogy to that, and it may not
8 be exactly the same, but in this sense, in terms
9 of the computation of the cash settlement price
10 but to the extent that it's narrow, that it's
11 earnings of a particular entity, that's probably a
12 similarity to this where it's focused on a
13 particular movie and it's not some sort of an
14 aggregate of, you know, a number of movies and you
15 have an index. It's looking at the actual
16 revenues at once. So, I think there is some, you
17 know, some -- a parallel there potentially.

18 COMMISSIONER O'MALIA: Do you have any
19 concern about the narrow nature of either the
20 corporate futures or this product in particular?

21 MR. SHILTS: Yeah, we didn't on the
22 other. This one we did from the -- you know, from

1 the beginning, and that's why had been working
2 with the Exchanges and had got their consent in
3 this provision that they would be submitting these
4 contracts for prior approval, because in that
5 sense it was unprecedented. The other contracts
6 were self-certified, so the Commission never
7 really had to take action, and then as you said
8 they never really traded anyway. But in this
9 case, it was something. I think that's probably
10 one of the key novel features of these products
11 and why we wanted to look at them more closely.

12 COMMISSIONER O'MALIA: Obviously, we all
13 know that Congress has taken -- or some in
14 Congress have taken a position that legislation's
15 out there, but I just want to make sure that you
16 and your staff don't have any questions that you
17 have not had answered or that contracts have not
18 -- the companies have not provided data to you
19 that you're seeking. Do you have every bit of
20 data you ever wanted on these contracts?

21 MR. SHILTS: Yes, they've been very
22 responsive to information that we've requested,

1 and as part of the review process it's -- you
2 know, it's kind of a -- it's working with the
3 Exchange and gathering more information, and we
4 may be going back, requesting changes to terms
5 whether it be speculative limits or other features
6 of the contract. But to date, they've been very
7 responsive. We've had no issues.

8 COMMISSIONER O'MALIA: Do you have any
9 specific questions regarding the oversight of
10 possible enforcement of these contracts if they're
11 approved?

12 MR. SHILTS: Not at this time. I mean,
13 that's something that we're looking at, and it's
14 part of the, you know, the overall process in
15 evaluating the -- you know, the settlement, the
16 price series and all of the mechanisms that the
17 Exchanges have in place for oversight.

18 COMMISSIONER O'MALIA: Do you have any
19 doubt that if approved your staff could identify
20 and enforce against any possible manipulation of
21 these contracts?

22 MR. SHILTS: I can tell you that our

1 staff would be very much focused on -- again, if
2 they trade on oversight, you know, valuating a
3 large trade or data, the trade data, monitoring,
4 you know, information in the market to ensure that
5 there aren't violations. Whether we can, you
6 know, be perfect, catch everything -- I can't
7 claim that, but we would be vigilant.

8 COMMISSIONER O'MALIA: Good. Thank you.

9 CHAIRMAN GENSLER: Thank you, Commission
10 O'Malia. I don't know that there's any more RAMs,
11 but General Counsel Berkovitz may have an answer
12 about commodities, excluded commodities, exempt
13 commodities. That would be helpful, by the way.

14 MR. BERKOVITZ: I'd be happy to expound
15 on that.

16 CHAIRMAN GENSLER: Okay.

17 MR. BERKOVITZ: I wanted to actually
18 supplement an answer, a previous answer I'd given
19 to a question that you had about the --

20 CHAIRMAN GENSLER: Oh, one of my
21 questions.

22 MR. BERKOVITZ: One of your questions,

1 Mr. Chairman.

2 CHAIRMAN GENSLER: All right.

3 MR. BERKOVITZ: You had asked about the
4 standard for the Commission under "would violate
5 the Act," and what standard the Commission has to
6 determine that something would violate the Act,
7 and the Commission's regulations in Section 40.3d
8 says that the Commission may find that it is able
9 to approve a product or instrument. The
10 commission is to briefly specify the nature of the
11 issues raised and including former -- including
12 finding that the product would violate, appears to
13 violate, or the violations of which cannot be
14 ascertained from the submission. So, those are
15 the standards within the Commission's regulations
16 for finding under the statute that disapproving --
17 disapprove --

18 CHAIRMAN GENSLER: And if my fellow
19 Commissioners will give me the spin of it, because
20 I didn't plan to ask a question. The earlier
21 question I had, had to do with the economic
22 purpose. You know, are these contracts used by

1 some hedgers out there? 2000 law repealed all of
2 that in a specific -- but some of the opponents of
3 this, you know, contract have said but there's
4 still this Title 3. A Title 3 for the public is
5 just our sort of purposes part. You know, every
6 law seems to have a little section about findings
7 and purpose, and that's what Title 3 is, as I
8 understand it.

9 So, my earlier question is does that get
10 read into this decision? How much weight does it
11 have in this decision? I mean, it seems --
12 everybody agrees that we have to focus on Core
13 Principle 3, which is manipulation; Core Principle
14 5, and so forth, but this economic purpose -- is
15 it used for hedging is one that I'm most
16 interested in. Is that on the table, not on the
17 table, how much is it on the table?

18 MR. BERKOVITZ: It is not as prior to
19 2000 as an explicit step that the Commission is
20 required to take in arriving at its judgment. If
21 the Commission were to conclude that because this
22 has no economic purpose or because there's no --

1 it can't be used for managing or assuming price
2 risks because it's fundamentally inconsistent or
3 appears to be fundamentally inconsistent, or you
4 can't ascertain whether it's fundamentally
5 inconsistent with a finding and purpose of the Act
6 as in Section 3, I believe the Commission would
7 have the authority to disapprove it.

8 CHAIRMAN GENSLER: And so if -- I mean,
9 so it's a matter of interpretation, but if we were
10 to do that, is it that no parties would hedge with
11 it, that just certain key movie studios wouldn't
12 hedge with it, because there's testimony that
13 we're about to hear from another panel that lists,
14 you know, 6 or 8 or 10 areas of people that might
15 hedge with it, you know, and there's other
16 testimony that says, you know, some parties like
17 the major movie studios, wouldn't use it for, you
18 know, well articulated reasons in that testimony.
19 So, since we don't normally read in any economic
20 purpose test -- in fact, have we ever done that in
21 the last ten years since the Commodity Futures
22 Modernization Act? So, this would be a first for

1 us. It would be good just to get a guidance. Is
2 it -- you know, there's zero hedgers? Lots of
3 hedgers? What would be the thing?

4 MR. SHILTS: I guess what I could
5 comment on is what staff looked at, you know, when
6 we had the explicit economic purpose test.

7 CHAIRMAN GENSLER: In the past.

8 MR. SHILTS: Yeah, and it was that, you
9 know, the contracts could be used for hedging on
10 more than an occasional basis. I think that came
11 out of the -- in '74 when the CFTC was
12 established.

13 CHAIRMAN GENSLER: I'm sorry, "could be"
14 --

15 MR. SHILTS: "Could be" used towards
16 hedging --

17 CHAIRMAN GENSLER: "Could be" used for
18 more than an occasional basis.

19 MR. SHILTS: More than an occasional --

20 CHAIRMAN GENSLER: All right, that
21 answers my question, yeah.

22 MR. SHILTS: So, it wasn't the entire

1 industry. You would just -- if there were some
2 segments of the industry or individuals that could
3 use it, and reasonably expect them to. Obviously
4 they don't swear to that, but.

5 CHAIRMAN GENSLER: I thank my fellow
6 Commissioners for indulging me (inaudible), you
7 know, brought that back up.

8 COMMISSIONER CHILTON: Oh, here, all
9 right. I'm sorry, I just wanted -- I had a little
10 time to digest Mr. Berkovitz' stuff, and I think I
11 know where you were, but on the 1(a)13, I mean,
12 you've mentioned the exempt contracts, but that
13 one is really defined by a negative if you're
14 using that for the definition of a commodity. You
15 know, that says it's not an Ag and it's not an
16 excluded, so energy or metals are in that, but I
17 think what you were talking about goes back to
18 what the chairman was asking originally. Again,
19 is it a commodity, this is right at the beginning
20 of the Act, and that's, you know, for a commodity,
21 which includes all, it says, "and all services,
22 rights, and interests in which contracts for

1 future delivery are presently or in the future
2 dealt with."

3 But, you know, that's sort of circular
4 in my mind. You can't just say it's a commodity
5 because we're going to have a contract on it in
6 the future, therefore, it exists. It's sort of
7 like, you know, the Commission long before any of
8 us were here considered terrorism contracts. I
9 mean, there wasn't an underlying commodity it was
10 when will the next, you know, terrorism act
11 happen. So, is that really what we're looking at
12 as to why this would be a commodity? And what
13 would be the difference between a terrorism
14 contract and a box office contract?

15 And that's all I have. Thank you.

16 MR. BERKOVITZ: The definition that was
17 put in the 1974 Act was intended to be extremely
18 broad. As you're aware, prior to 1974 every time
19 a commodity would come under regulation, Congress
20 actually had to pass an Act and say enumerate the
21 commodities within the Act. So, 1974 the
22 congressional decision was we're going to cover

1 everything, everything that now is potentially for
2 future delivery or something in the future maybe.

3 And because of the concern that you just
4 raised, Commissioner, because there might be a
5 terrorism contract, and because concern that there
6 wasn't really anything to limit this, this is why
7 they put the Public Interest Test in 1974, so that
8 this would be something that could legitimately be
9 used for hedging and the Public Interest Test was
10 interpreted by one of my predecessors -- who I
11 believe is in attendance today and legal advisor
12 to the Commission -- some 25 years ago to mean an
13 Economic Purpose Test. This is how the Commission
14 generally implemented it. And it was I think for
15 the policy considerations that you've identified
16 that there was a Public Interest Test.

17 In 2000, they took out the Public
18 Interest Test but for the reasons we've just been
19 discussing, we believe that within the findings
20 and purposes together with the requirement that
21 the Commission find that and not be violative of
22 the Act that there still is authority within the

1 statute for the Commission in a circumstance where
2 the Commission would believe that the contract
3 would violate the finding and the purpose of the
4 Act to reject that contract. So, there is
5 residual authority, we believe, to take care of
6 that concern.

7 CHAIRMAN GENSLER: I want to thank Mr.
8 Shilts and Mr. Berkovitz and welcome our next
9 panel up. I've no doubt that over the next couple
10 weeks as we're continuing to deliberate we'll have
11 a lot more questions of you about the Act, about
12 these contracts, and so forth.

13 (Pause)

14 CHAIRMAN GENSLER: Can I do this without
15 a quorum? Can I at least introduce them?

16 Hey, Eric. Can I do this without a
17 quorum? Can I introduce them?

18 SPEAKER: Yes.

19 CHAIRMAN GENSLER: Okay. I want to
20 thank our second panel, our first outside panel,
21 for being here today. And their patience with
22 this as we're sorting through these issues. This,

1 again, we're not taking any votes today but this
2 is a public meeting so that we can really inform
3 the Commission and the public on these important
4 matters.

5 I want to -- I'll just go, I guess, left
6 to right, and the next panel will go right to
7 left, I guess -- thank -- do I have the same list
8 here? Hopefully. Well, it's in a different
9 order. All right. But Richard Jaycobs from
10 Cantor -- Cantor Futures Exchange. I keep
11 thinking about an old name that you had but --
12 president of Cantor Futures Exchange. He'll be --
13 is one of the applicants. Robert Pisano, who is
14 from the Motion Pictures Association of America,
15 and I guess I think of you heading it up but still
16 is the interim chief executive officer of the
17 MPAA. Alice Neuhauser, who is a principal of
18 Complete Rights Management, and then Clark
19 Hallren, who is a managing director of Clear Scope
20 Partners. We thank all of you for being here.
21 Your written submissions will be put up on our
22 website. I know some of them just came in this

1 morning so -- but we'll put them all up on the
2 websites for the public to see. If you could
3 possibly help us out with summarizing in five
4 minutes in an oral -- and I know that's hard
5 because I do it a lot in front of Congress.

6 And then there's also going to be some
7 lights that our good friend Doug is going to try
8 to do that -- and we'll try to police ourselves,
9 too, when we do our Q&As. So, Richard, do you
10 want to start?

11 MR. JAYCOBS: To begin I would like to
12 acknowledge the hard work of the Commission staff
13 through the multi-year process during which our
14 exchange was approved. In that multi-year
15 process, we filed over 300 documents, many of
16 which are specific to the domestic box office
17 receipt contracts that we're proposing. We call
18 those DBOR. The staff has been thorough and
19 forthright with regard to the requirements of
20 approval.

21 In late March, Cantor Exchange submitted
22 its domestic box office receipt contract to the

1 Commission for approval. Although we had expected
2 to self-certify these contracts, we entered the
3 formal process when the Motion Picture Association
4 of America raised objections. We appreciate this
5 opportunity to publicly clarify the benefits of
6 our DBOR contract.

7 The six major studios that make up the
8 MPAA are all owned by large media companies, and
9 therefore have the ability to self-fund motion
10 picture production and development and
11 distribution. We accept that these industry
12 giants may not find DBOR contracts an attractive
13 hedging vehicle. However, others in the motion
14 picture industry, some of whom are speaking here
15 today, believe that hedging highly speculative
16 film investments is indeed a sound idea. The fact
17 that the MPAA members do not wish to participate
18 does not invalidate the market. OPEC's
19 participation was not a prerequisite for NYMEX
20 crude oil futures contract and neither should
21 MPAA's participation be a prerequisite for DBOR
22 contracts.

1 Hedging tools like DBOR futures will
2 foster competition among distributors, provide
3 access to a wider array of film financing, and
4 allow for more effective allocation of theatrical
5 resources and entertainment dollars. After
6 reviewing the many self-contradictory and baseless
7 claims made by the MPAA regarding our contract, we
8 conclude that their opposition is primarily
9 intended to maintain the status quo of film
10 financing and distribution.

11 I'd like to briefly address four key
12 aspects of our proposed market -- the hedging
13 utility of box office contract; the market's
14 potential impact on the motion picture industry;
15 the need for contract design features, such as
16 position limits; and concerns about inside
17 information, manipulation, and the integrity of
18 the final settlement calculation.

19 Everyone here today, proponents and
20 opponents to box office futures contracts, agrees
21 that film investing is an extraordinarily risky
22 business. The disagreement is whether a

1 transparent public market is desirable or even
2 necessary as a mechanism to manage that risk.
3 Opponents contend that since they won't use a
4 futures market, neither will any other commercial
5 enterprise in the motion picture industry. They
6 conclude from that that box office contracts
7 therefore are just a gambling device.

8 Today's hearing demonstrates that a
9 growing number of legitimate hedgers are coming
10 forward and publicly stating their support for the
11 contract. My written testimony provides several
12 hedging examples using DBOR futures. These
13 examples were derived from actual conversations
14 with potential market users, including investors,
15 theatre owners, and others. And I'm happy to
16 answer questions on these examples.

17 Both proponents and opponents of box
18 office contracts also agree that DBOR futures will
19 bring new and significant levels of transparency
20 to box office reporting. Again, the disagreement
21 is whether this transparency will benefit the
22 industry or harm it. Currently, the major studios

1 operate in a financial world where the
2 prognostications about a film's economic potential
3 go unchallenged. Investors in film have no means
4 to quantify the impact of a studio's decisions;
5 neither can they protect themselves from the
6 day-to-day decisions that are being made about
7 their investment. This inhibits investment.

8 Also, the MPAA's position fails to
9 recognize the large number of institutional and
10 private investors that would like to assume the
11 risk of film investing, standing
12 shoulder-to-shoulder with the MPAA members,
13 provided that the risk can be transferred at a low
14 cost, public liquid exchange. The MPAA is
15 concerned that box office contracts would imperil
16 their investment and bring harm to the reputations
17 of the directors and talent in filmmaking is
18 simply not supported by any facts.

19 We do believe that position limits are
20 necessary. Futures contracts are risk transfer
21 mechanism, and we agree with the MPAA that futures
22 should not be used to create perverse economic

1 structures or incentives. The motion picture
2 professionals and investors who bear risk should
3 be able to use the futures market to mitigate that
4 risk, but futures should not provide any incentive
5 for film owners and distributors to create bad
6 movies. Similarly, speculators should be
7 constrained in the positions that they can take so
8 that they may provide a meaningful liquidity
9 presence but certainly not dominate the market.

10 Finally, with regard to final
11 settlement, insider training, and manipulation
12 potential, I refer the Commission to my written
13 testimony. However, I would like to emphasize the
14 following. Final settlement calculations based
15 solely on Rentrak's electronically captured box
16 office receipts do not vary materially from that
17 reported by distributors. I cite the case of Iron
18 Man 2 in my written testimony; I have other
19 examples here. We've compared these values for
20 over a year and found no material discrepancies in
21 those calculations.

22 Second, contrary to MPAA's public

1 statements, knowledge of the artistic content of a
2 film by its directors, actors, editors, and others
3 is not material, nonpublic information, simply
4 because seeing a film is not a reliable predictor
5 of box office revenue. With regard to
6 manipulation, distributors determine advertising
7 budgets, screen counts, and release dates.
8 Certainly, these decisions impact box office
9 results. However, over-manipulation of these cash
10 market-type activities would be readily detected.
11 Furthermore, the economics of DBOR contracts are
12 such that any profit garnered from this activity
13 would require the accumulation of a relatively
14 large market position that would be regularly and
15 routinely surveilled.

16 CHAIRMAN GENSLER: If you could try to
17 summarize.

18 MR. JAYCOBS: I will do that. Overall,
19 we believe the opponents are correct to point out
20 that diligent market surveillance is needed, but
21 we also think they have failed to recognize the
22 role of the National Futures Association and our

1 own ability to detect fraud.

2 Again, I'd just like to thank the
3 staff's efforts in this regard, and I appreciate
4 the time.

5 CHAIRMAN GENSLER: Thank you Mr.
6 Jaycobs. Mr. Pisano.

7 MR. PISANO: Can everybody hear fine?
8 Good morning, Mr. Chairman, and fellow
9 commissioners. Thank you very much for the
10 opportunity to be here this morning.

11 I want to make clear at the start that
12 while I'm here as the representative of the Motion
13 Picture Association of America, which consists of
14 the six studios, I'm also here as a representative
15 of an unprecedented coalition. This proposal has
16 succeeded in uniting what are historically warring
17 factions of our industry and brought everybody to
18 the table. And that would include labor and
19 management, because two of the major unions are
20 represented here; distributors and exhibitors,
21 because the National Association of Theater Owners
22 are represented here; and the six major studios

1 and independent film producers who together
2 account for probably 95 percent of all the movies
3 released in America. So it's just not the six of
4 us who are objecting to this. It's the entire
5 motion picture industry from production,
6 distribution, marketing, work, in terms of the
7 workers, and the exhibitors who exhibit our movies
8 in theatres.

9 I'm here not necessarily as that
10 representative but I'm also here as someone who
11 spent 25 years in this industry at two studios, as
12 a senior executive, and as the head of the Screen
13 Actors Guild. In particular, that latter
14 responsibility has impressed upon me the work --
15 the amount of work and the effort that goes into
16 each of these movies by the performers who
17 actually make the movies as opposed to those of us
18 who wear suits and go to a studio office or write
19 the checks. So I'm not a financier. I'm not a
20 commodities lawyer. I would not be able to engage
21 in the kind of colloquy that the Commission did
22 with its general counsel. But I'm here as a

1 person who has actually made movies from the
2 standpoint of production, distribution, marketing,
3 and financing. And I've used all kinds of old
4 fashioned ways of hedging the risk when we make
5 movies. We've presold rights. We've done split
6 rights. We have done external financing. My
7 colleague at the end of the table, Mr. Hallren,
8 was our banker when I was at MGM and he was at JP
9 Morgan and we borrowed money the old fashioned way
10 from JP Morgan and we paid it back because we
11 invested that money in film and television
12 product.

13 So I come here as someone who has done
14 it in terms of the way the industry functions, and
15 I would like to make clear that speaking for the
16 coalition that I represent, we have never, ever
17 thought about hedging our risk or selling a movie
18 short. And we never will. Because the first time
19 we do that, the first time we go short against one
20 of our own movies, it'll be the last time that we
21 ever work with those filmmakers. And once that
22 becomes public and in the community, it will be

1 the last time many filmmakers will work with us.
2 Because when we make a monetary commitment to make
3 a movie, we're backing the creative integrity and
4 vision of the people who are involved in the
5 movies. And I can accept there are circumstances
6 when financial engineering, synthetic derivatives,
7 et cetera, play a role, but they certainly don't
8 play a role in the process of creating this
9 uniquely American product.

10 So we are -- operate in a world of
11 creativity. We operate in a world of a unique
12 product. And that brings me to some specific
13 questions about this -- these proposals. I've
14 heard the term commodity and I understand the
15 popular view of what a commodity is. The only
16 analogy I can think of, and analogies are
17 dangerous, is that this would be like taking a
18 contract out on Farmer John's spotted cow because
19 every single movie is unique and you can't
20 commoditize them. And if you do try to
21 commoditize them you will fail. So it's not a
22 commodity in the way I can see but what

1 commodities can be.

2 There's no price discovery because you
3 can't buy or sell the movie. You can't buy or
4 sell movie box office. No one can pay cash for
5 them. It's simply a synthetic, artificial piece
6 of information that is released by the studios.
7 And I can say that I probably bear some
8 responsibility for this being in the public domain
9 as opposed to inside industry information because
10 my studio in the 1980s, Paramount, was the first
11 to release at the end of a weekend how good our
12 box office was and why we had become the number
13 one movie for the weekend. So there's no price
14 determination. I think the hedging aspect has
15 been covered. The manipulation -- as a former
16 general counsel, I can tell you that this is a
17 nightmare to try to control the use of inside
18 information and another reason why the studios and
19 the independent film producers would never use it.

20 So what do we have here? We have a
21 synthetic, based on a number that is not real in
22 the sense of anybody actually using it. I think

1 we've got something close to or indeed a gambling
2 contract. It more properly should be regulated by
3 the gambling contracts and the Federal Wire Acts
4 and not be given the cloak of authenticity by
5 being traded as a future.

6 Thank you.

7 CHAIRMAN GENSLER: Thank you very much,
8 Mr. Pisano. And for even summarizing.

9 Ms. Neuhauser.

10 MS. NEUHAUSER: Good morning. Thank
11 you, Chairman Gensler and commissioners, for
12 inviting me to testify today.

13 I've been involved in business
14 entertainment for over two decades. During that
15 time I usually had some involvement in film
16 financing from managing \$200 million revolving
17 credit facilities, to multiple single picture
18 financings for some of the largest independently
19 financed pictures, including Terminator 2 and
20 Cliffhanger. I've managed film financing for
21 pictures ranging in budget from \$2 million to over
22 \$100 million, the vast majority of which were

1 released through standard studio distribution
2 arrangements, including approximately 14 pictures
3 in the last 4 years.

4 In the course of that time I've worked
5 with studios, banks, independent financiers,
6 international distributors, completion bond
7 companies, and other entities critical to the
8 financing of production of motion pictures. In
9 addition to film financing, I've looked for
10 opportunities with businesses ancillary to or
11 which support film production. The most
12 successful of those ventures was the development
13 of the Raleigh Manhattan Beach Studios in
14 Manhattan Beach, California. This film and
15 television production facility was built in 1998
16 and was the first full- service production
17 facility in Los Angeles in over 50 years. The
18 facility was built on 22-1/2 acres and includes 14
19 sound stages, 8 production buildings, a
20 commissary, a 4-story office building, and a
21 parking garage.

22 Establishing a new business model, we

1 took the real estate development mall model and
2 adapted it to the entertainment industry. So
3 instead of a Macy's taking a long-term lease as
4 anchor tenant in a new large-scale mall, we signed
5 20th Century Fox Television to a five-year term as
6 anchor tenant for Fox's television producer, David
7 Kelly, where he shot his shows *Ally McBeal*, *The*
8 *Practice*, and *Boston Public*.

9 In the real estate world, a five-year
10 lease would not have been considered long.
11 However, due to the economics of entertainment,
12 this was a workable length of time for
13 establishing the necessary debt service for
14 obtaining our construction loan. Since that time,
15 the studio facility has been continuously filled
16 with a variety of network and cable television
17 shows, as well as major studio film productions.
18 The studio is currently home to Marvel Studios,
19 which was the base for the filming of this year's
20 hit, *Iron Man 2*, and where Marvel intends to shoot
21 the film *Thor*, *The First Avenger*, *Captain America*,
22 and *The Avengers*.

1 Over the years, usually at the request
2 of various lenders, including GECC and JP Morgan
3 Chase, I've been retained by various distressed
4 entertainment companies on a workout basis to
5 either restructure or sell the assets of those
6 companies. Generally, this involves determining
7 how best to exploit the existing assets and the
8 various distribution channels on a worldwide basis
9 or packaging the assets, marketing them for sale,
10 and identifying potential buyers. As a result of
11 my livelihood being inextricably linked to the
12 ongoing business of film production, I've been
13 interested in the opportunity that trading in box
14 office futures might offer to the film community.

15 There are significant similarities
16 between building construction and film production.
17 Both require a significant amount of upfront
18 capital with a long lead time to completion.
19 Financing can have some similarities as well, with
20 pre-selling in the form of office space leases for
21 construction and output deals with foreign
22 distributors or pay television providers for film

1 television -- for film production. The industry
2 has been pretty successful in developing ways of
3 mitigating the risks inherent in production, from
4 buying weather and cast insurance, to obtaining a
5 completion bond to guarantee completion and
6 delivery of completed product. However, unlike
7 the building construction model where the
8 completed product might take a little while to
9 fully lease up, generally the building has the
10 same utility two years after completion as it does
11 on the date it is completed.

12 This is not the case for film
13 production. Generally, the theatrical performance
14 of a picture will determine its final ultimate
15 value. International box office, pay television
16 license fees, DVD sales, and downstream television
17 revenues are all impacted by the initial U.S. box
18 office performance. With ever increasingly
19 substantial investments in production and
20 distribution costs, the U.S. box office
21 performance becomes ever more important. While
22 the ability of box office futures contracts hedge

1 some of that performance risk doesn't change the
2 final ultimate revenues of a given picture, it
3 does provide the financiers -- whether studios,
4 lenders, P&A investors, et cetera -- the
5 opportunity to alter the actual financial outcome
6 of their investments. Just as this has been a
7 useful tool for grain producers who are subject to
8 the whims of the marketplace, such as when yields
9 are greater than expected, so it can provide risk
10 mitigation for those investors in the value chain
11 of film production and distribution. I would like
12 to see the opportunity for this hedging tool to be
13 made available to those parties who are
14 interested.

15 I thank you again for the opportunity to
16 speak today.

17 CHAIRMAN GENSLER: Thank you, Ms.
18 Neuhauser. Mr. Hallren. You might want to push
19 -- yeah, sorry.

20 MR. HALLREN: Mr. Chairman and
21 commissioners, thank you for the opportunity to
22 speak with you today.

1 I am the managing partner of Clear Scope
2 Partners and the entertainment advisory practice
3 that provides strategic and financial advice to
4 those either operating or investing in the
5 industry. Prior to forming Clear Scope in August
6 of 2009, I was a managing director of JP Morgan
7 Securities, a division of JP Morgan Chase. During
8 my 23 year career at JP Morgan and its predecessor
9 companies, I focused exclusively on providing
10 financial advice and capital to those who produce
11 or distribute intellectual property, including
12 primarily theatrical films. While I was with the
13 firm, JP Morgan was known as the dominant player
14 in the entertainment financing space. Due
15 primarily to my role at JP Morgan, I believe I
16 have seen or provided virtually every form of
17 financing for intellectual property that has

18 existed in the last quarter century. I estimate
19 that I have played a key role in raising
20 approximately \$50 billion of financing and
21 analyzed virtually every business plan that's been
22 in existence or has been contemplated. I've seen

1 multiple cycles of investors enter or leave the
2 industry, including Texas oil money, Middle
3 Eastern oil money, insurance-backed financing,
4 German tax financing, investments from wealthy
5 individuals, and the latest round of financing
6 from hedge funds.

7 I have conducted business at each of the
8 major studios, including Mr. Pisano's former
9 studio, that has existed during this time. And
10 I've been fortunate to serve as lead financier for
11 such name brand companies as MGM, United Artists,
12 and Stephen Spielberg's DreamWorks in its various
13 incarnations. I believe that my perspective on
14 the industry is well-grounded and very long dated.

15 My focus with the products that are
16 being considered by you for approval is simply to
17 increase the sources of capital that are available
18 to the entertainment industry. I believe this can
19 be accomplished by allowing investors to manage
20 the volatility that is inherent in the performance
21 of theatrical film. The volatility experienced by
22 many recent investors has caused a substantial

1 withdrawal of capital from the industry. This has
2 resulted in a meaningful reduction in the number
3 of films that are produced on an annual basis,
4 and, therefore, in my view has led to reduced
5 employment opportunities and a reduction of film
6 content export opportunities for the U.S. in
7 general. I think this is particularly important
8 as our film product is one of the U.S.'s largest
9 export items.

10 My thoughts are echoed in a letter I
11 bring to you written by John Miller, vice chairman
12 of JP Morgan and the senior manager of JP Morgan's
13 Entertainment Industries Group. Mr. Miller, who
14 is perhaps the best known and a highly respected
15 film finance professional, also notes in his
16 letter the objection by various entertainment
17 industry insiders to the product being traded on
18 the Exchange and being available to industry
19 outsiders. He states, and I quote, "In recent
20 years, studios have welcomed many risk mitigation
21 techniques, including allowing those interested in
22 investing in the industry to invest on a blind

1 basis by committing to invest in films that are
2 within the absolute total control of the studio
3 and are not identified or even exist at the time
4 of the investor's investment commitment. This
5 allows the studio a significant hedge in managing
6 the investment and their film slates while
7 maintaining complete control of the process."

8 Mr. Miller continues by stating, "I
9 believe that having a hedging product, such as a
10 box office future contract, will provide two key
11 benefits. First, it will allow investors who buy
12 into blind basis transaction, a method to manage
13 their risk and thereby encourage continued and
14 additional investment opportunities. Secondly,
15 and perhaps more importantly, it would also allow
16 investors to improve their investment opportunity
17 by investing in individual films that have
18 concrete and tangible information by which they
19 can make informed investment decisions at the time
20 of the release of the film. I continue to believe
21 that increased transparency is positive to
22 creating greater investment opportunities in the

1 film industry."

2 I agree with Mr. Miller's view and think
3 that the box office future product can have a
4 significant positive application in today's
5 environment. I thank you for the invitation to be
6 here today and look forward to answering any
7 questions that you might ask.

8 CHAIRMAN GENSLER: Thank you, Mr.
9 Hallren. Thank you to the whole panel.

10 My first question for Mr. Hallren and
11 for Ms. Neuhauser. Is it your -- what do you
12 believe in terms of the words that were used
13 earlier by our director of market oversight -- not
14 the law by the way -- but would these contracts,
15 if they were to trade, be used for hedging on more
16 than an occasional basis? I'll go all the way
17 down the panel but I'll start with the right side,
18 Mr. Hallren.

19 MR. HALLREN: I believe they will. I
20 have arranged a number --

21 CHAIRMAN GENSLER: Short answer, please.

22 MR. HALLREN: Sure. Sure. I believe

1 they will because it's very volatile and they need
2 a hedge.

3 CHAIRMAN GENSLER: Ms. Neuhauser?

4 MS. NEUHAUSER: I also do. And frankly,
5 in discussions with various studios we had very
6 high level studio executives who were coming up
7 with their own ideas of how they would want to use
8 this as a hedging opportunity.

9 CHAIRMAN GENSLER: On more than an
10 occasional basis?

11 MS. NEUHAUSER: Mm-hmm.

12 CHAIRMAN GENSLER: Mr. Pisano?

13 MR. PISANO: No. And no studio
14 executive that worked for me would be permitted to
15 do it.

16 CHAIRMAN GENSLER: I guess Mr. Jaycobs
17 (inaudible).

18 MR. JAYCOBS: With sufficient liquidity,
19 yes. Liquidity certain is a primary factor in
20 that. But yes.

21 CHAIRMAN GENSLER: Okay. So then my
22 question for Mr. Hallren, again, going down, why

1 do you think there is this different view that Mr.
2 Pisano suggests? I mean, you know, I don't want
3 to pit two against each other but you know more
4 about the movie industry in your pinkie little
5 than I will ever know. So.

6 MR. HALLREN: I happen to agree with Mr.
7 Pisano that I don't think the studios will short
8 their own films. I think that would be very
9 difficult for them to do, even though their
10 corporate parents might want them to. I believe
11 that the hedging of films or what I consider the
12 shorting of films to be used primarily by film
13 financiers. And I can see opportunities for
14 studios where they really believe in their films,
15 for them to in effect double-down and in effect,
16 go long on the over performance of their films. I
17 think that can also be done by equity investors
18 are invested in film production companies, that
19 may be part of the corporate environment and the
20 corporate security to be able to, in effect, go
21 long as well on film performance.

22 CHAIRMAN GENSLER: I see. So maybe

1 there's not that far difference between you about
2 the studio executives but you think the broader
3 marketplace would on more than an occasional basis
4 use contracts such as these for hedging?

5 MR. HALLREN: I do for hedging.

6 CHAIRMAN GENSLER: Ms. Neuhauser?

7 MS. NEUHAUSER: Yeah. I believe that as
8 well. I actually have been speaking recently with
9 some P&A financiers out of Canada.

10 CHAIRMAN GENSLER: P&A?

11 MS. NEUHAUSER: Sorry. Prints and
12 advertising. So when you're going to have a
13 theatrical release, they're the ones who cover the
14 distribution expenses which can run, you know, on
15 a lower budget in a studio movie maybe 15- to \$20
16 million can run up to \$60 million on a worldwide
17 basis.

18 CHAIRMAN GENSLER: Mr. Pisano, so now
19 that we may be narrowing differences, do you
20 share Mr. Hallren's view that maybe the studio
21 execs wouldn't but this broader group of
22 financiers might on more than an occasional basis?

1 MR. PISANO: No. And let me elaborate
2 just briefly on that. The notion that someone who
3 has put \$150 million into a movie, either the
4 studio's money or an outside financier's money, is
5 going to go long against it -- of your own money.
6 I find that to be -- I'll use the word ludicrous.
7 I just don't think that happens. And so,
8 therefore --

9 CHAIRMAN GENSLER: No, but his point on
10 the earlier one is that financiers who are putting
11 up money, who might be in these blind pools, you
12 know, that they're talking about or other
13 financiers, might use these contracts to hedge
14 their 10- or 20- or \$50 million that they've put
15 in.

16 MR. PISANO: To go short in other words?

17 CHAIRMAN GENSLER: Yeah. Well, to
18 protect them. They're not a studio executive.

19 MR. PISANO: Right.

20 CHAIRMAN GENSLER: They are a financier
21 is what Mr. Hallren is saying.

22 MR. PISANO: I think when I talked to

1 you informally, Mr. Chairman, I said that the fact
2 that there is a short position, even though there
3 is going to be a corresponding long position out
4 there is going to become a self-fulfilling
5 prophesy. And so we operate in rumor and gossip,
6 unlike Washington. And so the notion that you're
7 going to take the rumor and gossip that now exists
8 and we all freely admit it and cloak it with a
9 financial aura of respectability by money by going
10 short, which is going to get reported in the
11 press, is going to become a self-fulfilling
12 prophesy.

13 CHAIRMAN GENSLER: No, no, I understand
14 that. Since my yellow light is on, I think if I
15 can just to hone in a little bit more because I,
16 with all respect, think you carefully didn't
17 answer my question, is that Mr. Hallren is saying
18 that financiers that put up money -- they're not
19 studio executives -- he believes would use these
20 contracts on more than an occasional basis to
21 hedge that money that they have made. That's a
22 little different than whether it's rumor or

1 gossip, which is probably true even -- there's
2 rumor and gossip even in the oil markets. But I
3 was curious about whether financiers would use
4 this on more than an occasional basis.

5 MR. PISANO: As a matter of judgment I
6 don't believe so.

7 CHAIRMAN GENSLER: Okay. Thank you.
8 Commissioner Dunn?

9 COMMISSIONER DUNN: Thank you, Mr.
10 Chairman. I must confess I'm quite out of my
11 league in the motion picture industry. If it
12 didn't have John Wayne, Gene Autry, or Hoot Gibson
13 in it, I probably didn't see it.

14 But I have to disagree with my colleague
15 here when he says it's cool but it's not business.
16 I have a son that's in the skateboard business.
17 It's cool but believe me, it's business. And this
18 is all business. It's all about how you finance
19 and how you get your product to the marketplace.

20 I would like to know about how difficult
21 it is for these independent producers to get that
22 backing and get to the marketplace. And I'd ask

1 each of the panelists to talk about that that have
2 some knowledge of it.

3 MR. HALLREN: It's more difficult now
4 than I believe it's ever been in the last 25 years
5 in my banking career. There is a huge amount of
6 risk in the business. You have a number of
7 published reports about declining video values,
8 DVD values specifically. You have challenges in
9 the advertising market in making television sales
10 with what has happened with reduced advertising
11 budgets of people who are buying television
12 content. Those transactions and those contracts
13 are often used for this pre-sale financing, and
14 that market, Cannes, has just finished the film
15 festival and the word coming back is it was not
16 very robust because people aren't buying their
17 product.

18 You also have the capital markets in a
19 very challenged position. When I was a banker, I
20 syndicated transactions to consistently between 30
21 and 40 banks around the world. There are
22 literally nine of them now and they're very

1 conservative in their approach, the ones that are
2 still hanging in there. And I think that you can
3 invite more capital to come back into the business
4 if you give them a way to control the volatility.

5 MS. NEUHAUSER: Yeah. I would also
6 agree with that. In fact, when we met with Mr.
7 Miller originally, he indicated that literally on
8 a daily basis he was getting phone calls from
9 people on the production side trying to get some
10 kind of financing. And he said he just didn't
11 have any resources that were still available. Not
12 only in the context of watching declining
13 revenues, but we've also seen such an enormous
14 increase in the cost involved, both on the
15 production and the distribution side, that it is
16 just becoming -- some days it just feels like an
17 insurmountable challenge trying to figure out how
18 we're going to continue to keep this as an
19 important and robust industry within the country.

20 MR. PISANO: I don't think there's any
21 question that independent film makers have
22 difficulty raising financing. That's been true,

1 at least in my 25 years in the business. I think
2 it is telling though that the association that
3 represents more than 90 percent of the independent
4 film producers in the country has filed testimony
5 against this proposal. So it's just not the big
6 studios that are opposing it, Commissioner. It's
7 the very people who others contend would benefit
8 from this. And there is a whole host of reasons
9 listed in their testimony as to why this
10 particular financial synthetic product is not
11 going to help them with the one thing they do
12 desire, which is to raise capital. I don't think
13 anyone can doubt the need for more capital and the
14 need for risk management. We just don't believe,
15 based on our experience in the industry, both from
16 the studio standpoint and from the independent
17 film standpoint, that this vehicle is one that is
18 actually going to bring money into the system and
19 is going to be free of the kinds of manipulation
20 and really damage that these kinds of synthetic
21 products have done in other industries.

22 We don't want to make -- we don't want

1 to repeat in our industry what happened in the
2 mortgage industry. We don't want to repeat in our
3 industry what happened in some of the other
4 industries that were destroyed in the financial
5 meltdown that happened. And while I appreciate
6 when Mr. Hallren was in the business there were
7 30 banks, there are only nine today, part of that
8 reason is because people were engaged in widely
9 speculative synthetic instruments. And we just
10 don't support bringing that ethic and ethos and
11 financial model into our industry.

12 MR. JAYCOBS: Yeah. I would just say
13 that what you've had is a shift away from risky
14 investments. Period. Throughout the entire
15 economy. And one of the things I've heard from
16 the many film festivals I've now been attending is
17 that having a price discovery mechanism for what a
18 box office might earn for a film that's already
19 made. I'm not talking about one that's being
20 produced but one that's already made. That would
21 be an enormous benefit to those who want to get
22 their films into theaters and into distribution.

1 COMMISSIONER DUNN: My time is up but,
2 Mr. Pisano, you had said in your summary of your
3 statement that you were concerned about if word
4 got out that someone was on the other side of a
5 film that they had that it would be devastating
6 for them. We, as a regulator and the Exchanges,
7 take a great deal of pains to make sure that
8 individual positions do not get out. And that
9 probably, much to the consternation of some of
10 those folks that would like to know that
11 information.

12 CHAIRMAN GENSLER: Thank you,
13 Commissioner Dunn. That's actually in Title VIII.
14 Commissioner Sommers.

15 COMMISSIONER SOMMERS: Thank you, Mr.
16 Chairman. I think -- I have a number of very
17 specific questions about how the industry works.
18 We've all made it clear that we are in the process
19 of learning about this industry and how these
20 products actually may be used. And so one of my
21 specific questions for Mr. Pisano is just giving
22 us a general idea of how many theaters there are

1 out there, and when you look at the contract specs
2 and the threshold of 600 or 650 theaters that a
3 film would have to meet in order for a contract to
4 be based upon that film, is that a low threshold?
5 What kind of percentages of the actual amount of
6 theaters out there would that be?

7 MR. PISANO: To answer your first
8 question there are more than 30-some-odd-thousand
9 screens in America. First point. That's not
10 counting -- that's numbers of screens. That's not
11 the specific number of theaters or multiplexes.
12 Most of them have 10, 12 screens. Typical studio
13 release is 1,000 to 2,000, sometimes 3,000 screens
14 in America. A typical independent film release
15 would not meet that threshold. And so the very
16 people that that contract wants to help probably
17 wouldn't be able to avail themselves of it because
18 of the limited release.

19 So I think -- I could get you more
20 detailed statistics. I haven't looked at them
21 recently since I haven't been in the studio
22 business, but the overwhelming majority of total

1 pictures that are released never achieve that
2 threshold.

3 COMMISSIONER SOMMERS: Okay. My next
4 question is probably more appropriate for Mr.
5 Jaycobs with regard to how many films you
6 anticipate having contracts on at any one time.
7 How many films meet that threshold? You know,
8 will there be dozens of films at any one time that
9 you're offering contracts on?

10 MR. JAYCOBS: Yeah. There are
11 approximately -- I think the number is about 500
12 films every year of which about 150 are wide
13 releases. Our intent is to, at the very least,
14 trade all the wide releases. We'd also like to go
15 to some of the smaller films. It raises other
16 questions. In the beginning we started with the
17 wide releases. So since our contract generally
18 lists a movie six months in advance, there are 150
19 a year, that means we'll do about 75 at any one
20 point in time.

21 MR. PISANO: Commissioner, can I just
22 elaborate on that in one respect? Of the 150

1 films that are released -- wide released -- the
2 overwhelming majority of those are films from the
3 six studios that I represent directly, the very
4 people that would be prohibited from hedging by
5 virtue of the conflict of interest rules and
6 arguably the very people who are not looking for
7 those kind of financing. And conversely, the
8 people that might arguably want to do it, the
9 small independent filmmaker, they don't meet that
10 threshold. So this is -- to put it mildly, this
11 is a product in search of a solution that doesn't
12 exist.

13 COMMISSIONER SOMMERS: That brings me to
14 another question with regard to the financing.
15 And this concept of investing in a movie on a
16 blind -- or investing with a studio on a blind
17 basis. How would somebody who has invested on a
18 blind basis be able to hedge if they don't know
19 what movie they've invested in? So what contract
20 would they buy? They'd just buy all of them?

21 MR. HALLREN: No. They would not.
22 Financiers, when I use the term blind basis, they

1 will agree with the studio that they will finance
2 their next X-number of films, so 15, 20 films. So
3 at that point in time, maybe film 11, 12, 13 is
4 not known. So that's investing on a blind basis.
5 And they may choose to invest or be contracted and
6 required to invest 25, 35 percent of that film's
7 cost. So the way I see the product being able to
8 be used by those investors is as the film gets
9 closer to its release and there is more tangible
10 evidence about that film, there are trailers that
11 are put out and advertisements that are put out by
12 the studios to market their films that those
13 trailers in effect will start to inform the
14 audience about whether they want to go see that
15 film or not. There are many television shows,
16 blogs, et cetera, where information is freely
17 traded, maybe to the frustration of the studios.
18 And that can be used that if an investor has
19 invested in that film and they think that that
20 film is not going to perform, for them to go to
21 the market to try to short the contract to see if
22 that's cost efficient for them to do that.

1 Where I also think that you have a movie
2 like Avatar, it's probably the best example that I
3 use where the people that I speak with at 20th
4 Century Fox were 100 percent bullish on that film.
5 And so there was a difference in the market as far
6 as Fox being very positive where people in the
7 marketplace were saying I'm not so sure about that
8 film. And that's where I see a market developing.
9 How deep it will be, what the price points will
10 be, that's something I can't project but I can see
11 that possibility of that condition existing on a
12 number of films.

13 COMMISSIONER SOMMERS: Thank you. If I
14 can just follow up real quickly on one point just
15 real specifically. If somebody is investing on a
16 blind basis and investing in a studio's maybe next
17 10 films as you said but not knowing what those
18 next 10 films would be, at what point does the
19 investor find out what those next 10 films will
20 be?

21 MR. HALLREN: Typically at the green
22 lighting of the film. So the investor will know

1 that it's in the slate. So as it starts
2 production, then the investor would know that that
3 is one of the films that's being included by the
4 studio in the slate. And sometimes that is
5 contracted to the sequential. Sometimes it's a
6 selection process that goes on between the studio
7 and the financier. And in many cases, the studio
8 doesn't finance their films, such as sequels and
9 things that they have very high expectations for.

10 CHAIRMAN GENSLER: Just as a
11 clarification from staff, apparently they have
12 their quick research. I don't know if this is off
13 of some internet site, but 38,000 screens and
14 somewhere between 5,000 and 6,000 theaters.

15 Commissioner Chilton.

16 COMMISSIONER CHILTON: Thank you. Mr.
17 Jaycobs, you've mentioned that there was an
18 increasing group of people that were in favor of
19 this. And one of the things that's actually
20 surprised me is that we haven't got a lot of
21 letters. And we've got five or six letters. I do
22 appreciate the ones -- all of them that were

1 submitted. There's only three that I'm aware of
2 that were in favor of it, and they were well
3 written and make good arguments. But one of them
4 from Jeffrey Sparks at Truly Moving Pictures even
5 says, "I cannot be certain of box office future
6 products by my organization." Then he goes on to
7 say but he thinks it's a significant opportunity
8 for others.

9 I would like, Mr. Chairman, if there's
10 no objection, to submit some comments from nine
11 eminent professors all the way from UCLA, Wharton,
12 University of Iowa, and University of Chicago at
13 the appropriate point in the record. They have
14 concerns about moving forward on this effort.

15 CHAIRMAN GENSLER: Absolutely. And the
16 other one I wanted -- I wanted to speak clear, you
17 know, Commissioner Dunn picked up on my, you know,
18 it might be cool but may not be business -- may
19 not fit the definition of business under our act.
20 It's a big damn business. As a matter of fact,
21 it's one of the, as I recall, it used to be only
22 that food and films had a net positive export.

1 And then for a while the film industry was the
2 only positive balance of export. So it's a big
3 damn business and I want to keep it that way. I
4 just want to ensure that we're protecting
5 consumers and moviegoers alike from fraud, abuse,
6 and manipulation.

7 Ms. Neuhauser, given your, you know,
8 long history with making films, I mean, how long
9 do these things generally take to make? You know,
10 when do you need the financing? Your contract
11 doesn't allow hedging until a month before. The
12 Cantor contract, Mr. Jaycobs, it's six months. I
13 mean, don't these films need money before six
14 months?

15 MS. NEUHAUSER: Yeah, they absolutely
16 need money before six months. I think the
17 difference is that if financiers know that they
18 have the opportunity to hedge later on that it
19 gives them greater comfort going into it. The
20 lead time can vary anywhere from -- I've got a
21 picture right now that we're supposed to start
22 shooting in July. I think we closed the

1 underlying rights deal at the -- somewhere in the
2 fourth quarter of last year with release scheduled
3 for spring of next year. So -- and that's pretty
4 fast, generally speaking.

5 COMMISSIONER CHILTON: Okay.

6 MS. NEUHAUSER: But, you know, again,
7 getting to the idea of sort of who it is would be
8 looking for this financing, studio releases are
9 not necessarily either solely or even completely
10 studio investments. There are a lot of people who
11 go through the studio system, and frankly, it's
12 also part of the reason why I think a lot of
13 people had some concerns about having letters that
14 were going to be publicized because the studios
15 control real distribution. And so until there was
16 a decision made it could put them in an
17 uncomfortable position.

18 COMMISSIONER CHILTON: Okay. I'm not
19 going to have enough time to get to my series of
20 questions for Mr. Pisano but let me just ask you
21 this one that you can maybe respond briefly so we
22 stay on time. You mentioned your time at

1 Paramount when you first released box office
2 returns. I assume that there's really one reason
3 for that and that's to show the positive effect as
4 a marketing tool. Am I correct? Or are there
5 other reasons?

6 MR. PISANO: Absolutely, Commissioner.
7 It's a marketing tool.

8 COMMISSIONER CHILTON: So you used that
9 in order to assist you in your further box office
10 receipts?

11 MR. PISANO: Yes. And at that time the
12 notion of Monday morning reporting on who was the
13 number one film in the popular press was unheard
14 of. The only people who knew were industry
15 insiders. At the same time, we created a show
16 called Entertainment Tonight, which for the first
17 time popularized entertainment news. And so we
18 used that vehicle as the launch pad, if you will,
19 to promote the notion that we had the number one
20 movie. And in that timeframe we happened to have
21 the number one movie a number of weekends.

22 COMMISSIONER CHILTON: I noticed in USA

1 Today on Monday there is an article which shows
2 that Robin Hood had the biggest gross worldwide
3 receipts but domestically it was Iron Man 2. And
4 so this article talks about how the studios will
5 use any little ability to market that they can and
6 look for ads about Robin Hood saying it's the
7 number one movie in the world, even though it
8 raised \$16 million less than IM 2. And so, you
9 know, I wonder, given that you're trying to get
10 any competitive advantage, and I'll finish here,
11 Mr. Pisano, whether or not look you ahead in a
12 hypothetical crystal ball, and say these markets
13 exist. And would you, if you were a studio,
14 advertise and try to market say the week before a
15 film went out that, you know, for a leading
16 popcorn prediction market film as a way to sell
17 your movie?

18 MR. PISANO: We look for any way we can
19 to convince the public to come to see our movies.

20 COMMISSIONER CHILTON: So the markets
21 themselves could actually influence the price
22 ultimately if you were using it as a marketing

1 tool I guess is my theoretical question.

2 MR. PISANO: (Inaudible) and I want to
3 actually -- I want to clarify that to make sure we
4 use any tool we can that's legal --

5 COMMISSIONER CHILTON: Yes.

6 MR. PISANO: -- in order to encourage
7 people to come see our movies. That's the
8 business we're in.

9 COMMISSIONER CHILTON: Thank you.

10 CHAIRMAN GENSLER: I'm guessing then if
11 there were movie futures contracts and they were
12 trading well somebody may even refer to them in
13 the promotion of those movies.

14 MR. PISANO: It might happen, Mr.
15 Chairman. It might happen.

16 CHAIRMAN GENSLER: Commissioner O'Malia.

17 COMMISSIONER O'MALIA: Thank you. As
18 Commissioner Chilton noted, we have received a
19 handful of letters. And while not many in number,
20 they were helpful to -- helpful to me to
21 understand a little bit more about your business.
22 Terms like blind basis, slate deals, and renting

1 distribution to third parties, these are all new
2 terms to me. But one notable comment was since
3 2004, 14 billion worth of third- party financing
4 has come into the market. You had referenced some
5 other numbers, Mr. Hallren.

6 Obviously, I'm trying to reconcile the
7 difference between Mr. Pisano, your statement that
8 the studios won't trade this and therefore, that
9 is the center of gravity in this business, yet
10 we're talking about 14 billion worth of
11 third-party financing, which seems significant to
12 me. Help me understand what blind basis, slate
13 deals, and renting third-party distribution --
14 what they are, how they bring money to a studio,
15 and then the relevance of third-party financing.

16 Mr. Hallren.

17 MR. HALLREN: Blind basis and slate
18 financing are very similar. A slate means the
19 future output of a studio's films. So in a slate
20 financing would be where a third-party or a
21 financing entity would agree to finance 25 percent
22 of the next 20 films in the slate.

1 COMMISSIONER O'MALIA: You had mentioned
2 that with Commissioner Sommers.

3 MR. HALLREN: And blind pool means that
4 I don't have titles attached to each of those
5 films that I agree to finance. So I'm agreeing to
6 co-finance them on a statistical basis, assuming
7 they meet some qualifying film definition, such as
8 the budget is within this range.

9 So all of that \$14 billion, which is a
10 very accurate number, was financings that were
11 arranged using senior debt, mezzanine debt often,
12 and equity from largely hedged funds and private
13 equity and senior commercial bank lenders to
14 co-finance -- I'll use for example 25 percent of
15 Paramount's slate -- through financings that were
16 called Melrose I and II or Fox's slate.

17 COMMISSIONER O'MALIA: Let me interrupt.
18 Let me interrupt now. Does that financing, all
19 these tranches of debt, does that go through the
20 bank or does that go directly through the studio,
21 these deals? Do the studios arrange them?

22 MR. HALLREN: The -- they will often be

1 arranged by the studios and they will -- or they
2 would be arranged by independent third parties,
3 such as hedge funds or different money managers.
4 And so a money manager or a hedge fund or a senior
5 debt lender may go to a studio and say I would
6 like to arrange financing to co-finance your slate
7 going forward and negotiate terms.

8 I want to hit on the term rent-a-system.
9 That is a term that's generally used to say that
10 the studio doesn't own any of the underlying
11 economics of the film. They're just being paid a
12 distribution fee out of all proceeds to perform
13 distribution services. So, Ms. Neuhauser pointed
14 out that many independent third parties use the
15 services of a studio for distribution. That
16 independent third party, what we might be calling
17 an independent producer here, meaning a non-
18 studio producer, would be using a rent-a-system
19 through the studio to get their product to market.

20 COMMISSIONER O'MALIA: And who does
21 that? Who fills that role, rent-a-system?

22 MR. HALLREN: There are -- many of the

1 studios -- there's a number of companies that you
2 -- may not be household names: New Regency,
3 Morgan Creek, Lake Shore Entertainment. These are
4 what I would estimate provide maybe 30 to 40
5 percent of a studio's entire film slate that it
6 releases in 1 year. If you want to think of them
7 as being third-party feeders that are supplying
8 films to the studio's distribution operations and
9 that's attractive to the studio to not only get
10 additional product through their system that they
11 can distribute. It also helps them because
12 they're getting distribution fees from a
13 consistent source oftentimes without an outlay of
14 capital. So that \$14 billion of financing was
15 done for many studios. Virtually all of the
16 studios had some form of it but it was also
17 capital that was provided to independent third
18 parties, independent producers who were
19 distributing their films using the rent-a-system
20 of a studio.

21 COMMISSIONER O'MALIA: This is
22 fascinating. I'll wait another round of

1 questioning.

2 CHAIRMAN GENSLER: I was going to ask my
3 fellow commissioners, do you want another round?
4 All right. Well, then I guess there will be
5 another round. And therefore, I guess I'll have a
6 question or two.

7 Mr. Pisano earlier said -- I wrote some
8 notes. There were three things -- sort of whether
9 this was a commodity. There's some question that
10 you've raised about that. You talk about price
11 discovery and manipulation. I don't know where
12 we'll come out but I suspect given that the '74
13 Act is really very wide, it's likely staff is
14 going to recommend to the five of us that this
15 somehow fits into that broad colloquy that was
16 going back and forth earlier.

17 On the price discovery point there are a
18 lot of things that are off of indices, but I'm
19 going to have a question probably for Mr. Jaycobs
20 -- I'm tying off of what you said, Mr. Pisano --
21 is that we have lots of indices, whether it's the
22 housing index or the euro/dollar index. There are

1 a lot of indices that things are off of. But the
2 observation here is that this index isn't about
3 the value of something, I think. I mean, you
4 know, if it's a housing index, it's the value of
5 houses. If it's the euro/dollar, it's an interest
6 rate, which people would say that's the exchange
7 of money. And I take the point. This is
8 something different. This is aggregating all of
9 the box office receipts. It's not sort of the
10 value of something that trades. What's your
11 reaction to that point?

12 MR. JAYCOBS: Well, we think it is a
13 value. That there are real economic flows that
14 are associated with those box offices. In the
15 case of our contract, we take that box office and
16 basically slice it into a million pieces. If we
17 looked at how those pieces, the economic value of
18 those pieces flow through the waterfall of
19 investing in a film, you could trade those out.

20 CHAIRMAN GENSLER: But whereas the oil
21 index or Platts index or something, people
22 actually buy and sell oil. I'm trying to make

1 your point for you, Mr. Pisano. I'm just trying
2 to understand. And then the euro/dollar, somebody
3 actually borrows money and interest exchanges
4 hands. You know, feeder cattle. I could go
5 through the other indices. Houses. People buy
6 and sell a house. Does anybody buy and sell a box
7 office? That's your point, right?

8 MR. JAYCOBS: Yes, it is, Mr. Chairman.
9 Yeah. There are --

10 CHAIRMAN GENSLER: I don't know whether
11 it's legally relevant to us as a Commission, but
12 I'm just trying to understand.

13 MR. JAYCOBS: Where there is an economic
14 risk -- in this case the box office value will
15 flow, for example, theater owners in rough numbers
16 get half of the value of the box office. They are
17 exposed to that value. They are to be recipients
18 of those funds. Therefore, the risk and the
19 commodity, if you will, that's being traded is the
20 actual box office receipts.

21 CHAIRMAN GENSLER: So I guess your point
22 of view is if we determine it's a commodity, even

1 though the index doesn't have like a physical, you
2 know, it's not a cow, it's not a house.

3 MR. JAYCOBS: Yeah, CPI is just one
4 example. I mean, Mr. Shilts made reference to
5 several examples but no one owns a house that is
6 tied to any of the real estate indices. No one
7 actually owns the CPI Index. However, there are
8 people who have risks that are related to those
9 particular indices. And that's our view of box
10 office receipts.

11 CHAIRMAN GENSLER: Okay. All right. So
12 now let me turn to the third point that Mr.
13 Pisano, I think if I wrote my notes right, was the
14 manipulation point. And I'm not so much into
15 whether Rentrak, you know, because apparently they
16 collect data from like 98 percent of the theaters
17 or something. I'm more into the point that Mr.
18 Pisano raised that, you know, this is an artistic
19 product. I mean, the CPI Index is across probably
20 thousands of communities and it's hard to discern
21 that any one individual or group of individuals
22 can push around that. Now, maybe you could say

1 something different about the oil index maybe, but
2 in terms of the ability of some group or
3 individual to influence the box office receipts of
4 one particular movie, I think that's the point
5 there.

6 MR. JAYCOBS: I think, excuse me, I
7 think that, again, Mr. Shilts made reference to
8 this. I think the narrowness of the contract is
9 part of the discussion certainly. The ability to
10 manipulate a contract, I mean, the unfortunate
11 reality is our industry through the years has very
12 colorful examples of folks who have taken, you
13 know, who have been able to manipulate all sorts
14 of different markets. So the fact that some
15 criminal behavior is potentially there --

16 CHAIRMAN GENSLER: Well, here's the
17 thing. Let's say, and I don't expect you to have
18 the knowledge that Mr. Berkovitz had about our
19 statute, but let's say that staff said it's a
20 commodity and that we have other indices and that
21 sort of -- and maybe they even said this Rentrak
22 thing works, you know, which they haven't yet but,

1 you know, we've got to sort through that. But
2 somebody came in on an index that was similar on,
3 you know, one person's house, you know. And let's
4 say that's a commodity. I'm -- just for
5 hypothetical and it met all the other tests. If
6 it's a very narrow contract on one movie, that's
7 the question I think that Mr. Pisano is raising.

8 MR. JAYCOBS: Yeah. And I guess I would
9 just say to that -- and again, I think this was
10 addressed in some of the earlier comments -- a \$50
11 million movie is typical for the size that we
12 think will be trading with these wide releases.
13 If an average ticket is \$5 or \$10, pick your
14 number, you're talking about 5 or 10 million.

15 CHAIRMAN GENSLER: I would pick five for
16 me but usually they charge me more.

17 MR. JAYCOBS: That's the actions of 10
18 million individuals going to see a movie or not
19 going to see a movie. Certainly, marketing and
20 these other things can influence those but the
21 reality is that in terms of the ability to drive
22 10 million people to see a movie or not to see a

1 movie, they certainly can be influenced. But to
2 actively manipulate that in a very controlling
3 fashion we think can be readily surveilled.

4 CHAIRMAN GENSLER: All right. Thank you
5 very much. Commissioner Dunn. I hope it was all
6 right that I used your points.

7 MR. PISANO: Absolutely.

8 CHAIRMAN GENSLER: I'm just trying to
9 learn here. I don't --

10 COMMISSIONER DUNN: We'll cross-examine
11 him later. A lot of the communications we've got
12 are concerned that this is tantamount to betting.
13 And reality is and the futures market is a zero
14 sum game. Somebody wins and somebody loses. So
15 you may call it hedging or speculating but the
16 fact of the matter is there's always a winner and
17 there's always a loser in there. I'd ask all of
18 you if that is of concern to you, and do you
19 really see it as betting or is this a way to
20 hedge?

21 The second part of the question that I
22 have is probably to the Exchange but I'd like to

1 hear comments from the other, is how do we ensure
2 that the barriers for insider trading are in fact
3 in force? What is the Exchange going to do to
4 ensure the integrity of this contract?

5 MR. JAYCOBS: With regard to the first
6 comment, we are very concerned. In my opening
7 comments I referenced that we agree with the MPAA
8 in terms of having relatively small spec limits so
9 that we can make sure that the activity in the
10 market is a representative and fair priced market.
11 So, and I'd be happy to answer specific questions
12 on that.

13 With regard to insiders and barriers,
14 one of the things I thought was interesting in the
15 Congressional testimony was the opinion of
16 apparently a couple of the congressmen who thought
17 that the whole notion of any form of insider
18 blocking was not appropriate because it's not
19 generally part of our industry. Having said that,
20 we do believe -- and we've put together a list and
21 shared this with the staff -- we have identified a
22 number of information elements that we think are

1 worth monitoring. Again, we've shared that with
2 the staff. We can monitor these activities. I
3 don't want to go into too many of the specific
4 details here in a public hearing but in the
5 discussions with staff we think we have a very
6 good ability to monitor these items. There may be
7 other items that we need to add to this list and
8 basically enforce the contract to make sure that
9 the market is a level playing field.

10 COMMISSIONER DUNN: That implies that
11 there is a quid pro quo with that industry group.
12 How are you assured that you're going to have that
13 ability?

14 MR. JAYCOBS: By quid pro quo you mean
15 that they are somehow cooperating with us? Yeah.
16 One of the -- one of the things we firmly believe,
17 and I think Mr. Pisano would agree with this, is
18 that the industry is in the business of making
19 good movies. They do want to promote their
20 movies. They've said they want to market every
21 film so that it reaches its maximum potential.
22 And I think that the activities that we've

1 identified here are activities where they are
2 taking actions contrary to that interest, where
3 they do something to harm the film. We know that
4 they're trying to do everything that can help the
5 film. And so what we're mostly concerned about is
6 where there's a short position in the market,
7 either direct or indirect short position in the
8 market, and then some action is taken to harm the
9 value of that film. Again, we think in our
10 discussions with staff those are very easily
11 surveilled, those events.

12 MR. PISANO: Short answers to your
13 questions, Commissioner Dunn, are yes, it's
14 betting. Yes, there's going to be losers. And
15 yes, we're very concerned about that. We should
16 be. We're not interested in having people lose
17 money in our business, especially people who are
18 not sophisticated investors. And so -- and then
19 finally, the manipulation. The very fact that
20 traditionally, as I understand it and I'm not a
21 commodities lawyer or a trader, there are no
22 insider rules. The very fact that these exchanges

1 have had to craft a Jerry-built system of insider
2 rules that are going to apply to an industry that
3 doesn't want them and doesn't want to be part of
4 them, and could require compliance issues -- and I
5 was the general counsel at Paramount for a period
6 of time -- this is a nightmare. And that's
7 another reason why we think this is ill-advised
8 and wrong.

9 MS. NEUHAUSER: Well, I guess I sort of
10 go back to, you know, a baseball analogy which has
11 to do with, you know, what's considered a good
12 batting average in baseball would be great in the
13 film industry.

14 So, you know, as to whether or not it's
15 betting, I guess that would be whether you think
16 that, you know, you're betting going into an
17 initial investment as a studio to begin with. So,
18 I do firmly believe that this is an opportunity
19 for people to hedge their risk and hopefully to be
20 able to bring some new capital in.

21 MR. HALLREN: I think the production and
22 distribution of films is almost betting. It's a

1 very risky business. Every film that is produced
2 and released probably costs the studio now
3 averages about \$100 million. It is a hits
4 business. The majority of the films do lose
5 money. And the studios are in that business and
6 other financiers choose to participate in that
7 business. And I think it would be very valuable
8 for them to have a product to hedge or to go long
9 would encourage investment into the business. And
10 I think that's very much what's needed in the
11 industry at this time.

12 COMMISSIONER DUNN: My time has run out,
13 so Commissioner Sommers.

14 COMMISSIONER SOMMERS: Thank you. I
15 would like to explore some of the issues with
16 regard to Rentrak and ask you if you could just
17 walk us through, in your testimony you talk about
18 how the box office receipts have, in your review
19 of the history of the box office receipts versus
20 what the studios report as earnings have been, you
21 know, very close and within the minimum tic size
22 of the contract. But what happens if it's not?

1 And if you could walk us through from the
2 Exchange's position and your contract rules when
3 that falls outside of that number.

4 MR. JAYCOBS: Yeah, so I don't think we
5 should be prescriptive in that simply because we
6 don't want to create a target where manipulators
7 can take advantage of the statements I'm going to
8 make here and say we can rely on that fact.

9 Having said that, the --let me say
10 this. If we, and I believe this was in either my
11 Congressional written or testimony here -- if it
12 turned out that the studio-generated numbers were
13 either unavailable or unreliable, we would do what
14 Mr. Shilts said and propose an index that is based
15 strictly on the electronic calculations of
16 Rentrak. We can eliminate all the variability
17 here by just simply substituting that. The reason
18 we chose not to do that is, again, I think Mr.
19 Shilts made the statement, we think the industry
20 -- the studio distributor produced number is
21 actually a reliable indicator and respected by the
22 industry, and we've seen nothing to suggest

1 otherwise. So, yes, if it turned out that as a
2 result of the contract review process staff is
3 currently going through we shift strictly to the
4 exclusively electronically reported numbers, we
5 would make that adjustment in our contract design.

6 COMMISSIONER SOMMERS: Is there a reason
7 why you chose not to do that in the first place?
8 If the numbers are historically so close together,
9 why would you go through these hassles?

10 MR. JAYCOBS: We wanted to make friends
11 with the MPAA. We were afraid that if we came out
12 with electronic only numbers -- I'll give you an
13 example. Now, Mr. Pisano has said that, you know,
14 it's important that these numbers are as glorious
15 as they can possibly be. In the case of Iron Man
16 2, the electronic reported number was
17 \$156,745,024. The studio reported number was \$100
18 and -- I think I've got this right --
19 \$159,159,871. The electronic number is less and
20 we thought the studio would be very angry if we
21 reported a lower number so we went with the studio
22 number.

1 COMMISSIONER SOMMERS: Is that usually
2 the case where they're less? So that's why --

3 MR. JAYCOBS: Yes, because -- because
4 there are -- we call them non-reporting theaters.
5 I think Mr. Shilts referred to them as -- I
6 forget. There's another term for them.

7 COMMISSIONER SOMMERS: Call around.

8 MR. JAYCOBS: Yeah, the call around
9 theaters. So, and again, in the case of Iron Man,
10 which is a very widely distributed movie, 4,204
11 electronically reporting theaters, 176
12 non-reporting. And because they're non-reporting
13 they're generally smaller. You can estimate them
14 with a high degree -- a reasonable degree of
15 certainty.

16 CHAIRMAN GENSLER: Thank you,
17 Commissioner Sommers. Commissioner Chilton. And
18 I apologize. I do understand that Mr. Pisano has
19 either a flight to catch or something so we might
20 lose you before but hopefully not.

21 COMMISSIONER CHILTON: Thanks, Mr.
22 Chairman. I'll try to be brief and I'm going to

1 direct some of my stuff to Mr. Pisano, so you can
2 be brief, too, and catch your flight.

3 I'm not sure I agree with the Chairman
4 that, you know, it's a foregone conclusion that,
5 you know, the underlying is a commodity. I think
6 you have to --

7 CHAIRMAN GENSLER: Let me say -- I
8 wasn't -- I was saying that I would think that
9 under the '74 Act it's quite possible staff will
10 say, you know, that it's generally been over
11 30-some years read expansively. I'm saying just
12 what staff might. That's all.

13 COMMISSIONER CHILTON: Okay. Thank you.
14 I mean, and I'm sure they will because we have an
15 excellent general counsel. But you have to look
16 at the Act very broadly, which means Section 3
17 also. And, you know, I think that, you know, the
18 definition could be meaningless if you would just
19 include anything that doesn't have a true
20 underlying. But again, we'll wait for some of our
21 advice from counsel.

22 But, you know, this is not like a corn

1 or a crude contract where multiple people control
2 the contract or have an influence. And you know,
3 I know there is some debate about control but I
4 think it's, you know, the studios primarily who
5 have a major impact on this.

6 Mr. Pisano, here is where you can be
7 helpful and brief. This is a typical movie studio
8 organizational chart. You're not going to be able
9 to read it probably, right? So maybe I'll just go
10 through. But here there are, if you look at this
11 whole chart, you have production. They have an
12 impact on box office receipts obviously, right?

13 Acquisitions. This is what acquiring
14 the rights to films and scripts and stuff, so
15 maybe not so much. So that box, no. Theatrical
16 distributions, sales, marketing, absolutely 100
17 percent. Home video distribution sale. Does that
18 have anything to do with the box office receipts?
19 There's home video distribution sales and
20 marketing. Well, marketing.

21 MR. PISANO: Yes, sir. Because, first
22 of all, the majority of the receipts for a given

1 movie to the distributor don't come from
2 theatrical. They come from downstream markets.

3 COMMISSIONER CHILTON: Okay. And then
4 --

5 MR. PISANO: So, yes, the theatrical --
6 the home video distribution marketing people are
7 intimately familiar with what the movie is about
8 and how it's going to do, we think, and have all
9 of the inside information that flows around the
10 studio.

11 MS. NEUHAUSER: I'm sorry. If I could
12 just interrupt. Acquisitions can be for completed
13 product.

14 COMMISSIONER CHILTON: Okay.

15 MS. NEUHAUSER: It's not just the
16 acquisition --

17 COMMISSIONER CHILTON: So it actually
18 could impact the box office. Okay, good.

19 Okay. Then home video distribution --
20 oh, that's the one we just did. Television
21 distribution sales and marketing. Mr. Pisano,
22 would that affect the box office returns?

1 MR. PISANO: Well, it doesn't affect
2 them.

3 COMMISSIONER CHILTON: Is it an after
4 product?

5 MR. PISANO: But they're very concerned
6 about how the movie is going to be.

7 COMMISSIONER CHILTON: Yeah, but it
8 might not impact the opening weekend or something.

9 MR. PISANO: Probably not.

10 COMMISSIONER CHILTON: So we'll cross
11 that one off. And the consumer products and
12 merchandising.

13 MR. PISANO: Very much tied to box
14 office.

15 COMMISSIONER CHILTON: Very much because
16 people that make the Shrek doll or whatever.
17 Okay. Business affairs and legal. Subgroups are
18 anti-piracy and communications. Business affairs,
19 legal. I really don't know anything specifically.
20 Can you enlighten us? Would that affect the
21 opening box office?

22 MR. PISANO: Well, they certainly will

1 have inside information as to how --

2 COMMISSIONER CHILTON: They couldn't
3 trade. They might not have an impact on --

4 MR. PISANO: Correct.

5 COMMISSIONER CHILTON: Do you think no,
6 Ms. Neuhauser, too?

7 MS. NEUHAUSER: No.

8 COMMISSIONER CHILTON: Okay.

9 MS. NEUHAUSER: They're just dealing
10 with the contracts underlying it.

11 COMMISSIONER CHILTON: We'll cross it
12 off because they'll have inside information. They
13 couldn't trade but theoretically -- okay. And
14 then the last one is finance and administration.
15 I assume the finance part of that absolutely would
16 have an impact. The administration, the HR, the
17 facilities, and the information system. So if we
18 look at this whole organizational chart of a
19 studio, essentially you have the television
20 distribution, sales and marketing that would be
21 excluded, you know, they would have inside
22 information. The business affairs and legal

1 folks. And then the janitors and the technology
2 people.

3 But the rest of this entire organization
4 -- thank you, Clay -- the rest of this entire
5 organization is built towards making a movie and a
6 box office return. And so, you know, my concern
7 as I said at the outset is that they have such
8 control of the price that I worry that if they're
9 involved in it they could potentially have an
10 undue influence. Going back to the letter of the
11 law, you know, that they are a party that can
12 control -- it doesn't mean 100 percent -- but they
13 can control the contract and the contract is based
14 on an occurrence. The occurrence is the box
15 office future. So if you say, well, maybe he's
16 right. Maybe that dude just made a point. So get
17 them out of it. Don't let those guys participate
18 in this market.

19 Then the question goes back to what the
20 Chairman was asking earlier. Is it a legitimate
21 hedging vehicle? I mean, if you take the studios
22 out who are the 800-pound gorilla in this, and

1 we've already talked about how this may not really
2 help the independents, is there a legitimate
3 hedging vehicle here? And you go to -- and that's
4 a significant part of our law also where it said
5 it has to be -- and this is Section 3A of our Act
6 -- it has to be used for managing and assuming
7 price risk. If it's not, it doesn't meet the
8 criteria.

9 So Ms. Neuhauser says, you know, this
10 argument that -- which I understand but, you know,
11 I'm not sure I buy it 100 percent. Sort of the
12 field of dreams argument. If you build it they
13 will come. You know, they're not going to tell
14 you right now that they want to use these markets
15 because they're scared of the big, bad studios.
16 But once you build it they'll be there. And I'm
17 just not sure. It's a determination by the
18 Commission, by us, as to whether or not this will
19 be used more than on an occasional basis for
20 managing and assuming price risk.

21 So it's just an outstanding question in
22 my mind and I'm not sure that -- that was a great

1 movie but I'm not sure that this is going to pass
2 the legal hurdle for us. I feel bad I've used all
3 my time in diatribes but I'm not going to have
4 time to ask a question now.

5 CHAIRMAN GENSLER: Commissioner O'Malia.

6 COMMISSIONER O'MALIA: I'll quote Animal
7 House: It's not over until it's over. Right?
8 Bart, finish up.

9 CHAIRMAN GENSLER: He's giving you time.

10 COMMISSIONER O'MALIA: Knock yourself
11 out.

12 COMMISSIONER CHILTON: Well, Ms.
13 Neuhauser, what about that? I mean, and when you
14 all met with me and I assume the other
15 commissioners -- thank you, Commissioner O'Malia
16 -- when you all met with us you sort of said the
17 same thing. You said -- without, you know, I hope
18 I don't give away a confidence but, I mean, we
19 know lots of people at the studios and they really
20 want this thing. We can't tell you who they are
21 but they really want it and they think it's going
22 to be great. I mean, it's a little tough for us

1 to, you know, make a decision on a legal basis on
2 like a secret society.

3 MS. NEUHAUSER: Well, that I think is a
4 separate issue which is, you know, our meetings
5 were conducted in confidence. These are at very
6 high levels. And so I take as reality the people
7 who met with us and said that they had interest.

8 I don't really understand and I never
9 have really understood this idea that if it is so
10 bad for a studio to think about so-called betting
11 against their own pictures, who in that value
12 chain at the studio is going to be actively
13 working against the best box office possible?
14 Everybody's job in the studio is to maximize the
15 box office, so I don't -- I've never really
16 understood that idea that somebody is going to go
17 and tank it. You've got, you know, \$150 million
18 invested in a movie and for some reason some guy
19 in a box over here is going to say, eh, I want
20 this to go down. That's how you lose a job.

21 COMMISSIONER CHILTON: So I accept your
22 argument. They're not going to use the market.

1 So who is going to use these markets? How are
2 they going to hedge?

3 MS. NEUHAUSER: Well, I think we're
4 talking about the \$14 billion of other investors.
5 It is not just the studios who invest in movies
6 out of the studio system.

7 COMMISSIONER CHILTON: So who are they
8 going to do? I mean, I don't mean to cut you off.
9 I'm sorry. Do you want to finish? I'm sorry.

10 MS. NEUHAUSER: No, go ahead.

11 COMMISSIONER CHILTON: Okay. So, I
12 mean, really, we've got to make this decision.
13 We've got three letters, Mr. Jaycobs, and one of
14 them says I can't guarantee we're going to do it.
15 So how do we know? I mean, blind faith we say,
16 gee, it looks like they're going to use it. Maybe
17 they will. What do you say? Flip a coin.

18 MR. JAYCOBS: Well, I think Mr. Shilts
19 will recall much better than I do. I've been in
20 the industry since the mid-80s and my recollection
21 is that the standard when the law required the
22 Economic Purpose Test was we did get letters. I

1 think it was about a half dozen in a typical
2 contract. And to my recollection, every one of
3 those letters had the disclaimer that the use may
4 or may not occur. I think if we go back to the
5 standard, post-'74, pre-2000, if we go back to the
6 standard, the letters we're getting now would
7 certainly under the old standard would have been
8 germane.

9 I do think that the nature of this
10 dialogue and the MPAA's position has had a
11 chilling effect on folks who would like to come
12 forward. I'm thrilled we've gotten what we've
13 gotten. And if this process and the contract
14 moves forward, I'm sure we'll get more. We're
15 getting new letters every day. So, you know,
16 there are folks who are in favor of it and I think
17 the Chairman has asked the question from the
18 beginning, how many does it take?

19 COMMISSIONER CHILTON: Well, I mean, I
20 don't mean to be dismissive. The letters, as I
21 said earlier, I think were thoroughly articulate
22 letters and helpful to us. So if there's this big

1 group of people or if there is a group that's, you
2 know, the silent majority, they've got till the
3 26th and, you know, it's the 18th, 17th, 19th
4 today. So, you know, they've got another week, I
5 guess.

6 But, you know, quite frankly this issue
7 as the Chairman described, you know, earlier and
8 Mr. Shilts elaborated on, you know, this thing was
9 out there for a long time. Now, on the DCM
10 status, whether or not we approve you all, it
11 wasn't on a specific contract at that point. I
12 mean, you know, Goldman, you know, Bank of
13 America, Bank US, I mean, all these financiers,
14 you know, yeah. Okay. I didn't hear them either.
15 So it seems to me they've had a lot of time. So
16 maybe we're going to get a lot in the future and,
17 you know, I can see where this might be useful to
18 some people, but whether or not that's more than
19 occasional, I really don't have anything other
20 than, you know, your word saying it's going to
21 happen.

22 Did you want to make a comment? I'm

1 sorry. I left you out.

2 MR. HALLREN: I would, please. Thank
3 you, sir.

4 COMMISSIONER CHILTON: Thank you.

5 MR. HALLREN: I don't think that the
6 studios are first movers in very much of their
7 business. They have a very challenging business.
8 They have very challenged returns, especially in
9 today's environment. So I understand Mr. Pisano
10 and the people he represents' concern that this
11 could possibly be a negative and therefore let's
12 not have the market go forward. That \$14 billion
13 in financing had never been done before. It was
14 the availability of capital and it was breaking
15 new ground and using sophisticated Monte Carlo
16 analysis to try to project film performance.

17 So as a former banker and in trying to
18 understand this product, it was complex for me.
19 It's not something that I deal with. So to have
20 bankers or a flood of bankers or individual take a
21 position in something that they don't understand
22 and that is very complex is understandable to me

1 because I had to be educated on it to form an
2 opinion and to be able to voice that opinion.

3 COMMISSIONER CHILTON: That's helpful.
4 Thank you. Mr. Pisano. And then I'll finish. Do
5 you want to comment?

6 MR. PISANO: Well, no disrespect, Mr.
7 Chairman. I would miss an airplane but I've been
8 invited by the Vice President to a State Luncheon
9 for the President of Mexico representing our
10 industry. And I'm supposed to be there now. But
11 I would be pleased to answer any further questions
12 in writing that the Commission or individual
13 commissioners may have because this is very
14 important to us and it's very important to the
15 entire coalition that we represent.

16 CHAIRMAN GENSLER: We appreciate your
17 attendance at this hearing and we understand if
18 you have another thing.

19 I don't know if 30 seconds or something
20 you can just state (inaudible).

21 CHAIRMAN CHILTON: No, other than
22 thanking again Mr. O'Malia for being very gracious

1 with his time.

2 MR. O'MALIA: Mr. Pisano, you're welcome
3 to leave. The only worse thing than getting
4 invited to the White House is not being invited to
5 the White House.

6 I want to go back -- there is -- I was
7 informed by staff that the Rentrak number and the
8 box office receipt numbers are critical to other
9 merchandising deals in this business -- DVD sales,
10 other things. So I'm trying to reconcile how Mr.
11 Pisano's comments on insider trading and the
12 threat of that in his written comments talked
13 about how this is ripe for manipulation and almost
14 inevitable it seemed from his written comments.
15 How they do business doing deals on further, you
16 know, on downstream products -- if that's a term
17 you all use -- but downstream products, and based
18 on box office receipts that they seem to control,
19 isn't that a concern in the industry of whether
20 that number is valid or not? Do they use Rentrak?
21 Is that how they do their business? I'm trying to
22 reconcile how this business functions without a

1 reliable number if Mr. Pisano is correct.

2 MR. HALLREN: It's my view that the
3 number that is reported is reliable and it's used
4 in many ways. Mr. Pisano mentioned the marketing
5 of films. You know, highest Tuesday ever on a
6 rainy Tuesday weekend, you know, performance that
7 they use to market their films. Video performance
8 is highly correlated to box office. And the
9 industry and people who operate in the video
10 segment of the industry use those results to see
11 what is happening in trends and how many videos
12 they should buy if that correlation is still
13 holding as high as it used to. Pay television
14 agreements on Showtime and HBO are a direct
15 function of what we talked about was being rentals
16 which is a function of box office and exhibitors
17 split up the box office pie according to specific
18 -- often specific calculations that are pre-agreed
19 with between distributors and exhibitors. So if I
20 have a higher box office performance, I may have a
21 changing -- what's called a settlement rate that
22 determines rentals, which is what determines how

1 much HBO and Showtime pay for my films. Whenever
2 free television distributors, such as CBS or
3 networks begin their negotiations with studios,
4 they talk about the license fee that they will pay
5 as a percentage of box office. Box office is the
6 key and studios often use their box office results
7 for market share data, which they market as well.
8 So one of the ways that that number becomes very
9 efficient is when someone is over reporting then
10 you have -- and especially in the studio system --
11 then you often have the five other parties that
12 are part of that studio system questioning their
13 statement. So it's what our industry really
14 focuses on and it's -- to me has been a very
15 reliable number. There's also many websites that
16 use box office data.

17 COMMISSIONER O'MALIA: Mr. Jaycobs, you
18 had mentioned that you had had some additional
19 data regarding the fidelity of the Rentrak number
20 in your opening statement. Can you provide that
21 to the Commission?

22 MR. JAYCOBS: Yeah. And just to carry

1 on with Mr. Hallren, I would just say that one of
2 the things we discussed with staff is we did
3 research. Hollywood is filled with litigation
4 based on disputes over accounting numbers. And we
5 are unaware of litigation based on this box office
6 number. Does that mean that it's never occurred?
7 I'm not saying that we've been completely thorough
8 but we think that's -- in an industry that has
9 disputes over accounting, this does not seem to be
10 a central focus of those disputes.

11 Yeah, and again, we follow, we track on
12 a form and we've provided this to Commission
13 staff, we do track very detailed analysis of the
14 actual numbers that come out. So on average the
15 error is about 13 basis points or, you know, one
16 tenth of one percent is the difference between the
17 studio number and the estimate that we would come
18 to if we had an independently calculated or
19 proprietary index. And we have done that, you
20 know, for about one year's time. And so we think
21 the Rentrak numbers and the studio numbers are
22 actually, for various reasons, very highly

1 correlated and accurate.

2 COMMISSIONER O'MALIA: There was -- Mr.
3 Pisano made a -- and I'll certainly submit this in
4 writing for the forum -- his quote was, "It's a
5 nightmare to control insider information." I'm
6 troubled by that. You know, obviously he had to
7 leave but I'll ask him in writing what that may
8 mean and how bad it is. But I'll follow up, but
9 if anybody has a comment on that.

10 MR. JAYCOBS: Well, I would just comment
11 on one thing. I think that the -- one of the
12 issues we have with MPAA's position in the letters
13 is that they cast a very broad definition of
14 insider information. And I think that's core to
15 this discussion. The letters have said -- I don't
16 know if it's in the 11 May letter, but letters
17 have said that, you know, in their view every
18 director, every talent agent has some knowledge of
19 the fact that an actor has a disease. They've
20 cast this notion of inside information very
21 widely. We don't. Again, in terms of the staff
22 review, we've narrowed it to three very basic

1 points.

2 MS. NEUHAUSER: Well, on a very broad
3 basis, I mean, I would be concerned from an SEC
4 perspective for all of these publicly traded
5 companies if he legitimately believes that his
6 membership has problems with insider information
7 and how it's being used. But in any event,
8 whether, you know, getting back to Mr. Jaycobs
9 point, whether you're talking about, you know,
10 directors' information or whoever, I think we've
11 all pretty well established at this point that
12 whether it's Twitter, whether it's Entertainment
13 Tonight, whoever it might be, there is just a mass
14 of information that is currently available to
15 people. So, you know, a director having
16 information about a cast member is so dated at the
17 point that you're actually approaching anything
18 close to a release is, you know, both known and
19 fairly irrelevant I would say at that point.

20 COMMISSIONER O'MALIA: If I could ask
21 one brief question. If you could submit any data
22 you have on kind of the downstream value tied to

1 the Rentrak number, if there's any way to capture
2 that. I mean, it was a pretty interesting
3 discussion we just had. To understand what that
4 value is and how important the fidelity of the
5 Rentrak number or the box office receipt number,
6 whatever they tie that to for commercial
7 downstream purposes.

8 MS. NEUHAUSER: And just as a point, it
9 kind of missed half of the additional revenue
10 which is that international box office and,
11 therefore, all of their ancillary revenues are
12 also generally very highly correlated with U.S.
13 box office as opposed to what we saw with Robin
14 Hood, where it generally has a very big impact on
15 how it performs internationally.

16 MR. O'MALIA: Thank you.

17 MR. HALLREN: May I make one comment
18 just about your insider information question? I
19 think there's another side of this that I'm
20 confident just absolutely scares the studios to
21 death, and that is that people will -- a film
22 won't be turning out well and in pre-released

1 screenings or around the industry that it won't be
2 performing well and they're trying to keep that
3 information as close to the vest as possible to
4 try to get the film out and be released. Studios,
5 even at times when they're in that position, don't
6 even provide the film to be available to be
7 reviewed by third-party reviewers, one of their
8 biggest marketing sources.

9 And so I think that there's a lot of
10 information and I'm very sympathetic to the
11 studios in trying to control that because they
12 have a huge investment in the (inaudible) product
13 that is very risky.

14 COMMISSIONER O'MALIA: Well, we
15 certainly wish them all the best in every movie
16 they make and wish them great success in
17 international, you know, it is a major trade and
18 business for us here in the United States and we
19 wish them every success on every movie. But they
20 have put up some stinkers.

21 CHAIRMAN GENSLER: A lot of good lines
22 here today. I want to thank the panels but I just

1 -- this is just a yes or no. Are you familiar,
2 Mr. Hallren, because you seem to be closest to
3 this finance, does anyone do this same hedging
4 that we're talking about here in the
5 over-the-counter derivatives marketplace, which is
6 presumably allowed. So just curious. Do people
7 do transactions?

8 MR. HALLREN: Not that I'm aware of.
9 Not in any organized market that I'm aware.

10 CHAIRMAN GENSLER: So you're not aware
11 of any box office receipt over-the-counter swap?

12 MR. HALLREN: I am not.

13 CHAIRMAN GENSLER: Ms. Neuhauser?

14 MS. NEUHAUSER: No, I haven't.

15 CHAIRMAN GENSLER: But you still stand
16 by your earlier view that somebody will use this
17 thing to occasionally hedge? It's completely
18 unregulated. Nobody is using it to occasionally
19 hedge in the over-the-counter derivatives
20 marketplace, at least to your knowledge.

21 MR. HALLREN: To my knowledge there is
22 no organized market in which people are trading.

1 But one of the -- I'm highly confident that a
2 hedging tool that could affect box office
3 performance since all of these markets are
4 regulated to this would be very attractive to the
5 industry. To the point, what extent they'll use
6 it, it all depends on the price point and the
7 volume of the contracts that are trading.

8 CHAIRMAN GENSLER: I want to thank this
9 panel. It's been very helpful to the Commission.
10 We have another panel. I apologize to those who
11 have been waiting to come up. I won't officially
12 have a break. I'll just have those people swap in
13 and out if that's all right.

14 Thank you very much.

15 (Recess)

16 CHAIRMAN GENSLER: Well, I can do this,
17 or do this Shhh. We're pleased to have with us
18 Michael Burns from Lionsgate; Scott Harbinson from
19 International Alliance of Theater and Stage
20 Employees/Directors Guild of America; Schuler
21 Moore -- thank you -- Schuyler from Stroock,
22 Stroock and Lavan; and Robert Swagger from Media

1 Derivatives. And we'll go from right to left this
2 time and your written things will be in the
3 record, and I thank you for your patience. We're
4 running a little late here.

5 MR. BURNS: In the interest of time
6 instead of taking five minutes, I'd just like to
7 give the Commission if I could just sort of a
8 brief background on myself. I started actually in
9 1995 I co-founded the Hollywood Stock Exchange,
10 and then years later, before actually 9-11, I sold
11 the Hollywood Stock Exchange to Cantor Fitzgerald.
12 I was an independent producer, actually towards
13 the later part of my career as an investment
14 banker I ran the media practice for nine years for
15 Prudential and before that I spent nine years at
16 Shearson Lehman Brothers and went through nine
17 name changes in nine years.

18 And in 1999, I went on the board of
19 Lionsgate, which was a tiny little independent
20 producer and distributor. Market capital of
21 around \$60 million, we've grown the company -- my
22 partner John Feltheimer who ran Sony Television,

1 and I came over full time in early 2000, so we've
2 been there about 10 years. Today, Lionsgate is a
3 diversified media company owning channels, like TV
4 Guide. EPIX is our pay television channel that we
5 own with Viacom and MGM. We have a very
6 diversified slate of motion pictures; we put out
7 about 14 to 15 movies a year. We've had numerous
8 Academy Award nominations and wins. We also have
9 a very robust television business. Some shows
10 that you might know would be Mad Men, Nurse
11 Jackie, Weeds, and that's what we do.

12 CHAIRMAN GENSLER: Thank you, Mr. Burns.
13 Mr. Harbinson.

14 MR. HARBINSON: Good morning, Mr.
15 Chairman. My name is Scott Harbinson. I'm an
16 international representative with the
17 International Alliance of Theatrical Stage
18 Employees, and I'm here today representing both
19 the IATSE and the Directors Guild of America.

20 I hope my presence will underscore the
21 grave concern we have about the impact of movie
22 futures contracts, which are pending before the

1 CFTC. ITSE is a labor union that represents
2 110,000 members in the entertainment industry we
3 work in the motion picture and television
4 production, live theater and trade shows. DGA
5 represents over 14,000 directors, and members of
6 their directorial team who work on feature films,
7 television, news, sports, commercials, and new
8 media.

9 The realities of our business are not
10 easily understood by those outside of it, so let
11 me begin with a few of the specifics I hope will
12 shed light about our concerns on the MDEX and
13 Cantor Futures applications. The majority of the
14 middle class wage earners working on the creative
15 side of our industry do not hold a regular
16 full-time, Monday through Friday job; ours is a
17 freelance business.

18 We move from employer to employer, from
19 one project to the next. Our business model
20 recognizes and accounts for that uncertainty by
21 providing another type of security in the form of
22 residuals. These residuals which come from the

1 exploitation of our work and secondary markets;
2 such as DVD's, free and pay television, and new
3 media help people in between jobs either directly
4 or through contributions to their health or
5 pension plans.

6 Not surprising there's a high
7 correlation between box office success and
8 downstream revenues that enhance residuals
9 generated in these markets. The ability to place
10 lucrative bets on a films failure by shorting it
11 puts commercial success of the film at an even
12 greater risk. This new risk would not be
13 generated by the people who spent years and
14 invested millions of dollars by making the film.
15 It would be generated by those who are likely to
16 have no real stake in seeing the film succeed;
17 their goal is simply to make money for themselves.
18 What will follow will be diminished downstream
19 revenues, and when that happens our member will
20 suffer? Additionally the lower revenues will
21 dampen reinvestment, which leads to decreased
22 production and fewer jobs in the future.

1 It's hard for us to conceive how the
2 CFTC can allow a motion picture, which is in fact
3 an experience, not a commodity be monetized and
4 treated like Grade A wheat. At a fundamental
5 level, we believe that you need to consider
6 whether the motion picture industry will actually
7 benefit. Will there be a broad and greater
8 economic gain as a result?

9 And what about market manipulation? We
10 believe that as regulators your first duty is to
11 the welfare of the general public and the industry
12 stakeholders. Not to speculators on the margins
13 of the industry looking to make a quick buck.
14 Relative to a bushel of corn or a barrel of oil
15 there's no question that a contract tied to a
16 single motion pictures box office performance will
17 be far easier to manipulate. It's been suggested
18 by Cantor and MDEX that smaller films will be the
19 type that will most benefit. Actually it's the
20 smaller films that will be most vulnerable to that
21 manipulation.

22 The initial theatrical release -- the

1 initial theatrical success of a film is all about
2 the buzz created. Why would you create a new
3 economic incentive for gamblers and speculators to
4 intentionally produce negative impressions of our
5 films? The MPAA and IFTA represent companies
6 whose releases comprise of more than 95 percent of
7 the motion pictures that would be subject to these
8 exchanges. IATSE and DGA represent a crew who's
9 worked on virtually all of these productions. So,
10 you have almost the entire motion picture
11 industry, the purported beneficiaries of these
12 contracts absolutely opposed to them.

13 The proponents of these contracts are
14 the ones who will be the largest if not the sole
15 beneficiaries. And once again the Wall Street
16 guys stand to make millions, while the working
17 class -- and do so at the working class people's
18 peril. We've just seen the result of the
19 financial industry's helping other economic
20 sectors with new and exotic financial instruments.
21 This help is resulted in dire consequences for the
22 economy, and tragic outcomes for the middle class

1 who have been fleeced through no wrong doing of
2 their own. The motion picture industry has
3 reliably provided international trade surplus
4 every year since its founding; provides hundreds
5 of thousands of good middle class jobs that
6 provide health insurance and retirement benefits.

7 Our industry doesn't ask for bailouts,
8 and it doesn't need any help from Cantor or MDEX.
9 We seek only to grow and prosper without being
10 imperiled by profiteers who have no stake in the
11 continued success of our industry. Just because
12 these contracts may benefit Cantor and MDEX and
13 indulge the star struck gamblers for whom these
14 things are created, doesn't mean they're a good
15 idea.

16 Cantor and MDEX seem to have adopted the
17 line from Field of Dreams, "Build it and they will
18 come." But more aptly that line translates to
19 "Trust me." Well, I don't them, the working men
20 and women I represent don't trust them, the
21 directors don't trust them, and the motion picture
22 companies that have invested millions in this

1 industry don't trust them, and neither should you.

2 Hank you.

3 CHAIRMAN GENSLER: Thank you, Mr.
4 Harbinson. Mr. Moore.

5 MR. MOORE: I'm Schuyler Moore. I'm the
6 head of the entertainment department at a large
7 national law firm Stroock, Stroock and Lavan. I
8 have done this for a living for 29 years that is
9 what I do, film financing, and I represent the
10 money coming into Hollywood. That's what I do for
11 a living. I'm also an adjunct professor at the
12 UCLA Law School and the UCLA Anderson Business
13 School teaching film financing. I'm the author of
14 a book called The Biz, which is about film
15 financing; the author of a treatise called
16 Taxation of the Entertainment Industry; and I am
17 the author of an article that came out seven years
18 ago advocating this precise technique to raise
19 financing for Hollywood called Betting the Box
20 that I published seven years ago.

21 I am here to help this industry; I am
22 here to help the guilds, to help the unions, to

1 help the studios, to help Mr. Pisano. I'm here to
2 raise money, I will tell you on the frontline.
3 What's -- first of all, Hollywood is in deep
4 trouble right now. There has been a massive
5 withdraw of capital from Hollywood; massive.
6 Revenues are down the equity financing to New York
7 has backed off, and the reason is because there is
8 no objective clear transparent method to value
9 what you own. People don't want to invest and
10 simply get an opaque accounting statement from --
11 know that they're worried about Hollywood
12 accounting. And what this box office technique
13 brings, which is what I advocated seven years ago
14 open the paper and there it is. Now you know what
15 its worth, you see it the next day, you can trade
16 it, it's obvious. It will bring billions of
17 dollars of capital to this industry to help the
18 crew, to help the studios.

19 You know all you have is look back to
20 before there was public trading on stocks. How
21 much capital came into the corporate sector and
22 then once there was public trading multiples

1 multiples of capital compared to what it was when
2 I believe it was 1910. Take a look at a private
3 company versus a public company now and how much
4 easier it is to raise capital, when you have
5 publically traded stock and you can open the paper
6 and see what its worth. That's all we're asking
7 for, is so that investors in this industry can
8 have an objective clear transparent way of knowing
9 what they own.

10 My hope actually is that the studios
11 will take this a step further and do all
12 investments; the slate financings, the blind
13 pools, they really should tie all investments to
14 box office results because it's an objective clear
15 result that will bring money to the table. Will
16 they do it? Absolutely they will do it. Their
17 hand -- they've been doing this for years 29 years
18 this is what I do for a living. I help the
19 studios hedge. They're shorting their film every
20 time they do a split-right transaction, \$14
21 billion in the last 8 years of slate financings
22 with New York.

1 What's that? That's shorting their
2 films; that's shorting half the film. Don't --
3 they can't stand here and say they wouldn't do
4 this; they've done this for 29 years that I've
5 been in practice. Co-production, split rights,
6 pre sale that's what they do, this offers them a
7 transparent, simple, efficient technique to do it.
8 Every industry that has had a new exchange
9 proposed fights it almost without exception.
10 Enron went crazy when oil futures were proposed,
11 the Treasury went crazy when interest futures were
12 proposed. This industry is making the exact same
13 arguments that every other industry has made; fear
14 of the unknown, fear of what's new. And I'll tell
15 you what's really driving it, all right what's
16 really driving their paranoia. And it's myopic
17 and it's wrong, but it's clear this is what
18 they're concerned about and is driving everybody.
19 They are concerned that if a film is tracking
20 badly on the Exchange that theaters won't book it
21 and the public won't go, period end of discussion
22 that's their fear.

1 Right let's -- and here's the answer to
2 that. Asked and answered The Hollywood Stock
3 Exchange has been running since 1995 and that's
4 not had a single impact on a single film
5 attendance, theater booking, anything else. And
6 you can go online right now and see how a film is
7 tracking on The Hollywood Stock Exchange the
8 information has been there, so that's number one.

9 Number two is that there is a flood of
10 other pre- release information that's available to
11 the public; Ain'tItCool.com website, Rotten
12 Tomatoes, Reviews, Buzz. I mean, it's just an
13 absolute roar of pre-release buzz this would be a
14 drop in the bucket compared to everything else
15 that's out there. This will not adversely impact
16 the attendance at a film. I want to tell all the
17 studios this and the MPAA that they have lost
18 their mind on paranoia on this issue.

19 And finally, overall it's going to track
20 -- you made the comment that maybe it will
21 increase attendance. You're right, that's not a
22 joke. All right to the extent that there's a film

1 tracking badly will be made up by the fact that
2 other films are tracking well. And so overall on
3 average it's not going to have an adverse impact,
4 on average if anything it'll be a wash if not
5 better. All right. So I think that they've
6 become -- and they've got everyone excited about
7 this issue. They've got this gentleman here
8 excited he's going to lose jobs, I'm bringing in
9 -- I'm going to bring you billions of dollars.
10 They've got the -- they've got IFTA, which is the
11 Independent Film Agent -- Independent Film and
12 Television Alliance. They've got them excited and
13 joining the MPAA, I represent a lot of independent
14 film companies and IFTA did not come talk to my
15 clients. They didn't come talk to me all right.
16 So, and again I guarantee what happened MPAA said
17 oh, my god, a film might track badly, it might
18 hurt you. It's like come on, guys, stop with the
19 paranoia.

20 Every other argument, every single one
21 that they've made is make weight and I can prove
22 it. Every single one that they've made the answer

1 is don't trade on the exchange if this issue
2 really excites you. So, let's go down them.
3 Here's their argument that they've made. Oh, we
4 can't bet against our own film.

5 CHAIRMAN GENSLER: Mr. Moore, if you can
6 just summarize somehow because --

7 MR. MOORE: Okay. Sure, short answer is
8 on every other argument that they've made the
9 answer is don't trade. Okay. Anti-disparagement,
10 manipulation, insider trading et cetera -- every
11 single one you can just simply say to them, all
12 right, fine, don't trade, go do it the inefficient
13 way that you've been doing for years. Go continue
14 to do your slate financing.

15 I'd like to answer the issue -- the
16 concern that keeps being raised about manipulation
17 by the studios. The studios are -- we all know
18 they're trying to manipulate --

19 CHAIRMAN GENSLER: Do you want to do
20 that in here -- I promise I'll ask that as your
21 first question.

22 MR. MOORE: Okay. Have I hit my five

1 minutes? I don't think I've hit it.

2 CHAIRMAN GENSLER: Yeah, that red light
3 over there.

4 MR. MOORE: I'm just warming up.

5 CHAIRMAN GENSLER: We noticed, we
6 noticed.

7 MR. MOORE: Okay. So, do I have any
8 time? Do I -- let me just make a couple of other
9 -- a quick point.

10 CHAIRMAN GENSLER: One.

11 MR. MOORE: One. One other point, all
12 right. There is no insider trading prohibition on
13 the commodities exchange. This has become a great
14 red herring, it's like let's get done with this,
15 there's no insider trading prohibition.

16 CHAIRMAN GENSLER: Thank you, Mr. Moore.
17 Mr. Swagger.

18 MR. SWAGGER: Chairman Gensler and
19 Commissioners, thank you for inviting us to this
20 hearing today. I appreciate the time.

21 At the outset, I want to thank the
22 Commission for approving our application to

1 operate as a designated contract market. Having
2 worked with Commission staff for more than 11
3 months and submitting more than 100 documents, we
4 commend the Commission and staff on their efforts.
5 We believe that the approval was a forceful step
6 in the right direction, and we look forward to the
7 Commission's approval of our product application
8 on June 7th.

9 We believe that our product application
10 represents the very essence of innovation, which
11 the Commission has sought to promote for many
12 years. In my remarks today I would like to focus
13 chiefly on why our products offers a useful
14 hedging tool for the institutional entertainment
15 industry, and debunk the myth that box office
16 futures are tantamount to gambling contracts.

17 Despite the objectors unsupported
18 statements to the contrary, MDEX believes based on
19 its market research that demonstrable need for box
20 office futures and options does exist. We've had
21 discussions with many segments of the
22 entertainment industry, some of whom are here

1 today, about the economic utility of our products.
2 We are here today because we have received strong
3 support from these and other segments for our
4 products.

5 It's no secret that the risk management
6 tools such as futures promote financing and
7 capital investment because they allow those who
8 provide financing to hedge their investments. It
9 is also no secret that film financing has dropped
10 measurably over the past several years. As noted
11 in a recent article that has been provided to the
12 Commission, "With studios cutting back on their
13 financing thresholds and Wall Street nowhere close
14 to stepping up to plate, it will fall to places
15 like Abu Dhabi, Singapore, Russia, and India along
16 with the reliability of Star Trek billionaires to
17 fill the gap.

18 We do not want to see that happen, and
19 the objectors should not ask the Commission to
20 play party to such an outcome. Our products will
21 allow a host of parties with financial interest in
22 the movie, production, and revenue chain to hedge

1 the enormous risks associated with producing,
2 distributing, financing, ensuring major motion
3 pictures. These groups include original screen
4 play owners, debt and equity investors, investment
5 banks syndicating a financing slate, talent
6 involved in a film, studios both MPA and
7 independents. Banks and lenders ensure a talent
8 and movies, theaters, distributors and
9 co-promotional marketing partners.

10 Ultimately, while we cannot guarantee
11 our products will be used, we urge the Commission
12 to allow the market to decide whether these
13 products are right for them. Importantly the
14 contracts that MDEX seeks to list are not
15 dissimilar to other futures and options contracts
16 based on excluded commodities. As the objectors
17 note the definition of an excluded commodity under
18 the CEA does not require a cash market in an
19 excluded commodity. Cash markets, in fact, do
20 exist in many approved futures contracts including
21 only by way of example, virtually all economic
22 event contracts and weather contracts.

1 The objectors present to the Commission
2 however a straw man argument that an excluded
3 commodity with no cash market would not be within
4 the meaning of excluded commodity if the
5 occurrence is subject to "substantial influence"
6 or control of a number of different participants
7 in the motion picture industry. This is not what
8 the CEA says, rather the CEA provides that
9 excluded commodity includes "an occurrence beyond
10 control of the parties to the relevant contract,
11 and associated with a financial commercial or
12 economic consequence."

13 With respect to the first aspect "the
14 occurrence" that is whether the movie will
15 generate a viable audience of revenue is clearly
16 beyond the control of the parties. The MPA's own
17 letter cites a study by Professor Thomas Gruca
18 showing "empirical evidence of the arbitrariness
19 of motion picture box office pricing." With
20 respect to the second aspect before going
21 occurrences is clearly associated with a
22 financial, commercial, or economic consequence, or

1 else the studio would not produce the movie.

2 Studios are not for profit organizations.

3 The objectors, which, in fact, represent
4 only a slice of the entertainment industry, have
5 contended that the reputation and integrity of its
6 industry could be tarnished by allowing trading
7 and the movie futures contracts. This is patently
8 false; MDEX has no interest in disparaging the
9 reputation and integrity of Hollywood. Notably
10 the objectors' broad and populous statement could
11 apply to every industry that has had a product in
12 which a futures contract is listed. It could
13 apply, for example, to the U.S. Government and
14 listing of Treasury futures, the housing industry
15 and housing futures, the insurance industry, the
16 listing of weather futures, the listing of
17 aluminum futures in the aluminum industry, and the
18 agricultural industry in listing of corn, wheat,
19 soybean, and other futures.

20 The notion that regulated futures
21 contracts can tarnish an industry and is
22 tantamount to "legalized gambling" is not only

1 outdated but baseless. It's no surprise that many
2 groups would come at the MPAA's assertion that
3 this is gambling and be concerned because of how
4 it was presented wrongly by the MPAA to various
5 groups who are not represented here today and
6 voted not to come here today.

7 In designing its product MDEX has worked
8 closely with CFTC staff to reduce if not eliminate
9 the likelihood of excessive speculation and the
10 retail use of its products. MDEX has contracts --

11 CHAIRMAN GENSLER: Mr. Swagger --

12 MR. SWAGGER: -- specifications require
13 each contract to be fully funded, in other words
14 there's no leverage component thus reducing
15 excessive speculation. We've also imposed tight
16 recording levels --

17 CHAIRMAN GENSLER: Mr. Swagger, if you
18 can try to --

19 MR. SWAGGER: Yes, I have like three
20 more sentences.

21 CHAIRMAN GENSLER: Okay. Great.

22 MR. SWAGGER: Is it good? All right, at

1 the same time because they are fully margined and
2 essentially cleared by CFTC-regulated
3 clearinghouse there is no credit risk. In all
4 material respects MDEX's contracts seek to obviate
5 risk not create it.

6 MDEX thanks the Commission for the
7 opportunity to participate in this hearing. We
8 look forward to answering any questions you may
9 have.

10 CHAIRMAN GENSLER: I want to thank our
11 panelists very much. I think I made a promise to
12 ask about manipulation the first question.

13 So, Mr. Moore, I'm fulfilling that
14 promise as long as you -- you know, so I can get
15 to some of the other questions.

16 MR. MOORE: We -- no one's concerned I
17 assume that a manipulation that a studio will try
18 to make a film as high as possible. Duh. That's
19 what they do right? So, the only manipulation
20 could be possible is that a studio will "tank its
21 own film." Like that's ever going to happen,
22 right? Because they would kill themselves losing

1 money on the film, losing stock value, and losing
2 good will. So, that's never going to happen in
3 our lifetime. So, manipulation is not a bona fide
4 fear.

5 CHAIRMAN GENSLER: I think the question
6 under the Commodities and Exchange Act is whether
7 the contract itself is susceptible to manipulation
8 and whether the exchanges that we ever see you
9 know can control for that. I mean, we are an
10 agency; part of our mission is to promote fair and
11 orderly markets. But it's also to protect markets
12 against manipulation, so it's really about the
13 contracts. That's just to clarify.

14 MR. MOOR: Understood. But that -- I've
15 heard manipulation kind of expanded broader than
16 what you're saying. There is no manipulation
17 possible with respect to the reported box office
18 number. It is a self-regulating number, the
19 industry has used it for years, the studios, in
20 fact, pay talent box office bonus' based on box
21 offices. The studios have accepted the box office
22 number for many, many years for making hard cash

1 payments to talent.

2 CHAIRMAN GENSLER: Can I ask the
3 question that I asked at the end of the last
4 panel? Are any of you familiar with parties who
5 are currently hedging in the over-the-counter
6 derivatives marketplace, you know, on box office.
7 Mr. Burns?

8 MR. BURNS: As one of the only pure play
9 entertainment companies out there, I am sure that
10 there is a fair amount of trading in Lionsgate
11 stock in front of large releases. Because one
12 particular movie could be a significant --

13 CHAIRMAN GENSLER: So, they're certainly
14 shorter -- going longer short the company stock.
15 Are people using what might be called an
16 over-the-counter derivative or, you know --

17 MR. BURNS: I don't know.

18 CHAIRMAN GENSLER: Don't know. Does
19 anybody know? Do -- Mr. Moore?

20 MR. MOORE: Not on films.

21 CHAIRMAN GENSLER: Right, not on films.

22 MR. BURNS: Yes, not on films.

1 CHAIRMAN GENSLER: Mr. Swagger, do you
2 know?

3 MR. SWAGGER: I do not.

4 CHAIRMAN GENSLER: And to the question I
5 asked earlier, though, do you think that these
6 contracts, if they were on these two exchanges,
7 would be used on more than an occasional basis for
8 purposes of hedging? And if so, by whom?

9 MR. SWAGGER: I'll -- want me to
10 address?

11 CHAIRMAN GENSLER: Yes, Mr. Burns.

12 COMMISSIONER SOMMERS: (inaudible) their
13 mics.

14 CHAIRMAN GENSLER: Oh, you have to turn
15 off your mic, Mr. Moore.

16 MR. BURNS: I'm going to try to remember
17 that sky, okay? I think that actually people
18 would look at this as a hedging vehicle.

19 CHAIRMAN GENSLER: And actually use it.

20 MR. BURNS: I do believe so.

21 CHAIRMAN GENSLER: Mr. Harbinson, do you
22 have a view or no?

1 MR. HARBINSON: I'd like to know where
2 all of those people are today. Because all I've
3 seen up here at this panel is Cantor, MDEX, and
4 their extended family; six of them, and me and
5 Pisano. So, we have the industry 95 and -- or
6 more percent of the industry represented, we have
7 the bookies represented, but we don't have the
8 investors who are clamoring for this new and great
9 vehicle here at the table. I'd like to know why.

10 MR. MOORE: They're here. That's me I
11 represent the investors and I guarantee you that
12 we're going to use it and to the tune of hundreds
13 of millions of dollars. I also guarantee you that
14 studios will be using this to the tune of billions
15 of dollars just the same way they use the co-
16 productions, the slight financings from New York,
17 which didn't exist -- the market that didn't exist
18 10 year ago and \$14 billion dollars has been done.
19 They will do it for the exact same reason.

20 MR. SWAGGER: I wouldn't have spent
21 millions of dollars as an entrepreneur and
22 invested years of my life in building an exchange

1 that had no business model. I'm not an idiot and
2 the math I see today is extended family as Steve
3 would like to call it. Maybe greater than the two
4 whom are representing opponents to it. And it's
5 very significant with JP Morgan.

6 CHAIRMAN GENSLER: I suspected -- my
7 yellow light, so my last question --

8 MR. SWAGGER: Thank you.

9 CHAIRMAN GENSLER: -- is I do think
10 there's something different about this index,
11 which is on an individual movie then on a whole
12 lot of oil or a whole lot of corn, or a whole set
13 of houses. And I raised that at the last panel.
14 And I didn't know if any of you -- not that you're
15 familiar enough with the Commodities and Exchange
16 Act. But just wondering how you see that if you
17 were a Commissioner? How you would look at it?
18 It's like on an individual movie. It's not for
19 instance on all the movies that are in a quarter.

20 MR. BURNS: If I could just sort of give
21 you --sort of my view at 35,000 feet how I would
22 look at this. From the Commissioner's standpoint,

1 I would look at every individual movie that comes
2 out in a wide release as an individual company.
3 And the math works something like this, if a movie
4 does \$100 million of domestic box office and
5 domestic is typically North American box office,
6 that's what the totals are; it's Canada and the
7 United States.

8 And what happens is if a movie does \$100
9 million that means that movie will do about \$200
10 million in North American revenue. And so what
11 happens is is that our business is based upon
12 that. What we do -- and I'm assuming that every
13 studio does this is that we back into a --

14 CHAIRMAN GENSLER: Since I went over my
15 limit if you just shorten it up --

16 MR. BURNS: Sure. I was just going to
17 tell you that that's how I would look at it. So,
18 if a movie for example it does \$600 million at the
19 U.S. box office a giant hit that would be about
20 \$1.2 billion of revenue just in America and
21 Canada.

22 CHAIRMAN GENSLER: Commissioner Dunn.

1 COMMISSIONER DUNN: Thank you, Mr.
2 Chairman. And let me thank you again for having
3 this meeting. Because reading a dry seriatim does
4 not bring about the conviction and passion that
5 we're getting from Mr. Harbinson and Mr. Moore.
6 So, I appreciate the -- hearing this firsthand.

7 I guess there's been a lot of banter
8 back and forth about who's going to use it and is
9 there going to be a critical mass, and, as I said
10 in my opening statement, up to 80 percent of
11 contracts fail. So, I don't really see it's the
12 job of the Commission to determine whether this
13 will fail or not. It's our job to understand
14 whether or not it falls within the statute that we
15 have to look at. And that is important to me.

16 We're hearing Congress talk a great deal
17 about -- well, as they're looking at the financial
18 reform up on The Hill and they talk a lot about
19 naked shorts and that's not finding a Congressman
20 a compromising position or a sequel to the Naked
21 Gun. It is something that is a concern out there
22 about how investors have an impact on an industry

1 on a company. And I've heard Mr. Moore, you said
2 that a company is not going to try to tank their
3 own film.

4 But I do have a concern about what do we
5 have in place to ensure that -- because we're
6 hearing about how important it is to have these
7 revenues, and how important it would be to follow
8 the tic of what's going on in this marketplace for
9 marketing a whole bunch of things in addition to
10 the film in there. What do we have that will
11 assure us that another film company that's going
12 head to head with somebody on a box office event
13 are not using these contracts to tank their
14 opponents. And I'd like to hear from everyone on
15 that.

16 MR. SWAGGER: I'll keep it brief this
17 time. We can certainly provide some economic
18 details to the Commission on that that it makes no
19 economic sense for anybody to purposely try to
20 tank the movie. The contract size it's just not
21 going to make any economic sense.

22 COMMISSIONER DUNN: I'm not talking

1 about their own movie; I'm talking about their
2 competitor's movies.

3 MR. SWAGGER: Yeah. No, I think the
4 positions that would have to be taken relative to
5 the size of the contract and such it would not
6 allow another person's movie to be tanked. It
7 would take a tremendous number of groups to come
8 together to purposely try to tank the movie, and
9 then to need somebody to take the other side of
10 the position.

11 COMMISSIONER DUNN: And that's on the
12 assumption that this is widely traded, not thinly
13 traded?

14 MR. SWAGGER: Correct.

15 MR. MOORE: Could I just say that no
16 matter what they did, they couldn't hurt the box
17 office on another film. They can short all they
18 want; they can do whatever they want. The public
19 doesn't go to a movie based on whether or not
20 someone has shorted a film, or where it's tracking
21 on the exchange. Again the Hollywood Stock
22 Exchange has been around forever, and I don't know

1 a single person that makes a decision of whether
2 to go to Avatar based on how it's tracking on The
3 Hollywood Stock Exchange. So, I don't think it's
4 going to have any impact. I can't imagine anyone
5 even attempting it.

6 MR. HARBINSON: I'm not sure I'm the guy
7 to answer a question like this, but it seems to me
8 that I think you're right. I think that by virtue
9 of the fact that these are events these are
10 experiences, these are not commodities. This is
11 some sort of alchemy in my opinion. I think they
12 are subject to manipulation, whether they would
13 be, in fact, manipulated or not I have no way to
14 knowing, but neither do they.

15 MR. BURNS: I don't know how a
16 competitor could short another studio stock and
17 not have that become a disclosable event. And I
18 think that would be an incredibly risky thing for
19 Paramount to explain to MGM or Fox why they
20 shorted a particular movie of their competitor in
21 order to drive down the price. And I agree with
22 Sky, I don't think that's even a remote

1 possibility.

2 COMMISSIONER DUNN: Mr. Chairman.

3 CHAIRMAN GENSLER: Commissioner Sommers.

4 COMMISSIONER SOMMERS: I just have a
5 real quick question for Mr. Burns with regard to
6 how you would use this, because the way I
7 understand the contracts on Cantor, Cantor does
8 not allow distributors to participate with regard
9 to their own movies. The chart that Commissioner
10 Chilton put up identified maybe some small areas
11 within a studio that would not have the material
12 non-public information. But if you could just
13 talk about how you intend as a studio to use these
14 products.

15 MR. BURNS: Well, we would use it the
16 same way that we mitigate risk right now. So, if
17 a movie's going to cost \$50 million to make the
18 movie, we will typically pre-sell the foreign
19 rights to a movie to an all rights buyers in a
20 bunch of territories. Lionsgate is a little bit
21 unique in that we don't self distribute outside of
22 Canada and the UK. So, a market like Cannes, for

1 example, we're selling a bunch of movies right now
2 as we speak and having a good -- at Cannes I know
3 somebody up here said before that the market
4 wasn't robust, but it's actually pretty good for
5 us right now.

6 So, we would mitigate risk that way.
7 So, if the movie cost \$50 million we would have
8 \$30 million in foreign pre-sales and that is a way
9 of hedging that risk and that's just the way that
10 we do business. The same way as I understand that
11 Cantor Exchange is that we would have a moment in
12 time where we would be able to sell -- call it 10
13 percent of the domestic box office. So, if we
14 said that contract was striking at \$50 million of
15 U.S. box office, we could sell \$5 million of that,
16 take that \$5 million in, use that for print and
17 advertising money if we wanted to do that or the
18 production itself and mitigate some risk that way.
19 If the movie did \$100 million the people that
20 bought that contract for five would actually get
21 \$10 million. If it did \$20 million they would
22 lose \$3 of the \$5. That's my understanding of how

1 those contracts work.

2 But again, we hedge almost every one of
3 our pictures because it's all about our base case
4 return; it's not about playing for homeruns.

5 MR. MOORE: Could I -- I want to address
6 one issue on this, because this keeps coming up
7 and it's this issue of insider trading with his --
8 you know, Mr. Chilton's chart. There again --
9 number one, legally there is no prohibition on
10 insider trading on a commodities exchange.

11 COMMISSIONER SOMMERS: It's in the
12 contract specs --

13 MR. MOORE: No, but on --

14 COMMISSIONER SOMMERS: -- not the
15 contract.

16 MR. MOORE: Let me -- on Cantor's it's
17 not in the contract. All it addresses is a
18 firewall and it's very limited. It's only -- they
19 shouldn't have done this because it's become this
20 red herring that everyone's run off on insider
21 trading. All it limits is the trading by the
22 people who are determining the box office number.

1 It's like the one person at the studio. It's not
2 the whole list if anyone has any knowledge of the
3 film. And what's happened is because of that
4 firewall that they've proposed in their contract
5 everyone's run off into insider trader land. But
6 it's -- and I -- they shouldn't have done it,
7 frankly, but there really should be no -- just
8 like an oil executive who knows that there's an
9 oil find is allowed to go trade on the oil
10 exchange because that's disseminating information,
11 or a farmer that knows locust's have hit the
12 Midwest he's allowed to trade. That's not insider
13 trading that's sharing information. All right,
14 and that's how the market should work.

15 CHAIRMAN GENSLER: Commissioner Sommers.
16 Commissioner Chilton.

17 COMMISSIONER CHILTON: Thank you, Mr.
18 Chairman. Just a quick comment. You know, again,
19 there's a difference in this issue, the Chairman
20 talked about it. It's just that the studio is the
21 people that sort of control this is one of my
22 concerns. If, for example -- and nobody's

1 proposed this that I know of -- but if you had a
2 basket of films -- and I still may have a concern
3 about whether or not there's a commodity in
4 general -- but if you had a basket of films, or if
5 you had, you know, the summer movies or something
6 that had multiple studios, then I'd be less
7 concerned about the control of the occurrence.

8 And, you know, you're right, Mr. Moore
9 and Mr. Swagger, we don't have insider trading
10 rules here, but we do have conflict of interest
11 rules that are really important to us. And that's
12 what I'm trying to make sure that we're looking at
13 as the studios are potentially, you know,
14 hypothetically, going to be involved in this.

15 Mr. Swagger, I want go back to what I
16 said earlier because I really do think you have a
17 neat and novel approach and I am impressed with
18 it. But I keep going back to, you know, we have
19 to make a judgment. I mean, Mr. Moore is very
20 impassioned and makes a good point about you would
21 use it and others in the room who would think
22 they'll use this as a hedging vehicle. But you

1 say you've done market research and you have
2 strong support for your products. I mean, have
3 you provided that to the Commission?

4 MR. SWAGGER: We've provided a lot of in
5 to the Commission over the last 11 months, and we
6 have done market research that would support that.
7 And actually we've had in-depth conversations with
8 half of the MPAA representatives. And --

9 COMMISSIONER CHILTON: I mean --

10 MR. SWAGGER: -- this issue did not come
11 up until it was falsely presented as gambling and
12 there was misinformation provided to the media,
13 and this was taken to Capitol Hill and put into a
14 piece of legislation. There was no issue until
15 this rhetoric was taken out of proportion by
16 people who don't understand the futures
17 commodities industry.

18 COMMISSIONER CHILTON: Well, like I
19 said, I think a lot of people were sort of, you
20 know, late to the party, and I know you've been
21 doing this for a long time and spent a lot of your
22 own personal money, so I sympathize with you.

1 But, you know, we've got to -- we're the ones that
2 make this decision.

3 And I apologize for poaching your Field
4 of Dreams line, I didn't read your entire
5 testimony. It came organically, I promise. But,
6 you know, we've got to know if it's going to be
7 used for more than occasional. And Mr. Moore
8 makes an important point and, you know, nobody
9 seems more passionate than you, sir, but you know
10 other than you just telling me how do we know this
11 is going to be used? Either one of you, Mr. Moore
12 first perhaps?

13 MR. MOORE: You know, it's going to be
14 used because all you have to do is look at
15 history. You just -- let's look at the -- again,
16 the last 10 years the studio shorted \$14 billion
17 worth of production risk. There's -- so we know
18 there's a need, they know that they do it, they
19 know that they're not scared of all the arguments
20 that they make against it; anti-disparagement, oh,
21 my god, what would the public think if we shorted
22 our film? They have shorted \$14 billion of

1 production risk in the last 10 years. In my
2 career of 29 years I have helped them short about
3 \$25-30 billion of production risk through various
4 means over 29 years. They do it, they must do it,
5 they will do it, and this is the next logical step
6 for them to do it.

7 COMMISSIONER CHILTON: Mr. Harbinson do
8 you have a response to that with you know him
9 saying that the motion picture industry is
10 actually shorting themselves?

11 MR. HARBINSON: I don't know that I have
12 -- you know, I'm the one to ask about that, but it
13 seems to me that the timing of the short is
14 different with the hedging instruments that are
15 contemplated here versus the current tools that
16 the studios use. And I think that makes a bit of
17 a difference.

18 COMMISSIONER CHILTON: My last question.
19 I think it was Mr. Swagger who said, you know,
20 that studios, you know, don't have that impact.
21 But, I mean, you've got to admit nobody disagrees
22 that their marketing doesn't have an impact on the

1 box office revenues, right? I mean, you might
2 disagree with my boxes, you may say, well, they
3 all don't control it, but certainly the marketing
4 of the movie, certainly whether or not a star
5 appears on a show on a Thursday night before
6 opening weekend -- right? I mean, it has some
7 impact.

8 MR. SWAGGER: Yeah, I think what we are
9 seeking with the exchanges is the same is what the
10 Commission is seeking is transparency and a very
11 opaque market. And there's a lot of rhetoric
12 that's been put out there, Hollywood is full of
13 smoke and mirrors. And to have a transparent
14 marketplace, the design of our contracts within a
15 four-week period of time, we don't see where that
16 manipulation is going to occur. Now if the
17 question is you've got these six large studios and
18 then you've got groups such as the theaters and
19 the groups that we announce who's the person
20 that's manipulating the numbers, I mean, the
21 studios are trying to manipulate to try and
22 encourage you to go see a movie. And the studios

1 aren't going to affect my opinion, yet there's 20

2 --

3 COMMISSIONER CHILTON: Yeah, but if you
4 see an ad --

5 MR. SWAGGER: -- 20 something websites
6 --

7 COMMISSIONER CHILTON: -- I mean, you
8 know, how do you find out about movies? You watch
9 the trailers, you watch the ads. This thing I
10 held up earlier, you know, is it the number one
11 movie in the world, the number one movie in the
12 U.S.? I mean, as Mr. Pisano said, any little bit,
13 you know, they're going to have a competitive leg
14 up, so.

15 MR. MOORE: They will always attempt to
16 manipulate it to make it as high as possible.

17 COMMISSIONER CHILTON: Yeah.

18 MR. MOORE: We accept that. They will
19 never ever manipulate it down.

20 COMMISSIONER CHILTON: Okay. And then
21 I'll finish because my time here's up, but, I mean
22 maybe they're not taking it down, but maybe

1 they're going to say we're not going to put any
2 more money into this dog. You know, Russell Crowe
3 go on vacation, you don't have to show up for
4 Letterman. Let's not buy advertising for the next
5 week. I mean, they're going to tank it, but they
6 can make a decision whether or not it's okay for a
7 movie, correct, Mr. Moore?

8 MR. MOORE: They will never do it based
9 on some attempt to manipulate the exchange. They
10 will always do it for bona fide business reasons.
11 They will always do the best they can to maximize
12 revenues compared to costs.

13 MR. BURNS: Commissioner, if I could
14 just for one moment, because I think you're making
15 an interesting point. Typically what happens that
16 you're buying your advertising, you're putting
17 your trailers out a month in advance. You don't
18 have the flexibility to move that around
19 dramatically, but I do believe that you can change
20 commercials. And I think Schuyler's right again
21 where they're going to be looking for the upside.
22 I think actually studios when this is real money

1 at stake the studios will pay closer attention to
2 it and will likely pay attention to this to see
3 whether their marketing campaign is working or
4 not.

5 COMMISSIONER CHILTON: Right.

6 MR. BURNS: And my sense is it will just
7 basically encourage them to switch out commercials
8 to try to achieve a higher box office. That's
9 what I think would happen.

10 COMMISSIONER CHILTON: Okay. That's
11 interesting; I'll follow up with this later.
12 Thank you.

13 CHAIRMAN GENSLER: Thank you.
14 Commissioner O'Malia.

15 COMMISSIONER O'MALIA: Thank you. Mr.
16 Harbinson, you mentioned -- your quote was,
17 "Smaller movies would be most likely to be
18 manipulated." Mr. Pisano earlier said he had
19 concerns about the manipulation in the industry.
20 Two people who are focused and in the industry, if
21 we're to approve these contracts where do we look
22 for this manipulation that you've both raised

1 specifically?

2 Mr. HARBINSON: I can't speak for Mr.
3 Pisano, but, you know, a small film by its nature
4 is fairly vulnerable. If you're asking me how I
5 personally could manipulate a film? What I do
6 when I'm not up here talking to you guys is I
7 negotiate contracts; I organize films, which means
8 leading strikes. And I do, from time to time,
9 come across and organize low budget films.

10 So, you know an unscrupulous union
11 representative could lead a strike and the film
12 would never get out of the starting gate. Now, is
13 that manipulation or that there's a rumor of labor
14 unrest, or a looming strike on the set. Would
15 that affect the value of these instruments? I
16 don't know. I think it would, but that's not for
17 me to answer.

18 COMMISSIONER O'MALIA: Would you admit
19 that if that was the risk posed on small budget
20 films, or small -- and this, of course, being
21 hypothetical. Wouldn't investors want to have
22 some commercial hedging ability to mitigate that

1 risk of a strike or something like that?

2 MR. HARBINSON: I don't' come from the
3 investor side of the business, so I don't know.
4 The industry has been fairly successful in
5 producing motion pictures, producing jobs,
6 producing a surplus of international trade for a
7 long time without this. And you know what you're
8 being asked is to approve this hypothetical
9 instrument in the theory that it's going to make
10 things better. We don't agree.

11 COMMISSIONER O'MALIA: Well, just like
12 Commissioner Chilton had said earlier, how do we
13 know that they're going to be successful? You
14 know, if we're going to approve these in these
15 hearings, an attempt to understand where they
16 would possibly be manipulated be is -- two
17 industry representatives have now raised the
18 manipulation within their industry concern. I
19 just want to try to really hone in on that and try
20 to get a better handle. I think you've answered
21 it and I appreciate that, and I'd like to go on to
22 my next question.

1 There's a Bloomberg story, headline is
2 Murdock spreads risk nets \$400 million from
3 Avatar. The quote that caught my attention was
4 quoting Murdock in a conference call, "Jim
5 Cameron's pictures tend to go over budget, Murdock
6 said in a February 2 conference call. It's very
7 easy to drop \$100 million in a hurry on a film.
8 We'd like to lay off a lot of that risk."

9 Mr. Burns, could you kind of speak to
10 this and how the markets operate in this --

11 MR. BURNS: I think that every studio
12 looks at what their return -- who they're shooting
13 for in their motion picture slate of pictures.
14 And I think that, for example, studios will do
15 co-productions, they'll want to have a partner. I
16 think that's not going to change. I think this is
17 just one other tool that we, Lionsgate, could use
18 and ultimately all the major studios could use to
19 mitigate risk.

20 COMMISSIONER O'MALIA: Let me just ask
21 one last question. I've got three kids; I've got
22 to find some movies for them this summer. Do you

1 have any recommendations?

2 MR. BURNS: How old are your kids?

3 COMMISSIONER O'MALIA: Eleven, 9, and 6,
4 and I don't want to have to sit through their
5 movies.

6 MR. BURNS: I definitely would not
7 recommend Kick Ass for them. It's a little -- I
8 would go a little older or Expendables for that
9 matter.

10 MR. MOORE: Twilight Eclipse, if they're
11 girls.

12 COMMISSIONER O'MALIA: Yes, they read
13 the book and I'm scared of that one.

14 Mr. Harbinson, any recommendations?

15 MR. HARBINSON: My kids are a little bit
16 older, so we're still in the PG-13 to R range.
17 So, you probably shouldn't get a recommendation
18 from me.

19 COMMISSIONER O'MALIA: Yeah, definitely
20 not.

21 CHAIRMAN GENSLER: Very good question.
22 Any more? Mr. Chilton isn't here, I might be able

1 to even be able to -- do we know does the Board
2 have any more questions? No? No, great.

3 I would note, though, that there hasn't
4 been talk about this, but there are other parties
5 that could possibly be affected by this, but the
6 retailers, the fast food companies that, you know,
7 kind of tie in all of these other parties that you
8 all probably lay off risk with, right. Do you
9 think that they would use this contract?

10 MR. BURNS: I think they could. I think
11 they could. We're teaming up, for example, in the
12 UK with McDonald's on a movie called Alpha and
13 Omega, an animated movie. They make a huge
14 marketing commitment in advance, so absolutely a
15 promotional partner that has a lot of money
16 betting on a movie doing particularly well.

17 CHAIRMAN GENSLER: Right.

18 MR. BURNS: That would absolutely give
19 them an opportunity to hedge out of that risk.

20 CHAIRMAN GENSLER: I want to thank the
21 panelists for all of their time, and energy, and
22 patience because it took a little while to get to

1 this panel. I want to thank the public through
2 March -- May 26th to please submit further
3 comments, keep this record open would be very
4 helpful. We're going to move onto one other
5 matter of business, but we can thank the panel and
6 let them move on.

7 I think that we -- also we had put this
8 in the federal register notice in somewhat --

9 COMMISSIONER CHILTON: Mr. Chairman, I'm
10 sorry to interrupt. Did you want to make some
11 sort of --

12 CHAIRMAN GENSLER: Just -- I will, but I
13 was just going to go through this. Just that we
14 will look at the full record, I think that there's
15 two contracts in front of us, I can't remember
16 their dates, but they're sometime in June. June
17 7th and June 28th, and unless those are, you know,
18 for some reason amended or delayed, and that these
19 five Commissioners appreciate this because we will
20 make -- whatever deliberation we're going to do is
21 going to be done as a Commission.

22 Also, on today's agenda is the

1 establishment of the Technology Advisory Committee
2 for the Commodity Futures Trading Commission.
3 This is an advisory committee that once existed,
4 and then for some historic reason the Commission
5 didn't continue on. And I thanked Commissioner
6 O'Malia earlier because it still takes somebody to
7 sort of gin us up and make sure we reinstall this,
8 and I think it's a great idea. But the staff has
9 prepared an order for the Commission to do this;
10 we normally might just do this as seriatim, as
11 Commissioner Dunn said, but since we have this
12 meeting we thought we'd do it here. So, this is
13 the actual adoption of an order and it does
14 several things.

15 It reestablishes the charter and finding
16 that the reestablishment is in the public
17 interest.

18 And secondly is an authorization to
19 publish the notice in the Federal Register.

20 Third, it's an authorization to file the
21 charter with our Congressional Committees of
22 jurisdiction and the General Services

1 Administration.

2 And fourth, a designation of the
3 designated federal officer of the committee who's
4 somebody would be here.

5 But at this time, I'll entertain a
6 motion to approve the order. Maybe I'll let Mr.
7 O'Malia do it.

8 COMMISSIONER O'MALIA: So moved.

9 CHAIRMAN GENSLER: Any second?

10 COMMISSIONER DUNN: Second.

11 CHAIRMAN GENSLER: Any discussion of
12 this?

13 COMMISSIONER O'MALIA: We can approve
14 it, and then I'd just like to make a brief
15 comment.

16 CHAIRMAN GENSLER: Either way. All
17 right. So all those in favor say aye.

18 GROUP: Aye.

19 CHAIRMAN GENSLER: Any opposed? Not
20 hearing any, it seems to be unanimous.

21 Commissioner O'Malia.

22 COMMISSIONER O'MALIA: Well, this is an

1 important topic. I greatly appreciate the
2 Commission's support of this. Obviously with the
3 result of happened on May 6th technology is
4 critically important. I look forward to
5 participating in the CFTC-SEC Joint Advisory Panel
6 on Monday, and we'll be circulating participant
7 names and agendas for the upcoming July 14th is
8 kind of our tentative date that we've identified
9 for the Technology Committee. And I'd like to get
10 your input on that.

11 Thank you.

12 CHAIRMAN GENSLER: Great. So, now I'll
13 entertain a motion to adjourn.

14 COMMISSIONER DUNN: So moved.

15 COMMISSIONER SOMMERS: Second.

16 CHAIRMAN GENSLER: All those in favor
17 aye?

18 GROUP: Aye.

19 CHAIRMAN GENSLER: The meeting is
20 adjourned. Thank you.

21 (Whereupon, at 1:20 p.m., the

22 PROCEEDINGS were adjourned.)

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1 CERTIFICATE OF NOTARY PUBLIC

2 I, Carleton J. Anderson, III do hereby
3 certify that the forgoing electronic file when
4 originally transmitted was reduced to text at my
5 direction; that said transcript is a true record
6 of the proceedings therein referenced; that I am
7 neither counsel for, related to, nor employed by
8 any of the parties to the action in which these
9 proceedings were taken; and, furthermore, that I
10 am neither a relative or employee of any attorney
11 or counsel employed by the parties hereto, nor
12 financially or otherwise interested in the outcome
13 of this action.

14 /s/Carleton J. Anderson, III

15

16

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18 Commonwealth of Virginia

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2 _____

3 Case Name: _____

4 CORRECTIONS

| 5 | Pg. Ln. | Now Reads | Should Read | Reasons: |
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2 Please note any errors and the
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5 be a general reason, such as "To correct
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7 or "To conform with the facts." Once you have
8 completed the sheet, signed and dated it, return
9 the sheet to your attorney, not to the court
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11 errata sheets among the parties.

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