Independent Film & Television Alliance®


NATO

2010 APR 19 AM 10 32

16 April 2010

David Stawick, Secretary
Office of the Secretariat
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Application of Cantor Futures Exchange, L.P. for Designation as a Contract Market

Dear Mr. Stawick:

The Directors Guild of America, Inc. ("DGA"), the Independent Film & Television Alliance ("IFTA"), the International Alliance of Theatrical Stage Employees ("IATSE"), the Motion Picture Association of America, Inc., and its member companies, Paramount Pictures Corporation, Sony Pictures Entertainment Inc., Twentieth Century Fox Film Corporation, Universal City Studios LLLP, Walt Disney Studios Motion Pictures, and Warner Bros. Entertainment Inc., and the National Association of Theatre Owners ("NATO") – collectively, the motion picture industry – respectfully file this comment in opposition to approval of the application of Cantor Futures Exchange, L.P. ("Cantor") for designation as a contract market ("DCM") under the Commodity Exchange Act, as amended, 7 U.S.C. § 1, *et seq.* ("CEA").

We will file a separate comment on Cantor's application for Commission approval of its Domestic Box Office Receipts Futures Contracts (the "Cantor Contracts" or "Contracts"). However, because the Cantor Contracts are the sole instruments Cantor seeks to trade, our comments on the merits of Cantor's application to be approved as a DCM will necessarily take into account its ability to satisfy the statutory criteria and core principles for registration as a DCM with respect to the Cantor Contracts. One of the principal issues in determining whether to grant a DCM application is whether the applicant has shown that it can be trusted in the future with the august power to self-certify new futures contracts without governmental approval. The products offered by an applicant are relevant to such a determination, especially where, as here, they involve legal, conceptual and structural flaws at odds with the public interests the CEA was enacted to protect and advance. The propriety of granting a governmental license to unilaterally inject new, esoteric financial products into the American economy should not be considered in a vacuum without taking into account the nature of the products the applicant intends to use its license to market. By analogy, if the government were asked to officially designate a cook as a master chef would it be enough to conclude that he or she has serviceable cooking utensils and kitchen appliances, if the only dish he or she offered for consideration was moldy onions?

Cantor has represented that it has received expressions of support for its applications for Commission approval as a DCM and of the Cantor Contracts, but as this comment reflects, virtually the entire motion picture industry opposes both.

The designation of Cantor as a contract market is not warranted where, as here, the sole instruments it now proposes to trade do not constitute legitimate futures contracts, but are in essence wagers that are susceptible to manipulation. Rather than providing a real and useful means for price discovery or hedging risk, the Cantor Contracts will be harmful and burdensome to the motion picture industry. Moreover, as discussed below, the material terms of the Cantor Contracts can vary significantly from one motion picture title to another, and certain of those material terms – such as the length of time over which the contract will be priced – may not be known when trading commences. In such circumstances, it is very difficult, if not impossible, to anticipate all the potential devices that might be used to game or manipulate the pricing and terms of any particular contract. The parts of Cantor's submission that are available to the public do not address this dilemma.

Because Cantor, at a minimum, cannot demonstrate that (1) it has the capacity to prevent market manipulation in the Cantor Contracts, (2) it has the ability to gather necessary information to police the market effectively, and (3) its Contracts are not readily susceptible to manipulation, Cantor cannot satisfy Designation Criteria 2 and 8 and Core Principles 3 and 4, and, therefore, the Commission may not designate Cantor as a contract market.[1]

A. The Cantor Contracts

As more fully discussed in Section D.2 below, the Cantor Contracts are complicated, and to some degree uncertain, trading instruments, and their material terms can vary from one motion picture title to another and even without notice to traders at the time trading commences.[2] Generally, however, the Cantor submission states that its Contracts would provide a means to bet on gross domestic box office receipts ("DBOR") of select motion pictures released in the United States and Canada, "as compiled by Rentrak Theatrical and/or Nielsen EDI and published in Variety Magazine (or such other publicly available source or sources *as may be designated* by the Exchange from time to time)."[3] This description is confusing because, as explained in Section D.3 below, the information about gross box office receipts *as published by Variety Magazine* is not the same as the information "compiled by Rentrak" *from exhibitors*. (Rentrak's compilations from exhibitors do not account for 100% of gross box office receipts, and the

[1] CEA Section 5(b)(1), (2), (8) and (d)(3) and (4), 7 U.S.C. § 7(b)(1), (2), (8) and (d)(3) and (4).

[2] *See* Cantor Rule I-1, Definition, "First Trading Day" (noting First Trading Day "will be specified in each DBOR Contract"); Cantor Rule II-3(b) (discussing fluid DBOR Determination Period).

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

percentage of the total box office receipts reflected in the figures it collects from exhibitors can materially vary from motion picture to motion picture.)

The Cantor submission states that each motion picture will be the subject of its own separate contract, and Cantor will decide in its discretion the motion pictures for which it will list futures contracts on its platform.[4] The Cantor Contracts will call for traders to bet on the gross DBOR over the "DBOR Determination Period." The DBOR Determination Period runs from the date of the motion picture's opening until four weeks after the motion picture first qualifies for "wide release" status as defined by the Cantor rules.[5] Those rules define "wide release" status to occur once a motion picture is shown simultaneously on the same day in 650 theaters.[6] The "Final Settlement Price" will be a fractional equivalent of the gross DBOR over the DBOR Determination Period.[7] Problematic aspects of these terms are discussed in Section D.2 below.

B. The Public Interest in Futures Trading Requires That Contracts Fulfill Both Price Discovery and Hedging Functions

The only thing that distinguishes gambling wagers from legitimate futures contracts is, as provided by Section 3(a) of the CEA, 7 U.S.C. § 5(a), the latter provide "a means for managing and assuming price risks, discovering prices, or disseminating price information." CEA Section

---

[4] Cantor Rule II-10.

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

[6] Cantor Rule I-1, Definition, "Wide Release."

[7] Each Contract will be settled at the equivalent of one millionth of the gross DBOR for the United States and Canada showings over the DBOR Determination Period – *i.e.*, if the gross DBOR over the DBOR Determination Period are $56 million, the Final Settlement Price of the Contract would be $56. Cantor Rule II-3(a). Upon settlement, each buyer of Cantor Contracts who holds them to maturity will be entitled to receive, and each seller will be obligated to pay, one millionth of the gross DBOR for the DBOR Determination Period. Cantor provides the following example in Rule II-13(a): If an underlying motion picture title has earned a DBOR of $56,455,000 during the DBOR Determination Period, the Final Settlement Price would be calculated by dividing $56,455,000 by 1,000,000 (equaling $56.455), and then rounding such amount to $56.46.

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

3(b), 7 U.S.C. § 5(b), declares that it is the "purpose of this Act to serve the public interests described in subsection (a) . . . ."[8]

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

These features of the CEA unambiguously demonstrate Congress's intent that, for futures contracts to be lawful, they must provide price discovery and hedging functions and not simply be an outlet for speculation. The Commodity Futures Modernization Act of 2000 ("CFMA") may have relaxed the procedures for designating contract markets, but it did not extinguish or even change the statute's central requirement that regulated futures contracts meet those criteria.[9]

It is, therefore, incumbent upon any applicant for contract market designation by the Commission to show that the contracts for which it is seeking designation serve the public purposes of price discovery, managing price risks (*i.e.*, hedging), and disseminating valid pricing information. Consistent with the foregoing statutory requirements and Congressional intent, an application to become a DCM should be denied unless the applicant can demonstrate that the contract it proposes to trade would in fact meet these public interest prerequisites and *would in fact be used* for price discovery and hedging.[10]

---

[8] In contrast, Congress has outlawed the use of interstate commerce for online gambling in the United States. *See, e.g.*, 18 U.S.C. § 1084. CEA Section 12(e), 7 U.S.C. § 16(e), expressly provides that "[n]othing in this Act shall supersede or preempt . . . any criminal prosecution under any Federal criminal statute."

[9] It is noteworthy that, although Congress in the CFMA amended CEA Section 3 to more specifically describe the Commission's role in overseeing the regulation of trading facilities, clearing systems, market professionals and market participants, it did not diminish in any way the recognition that futures contracts are affected with the public interest because of their salutory economic use for price discovery and hedging risk in an underlying commodity.

[10] We respectfully submit that the Commission's current proposed rulemaking to adopt hard, federal speculative position limits in certain energy contracts inherently recognizes that the CEA requires much more than a *theoretical* hedging use to sanction trading of a futures contract.

The Cantor Contracts cannot serve these public interests. It is undisputed that they will not provide a means of price discovery; indeed, Cantor does not even argue that its Contracts will. Nor, as discussed below, will the Cantor Contracts in fact be used for hedging. Rather, they are simply a means by which Cantor seeks to serve its own private interests and the private interests of persons who would like yet another outlet for speculative pursuits. Such activity should not receive the sanction of the federal government or take up any of the government's scarce regulatory resources especially where, as here, the Contracts would be harmful to the industry they purport to serve. Accordingly, Cantor's application for designation as a contract market should be denied.

C. The Cantor Contracts Do Not Satisfy the Public Interest Criteria and Their Inherent Flaws and Susceptibility to Manipulation Cannot Be Cured by Contract Market Rules

The Cantor Contracts do not provide price discovery of an underlying product, will not be used for hedging, and are susceptible to manipulation by a single person or small group of persons. They will not establish a value for a traded commodity and therefore would not serve the public interest of providing a means to better price a commodity. They are simply a bet on the ultimate economic performance of a single product of a single producer. They are no different in kind from bets on how much revenue *a single farm* will receive for its wheat in the first month of the season when the quality of the wheat is unknown, the farm can quickly change, without notice, the amount of wheat it will choose to deliver during that period, and while intermediaries acting for the farm can unilaterally discount the price of the wheat. Such bets would have no legitimate economic purpose and would surely be disallowed by the Commission if anyone sought approval to trade in such a contract. The same should be true for Cantor.

Cantor expressly concedes that there is no cash market in motion picture box office receipts; there are no buyers and sellers of, and no supply of and demand for, such receipts. Indeed, in contrast to all existing futures contracts, the Cantor Contracts do not relate to the valuation of any *traded* hard or intangible commodity.[11] Further, unlike all other futures and cash markets, there are no natural sellers of box office receipts that need to hedge against rising receipts – no person experiences risk of financial loss by upward movements in box office receipts.[12] Due to the asymmetry of the market, the Cantor Contracts would be readily

[11] The S&P 500 Index futures contract, for example, ties back to trading in the constituent securities of the index. Weather futures tie back to trading in commodities whose values and costs can be affected by and correlated with weather patterns, such as natural gas, and thus they can be valued on the basis of their effect on the underlying commodity. Future crops of winter wheat are bought and sold in commercial markets in advance of their planting. The Consumer Price Index is used as a measure to adjust wages in numerous labor contracts and for various government payments to retirees, Social Security beneficiaries, etc. The proposed Cantor Contracts tie back to nothing at all.

[12] The Commission's Staff informed us that Cantor has not identified any natural sellers of box office receipts.

susceptible to manipulation because there is no natural price competition between longs and shorts in an underlying commercial market.

Because no rights or interests are traded in motion picture box office receipts, such receipts (as announced by *Variety*) do not value any other traded article, good, right or interest, and such receipts are not beyond the control of certain industry insiders, motion picture box office receipts are outside of the legal definition of a "commodity." All of the commodities specifically enumerated in CEA Section 1a(4) are traded in cash markets, and the requirement that futures prices reflect the legitimate forces of supply and demand of an underlying cash market further requires that futures contracts be permitted only to the extent that they reflect the valuation of articles, rights and interests that are traded. In addition, box office receipts are not within the definition of "excluded commodity" because they are within the control of or, at a minimum, highly influenced by, a small group of entities (*i.e.*, producers, distributors and exhibitors) that control, among other things, the number and location of theaters in which a motion picture is shown, the number of screens and size of screens on which a motion picture is shown, and the marketing budgets for a motion picture. *See* CEA Section 1a(13)(iv)(I), 7 U.S.C. § 1a(13)(iv)(I).

1. The Cantor Contracts Would Not Provide Any Legitimate Price Discovery

Cantor makes no claim that its Contracts would provide any price discovery function. Studios receive information on the DBOR directly from exhibitors and others, including Rentrak. The public receives estimates of DBOR from, at a minimum, published reports from studios and Rentrak. DBOR are not used to price any traded commodity and thus the pricing of the Cantor Contracts would not provide any "discovery" of prices for any commodity.

Moreover, the bets made on Cantor Contracts by anyone other than an industry insider would not be a reliable indicator of DBOR because much material information affecting DBOR is non-public. Traders in the Cantor Contracts would not have access at any time to much of the material information affecting a motion picture's box office performance (*e.g.*, marketing budgets, distribution agreements) within the first four to twelve week period, because it generally is not publicly available. Trying to forecast box office receipts prior to a motion picture's release without the benefit of the non-public information that is closely held by studios and other motion picture industry insiders is arbitrary and speculative.[13] Significantly, none of the means used to assess the legitimacy of futures pricing based on supply and demand would exist for the Cantor Contracts. Prior to the publication of estimates of DBOR following the first weekend release, there is no cash market pricing, no additional months of futures market pricing, and no actual cash market transactions against which to measure the legitimacy of the futures price.

---

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

Further, non-public business decisions regarding motion picture marketing and distribution plans that affect box office receipts can and do occur up to the release of the motion picture and afterward. Although a preliminary plan is prepared in advance of approving a motion picture for production (*i.e.*, well before a release date is scheduled), the plan remains subject to change and in fact is continually adjusted until the motion picture is released and beyond. Marketing changes generally can be made within a day and in some cases almost immediately, in terms of changing marketing materials, their placement, or their relative frequency of use.[14]

2. The Cantor Contracts Would Not Be Used For Hedging

This comment demonstrates that there is no basis to conclude that the Cantor Contracts will engender any meaningful hedging by the motion picture industry and, as explained below, Cantor's rules against insider trading effectively prevent it. The industry's opposition demonstrates there is no general call for this kind of financing mechanism; the studios have their own financing, or in the past have raised it through private investment or public financing. The realities of the marketplace are that no commercial interests involved in the production, marketing or distribution of the motion picture will want to run the risk of negative publicity and characterizations that it was "betting against" the success of its own motion picture by "shorting" it, thereby undermining the public acceptance of it. For much the same reason, there is a concern that such transactions could generate claims of violating standard mutual covenants in industry contracts with exhibitors, directors, actors and others that prohibit disparagement of the work.

Although studios take a number of measures to mitigate risk at the pre-production stage or early in the production stage, selling a motion picture short just before its release -- at the very end of the production and post-production timeline – would be viewed as an indictment on the quality of the motion picture (otherwise, why would the studio do it) and would therefore negatively influence the public's opinion of that particular movie.

The potential for harm to the studios raised by the Cantor Contracts applies to directors in ways that are different in kind and degree. A director's investment in a picture is unique. Directors spend many years in the development, pre-production, production and editing of their motion picture, in collaboration with many other talented individuals. By virtue of the time and creative effort he or she puts into a picture, the director (and other motion picture artists who are intimately involved in the creation of the final work) has a great deal to lose if the picture's chances for success are maliciously undermined. Ultimately, the damage to the director whose work is harmed goes beyond the economic. From this perspective, it is impossible to imagine a

---

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

director deciding to "short" his or her own picture during the first four or 12 weeks of its release – it is highly improbable that a director would purposely seek to undermine his/her own work at the exact time when there is the greatest at stake in its success. It is also worth noting that directors have no need to "bet the over" on their pictures, because their personal services agreements often contain provisions rewarding strong performance at the box office, whether in the form of box office bonuses or profit participation, or both.

A theater owner has no incentive to hedge. By virtue of the Paramount Antitrust Consent Decrees entered into with most of the major motion picture studios about 60 years ago, the studios license on a theater-by-theater and picture-by-picture basis. Motion picture licenses are *not* tied one picture to another. Doing so would be a violation of the Paramount Antitrust Consent Decrees and, in any case, also would raise antitrust considerations. Therefore, *no exhibitor is obligated* to license *any* motion picture. If an exhibitor *chooses* to license a motion picture, the rental for that license is negotiated separately, and any concern that the exhibitor may have regarding the public's interest in the motion picture (*i.e.*, potential success) will be reflected by the percentage of the rental the theater owner agrees to pay based on those negotiations. Motion picture rental is paid as a *percentage* of the gross receipts of tickets *sold*. For "potential blockbusters," the motion picture distributors will receive a higher percentage of the net gross receipts than for a "smaller" picture. Further, the motion picture distributor does not share in *any* concession income (*e.g.*, popcorn, soda, candy, hot dogs) derived by the theater owner from those who purchase tickets to see the picture.

As most theaters are multiplexes (*i.e.*, with multiple screens at each location), it is in the theater owner's best interest to have motion pictures that appeal to many segments of the public. Therefore, more specialized and less widely appealing pictures are an important part of the theater's portfolio of products on screen at any one time. Further, by having various different motion pictures being exhibited at the same time, the theater owner is able to protect itself when any one picture performs poorly. Most theater owners also own more than one theater, and motion pictures very often will perform differently (better or worse) at theaters with different local demographics. Further, when a picture does not perform well enough at a particular theater to justify continuing to show it on that screen, the theater owner generally can end the license at that theater at the conclusion of that engagement week, while continuing to show the picture at its other theaters.

It is well understood in the industry that there is no fast and hard "formula" for success, regardless of the hard work and talent involved – in fact, success for any motion picture is never a foregone conclusion. That is the accepted risk that both those who finance motion pictures and those who create them recognize and undertake.

Further, no studios or other industry insiders who have the ability to materially affect the level of box office receipts will want to trade in the Cantor Contracts because any purported benefit from such trading is clearly outweighed by the potential exposure to the threat of strike suits for claims of manipulation from disappointed traders, as well as to Commission and Department of Justice investigations of claims of manipulation when complaints about futures pricing are received. Knowledge about a motion picture may be closely guarded, but the number

of those who possess that knowledge is very substantial. There are many individuals who have some form of "insider" knowledge (certainly a director does; another example would be motion picture editors, among numerous others) and the structure of the industry is such that many of them work on a free-lance basis from picture to picture and are not full-time employees. For that reason, the definition of who constitutes an "insider" would have to be quite broad in order to encompass the number and types of individuals who have material knowledge about a motion picture before its release. All of these persons would be subject to the same concerns of potential unwarranted, but very costly, exposure to legal proceedings.

It should be noted that studios, using public and their own non-public information, can predict box office performance of a motion picture much more accurately after the opening weekend. This is one of the reasons that Cantor seeks to impose an "Information Barrier" and prohibit trading on inside information with respect to trading by insiders, such as members of the MPAA. It is a fiction, however, to believe the "Information Barrier" provides a legitimate means for insiders to use the Cantor Contracts for hedging. In fact, such a barrier would prevent informed trading for purposes of hedging. It is noteworthy that no other futures contract that has been approved by the Commission requires such a barrier for proprietary trading by commercial interests. Indeed, the novel requirement of one here only underscores that the characteristics of this contract are not those of legitimate futures contracts. The Cantor Information Barrier requirement essentially requires that any trading by a studio must be left to persons who are unaware of material information within the studio that affects and would permit it to project box office receipts for any motion picture. Accordingly, the Information Barrier prevents any informed trading for the purposes of hedging and requires instead blind trading without the ability to know the studio's information that would be material to making hedging decisions. As a practical matter, any decisions by a studio to hedge any risk would be cleared with senior management, who necessarily have intimate knowledge of all financial and contractual information relating to a motion picture.

Indeed, even if a studio wanted to use Cantor Contracts to hedge, the Cantor rules would make it impossible to do so without totally reorganizing how studios conduct their business. Before a studio could be approved to trade DBOR Contracts, Cantor will require that the studio provide Cantor with a copy of its Information Barrier procedures. These procedures are supposed to include a physical separation between the persons who compile or compute box office receipts and those employees that would trade the DBOR Contracts, as well as separate management and reporting lines between these two groups of employees.[15] This requirement in Cantor's rules fails to take account of the fact that box office receipts data is very important and sensitive information that is shared within a studio with, among others, key mid-level marketing personnel, the General Counsel's Office, and senior management. No studio is arranged or intends to reorganize itself so as to separate the management and reporting lines of persons with access to the box office receipts data and the persons who compile or compute those figures. It makes no sense to do so and would prevent a studio from utilizing the box office receipts data in the most efficient manner. The Information Barrier concept further illustrates how impractical it

[15] Cantor Rule II-19.

would be for any studio even to attempt to trade Cantor Contracts, and is further evidence that the true target market for those Contracts is the speculator and not the hedger.

On top of that, Cantor's filing on April 14, 2010 with the Commission of a DBOR Contract based upon "The Expendables" expressly prohibits any person in possession of material non-public information from trading in the Contract until the information has become public. Examples of such information cited in Cantor's rules include, but are not limited to, changes in release date or the promotion or advertising budgets, number of theaters showing the film, and actual box office receipt statistics following release. Cantor's rules purport to require studios and other entities to adopt policies to ensure that their officers, directors, employees, and agents, including authorized traders, do not trade on the basis of material, non-public information.[16] These rules make it impossible not only for studios, but numerous other motion picture industry businesses, to trade Cantor Contracts, because both before and during the showing of a motion picture they will be in possession of material, non-public information about motion pictures they have worked on. Here again, these rules illustrate that even those industry persons who may express an interest in hedging using Cantor Contracts will be unable to do so due to the nature of the information flow in the industry.

D. Cantor Has Not Reached a Sufficient State of Development as a Board of Trade to Warrant Approval as a DCM, and it Does Not Have Sufficient Ability to Detect and Prevent Manipulation or Insider Trading for the Contracts it Seeks to Trade

1. The Commission Approval Cantor Seeks Seems at Variance with CEA Requirements

We respectfully submit that Cantor's application to be approved as a DCM does not reflect sufficient attention to CEA compliance to warrant approval as a DCM at this time. The only contract it brings before the Commission is itself burdened with conflicting rules on material contract terms, such as the period during which the contract will trade. *See* D.2, below. Cantor's submission effectively seeks Commission pre-approval, sight unseen, of many future separate individualized contracts on DBOR on specific motion picture titles that can and likely would be subject to very different rules particular to each. To comply with the CEA, Cantor should be required to seek Commission approval for each separate contract on each motion picture title. The fact that Cantor appears to seek to circumvent this requirement calls into question whether it is focused adequately on CEA compliance.

---

[16] Cantor Rule II-18.

2. The Terms of the Cantor Contracts Are Not Sufficiently Defined and Their Vagueness Invites Gaming and Manipulation

When trading on Cantor Contracts will commence is not clear from the Cantor rules; it appears that, at Cantor's discretion, it could commence anytime between a year and one day before a motion picture's release and presumably start dates could vary from contract to contract.[17] The time period of the DBOR Determination Period might not be knowable at the time trading commences – that period could span from four to twelve weeks, depending on if and when a motion picture first qualifies as a "wide release."[18] Accordingly, at the time trading commences, traders would not even have notice of the terms of their bets. It also is unclear when trading will end. The chart accompanying the latest Cantor Contracts submission (for "Wall Street: Money Never Sleeps") states that "The longest trading period for a DBOR Contract is a period of four Release weeks." If trading must cease no later than four Release weeks after the opening, trading could be limited to a shorter time period than the DBOR Determination Period. For example, theoretically trading would end *four weeks* after the opening, but the DBOR Determination Period could be the first *six weeks* following release, if a motion picture fails to qualify as a "wide release" until the third week after its release. This can cause substantial uncertainty for pricing and perhaps invite gaming. In contrast, the definition of "Last Trading Day" in the Contract Terms and Conditions states that "the Last Trading Day shall under no circumstances be any earlier than the Tuesday following the close of the DBOR Determination Period." Pursuant to this definition, trading could last as long as twelve weeks for a motion picture that fails to achieve wide release status. Significantly, under this definition, trading potentially could extend beyond the DBOR Determination Period -- *after the settlement price is known publicly or by those with inside information.*

3. Cantor's Reliance on *Variety* Magazine Published Reports Can Be Problematic

The practice in the industry is to report *estimates* of weekend gross box office receipts on Sunday, based on projections informed by receipts received for Friday and Saturday showings. *Variety* publishes those estimates on Monday, as do many major newspapers and media sources.

---

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

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

Those estimates, which are generated by the studios, are based in part on non-public and undisclosed projections and assumptions that can vary from motion picture to motion picture and from studio to studio. *Variety* provides this disclaimer about the information it publishes:

> "Variety publishes data compiled by Rentrak Theatrical, which collects *studio reported data* as well as box-office figures from North American theatre locations. Any information provided by Rentrak has been obtained from sources believed to be reliable. However, Rentrak does not make any warranties as to the accuracy, completeness or adequacy of this information and data. The user of this data agrees Rentrak, its officers and employees will have no liability arising from the use or disclosure of this information and data. To submit any questions to Rentrak, please email: boxofficeinfo@rentrak.com."

See: http://www.variety.com/index.asp?layout=b_o_layout&dept=Film (emphasis added). Those estimates, although traders might use them, can be mistaken – see the article from *Variety* about errors in estimates on the April 10 and 11, 2010 weekend's box office receipts, which is attached hereto.

The box office receipt information Rentrak compiles from the exhibitors that have agreed to provide that information to Rentrak is itself incomplete, and we understand that the percentage of the total box office receipts that is reported by exhibitors to Rentrak can vary materially from motion picture to motion picture depending on how many exhibitors within its universe of reporting exhibitors are showing a particular motion picture. We understand that many exhibitors record box office receipts electronically and then provide the aggregate information to Rentrak through an electronic feed, but also that many exhibitors tabulate their receipts manually. However, *some exhibitors never report to Rentrak, either automatically or manually.*[19]

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

---

[19] Our understanding is that not all exhibitors provide information to Rentrak and, therefore, the completeness of Rentrak's tabulations for any particular motion picture for a four or 12 week period, as measured against the entire universe of box office receipts for a motion picture for that period, can vary based upon the number of screens on which it is shown by exhibitors that provide their information to Rentrak.

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

4. Cantor Does Not Have the Resources to Capably Prevent Manipulation and Price Distortion of the Contracts It Seeks to Market to the Public

In the first instance, as described above at page 6, the lack of any legitimate economic measure of valid pricing before the Rentrak numbers are announced prevents any ability to even identify a manipulated price.[20] Further, the potential box office receipts for a motion picture can be materially affected by individual industry participants in a variety of different ways that would be exceedingly difficult for Cantor to detect. Exhibitors that contribute to the Rentrak numbers could, either intentionally or accidentally, misreport their data. A distributor could determine within the period following a motion picture's release to reduce or increase the number of theaters that would show the motion picture. A distributor for a variety of reasons could determine to substantially reduce or expand its marketing budget, which can materially affect box office receipts. A major exhibitor could decide to show the motion picture on smaller or larger screens, which can materially affect audience interest and capacity. We respectfully submit that Cantor has no effective means to detect or prevent such conduct or to determine whether it was undertaken for valid business reasons, rather than to manipulate futures prices.

Futures prices also are susceptible to manipulation by false market rumors. In the unique circumstances of the motion picture industry, it would be virtually impossible to identify the sources of such rumors or to prosecute any alleged manipulation by false rumors, because such rumors would typically be based on opinions relating to a motion picture's artistic or entertainment merit rather than verifiable facts. There already are plenty of rumor mills with respect to the quality of motion pictures. These range from reviews by members of the public who have attended screenings, press reports relating to rumored or perceived "trouble" on motion pictures (multiple writers, talent defections, re-shoots, postponed release dates, etc.), and

---

[20] The Commission's Staff has advised us that the materials submitted by Cantor that have not been posted on the Commission's website constitute non-public information and thus are not available for review. We assume some of those materials contain Cantor's demonstration that it would be able to conduct meaningful surveillance to prevent and detect attempted manipulation and to take meaningful disciplinary action against manipulators. Because those materials are not accessible to us, we are at a disadvantage in commenting on them. However, we find it difficult to believe Cantor – or anyone – would have sufficient resources, means of detection, and enforcement authority to meaningfully prevent, detect and deter manipulation and attempted manipulation given the unique characteristics of the Cantor Contracts.

reports of the quality of footage that have leaked pre- or post-release. There is no effective way to police such rumors or reliably determine their source. These sorts of rumors can depress or increase box office performance. Therefore, the ability to profit from rumors by trading in the Cantor Contracts would intensify any incentive to spread false rumors in a manner that Cantor could neither detect nor control.

Cantor's rules fail to address compliance issues with insider trading proscriptions of the federal securities laws. Where a motion picture's first four or twelve weeks of box office success is material to the market value of its producer's publicly traded securities, Cantor Contracts could function in a manner similar to security futures. Motion picture box office receipts for the first four or twelve week period can impact the price of the stock of the studio that produced the motion picture or its parent and other affiliates. Also, the rise or fall of a small company's release could have a material impact on its future ability to function; trading in such a picture's prospects could doom not only that picture, but the entire company. The Cantor Contracts thus could be used by insiders as surrogates for their companies' securities in order to profit from inside information. Cantor's rules fail to adequately anticipate or prevent this.

E. The Cantor Contracts Will Harm the Motion Picture Industry

Cantor should not be approved as a DCM where, as here, the contracts it will list and trade will be detrimental to the industry they ostensibly are created to serve. The Cantor Contracts create a panoply of negative effects and risks for the motion picture industry *that do not now exist.* They can *create* conflicts of interest for studio employees and independent contractors by providing the means to bet against the success of motion pictures. The Cantor Contracts will *create* complications for motion picture financing by creating new, but unreliable and non-economic, valuations of a motion picture's success. They can *create* new legal risk for studios in their announcing estimates of box office receipts, because such information might be consequential to Cantor Contracts' pricing if relied on by traders.

The risk of depressed box office receipts is more pronounced with box office futures because futures pricing, although lacking any reliable economic basis, could nonetheless affect a motion picture's prospects by negatively affecting financiers' and audiences' perception. Because the ultimate breadth of distribution can be revised up to the time of release and afterward, the Cantor market could affect distributors' ability to secure screens if the Cantor Contracts are perceived to signal negative box office results. The harmful effect of negative publicity is not limited to theater showings. Many prices for downstream licenses and other sources of revenue are driven in part by box office gross.

Motion pictures slated to open in limited theaters (which can still involve openings in 650 or more theaters) and then broaden based on word of mouth could be ruined by futures pricing that casts them in the false light of a failed opening.

Currently, studio estimates of box office receipts do not impact anyone; they are of no consequence to the public's interests. However, Commission approval of the Cantor Contracts will *create* consequences from the reporting of box office receipts, which in turn will burden the

studios with much higher legal risk associated with their announcement of box office receipt estimates. The legal risk involves potential civil damage claims from traders in the Cantor Contracts that they relied on an estimate that allegedly was purposefully or mistakenly inaccurate. The cost of fending off even unmeritorious claims could be substantial and cause studios to cease or significantly alter the practice of public announcements.

Approval of the Cantor Contracts also will require studios and all other industry participants that have the power to affect futures pricing to institute and police anti-insider trading compliance regimes for the Cantor Contracts. It is problematic whether any prohibition on insider trading would need to take into account inside information held by insiders who are not subject to the control of the studios. There are many industry participants who have access to material, non-public information and could try to use that information to profitably bet on the Cantor Contracts. These range from financiers and their advisors, potential distribution partners, exhibitors (who have a right to see a motion picture prior to licensing it in the U.S.), talent, crew, agents and other representatives, special effects and other post-production vendors, trailer houses, festival screening committees and the employees, families, and friends of all these people.[21]

Trading in the Cantor Contracts also creates a new means to try to profit from theft of studios' confidential motion picture materials, thereby increasing the likelihood of such theft and exacerbating our industry's existing widespread motion picture piracy problems. For example, a person who steals a motion picture or motion picture creative materials, in finished or unfinished form, before its release could short the contract and then post it on the Internet to hurt box office receipts. Similarly, a thief armed with critical inside information might use it to profitably trade in the Cantor Contracts. Nothing in Cantor's publicly available materials concerning its satisfaction of DCM criteria and core principles begins to suggest how it will be able to detect and prevent such manipulative conduct. Given the rise of the Internet and other technologies, piracy is a growing threat to the motion picture industry. The Commission should not provide any additional incentives for motion picture piracy and stealing of intellectual property by approving Cantor's applications.

The Cantor Contracts also create legal risk and expense for an industry that does not intend to use these Contracts. Even if such a studio compliance system is designed and executed to perfection, it is possible that, at some point, the Commission or the Department of Justice would investigate a suspicion of possible manipulation of the Cantor Contracts, causing large legal expenses for the industry, which does not want or intend to use the Contracts. The studios would be put to great expense to comply with the investigation. Moreover, studios and other industry insiders would be natural targets for strike suits by disappointed traders. Further, the negative publicity that could flow from rumors or announcements of an investigation and from strike suits would be damaging to the industry parties involved.

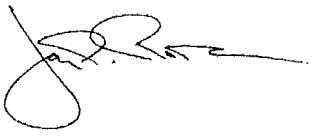
---

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

F. Conclusion

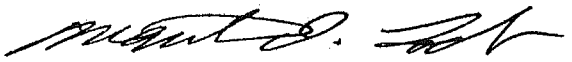
For the reasons set forth above, we respectfully and strongly recommend that the Commission deny the application of Cantor to become a DCM. We thank the Commission for its consideration of this comment letter. Please contact Greg Frazier of the MPAA, at 202-378-9107 or Greg_Frazier@mpaa.org, if you have any questions or need further information.

Sincerely,

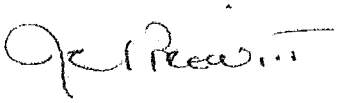


Jay D. Roth,
National Executive Director
Directors Guild of America, Inc.

A. Robert Pisano,
Interim Chief Executive Officer
Motion Picture Association of America,nc.



Matthew D. Loeb,
International President
International Alliance of Theatrical Stage Employees



Jean M. Prewitt,
President and Chief Executive Officer
Independent Film & Television Alliance

John Fithian,
President and Chief Executive Officer
National Association of Theatre Owners

cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Jill E. Sommers
Commissioner Bart Chilton
Commissioner Scott D. O'Malia
Mr. Richard Shilts
Riva Spear Adriance, Esq.
Gabrielle A. Sudik, Esq.