

**Oral Testimony  
of  
Robert S. Swagger  
Chairman and Chief Executive Officer  
Media Derivatives, Inc.  
Before the  
Commodity Futures Trading Commission  
May 19, 2010**

**I. Introduction**

Thank you Chairman Gensler and Commissioners for allowing me to testify today. I am Robert Swagger, Chairman and Chief Executive Officer of Media Derivatives, also known as The Trend Exchange. You have asked me to discuss our application to list futures and options contracts based upon movie box office revenues. I am pleased to offer our views on this important matter.

At the outset, I want to thank the Commission for approving our application to operate as a designated contract market. Having worked with Commission staff for more than 11 months and submitting more than 100 documents, we commend the Commission and its staff on their efforts. We believe that the approval was a forceful step in the right direction, and we look forward to the Commission's approval of our product application on June 7.

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

**II. MDEX's Proposed Contracts Serve Important Economic Purposes**

Despite the Objectors' unsupported statements to the contrary, MDEX believes, based upon its market research, that a demonstrable need for box office futures and options exists. We have had discussions with many segments of the entertainment industry, some of whom are here today, about the economic utility of our products. We are here today because we have received strong support from these and other segments for our product.

It is no secret that risk management tools such as futures promote financing and capital investment because they allow those who provide financing to hedge their investments. It is also no secret that film financing has dropped measurably over the past several years. As noted in a recent article that has been provided to the Commission, "With the studios cutting back on their financing thresholds and Wall Street nowhere close to stepping up to the plate, it will fall to places like Abu Dhabi, Singapore, Russia and India . . . along with the reliably star-struck

billionaires to fill the gap.”<sup>1</sup> We do not want to see that happen and the Objectors should not ask the Commission to play party to such an outcome. Our products will allow a host of parties with financial interests in the movie production and revenue chain to hedge the enormous risks associated with producing, distributing, financing and insuring major motion pictures. These groups include:

- Original screenplay owners;
- Debt and equity investors;
- Investment banks syndicating a financing slate;
- Talent involved in the film;
- Studios (MPAA and Independents);
- Banks and lenders;
- Insurers of talent and movies;
- Theaters;
- Distributors; and
- Co-promotional marketing partners.

Ultimately, while we cannot guarantee that our products will be used, we urge the Commission to allow the market to decide whether these products are right for them.

### **III.MDEX’s Proposed Contracts Are Consistent with Other Commission-Permitted Contracts**

Importantly, the contracts that MDEX seeks to list are not dissimilar to other futures and options contracts based upon “excluded commodities.” As the Objectors note, the definition of “excluded commodity” under the CEA does not require a cash market in the excluded commodity. Cash markets in fact do not exist in many approved futures contracts, including—only by way of example—virtually all economic event contracts and weather contracts.

The Objectors present to the Commission, however, a straw man argument that an excluded commodity with no cash market would not be within the meaning of “excluded commodity” if the occurrence is subject to “substantial influence or control of a number of different participants in the motion picture industry.” This is not what the CEA says. Rather, the CEA provides that an excluded commodity includes “an occurrence . . . beyond the control of the parties to the relevant contract . . . and associated with a financial, commercial, or economic consequence.”

With respect to the first aspect, the occurrence—that is, whether the movie will generate a viable audience and revenue—is clearly “beyond the control of the parties.” The MPAA’s own letter cites a study by Professor Thomas Gruca showing “empirical evidence of the arbitrariness of motion picture box office pricing.” With respect to the second aspect, the foregoing

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<sup>1</sup> The Cannes Festival Opens With a Search for Money by Sharon Waxman; The Wrap (May 12, 2010).

occurrence is clearly “associated with a financial, commercial, or economic consequence” or else the studio would not produce the movie.

The Objectors also contend that “implicit” in the CEA’s public interest test for a legitimate futures contract is a requirement that it “must in fact be material to valuing a cash commodity.” Again, this is not in the CEA (whatever it means), and to our knowledge the CFTC has never articulated this requirement as a basis for approving or denying a futures contract. The Objectors desperate attempt to impose materiality and valuation requirements upon the Commission should be rejected.

#### **IV. MDEX Seeks to Offer a Regulated, Transparent, Risk Management Tool to the Entertainment Industry**

The Objectors—which in fact represent only a slice of the entertainment industry—have contended that the reputation and integrity of its industry could be tarnished by allowing trading in the movie futures contracts. This is patently false. MDEX has no interest in disparaging the reputation and integrity of Hollywood. Notably, the Objectors’ broad and populist statement could apply to every industry that has a product upon which a futures contract is listed. It could apply, for example, to the U.S. government and the listing of Treasury futures; the housing industry and the listing of housing futures; the insurance industry and the listing of weather futures; the listing of aluminum futures and the aluminum industry; and the agricultural industry and the listing of corn, wheat, soybean and other futures. The notion that regulated futures contracts can tarnish an industry and is tantamount to “legalized gambling” is not only outdated, but baseless.

#### **V. MDEX’s Futures Contract Do Not Rely Upon Leverage**

In designing its product, MDEX has worked closely with CFTC staff to reduce—if not eliminate—the likelihood of excessive speculation and the retail use of its products. MDEX’s contract specifications require each contract to be fully funded - in other words, there is no leverage component thus reducing excessive speculation. We have also imposed tight reporting levels and position limits. At the same time, because they are fully margined and centrally-cleared by a CFTC-regulated clearing house, there is no credit risk. In all material respects, MDEX’s contracts seek to obviate risk—not create it.

#### **VI. MDEX’s Futures Contracts Are Not Susceptible to Manipulation**

The Objectors have raised a concern regarding possible insider influence on compiling the public box office figures in order to affect final settlement prices for MDEX products, as well as possible actions that a film studio or distributor might take on the use of a movie’s advertising budget to influence daily pricing of the contracts. MDEX has addressed these issues through its product design, processes and procedures.

Importantly, the CEA does *not* prohibit insider trading by market participants in the

commodity futures and options markets, based upon the premise that barring insider trading would defeat the market's basic economic function of allowing traders to hedge the risks of their commercial enterprises.<sup>2</sup> In other words, virtually every commercial hedger has some amount of inside information.

With respect to the Objectors' claim that the contracts may be susceptible to manipulation, in approving MDEX's DCM application, the CFTC has recognized that each of MDEX and the CFTC have the expertise and resources necessary to conduct market surveillance with respect to the commodities upon which MDEX seeks to list futures contracts. In working with the CFTC over the past 11 months, MDEX has taken the steps necessary to ensure that its opening weekend contracts will not be readily susceptible to manipulation. MDEX has satisfied these concerns through product design and various processes and procedures.

With respect to product design, MDEX's proposed opening weekend box office products are short-term contracts that are only listed for trading four weeks in advance of a movie's release. Four weeks prior to a movie's release, the market has a significant amount of public information at its disposal to render trading decisions, and marketing plans are well into the execution phase. Theater screens are set for the showing of the movie and only minimally adjusted in the final weeks prior to opening. Movie theater screens are finite real estate, and with the competition among movies at any given point in time, large numbers of screens are simply not available for a last minute changes. Importantly, MDEX rules require that the opening weekend revenue products cease trading prior to a movie's release in theaters. This serves to remove the concern regarding the earlier availability of box office information to the studio/distributor than the public.

Moreover, an important aspect of product integrity addressed by the CFTC and MDEX is the determination of the box office revenue figure used in establishing the products' expiration prices. MDEX has presented information and developed rules and processes to ensure the integrity of its expiration prices. In particular, MDEX has entered into an arrangement with the leading independent third-party provider of movie box office receipts, Rentrak, and developed a comprehensive set of "Motion Revenue Contracts Box Office Revenues Validation and

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<sup>2</sup> See, e.g., Testimony of Commission Chairman Phillip McBride before the SEC/CFTC Jurisdictional Issues and Oversight: Hearings on H.R. 5447, H.R. 5515 and H.R. 6156 Before the Subcommittee on Telecommunications, Consumer Protection and Finance of the House Committee on Energy and Commerce, 97th Cong., 2nd Sess, Part 1 at 21 (1982); A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material Non-Public Information (Sept. 1986). Trading on material non-public information is prohibited under the CEA, but only with respect to three general categories of persons. First, the statute prohibits CFTC Commissioners, employees and agents from trading on non-public information. CEA § 9(a)(4), 7 U.S.C. § 13(a)(4). The statute similarly prohibits CFTC Commissioners and CFTC employees from delivering nonpublic information to third parties with the intent to assist them in conducting trades; the CEA also forbids individuals who receive this information from trading on it. CEA § 9(d), 7 U.S.C. § 13(d). Finally, the CEA prohibits employees and board and committee members of a board of trade, registered entity, or registered futures association, from willfully and knowingly trading for their own or on behalf of any other account, futures or options contracts on the basis of any material non-public information obtained through special access related to the performance of their duties. CEA § 9(e), 7 U.S.C. § 13(e).

Verification Processes.”

## **VII. Conclusion**

In conclusion, we urge the Commission to approve our product submission and allow the market to determine the utility of our products. The Commission is fully authorized to take any action it deems appropriate against MDEX or any market participant if the Commission believes it is appropriate. In becoming a fully-registered DCM, we have invited and look forward to such oversight. Over the past year, we have strived to be responsive to all of the Commission’s needs and requests, and have worked tirelessly to structure our product to promote investment in a transparent, sound and responsible manner.

MDEX thanks the Commission for the opportunity to participate in this hearing and we look forward to answering any questions that you may have.