Chairman

Directors Guild of America DGA | Independent Film & Television Alliance® | IA TSE | Motion Picture Association of America, Inc.® | NATO

2010 MAY 12 PM 1 37

C.F.T.C.
OFFICE OF THE SECRETARIAT

11 May 2010

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

Re: Application Of Media Derivatives, Inc. For Approval Of Binary Options And Collared Futures In Opening Weekend Motion Picture Box Office Receipts

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 the application of Media Derivatives, Inc. ("MDEX") for approval to offer trading of binary options and collared futures contracts in opening weekend motion picture box office receipts (the "MDEX Contracts" or "Contracts") under the Commodity Exchange Act, as amended, 7 U.S.C. § 1, *et seq.* ("CEA").[1] Our coalition filed a separate comment letter dated April 8, 2010 on MDEX's application for Commission designation as a contract market ("DCM") under the CEA.

---

[1] The MDEX Contracts are designed to provide a means to profit from bets on the approximation of total box office receipts, as declared by MDEX, from the opening weekend for "major releases." MDEX's proposed binary option contracts would be issued over a series of strike prices (tied to the level of first weekend box office receipts that MDEX itself will declare after consulting reports from Rentrak Theatrical, Inc. ("Rentrak") and studio estimates). The options would be exercisable only upon expiration (European style) and only if the strike price for the first weekend box office receipts, as declared by MDEX, is reached. Upon successful exercise, the purchaser would be entitled to receive $5,000 per option contract.

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

MDEX has represented that it has received expressions of support for its applications for Commission approval of the MDEX Contracts from unidentified persons in the motion picture industry, but as this comment and our earlier comment reflect, the overwhelming majority consensus of the motion picture industry opposes both. In brief, as we explain in greater detail below, the Commission should not approve the Contracts because: (1) the Contracts do not serve the public interest purposes of legitimate futures – they do not provide price discovery and will not be used for hedging; (2) the Contracts would effectively circumvent anti-gambling laws; (3) the box office receipts numbers that will be used to settle the Contracts are only estimates that are inherently vulnerable to manipulation in a manner that is virtually uncontrollable; and (4) the Contracts will harm the motion picture industry. Significantly, Rentrak's terms of use on its website expressly cautions that its tabulations should not be used as primary research for "investment decisions": *"The Rentrak.com Data and the Rentrak.com Website are not intended to be used (a) in connection with research where the primary use of such data or site is for making investment decisions, or (b) for reporting or calculating royalties or other fees based on usage . . ."* (see page 10, *infra*).

MDEX's contention that its Contracts will serve to bring contracts on motion picture box office receipts out of "dark markets" or foreign markets is without factual basis. There are no legitimate futures contracts now traded on motion picture box office receipts; all current contracts are – as MDEX's Contracts would be – purely wagering contracts. The Hollywood Stock Exchange ("HSX"), an online site for fantasy betting on motion picture box office receipts, must limit its operation to *fantasy betting only* because money bets would violate the Wire Act, 18 U.S.C. § 1084(a). Similarly, the Irish website Intrade is an online wagering site for "prediction markets" that must block actual money bets on motion pictures from the United States to avoid violation of the Wire Act. Intrade is owned and operated by Trade Exchange Network, Ltd., a limited liability company registered in Ireland. A 2005 Commission settlement order against Trade Exchange Network found that it violated the Commission's ban on over-the-counter options in Regulation 32.11, 17 CFR 32.11, by offering to U.S. residents options that were not excepted or exempted from the ban. *In the Matter of Trade Exchange Network*, CFTC Docket No. 05-14 (Sept. 29, 2005). The trading of such contracts on the Iowa Electronic Market ("IEM") involves only nominal sums for the purpose of aiding the reliability of academic research and operates under no-action relief from the Commission staff that restricts IEM's trading to academic uses only. But for those facts, trading for IEM contracts with more than nominal sums would violate U.S. gambling laws.

The fact that gambling on movie box office receipts occurs outside the United States, however, does not warrant granting a federal license to trade such contracts as futures contracts, anymore than wagering outside the United States on the Super Bowl would provide a legitimate rationale for granting a federal license to trade such contracts under the CEA.

A. The Public Interest In Futures Trading Requires That Contracts Meet The CEA's Public Interest Tests

Section 3(a) of the CEA, 7 U.S.C. § 5(a), provides that legitimate futures contracts serve the public interest "by providing a means for managing and assuming price risks, discovering prices, or disseminating price information." CEA Section 3(b), 7 U.S.C. § 5(b), declares that it is the "purpose of this Act to serve the public interests described in subsection (a)." It is service of these public interests – which effectively require that futures contracts have legitimate economic uses beyond pure speculation – that distinguishes legitimate, lawful futures contracts from gambling contracts that are either proscribed as crimes by the federal Wire Act, 18 U.S.C. § 1084(a), or regulated by state gaming authorities. Indeed, CEA Section 4(a), 7 U.S.C. § 6(a), expressly condemns excessive speculation and authorizes the Commission to prohibit it.[2] Acknowledging the essential economic purpose of futures contracts, the Commission has often declared that futures prices must reflect the "legitimate forces of supply and demand" in the relevant cash market.

Consistent with the foregoing statutory requirements and Congressional mandate, an application for new products should be denied unless the applicant can demonstrate that its proposed Contracts would in fact be used for hedging or price discovery. It is, therefore, incumbent upon any applicant to show that the contracts for which it is seeking approval serve these public interest purposes of price discovery, managing price risks (*i.e.*, hedging), or disseminating valid pricing information, and this application is void of such demonstration.

The proposed MDEX Contracts cannot serve these public interests. They do not and cannot provide a means of price discovery. Because there is no cash market in a motion picture or its box office receipts, there is no cash market price to be discovered. Indeed, MDEX's submissions do not even attempt to explain what price discovery purpose its Contracts could have. Nor, as discussed below, will the proposed Contracts in fact be used for hedging. Rather, they are simply 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, MDEX's application for approval of trading of binary options and collared futures Contracts in opening weekend motion picture box office receipts should be denied.

B. Motion Pictures And Box Office Receipts Are Not Commodities

A motion picture, unlike commodities governed by the CEA, is a unique artistic work that derives its value not from any intrinsic utilitarian use, but from public reaction to a motion picture's artistic or entertainment merit, which are subjective judgments and unpredictable rather than verifiable facts. Further, a motion picture's box office receipts are not a commodity – they are not bought and sold, there is no market in them. Consequently, trading in MDEX Contracts has nothing to do with a commodity market. MDEX's Contracts are no different in kind from bets *before any deliveries occur* on how much wheat from one farm will be accepted for delivery in the market as meeting deliverable grade for one week, where the standard for deliverable grade wheat is based on subjective standards of taste and the bettor does not know the farm's acreage or the quality of its 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 contracts. The same should be true for MDEX's Contracts.

The definition of "commodity" enacted as part of the CEA in 1936 included only specifically enumerated agricultural commodities, all of which fell within the ordinary definition of commodity. When Congress amended the definition of commodity in 1974 to include "all other goods and articles, except onions..., and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in," it still intended to capture

[2] 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 or option contract.

only services, rights and interests for which there was an underlying cash market. This is clear from Congress's description of

> "contracts for future delivery" as "futures transactions" that are carried on in large volume by the public generally and persons engaged in the business of buying and selling commodities and the products and byproducts thereof in interstate commerce. The prices involved in such transactions are generally quoted and disseminated throughout the United States and in foreign countries *as a basis for determining the prices to the producer and the consumer of commodities and the products and byproducts thereof . . . and to facilitate movements thereof in interstate commerce.* Such transactions are utilized by shippers, dealers, millers and others engaged in handling commodities and the products and byproducts thereof in interstate commerce as a means of hedging themselves against possible loss through fluctuations in price.

CEA Section 3, 7 U.S.C. § 5 (Supp. 5 1994) (emphasis added). This description clearly describes contracts in products that have cash markets. Consistent with this, the submission of an application for approval of a new futures or option contract requires a description of the cash market for the underlying commodity. Commission Regulation 40.3(a)(4)(iv), 17 C.F.R. §40.3(a)(4)(iv).

In 2000, Congress passed the Commodity Futures Modernization Act ("CFMA"). The CFMA added a new defined term to the CEA, "excluded commodity," which was defined to include, among other things, any "rate, differential, index, or measure of economic or commercial risk, return, or value" that is based on "1 or more commodities with no cash market," provided that it is not within the control of any party to the transactions in the "excluded commodity." In the CFMA, Congress enacted a host of exclusions and exemptions from the CEA for transactions in "excluded commodities" that rendered such transactions in most situations entirely unregulated by the CEA, and in others only lightly regulated under the CEA. This regulatory shift was based on the premise that "excluded commodities" were a class of commodities that were not susceptible to manipulation.[3] Consistent with that new definition's exception for an "excluded commodity" with no cash market, Congress struck the language quoted above from CEA Section 3.

MDEX's reliance on the definition of "excluded commodity" to argue that the absence of any cash market in movie box office receipts is not an impediment to the Commission's approval of its Contracts is erroneous. Motion picture box office receipts are not within the CEA's narrow definition of "excluded commodity" because such receipts *are* within the substantial influence or control of a number of different participants in the motion picture industry. A relatively small

[3] Excluded commodities were deemed "excluded" and therefore subject to the least regulatory coverage because they generally are thought not to be susceptible to manipulation because they are (1) broad-based indices, statistical measurements or rates that are not based on a narrow group of commodities and are not within the control of the parties, or (2) occurrences or contingences beyond the control of the parties. The definition of "excluded commodity" makes clear that a product with no cash market would *not* be within the intended meaning of "excluded commodity" if it is subject to substantial influence or control by any party or involves an occurrence, extent of an occurrence, or contingency that is not beyond the control of the parties. *See* CEA Section 1a(13)(iii) and (iv)(I), 7 U.S.C. § 1a(13)(iii) and (iv)(I).

number of entities (the studio, the exhibitors, and marketers) have inordinate impact on the potential for box office numbers in the opening weekend and beyond for any particular motion picture. Their private decisions as to release dates, opening locations, number of theaters, number of screens, size of screens, and marketing budgets can significantly impact box office numbers in the early weeks of showings. Those decisions can be in flux up to the opening release and beyond, and much of the information regarding those decisions is closely held and protected from public dissemination. These decisions also can fluctuate based on the nature of the releasing and distribution company. For example, independent producers often do not take part in these decisions and do not control these elements of theatrical release, so any decision to hedge by the U.S. theatrical distributor can have enormous negative consequences on independent producers and distributors, which rely on international distribution to provide financing and distribution for their films.

In addition, we respectfully submit that implicit in the CEA's public interest tests for legitimate futures contracts is the requirement that every futures contract must in fact be material to valuing a cash commodity, even for contracts in those excluded commodities that do not themselves have a cash market. Thus, for example, although there is no cash market in weather, weather futures pricing is material to the cash market valuation of other commodities, such as natural gas. Similarly, 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 same cannot be said of motion picture box office receipts. Futures prices on motion picture box office receipts would have no relevance to the valuation of any commercial transactions. Any contracts in the motion picture industry that are based on motion picture box office receipts are determined by the actual receipts received, not on the numbers supplied by Rentrak or the estimates of the studios, which would be the basis for any MDEX declared box office receipts number.

C. The MDEX Contracts Would Not Provide Any Legitimate Price Discovery Because They Would Be Traded In An Informational Vacuum Without Any Reliable Economic Grounding

Any "pricing" of motion picture box office receipts by transactions in MDEX Contracts will be arbitrary and could never "reflect the legitimate forces of supply and demand" because trading in MDEX Contracts would occur only for four weeks *preceding* a motion picture's release, when bettors generally will not have viewed the motion picture they are gambling on. Whether a motion picture will connect with an audience has proven quite difficult to predict, and in some instances positive sentiment for a motion picture can prove to be quite fleeting. There is no set formula for success, which depends upon the totality of such things as the contributions of creative talent, including dialogue, performance, production design, cinematography, editing, musical composition, the overarching directorial vision and other artistic intangibles, marketing, release date, opening locations, and the national mood, fears, and fascinations at a particular time. For bettors to recklessly try to assess those intangibles without even seeing the motion picture is a fool's errand and harmful to the motion picture industry.

Significantly, none of the means used to assess the legitimacy of futures pricing based on supply and demand would exist for the MDEX Contracts. During the four-week, pre-release trading period, 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. In addition, unlike all other industries that use futures contracts, the motion picture industry has no constituents that would be natural long hedgers – no one has a risk of loss if a motion picture is wildly successful. Accordingly, there is no natural price competition between longs and shorts in any purported "market" for box office numbers.[4]

Further undermining any reliability of MDEX Contract pricing is the fact that much of the material information affecting such box office numbers is non-public. Bettors would not have access to much of the material information affecting a motion picture's first weekend box office performance (*e.g.*, marketing budgets, distribution agreements, private focus group screenings), because it generally is not publicly available. Trying to forecast box office receipts without the benefit of the non-public information that is closely held by studios and other motion picture industry insiders is arbitrary.[5]

Non-public business decisions regarding motion picture marketing and distribution plans that affect box office numbers can and do occur up to and throughout the release of the motion picture, with studios constantly adjusting their distribution patterns and marketing spend to take account of consumer acceptance of a film. Although a preliminary plan is prepared in advance of approving a motion picture for production (*i.e.*, well before a release date is scheduled), the plan remains subject to change and in fact is continually adjusted until the motion picture is released and beyond. Marketing changes generally can be made within a day and in some cases almost immediately, in terms of altering marketing materials, their placement, or their relative frequency of use.[6] The distribution plan for a motion picture (which is distinct from, though complementary to, the marketing plan) changes continually and is not final until the day of print shipment. State laws may also influence the distribution of a motion picture, because many states mandate offering a screening of a motion picture to all exhibitors in the state prior to commencing negotiations for any licensing deal and such a screening may not be available until a week or two before opening.

The research of Thomas S. Gruca, a marketing professor at the University of Iowa's Tippie College of Business, provides empirical evidence of the arbitrariness of motion picture box office futures pricing. His research disclosed that the average percentage error in predicting motion picture box office receipts is 38 percent for IEM and 31 percent for the HSX.[7] The research failed to find any significant improvement over time. The research also showed that

---

[4] The Commission Staff informed us during a meeting on March 30, 2010 that MDEX has admitted that there are no natural sellers of opening weekend box office receipts.

[5] 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.

[6] 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 opening weekend box office numbers.

[7] In contrast, the IEM's presidential vote share market has an average error of only 1.8 percent. *See*, Iowa Offers Lessons in Box Office Prediction Markets, University of Iowa News Release (April 12, 2010), which is accessible at http://news-releases.uiowa.edu/2010/april/041210IEM-boxoffice.html.

using real, as opposed to play, money did not improve results, and indeed the error rate was greater for the real-money IEM compared to the play-money HSX.[8]

D. MDEX Contracts Would Not Be Used For Hedging

The motion picture industry does not intend to use an MDEX Contract for hedging purposes; therefore, the proposed Contracts have little appeal or use with respect to the public interest criterion of hedging and impose substantial burdens on the industry. In fact, such hedging will interfere with the existing risk mitigation strategies that have been and are prevalent in the industry. Studios mitigate their financial risk by a host of techniques, including partnering with other companies to share the risk, diversifying projects across different segments of the viewing audience, selling downstream rights early to cover costs, and raising capital in private and public markets to effectively syndicate the risks. Studios further mitigate their financial risk by balancing their slate of motion pictures with a variety of types of pictures (new films and remakes; low budget and high budget; teen and adult; comedy, drama and horror, etc.).

Independent producers mitigate risk by utilizing a "presale" financial model. Prior to production, the independent producer seeks financial and distribution commitments from distributors worldwide, and once enough territories are licensed, those distribution agreements are collateralized by a bank, which then loans the producer funds, subject to an assignment to the bank of copyright in the motion picture until loan repayment. Because the U.S. theatrical release is only one piece of worldwide distribution, independent producers must rely on the international revenues for the majority of revenues and to repay their production loans and other equity investors. Negative press stemming from hedging of the U.S. theatrical release could doom worldwide exploitation of the film by local distributors who have already paid minimum guarantees for the license of the motion picture and are unlikely to engage in a U.S.-based futures market.

The Contracts are inherently flawed as hedging vehicles because they provide no opportunity to hedge investment risks at the pre-production and production stages when the real financial risks are taken in funding a motion picture. Worse still, MDEX Contracts would *imperil* the massive investments that studios and independent producers have made in a motion picture by starting to trade at the very time when they could have the maximum potential harm to the reputation and public acceptance of a motion picture. The substantial risk of reputational harm they would create far outweighs any theoretical hedge.

Selling a motion picture "short" after production would invite damaging collateral consequences, both for the particular film's success and for the trader's future relationships with financiers, directors, actors, exhibitors and others. Commercial interests invested in a motion picture will not run the risk of negative publicity by creating even the potential for accusations or rumors that it was "betting against" the success of its own picture by "shorting" it in a futures market. Moreover, there is a legal concern that such shorting transactions could generate claims of violating standard mutual covenants in industry contracts with exhibitors, directors, actors and others that prohibit disparagement of the work. Further, any theoretical financial offset from a hedge on a single motion picture would not compensate for the harm to artistic and business

[8] Gruca, Thomas S., Berg, Joyce E. and Cipriano, Michael, *Incentive and Accuracy Issues in Movie Prediction Markets*, The Journal of Prediction Markets, Volume 2, Number 1, May 2008, pp. 29-43, University of Buckingham Press. Ms. Berg is a professor of accounting, Tippie College of Business, and Mr. Cipriano is an assistant professor of accounting at the College of Charleston in Charleston, S.C.

reputation as well as relationships with other industry participants if futures prices negatively influenced box office performance.

For independent producers and their worldwide distributors and equity investors, whose films are often released in the U.S. by the major studios, which may control marketing and release plans, mitigating financial risk is even more difficult but is accomplished by established financial models. As we have stated, independent producers secure financing on a film-by-film basis with different investors for each film and rely heavily on the distribution commitments of foreign distributors before production of the film even begins. Those minimum commitments, along with any government incentive programs, are collateralized by financial institutions and other investors, which loan the producer the production budget. Independent producers rely on the proceeds of foreign distribution to pay back the production loan, and therefore any hedging by U.S. distributors could harm not only independent producers, but also the dozens of financial and commercial partnerships they must build worldwide to secure financing for each film. Further, an independent producer is unlikely to bet against its own film for the same reasons that a studio would not bet against one of its own films, as described above.

Theater owners similarly have no incentive to bet against a motion picture as a hedging strategy. They do not want to be perceived as betting against the product they will be offering and they have other means to mitigate risk. Motion picture rental is paid as a *percentage* of the gross numbers of tickets sold. The fact that exhibitors negotiate with distributors on a film-by-film basis makes it less likely that exhibitors would ever want to use futures contracts to hedge. Why book and negotiate one movie, and then bet against it?

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

As a practical matter, any decisions by a studio to hedge any risk would need to be cleared with senior management, who necessarily have intimate knowledge of all financial and contractual information relating to a motion picture and under MDEX's rules would not be permitted to interact with traders. In this connection, box office numbers data are very important and sensitive, and such information is shared within a studio by, 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 numbers data and the persons who compile or compute those figures. It makes no sense to do so and would prevent a studio from utilizing the box office numbers data in the most efficient manner. This would be even more pronounced for small production companies and independent filmmakers.

The foregoing reveals a legal impediment for approval of the MDEX Contracts. To the extent persons with substantial influence or control over the level of box office receipts are banned from entering into the proposed Contracts, the Contracts do not meet the public interest tests for hedging. To the extent the individuals and entities that can exercise substantial influence or control over the level of box office receipts are permitted to enter into the contracts, agreements and transactions, motion picture box office receipts do not fit within the definition of "excluded commodity."

E. The MDEX Contracts Are Susceptible To Manipulation And Insider Trading

MDEX, the motion picture industry, and the Commission do not have adequate resources to detect and deter potential manipulation. In the first instance, as described above at pages 5-6, the lack of any legitimate economic measure for validly pricing box office receipts before the Rentrak numbers are announced prevents any ability to even identify a manipulated price. But even if, for the sake of argument, there were a means to determine the economic validity of a pre-release futures price, collecting sufficient information to do that credibly and reliably in the context of the complexity of the motion picture industry and the box office performance of motion pictures would require extensive new surveillance resources virtually dedicated to the MDEX Contracts alone and new, broad information-gathering powers.

The potential box office receipts for a motion picture can be materially affected by individual industry participants in a variety of different ways. Individuals working for exhibitors who contribute to the Rentrak numbers could, either intentionally or accidentally, misreport their data. A distributor's employee could determine within the four-week period preceding a motion picture's release to decrease or increase the number of theaters that would show the motion picture on the opening weekend. A distributor's employee for a variety of reasons could determine to substantially reduce or expand its marketing budget, which can materially affect opening weekend box office receipts. A major exhibitor's employee could determine to show the motion picture on smaller or larger screens, which can materially affect audience interest and capacity.

There is no factual basis for MDEX's contention that in setting its settlement price it can rely on the studios' proprietary information regarding box office receipts. The exchange has no authority to compel the motion picture industry or other private institutions to disclose any proprietary information and no such authority can be conferred on it by or pursuant to the approval of the MDEX Contracts. Studios have always carefully guarded this highly confidential and sensitive information.

Futures prices also are susceptible to manipulation by false market rumors. In the specific 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 merit or entertainment value rather than verifiable facts. There already are many pre-release rumor mills with respect to the quality of motion pictures. These rumors are generated by (1) reviews by members of the public who have attended screenings, (2) press reports relating to rumored or perceived "trouble" on motion pictures (multiple writers, talent defections, re-shoots, postponed release dates, etc.), and (3) reports of the quality of a motion picture's footage that have leaked pre-release. There is no effective way to police such rumors or reliably determine their source. These sorts of rumors can depress or spur box office performance. Therefore, the ability to profit from rumors by trading in the MDEX Contracts would intensify any incentive to spread false rumors in a manner that MDEX could neither detect nor control.

MDEX's rules fail to address compliance issues with insider trading proscriptions of the federal securities laws. Where a motion picture's first weekend box office success is material to the market value of a distributor's publicly traded securities, trading in the MDEX Contracts could be used by insiders as a surrogate for trading in their companies' securities in order to profit from inside information. MDEX's rules fail to adequately anticipate or prevent this.

F. Reports Of Box Office Numbers Are Not Free From Error

As we have noted above, there are numerous objections to the MDEX Contracts, and the Contracts would be problematical even if they relied upon a foolproof data source. Although Rentrak provides a useful service, there are inherent limitations in any system that attempts to gather box office numbers prior to the formal tabulation of actual receipts by exhibitors and distributors, which occurs weeks after Rentrak reports its numbers. Rentrak itself recognizes these limitations in its terms of use. Rentrak's contract states on its website that its data are not intended to be used in connection with "making investment decisions" or for reporting or calculating royalties or other fees based on usage.[9] Where, as here, the purveyor of data warns that it should not be used in connection with investment decisions, there is no proper basis for the Commission to license a financial instrument based on such data.

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

> "Variety publishes data compiled by Rentrak Theatrical, which collects studio reported data as well as box-office figures from North American theatre locations. Any information provided by Rentrak has been obtained from sources believed to be reliable.
>
> However, Rentrak does not make any warranties as to the accuracy, completeness or adequacy of this information and data.

---

[9] The second paragraph of the Rentrak Terms of Use agreement states as follows (emphasis added):

"Use of the Rentrak.com Website and Data. Rentrak hereby grants User, on the terms of these TOU and the Service Agreement (if applicable), the non-exclusive right to access the Rentrak.com Website and view and use the Rentrak.com Data solely for User's internal business purposes. *The Rentrak.com Data and the Rentrak.com Website are not intended to be used (a) in connection with research where the primary use of such data or site is for making investment decisions, or (b) for reporting or calculating royalties or other fees based on usage, and any use of the Rentrak.com Data or the Rentrak.com Website for such purposes shall be at User's sole risk.* User shall not have the right to display, publish, distribute, disseminate or otherwise make public any Rentrak.com Data without Rentrak's prior written consent. User acknowledges that all Rentrak.com Data is "Confidential Information" subject to Section 6 below and that in all events User may not rely on the accuracy of the Rentrak.com Data in making representations to advertisers or similar parties concerning the usage of content."

> The user of this data agrees Rentrak, its officers and employees will have no liability arising from the use or disclosure of this information and data. To submit any questions to Rentrak, please email: boxofficeinfo@rentrak.com."

See: http://www.variety.com/index.asp?layout=b_o_layout&dept=Film (emphasis added). Those estimates, as with estimates of all types, can be flawed, although traders might rely on them – see the articles from *Variety* about errors in estimates of weekend box office numbers for the second and third weekends in April 2010, which are attached hereto as Attachments A and B. These corrections were voluntary and, although made on the Mondays following those weekends, could have been made later in the week instead (after MDEX would have declared the settlement price for its Contracts).

The box office receipt information Rentrak compiles from the exhibitors that have agreed to provide that information to Rentrak is itself incomplete, and we understand that the percentage of the total box office numbers that is reported by exhibitors to Rentrak can vary materially from motion picture to motion picture (*e.g.*, 12%) depending on how many exhibitors within its universe of reporting exhibitors are showing a particular motion picture. We understand that many exhibitors record box office numbers electronically and then provide the aggregate information to Rentrak through an electronic feed, but also that many exhibitors tabulate their numbers manually. However, *some exhibitors never report to Rentrak, either automatically or manually.*

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

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

G. The MDEX Contracts Will Harm the Motion Picture Industry

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

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

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

Approval of the MDEX Contracts also creates a host of new financial and legal costs and burdens that do not now exist. Once a contract is traded in box office numbers estimates, the announcement of such estimates has consequences for bettors. This, in turn, creates legal risk for studios in announcing their estimates – where none exists now. Mistakes that are currently meaningless could now be portrayed as impacting bettors' financial results from their contracts, thus giving rise to private claims for damages for negligence, misrepresentation or even manipulation. The cost of litigating unmeritorious claims could be substantial and cause studios to cease or significantly alter the practice of public announcements.

Approval of the proposed Contracts also will require studios and all other industry participants that have the power to affect futures pricing to institute and police anti-insider trading compliance regimes for the proposed Contracts. Even if the MDEX Contracts do not meet the promoters' projections for acceptance in the marketplace, the Contracts would be available and force the motion picture industry to incur substantial costs to maintain an anti-insider trading program. It is problematic when any prohibition on insider trading would need to take into account inside information held by persons who are not subject to the control of the studios and other producers and distributors. There are many industry participants who have access to material, non-public information and could try to use that information to profitably bet on the proposed Contracts. There are many insiders, for example, in studio marketing and distribution departments and upper management or that are hired as outside vendors by marketing departments and in exhibitors' finance, marketing and contracting departments, who have access to such material, non-public information as actual box office data, internal forecasts, advertising strategies and spending, and release patterns.[10] Exhibitors also have a right to see a motion picture prior to licensing it in the U.S.[11]

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

H. Conclusion

For the reasons set forth above, we respectfully and strongly recommend that the Commission deny the application of MDEX to offer trading of binary options and collared futures contracts in opening weekend motion picture box office receipts. We thank the

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

[11] 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.

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, Inc.

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
Thomas Leahy, Jr.

ATTACHMENT A

VARIETY

April 13, 2010

'Titans' victorious at weekend box office

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

By ANDREW STEWART

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

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

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

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

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

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

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

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

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

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

ATTACHMENT B

'Kick-Ass' slays 'Dragon'
Another swap at B.O. top
By ANDREW STEWART

Despite early estimates, 'Kick-Ass' took the top spot at the B.O.

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

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

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

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

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

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

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

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

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

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