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## Antitrust and Pricing in the Motion Picture Industry **Barak Y. Orbach**

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# Antitrust and Pricing in the Motion Picture Industry

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*Since the 1970s, at any given movie theater, one price has been charged for all movies, seven days a week, throughout the year. This Article studies the economic and legal causes that led to the formation of this peculiar phenomenon of uniform pricing for differentiated goods. The Article studies the history of the motion picture industry's pricing systems in their legal, economic, and technological contexts. It shows that, despite intensive antitrust scrutiny and litigation, forces with considerable market power have almost always shaped the industry's pricing systems. Uniform pricing, it is argued, is a consequence of the industry's history, structure, and governing legal rules. In particular, the Article argues that the uniform pricing regime has been maintained by the same forces that have always controlled the market. The Article explores the justifications for the uniform pricing regime and concludes that the vertical restraints that perpetuate this regime are the industry's response to the broad 1948 Paramount prohibitions on vertical restraints. The enforcement of uniform pricing is generally less observable than the enforcement of other forms of vertical restraints and has never been challenged by the government or private parties. More generally, the Article illustrates how inefficient pricing systems may form, evolve, and survive in the shadow of antitrust law, even in a high-profile industry such as the motion picture industry.*

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“The fact that it is a service industry with constantly changing product . . . makes some pattern of price discrimination a marketing necessity.”<sup>1</sup>

## Introduction

At the movie theater’s box office, moviegoers face a puzzling phenomenon: Tickets to all movies carry the same price tag seven days a week, throughout the year.<sup>2</sup> Most moviegoers do not question this pricing pattern because they were born after it was established in the early 1970s or because they have forgotten that once movie tickets were priced differently.<sup>3</sup> Uniform pricing, however, is far from obvious: Sellers

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1 MICHAEL CONANT, ANTITRUST IN THE MOTION PICTURE INDUSTRY: ECONOMIC AND LEGAL ANALYSIS vii (1960).

2 The exceptions to this pricing pattern are discussed *infra* Section I.A.

3 Approximately thirty percent of moviegoers in the United States are younger than

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normally price their products according to demand elasticities, which vary across products. Box office pricing was not always uniform, but it conformed to this economic principle only during the early days of the industry, from 1896 to 1905.

Uniform prices for differentiated goods are common in many markets. For example, all long-distance calls using the same carrier cost the same, different flavors of ice cream or soda of the same brand carry identical price tags, hosting sports teams normally price particular seats uniformly regardless of the visiting team's popularity,<sup>4</sup> and digital music providers charge the same price for all songs.<sup>5</sup> Such uniform prices are often explained by regulatory constraints and transactions costs, such as information and menu costs.<sup>6</sup> As discussed below, none of these explanations apply to the uniform admission prices of the motion picture industry.

The motion picture industry was born with the twentieth century and has grown into a multi-billion dollar industry.<sup>7</sup> From its beginning, the industry has been subject to antitrust actions and scrutiny that, as discussed in this Article, have never succeeded in removing vertical constraints from the price mechanisms of the exhibition segment.

Box office pricing first drew the attention of antitrust agencies in the second quarter of the twentieth century,<sup>8</sup> when a few large distributors acquired control over admission prices.<sup>9</sup> For twenty years, antitrust actions against these distributors failed to bring competition to the industry, until the 1948 Supreme Court decision in *United States v. Paramount Pictures*.<sup>10</sup> The *Paramount* Court directly addressed the industry's pricing

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twenty-five years old, and approximately sixty percent of moviegoers are younger than forty years old. MOTION PICTURE ASSOCIATION, 2002 U.S. MOVIE ATTENDANCE STUDY 4 (2003), at <http://www.mpa.org/useconomicreview> (last visited Mar. 24, 2004).

4 For a discussion of the very recent trend toward variable-price ticketing in sports leagues, see John Morrel, *How Much for Tickets? You Need a Scorecard*, N.Y. TIMES, June 8, 2003, at C4.

5 Walter S. Mossberg, *Music That You Don't Have To Steal*, WALL ST. J., Apr. 30, 2003, at D1; Walter S. Mossberg, *New Web Music Stores Offer Unique Features, and One Is a Winner*, WALL ST. J., Apr. 1, 2004, at B1.

6 See, e.g., Rob McMillan, *Different Flavor, Same Price: The Puzzle of Uniform Pricing for Differentiated Products* (Nov. 12, 2003) (unpublished manuscript, on file with Yale Journal on Regulation); Tommaso Valletti et al., *Universal Service and Entry: The Role of Uniform Pricing and Coverage Constraints* (May 2001) (unpublished manuscript, on file with Yale Journal on Regulation), available at <http://www.cepr.org/pubs/dps/DP2789.asp> (last visited Mar. 24, 2004).

7 In 2002, gross box office receipts totaled \$9.5 billion. MOTION PICTURE ASSOCIATION WORLDWIDE MARKET RESEARCH, U.S. ENTERTAINMENT INDUSTRY: 2002 MPA MARKET STATISTICS 3 (2003), at <http://www.mpa.org/useconomicreview> (last visited Mar. 24, 2004). See *infra* Figure 7. Box office receipts represent only a small portion of the industry's revenues, which also include concession sales; licenses to broadcasting; merchandise; video and DVD sales; and so forth.

8 See, e.g., *Schine Chain Theatres, Inc. v. United States*, 334 U.S. 110, 120-21 (1948); *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939); *United States v. Paramount Pictures, Inc.*, 66 F. Supp. 323, 334-41 (S.D.N.Y. 1946).

9 See *infra* Section II.C.

10 334 U.S. 131 (1948).

structure,<sup>11</sup> and the decrees that followed prohibited and were designed to prevent distributors' intervention in setting admission prices, among other things.<sup>12</sup> This prohibition against distributors' intervention in setting admission prices is still in force.

At the time, *Paramount* was described as "the Government's greatest economic victory in the sixty year history of antitrust enforcement."<sup>13</sup> Over the years, numerous books and articles have addressed the impact of the *Paramount* decrees on the industry's structure and competitiveness.<sup>14</sup> Surprisingly, box office pricing and the convergence of the industry to uniform pricing that followed the *Paramount* decrees have been neglected in the literature. The development of ticket pricing is interesting because it allows one to examine the impact of antitrust policy on one facet of the price charged to the consumer.

Although the practice of uniform pricing in the movie theater industry has not been studied, several scholars and industry professionals have addressed it in passing. Some of them argue that setting variable admission prices "is too complex an undertaking that could cause confusion in the minds of consumers"<sup>15</sup> or raise other arguments against price differentiation.<sup>16</sup> Many others point out the advantages of variable pricing.<sup>17</sup> Among the latter is Michael Conant, who notes, "[A]dmission prices for films that are not hits and that leave theaters largely empty do

11 *Id.* at 141-44.

12 *See infra* Subsection II.C.2.

13 Walter Adams, *Dissolution, Divorcement, Divestiture: The Pyrrhic Victories of Antitrust*, 27 *IND. L.J.* 1, 5 n.18 (1951).

14 *See, e.g.*, CONANT, *supra* note 1; Ralph Cassady, Jr., *Impact of the Paramount Decision on Motion Picture Distribution and Price Making*, 31 *S. CAL. L. REV.* 150 (1958); Michael Conant, *The Paramount Decrees Reconsidered*, *L. & CONTEMP. PROBS.*, Autumn 1981, at 79, 103; Robert W. Crandall, *The Postwar Performance of the Motion Picture Industry*, 20 *ANTITRUST BULL.* 49 (1975); Arthur De Vany & Ross Eckert, *Motion Picture Antitrust: The Paramount Cases Revisited*, 14 *RES. L. & ECON.* 51 (1991); Brian J. Wolf, *The Prohibitions Against Studio Ownership of Theaters: Are They an Anachronism?*, 13 *LOY. L.A. ENT. L.J.* 413 (1993); Note, *An Experiment in Preventive Anti-Trust: Judicial Regulation of the Motion Picture Exhibition Market Under the Paramount Decrees*, 74 *YALE L.J.* 1040 (1965); Kraig G. Fox, Note, *Paramount Revisited: The Resurgence of Vertical Integration in the Motion Picture Industry*, 21 *HOFSTRA L. REV.* 505 (1992).

15 BARRY R. LITMAN, *THE MOTION PICTURE MEGA-INDUSTRY* 45 (1998). Section III.D of this article addresses possible problems that price variation may cause by confusing consumers and explains how to solve such problems.

16 *See, e.g.*, De Vany & Eckert, *supra* note 14, at 72-77.

17 *See, e.g.*, Stephen Battaglio & Kirk Honeycutt, *Bronfman: Event Films Need Event Ticket Prices*, *HOLLYWOOD REP.*, Apr. 1, 1998, at 3 ("This is a pricing model which makes no sense, and I believe the entire industry should revisit it." (quoting Edgar Bronfman, Jr., then-CEO of Universal Pictures)); *How easy Does Just About Everything*, *BUS. WK.*, Jan. 28, 2003, at [http://www.businessweek.com/bwdaily/dnflash/jan2003/nf20030128\\_4841.htm](http://www.businessweek.com/bwdaily/dnflash/jan2003/nf20030128_4841.htm) (last visited Apr. 12, 2004) ("First thing is price elasticity—i.e. you reduce the price of something and people will consume more of it. Then, we have the ability to yield-manage, to charge prices according to demand . . . I'm taking that idea to cinema." (quoting Stelios Haji-Ioannou, founder of easyCinema)); James Surowiecki, *What Price Hollywood*, *NEW YORKER*, Jan. 15, 2001, at 38; Paul Sweeting, *Imposing Real World on Pix Finds a Buyer*, *VARIETY*, Apr. 13, 1998, at 11. For a formal treatment of optimal ticket pricing, see Sherwin Rosen & Andrew M. Rosenfield, *Ticket Pricing*, 40 *J.L. & ECON.* 351 (1997).

not result in admission-price cutting. [E]xhibitors generally consider demand to be relatively inelastic. The question is whether they have tested this hypothesis with price changes for films of different quality.”<sup>18</sup>

This Article fills the gap in the literature on movie theater pricing. It demonstrates how, despite extensive scrutiny and litigation in the motion picture industry, a few powerful players in the upstream market—the distribution segment—have always controlled the structure of box office pricing. These findings emphasize the ineffectiveness of antitrust enforcement in the motion picture industry, as the type of control distributors have exercised over admission prices has never been legal.<sup>19</sup> The Article argues that, because of various structural problems in the industry, the broad *Paramount* prohibitions on vertical restraints between distributors and exhibitors are the major cause for the persistence of the uniform pricing regime and that these prohibitions in their broad form are undesirable.

The plan of the Article is as follows. Part I presents the puzzle of uniform prices at the box office and demonstrates that the prerequisites for variable pricing are easily satisfied. Part II studies the history of the industry’s pricing systems and their evolution in the shadow of antitrust enforcement. It shows that forces with considerable market power have always had some control over the pricing structure of the exhibition segment, although they changed form. Part III explores the justifications for uniform pricing at the box office and concludes that, although a few contestable factors play a role in the persistence of the practice, the major explanation is the distributors’ objections to variable pricing. Part IV addresses the welfare implications of uniform pricing at the box office and offers some conclusions.

## I. The Puzzle

### A. *Uniform Prices for Differentiated Goods*

The motion picture industry is all about differentiated products: Consumers consider different movies and different show times to be imperfect substitutes. Absent unique circumstances, one would expect some price variation across differentiated goods in free markets. This economic rationale, however, does not hold at the movie theater’s box office. With a few exceptions, at any given movie theater tickets are priced uniformly regardless of the movie’s popularity, the day of the week, and the time of year. The exceptions typically involve matinees, students’,

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<sup>18</sup> Conant, *supra* note 14, at 103.

<sup>19</sup> See *infra* Sections II.C-II.E.

seniors', children's, veterans', and bulk discount tickets.<sup>20</sup> The discounts offered create some price discrimination among patrons, but with the exception of matinees, they do not establish price variation across differentiated products. Concession sales also facilitate price discrimination across patrons according to their financial means, nutrition preferences, and willingness to wait in line. In addition, some price differentiation occurs indirectly through means other than ticket and concession sales. For example, in a multiplex, the auditoriums with the bigger screens, better sound systems, and newer seats are usually reserved for popular movies.<sup>21</sup>

The unique circumstances that explain uniform prices for differentiated goods in other industries are not present in the movie theater industry: (i) Admission prices are unregulated; (ii) exhibitors' costs vary substantially across movies; (iii) season tickets and subscriptions are generally not offered;<sup>22</sup> and (iv) simple schemes of variable pricing are unlikely to entail prohibitive costs or to create confusion among moviegoers.<sup>23</sup>

The puzzle of uniform prices at the movie theater is particularly striking in light of price variation across theaters.<sup>24</sup> Admission fees in certain cities are as much as three times higher than in other cities. Similar price differences exist between first- and second-run theaters within the same city. Somewhat lower price variation exists across theaters within the same geographic area, according to their location, design, physical conditions, and other factors. These types of cross-theater price variation indicate that theater circuits invest time and resources in devising and administering pricing policies. Nevertheless, they do not apply the same methods within each theater.<sup>25</sup>

Another factor that seems relevant to the puzzle is the existence of imperfect substitutes for watching movies at the theater. For many

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20 Approximately forty percent of moviegoers are below age twenty-five or above age fifty-nine, MOTION PICTURE ASSOCIATION, *supra* note 3, at 4, but there is no public information on how many of them use available discounts. Nor is there any public information on the percentage of tickets sold at regular price.

21 At least in Hong Kong, there is price variation across seats in the same theater. Steven N.S. Cheung, *Why Are Better Seats "Underpriced"?*, 15 ECON. INQUIRY 513 (1977).

22 In a few selected cities, AMC, the second largest theater circuit in the United States, employs a plan ("MovieWatcher Premium Card") that allows moviegoers to pay a flat monthly fee and to see up to one movie a day. This plan is similar to movie passes offered by several major theater chains in France. Jill Goldsmith, *AMC Tempts Auds with Multi-Pic Card*, DAILY VARIETY, June 11, 2001, at 28.

23 See *infra* Section III.D.

24 Peter Davis, *The Effect of Local Competition on Retail Prices: The U.S. Motion Picture Exhibition Market* (2003) (unpublished manuscript, on file with Yale Journal on Regulation).

25 See also William Grimes, *Film Price Hits \$8.50, But There Are Ways to Save*, N.Y. TIMES, Mar. 13, 1996, at C13 ("Pricing is something that we review at least twice a year on a very specific market-by-market basis.") (quoting the executive vice president for marketing and communications of Cineplex Odeon).

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individuals, video rentals, and video-on-demand may substitute for movie going.<sup>26</sup> These forms of substitutes are considerably cheaper than movie tickets, especially since a single rental or video-on-demand may serve a household that at the theater would have to purchase several tickets. Movies at home may constrain the level of admission prices, but because the constraints are unlikely to bind across the board, video rentals and video-on-demand do not explain uniform pricing. In addition, video rentals and video-on-demand are not always attractive substitutes for movie-going. For instance, on weekends and during the summer, many individuals would rather watch a movie at a theater than stay at home, while on weekdays and during the winter they may prefer to watch movies at home. In the same spirit, an individual is more likely to watch event movies at the theater than “regular” movies. Therefore, the varying nature of the substitution relationship between theater attendance and home exhibition further supports variable pricing.

Finally, some consideration of exhibitors’ costs per movie is important for understanding the relevant aspects of the complex distributor-exhibitor relationships that constrain box office pricing.<sup>27</sup> License agreements are standard agreements that typically define four critical elements: the house nut, the formula, the floor, and the per capita requirement. The *house nut* sets exhibitor expenses, including rent and other types of overhead costs.<sup>28</sup> Normally the house nut provides exhibitors with a small cushion of profit. The *formula* stipulates a sliding scale for sharing box office receipts that exceed the house nut between the distributor and the exhibitor.<sup>29</sup> During the first week or two, the distributor receives seventy to ninety percent of the net box office receipts, and thereafter the exhibitor’s share increases. The *floor* is the minimum share of gross box office receipts remitted to the distributor before subtracting the house nut, and it declines over time.<sup>30</sup> The *per capita requirement* sets a minimum dollar amount to be paid to the distributor for any patron who watches that distributor’s movies. Following *Paramount*, these terms are supposed to be negotiated on a movie-by-movie and theater-by-theater basis, so that exhibitors’ costs vary across movies.

Although the exhibitors’ cost structure may be complicated, devising variable pricing is a relatively simple task, and workable criteria for

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26 Michael D. Basil, *The Film Audience: Theater Versus Video Consumers*, 28 ADVANCES IN CONSUMER RES. 349 (2001); Indra De Silva, *Consumer Selection of Motion Pictures*, in THE MOTION PICTURE MEGA-INDUSTRY 144, 155-57 (Barry R. Litman ed., 1998); Barry R. Litman & Anne M. Hoag, *Merger Madness*, in THE MOTION PICTURE MEGA-INDUSTRY 97, 98-101 (Barry R. Litman ed., 1998).

27 For a description of exhibition agreements, see HAROLD L. VOGEL, ENTERTAINMENT INDUSTRY ECONOMICS: A GUIDE FOR FINANCIAL ANALYSIS 84-87 (5th ed. 2001).

28 *Id.* at 85.

29 *Id.*

30 *Id.* at 87.



variable pricing can be easily defined. The remainder of this Part presents two general demand dimensions across which theaters could establish profitable variable pricing.<sup>31</sup>

### B. *Weekly and Seasonal Patterns of Demand*

The demand for movies is cyclical with respect to the day of the week and the time of year. The average box office revenues collected on weekends (Friday through Sunday) account for approximately seventy-two percent of the average weekly box office revenues. In other words, under present conditions, the demand for movies on an average weekend day is about 3.4 times higher than on an average weekday. Such a demand pattern suggests that raising admission prices on weekends is likely to increase profits, even if the price increase discourages some patrons from visiting the theater. This pattern also casts some doubt on the rationale behind low admission prices for matinees on weekends, as it is unclear whether the weekend audiences have the same demand elasticity as those who attend weekday matinees. Some circuits partially apply that logic and limit some of their discounts to weekdays only.<sup>32</sup> Pricing could be further refined through analysis of more specific demand patterns and local demand characteristics, as weekend demand is not uniform. For example, on weekends, the demand for evening shows is highest on Saturdays and lowest on Sundays. For this reason, most theaters that employed weekend pricing traditionally applied premiums only on Fridays and Saturdays or only on Saturdays.

As shown in Figure 1, seasonal patterns also suggest profitable variable pricing schemes. The demand during the summer and holidays is much higher than during the rest of the year.<sup>33</sup> Therefore, charging higher prices during these seasons, or giving discounts during the rest of the year, would probably result in greater profits.

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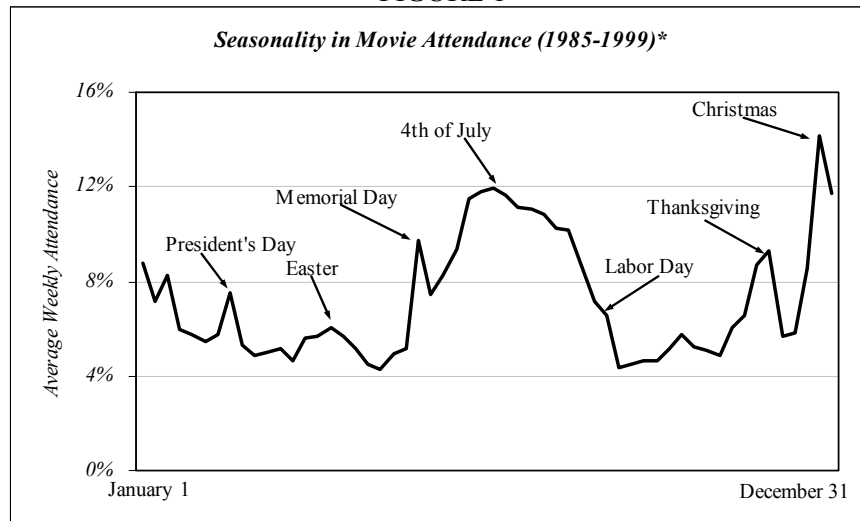
31 The descriptive statistics presented in this Part and referenced in Figures 1, 4, and 5 are based on data for all the movies released in the United States between 1985 and 1999, which amount to 3523 movies. Database is on file with the Author. A detailed description of the data can be found in Liran Einav, *Gross Seasonality and Underlying Seasonality: Evidence from the U.S. Motion Picture Industry* (2003) (unpublished manuscript, on file with Yale Journal on Regulation).

32 Loew's Cineplex, for example, limits one of its bulk discounts (the Weekday Escape Ticket) to Mondays through Thursdays only. Corporate Discount Ticket Program, at [http://www.enjoytherealdeal.com/us\\_eng/pages/frameets\\_main/frame\\_nav2.asp](http://www.enjoytherealdeal.com/us_eng/pages/frameets_main/frame_nav2.asp) (last visited Mar. 24, 2004). In contrast, in New York City, rather than differentiating between weekdays and weekends, most theaters have no matinee rates at all. See, e.g., Fandango, Theater Showtimes: Loews 34th Street, at [http://www.fandango.com/theater.asp?distance=15&chain\\_id=SONY&theater\\_id=AAQCR\\_LIVE&refreshdate=4/27/2004&from=](http://www.fandango.com/theater.asp?distance=15&chain_id=SONY&theater_id=AAQCR_LIVE&refreshdate=4/27/2004&from=) (last visited Apr. 27, 2004).

33 A similar pattern of seasonality for the years 1969 through 1984 can be found in VOGEL, *supra* note 27, at 46.

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FIGURE 1



\* The Average Weekly Attendance axis represents the average share of the American population that attended movie theaters in a given week.

DATA SOURCE: Author's database (on file with Yale Journal on Regulation).

It should be mentioned that the representation depicted in Figure 1 may be somewhat misleading. To some extent, the demand for movies follows the supply, which, in turn, is partially determined by industry beliefs regarding the demand.<sup>34</sup> Even so, the general attendance trends can be used for ticket pricing, since factors such as national holidays and school breaks are independent of supply and are good predictors for demand peaks and troughs. Furthermore, large exhibitors' costs per movie indirectly follow recurring seasonal patterns: For high season movies, large exhibitors "sometimes have to offer a substantial advance in nonrefundable cash against future [reel] rentals."<sup>35</sup> In addition, distributors often charge seasonal premiums by adjusting the rental terms to the season. This adds to the pricing puzzle: Even though distributors adjust their prices by season and exhibitors could easily follow suit, uniform pricing at the box office persists.

Systematic evidence on the profitability of using the time dimension of demand for movies as a pricing factor is unavailable. Since 1996, two major theater chains (called "circuits" in the industry) have charged higher prices on weekends.<sup>36</sup> Usually weekend pricing is employed in towns

34 Einav, *supra* note 31.

35 VOGEL, *supra* note 27, at 88.

36 Cinemark, the third largest circuit in the U.S., charges \$0.25 to \$0.50 more for Friday and Saturday evening shows in some of its theaters than it charges on other days of the week. For the first matinees on Monday through Thursday, Cinemark charges \$0.50 to \$1.50 less than for later matinees. Examples of towns in which Cinemark employs weekend pricing include Chico, Hanford, and Redding

where there is no competition among local theaters. One explanation for this pattern is that, in the absence of competition, exhibitors face no threat of distributors' retaliation, as movies cannot be licensed to rival exhibitors.<sup>37</sup> The persistence of weekend pricing offers some support to the general argument of this Article.

There is anecdotal evidence that variable pricing would increase revenues. In 1970, several local exhibitors in Washington, D.C., slashed their admission fees on weekdays by sixty-seven percent and, as a result, significantly increased their box-office revenues and more than doubled their popcorn sales.<sup>38</sup> During the 1980s and 1990s, several circuits revived the practice of discount days; but, despite positive results, these policies were abandoned because of per-capita requirements, which made the practice unprofitable for exhibitors.<sup>39</sup> In the late 1990s, this policy emerged again, and today many theaters have discount days in which they offer tickets at reduced admission prices. Finally, the Australian market provides another inspiring example. In Australia, prices are sensitive to seasonal demand and special events. During the Sidney 2000 Olympic Games, for example, prices were cut aggressively.<sup>40</sup>

### C. *Specific Movie Demand*

Another possible dimension for price variation is specific movie demand. Although the motion picture industry is notorious for the uncertain commercial success of newly released films,<sup>41</sup> several factors may assist in predicting general levels of box office revenues. The most intuitive factor, though often contested,<sup>42</sup> is star participation. Empirical evidence on the contribution of stars to the market success of films indicates that certain movie stars do make a demonstrable difference.<sup>43</sup>

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in California; Jacksonville and Orlando in Florida; and Amarillo, Austin, Dallas, El Paso, and Houston in Texas. Cinemark, Tickets & Showtimes, at <http://www.cinemark.com/tspage.asp> (last visited Apr. 15, 2004). Century Theaters, the seventh largest circuit in the U.S., charges between \$0.25 and \$0.50 more for Friday and Saturday shows in some of its theaters than it charges on other days of the week. Examples of towns in which Century Theaters employs weekend pricing include Mountain View, Orange, and Redwood City in California, and Evanston in Illinois. See, e.g., Fandango, Theater Showtimes: Century 12 Evanston, at [http://www.fandango.com/theater.asp?distance=15&chain\\_id=CENT&theater\\_id=12031&refreshdate=4/15/2004&from=](http://www.fandango.com/theater.asp?distance=15&chain_id=CENT&theater_id=12031&refreshdate=4/15/2004&from=) (last visited Apr. 15, 2004).

<sup>37</sup> See *infra* Section III.F.

<sup>38</sup> ROBERT K. HEADLEY, MOTION PICTURE EXHIBITION IN WASHINGTON, D.C.: AN ILLUSTRATED HISTORY OF PARLORS, PALACES AND MULTIPLEXES IN THE METROPOLITAN AREA, 1894-1997, at 206-07 (1999).

<sup>39</sup> Thomas R. King, *Coming Soon: Cut-Rate Films on Tuesday*, WALL ST. J., Feb. 13, 1992, at B1.

<sup>40</sup> Don Groves, *Refocus Includes Exhibition Cutbacks*, VARIETY, Dec. 4-10, 2000, at 47.

<sup>41</sup> See, e.g., ARTHUR DE VANY, HOLLYWOOD ECONOMICS: HOW EXTREME UNCERTAINTY SHAPES THE FILM INDUSTRY (2004); see also *infra* Section III.B.

<sup>42</sup> See, e.g., Arthur De Vany & W. David Walls, *Uncertainty in the Movie Industry: Does Star Power Reduce the Terror of the Box Office?*, 23 J. CULTURAL ECON. 285 (1999).

<sup>43</sup> See, e.g., Steven Albert, *Movie Stars and the Distribution of Financially Successful Films*

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Another factor is production costs, with which gross box office revenues are strongly correlated, with simple correlation coefficients of 0.5 to 0.7 for each year between 1985 and 1999.<sup>44</sup> Similar correlation coefficients characterize the relationship between the performance of sequels and their originals.<sup>45</sup> Other factors relevant to commercial success are participation of top directors, ratings (for example, G or PG), competition from other movies, and advertising.<sup>46</sup> These factors are not perfect predictors but are reliable enough in the eyes of industry professionals to justify large expenditures for their study.<sup>47</sup>

Although it would probably be impossible to price each movie according to its estimated demand, price differentiation across categories of movies may improve financial results. For example, charging premiums for event movies, such as high-budget films and sequels of successful films, makes economic sense and may even increase the demand for such movies if prices signal movie quality.<sup>48</sup> By the same token, giving discounts on children's movies and documentaries may attract more patrons.

### II. A Concise History of the Motion Picture Industry's Pricing Systems

Uniform pricing at the box office in its present form appeared in the early 1970s. The persistence of the practice for more than thirty years adds some mystery to the puzzle of uniform prices, as the length of the period

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*in the Motion Picture Industry*, 22 J. CULTURAL ECON. 249 (1998); E. Ray Canterbery & A. Marvasti, *The U.S. Motion Pictures Industry: An Empirical Approach*, 19 REV. INDUS. ORG. 81 (2001); Gorham Kindem, *Hollywood's Movie Star System: A Historical Overview*, in THE AMERICAN MOVIE INDUSTRY: THE BUSINESS OF MOTION PICTURES 79 (Gorham Kindem ed., 1982); S. Abraham Ravid, *Information, Blockbusters and Stars: A Study of the Film Industry*, 72 J. BUS. 463 (1999); W. Timothy Wallace et al., *The Role of Actors and Actresses in the Success of Films: How Much Is a Movie Star Worth?*, 17 J. CULTURAL ECON. 1 (1993); see also Cathy Klapat, *The Star as Market Strategy: Bette Davis in Another Light*, in THE AMERICAN FILM INDUSTRY 351 (Tino Balio ed., rev. ed. 1985).

<sup>44</sup> Jay Prag & James Casavant, *An Empirical Study of the Determinants of Revenues and Marketing Expenditures in the Motion Picture Industry*, 18 J. CULTURAL ECON. 217 (1994); see also Einav, *supra* note 31.

<sup>45</sup> Ravid, *supra* note 43, at 476.

<sup>46</sup> De Silva, *supra* note 26; Barry R. Litman & Hoekyun Ahn, *Predicting Financial Success of Motion Pictures: The Early '90s Experience*, in THE MOTION PICTURE MEGA-INDUSTRY 172 (Barry R. Litman ed., 1998); Barry R. Litman & Linda S. Kohl, *Predicting Financial Success of Motion Pictures: The 80's Experience*, 17 J. MEDIA ECON. 35 (1989); Ravid, *supra* note 43.

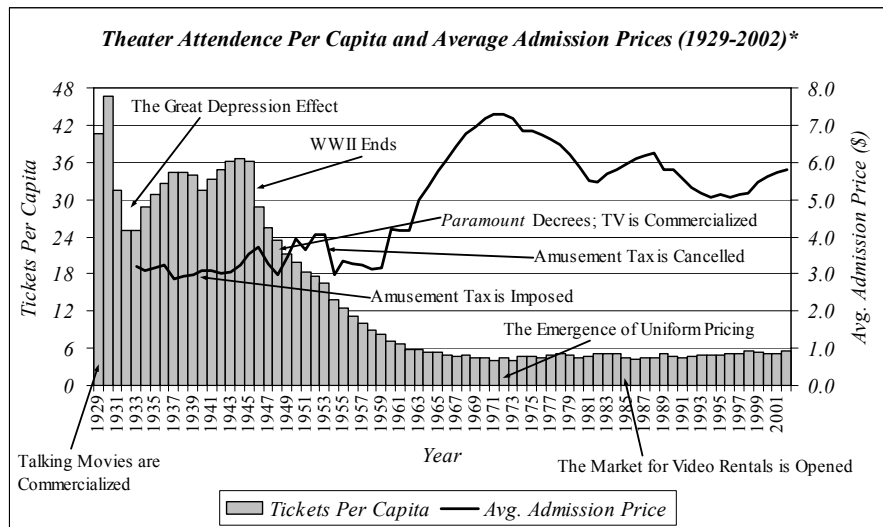
<sup>47</sup> See, e.g., BRUCE A. AUSTIN, IMMEDIATE SEATING: A LOOK AT MOVIE AUDIENCES 9-24 (1989); Gerben Bakker, *Building Knowledge About the Consumer: The Emergence of Market Research in the Motion Picture Industry*, 45 BUS. HIST. 101 (2003).

<sup>48</sup> To some extent, event movies may have the characteristics of luxury goods, the demand for which increases with their price. See generally CHRISTOPHER J. BERRY, THE IDEA OF LUXURY: A CONCEPTUAL AND HISTORICAL INVESTIGATION (1994); Simon Kemp, *Perceiving Luxury and Necessity*, 19 J. ECON. PSYCHOL. 591 (1998) (explaining the concept of luxury goods). A famous example of using prices to establish luxury-good status is the case of Russian vodka. Marketers of Russian vodka failed to spur a demand for their product until they purposefully raised prices. Patricia Winters, *The Princely Profits and Allure of Premium Brands*, N.Y. TIMES, July 9, 1989, at F13.

could arguably serve as evidence of its efficiency. This Part studies the history of the industry’s pricing systems in their technological, economic, and legal contexts. It shows how the consistent domination of the upstream market—the distribution segment—by a few powerful players has influenced the evolution of the industry’s pricing systems.

Systematic data on the dispersion of admission prices could not be collected, and, therefore, a quantitative analysis of the pricing systems was not possible. Figure 2 presents a summary of the available information on movie theater attendance and inflation-adjusted average ticket prices as periodically published in industry trade publications. Some distortions in average admission prices are possible, as the methodology of calculating these figures is unknown. Nevertheless, a summary presentation of the available data is helpful for understanding general trends in the history of box office pricing systems. In particular, as discussed in the following Sections, sharp changes in attendance and in average admission prices paralleled developments in the pricing of movie tickets.

FIGURE 2



\* Prices are adjusted to 2002.  
 DATA SOURCES: NAT'L ASS'N OF THEATER OWNERS, THE ENCYCLOPEDIA OF EXHIBITION (2003-2004); MOTION PICTURE ALMANAC (1929-1945, 2002); BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CONSUMER PRICE INDEX: ALL URBAN CONSUMERS (2004), <ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.ai.txt>; COBBETT S. STEINBERG, FILM FACTS 44 (1980).

## Antitrust and Pricing in the Motion Picture Industry

### A. *Early Days (1894-1905)*

#### 1. Peepshow Machines (1894-1895)

The movie theater industry was born on April 14, 1894, with the opening of the Holland Brothers' amusement arcade at 1155 Broadway in New York City. The Holland Brothers bought ten Kinetoscope peepshow machines from Thomas Edison and arranged them in a converted shoe store in two rows of five, with brass rails for customers to lean on during the film. Each machine offered a different film that lasted twenty seconds, and patrons paid twenty-five cents to view all five machines in one of the two rows.<sup>49</sup>

Shortly after the introduction of the Kinetoscope, Edison developed nickel-in-the-slot machines to cut down on exhibitors' manpower.<sup>50</sup> This innovation might have lowered exhibitors' operation costs, but it also fixed the admission price per movie. Given the length of movies at the time, which made demand more uniform across the day since such short films could be viewed even on breaks from work, and the fact that they only presented scenes,<sup>51</sup> pricing movies uniformly made commercial sense. It is difficult, however, to understand why Edison offered a machine that technologically constrained exhibitors' pricing. Even when uniform prices were warranted, the desirable price level varied geographically, and such price variation was impossible with the nickel-in-the-slot machine. This rigid pricing constraint partially explains why the Mutoscope, a penny-in-the-slot machine, took over the peep-show market from Edison.<sup>52</sup>

#### 2. Projecting Machines (1896-1905)

Thomas Edison perceived motion pictures as a short form of entertainment, publicly declined proposals to develop a projecting machine, and dedicated only limited resources to such a project in a secret laboratory.<sup>53</sup> Other entrepreneurs in Europe, England, and the United

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49 For the early history of peepshows, see CHARLES MUSSER, *THE EMERGENCE OF CINEMA: THE AMERICAN SCREEN TO 1907*, 12-89 (1990); DAVID ROBINSON, *FROM PEEP SHOW TO PALACE: THE BIRTH OF AMERICAN FILM* 2-51 (1996). Many of Edison's movies were digitalized and can be found online at Library of Congress: American Memory Web Site, Edison Motion Pictures, at <http://memory.loc.gov/ammem/edhtml/edmvhm.html> (last visited Mar. 24, 2004).

50 Kenneth Macgowan, *The Coming of Camera and Projector—Part II*, 9 Q. FILM, RADIO & TELEVISION 124, 131-32 (1954-1955).

51 Two of the popular movies of that era were a short show of the famous bodybuilder, Eugen Sandow, from 1894, see Eugen Sandow on Film, at <http://www.sandowmuseum.com/sandowfilm.html> (last visited Mar. 24, 2004), and *The Kiss*, from 1896, which filmed a kissing scene from the play *The Widow Jones* with May Erwin and John Rice and presented the first kisses on film. See PATRICK ROBERTSON, *FILM FACTS* 67 (2001).

52 Macgowan, *supra* note 50, at 135-36.

53 MAE D. HUETTIG, *ECONOMIC CONTROL OF THE MOTION PICTURE INDUSTRY: A STUDY*

States realized the potential of projectors as a means for mass marketing of motion pictures. Independently and simultaneously, they invented projecting machines that were introduced in 1895 and early 1896.<sup>54</sup> Following the public interest in movies on screen, Edison gave his name and sponsorship to one of the fledgling technologies, the Vitascope,<sup>55</sup> and soon a rivalry among the various technologies developed.<sup>56</sup> An important characteristic of this competition was the rapid technological convergence to Kodak's 35 millimeter film as the industry standard.<sup>57</sup> This convergence enhanced competition among producers, since exhibitors were not technologically tied to incompatible film standards.

Competition, however, was not indicative of profitability. Around 1900, the industry experienced the first box office downturn as the public lost interest in the technology. The key to the industry's quick recovery two years later was the creation and development of story films that, among other things, differentiated the products on the market.<sup>58</sup>

By the end of 1905, motion pictures were shown in thousands of store shows, vaudeville theaters, and amusement parks throughout the country and by many traveling exhibitors.<sup>59</sup> Admission fees charged by these theaters and traveling exhibitors varied according to the projector's technology, the movie's popularity, and the exhibition conditions and location. For example, prices at vaudeville theaters ranged from ten to thirty-five cents depending on seat location and day of the week, while prices at premiere vaudeville theaters in major cities could reach as much as \$1.50.<sup>60</sup>

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IN INDUSTRIAL ORGANIZATION 9-12 (1944); TERRY RAMSAYE, A MILLION AND ONE NIGHTS 119-21 (1926); Macgowan, *supra* note 50, at 135-36. Most contemporary scholars believe that Edison thought motion pictures would be a temporary fad and credit Edison's assistant, William Kennedy Laurie Dickson, with the invention and development of the Kinetoscope. See, e.g., CHARLES MUSSER, THOMAS A. EDISON AND HIS KINETOGRAPHIC MOTION PICTURES (1995).

54 MUSSER, *supra* note 49, at 91-105; ROBINSON, *supra* note 49, at 53-66.

55 RAMSAYE, *supra* note 53, at 223-31.

56 HUETTIG, *supra* note 53, at 12-13; MUSSER, *supra* note 49, at 109-89; ROBINSON, *supra* note 49, at 59-66; Robert C. Allen, *Vitascope/Cinématographe: Initial Patterns of American Film Industrial Practice*, 31 J. U. FILM ASS'N 13 (1979); Macgowan, *supra* note 50, at 132-36.

57 Macgowan, *supra* note 50, at 134.

58 MUSSER, *supra* note 49, at 297-369. The most celebrated, although not the first, movie of the early story-telling films is *The Great Train Robbery*, which opened in November 1903. See Library of Congress: American Memory Web Site, Edison Motion Picture & Sound Recordings: The Great Train Robbery, at <http://memory.loc.gov/ammem/edhtml/gtr.html> (last visited Mar. 24, 2004).

59 DOUGLAS GOMERY, SHARED PLEASURES: A HISTORY OF MOVIE PRESENTATION IN THE UNITED STATES 4-16 (1992); Robert C. Allen, *The Movies in Vaudeville: Historical Context of the Movies as Popular Entertainment*, in THE AMERICAN FILM INDUSTRY 57 (Tino Balio ed., rev. ed. 1985). For traveling exhibitors in that era, see CHARLES MUSSER, HIGH-CLASS MOVING PICTURES: LYMAN H. HOWE AND THE FORGOTTEN ERA OF TRAVELING EXHIBITION, 1880-1920 (1991).

60 RICHARD ABEL, THE RED ROOSTER SCARE: MAKING CINEMA AMERICAN, 1900-1910, at 36 (1999); ROBINSON, *supra* note 49, at 45-87; BARBARA STONES, AMERICA GOES TO THE MOVIES 5-18 (1993). See also Taso G. Lagos, *Film Exhibition in Seattle, 1897-1912: Leisure Activity in a Scraggly, Smelly Frontier Town*, 23 HIST. J. FILM, RADIO & TELEVISION 101, 104-05 (2003).

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### B. *Nickelodeons and the Monopolization of Production and Distribution (1905-1915)*

#### 1. Uniform Prices at the Nickelodeon

Uniform admission fees as the primary pricing policy in the movie theater industry first appeared at the nickelodeon theater.<sup>61</sup> The nickelodeons, which sprung up across the country between 1905 and 1914,<sup>62</sup> were named after their early uniform admission fee of five cents per movie and kept the name when their ticket price went up to ten cents.<sup>63</sup> The business concept of the nickelodeon was simple: Offer cheap movies to large numbers of patrons through daily programs which run several times a day. Shows lasted from ten to twenty minutes, and charging nickels and dimes facilitated fast turnover of patrons, as it saved some transaction time.<sup>64</sup> Movies in that era were standardized and produced in a few forms, had simple plots and no sound, and were priced to exhibitors initially by the foot<sup>65</sup> and later according to the theater classification.<sup>66</sup> The one-reel movies of the nickelodeon age were a cheap commodity consumed by moviegoers “on the way to work, on a lunch break, when returning home or later in the evening.”<sup>67</sup> Given the product commodification and limited product differentiation, uniform admission prices were economically reasonable. The standardization of movies during the nickelodeon age, however, was a product of the monopolization of the production and distribution segments and would not endure.<sup>68</sup>

#### 2. The Trust

As the industry realized the commercial promise of motion pictures, many patent battles were fought during the decade following the introduction of projecting machines.<sup>69</sup> In September 1908, the major rivals

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61 It is believed that the first nickelodeon opened in Pittsburgh in June 1905. For the birth and early days of the nickelodeons, see MUSSER, *supra* note 49, at 417-95. Some inconclusive evidence indicates that in 1902 a nickelodeon opened in Seattle. Lagos, *supra* note 60, at 107-08.

62 For important studies of the nickelodeons in Manhattan and Boston, see Robert C. Allen, *Motion Picture Exhibition in Manhattan 1906-1912: Beyond the Nickelodeon*, 18 CINEMA J. 2 (1979); Russell Merritt, *Nickelodeon Theaters, 1905-1914: Building an Audience for Movies*, in THE AMERICAN FILM INDUSTRY 83 (Tino Balio ed., rev. ed. 1985).

63 The nickelodeons' admission prices were doubled from nickels to dimes around 1909, when exhibitors realized that moviegoers were willing to pay more for watching movies in better theaters. BENJAMIN B. HAMPTON, A HISTORY OF THE MOVIES 61 (1931).

64 GOMERY, *supra* note 59, at 18-33; STONES, *supra* note 60, at 19-33.

65 HOWARD T. LEWIS, THE MOTION PICTURE INDUSTRY 7 (1933).

66 HAMPTON, *supra* note 63, at 72-82 (1931).

67 STONES, *supra* note 60, at 21.

68 See *infra* Subsection II.B.3.

69 See, e.g., *Edison v. Am. Mutoscope & Biograph Co.*, 151 F. 767 (2d Cir. 1907); *Armat Moving Picture Co. v. Edison Mfg. Co.*, 125 F. 939 (2d Cir. 1903); *Edison v. Lubin*, 122 F. 240 (3d



joined forces and formed the Motion Picture Patents Company, commonly known as the "Trust." The Trust gained control over the industry by pooling all of the patents of any importance in the early motion picture industry.<sup>70</sup> To prevent entry into its markets, the Trust established a complex nexus of licenses and agreements that restricted transactions among machine manufacturers, film producers, distributors, and exhibitors only to licensed agents.<sup>71</sup> In addition, the Trust entered into an exclusive dealing agreement with Eastman Kodak, whereby Eastman Kodak sold raw films only to licensed producers and charged them pass-through royalties paid to the Trust, effectively charging producers according to their use of the camera. In return, the Trust's licensees were obligated to purchase raw film only from Eastman Kodak.<sup>72</sup> At the time, Eastman Kodak was the only domestic manufacturer of raw film, and the agreement enabled it to maintain its market hold. Likewise, the Trust-Kodak agreement foreclosed potential competitors of the Trust, as it barred access to a key source of a necessary input. Additionally, the Trust aggressively filed patent suits against unlicensed businesses<sup>73</sup> and allegedly hired detectives, gunmen, and gangsters to deter unlicensed producers.<sup>74</sup>

The Motion Picture Patents Company further tightened its control through its distribution arm, the General Film Company, a sister company organized in April 1910 by ten licensed producers and film importers. The General Film Company organized its operations by purchasing existing film exchanges rather than establishing new ones.<sup>75</sup> When it began operations in June 1910, there were sixty-nine independent licensed

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Cir. 1903); *Edison v. Am. Mutoscope*, 114 F. 926 (2d Cir. 1902). See generally Martin Sopocy, *The Edison-Biograph Patent Litigation of 1901-1907*, 3 FILM HIST. 11 (1989).

<sup>70</sup> For the events that led to the formation of the motion picture industry, see EILEEN BOWSER, *THE TRANSFORMATION OF CINEMA, 1907-1915*, in 2 HISTORY OF THE AMERICAN CINEMA 21-36 (1990).

<sup>71</sup> For a detailed study of the Trust's constituting documents and side agreements, see Ralph Cassady, Jr., *Monopoly in Motion Picture Production and Distribution: 1908-1915*, 32 S. CAL. L. REV. 325, 329-45 (1959).

<sup>72</sup> *Id.* at 333-35.

<sup>73</sup> See, e.g., *Motion Picture Patents Co. v. Indep. Moving Pictures Co. of Am.*, 200 F. 411 (2d Cir. 1912); *Motion Picture Patents Co. v. Yankee Film Co.*, 187 F. 1007 (2d Cir. 1911); *Motion Picture Patents Co. v. Centaur Film Co.*, 217 F. 247 (D.N.J. 1914); *Motion Picture Patents Co. v. Laemmle*, 214 F. 787 (S.D.N.Y. 1914); *Motion Picture Patents Co. v. Champion Film Co.*, 183 F. 986 (S.D.N.Y. 1910); *Motion Picture Patents Co. v. Ullman*, 186 F. 174 (S.D.N.Y. 1910); *Motion Picture Patents Co. v. Laemmle*, 178 F. 104 (S.D.N.Y. 1910); *Motion Picture Patents Co. v. N.Y. Motion Picture Co.*, 174 F. 51 (E.D.N.Y. 1909). See also HAMPTON, *supra* note 63, at 72-82.

<sup>74</sup> FRED J. BALSHOFER & ARTHUR C. MILLER, *ONE REEL A WEEK* 34, 36-37, 50, 62-64 (1967); HAMPTON, *supra* note 63, at 72-82; KENNETH MACGOWAN, *BEHIND THE SCREEN: THE HISTORY AND TECHNIQUES OF THE MOTION PICTURE* 137 (1965); RAMSAYE, *supra* note 53, at 534; Cassady, *supra* note 71, at 365-66 n.227.

<sup>75</sup> Until 1902, moving pictures were purchased by exhibitors and then resold on secondary markets. Starting in 1902, established companies formed film exchanges that purchased films from producers and exhibitors and rented them to exhibitors. In the nickelodeon era, exhibitors stopped purchasing films, and film distribution was channeled only through exchanges. See HUETTIG, *supra* note 53, at 13; MUSSER, *supra* note 49, at 365-68, 433-38.

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exchanges. Within three months of operations, it acquired twenty-three exchanges. Within another fifteen months, ten independent, licensed exchanges lost their licenses; the General Film Company owned fifty-eight exchanges; and the only independent, licensed exchange left was William Fox's Greater New York Film Rental Company.<sup>76</sup> The Trust's indirect control over the distribution segment made it more difficult for independent producers and importers to market films, and they were forced to rely on unlicensed exchanges or to establish their own exchanges.<sup>77</sup>

As for intervention in pricing mechanisms, the Trust fixed prices charged by producers to distributors but did not set prices charged to exhibitors and moviegoers.<sup>78</sup> However, once the General Film Company took over the distribution segment, one entity determined the prices charged to almost all licensed exhibitors.

### 3. Product Standardization and Box Office Pricing

The exhibitors created and maintained the uniform pricing regime of the nickelodeon era, but this regime persisted due to the monopolization of production and distribution by the Motion Picture Patents Company and the General Film Company. The uniform pricing regime fit the standardization of production dictated by the Trust: low budget, one-reel films with assembly-line formulas.<sup>79</sup> The standardization eliminated much of the potential product differentiation, thereby sustaining uniform pricing.

Uniform prices during the nickelodeon age reflected one type of social cost associated with monopolies. The pricing system was efficient given the lack of competition in film technology and quality. However, the lack of competition resulted in a low variety of products that, in turn, entailed some welfare loss. More than anything else, the nickelodeons' uniform pricing reflected the impact of monopolization on product

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<sup>76</sup> Cassady, *supra* note 71, at 355-59. Professor Cassady believed that the principal goal of the General Film Company was to enhance efficiency in the distribution segment.

<sup>77</sup> BOWSER, *supra* note 70, at 73-85; Cassady, *supra* note 71, at 362-86.

<sup>78</sup> Cassady, *supra* note 71, at 336-37, 341, 346-47.

<sup>79</sup> See BOWSER, *supra* note 70, at 53-71, 103-19 (attributing the standardization of movies primarily to the need for a simple plot for a diverse audience of immigrants and to the fact that early filmmakers were businessmen and technicians, rather than artists); STONES, *supra* note 60, at 27-30; Michael Quinn, *Distribution, the Transient Audience, and the Transition to the Feature Film*, 40 CINEMA J. 35 (2001). Various case studies of the nickelodeon era contradict the view that nickelodeons served primarily poor immigrants and that the demand was for simple, short plots that would be understood by such audiences. See, e.g., HUETTIG, *supra* note 53, at 18-20 (attributing the Trust's fixation on standardization to the inventor generation's misunderstanding of the exhibition business); Merritt, *supra* note 62; Allen, *supra* note 62. See also HAMPTON, *supra* note 63, at 105-20 (arguing that the fixation on standard, short films resulted from marketing problems and efforts to sustain the existing system); Richard Barry, *Five Dollar Movies Prophesied*, N.Y. TIMES, Mar. 28, 1915, at SM16 (interviewing American feature pioneer David Griffith, who linked movie quality to admission prices).

diversity.

The uniform price system of the nickelodeon era, however, was not as firm as today's uniform pricing regime. Several filmmakers and actors sparked through the technological and conceptual barriers of the era and charged premiums for their popularity. Exhibitors, in turn, passed on the extra costs of special releases and of movies with well-known stars by raising admission fees for such movies.<sup>80</sup> Premiums were also charged by some theaters in which there were narrators or players ("talking picture plays").<sup>81</sup>

#### 4. Competition and Product Differentiation

In 1912, multiple-reel films with substantive plots and significant promotion budgets ("features") were successfully introduced to the American public by independent producers and spelled the end of the nickelodeon era and its uniform pricing regime.<sup>82</sup> In the same year, the government filed an antitrust action against the Motion Picture Patents Company, the General Film Company, and their members.<sup>83</sup> The court dismissed the defendants' argument that, as a business of dramatic representation, the motion picture business is a form of art, not of trade. The court also held that the defendants' patents did not exempt them from the Sherman Act. The defendants were found to have engaged in unreasonable restraints of trade and to have monopolized commerce in films, cameras, projectors, and accessories. The patent agreements were found to have been made primarily to exclude rivals from the motion picture business and to control the supply and price of motion pictures.<sup>84</sup> Shortly after this defeat, the Motion Picture Patents Company lost a key patent infringement suit on antitrust grounds. Its tying practices of films to

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80 BOWSER, *supra* note 70, at 47; Ralph Cassady, Jr., *Monopoly in Motion Picture Production and Distribution: 1908-1915*, in *THE AMERICAN MOVIE INDUSTRY: THE BUSINESS MOTION PICTURE* 25, 44 (Gorham Kindem ed., 1982), *revised and reprinted in* 32 S. CAL. L. REV. 325 (1959).

81 BOWSER, *supra* note 70, at 19, 44.

82 *Id.* at 191-215; STONES, *supra* note 60; Cassady, *supra* note 71, at 374-86. *See also* ADOLPH ZUKOR, *THE PUBLIC IS NEVER WRONG: MY FIFTY YEARS IN THE MOTION PICTURE INDUSTRY* 3-4, 19-20, 56-58, 75-89 (describing the introduction of features by independent producers and the general reluctance of the Trust to produce and distribute features). (Zukor founded Famous Players, which eventually became part of Paramount Pictures.) The first features that were hits at the box office were *Queen Elizabeth*, which was imported from France in 1912 and ran for forty minutes, and *Quo Vadis*, which was imported from Italy in 1913, ran for 120 minutes, and was priced at \$1 for early shows. The breakthrough domestic production was Griffith's *The Birth of a Nation*, which opened in 1915, ran for 2.5 hours, and charged the then-highest fee of \$2. For a discussion of feature pricing, see *Economics of the Movies*, N.Y. TIMES, Dec. 28, 1914, at 8.

83 *See* Brief for the United States, *United States v. Motion Picture Patents Co.*, 225 F. 800 (E.D.Pa. 1915) (No. 889), *reprinted in* 1 FILM HIST. 187 (1987).

84 *United States v. Motion Picture Patents Co.*, 225 F. 800 (E.D. Pa. 1915). For an analysis of the anticompetitive effects of patent pools, see George L. Priest, *Cartels and Patent License Arrangements*, 20 J.L. & ECON. 309 (1977).

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distribution and to projectors were held illegal under Section 3 of the Clayton Act.<sup>85</sup>

Following these suits and the emergence of features, the Trust's market power declined, and in 1918 it dissolved after one of its pivotal patents was held invalid.<sup>86</sup> The demise of the Motion Picture Patents Company and of the General Film Company left the market to the independent producers and large exhibitors, which by then had already accumulated significant market power.

### C. *The Reign of the Organized Distributors (1915-1950)*

#### 1. Transformation of the Industry

##### a. Structural and Business Developments

General business developments which utilized economies of scale, "scientific management,"<sup>87</sup> and growing production costs led to the organization of large theater circuits and various forms of vertical integration in the industry.<sup>88</sup> The consolidation and expansion trends originated in pursuit of efficiency gains but continued with the race by the vertically integrated players to accumulate market power through further consolidation and expansion. Between 1915 and 1948, the industry underwent several waves of business expansion and contraction; some of the major industry players merged, and others dissolved. During most of the period eight powerful national distributors (the "Organized Distributors") dominated the industry.<sup>89</sup> Five of these distributors integrated production, distribution, and exhibition (the "Majors");<sup>90</sup> two Organized Distributors integrated production and distribution;<sup>91</sup> and the

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<sup>85</sup> Motion Picture Patents Co. v. Universal Film Mfg. Co., 235 F. 398 (2d Cir. 1916).

<sup>86</sup> The Latham Loop patent, which enabled the projection of thousand-foot reels, was held invalid in January 1918. Motion Picture Patents Co. v. Cahuff Supply Co., 248 F. 724 (E.D. Pa. 1918). See generally Jeanne Thomas, *The Decay of the Motion Picture Patents Company*, 10 CINEMA J. 34 (1971).

<sup>87</sup> The term "scientific management" was coined by Frederick Winslow Taylor, the pioneer of efficiency engineering, in his influential book, *THE PRINCIPLES OF SCIENTIFIC MANAGEMENT* (1911).

<sup>88</sup> See generally Douglas Gomery, *The Movies Become Big Business: Publix Theatres and the Chain-Store Strategy*, in *THE AMERICAN MOVIE INDUSTRY: THE BUSINESS OF MOTION PICTURES* 104 (Gorham Kindem ed., 1982); Douglas Gomery, *U.S. Film Exhibition: The Formation of a Big Business*, in *THE AMERICAN FILM INDUSTRY* 218 (Tino Balio ed., rev. ed. 1985); HUETTIG, *supra* note 53, at 31-39; RICHARD KOSZARSKI, *AN EVENING'S ENTERTAINMENT: THE AGE OF THE SILENT FEATURE PICTURE, 1915-1928*, in *3 HISTORY OF THE AMERICAN CINEMA* 65-94 (1990).

<sup>89</sup> For a concise presentation of the players, see *United States v. Paramount Pictures Inc.*, 70 F. Supp. 53, 55-60 (S.D.N.Y. 1946).

<sup>90</sup> These players evolved into Paramount, Loew's, Radio-Keith-Orpheum ("RKO"), Twentieth Century-Fox Film, and Warner Brother Pictures. *Id.* at 56-58.

<sup>91</sup> Columbia and Universal. *Id.* at 58-59.

eighth Organized Distributor primarily distributed independent films.<sup>92</sup> Perhaps the most peculiar characteristic of the movie theater industry during this era was the Majors' substantial ownership stake in most of the important theaters in the country.<sup>93</sup> This feature explains their strong interest in admission prices.<sup>94</sup>

At the exhibition level, features offered new opportunities to organize exhibition enterprises: Build large, fancy, and comfortable theaters that could accommodate more than a thousand patrons each, and charge premiums for the convenience, the luxury, and the movie itself.<sup>95</sup> Large theaters of 800 seats or more had already appeared in 1909, before the introduction of features. With the arrival of features, movie palaces of over 1500 seats appeared and dominated the exhibition segment until the Great Depression.<sup>96</sup> Large theaters employed price differentiation across seats: Orchestra seats could cost twice as much as balcony seats, which cost still more than floor seats.<sup>97</sup>

#### b. Distributors' Control over Pricing

Cross-seat price differentiation was not the only, or even the major, development of the era. Beginning in the early 1920s, exhibitors were no longer free to set admission prices; rather, virtually all the distribution contracts stipulated minimum admission price requirements,<sup>98</sup> derived from a new distribution system. The new pricing system integrated three principal marketing practices: intertemporal pricing, film grading, and block-booking.

*Intertemporal Pricing.* During the nickelodeon age, movie rentals were set according to the film's length or theater classification.<sup>99</sup> Under the new system, theaters were classified according to their affiliation, luxuriousness, age, and location. Based on this classification, a "run-clearance-zone" system was established: In any defined geographic

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92 United Artists. *Id.* at 60.

93 DANIEL BERTRAND ET AL., *THE MOTION PICTURE INDUSTRY: A PATTERN OF CONTROL* 9-13 (Temp. Nat'l Econ. Comm., Monograph No. 43, 1941); HUETTIG, *supra* note 53, at 74-84.

94 CONANT, *supra* note 1, at 48-57; HUETTIG, *supra* note 53, at 54-95.

95 See BOWSER, *supra* note 70, at 121-36; STONES, *supra* note 60, at 28-61. One of the luxuries of the palaces was air conditioning. See GAIL COOPER, *AIR-CONDITIONING AMERICA, 1900-1960*, at 80-109 (1998). For an illustration of the variation in admission fees across theaters of different sizes, see KOSZARSKI, *supra* note 88, at 12-13.

96 For a comprehensive study of the movie palace age, see BEN M. HALL, *THE BEST REMAINING SEATS: THE GOLDEN AGE OF THE MOVIE PALACE* 93 (1961).

97 *Regulation of Motion Picture Theater Ticket Sales: Hearing Before the Subcomm. of the Comm. on the D.C.*, 72d Cong. 8-9, 19-20 (1932) (statements of A. Julian Brylawski, President, Motion Picture Theater Owners of the District of Columbia, and T. R. Shearer, a moviegoer); STONES, *supra* note 60, at 28. See also *\$10 To See Griffith Film*, N.Y. TIMES, Aug. 28, 1920, at 11.

98 BERTRAND ET AL., *supra* note 93, at 41, 45-49; CONANT, *supra* note 1, at 69-70. See also *United States v. Paramount Pictures, Inc.*, 66 F. Supp. 323, at 334-41.

99 See *supra* text accompanying notes 65-66.

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location (“zone”), a given movie played at one theater (“run”), and another theater within the same zone could show the same movie only after a defined period lapsed (“clearance”).<sup>100</sup> This allowed the Organized Distributors and several other players to benefit from the variation in the demand. The system, however, did not equally benefit all exhibitors, as it systematically favored theaters affiliated with the Majors or with large circuits. As a result, and given the minimum price requirements, independent, small exhibitors often faced difficulties in attracting audiences.<sup>101</sup>

Within a few years of the establishment of the run-clearance-zone system, the terms each exhibitor obtained from each one of the eight Organized Distributors became very similar.<sup>102</sup> This convergence to the run-clearance-zone system was not the outcome of a competitive evolutionary process. Defining zoning protection, establishing clearance schedules, and stipulating minimum admission fees were intricate procedures, which were subject to intense negotiations between distributors and exhibitors. It is implausible that the outcomes of such negotiations were close to uniform without exploitation of market power by large circuits, some coordination among the distributors, or at least conscious parallelism.<sup>103</sup> *Interstate Circuit v. United States* illustrates one manner of anticompetitive convergence.<sup>104</sup> In *Interstate Circuit*, the manager of two large circuits in New Mexico and Texas sent an identical letter to each of the eight Organized Distributors. Each letter named all the Organized Distributors and made two demands as a condition of playing the distributors’ films in first-run theaters at night for an admission fee of forty cents or more. One demand was that the admission fee in subsequent runs would not be less than twenty-five cents. The other demand was that patrons of an A movie would not be offered another feature free, a common practice at the time that was known as “double-features.”<sup>105</sup> All Organized Distributors complied with the demands. A judgment against the defendants was granted on the grounds that the distributors had agreed among themselves to raise the prices of Interstate’s rivals.<sup>106</sup>

*Film Grading.* One advantage of the leading producers of the time over the Trust they replaced was their understanding of the potential profitability of product differentiation in the motion picture industry.<sup>107</sup>

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100 BERTRAND ET AL., *supra* note 93, at 40-45; HUETTIG, *supra* note 53, at 125-31.

101 *See Paramount*, 334 U.S. at 352-53. *See also* BERTRAND ET AL., *supra* note 93, at 40-49.

102 BERTRAND ET AL., *supra* note 93, at 40; HUETTIG, *supra* note 53, at 127-30.

103 HUETTIG, *supra* note 53, at 127-28.

104 306 U.S. 208 (1939).

105 *Id.* at 217.

106 *Id.* at 228-32.

107 Quinn, *supra* note 79. *See also Calls on Movies To Reduce Price*, N.Y. TIMES, Dec. 27, 1914, at 11.

Already before 1920, production lines of varying quality formed based on budget, leading actors' popularity, genre, and story quality.<sup>108</sup> Films from these production lines were graded A, B, or C, and admission prices were set accordingly.

*Block-Booking.* Block-booking involves licensing motion pictures as a package, without allowing the exhibitor to select specific movies in the package. Block-booking was often combined with blind-selling, a practice whereby a distributor licenses a feature before the exhibitor has an opportunity to view it. Since its invention in 1917,<sup>109</sup> the practice of block-booking has been, and still is, an endless source of litigation and academic debate.<sup>110</sup> For the purpose of this Article, the interesting characteristic of block-booking during this era is that, although exhibitors paid one price for a bundle of movies, admission prices per movie varied across movies even for premieres.<sup>111</sup> In contrast, films today are licensed and priced to exhibitors on a movie-by-movie basis. Nevertheless, exhibitors charge one price for all movies.

To summarize, under the new pricing system, admission prices varied over time, across theaters, and across movies. The new pricing order as administered by the Organized Distributors was illegal, given that resale price maintenance had been a per se violation of the Sherman Act since 1911.<sup>112</sup> Nevertheless, there is some disagreement over whether the practice of uniform minimum admission price requirements decreased social welfare. Several scholars argue that the reduced competition in the

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108 HUETTIG, *supra* note 53, at 24-25; Tino Balio, *Feeding the Maw of Exhibition, in GRAND DESIGN: HOLLYWOOD AS A MODERN BUSINESS ENTERPRISE 1930-1939, in 5 HISTORY OF THE AMERICAN CINEMA* 98-107 (Tino Balio ed., 1993); Brian Taves, *The B Film: Hollywood's Other Half, in GRAND DESIGN: HOLLYWOOD AS A MODERN BUSINESS ENTERPRISE 1930-1939, in 5 HISTORY OF THE AMERICAN CINEMA* 313-50 (Tino Balio ed., 1993).

109 KOSZARSKI, *supra* note 88, at 71-72.

110 See, e.g., *United States v. Loew's, Inc.*, 371 U.S. 38 (1962); *Paramount*, 334 U.S. at 156-59; *In re Famous Players-Lasky Corp.*, 11 F.T.C. 187 (1927); *United States v. Twentieth Century Fox Film Corp.*, 882 F.2d 656 (2d Cir. 1989); *FTC v. Paramount Famous-Lasky Corp.*, 57 F.2d 152 (2d Cir. 1932). See also F. Andrew Hanssen, *The Block Booking of Films Reexamined*, 43 J.L. & ECON. 395 (2000); Roy W. Kenney & Benjamin Klein, *How Block Booking Facilitated Self-Enforcing Film Contracts*, 43 J.L. & ECON. 427 (2000); Roy W. Kenney & Benjamin Klein, *The Economics of Block Booking*, 26 J.L. & ECON. 497 (1983); George J. Stigler, *United States v. Loew's, Inc.: A Note on Block-Booking*, 1963 S. CT. REV. 152 (1963).

111 Cross-movie price variation is less surprising in subsequent runs than in first runs and premieres, because much of the uncertainty regarding the success of the movie is by then resolved.

112 *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). In 1937, Congress responded to the per se rule by giving the states the right to authorize resale price maintenance for sales within their borders. *Miller-Tydings Act of 1937*, 50 Stat. 693 (1937). Forty years later, Congress changed its mind, and the authorization was withdrawn by the *Consumer Goods Pricing Act of 1975*, 89 Stat. 101 (1975).

The per se rule has been heavily criticized as based on faulty economics but has not been overruled. In 1987, the Supreme Court reaffirmed the per se rule in *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 341-43 (1987). For criticism, see, for example, Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981); Lester G. Tesler, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960).

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exhibition segment did not entail any social welfare loss, because the declining pricing made movies affordable for all moviegoers.<sup>113</sup> However, the territorial segregation of theater control among the Majors<sup>114</sup> and various contractual arrangements, such as overbuying and selective contracts,<sup>115</sup> limited the variety of movies in many geographic areas.<sup>116</sup> Such a limited variety of products necessarily created some social welfare loss. Moreover, the collaboration of the Organized Distributors and the control of the Majors over the first-run theaters in major cities erected barriers to entry into the production and distribution markets, because rival producers and distributors had limited outlets for their films.<sup>117</sup> In turn, these entry barriers further limited the potential variety of films and generated additional social welfare loss.

### c. Price Variation Established by Exhibitors

Exhibitors also had a hand in creating price variation during the reign of the Organized Distributors. In addition to cross-seat price variation, exhibitors engaged in other pricing practices which utilized various dimensions of the demand for movies. The primary practice was charging admission fees higher than the required minimums on weekends and during holidays,<sup>118</sup> when the demand for watching movies was relatively inelastic. The corresponding practice of the Organized Distributors to this demand pattern was “designated play dates.” Since theaters at the time had only one screen, exhibitors had to allocate available movies over various show times, and the Organized Distributors used their market power to force exhibitors to play their movies at the best show times.<sup>119</sup>

Many exhibitors also offered indirect discounts in order to sell tickets below the stipulated minimum admission prices. Some examples of such

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113 See, e.g., De Vany & Eckert, *supra* note 14. For an analysis of the argument in the context of *Interstate Circuit*, see David A. Butz and Andrew N. Kleit, *Are Vertical Restraints Pro- or Anticompetitive? Lessons from Interstate Circuit*, 44 J. L. & ECON. 131 (2001).

114 For a description of the geographic segregation, see BERTRAND ET AL., *supra* note 93, at 12-17.

115 Overbuying is a practice whereby an exhibitor licenses more features than are necessary for the operation of a theater, thereby preventing competitors from securing enough good pictures to permit profitable operation. Selective contracting is a practice whereby an exhibitor contracts for all the pictures released by a distributor but obligates himself to use and pay for only a part of these.

116 For an illustration of the effect of geography on variety, see CONANT, *supra* note 1, at 63 (illustrating statistically that an affiliated theater rented significantly more features from the controlling distributor than from other distributors). See also BERTRAND ET AL., *supra* note 93, at 36-39.

117 J.A. ABERDEEN, *HOLLYWOOD RENEGADES: THE SOCIETY OF INDEPENDENT MOTION PICTURE PRODUCERS 44-77* (2000); BERTRAND ET AL., *supra* note 93, at 13-14, 16, 24; CONANT, *supra* note 1, at 35-39, 80-83. See also *infra* text accompanying note 119.

118 See, e.g., *Movie House Prices Cut*, N.Y. TIMES, Jan. 11, 1933, at 1; *Paramount Cuts Prices of Shows*, N.Y. TIMES, Feb. 24, 1947, at 21; A.H. Weiler, *Are Lower Prices Coming?*, N.Y. TIMES, Mar. 2, 1947, at 69.

119 BERTRAND ET AL., *supra* note 93, at 34-35.



discounts were double features, giveaways, free ladies' nights, and prizes. Probabilistic indirect discounts (lotteries) in various forms, including a chance to win a basket of groceries, became particularly common when the Great Depression hit the movie theater industry in 1931 and the permitted price cuts were insufficient to attract audiences.<sup>120</sup>

During the National Recovery Administration, 1933-1935, most indirect discounts were prohibited for the sake of "fair competition." Pursuant to the National Industrial Recovery Act of 1933,<sup>121</sup> the Administration and the industry promulgated a *Trade Code for Moving Picture Exhibitors*,<sup>122</sup> which provided a legal umbrella for the collusion of the Organized Distributors.<sup>123</sup> Several provisions of the Code purported to protect the interests of independent exhibitors. For example, the Code prohibited discrimination among theaters, overbuying, coercion, and bribing ("gratuit[ies]").<sup>124</sup> However, these prohibitions were not enforced.<sup>125</sup> On May 27, 1935, the Supreme Court declared the National Industrial Recovery Act unconstitutional and brought to an end the 450 codes that regulated the country's major industries.<sup>126</sup> Competitive pricing practices in the motion picture industry, however, continued to be publicly disputed until the Supreme Court decided *Paramount*.<sup>127</sup>

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120 STONES, *supra* note 60, at 75-84; Balio, *supra* note 108, at 26-30. As shown in *supra* Figure 2, the arrival of the talkies delayed the impact of the Great Depression on the movie theater industry.

121 National Industrial Recovery Act of 1933, Pub. L. No. 73-67, 48 Stat. 195 (1933).

122 The Code was published in *Text of Trade Code for Moving Picture Exhibitors*, WALL ST. J., Sept. 11, 1933, at 8 [hereinafter *Trade Code*]. For enforcement of these prohibitions, see *Theatre Accused of Violating Code*, N.Y. TIMES, Aug. 22, 1934, at 21.

123 BERTRAND ET AL., *supra* note 93, at 7-8; CONANT, *supra* note 1, at 32; Balio, *supra* note 108, at 18-21; J. Douglas Gomery, *Hollywood, the National Recovery Administration, and the Question of Monopoly Power*, 31 J.U. FILM ASS'N 47 (1979); Douglas Gomery, *Rethinking American Film History: The Depression Decade and Monopoly Control*, 10 FILM & HIST. 32 (1980). For the structure of the cartel system established by the Code, see LOUIS NIZER, *NEW COURTS OF INDUSTRY: SELF-REGULATION UNDER THE MOTION PICTURE CODE* (1935). For judicial enforcement of the Code, see *Glass v. Hoblitzelle*, 83 S.W.2d 796 (Tex. Civ. App. 1935); *cf.* *Perelman v. Warner Bros. Pictures*, 9 F. Supp. 729 (E.D. Pa. 1935) (holding that prohibitions against double features violate antitrust laws). The major distributors publicly lobbied against the practice of showing double features. See *Double Features*, N.Y. TIMES, Apr. 16, 1933, at X3. For empirical analyses of the anticompetitive effects of the National Industrial Recovery Act, see Barbara Alexander, *The Impact of the National Industrial Recovery Act on Cartel Formation and Maintenance Costs*, 76 REV. ECON. & STAT. 245 (1994); Matthew B. Krepps, *Another Look at the Impact of the National Industrial Recovery Act on Cartel Formation and Maintenance Costs*, 79 REV. ECON. & STAT. 151 (1997).

124 These provisions were in Articles 2, 6, 7, 9, 12, 36, and 41. *Trade Code*, *supra* note 122.

125 See, e.g., BERTRAND ET AL., *supra* note 93, at 26.

126 A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935).

127 See, e.g., *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939); *Vitagraph, Inc. v. Perelman*, 95 F.2d 142 (3d Cir. 1938); *United States v. Paramount Pictures, Inc.*, 66 F. Supp. 323, 343-44 (S.D.N.Y. 1946). See also *Restraints on Motion Picture Exhibition and the Anti-Trust Laws*, 33 ILL. L. REV. 424, 433-437 (1938) [hereinafter *Restraints on Exhibition*]; Bosley Crowther, *Double Feature Trouble*, N.Y. TIMES, Jul. 14, 1940, at 86; *Goldwyn Renews Double-Bill Drive*, N.Y. TIMES, Nov. 14, 1947, at 29; Frank S. Nuhent, *Double, Double, Toil and Trouble*, N.Y. TIMES, Jan. 17, 1943, at SM11.

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### d. The Era's Unique Conditions

The reign of the Organized Distributors illustrates how, under certain circumstances, variable pricing within the same theater is sustainable. The particular conditions that characterized the era were (i) production lines of varying quality and minimum admission price requirements, each facilitating cross-movie price variation, (ii) recurring demand patterns, which were used to facilitate price variation across show times, and (iii) large theaters, which allowed cross-seat price variation. Most of these conditions no longer exist: Ranked production lines and large theaters were idiosyncratic to that era,<sup>128</sup> and minimum admission price requirements were banned by the *Paramount* decrees. Yet some conditions that could sustain intra-theater price variation still exist. First, event movies—a particular, distinct production line—are still produced.<sup>129</sup> Second, identifiable and recurring demand patterns still exist.

## 2. The *Paramount* Case

### a. Introduction to *Paramount*

While the reign of the Trust was characterized by numerous patent actions, the era of the Organized Distributors enriched the antitrust case law with an unprecedented number of decisions.<sup>130</sup> Although the government and private plaintiffs won many cases before *Paramount*, they had only a small impact on the industry. The *Paramount* case, however,

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<sup>128</sup> The causes for the disappearance of large theaters and ranked production lines are discussed *infra* Sections II.C-II.D.

<sup>129</sup> See *infra* Section II.C. The first event movie that was shown at regular admission price was *Arch of Triumph*, starring Ingrid Bergman and Charles Boyer. *Practice of Showing Costly Films at Higher Prices Receives Jolt*, WALL ST. J., Mar. 17, 1948, at 3.

<sup>130</sup> See, e.g., *Schine Chain Theatres, Inc. v. United States*, 334 U.S. 110 (1948); *United States v. Griffith Amusement Co.*, 334 U.S. 100 (1948); *United States v. Crescent Amusement Co.*, 323 U.S. 173 (1944); *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939); *Fox Film Corp. v. Muller*, 296 U.S. 207 (1935); *Paramount Famous Lasky Corp. v. United States*, 282 U.S. 30 (1930); *United States v. First Nat'l Pictures, Inc.*, 282 U.S. 44 (1930); *Binderup v. Pathe Exchange, Inc.*, 263 U.S. 291 (1923); *Bigelow v. RKO Radio Pictures*, 150 F.2d 877 (7th Cir. 1945); *William Goldman Theatres v. Loew's, Inc.*, 150 F.2d 738 (3d Cir. 1945); *Schad v. Twentieth Century-Fox Film Corp.*, 136 F.2d 991 (3d Cir. 1943); *Gary Theatre Co. v. Columbia Pictures Corp.*, 120 F.2d 891 (7th Cir. 1941); *Westway Theatre, Inc. v. Twentieth Century-Fox Film Corp.*, 113 F.2d 932 (4th Cir. 1940); *Paramount Pictures v. United Motion Picture Theatre Owners of E. Pa., S.N.J. & Del., Inc.*, 93 F.2d 714 (3rd Cir. 1937); *First Nat'l Pictures, Inc. v. Robison*, 72 F.2d 37 (9th Cir. 1934); *FTC v. Paramount Famous-Lasky Corp.*, 57 F.2d 152 (2d Cir. 1932); *Perelman v. Warner Bros. Pictures, Inc.*, 9 F. Supp. 729 (E.D. Pa. 1935); *United States v. Fox West Coast Theaters, 1932-1939 Trade Cas. (CCH) ¶ 55,018 (S.D.Cal. 1932)*; *United States v. Balaban & Katz Corp., 1932-1939 Trade Cas. (CCH) ¶ 55,001 (N.D.Ill. 1932)*; *Metro-Goldwyn-Mayer Distrib. Corp. v. Kiggins*, 184 Wash. 497 (1935); *Glass v. Hoblitzelle*, 83 S.W.2d 796 (Tex. Civ. App. 1935); *Walker Theatre Co. v. R.K.O. Distrib. Corp.*, 189 N.E. 162 (Ind. App. 1934); *In re Famous Players-Lasky Corp.*, 11 F.T.C. 187 (1927). See also William F. Whitman, *Antitrust Cases Affecting the Distribution of Motion Pictures*, 7 FORDHAM L. REV. 189 (1938); *Restraints on Exhibition*, *supra* note 127.

would change the face of the industry forever.

The government filed a complaint against the Organized Distributors in July 1938<sup>131</sup> that asserted seven major charges:<sup>132</sup> (i) conspiring to fix film license terms, runs, clearances, and minimum admission prices; (ii) block-booking; (iii) blind-selling; (iv) discriminating systematically against small, independent theaters; (v) excluding independent producers; (vi) pooling profits in cities where two or more majors operated theaters; and (vii) effecting a division of territories in the entire United States. By the end of the *Paramount* litigation in 1949, three new legal rules would govern the industry: (i) no direct or indirect intervention in admission price setting by producers and distributors; (ii) no licensing negotiations except on theater-by-theater and movie-by-movie bases; and (iii) no vertical integration between the *Paramount* defendants and exhibitors. The courts intended these rules to open the market to independent producers and distributors, to allow exhibitors to select which movies they would show, and to remove artificial constraints on ticket pricing.

Reaching this result took fourteen years, four proceedings (two trials in the Southern District of New York, an appeal to the Supreme Court, and a remand to the Southern District), and several decrees and consent decrees. This Section summarizes the proceedings to illustrate their complexity and how effectively the Organized Distributors had extended their control over the movie theater industry. The immediate impact of *Paramount* on admission prices, which is more relevant to the Article's overall argument than is the history of the *Paramount* case, is discussed at the end of this Section.<sup>133</sup>

#### b. First Trial and Consent Decree: 1938-1944

The Government's first complaint against the Organized Distributors in 1938 was resolved in November 1940, when the government and the Majors reached a consent decree that would last three years.<sup>134</sup> Among other remedies, the decree (i) limited the Majors' expansion of their exhibition businesses,<sup>135</sup> (ii) permitted reasonable run-clearance-zone systems,<sup>136</sup> (iii) prohibited discrimination among theaters,<sup>137</sup> and (iv)

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131 The complaint was amended and supplemented in November 1940. See Amended and Supplemental Complaint, *United States v. Paramount Pictures, Inc.*, 66 F. Supp. 323 (S.D.N.Y. 1946) (Eq. No. 87-273), reprinted in 4 FILM HIST. 3 (1990).

132 BERTRAND ET AL., *supra* note 93, at 73-74.

133 See *infra* Subsection II.C.2.f.

134 *United States v. Paramount Pictures, Inc.*, 1940-1943 Trade Cas. (CCH) ¶ 56,072 (S.D.N.Y. 1940). For analyses of the consent decree, see BERTRAND ET AL., *supra* note 93, at 75-85; Comment, *Legislation by Consent in the Motion Picture Industry*, 50 YALE L.J. 854 (1941); Note, *The Sherman Act and the Motion Picture Industry*, 13 U. CHI. L. REV. 346 (1946).

135 *Paramount Pictures*, 1940-1943 Trade Cas. (CCH) at 294.

136 *Id.* at 291-92.

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prohibited block-booking of more than five features.<sup>138</sup> The decree also set up an arbitration system remarkably similar to the industry's self-government under the National Industrial Recovery Act.<sup>139</sup>

### c. Second Trial and Consent Decree: 1944-1946

When only minor changes in the run-clearance-zone system were achieved by 1944, the government sought modification of the consent decree, including the separation of theaters from distribution and production. The case was tried in late 1945, and in June 1946 the district court issued its opinion.<sup>140</sup> The court held that a run-clearance-zone system with reasonable clearances and zone restrictions could be lawful, given the substantive similarities between movie licensing and a sale of a business' goodwill with covenants not to compete.<sup>141</sup> Based on the nearly uniform minimum admission price requirements of the eight defendants, the court held that the governing run-clearance-zone system was not reasonable and that the established uniform pricing scheme did not result from free and open competition but from the defendants' concerted actions in violation of the Sherman Act.<sup>142</sup> The court inferred a horizontal price-fixing conspiracy among the defendants and a vertical price-fixing conspiracy between each defendant and its licensees.<sup>143</sup>

In December 1946, the court issued a decree pursuant to its opinion.<sup>144</sup> The decree prohibited (i) stipulated minimum admission prices, (ii) agreements to maintain a run-clearance-zone system, (iii) anti-competitive or unreasonable clearances, (iv) licenses granted by any method other than competitive bidding, (v) block-booking, (vi) broad blind-selling, (vii) discrimination among theaters, (viii) arbitrary refusals to deal, (ix) pooling agreements, (x) joint interests in theaters, (xi) expansion of the Majors' theater businesses, and (xii) several other trade practices.

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137 *Id.* at 292-94.

138 *Id.* at 289-90.

139 See Louis Nizer, *Duty To Bargain in the Motion-Picture Industry*, 43 COLUM. L. REV. 705 (1943); Comment, *Operation of the Consent Decree in the Motion-Picture Industry*, 51 YALE L.J. 1175 (1942); Symposium, *Arbitration in the Motion Picture Industry: Introduction to the Industry*, 5 ARB. J. 10 (1941).

140 *United States v. Paramount Pictures, Inc.*, 66 F. Supp. 323 (S.D.N.Y. 1946). For a summary of the findings and conclusions of law, see *United States v. Paramount Pictures, Inc.*, 70 F. Supp. 53, 53-54 (S.D.N.Y. 1946).

141 *Paramount*, 70 F. Supp. at 61-62; *Paramount*, 66 F. Supp. at 341-43.

142 *Paramount*, 70 F. Supp. at 62; *Paramount*, 66 F. Supp. at 343-46.

143 *Paramount*, 70 F. Supp. at 60-61; *Paramount*, 66 F. Supp. at 334-41.

144 *United States v. Paramount Pictures, Inc.*, 1946-1947 Trade Cas. (CCH) ¶ 57,526 (S.D.N.Y. 1946). See also Note, *Judicial Regulation of the Motion-Picture Industry: The Paramount Case*, 95 U. PA. L. REV. 662 (1946) (analyzing the second consent decree).

## d. The Appeal: 1947-1948

Pursuant to Section 2 of the Expediting Act of 1903,<sup>145</sup> the appeal went directly to the Supreme Court, which issued its decision in May 1948. The Supreme Court affirmed most of the district court's rulings.<sup>146</sup> The Court, however, held that the district court erred in failing to inquire into the circumstances under which joint interests in theaters were acquired, since in a few cases those might have been innocent investments.<sup>147</sup> The Court also ruled that the district court failed to make necessary findings as to the existence or absence of monopoly power in the market for first-run theaters and erred in its analysis of the Majors' ownership of theaters.<sup>148</sup> Finally, competitive bidding was held undesirable and impractical: It would favor the exhibitors with the "longest purse," and, given the many facets of a bid,<sup>149</sup> it would often be too difficult to identify the highest one. In addition, competitive bidding would require extensive judicial involvement in the daily operation of the industry. In light of the central role of competitive bidding in the decree, the Supreme Court remanded the case for reconsideration of the entire decree.<sup>150</sup>

## e. The Remand and Final Decrees: 1949-1952

After the remand from the Supreme Court but before further hearings in the case, two of the Majors consented to decrees divorcing their theater circuits, divesting certain theaters from the circuits, and enjoining certain practices.<sup>151</sup> The trial court issued its supplemental findings in July 1949,<sup>152</sup> finding that the vertical integration of the Majors facilitated the conspiracy to fix prices, runs, and clearances, and so was unlawful.<sup>153</sup> The court held that the defendants must be viewed collectively—rather than independently—with respect to monopoly power, and that collectively they possessed monopoly power in the distribution and first-run theater markets.<sup>154</sup> Since the Supreme Court held that competitive bidding was

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145 Pub. L. No. 57-82, 32 Stat. 823 (1903). The Expediting Act was enacted in order to allow the Attorney General to seek expeditious treatment for cases of general public importance that were brought under the Sherman Act.

146 *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 131-38 (1948).

147 *Id.* at 152-53.

148 *Id.* at 166-75.

149 A bid would have to include the theater properties, the clearance terms, and a price formula for the license.

150 *Paramount*, 334 U.S. at 166.

151 *United States v. Paramount Pictures, Inc.*, 1948-1949 Trade Cas. (CCH) ¶ 62,377 (S.D.N.Y. 1949) (entering Paramount's consent decree); *United States v. Paramount Pictures, Inc.*, 1948-1949 Trade Cas. (CCH) ¶ 62,335 (S.D.N.Y. 1948) (entering RKO's consent decree).

152 *United States v. Paramount Pictures, Inc.*, 85 F. Supp. 881 (S.D.N.Y. 1949).

153 *Id.* at 893-94.

154 In 1945, the Majors owned at least 70% of the first-run theaters in the 92 largest cities and 60% of the first-run theaters in cities with populations between 25,000 and 100,000. The

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inadequate, the court ruled that exhibition business must be divorced from production and distribution.<sup>155</sup> In February 1950, the court issued its final decree against the six Organized Distributors that did not enter into consent decrees.<sup>156</sup> Detailed consent decrees that delineated the divorcement and divestiture of theaters from the three Majors that did not enter into consent decrees prior to the remand were signed between 1950 and 1952.<sup>157</sup>

### f. The Immediate Impact on the Pricing System

The *Paramount* case attacked and undermined the pricing system established by the Organized Distributors. The *Paramount* decrees were designed to revive competition in the exhibition segment and to prevent the leverage of market power in the distribution market by three general prohibitions: (i) a prohibition against the maintenance of a uniform run-clearance-zone system; (ii) a prohibition against minimum admission prices in license agreements or by any other means; and (iii) a prohibition against licensing negotiations on any basis other than theater-by-theater and movie-by-movie. No less important, by requiring divestiture, the decrees eliminated the incentives of the Organized Distributors to favor affiliated theaters.<sup>158</sup>

Theaters in the post-*Paramount* era did not lose their limited monopolistic power in their local territories, as the *Paramount* decrees did not prohibit the organization of film licensing through run-clearance-zone systems. This feature of the decrees still allowed theaters to charge premiums for popular movies. Furthermore, the prohibition of block-booking and the duty to negotiate licensing on a movie-by-movie basis added to the exhibitors' pricing calculus the exact costs of each movie. The three central rules which governed the motion picture industry after *Paramount*—no stipulation of admission prices by producers and distributors, licensing negotiations on theater-by-theater and movie-by-movie bases, and no vertical integration between the *Paramount*

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defendants' share in domestic film rentals, excluding westerns, was approximately 73%. *Id.* at 894-95.

155 *Id.* at 895-96.

156 *United States v. Loew's, Inc.*, 1950-1951 Trade Cas. (CCH) ¶ 62,573 (S.D.N.Y. 1950).

157 Twentieth-Century Fox signed its consent decree in February 1950, Warner Brothers in January 1951, and Loew's in February 1952. *United States v. Loew's, Inc.*, 1952-1953 Trade Cas. (CCH) ¶ 67,228 (S.D.N.Y., 1951) (entering Loew's consent decree); *United States v. Loew's, Inc.*, 1950-1951 Trade Cas. (CCH) ¶ 62,861 (S.D.N.Y., 1951) (entering Twentieth-Century Fox's consent decree); *United States v. Loew's, Inc.*, 1950-1951 Trade Cas. (CCH) ¶ 62,765 (S.D.N.Y., 1951) (entering Warner Brothers' consent decree).

158 The divorcement and divestiture of theaters pursuant to the *Paramount* decision was completed only in 1959, primarily due to the difficulty of selling assets of a declining industry. See CONANT, *supra* note 1, at 107-12. In 1956, the divorced circuits were forbidden from entering the production business. *Motion Picture Distribution Trade Practices—1956: Report of Select Comm. on Small Businesses*, 84th Cong. 49-50, 56 (1956) [hereinafter *Report*].

defendants and exhibitors—were intended to allow exhibitors to select the movies shown and attempted to remove artificial constraints on ticket pricing. The new rules reduced somewhat the inequality among theaters that the uniform run-clearance-zone system had established.<sup>159</sup> More than fifty years after *Paramount*, however, large theaters in major cities consistently show movies of only a few distributors, as personal relationships and *de facto* product splitting<sup>160</sup> play an important role in the negotiations between distributors and exhibitors.<sup>161</sup> Most importantly, distributors have continued to intervene directly and indirectly in ticket pricing.

D. *Post-Paramount Developments (1950-1970)*

During the late 1940s, the movie theater industry entered a deep recession, primarily because of the post-World War II economic contraction (1946-1948), dramatic changes in Americans' consumption of leisure, and the advent of television.<sup>162</sup> Some of these changes are captured in Figure 3, which depicts the percentage of personal expenditures spent at the box office and the corresponding trends in movie theater attendance. The decline in the movie-exhibition business started in 1946 and continued uninterrupted until the 1970s, although the rate of decline diminished over time. In dollar amounts, annual box office revenues fell from a peak of \$1.7 billion in 1946 to \$942 million in 1962. Adjusted to 2002 dollars, the box office record of 1946 totaled \$15.6 billion dollars, hit a bottom of \$5.5 billion in 1964, and gradually climbed to \$9.5 billion in 2002.<sup>163</sup> The adjusted figures of per capita spending are even more dramatic: Annual per capita spending at the box office dropped from \$110 in 1946 to \$29 in 1963 and since then has never passed the level of \$33.<sup>164</sup> The percentage of personal expenditures spent at the box office reached a peak of 1.28% in 1943 and declined until the 1990s, when it stabilized at a level of 0.11%-0.13%. The latter figures were not adjusted to changes in income nor

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159 Crandall, *supra* note 14, at 64-65 (studying the gradual reduction of the admission price inequality through 1967).

160 Product splitting is a practice whereby several theaters in a territory tacitly or explicitly agree not to bid aggressively against each other for certain films. Each theater in the territory has the opportunity, on a rotating basis, to obtain major new films for relatively low rental terms.

161 VOGEL, *supra* note 27, at 88. *See also* Crandall, *supra* note 14, at 75-76 (concluding that the oligopolistic structure of the motion picture industry, the transparency of competitors' present and future output, and the transparency of transactions between distributors and exhibitors inhibit competition among distributors).

162 *See generally* Crandall, *supra* note 14. For the impact of television on movie theater attendance, see Fredric Stuart, *The Effects of Television on the Motion Picture Industry: 1948-1960*, in *THE AMERICAN MOVIE INDUSTRY: THE BUSINESS OF MOTION PICTURES* 257 (Gorham Kindem ed., 1982).

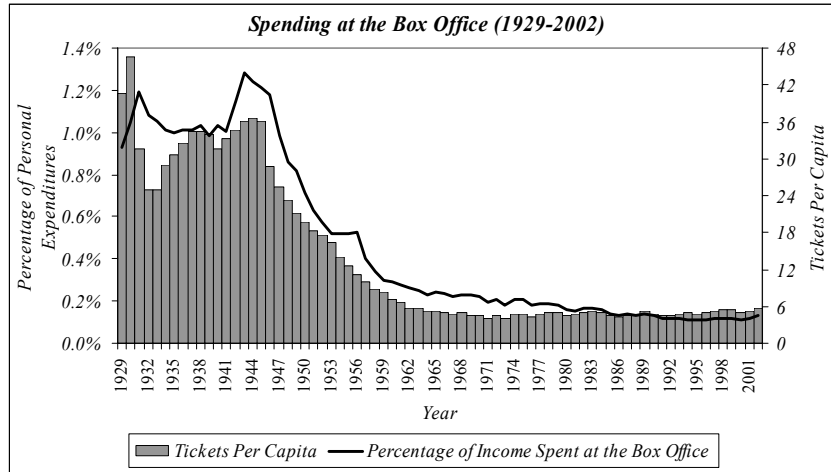
163 *See infra* Figure 7.

164 *Id.*

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controlled for substitutes for movies. Nevertheless, given the drastic change in magnitude and together with the other figures, they shed some light on the trends at the box office.

FIGURE 3



DATA SOURCES: NAT'L ASS'N OF THEATER OWNERS, THE ENCYCLOPEDIA OF EXHIBITION (2003-2004); PRESIDENT OF THE UNITED STATES, ECONOMIC REPORT OF THE PRESIDENT 2004, at app. B-16; MOTION PICTURE ALMANAC (1929-1945; 2002), BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CONSUMER PRICE INDEX: ALL URBAN CONSUMERS (2004), <ftp://ftp.bls.gov/pub/special.requests/cpi/cpiat.txt>.

The 1950s and 1960s were an era of decline from which the movie theater industry has never recovered. The changes in attendance patterns, coupled with the entry of independent producers,<sup>165</sup> naturally affected the supply of movies and box office pricing. As predicted by standard economic models, the major studios replied to the decline in demand by lowering the supply of movies.<sup>166</sup> Additionally, the nature of the supply changed; significantly fewer B and C movies were produced as a consequence of competition from television, exhibitors' ability to purchase individual movies of any quality, and the entry of independent producers.<sup>167</sup>

<sup>165</sup> Report, *supra* note 158, at 29-34, 36-38; CONANT, *supra* note 1, at 112-18, 122-29, 148-53; Taves, *supra* note 108. For the history of the independent producers, see ABERDEEN, *supra* note 117.

<sup>166</sup> See Report, *supra* note 158, at 10-13, 38-39; *infra* Figure 8. See also Stanley W. Penn, *Movie Makers To Cut '59 Output 15% to Post-War Low, Stress Big-Budget Films To Counter Box Office Slump*, N.Y. TIMES, Feb. 4, 1959, at 24.

<sup>167</sup> Report, *supra* note 158, at 29-34, 36-38; CONANT, *supra* note 1, at 112-18, 122-29, 148-53; Taves, *supra* note 108. For the history of the independent producers, see ABERDEEN, *supra* note 117. See also Bosley Crowther, 'A' Movies on 'B' Budgets, N.Y. TIMES, Nov. 12, 1950, at 183; Penn, *supra* note 166; Thomas M. Pryor, 'B' Pictures Facing New Hurdle?, N.Y. TIMES, Mar. 27, 1949, at X5; Howard Thompson, *Movie Costs Rise in Neighborhoods*, N.Y. TIMES, Nov. 15, 1963, at 25.



As shown in Figure 2 above, the immediate price response to changes in the industry was a significant increase in the average admission price.<sup>168</sup> This upward trend in admission prices continued almost unabated until the 1970s, with the exception of a sharp price decline in 1954. The price decline of 1954 is explained by the cut in the federal admission tax<sup>169</sup> and the change in the ratio of newly released to re-issued movies.<sup>170</sup> The general upward trend in admission prices is due to the contraction of the market for low-price B and C movies, the collapse of the uniform run-clearance-zone system, and the relatively inelastic demand of audiences that continued to patronize the theater.<sup>171</sup> The combination of these factors allowed theaters to select attractive movies, to show early runs, and to raise prices.<sup>172</sup>

The industry's gravitation toward A movies during the post-*Paramount* era necessarily implied less price dispersion, as the product was less differentiated. Explicit price management by distributors was prohibited by the *Paramount* decrees, and, therefore, presumably most of the artificial mechanisms that could sustain price variation across movies were removed. Nevertheless, throughout the 1950s and 1960s there was a clear distinction between pricing of regular and event movies. Exhibitors also maintained price variation between weekdays and weekends and among different types of seats.<sup>173</sup> Furthermore, in an attempt to attract price-sensitive patrons, exhibitors devised student and senior discounts that were tried before the 1950s but had never been consistently

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168 For a study of box office pricing characteristics for the years 1947-1963, see Robert D. Lamson, *Measured Productivity and Price Change: Some Empirical Evidence on Service Industry Bias, Motion Picture Theaters*, 78 J. POL. ECON. 291 (1970).

169 In April 1, 1954, the admission tax was cut by ten percent and was completely removed on admissions of fifty cents or less. Exhibitors were specifically instructed to pass on the tax cut to moviegoers. See *Admissions Tax on Motion Picture Theaters: Hearing Before the Comm. On Ways and Means*, H.R. 157, 83d Cong. (1953); *Report*, *supra* note 158, at 50; *Tax Cut Rules Set: U.S. Warns Ticket Purchasers Must Be Told of Changes*, N.Y. TIMES, Apr. 9, 1954, at 17.

170 See *infra* Figure 8. In 1954, the percentage of low-priced, re-issued movies was higher than in any previous year.

171 For the effects of these factors, see CONANT, *supra* note 1, at 12-15, 138-53; Crandall, *supra* note 14, at 61-65. There is no public information on estimates of moviegoers' demand elasticities. However, in 1956 it was estimated that 26% of the adult population attended the movies more than once a month, accounting for 85% of the total theater admission, and that 7% of the adult population attended the movies more than once a week, providing almost 44% of box office receipts. *Report*, *supra* note 158, at 27-28. Such findings suggest that the audience that continued to patronize motion pictures was demand inelastic. See also Crandall, *supra* note 14, at 63.

172 See, e.g., Penn, *supra* note 166.

173 For anecdotal reports on such price differentiation, see, for example, Eugene Archer, *A \$4.80 Admission Set for New Film*, N.Y. TIMES, Sept. 15, 1962, at 15; *Rugoff Executive Clarifies Movie-Admission Policy*, N.Y. TIMES, Dec. 20, 1968, at 62; Thompson, *supra* note 167; *\$3 for Movie Ticket? Theater Owners Here Explain Why*, N.Y. TIMES, Dec. 19, 1968, at 62. See also *Report*, *supra* note 158, at 46 ("Implicit in this argument is the contention that exhibitors who own the big first-run houses would charge the same admission regardless of the picture being played. The committee questions whether all exhibitors charge the same for a first-run showing of a top attraction as for a run-of-the-mill picture.").

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employed.<sup>174</sup>

Although much of the price differentiation during the 1950s and 1960s was voluntary on the part of exhibitors, there were many complaints regarding the direct and indirect intervention of distributors in the setting of admission prices. Conduct related to the maintenance of a uniform run-clearance-zone system was not easy to prove, and apparently some uniformity persisted.<sup>175</sup> Enforcement of the prohibition against intervention of distributors in setting admission prices was particularly difficult, despite many reported complaints.<sup>176</sup> The old minimum admission price requirements became mere suggestions, whose “cheap-talk” nature was outside of the *Paramount* prohibitions,<sup>177</sup> but their repetition had a self-enforcing power.<sup>178</sup> Suggested admission prices took the form of recommendations during licensing negotiations as well as more binding forms, such as raising shares of box office revenues, instituting per-capita requirements for exhibitors, and punishing exhibitors who charged low admission prices.<sup>179</sup> A conservative conclusion from the existing evidence is that, until the 1970s, the distributors remained active

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174 See, e.g., *Film Houses Urged To Cut Students' Fees*, N.Y. TIMES, Feb. 5, 1938, at A5; *Film Patrons Over 60 Offered Lower Prices*, N.Y. TIMES, Jan. 9, 1964, at 37; *Movies Lay Plans for Student Rate*, N.Y. TIMES, Mar. 11, 1955, at 19; *Movies To Cut Rates For Young This Week*, N.Y. TIMES, Aug. 23, 1944, at 17. For Saturday children's shows, see STONES, *supra* note 60, at 125-30.

175 See, e.g., *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959); *Naumkeag Theatres Co. v. New England Theatres, Inc.*, 345 F.2d 910 (1st Cir. 1965); *Theatre Enter., Inc. v. Paramount Film Distrib. Corp.*, 201 F.2d 306 (4th Cir. 1953); *Milgram v. Loew's, Inc.*, 192 F.2d 579 (3d Cir. 1951); *Basle Theatres, Inc. v. Warner Bros. Pictures Distrib. Corp.*, 168 F. Supp. 553 (W.D. Pa. 1959); *Orbo Theatre Corp. v. Loew's, Inc.*, 156 F. Supp. 770 (D.C.D.C. 1957) (holding that a uniform twenty-one-day clearance did not violate the Sherman Act); *Fanchon & Marco v. Paramount Pictures, Inc.*, 100 F. Supp. 84 (S.D. Cal. 1951). See also *Report, supra* note 158, at 12-13, 25-26, 41-44; *Crandall, supra* note 14, at 64-65.

176 *Problems of Independent Motion-Picture Exhibitors: Report of the Select Comm. on Small Bus.*, 83d Cong. 5-7 (1953); *Report, supra* note 158, at 10-15. See also CONANT, *supra* note 1, at 152.

177 “Cheap talk” is an economic term for nonverifiable communication that may facilitate self-enforcing coordination. See Joseph Farrell, *Cheap Talk, Coordination, and Entry*, 18 RAND J. ECON. 34 (1987); Joseph Farrell & Matthew Rabin, *Cheap Talk*, 10 J. ECON. PERSP. 103 (1996). See also *Crandall, supra* note 14, at 56, 62 (stating in the context of the motion picture industry that “few economists would believe that forbidding overt communication among rivals would guarantee competitive market behavior” and that “admission prices are clearly discussed in negotiations of contracts”).

178 Repeated interactions of players may facilitate a self-enforcing equilibrium that could not be sustained otherwise. See generally DREW FUDENBERG & JEAN TIROLE, *GAME THEORY* 145-200 (1991); Irving Fisher, *Cournot and Mathematical Economics*, 12 Q.J. ECON. 119, 126 (1898) (“[N]o business man assumes either that his rival's output or price will remain constant any more than a chess player assumes that his opponent will not interfere with his effort to capture a knight.”); Robert H. Porter, *A Study of Cartel Stability: The Joint Executive Committee, 1880-1886*, 14 BELL J. ECON. 301 (1983). See also *Report, supra* note 158, at 46 (“[A]n exhibitor who makes a bid in which he states he intends to charge a certain price . . . may be legally free to [charge less, but] it is obvious he would find it most difficult to be awarded a top picture again.”)

179 See *Problems of Independent Motion Picture Exhibitors, supra* note 176, at 5-7; *Report, supra* note 158, at 10-15, 25, 39-41, 46-47. See also CONANT, *supra* note 1, at 152. For a detailed study of admission price negotiations, see Cassady, *supra* note 14, at 165-75.

in the determination of admission prices in violation of the *Paramount* decrees and general antitrust law. As one scholar who studied the industry during the 1950s and 1960s noted: “For all intents and purposes, the old cartel remained, stripped of its theaters and formal channels of communication.”<sup>180</sup>

E. *Modern Times (1970-Present)*

Uniform prices in their present form appeared in the early 1970s, but the causes and reasons for the convergence to this pricing system could not be traced. In 1972, *The Godfather*, a high-profile event movie, opened at regular admission prices and became the highest-grossing film ever.<sup>181</sup> It is implausible that all exhibitors across the country decided individually to charge a regular price for *The Godfather*. Therefore, it seems reasonable to infer that Paramount, the producer-distributor of the movie, was at least somewhat involved in the pricing transition. Such intervention, if it occurred, was in violation of the *Paramount* decrees, as well as the per se rule against maximum resale price maintenance that was in force since 1968.<sup>182</sup> Specific support for the hypothesis that Paramount intervened in the pricing of *The Godfather* has not been uncovered. *The Godfather*, however, set a new norm for event movies. Price variation across movies quickly disappeared after its success.

The emergence of one price for all movies roughly paralleled the appearance of multiplexes,<sup>183</sup> and this historical correspondence may indicate causality: At the multiplex, the costs of administering variable pricing across movies could make such a scheme unprofitable.<sup>184</sup> However, in the mid 1970s, when price differentiation across movies largely disappeared, there were still no multiplexes in most towns, and the vast majority of theaters in the country had a single screen.<sup>185</sup> Therefore,

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180 Crandall, *supra* note 14, at 57. However, a congressional committee that in 1956 investigated the problems of independent motion picture exhibitors concluded, “Under [the governing distribution] system there is the possibility that a distributor and exhibitor may actually agree between themselves on a certain admission price and thereby be engaging in illegal price fixing. But such danger does not make the system itself necessarily illegal.” *Report*, *supra* note 158, at 46.

181 Leonard Klady, *Lengthy Pix Turn Up Heat On Exhibs, Auds*, VARIETY, Jan. 15, 1996, at 13. *The Godfather* was released on March 15, 1972, and its domestic gross receipts were \$133,698,921.

182 *Albrecht v. Herald Co.*, 390 U.S. 145, 152-54 (1968). In 1997, the Supreme Court reversed its position and voted unanimously that maximum resale price maintenance should be evaluated under the rule of reason. *State Oil Co. v. Khan*, 522 U.S. 3 (1997).

183 The first multiplex was built in Kansas City by AMC Entertainment in 1963. PAUL MONACO, *THE SIXTIES: 1960-1969*, in 8 HISTORY OF THE AMERICAN CINEMA 48-50 (2001). For a study of the rise of multiplexes in Washington, D.C., see HEADLEY, *supra* note 38, at 200-21.

184 See *infra* Section III.D.

185 In 1979, there were 9021 indoor theaters in the United States with 13,331 screens or 1.48 screens per indoor theater. The leading builder of multiplexes in the 1970s, General Cinema Corp., had 203 theaters with 256 screens (1.26 screens per theater) in 1970, and 337 theaters with 843 screens (2.5

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the appearance of multiplexes does not seem to explain the emergence of one price for all movies.

Price variation across seats apparently disappeared in light of theaters' excess capacity, which made it too costly to monitor patrons in the auditorium. Later, when multiplexes and megaplexes started taking over the industry,<sup>186</sup> movie screens shrank, and it became costly to set and administer different prices for different seats.

As for price differentiation across the week, some reports indicate that, at least until 1970, admission prices in New York City were higher on Saturdays than during the rest of the week.<sup>187</sup> However, cuts of weekday admission prices in Washington, D.C. in 1970 seemed to violate the pricing norm.<sup>188</sup>

Finally, a study of movie theater history requires a reference to the rise of video rentals and video-on-demand in the 1980s and late 1990s, respectively. Both types of alternative exhibition media are imperfect substitutes for the theatrical experience.<sup>189</sup> There is, in fact, good evidence that the impact on movie theater demand of these developments was primarily limited to potential growth: Figure 2 shows that average movie theater attendance per capita was stable during the 1980s and early 1990s and has even risen more recently. In contrast to this stability, empirical evidence suggests that people today watch more movies, spend more money on home exhibition than on movie tickets,<sup>190</sup> and spend more money on movie-related items than ever before. This, in turn, implies that home exhibition steals some business from the movie theater industry.<sup>191</sup> Such a loss of business should motivate exhibitors to adjust their business strategies to the changing reality. For example, as discussed earlier, the inverse relationship between the demand for movies at the theater and the demand for movies at home presumably provides exhibitors with further incentives to switch to variable pricing.<sup>192</sup>

News reports suggest that producers and distributors object to

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screens per theater) in 1979. Conant, *supra* note 14, at 98.

186 In 2002, 27.8% of theaters had a single screen; 40.6% had two to seven screens; 23.8% had eight to fifteen screens; and 7.8% had more than sixteen screens. MOTION PICTURE ASSOCIATION WORLDWIDE MARKET RESEARCH, *supra* note 7. The average number of screens per theater continuously increases. From 1995 to 2002 it went up by over 60%, from 3.89 to 6.27 screens per theater.

187 See, e.g., Leonard Sloane, *Low-Admission Movie Theaters Are Gaining*, N.Y. TIMES, Mar. 29, 1970, at 139.

188 See *supra* text accompanying note 38.

189 See De Silva, *supra* note 26, at 153-55 (providing empirical evidence on the positive impact of the social context on theater attendance).

190 See, e.g., Litman & Hoang, *supra* note 26, at 98-101.

191 See Gregory W. Cermak, *Budget Allocation as a Measure of Potential Demand*, 17 J. ECON. PSYCHOL. 591 (1996) (offering some evidence on the cross demand elasticities among various forms of movie exhibition).

192 See *supra* text accompanying note 26.

deviation from uniform pricing and often prevent deviation from the present pricing regime.<sup>193</sup> Such intervention, although never challenged, is illegal under the *Paramount* decrees that are still in force.<sup>194</sup> The scattered anecdotal evidence may indicate that producers and distributors sometimes act to discourage deviation from the present pricing regime, but it does not indicate whether they acted consciously together or unilaterally to bring about the uniform pricing regime. The study of the uniform-pricing puzzle in the next Part of the Article focuses on the economic justifications for uniform pricing and the possibility that the present pricing regime is sustained, at least partially, by the distributors' conduct.

### III. Explanations for Uniform Prices

For advocates of the efficient-market hypothesis, the persistence of the uniform pricing regime for more than thirty years could be seen as evidence for its efficiency. To examine this hypothesis, the Author interviewed industry executives, scholars, and journalists.<sup>195</sup> Generally, explanations of the uniform pricing regime fall into five categories of economic justifications: (i) concerns that variable pricing would antagonize patrons; (ii) uncertainty surrounding the success of newly released movies; (iii) concerns that prices would be interpreted as quality signals; (iv) the cost of administering variable pricing; and (v) concerns that variable pricing would complicate the already complex relationships between exhibitors and distributors. In addition, there were suggestions that distributors intervene directly and indirectly in the pricing regime. This Part of the Article examines the suggested economic justifications and the possibility that distributors still intervene in the pricing structure of movie exhibition.

#### A. *Perceived Fairness*

Businesspeople often believe that price changes that consumers perceive as unfair are undesirable.<sup>196</sup> For example, Coca-Cola took fire for

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193 See, e.g., Jill Goldsmith, *AMC Tempts Auds with Multi-Pic Card*, DAILY VARIETY, June 11, 2001, at 28 (describing a discount program of a major theater circuit and quoting the distribution chief of DreamWorks as saying that they could not tell exhibitors what to charge but could include per-capita requirements in the rental contracts); Andrew Hines, *Multiplex Showdown in Desert*, VARIETY, Mar. 24, 1997, at 9 (“In the event that one or both [of the competing] exhibitors decides to slash admission prices, distrib[utors] have the option of selling pictures on a ‘per capita’ basis, collecting a fixed amount per patron.”). See also Battaglio & Honeycutt, *supra* note 17.

194 In the 1980s, the prohibitions against vertical integration were relaxed. See Fox, *supra* note 14.

195 Most interviewees, particularly industry executives, requested anonymity. A partial list of those interviewed is on file with Yale Journal on Regulation.

196 See ALAN S. BLINDER ET AL., ASKING ABOUT PRICES: A NEW APPROACH TO UNDERSTANDING PRICE STICKINESS (1998).

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introducing a vending machine that adjusted prices to weather conditions.<sup>197</sup> Economists who have studied this intuition argue that it deters businesses from taking full advantage of the law of supply and demand.<sup>198</sup> In the context of entertainment industries, Arthur Okun noted:

[I]mplicit contracts or conventions . . . introduce a concept of fairness in the relations between suppliers and customers whereby price increases based on cost increases are generally accepted as fair, but many that might be based on demand increases are ruled out as unfair. That analysis leaves many specific questions unanswered. Some forms of peak-load pricing by utilities or transport are accepted (even by regulators) as fair; some hotels in college towns charge especially high rates on football weekends. On the other hand, firms in the sports and entertainment industries offer their customers tickets at standard prices for events that clearly generate excess demand.<sup>199</sup>

The standard analysis of perceived fair prices focuses on a reference transaction,<sup>200</sup> which here is the purchase of a movie ticket. Presently, moviegoers are accustomed to uniform admission prices, and this transactional experience may create the assumption that exhibitors' costs do not vary across movies. Accordingly, modifying admission prices uniformly in accordance with changes in general costs may be more acceptable than setting different prices for different movies and different show times. For example, charging higher prices on weekends and holidays may antagonize patrons because they would perceive it as an act to increase exhibitors' profits in an unfair fashion. As the president of the National Association of Theatre Owners put it, "We want people to get in the habit [of visiting the theater] on a regular basis and to see as many movies a year as possible. To build that kind of loyal clientele, you can't bounce admission prices around on them."<sup>201</sup> According to this point of

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197 See Constance L. Hays, *Variable-Price Coke Machine Being Tested*, N.Y. TIMES, Oct. 28, 1999, at C1; Betsy McKay, *Tone Deaf: Ivester Had All Skills of a CEO but One*, WALL ST. J., Dec. 17, 1999, at A1.

198 See, e.g., George A. Akerlof, *Labor Contracts as Partial Gift Exchange*, 97 Q.J. ECON. 543 (1982); Daniel Kahneman et al., *Fairness and the Assumptions of Economics*, 69 J. BUS. S285 (1986); Daniel Kahneman et al., *Fairness as a Constraint on Profit Seeking: Entitlements in the Market*, 76 AM. ECON. REV. 728 (1986) [hereinafter Kahneman et al., *Profit Seeking*].

199 ARTHUR M. OKUN, PRICES AND QUANTITIES: A MACROECONOMIC ANALYSIS 170 (1981).

200 Kahneman et al., *Profit Seeking*, *supra* note 198, at 729-31.

201 Battaglio & Honeycutt, *supra* note 17, at 3 (quoting Bill Kartoizian, president of the National Association of Theater Owners, in response to the 1998 call of Edgar Bronfman, Jr., to revise the pricing system).

[Paramount's] stabilization of admission . . . will perhaps prove to be the biggest boon to moviegoers in the long run. The policy of juggling prices according to the demand for tickets has been the public's most frequent cause of complaint. It was not uncommon for a person to join a long street line when the admission was priced at 95 cents, only to find upon reaching the ticket window a half hour later that the tariff had been upped another 25 cents or more.

Weiler, *supra* note 118, at 69.

view, pricing movies in any way other than uniformly is likely to backfire.<sup>202</sup>

Despite the difficulties that fairness perceptions may present, it can hardly justify uniform admission prices. Uniform prices seem fair merely because of the system's regularity, not due to any intrinsic justice.<sup>203</sup> No sophisticated schemes and ploys are needed to change the present reference transaction; in fact, simple marketing mechanisms could do the trick. The general rule is that consumers may be hostile toward price increases but always welcome discounts.<sup>204</sup> Therefore, discounts during weekdays and slow seasons and for certain movie categories could establish a non-uniform pricing system without antagonizing patrons. Once such a pricing regime is established, price modifications for specific movie categories or show times are unlikely to violate fairness perceptions since the structure of the reference transaction has lost its uniformity.

The perceptive asymmetry between discounts and surcharges is important: For human beings, it is easier to forgo discounts than accept surcharges.<sup>205</sup> Therefore, although charging "summer surcharges" and canceling "winter discounts" are economically equivalent, the latter is likely to be more acceptable. More generally, a successful transition to variable pricing could be facilitated through simple framing strategies.<sup>206</sup>

Furthermore, since charging higher prices for event movies was a successful practice in the past and still is successful in several international

202 The desire not to antagonize patrons explains the unpublished policy of many circuits to refund disgruntled moviegoers. See Tom King, *Just Walk Out—Theaters Ease Refund Rules for Folks Fleeing Flicks*, WALL ST. J., Nov. 24, 2000.

203 Kahneman et al. point out that "[p]sychological studies of adaptation suggest that any stable state of affairs tends to become accepted eventually, at least in the sense that alternatives to it no longer readily come to mind." Kahneman et al., *Profit Seeking*, *supra* note 198, at 730-31. In the same spirit, Franciosi et al. conducted several experiments and showed that, although a transition path to a new equilibrium may be affected by fairness considerations, equilibrium outcomes reflect standard economic models. Robert Franciosi et al., *Fairness: Effect on Temporary and Equilibrium Prices in Posted-Offer Markets*, 105 ECON. J. 938 (1995).

204 See, e.g., RICHARD H. THALER, *Toward a Positive Theory of Consumer Choice*, in QUASI RATIONAL ECONOMICS 7-10 (1991); Daniel Kahneman et al., *The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSP. 193, 203-04 (1991).

205 THALER, *supra* note 204, at 7-10.

206 See generally John Gourville & Dilip Soman, *Pricing and the Psychology of Consumption*, HARV. BUS. REV., Sept. 2002, at 90; Richard J. Harris & Mark A. Joyce, *What's Fair? It Depends on How You Phrase the Question*, 38 J. PERSONALITY & SOC. PSYCHOL. 165 (1980). Several studies show that consumers are susceptible to explanations regarding the rationale for pricing and alter their fairness perceptions following such explanations. See, e.g., Yew-Kwang Ng, *Economic Efficiency Versus Egalitarian Rights*, 41 KYKLOS 215, 230-35 (1988) (demonstrating how a short explanation may affect consumers' acceptance of restaurant surcharges on Saturday night reservations). See also RAMSAYE, *supra* note 53, at 710 ("Owing to the enormous salary which it has been necessary to pay Miss [Mary] Pickford in order to secure her services, all future releases will be first released to big city theaters charging a minimum price of twenty-five cents" (quoting an announcement of Paramount explaining the reasons for price variation)); *Broadway Movies To Put Price at \$2*, N.Y. TIMES, Aug. 7, 1923, at 20 (explaining the reasons for high admission prices in selected theaters for special premieres); *\$3 for Movie Ticket? Theater Owners Here Explain Why*, *supra* note 173.

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markets,<sup>207</sup> there is reason to believe that patrons would not perceive such a practice as unfair.

### B. Demand Uncertainty

Demand uncertainty is perhaps the most mentioned cause for the difficulties in varying admission prices. Industry professionals and scholars commonly use the phrase “Nobody Knows Anything”<sup>208</sup> to describe the unpredictability of movies’ success.<sup>209</sup> The problem involves pricing a movie before its opening, because much of the uncertainty is revealed after the first weekend on the screens.<sup>210</sup> *Ex post* modifications of initial admission prices in light of the premiere’s success seem undesirable: Price cuts are likely to be perceived as quality signals and may deter patrons rather than increase demand,<sup>211</sup> and price increases may antagonize patrons and have a chilling effect.

Figure 4 demonstrates one facet of demand uncertainty in the industry that precludes price differentiation across genres. Within each genre, the variance of the box office revenues is too high to allow profitable price variation across genres. The two exceptions are documentaries and black comedies, the demand for which is significantly lower than the demand for other genres. No good data on the performance of children’s movies are available since they are not classified as a genre. It is possible, however, that this category of movies could be distinguished from other movies for pricing purposes. Given the specific audiences of these movie categories, lowering their admission prices may be profitable.

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207 See, e.g., Monte MacKenzie, *Rising Boxoffice*, HOLLYWOOD REP., Sep. 21, 1993, at S1 (noting that tickets to *Jurassic Park* were sold in Japan for a premium of 67%); Cathy Meils, *Czech Public Tests Ticket Hike*, DAILY VARIETY, Jan. 8, 1997, at 39 (noting that tickets to *Evita* and *Independence Day* were sold in the Czech Republic at significant premiums); Cathy Meils, *‘Titanic’ Raising Tix Tab*, DAILY VARIETY, Feb. 2, 1998, at 13 (noting that advance tickets to *Titanic* were sold in Poland at a 67% premium); Jonathan Watts, *‘Austin’ Goes for Cheap in Japan*, HOLLYWOOD REP., June 29, 1999, at 59 (noting that advance tickets to *Austin Powers: The Spy Who Shagged Me* were sold in Japan for 45% less than the regular price to attract young audiences).

208 The phrase was coined by screenwriter William Goldman. WILLIAM GOLDMAN, *ADVENTURES IN THE SCREEN TRADE: A PERSONAL VIEW OF HOLLYWOOD AND SCREENWRITING* 39 (1983).

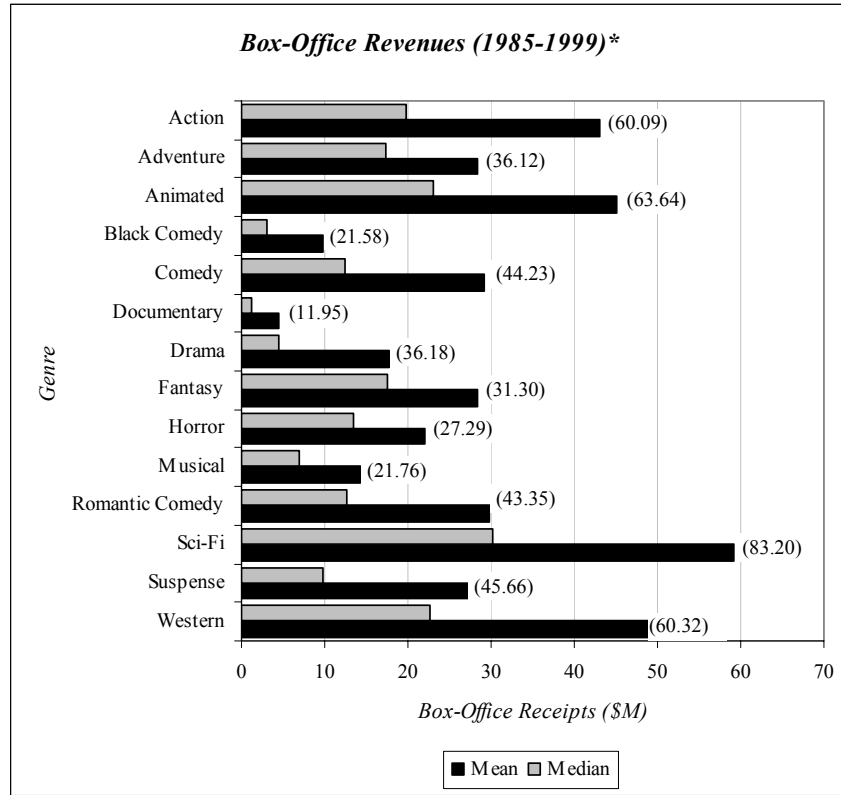
209 For a thorough study of uncertainty in the motion picture industry, see DE VANY, *supra* note 41.

210 Einav, *supra* note 31. See also *infra* Figure 5.

211 See *infra* Section III.C, which deals with admission prices as quality signals.



FIGURE 4



\* Figures in parentheses represent the standard deviation for each genre. Figures are adjusted to 1999, including changes in population.  
 DATA SOURCE: Author's database (on file with Yale Journal on Regulation).

Studies of other criteria relating to demand patterns also suggest that no general criteria can be used to forecast box office revenues.<sup>212</sup> The demand uncertainty argument, however, is too broad, and, despite its popularity, it does not explain the puzzle of uniform admission prices. First, empirical evidence shows that demand uncertainty is not as great as popularly argued and that the determinants of success in the industry are not totally random.<sup>213</sup> Producers may be unable to predict box office revenues of most movies, but identifiable event movies are likely to perform better at the box office.

Second, the argument fails to explain the uniformity of admission prices over time. Uncertainty regarding the performance of new movies

212 See, e.g., DE VANY, *supra* note 41.

213 See *supra* Section I.C.

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has nothing to do with possible differentiation across seasons or differentiation between weekdays and weekends.

The counterargument of industry professionals is that the apparent popularity of weekends is misleading, since, given the short screen lives of movies, the opening weekend is particularly important.<sup>214</sup> As shown in Figure 5, depending on the genre, box office revenues on the first weekend normally count for more than fifteen percent of total revenues and can account for more than thirty percent. It is believed that weekend pricing would divert moviegoers to weekdays, especially due to uncertainty regarding the quality of newly released movies. Waiting for information from first-weekend reviews may be valuable to potential moviegoers, and weekend pricing would provide an additional reason to postpone the visit to the theater. The impact is likely to be inversely related to potential box office performance, as after the opening weekend undecided patrons would adjust their preferences based on first reviews and acceptance by the public.<sup>215</sup> In other words, uninformed patrons may watch on opening weekends movies they would not see once information on such movies is disseminated after the premiere and, therefore, it is particularly important to attract patrons to the box office on the opening weekend for bad movies.<sup>216</sup> Even for potentially successful movies the opening weekend argument applies. It is believed that “[i]f it doesn’t open, you are dead”;<sup>217</sup> that is, if a movie does not create a cascade on the first weekend, its chances of success at the box office and in secondary markets are low.<sup>218</sup> Thus, any diversion of moviegoers from the opening weekend to later periods may be detrimental to general performance.

The opening weekend argument reflects an unexamined hypothesis that the demand on weekends is very elastic. However, the general descriptive statistics of weekend attendance and existing weekend pricing policies<sup>219</sup> suggest that this hypothesis is probably wrong. Patrons’

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214 The pressure on distributors to make a significant impact in the opening weekend for certain films has led to distributors’ willingness to play films on screens in closer proximity to maximize initial box office results which are at high film rent terms to the exhibitor. This quick “burn off” of film has resulted in an industry-wide increase in film cost (as a percentage of box office revenue) over the past several years.

LOEWS CINEPLEX ENTERTAINMENT CORP., SEC FORM 10-K, at 4 (2001).

215 Movie appreciation is often related to prior information and, therefore, the adjustment process is likely to be particularly strong. For some evidence on movie appreciation and prior information, see Michael H. Burzynski & Dewey J. Bayer, *The Effect of Prior Information on Motion Picture Appreciation*, 101 J. SOC. PSYCHOL. 215 (1977).

216 See generally Patrick DeGraba, *Buying Frenzies and Seller-Induced Excess Demand*, 26 RAND J. ECON. 331 (1995).

217 MARK LITWAK, REEL POWER: THE STRUGGLE FOR INFLUENCE AND SUCCESS IN THE NEW HOLLYWOOD 84 (1986).

218 See Sushil Bikhchandani et al., *A Theory of Fads, Fashion, Custom, and Cultural Change as Informational Cascades*, 100 J. POL. ECON. 992 (1992).

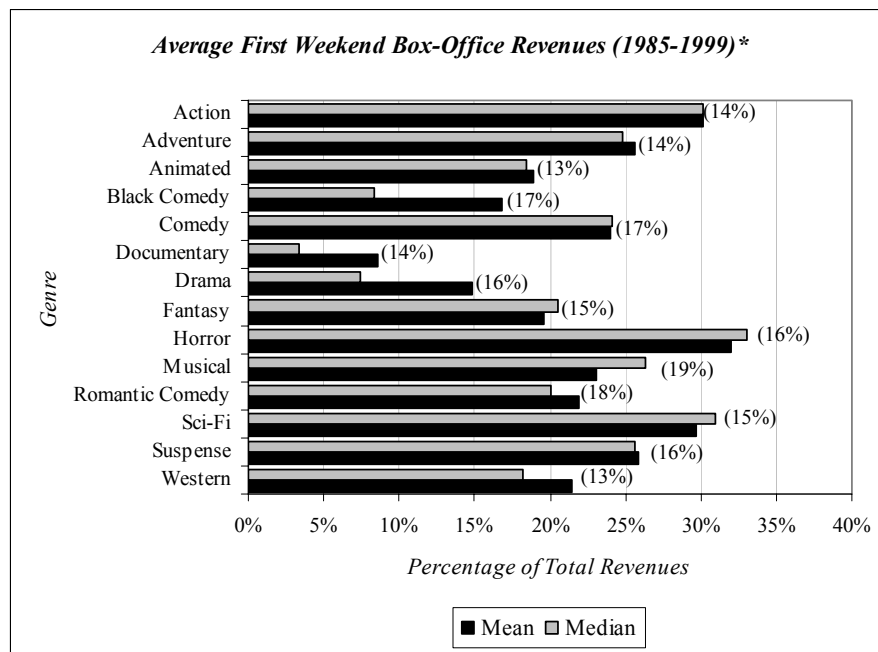
219 See *supra* text accompanying note 32.

revealed preferences of weekends over weekdays indicate that small changes in weekend pricing may increase profits. Furthermore, to the extent that one price for weekdays and weekends allows the industry to capture more value from uninformed moviegoers, this strategy can still be combined with premium rates for event movies' premieres.

The concerns regarding the impact of weekend pricing on secondary markets, such as merchandise and licensing to home exhibition channels, presents a conflict of interest between exhibitors and distributors. Producers and distributors may prefer to maximize numbers of patrons on opening weekends, even at the expense of box office revenues, because their major source of income is in the secondary markets, which are often fostered by opening weekend cascades. To the extent that such an interest plays a role in box office pricing, its promotion is probably illegal under the *Paramount* decrees: Distributors are prohibited from intervening in movie pricing regardless of the interests that such pricing promotes.

Finally, the demand uncertainty and opening weekend arguments do not explain uniform prices across seasons. Adjusting admission prices to demand during high seasons entails very limited uncertainty, if any, and would not have any impact on opening weekends.

FIGURE 5



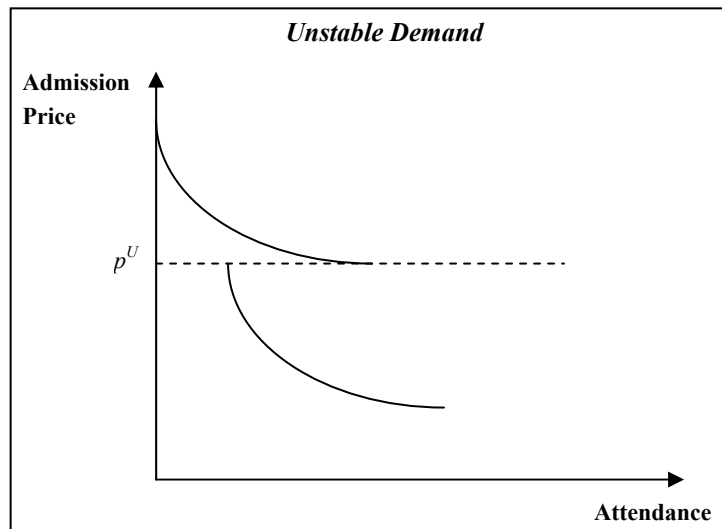
Figures in parentheses represent the standard deviation for each genre.  
 DATA SOURCE: Author's database (on file with Yale Journal on Regulation).

C. *Unstable Demand*

Another common explanation for uniform prices is that, under a non-uniform pricing regime, patrons would perceive the price as a quality signal. According to this view, price differentiation would deter patrons from low-priced movies. In economic terms, the fear is that the demand for movies is unstable,<sup>220</sup> such that any price drop below the uniform price would lead to a sharp decrease in demand.

Figure 6 illustrates a hypothetical case of unstable demand. The demand curve behaves normally above and below the uniform price ( $p^U$ ), at which a slight deviation downward would result in a sharp drop in demand.

FIGURE 6



The question of whether ticket prices are perceived by moviegoers as quality signals and will therefore affect demand is an empirical one and has never been tested. Even if demand were unstable, some price variation would still be profitable. First, the unstable-demand argument fails to explain why admission fees do not vary according to recurring demand patterns. Lower prices on weekdays and slow seasons need not convey any quality signals. Second, assuming that ticket prices would convey quality signals, price differentiation can still increase revenues. Charging higher prices for event movies is unlikely to have any negative effect on the

220 Gary S. Becker, *A Note on Restaurant Pricing and Other Examples of Social Influences on Price*, 99 J. POL. ECON. 1109 (1991).

demand for other movies: Patrons clearly distinguish between “regular” and event movies. Similarly, different admission fees for movies that target different audiences are unlikely to destabilize the demand for less pricey movies. For example, lowering prices for documentaries and children’s movies may increase the demand for those movies rather than shrink it. Thus, the unstable-demand argument applies only to price differentiation across movies with a similar profile.

#### D. *Transaction and Confusion Costs*

Administering variable pricing could be costly. For example, differentiating among movies would necessitate monitoring mechanisms to prevent patrons from purchasing tickets for a low-price movie and watching a premium-price movie. Similarly, variable pricing could result in a complicated price menu that could confuse moviegoers.

In practice, the problem is limited to arbitrage opportunities at the multiplex and agency costs that are discussed in the next Section. Discounts during slow seasons are unlikely to entail any costs or to create confusion among patrons. Weekend pricing may complicate the price menu but would not be confusing if simple, consistent pricing were implemented.

Arbitrage opportunities could probably be prevented by monitoring mechanisms that are not much different from the mechanisms already employed by exhibitors. Today, some screens are sold out while others are not, and, therefore, exhibitors must monitor the patrons entering sold-out movies. Otherwise patrons who could not purchase a ticket to a sold-out movie could use a ticket to another movie. Put simply, the arbitrage opportunities today are similar to those available under a regime in which there is a token premium for event movies.

#### E. *Agency Problem*

At the box office, the interests of exhibitors and distributors may diverge, even though they share revenues. For the exhibitor, a dollar spent by a patron on refreshments is better than a dollar spent on a ticket, as the markup on refreshments is approximately 85% and on tickets approximately 45%.<sup>221</sup> As a result, the exhibitor’s interest is not necessarily to maximize box office revenues.<sup>222</sup> It has been argued that, to

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221 For representative financial information, see AMC ENTERTAINMENT INC., 2003 ANNUAL REPORT 17 (2003); CARMIKE CINEMAS, INC., SEC FORM 10-K, at F-4 (2002). For the history of concessions sales at the theater, see STONES, *supra* note 60, at 101-113.

222 See, e.g., Aljean Harmetz, *They Gamble on Films, Popcorn, Soda and Craps*, N.Y. TIMES, Nov. 12, 1981, at C18; Katja Hofmann, *It’ll Win an Oscar but Will It Sell Popcorn?*, FIN. TIMES, Feb. 30, 2003, at Creative Business 6.

protect their interests, distributors act to maintain firm ticket pricing,<sup>223</sup> which is easier under uniform pricing than under variable pricing. This argument could be true, but it is too simplistic to explain price uniformity across time. Simple weekend and seasonal pricing schemes could serve the mutual interests of exhibitors and distributors without raising additional complexities.<sup>224</sup>

Another agency problem at the box office results from the fact that the exhibitor is a servant (agent) of more than one master (principal). At the multiplex, movies from several distributors are shown at the same time. Consequently, aligning the interests of the exhibitor with those of the distributors is not only about popcorn sales. Different admission prices for different movies would require exhibitors to establish monitoring systems for screens of high-priced movies to avoid arbitrage across movies, particularly across movies of different distributors. Therefore, from the standpoint of each distributor, the transition to variable pricing involves some risk, as a distributor's receipts would depend on the interactions of its licensed exhibitors with other distributors, the effectiveness of the exhibitors' monitoring systems, and the exhibitors' accounting systems.

The multiple-principal problem, however, does not prevent price differentiation along recurring demand patterns, since the same patterns apply to all movies. The problem highlights certain costs of variable pricing across movies, but the magnitude of these costs is unknown, since the existing monitoring mechanisms that regulate attendance of sold out movies could mitigate the problem. Critics of this approach argue that variable pricing would encourage exhibitors to misstate attendance statistics in order to keep a higher share of box office receipts. Specifically, the reported attendance would attribute patrons of high-priced movies to low-priced movies, so that an exhibitor would not share the difference with the distributors, thereby pocketing the premium. Such a concern, to the extent it is realistic, should not be imputed to variable pricing. Variable pricing may add only a marginal incentive to misstate attendance statistics to today's incentives to misstate the number of patrons and keep a larger share of admission receipts. Therefore, variable pricing would have only a marginal impact on existing agency problems.

#### F. *Distributors' Interests, Conservatism, and Unilateral Transition*

Several industry professionals who were interviewed for this Article

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<sup>223</sup> See, e.g., VOGEL, *supra* note 27, at 87 ("Given the high percentage normally taken by the distributor, it is in the distributor's interest to maintain firm ticket pricing, whereas it may be in the exhibitor's interest to set low ticket prices to attract candy-stand patronage.")

<sup>224</sup> In certain situations, per-capita requirements are used to mitigate the agency problem caused by exhibitors' incentives to attract candy consumers. See, e.g., *id.* at 87 (noting that per capita requirements were used to raise children's rates for *Superman*, *Annie*, and a few Disney films).

indicated that the major distributors object to changes in the present pricing structure and act—directly or indirectly—against such changes.<sup>225</sup> A recent example is a letter from United International Pictures, one of the six largest Hollywood distributors, to Mr. Stelios Haji-Ioannou, a pricing entrepreneur who tries to match admission prices with consumers' reservation prices:<sup>226</sup> “We have concluded that your business model is unlikely to lead to a sustainable increase in aggregate [reel] rentals and on this basis that we should not begin a business relationship.”<sup>227</sup>

There are three standard explanations for the distributors' objections to variable pricing: First, changing the status quo could lead to revisions in the customary distribution of box office revenues that would be detrimental to the distributors. Second, cross-movie price variation might accelerate ego wars in the industry, since producers and directors would like their movies priced at a premium. Third, uniform pricing enables distributors to compare neighboring exhibitors and to optimize movie allocation. Variable pricing, particularly price variation across movies, would complicate such a comparison.<sup>228</sup> The first two arguments refer to beliefs that a transition to variable pricing would have a negative impact on the distributors' profits. The third one is unconvincing, as it suggests that computation problems lead distributors to neglect potential profits.

A fourth and more theoretical explanation is that the distributors wish to eliminate a double markup.<sup>229</sup> Where a manufacturer (a producer or distributor) and a retailer (an exhibitor) have some market power, each adds a markup that reflects its relative market power. Under such circumstances, consumers face two markups instead of one. This double markup provides an incentive for firms either to integrate vertically or to use vertical restrictions, such as resale price maintenance, to increase joint profits. In the motion picture industry, a distributor's exclusive right to market a specific movie conveys some market power. Correspondingly, most exhibitors enjoy some market power in their geographic locations either because they are the only theater in town or because the movies they show are licensed exclusively to them in their geographic area.<sup>230</sup> In such

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225 See also *supra* note 194.

226 *How easy Does Just About Everything*, *supra* note 17.

227 Gautam Malkani, *Cut-Price Gladiator Goes to the Cinema*, FIN. TIMES, May 15, 2003 at 15 (Finance & Marketing).

228 See *Report*, *supra* note 158, at 46.

229 See G. F. Mathewson & R. A. Winter, *An Economic Theory of Vertical Restraints*, 15 RAND J. ECON. 27 (1984); Patrick Rey & Jean Tirole, *The Logic of Vertical Restraints*, 76 AM. ECON. REV. 921 (1986); Joseph J. Spengler, *Vertical Integration and Antitrust Policy*, 58 J. POL. ECON. 347 (1950).

230 Market power is not a necessary condition for price discrimination. See, e.g., Mark Armstrong & John Vickers, *Competitive Price Discrimination*, 32 RAND J. ECON. 579 (2001); Michael E. Levine, *Price Discrimination Without Market Power*, 19 YALE J. REG. 1 (2002); Luis Locay & Alvaro Rodriguez, *Price Discrimination in Competitive Markets*, 100 J. POL. ECON. 954 (1992). This Article focuses primarily on price variation across differentiated goods, not on price discrimination,

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circumstances, resale price maintenance is a particularly efficient solution to demand uncertainty and potential double markup problems.<sup>231</sup> That traditional solution, however, is prohibited by the *Paramount* decrees. Vertical integration is not a complete solution in the motion picture industry, because distributors could not rely on integrated theaters to be the sole outlet for their movies.<sup>232</sup> Uniform pricing mitigates the double markup problem because, under such a pricing regime, the exhibitors' markup is not adjusted to the demand for specific movies and show times and, therefore, it only partially reflects their market power. This mechanism is, however, very rudimentary since the specific demand characteristics are not incorporated in the price to the consumer. Moreover, very often exhibitors absorb much of the distributors' markup, which is derived from their negotiated share of box office revenues.<sup>233</sup> In other words, uniform pricing prevents exhibitors from incorporating specific movie and show time demand in ticket pricing, while the distributors' share of box office receipts incorporates specific movie demand and frequently also seasonal demand.<sup>234</sup>

In sum, to the extent that the double-markup problem plays any role in the persistence of the uniform-pricing regime, it originated in the *Paramount* prohibitions against distributors' intervention in box office pricing. Uniform pricing, although it may mitigate the problem of double markup, creates inefficiencies since prices are not matched to demand. Additionally, uniform pricing has some distributional consequences because often exhibitors' interests are compromised. Nevertheless, distributors' actions against variable pricing are either ignored by the Justice Department or are construed informally so as to escape the scope of the *Paramount* decrees.

The inevitable question is why exhibitors do not switch to variable pricing if they would be better off doing so. The answer seems to be a combination of conservatism and fear of retaliation. Conservatism in this context is the adherence of the industry to an established practice without examining its justifications.<sup>235</sup> In the exhibition market, conservatism seems to be fed by unexamined concerns that the transition to variable

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and so this point will not be discussed further.

231 See generally David A. Butz, *Vertical Price Control with Uncertain Demand*, 40 J. L. & ECON. 433 (1997).

232 The *Paramount* prohibitions against vertical integration were partially relaxed in the mid-1980s, but certain limitations on distributors' use of integrated theaters as their sole outlets were imposed. See Fox, *supra* note 14.

233 Exhibitors' minimum share of box office revenues is forty to seventy percent. On average, the distributors' share is fifty-five percent. The exact revenue sharing formula is negotiated for each film. For descriptions of exhibition contracts, see *supra* text accompanying note 27.

234 For the distributors' seasonal markup, see *supra* text accompanying note 35.

235 For conservatism, see generally Timur Kuran, *The Tenacious Past: Theories of Personal and Collective Conservatism*, 10 J. ECON. BEHAV. & ORG. 143 (1988); Moti Nissani, *Conceptual Conservatism: An Understated Variable in Human Affairs?*, 31 SOC. SCI. J. 307 (1994).



pricing would be financially disadvantageous. The fear of retaliation refers to exhibitors' concerns that distributors would react to a unilateral transition to non-uniform pricing by disadvantageous licensing, such as by allocating promising movies to rivals or by licensing such movies late in their screen lives. Together they prevent what would be an overall improvement to the industry. A coordinated transition to variable pricing, such as an industry decision to cut weekday and winter admission prices by ten percent, may be the only way to overcome the industry's inertia. Such coordination, however, is generally unlawful, as antitrust law prohibits price coordination among competitors. A one-time exception to this general prohibition may be warranted in the case of the movie theater industry in order to facilitate variable pricing.

#### IV. Concluding Remarks

Much literature on vertical restraints has been inspired by the *Paramount* litigation, but the impact of the *Paramount* prohibitions on vertical restraints on the price to the consumer has been neglected in the literature. This Article fills the gap. The Article illustrates how an inefficient pricing system could form, evolve, and survive in the shadow of antitrust law, even in a high-profile industry such as the motion picture industry. It illustrates that, in practice, it may be difficult to enforce prohibitions on vertical restraints and that such prohibitions may impair market clearance. The Article further demonstrates that the persistence of a particular business practice is not necessarily proof of its efficiency.

It is difficult to estimate the welfare implications of uniform pricing at the box office. The Article's analysis indicates that a transition to variable pricing would likely benefit exhibitors and patrons. Exhibitors could increase profits through simple, variable pricing schemes, and the admission price patrons pay would be more closely related to their demand elasticities. Refining box office pricing according to moviegoers' demand elasticities means that patrons' movie going would better track their preferences than now. Price-sensitive patrons could watch movies at low rates during the week, at matinees, or after the initial demand for a newly released movie is satisfied. Time-sensitive patrons could watch movies on weekend nights, and the most dedicated fans could watch the premieres of event movies. Since the distributors' share of revenues is a percentage of box office receipts, direct financial results are likely to be positive for them too. It is possible that equating the admission prices of opening weekends to weekday rates allows the industry to capture more value because of quality uncertainty, but that creates the social cost of patrons unwittingly watching poor movies. In addition, for producers and distributors, numbers of patrons on opening weekends are sometimes more

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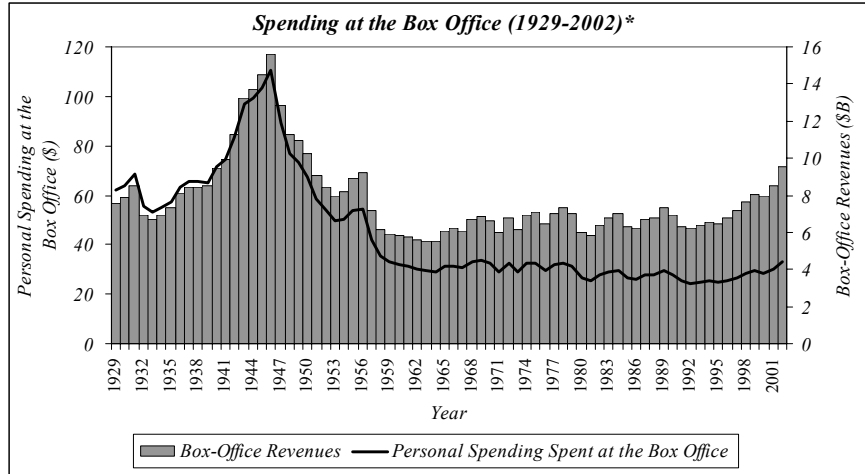
important than box office revenues. It is unclear, however, whether changes in the number of patrons on opening weekends (as opposed to weekdays) would have any social-welfare implications.

The history of box office pricing reveals that, despite extensive antitrust litigation and scrutiny, distributors have almost always influenced box office pricing both through illegal practices and through circumventing existing legal rules. The old *Paramount* decrees were designed to prohibit and prevent such intervention in box office pricing, but, although their fiftieth birthday has already passed, this goal has not been achieved. In fact, there are good reasons to believe that the *Paramount* prohibition against distributors' intervention in box office pricing is one of the causes for uniform pricing. Therefore, modifying the outdated *Paramount* prohibitions on vertical restraints is necessary to making that improvement and modernizing the regulation of the motion picture industry.

The legal technicalities aside, the Article distinguishes between price variation along recurring demand patterns and across movies and suggests that a move toward variable pricing would be an improvement for the industry. Although establishing price variation across types of movies is an intellectual challenge that might be too costly, devising price variation along recurring demand patterns is simple and inexpensive.

APPENDIX: INDUSTRY STATISTICS

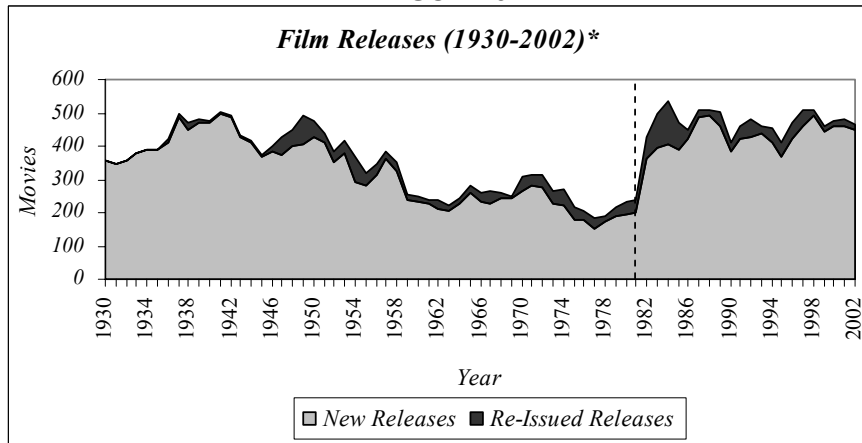
FIGURE 7



\* Figures are adjusted to 2002

DATA SOURCES: NAT'L ASS'N OF THEATER OWNERS, THE ENCYCLOPEDIA OF EXHIBITION (2003-2004) ; PRESIDENT OF THE UNITED STATES, ECONOMIC REPORT OF THE PRESIDENT 2004, at app. B-16; THE MOTION PICTURE ALMANAC (1929-1945; 2002); BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CONSUMER PRICE INDEX: ALL URBAN CONSUMERS (2004), <ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.txt>.

FIGURE 8



\* Figures until 1981 included only releases of the major studios. No systematic data is available for releases of non-major studios prior to 1982.

DATA SOURCES: NAT'L ASS'N OF THEATER OWNERS, THE ENCYCLOPEDIA OF EXHIBITION (2003-2004).