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# Introducing Price Competition at the Box Office

Harrison J. Reynolds\*

*Why is it that movie ticket prices do not vary between films that cost vastly different amounts to make? It is because the current model for the production, distribution, and theatrical exhibition of feature films is deeply flawed. Despite long-awaited federal action designed to curb anticompetitive behavior, film distributors have continued to exert inappropriate control over pricing at the box office. The result is an insufficiently competitive—and hence inefficient—market for theatrical exhibition. Previous scholarship has discussed some of the root causes of this behavior and has called for ticket price differentiation based upon the context of a screening (such as the time of day, the day of the week, the season, or the seating). Some scholars have also suggested pricing based on film genre. Unfortunately, these proposed solutions fall short of the mark, and there has been a glaring absence of discussion or scholarship about the market problems resulting from a lack of price differentiation between individual films. This article analyzes anticompetitive behavior in film exhibition, focuses on the resulting market inefficiencies that ultimately harm the consumer, and calls for a pricing system primarily influenced by film-specific costs.*

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\* Associate, Greenberg Glusker Fields Claman & Machtinger, LLP; J.D., Stanford Law School, 2012; B.A., Brigham Young University, 2009. The author thanks Professors Mark A. Lemley and Barbara van Schewick for valuable insight and encouragement, Barak Y. Orbach and Liran Einav for blazing a trail, and the editors and staff of the UCLA Entertainment Law Review for their tireless efforts and contributions.

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## I. INTRODUCTION – ALL MOVIES ARE PRICED THE SAME

Approach any movie theater box office and you will be confronted by a phenomenon so familiar and pervasive that it is easy to overlook how unusual and anticompetitive the practice actually is: Generally speaking, all movies are priced the same.

Although this may not initially appear to be a strange or inappropriate outcome, it represents an astonishing lack of competition in the market for theatrical exhibitions. Consumers generally choose which movie to see based on some combination of their perceptions of film quality (as determined by personal interests) or popularity (e.g., a communal experience or peer-pressured response). Thus, movies at the box office do compete to some degree on the basis of the comparative attractiveness of available films. Nevertheless, a significant portion of the typical competition arena is entirely removed. There is no competition based upon the *price* of the goods offered.

This rule is not absolute. Under various circumstances, the price consumers pay will vary for any number of reasons. Unfortunately, virtually none of those reasons correspond directly to the underlying copyrighted work. And for some reason—perhaps just longstanding familiarity—consumers and administrative agencies have not challenged the practice as anticompetitive despite how much the scenario differs from natural pricing behavior in other industries.

The deep-seated problem behind uniform pricing practices in the film exhibition industry<sup>1</sup> is qualitative valuation. How do you price a unique copyrighted good? As one court has explained:

Preference is a matter of individual taste. The only question that can be answered is whether there is sufficient demand for a particular product to make its production worthwhile, and the response, so long as the free choice of consumers is preserved, can only be inferred from the reaction of the market.<sup>2</sup>

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<sup>1</sup> For the purposes of this Article, the “film exhibition industry” refers both to the U.S. companies operating theater houses that publicly exhibit feature-length films for profit (e.g., AMC Entertainment, Inc., Carmike Cinemas, Cinemark Theatres, and Regal Entertainment Group), and to the feature-length film distributors that provide content to those exhibitors (e.g., Warner Bros, Walt Disney Pictures, Sony Pictures, Paramount Pictures, 20<sup>th</sup> Century Fox, and Universal). Hereinafter, this Article refers to the commercial film exhibition industry, as defined, as “the exhibition industry.”

<sup>2</sup> *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 287 (2d Cir. 1979).

It may be in partial recognition of this difficulty in pricing that our intellectual property laws grant temporary monopolistic control to authors and inventors. By allowing the holders of intellectual property rights to set their prices, and to do so free from direct (i.e., infringing) competition, we avoid the difficulty of having to determine the proper value for untested goods. We leave that guesswork up to the most interested party (the rights holder), and market response is the ultimate judge of whether goods are priced appropriately.

But how does the monopolist decide what price to set? One possible approach involves pricing based upon perceived demand. The owner of a unique good might attempt to forecast demand by looking at comparable products already on the market, or by selling in a limited market to test the water before opening distribution to wide release.<sup>3</sup> Ultimately, however, if they possess a unique or singular product they can sell at whatever monopolistic rate they want, forcing consumers to pay up or forego the pleasure of consuming the distinctive good.<sup>4</sup>

In certain contexts, an intellectual property holder may not be able to set truly monopolistic pricing rates. For example, a “patent confers a monopoly in the sense of a right to exclude others from selling the patented product. But if there are close substitutes for the patented product, the patent ‘monopoly’ is not a monopoly in a sense relevant to antitrust law.”<sup>5</sup> While a granted monopoly may technically exist in all cases of exclusive intellectual property rights, this “monopoly” does not necessarily accompany significant market power. Any monopoly over a specific good is only as valuable as that good’s lack of competition.

In the case of substitutable goods, free market competition typically encourages a pricing system that accounts for demand *and* costs associated with bringing the goods to market. In other words, natural competition prevents monopolistic prices, because “the ability of consumers to turn to other suppliers restrains a firm from raising prices above the competitive level”: market forces drive prices closer and closer to-

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<sup>3</sup> See Arthur De Vany & W. David Walls, *Bose-Einstein Dynamics and Adaptive Contracting in the Motion Picture Industry*, 106 *ECON. J* 1493, 1497 (1996).

<sup>4</sup> Monopolistic pricing has several negative effects, including edging some potential consumers out of the market. Note that it might become economically *detrimental* for monopolists to charge beyond a certain price point, as consumers will cease to purchase even monopoly goods if prices are too high; but that price point will be determined by consumer demand alone—a true monopolist does not face the competitive market forces that otherwise might lower prices further. See LAWRENCE A. SULLIVAN & WARREN S. GRIMES, *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* 12 (2d ed. 2006).

<sup>5</sup> *Asahi Glass Co., Ltd. v. Pentech Pharm., Inc.*, 289 F. Supp. 2d 986, 995 (N.D. Ill. 2003).

wards the level of productions costs.<sup>6</sup>

To determine whether the box office price for a particular movie violates antitrust law, one must first define the relevant market to determine whether the movie possesses sufficient market power to displace the normal tendency of competition to reduce prices. The relevant market must include all products “reasonably interchangeable by consumers for the same purposes.”<sup>7</sup>

Applying this test, all widely released theatrical films compete in the same market, at least to some degree. Raise the price of a particular movie too much and moviegoers might choose to watch a different film instead.<sup>8</sup> Furthermore, some viewers may go to the theaters without a particular film in mind, essentially deciding which to watch once they arrive. To some degree, films are substitutable, at least within broad categories. The very fact that the public endures equal pricing for all movies<sup>9</sup> further supports the supposition that films are fairly substitutable goods that compete in the same market. Of course, a market full of *identically* priced rival goods also may suggest that competition in that market either has maximized efficiency or has broken down (i.e., under the influence of anticompetitive behavior). Across-the-board, identical pricing of distinguishable goods from various competing firms is too great a coincidence to permit many possibilities. If truly competing goods have reached the *exact* same price point, it is highly likely either because production *cannot* endure a lower profit (which is the final result of efficient market forces gradually driving down costs and prices), or because competitors have agreed to fix prices at a certain level (which is anticompetitive behavior).<sup>10</sup>

In the case of the movie business, all signs seem to point towards antitrust concerns. For argument’s sake, consider two high-grossing films from 2010: *The King’s Speech* and *The Last Airbender*.<sup>11</sup> These films’ gross revenues at the box office were within 2.72% of each oth-

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<sup>6</sup> *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 218 (D.C. Cir. 1986).

<sup>7</sup> *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 371, 395 (1956).

<sup>8</sup> See SULLIVAN & GRIMES, *supra* note 4.

<sup>9</sup> Again, certain qualifications to this statement exist, and will be treated below. However, as will be explained in Part III.A, *infra*, these exceptions to uniform pricing largely do not relate to the underlying films themselves.

<sup>10</sup> For judicial application of this assertion, see *infra* note 31.

<sup>11</sup> Out of a total of 535 theatrical releases in 2010, these two films earned, respectively, the seventeenth and eighteenth highest domestic gross receipts, thus ranking in the top four percent. See *2010 Domestic Gross*, BOX OFFICE MOJO, <http://www.boxofficemojo.com/yearly/chart/?yr=2010&p=.htm> (last visited Mar. 8, 2013).

er.<sup>12</sup> That statistic, taken alone, would seem to indicate fairly equivalent products—perhaps validating equivalent pricing. But the two films could not have been more different. *The Last Airbender* is a PG-rated action/adventure/family film. *The King's Speech* is an R-rated<sup>13</sup> biographical/dramatic/period-piece film. *The King's Speech* won Oscar Awards for Best Picture, Best Director, Best Original Screenplay, and Best Lead Actor.<sup>14</sup> *The Last Airbender*, on the other hand, won the questionable honor of Razzie Awards for Worst Picture, Worst Director, Worst Screenplay, and Worst Supporting Actor.<sup>15</sup> Clearly, extreme qualitative differences exist between these two films.<sup>16</sup> Of course, that fact taken alone does not necessarily incriminate equivalent pricing techniques. The proverbial nail in the competitive coffin comes with recognition of the fact that the estimated production budgets<sup>17</sup> of these two films vary by a factor of 1000 percent.<sup>18</sup>

Of course, demand for *The King's Speech* may well have supported the high market price charged relative to its low production costs. Meanwhile, the apparently non-appealing *The Last Airbender* had a relatively low market price if compared to its massive budget. In the case of these two films, perhaps the standard ticket price was fairly near the “sweet spot” that generates the most revenue—extracting higher profit margins for the highly decorated film, and settling for

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<sup>12</sup> See *The King's Speech (2010)*, BOX OFFICE MOJO, <http://boxofficemojo.com/movies/?id=kingsspeech.htm> (last visited Mar. 8, 2013); *The Last Airbender (2010)*, BOX OFFICE MOJO, <http://boxofficemojo.com/movies/?id=lastairbender.htm> (last visited Mar. 8, 2013) (showing the domestic grosses to be approximately \$135 million and \$131 million, respectively).

<sup>13</sup> *The King's Speech* was re-edited and re-released under a PG-13 MPAA rating in some markets. See Nicole Sperling, *Quick Takes: Scrubbed 'King's Speech' Gets PG-13 Rating*, L.A. TIMES (Feb. 26, 2011) <http://articles.latimes.com/2011/feb/26/entertainment/la-et-quick-20110226>.

<sup>14</sup> *The King's Speech (2010): Awards*, IMDB, <http://www.imdb.com/title/tt1504320/awards> (last visited Mar. 8, 2013).

<sup>15</sup> *The Last Airbender (2010): Awards*, IMDB, <http://www.imdb.com/title/tt0938283/awards> (last visited Mar. 8, 2013).

<sup>16</sup> A similar gulf seems to exist between these films in terms of audience approval. Users of the Internet Movie Database (IMDb) rate *The King's Speech* an 8.2 out of 10 possible stars, while they rate *The Last Airbender* a 4.5. See *The King's Speech (2010)*, IMDB, <http://www.imdb.com/title/tt1504320> (last visited Mar. 8, 2013); *The Last Airbender (2010)*, IMDB, <http://www.imdb.com/title/tt0938283> (last visited Mar. 8, 2013). Similarly, Fandango fan ratings vote *The King's Speech* to be a “Must Go!” film (the highest of 5 possible ratings), while voting *The Last Airbender* to be a “No!” film (the second lowest possible rating). See *The King's Speech Movie Reviews*, FANDANGO, [http://www.fandango.com/thekingsspeech\\_134227/moviereviews](http://www.fandango.com/thekingsspeech_134227/moviereviews) (last visited Mar. 8, 2013); *The Last Airbender Movie Reviews*, FANDANGO, [http://www.fandango.com/thelastairbender\\_126056/moviereviews](http://www.fandango.com/thelastairbender_126056/moviereviews) (last visited Mar. 8, 2013).

<sup>17</sup> Hereinafter, this Article will also refer to production budgets as “costs.”

<sup>18</sup> *The King's Speech* had a reported production budget of \$15 million, as compared to the reported \$150 million budget for *The Last Airbender*. See BOX OFFICE MOJO, *supra* note 12.

lower profit margins for the one that would be poorly received. The fact that both films did relatively well at the box office could suggest that they were indeed priced right.

But that argument—even if an accurate description of these two films—is based on happenstance. If one price at the box office is appropriate for all films, that means that tickets to all the low-budget films are selling with high profit margins and all high-budget films are selling with low ones. Such a system values films as if all independent releases are winners and all blockbusters are barely worth their costs. This, of course, makes no sense. In what other industry is it justifiable practice for costs to be inversely proportional to projected demand? Carried forward, an argument that these two film’s box-office receipts validate equal pricing for all others implies that poor scripts should have big budgets and money thrown at them, while guaranteed pleasers should pinch their pennies, all to ensure that the respective profit margins properly reflect market demand. Formidable Hollywood talent would have to choose between doing potentially great films for relatively nothing, or doing poorly-valued films for compensation somewhere nearer to what their services are worth, if production budget and forecasted reception are to be inversely proportional to each other.

In short, the box office outcome of these two films demonstrates (if anything) the exception, not the rule. For two distinctive films to be priced exactly the same although they had dissimilar target audiences, received vastly differing critical acclaim and lay audience reviews, and had extremely different costs suggests that appropriately competitive pricing practices are not in play with respect to films at the box office. There are a number of other possible explanations for why these films grossed roughly the same amount under uniform pricing. It could be due to misleading advertising, the timing of their respective releases, or even pure coincidence. But it is a hard sell to say that all films should be equivalently priced. A general lack of competitive pricing, however enacted, maintained, or excused, represents a failure of our antitrust regime, which is based on the belief “that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone.”<sup>19</sup>

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<sup>19</sup> United States v. Aluminum Co. of Am., 148 F.2d 416, 427 (2d Cir. 1945).

Without adequate competition, market efficiency erodes.<sup>20</sup> When that erosion advances to monopolistic behavior, several undesirable consequences ensue.<sup>21</sup> Some consumers are priced out of the market altogether, resulting in reduced production levels and an overall decrease in the number of desirable goods and services that are distributed.<sup>22</sup> Meanwhile, others pay higher prices than they would in a competitive market, and quality, innovation, and cost-efficiency all suffer.<sup>23</sup> This Article argues for cost-based ticket pricing for first-run films as a solution to increase market efficiency through competitive pricing practices. While not the be-all, end-all of price determinants, production budgets and marketing expenses should play a large role in setting admission prices.

## II. *PARAMOUNT* – AN ATTEMPT TO FIX ANTICOMPETITIVE HOLLYWOOD

### A. *The Industry Before Paramount – Block-booking & Vertical Price Restraints*

Prior to *United States v. Paramount Pictures*,<sup>24</sup> film admission prices varied “over time, across theaters, and across movies.”<sup>25</sup> At the same time, however, admission prices were largely determined by resale price maintenance,<sup>26</sup> a practice which had been a per se violation of the Sherman Act since 1911.<sup>27</sup> *Paramount* was an antitrust case brought by the United States against the major film production, distribution, and exhibition companies of the day, for violation of the Sherman Act.<sup>28</sup> All of the defendants owned, operated, or were affiliated

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<sup>20</sup> See SULLIVAN & GRIMES, *supra* note 4.

<sup>21</sup> While the pricing practices of the film exhibition industry are more properly labeled as price-fixing vertical restraint than monopoly (*see* Part II.A herein), the potential harm is the same (if potentially less severe). Judge Learned Hand, in *Aluminum Co.*, noted that the distinction between price-fixing agreements and monopolies is “purely formal.” 148 F.2d at 428.

<sup>22</sup> Economists refer to this as a deadweight loss. See SULLIVAN & GRIMES, *supra* note 4, at 12.

<sup>23</sup> See SULLIVAN & GRIMES, *supra* note 4, at 11-15.

<sup>24</sup> 334 U.S. 131, 152 (1948).

<sup>25</sup> Barak Y. Orbach, *Antitrust and Pricing in the Motion Picture Industry*, 21 YALE J. ON REG. 317, 338 (2004).

<sup>26</sup> As used herein, “resale price maintenance” refers to the practice of film distributors mandating minimum amounts for the ticket prices exhibitors charge at the box office.

<sup>27</sup> Orbach, *supra* note 25, at 334. See also 15 U.S.C. § 1 (2006) (making illegal “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States”).

<sup>28</sup> Named defendants include Paramount Pictures, Inc.; Loew’s, Incorporated; Radio-Keith-Orpheum Corporation; Warner Bros. Pictures, Inc.; Twentieth Century-Fox Film Corporation; Columbia Pictures Corporation; Universal Corporation; and United Artists Corporation. *Par-*

with film distribution companies, and most were vertically-integrated conglomerates that operated at all stages of the motion picture industry—production, distribution, and exhibition.<sup>29</sup>

The Court in *Paramount* noted that “two price-fixing conspiracies existed—a horizontal one between all the defendants, [and] a vertical one between each distributor-defendant and its licensees,” with “the latter . . . based on express agreements [that made it] plainly established.”<sup>30</sup> Although the Court conceded that producer/distributor/exhibitor conglomerates could *technically* fix prices for any films screened in their own theaters, the Court inferred the existence of an unlawful horizontal agreement between these conglomerates based upon their actions in the market.<sup>31</sup>

*Paramount* also examined the convention of compulsory “block-booking”—the practice of distributors requiring exhibitors to purchase entire bundles of films instead of allowing them to negotiate on a film-by-film basis.<sup>32</sup> In its rejection of compulsory block-booking,<sup>33</sup> the Court explained that this practice involves an improper extension of the “copyright monopoly” because it forces the sale of one item by leveraging the market power of another.<sup>34</sup> In other words, compulsory block-booking of copyrighted works is a tying arrangement.<sup>35</sup>

In sum, due to the assortment of anticompetitive relationships and agreements in operation, film variety was greatly limited in many geographic areas.<sup>36</sup> Established practices and agreements “erected barriers to entry into the production and distribution markets, because rival

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amount, 334 U.S. at 140.

<sup>29</sup> *Id.*

<sup>30</sup> *Paramount*, 334 U.S. at 142.

<sup>31</sup> *See id.* (determining by inference that a horizontal agreement existed between defendants based on the “pattern of price fixing disclosed in the record”). *See also* United States v. Paramount Pictures, Inc., 334 F. Supp. 323, 336 (S.D.N.Y. 1946) (“The whole system presupposed a fixing of prices by all parties concerned in all competitive areas”); Alexandra Gil, *Breaking the Studios: Antitrust and the Motion Picture Industry*, 3 NYU J.L. & LIBERTY 83, 111-12 (2008) (“The implication of this logic is that absent an agreement between all defendants to set a minimum admission price, one or more of the defendants would have lowered its admission price, thereby attracting more consumers and forcing price competition.”).

<sup>32</sup> *Paramount*, 334 U.S. at 156.

<sup>33</sup> Note, though, that the Court did not hold that *voluntary* block-booking was illegal. *See id.* at 157-58.

<sup>34</sup> *See id.* at 158.

<sup>35</sup> Tying arrangements (or “tie-ins”) have been challenged as violations of Sections 1 and 2 of the Sherman Act, Section 3 of the Clayton Act, and Section 5 of the Federal Trade Commission Act. SULLIVAN & GRIMES, *supra* note 4 at 423.

<sup>36</sup> Orbach, *supra* note 25, at 339.

producers and distributors had limited outlets for their films. In turn, these entry barriers further limited the potential variety of films and generated additional social welfare loss.<sup>37</sup>

### B. Paramount's Proposed Solution

The *Paramount* ruling represented the culmination of twenty years of failed antitrust actions against a few large distributors that had acquired control over admission prices.<sup>38</sup> The government's complaint alleged seven major charges:

- (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.<sup>39</sup>

*Paramount* resulted in three legal rules intended to 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."<sup>40</sup> The ultimate goal was "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,"<sup>41</sup> as "a copyright may no more be used than a patent to deter competition between rivals in the exploitation of their licenses."<sup>42</sup>

### C. Paramount Failed

Unfortunately, in spite of all grand intentions, *Paramount* failed.<sup>43</sup> In fact, "[i]f the goals of antitrust law are to increase competition, increase output, improve quality, decrease price, and generally improve the condition of the market for consumers, the Paramount decision

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<sup>37</sup> *Id.* (citation omitted).

<sup>38</sup> *Id.* at 319.

<sup>39</sup> *Id.* at 342 (citation omitted).

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Paramount*, 334 U.S. at 144.

<sup>43</sup> Gil, *supra* note 31, at 123 ("Although the Paramount decision was an attempt to increase competition and improve the market for film distribution and exhibition, its long term effect was simply to replace one set of industry leaders with another without diminishing their control over the market. Antitrust law intervened in Hollywood without success.").

managed to accomplish the exact opposite of its intended goals.”<sup>44</sup> Indeed, more recent descriptions of the state of the motion picture industry indicate that very little has changed since *Paramount*:

[E]xhibitors have been required to obligate themselves contractually prior to film completion, and to make non-refundable payments on film rentals. Moreover, film distributors without established reputations, known in the industry as ‘independents,’ are often precluded from licensing films to the more desirable movie theaters because the major distributors book those theaters months in advance through blind bidding.<sup>45</sup>

Complaints of improper distributor involvement in the setting of admission prices have persisted, and enforcement has proven particularly difficult.<sup>46</sup> By re-labeling their old minimum resale price restrictions as “suggestions”—which nonetheless might determine whether a deal is ultimately made—distributors danced around the *Paramount* prohibitions.<sup>47</sup> And distributor intervention in the setting of ticket-prices has gone further than just offering admission price “suggestions;” distributors have raised their shares of box-office revenues, instituted per-capita requirements on exhibitors (i.e., demanding minimum levels of compensation based upon the number of patrons who actually attend a given film), and have punished exhibitors who charge admission prices lower than desired.<sup>48</sup> Despite all that *Paramount* proposed to address, “[f]or all intents and purposes, the old cartel remained, stripped of its theaters and formal channels of communication.”<sup>49</sup>

Ironically, prior to *Paramount*, “although exhibitors paid one price for a bundle of movies, admission prices per movie varied across movies even for premieres. In contrast, films today are licensed and priced to exhibitors on a movie-by-movie basis. Nevertheless, exhibitors charge one price for all movies.”<sup>50</sup>

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<sup>44</sup> *Id.* at 118-19.

<sup>45</sup> *Id.* at 122 (quoting Mary Elizabeth Kilgannon, Note, *Motion Picture Licensing Acts: An Analysis of the Constitutionality of Their Provisions*, 51 *FORDHAM L. REV.* 293, 294 (1982)).

<sup>46</sup> Orbach, *supra* note 25, at 349 (citation omitted).

<sup>47</sup> *Id.*

<sup>48</sup> *Id.* at 349-50 (citation omitted).

<sup>49</sup> *Id.* at 350 (quoting Robert W. Crandall, *The Postwar Performance of the Motion Picture Industry*, 20 *ANTITRUST BULL.* 49, 57 (1975)).

<sup>50</sup> Orbach, *supra* note 255, at 338.

#### D. *The Industry After Paramount*

In the aftermath of *Paramount's* failure, legal scholars have voiced a number of concerns about the state of the industry. One prominent article goes so far as to argue that “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,”<sup>51</sup> essentially calling for a direct reversal of what the Court intended as solutions. Scholars have described the ruling’s effect as superficial—effectually futile, even, in the face of historical forces.<sup>52</sup> Such criticisms of *Paramount's* shortcomings are not a recent development. Just one year after the case, a scholarly article explained that courts—including the U.S. Supreme Court in *Paramount*—had thus far failed to fix the anticompetitive problems of the film trade because they failed to recognize the “cause of noncompetitive behavior—a monopolistic or oligopolistic industry.”<sup>53</sup>

Various responses to *Paramount's* effect on film-industry competition have surfaced over the years. Although some economists have argued that competition has in fact increased post-*Paramount*, this increase in competition has largely occurred only at the point of film production.<sup>54</sup> Independent producers have gained no post-*Paramount* leverage in negotiating the release and distribution of their films, and without connections to distributors they are typically unable to get their

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<sup>51</sup> *Id.* at 321. For more on this line of reasoning, see *infra* Part III.C.

<sup>52</sup> Stanley Ornstein explained the hopelessness of *Paramount's* ruling thusly:

Lost in the process of these sweeping changes were the efficiency gains from vertical integration, long-term franchising, and block-booking. Whatever the anticompetitive effects of these policies as decided under *Paramount*, they had clearly served to reduce distribution costs. The banned policies evolved over many years of competitive pressures for efficient distribution. Such efficiencies are not forsaken easily. Distributors and exhibitors would naturally seek close legal substitutes for the forbidden practices.

Stanley I. Ornstein, *Motion Picture Distribution, Film Splitting, and Antitrust Policy*, 17 HASTINGS COMM. & ENT L.J. 415, 436-37 (1995). See also Orbach, *supra* note 25, at 365 (“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.”).

<sup>53</sup> John R. McDonough, Jr. & Robert L. Winslow, *The Motion Picture Industry: United States v. Oligopoly*, 1 STAN. L. REV. 385, 427 (1949).

<sup>54</sup> Gil, *supra* note 31, at 121-22 (arguing that “the *Paramount* decision created more competition between the defendants themselves, rather than any potential new entrants into the market”); *id.* at 122 (“The barriers to entry for film production have continued to drop with the introduction of new technology that allows filmmakers to produce high quality films at lower prices, but the barriers to entry for film distribution and exhibition remain unchanged.”).

films screened.<sup>55</sup>

Foreseeing this very concern, John McDonough and Robert Winslow argued in 1949 that *Paramount's* “principle of using divestiture to eliminate interlocking ownership between business enterprises which have violated the antitrust laws would [further] warrant elimination of the Big Eight’s vertical integration of *production and distribution*,” in addition to exhibition.<sup>56</sup> Accordingly, they suggested the following:

(1) there should be no vertical integration between any of the phases of the industry; (2) there should be so many producers and distributors that any member of one group could afford to lose the business of any member (or even several members) of the other group; (3) there should be so many distributors and exhibitors that any member of one group could afford to lose the business of any member (or even several members) of the other group.<sup>57</sup>

According to some, until the courts treat the systemic issue of oligopoly and integration, their efforts will be no more successful than pruning the leaves of an undesirable weed.<sup>58</sup>

A complete dismantling of the film industry oligopoly may yet be a long while coming. In the meantime, “[a]lmost 60 years after *Paramount* . . . distributors have continued to intervene at least indirectly in ticket pricing.”<sup>59</sup> Although such intervention is technically illegal, distributors enforce uniform pricing by refusing to deal with exhibitors

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<sup>55</sup> *Id.* at 122-23.

<sup>56</sup> McDonough & Winslow, *supra* note 53, at 417 (citation omitted) (emphasis added). McDonough & Winslow explain:

[T]he Big Eight have convincingly demonstrated that together they have had not only the power to exclude competitors from motion picture production and distribution, but also the purpose and intent to do so. The Court has declared that such power must be destroyed through divestiture. Yet, much of the power will be retained by the producer-distributor companies to be created under the consent decrees. Can the courts reasonably believe that the Big Eight have now abandoned the purpose and intent to exclude competitors manifested during 25 years of unlawful activity?

*Id.* at 418.

<sup>57</sup> *Id.* at 419.

<sup>58</sup> *See id.* at 427 (“Because of their failure to come adequately to grips with the economic problem of oligopoly, eleven years of litigation have not realized the goal set in 1938: that the theatres of the country will become a free, open and untrammled market to which all producers may have access for the distribution and licensing of films based upon merit [and] exhibitors likewise will have access to all available motion-picture products in accordance with their respective abilities to pay for and utilize that product.”) (citation and internal quotation marks omitted).

<sup>59</sup> Barak Y. Orbach & Liran Einav, *Uniform Prices for Differentiated Goods: The Case of the Movie-Theater Industry*, 27 INT’L REV. L. & ECON. 129, 140 (2007).

who attempt to switch to a system of variable pricing.<sup>60</sup> A change to these pricing practices—at least as far as they result in uniform pricing at the box office—would inject some much-needed competition into a stagnating price regime.

### III. THE CURRENT SYSTEM: UNIFORM PRICING

Admissions tickets for movies are priced uniformly, without regard for the distinctive characteristics of particular films. This practice first appeared in the early 1970s, and is popularly believed to have begun with the regular admission prices charged nationwide for *The Godfather* in 1972 (in all likelihood due to pressure from the producer-distributor Paramount).<sup>61</sup> Eventually, uniform pricing across all movies became the norm, and then the rule.<sup>62</sup>

#### A. Price Variations Relative to the Movie-Going Experience

To say that current pricing practices do not discriminate between films does not mean that all moviegoers pay the same price. A number of factors can cause ticket prices to vary. But all of these factors are more or less independent from the copyrighted work itself; instead, they correspond to the services involved in exhibition. Prices for films generally differ from theater to theater, perhaps based upon the state of upkeep of a theater, the quality and quantity of staff, the convenience or cost of the theater's location, or the local cost of living.<sup>63</sup> The pricing might also correspond to the general class of the cinema house—whether it is a first-run multiplex, a so-called “discount theater” which only houses films that have already run a full course in the first-run theaters, or an art-house theater dealing in independent and specialty

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<sup>60</sup> See *id.* at 150 (“Such refusal to deal may be legally questionable, but it is not in violation of the *Paramount* decrees and, to the best of our knowledge, has never been challenged by private parties or by the antitrust agencies.”); see also Orbach, *supra* note 25, at 364 (“[D]istributors’ 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.”).

<sup>61</sup> See Orbach & Einav, *supra* note 59, at 143 (“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 this pricing transition. Such intervention, if it occurred, was in violation of the *Paramount* decrees.”).

<sup>62</sup> See *id.* at 143-44 (“The emergence of one price for all movies roughly paralleled the appearance of multiplexes, and, at least theoretically, this historical correspondence may indicate causality. At the multiplex, the costs of administering variable pricing across movies could arguably make such a scheme unprofitable.”) (internal citation omitted).

<sup>63</sup> See, e.g., Orbach & Einav, *supra* note 59, at 133-34.

films.<sup>64</sup>

There are also reasons for the individual films exhibited at a given theater to vary in price at any given time, but, again, these factors relate almost exclusively to the service behind the screening rather than to the exhibited films themselves. For example, theaters charge non-standard rates for films based on the time of day or day of the week on which they are viewed.<sup>65</sup> Moreover, if the film is shown in a premium format, such as 3D, IMAX, or XD-Digital, the ticket price is typically higher. Prices may differ based upon seating options.<sup>66</sup> Live or one-time event films (for example, concert or opera broadcasts or recasts) also usually garner differentiated pricing. Theaters even offer discount tickets to children, senior citizens, veterans, and students.<sup>67</sup>

All these factors indicate that exhibitors know how to vary pricing and that consumers to some extent are comfortable with this practice. No reasonable argument can be made that moviegoers expect to pay the exact same amount for every movie they see (i.e., because they already pay different prices for different times, locations, or experiences), so the notion of variable pricing is not altogether foreign. What is glaringly absent from this scenario, however, is differentiated pricing based upon *the films themselves*. All 3-D movies are equally priced at any given theater at any given time, as are all 2-D movies showing on equivalent screens with equivalent seating procedures, indicating that no differences in ticket price correspond to differences in film demand alone (independent from the exhibition experience).

This lack of differentiation means that box-office price competition only exists on a theater-to-theater or service-to-service basis. Various film-viewing experiences (for example, 3-D, IMAX, and reserved seating) are in competition with each other, but no price competition exists in correlation to the underlying *films*.<sup>68</sup> Accordingly, we proceed with

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<sup>64</sup> *See id.*

<sup>65</sup> *Id.* at 133.

<sup>66</sup> *Id.* at 148.

<sup>67</sup> *Id.* at 133.

<sup>68</sup> In all fairness, 3-D and IMAX capability is determined during the production or post-production stage of filmmaking, and is built into the media distributed to theaters for that purpose. Thus, surcharges for such films may be said to correlate in some degree with the underlying films. But the surcharge is still standardized at the exhibitor level, so while a producer may increase the price of his or her film by offering a 3-D or IMAX release, the price increase only represents the added value of the experience-based service. Furthermore, movies enabled for 3-D or IMAX exhibition are typically co-released in standard 2-D format at standard pricing. In these circumstances, the only real competition is between the various offered viewing-formats of the film, which again is more of a competition between services than between

a basic understanding that, if we ignore the portion of film ticket prices that corresponds only to various service-related options, all films are equally priced.

B. *The Continuing Problem of Aggregate Monopolistic Pricing*

Uniform pricing greatly diminishes the competitive force that would otherwise police monopolistic pricing. Substitutable goods usually offset the anticompetitive potential of a copyright monopoly, but this process only functions in conjunction with price differentiation among substitutable products. If all movies are equally priced, and the consumer can only distinguish between the goods (not between their prices), the substitutable goods exert no economic pressure on each other, at least not at the box office.<sup>69</sup>

This unusual arrangement looks suspiciously like a horizontal price-fixing agreement. By jointly setting the price at which all their goods are sold, competitors are able to avoid the race to the lowest profit margin by circumventing the market forces that instigate it. This practice may sound good for competitors, but it is bad for consumers. A film exhibitor that *independently* prices all of its offerings uniformly is not participating in a horizontal price-fixing agreement (because who is the conspirator in a party of one?).<sup>70</sup> However, the ultimate effect is that individual films are subject to no price-based competition, which is the functional equivalent of price fixing. Where those films are owned and distributed by competing studio conglomerates that exercise considerable control over box-office pricing, the legality of the arrangement becomes increasingly questionable, and it begins to look more and more like a price-fixing agreement at the distributor level.

The uniform pricing of films enables quasi joint-monopolistic behavior that allows film distributors to collectively maximize their rates. Beyond a certain point, audiences will not accept the uniform prices.<sup>71</sup> But that does not mean that monopoly powers are not being exerted—the reason consumers will not endure a price hike may be precisely because the maximum monopolistic rate has already been imposed, such that consumers will not endure a higher price even for a monopoly

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goods.

<sup>69</sup> After first-run theater exhibition, specific demand is easier to determine, so economic/pricing pressure can come into play down the road. This Article, however, limits its focus to uniform pricing at the first stage of exploitation.

<sup>70</sup> It is highly unlikely, of course, that exhibitors actually have acted independently. The legal ramifications of industry-wide uniform pricing practices will be discussed in Part V, *infra*.

<sup>71</sup> See SULLIVAN & GRIMES, *supra* note 4.

good; to reason otherwise is to fall prey to “the Cellophane Trap.”<sup>72</sup>

Recognizing that all films are not of equal value, however, means that in a system of uniform pricing, the films must not all be priced at the sweet spot of their true monopolistic potential (because different films should have different demand and potential). Instead, films are participating in a sort of collective or aggregated monopoly, with an averaged monopoly value. Those films priced lower than their absolute potential may thus garner more views, and those priced higher than their monopolistic peak are comparatively under-attended.

### 1. Comparing Uniform Pricing to Block-Booking

Uniform pricing is the functional equivalent of just the sort of compulsory block-booking that *Paramount* intended to do away with. Before exploring how this practice mirrors block-booking, however, it is important to understand the motivations behind a typical block-booking arrangement.

Consider an example based on a hypothetical situation posed by Justice Goldberg in *United States v. Loew's, Inc.*<sup>73</sup> Suppose *Gone with the Wind* is worth no more than \$10,000 to a potential exhibitor, while *Getting Gertie's Garter* is completely worthless to him or her.<sup>74</sup> It would seem pointless for the distributor, under these circumstances, to block-book the two titles (selling them together, as a package deal), because the exhibitor will pay no more than \$10,000, and is willing to part with all of it in exchange for just one of the titles.<sup>75</sup> As George Stigler has pointed out, the distributor might just as well be forcing the exhibitor to purchase *Gone with the Wind* and seven Ouija boards as *Gone With the Wind* and an unwanted movie.<sup>76</sup> Intuition would call for the distributor to just rent out *Gone With the Wind* at \$10,000, and call it a day, exerting all the monopolistic power of the movie on setting its

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<sup>72</sup> The Cellophane Trap refers to du Pont's argument in *United States vs. E. I. du Pont de Nemours & Co.* that it could not raise its prices without losing customers, and that it therefore must not have had monopoly power. 351 U.S. 377, 400 (1956). Although the Supreme Court accepted du Pont's reasoning, the decision to do so is universally accepted as wrong. See, e.g., CHRISTOPHER R. LESLIE, *ANTITRUST LAW AND INTELLECTUAL PROPERTY RIGHTS: CASES AND MATERIALS* 30 (2011).

<sup>73</sup> 371 U.S. 38, 48 (1962). See George J. Stigler, *United States v. Lowe's Inc.: A Note On Block-Booking*, 1963 SUP. CT. REV. 152, 152-53 (1963).

<sup>74</sup> See Stigler, *supra* note 73, at 152.

<sup>75</sup> See *id.*

<sup>76</sup> See *id.* at 153.

individual price.<sup>77</sup> So, clearly, there must be some other reasoning for block-booking.<sup>78</sup>

The answer is that in reality, various buyers are likely interested, to some degree, in *both* films, but all may value the two films differently.<sup>79</sup> If the seller must offer the same prices to all buyers (e.g., because of transactional costs and market pressures), block-booking can generate higher revenues than individual sale.<sup>80</sup> Consider the following example:<sup>81</sup>

- Exhibitor A is willing to pay a maximum of \$8000 for film X and \$2500 for film Y.<sup>82</sup>
- Exhibitor B is willing to pay a maximum of \$7000 for film X and \$3000 for film Y.<sup>83</sup>
- If the distributor were to price and sell the two films separately, it would receive:<sup>84</sup>
  1. \$5000 from the rental of film Y, at \$2500 per buyer. A higher price would exclude A and reduce receipts.<sup>85</sup>
  2. \$14,000 from the rental of X, at \$7000 per buyer, on the same logic.<sup>86</sup>

The distributor's revenues under individual sale thus total \$19,000.<sup>87</sup> With block-booking, however, the distributor can charge a single price of \$10,000 for the pair of films (as both buyers value the package at no less than \$10,000), and take in \$20,000 instead of \$19,000.<sup>88</sup>

In other words, block-booking is profitable because it "prevents competitors from bidding for single features on their individual merits."<sup>89</sup> It is a method of generating greater revenues in a market where sellers may be unable to vary prices among individual buyers of differ-

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<sup>77</sup> See *id.* at 152-53.

<sup>78</sup> *Id.* at 153.

<sup>79</sup> *Id.*

<sup>80</sup> See *id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> *Paramount*, 334 U.S. at 156-57.

ing preferences. It is also a method of using the desirability of one product to sell another.<sup>90</sup>

By averaging admission ticket prices, exhibitors are economically tying one product to another, similar to block-booking. When you buy a ticket at the box office, although you are not purchasing the right to view two films—so it is not technically block-booking—you are paying at a rate ultimately intended to finance both films. Similar to block-booking, this pricing scheme will extract more, on average, from individuals who would choose to watch both films (the underpriced film and the overpriced film), though the total price likely approximates at least such an individual's perceived *ex-ante* value of the films.

However, because this variant of block-booking does not *require* the purchase of tickets to both films, it systematically subjects some viewers to vastly inflated prices. The viewer of the overpriced film who chooses not to watch the underpriced film is paying an inflated price for the overpriced film and never recouping value by watching the underpriced film. To remedy this inequity, a consumer must watch all released films; only then is he or she likely to have paid a total amount that reflects his or her differing appreciation for each film seen. The economic incentives of uniform pricing thus correlate to block-booking because a viewer will rarely know in advance whether a film is actually overpriced or underpriced, and thus must view all films in order to obtain an overall fair price.

Uniform pricing practices are thus in many ways a scheme unfriendly to moviegoers. Rather than set a reduced price for a film forecasted to be worth less to audiences, distributors (and thus exhibitors under their influence) hope that enough people will be duped into paying a uniform inflated price to make up for the lessened demand for the film and the underpricing of higher-value films.<sup>91</sup> Because unique

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<sup>90</sup> See *supra*, Part II.A ¶3. Block-booking at the box office also reduces the number of remaining show times at a given theater available for films from other distributors. By packaging less-desirable films with more-desirable ones, distributors are potentially able to rent-out the less-desirable films that might otherwise be passed over. Although these additional films could theoretically cannibalize ticket sales from the more-desirable films they are block-booked with, the revenues still all go to the same distributor. Block booking can thus reduce the competition for a distributor's films by increasing the proportion of exhibited films that come from that distributor (as compared to exhibited films coming from competing distributors).

<sup>91</sup> Of course, such higher-value films may only be *relatively* underpriced (as compared to lower-value films). If the lack of proper pricing competition has indeed enabled distributors to charge maximum monopolistic rates, the uniform box office price may reflect a value equivalent to or in excess of actual demand for even high-value films. That is to say, if box-office prices are currently at monopolistic rates, *all* films are over-priced, and some more than others.

goods cannot possibly be of equivalent value, uniform pricing constitutes uncompetitive pricing for an unhealthy number of films.

*C. The Economic Disconnect Between Distributors and Exhibitors*

Part of the reason for the continuance of uniform pricing is the economic disconnect between exhibitors and distributors, which is a direct consequence of *Paramount*.<sup>92</sup> Although exhibitors charge uniform prices to audiences, the deals negotiated with distributors vary from movie to movie.<sup>93</sup> Costs differ between films all along the distribution chain—from inception to distribution—but this differentiation disappears at the exhibition stage. This does not necessarily mean, however, that exhibitors are pocketing the difference between film values and their uniform prices; to the contrary, distribution agreements are typically structured to provide the distributor with any margins associated with over- or underpricing.<sup>94</sup>

As most major studios are vertically integrated with distributors, but are legally prevented from integrating with exhibitors, this distributor tendency to pocket the difference between value and price may be a symptom of the studios' desire to mitigate risk. Filmmaking is a risky business.<sup>95</sup> The odds that any one film will break even—let alone make a healthy profit—are relatively low.<sup>96</sup> In that sense, the business is similar to venture capitalism; investors place their money in an assortment of projects, looking for one or two grand successes to make

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<sup>92</sup> See Orbach, *supra* note 25, at 361 (explaining that because exhibitors are primarily concerned with selling high mark-up items such as refreshments, distributors can more easily implement uniform pricing to satisfy their primary concern of maximizing box office revenues); see also Orbach & Einav, *supra* note 59, at 149 (“A unique characteristic of the motion-picture industry is the legal constraints on the relationships between distributors and retailers (exhibitors). The *Paramount* decrees significantly restrict the form and substance of the negotiations and contracts between distributors and exhibitors and attempt to facilitate competitive bidding markets for films. Among other constraints, the *Paramount* decrees prohibit any involvement of distributors in box-office pricing, restricting the design of pricing mechanisms that could align the interests along the supply chain.”).

<sup>93</sup> See Orbach, *supra* note 25, at 323 (noting that as a result of *Paramount*, exhibitors are supposed to negotiate deals with distributors on “a movie-by-movie and theater-by-theater basis, so that exhibitors’ costs vary across movies”).

<sup>94</sup> See *id.* at 364 (“[V]ery often exhibitors absorb much of the distributors’ markup, which is derived from their negotiated share of box office revenues. 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.”) (citation omitted).

<sup>95</sup> SCHUYLER M. MOORE, *THE BIZ: THE BASIC BUSINESS, LEGAL AND FINANCIAL ASPECTS OF THE FILM INDUSTRY* 11 (3d ed. 2007).

<sup>96</sup> *Id.*

the whole enterprise worthwhile.<sup>97</sup>

Distributors adjust individual film exhibition contracts based upon forecasted box office receipts, structuring their agreements to retain the majority of the profits, typically via a complex arrangement that begins with a negotiated minimum rate of revenue-sharing.<sup>98</sup> This enables distributors to maintain diversification premiums (i.e., because they retain most of the risk margin), allowing them to allocate excess gains from some films to outlay losses on other films. Thus, film production becomes a collective business, with all films from a studio competing like a team on which star players are able to pick up the slack of poor performers and ultimately lead to aggregate victory (profitability).<sup>99</sup>

The other parties to these agreements—the exhibitors—accordingly see significantly blander distinctions between various films’ revenues. Profits are largely equalized between films, and exhibitors rely upon concession sales to reap profits from successful movies (that bring more people into the theater), so over-charging or under-charging does not affect exhibitors unless people stop coming.<sup>100</sup> In sum, because distributors retain most of the profit margin (and associated payoff or loss), exhibitors are largely indifferent to the relational difference between ticket prices and demand for individual films.<sup>101</sup>

Distributors’ profit-pooling amongst films would be relatively innocuous if the practice were not accompanied by a uniform pricing scheme that averages value between unique works, effectively reducing competition between said works. Where the consumer would ordinarily benefit from competition between two forces in the market, our antitrust law usually functions to break up any profit-sharing arrangements that stand in the way.<sup>102</sup> This Article argues in part that the uniform pricing of movie tickets creates the same kinds of economic and anti-competitive concerns as other forms of profit-sharing, and that antitrust law should similarly be brought to bear upon the practice.

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<sup>97</sup> *Id.* at 12.

<sup>98</sup> Orbach, *supra* note 25, at 323.

<sup>99</sup> See MOORE, *supra* note 95, at 12.

<sup>100</sup> See Orbach, *supra* note 25 at 361 (“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%. As a result, the exhibitor’s interest is not necessarily to maximize box office revenues.”).

<sup>101</sup> See *id.*

<sup>102</sup> See, e.g., *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46, 48-49, (1990) (noting that revenue sharing between would-be competitors has anticompetitive effect of raising prices for goods).

The unaligned economic interests of distributors and exhibitors make a naturally occurring break from the inertia of current pricing tactics unlikely. Because exhibition contracts are historically negotiated from an assumption that all films are to be shown at the same price (and distributors have been known to enforce such uniform pricing),<sup>103</sup> and because distributors typically absorb the valuation and cost differences between films,<sup>104</sup> exhibitors' greatest concern is not how films are priced in relation to each other, but rather how all their films are priced relative to any other exhibitors' offerings competing in the same market. Exhibitors thus have a greatly weakened incentive to differentiate between movies, due to fear that doing so would decrease their market competitiveness.

By botching its antitrust solution, in many ways *Paramount* only made things worse. If distributors were still vertically integrated with exhibitors, they would be more likely to differentiate prices between films, as the price difference would still be passed all the way up the chain (promoting the risk diversification interests of film owners). Alternatively, if distributors had been entirely prevented from effectively participating in resale price maintenance or price-fixing (*Paramount's* unachieved goal), exhibitors would be able to purchase and exhibit movies at unique pricings that more closely track the actual costs and values of particular films. But *Paramount* removed the risk diversification incentives from exhibition, while subsequent lack of enforcement has allowed distributors to continue to structure contracts to influence standard minimum pricing.

A clean wound heals quickly, while a rough cut is more likely to fester and scar. *Paramount* did a very dirty job severing the ties between producer-distributors and exhibitors, and consumers are suffering the consequences. Distributors have maintained price control without holding on to tied economic interests, and the result is anti-competitive resale price maintenance.

The traditional justifications for vertical resale price restraints are missing from the relationship between distributors and exhibitors. The U.S. Supreme Court has explained that “[m]inimum resale price maintenance can stimulate interbrand competition—the competition among manufacturers selling different brands of the same type of product—by reducing intrabrand competition—the competition among retailers selling the same brand.”<sup>105</sup> At the movie theater, however, re-

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<sup>103</sup> See *supra* notes 46-48, 60 and accompanying text.

<sup>104</sup> See *supra* notes 94 and 101, and accompanying text.

<sup>105</sup> *Leegin Creative Leather Prods, Inc. v. PSKS, Inc.*, 551 U.S. 877, 890 (2007) (citation

sale price maintenance has been uniformly applied, instead of individually applied on a film-by-film basis. This practice greatly reduces interbrand competition (between films) and encourages exhibitors to focus instead on intrabrand competition (between theaters). While this form of competition might be promoting improvements in theater quality and service, “the primary purpose of the antitrust laws is to protect interbrand competition.”<sup>106</sup>

Instead of using vertical price restraints to protect film variety (by causing exhibitors to sell films at product-specific prices), risk-adverse distributors use vertical pricing contrarily, to force a (comparatively) lowered price on higher-value films and a higher price on lower-value films. Thus, while “[r]esale price maintenance . . . has the potential to give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between,”<sup>107</sup> uniform pricing practices in the film exhibition industry have had the opposite effect.

#### D. *Negative Effects on Film Quality and Uniqueness*

Disconnecting film value from admissions pricing undercuts an important part of the competitive process. Lack of competition has negative effects upon the market from a consumer standpoint,<sup>108</sup> and in the case of the film industry this means that film quality and/or uniqueness decrease.<sup>109</sup> Because Hollywood’s ultimate goal is aggregate success,<sup>110</sup> and all films are equally priced, studios’ incentives are tied up in appealing to the widest audience possible.

This is the same problem faced by network television. In the case of broadcast network television, because the price to the consumer for all programming is the same (zero),<sup>111</sup> and because profits depend almost entirely upon the number of viewers,<sup>112</sup> studios are incentivized to

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omitted).

<sup>106</sup> *State Oil Co. v. Khan*, 522 U.S. 3, 15 (1997).

<sup>107</sup> *Leegin*, 551 U.S. at 890.

<sup>108</sup> See *supra* Part I; see also notes 20-23 and accompanying text.

<sup>109</sup> See SULLIVAN & GRIMES, *supra* note 4, at 11-15 (explaining how inadequate competition leads to reduced innovation, reduced cost-efficiency, and reduced concern with courting consumer demand).

<sup>110</sup> See MOORE, *supra* note 95, at 12.

<sup>111</sup> Broadcast television is, by definition, broadcast over the airwaves, freely viewable to all consumers within range who possess adequate equipment (i.e. an antenna and a television set).

<sup>112</sup> Broadcast television revenues nearly all come from selling commercial time to advertisers, who are attracted and pay based upon the number of viewers the advertising is projected to

create shows that appeal to the broadest possible base of viewers. Appealing to the lowest common denominator results by definition in broader offerings. Critically acclaimed or highly targeted (niche) offerings more often come from subscription television,<sup>113</sup> likely because the opportunity to differentiate prices allows the providers to capitalize on the added value provided. Without price differentiation, consumer voting becomes binary instead of incremental; producers cannot capitalize off of how much consumers enjoy a show—they either fail or succeed in getting a viewer to watch (and thus add to the viewership ratings that attract advertising and associated revenues).<sup>114</sup> Absent that added incentive or ability to profit from higher-value offerings and intensity of viewer preference, network television producers only need to clear the minimum threshold of quality necessary to gain a critical mass of viewership, however mild the interest.<sup>115</sup>

With uniform pricing practices that do not allow moviegoers to express their degree of demand for specific movies, film exhibition suffers from the same quality concerns as network television. There is simply not the same market incentive to create unique and interesting products.<sup>116</sup> In short, averaged prices yield average films, because averaging box office results reduces economic incentive for film studios

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reach. HOWARD J. BLUMENTHAL & OLIVER R. GOODENOUGH, *THIS BUSINESS OF TELEVISION* 2, 66 (3d ed. 2006).

<sup>113</sup> For example, over the last five years, content from subscription television has consistently outshone broadcast television offerings at both the Primetime Emmys and the Golden Globes. Among the top seven Primetime Emmy Award categories (for best drama, comedy, and variety series, and for best performances by actors and actresses in comedy and drama series), subscription television offerings won fifty percent more often than broadcast network shows. See *Primetime Emmy Awards Nominations*, EMMYS, <http://www.emmys.com/nominations> (last visited Mar. 8, 2013) (showing fourteen broadcast network wins and twenty-one subscription network wins). Among the top six Golden Globe Award categories for television (for best drama, comedy, and best performances by actors and actresses in comedy and drama series), subscription television offerings won twice as many awards as broadcast network shows. See *Awards Search*, GOLDEN GLOBE AWARDS, <http://www.goldenglobes.org/awards-search/> (last visited Mar. 8, 2013) (showing ten broadcast network wins and twenty subscription network wins).

<sup>114</sup> See *supra* note 112.

<sup>115</sup> Although programmers are not motivated *only* by the numbers of viewers a show will generate, “[a]s a rule, the network will pay as little as possible for the highest possible [viewer-ship].” BLUMENTHAL & GOODENOUGH, *supra* note 112 at 112. Because it focuses on the *number* of viewers, competition in broadcast television does not directly motivate attention to the level of *appreciation* of viewers. Without competition directly driving that focus, broadcast networks have little, if any, direct market motivation to create shows that particular individuals will *love*; networks only need viewers to *like* a show better than everything else on at the same time, or at least enough to turn on the television in the first place.

<sup>116</sup> See *supra* note 115 and accompanying text.

to create works of outstanding quality.<sup>117</sup>

It is important to note that producer/distributor conglomerates are not entirely affected by whether their films are *actually* “worth it” to consumers; films just have to appear to be worthwhile *ex-ante*. As long as the consumer buys a ticket, producer/distributor conglomerates have made their money. Consumer goodwill in the movie industry does not seem to really attach to studios or distributors—only to so-called “talent,” particularly actors, directors, and writers.<sup>118</sup> So a studio does not experience much reputational harm if an audience is dissatisfied; only the reputation of popularly recognizable talent attached to the film suffers.<sup>119</sup> This ironically shifts quality-control pressures away from the studio decision makers and towards the hired talent who typically have little control beyond the quality of their own contributions.

#### E. *Negative Effects on Cost Efficiency*

Quality is not the only casualty of uniform pricing. The practice also results in an overall loss in cost efficiency. Uniform pricing creates inefficiencies because prices do not match demand.<sup>120</sup> If all movies compete with each other at the same price, then competitive forces focus producer–distributor interests on beating the general demand for other movies exhibited at the same time, instead of on making a film

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<sup>117</sup> See *Paramount*, 334 U.S. at 158. The Court explained the problem thusly:

It is said that reward to the author or artist serves to induce release to the public of the products of his creative genius. But the reward does not serve its public purpose if it is not related to the quality of the copyright. Where a high quality film greatly desired is licensed only if an inferior one is taken, the latter borrows quality from the former and strengthens its monopoly by drawing on the other. The practice tends to equalize rather than differentiate the reward for the individual copyrights.

*Id.* at 158. While the context of the Court’s statement was the practice of block-booking, the principle applies in the case of uniform ticket pricing as well, because, as this Article argues, both practices involve economically tying separate and distinctive goods. *Supra* Part III.B.1.

<sup>118</sup> For example, consider the last film you saw that you did not like. Can you name, or at least picture, the actors? Can you name the distributor? If you can name the distributor, do you think your future consumption decisions will be more likely determined by whether the actors you recall are featured, or by whether the distributor is the same? See John Yudelson, *The Impact of Actors and Producers in Studio-Financed Movie Deals*, 3 J. OF BEHAVIORAL STUD. IN BUS. 7-8 (Apr. 2011). See also *infra*, note 127 and accompanying text.

<sup>119</sup> A studio’s bottom line may be hurt by a film that performs poorly, but audiences are unlikely to associate negative feelings with the studio’s brand. Recognizable talent, however, will quite possibly find their appeal diminished. See Matthew Thomson, *Human Brands: Investigating Antecedents to Consumers’ Strong Attachments to Celebrities*, 70 J. OF MKTG. 104, 104-107 (2006) (recounting literature on consumers’ “strong attachments to human brands”).

<sup>120</sup> Orbach, *supra* note 25, at 364.

that provides the highest value for the cost involved.<sup>121</sup> These circumstances essentially mirror the old adage, “I don’t need to outrun the bear, so long as I outrun you.”

Additionally, blunted competition between studios can result in the introduction of new kinds of costs, such as x-inefficiencies and rent-seeking.<sup>122</sup> X-inefficiencies refer to the increase in costs that occurs when a firm becomes over-confident and then relaxed or self-indulgent due to market power.<sup>123</sup> Such a firm might, for example, become less diligent in keeping production and marketing costs down, or might bargain less aggressively for labor or other necessary services.<sup>124</sup> Rent-seeking behavior refers to additional expenditures a firm makes to maintain or enhance its position of power in a market.<sup>125</sup> Interestingly, a firm suffering from weak competition may be more willing to reduce profit to maintain power (e.g., by spending on lobbying or advertising) than to reduce profit to lower ticket prices—even if the profit reduction is identical under both strategies.<sup>126</sup>

#### F. *Analyzing Market Incentives Based upon Two Types of Moviegoers*

To understand the way cost inefficiency and quality disincentives play out, consider a thought experiment involving two types of moviegoers under the current uniform pricing system. “General-experience-demand” moviegoers arrive at the theater to see a movie and choose among the available options. “Specific-product-demand” moviegoers, on the other hand, go to the theater with a particular movie in mind.

##### 1. The General-Experience-Demand Moviegoer

The general-experience-demand moviegoer decides which film to see based on an *ex-ante* perception of attractiveness in relation to the other available options.<sup>127</sup> Proponents of uniform pricing might argue that such pricing focuses the competition on quality,<sup>128</sup> thus fueling the

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<sup>121</sup> For a more extensive treatment of this argument, see *infra* Part III.F.

<sup>122</sup> See SULLIVAN & GRIMES, *supra* note 4, at 14.

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.* at 15.

<sup>126</sup> See *id.*

<sup>127</sup> Consumers typically select films based upon such factors as “word-of-mouth advertising, critics’ reviews, and performers.” Ornstein, *supra* note 52, at 443.

<sup>128</sup> With price differentiation taken out of the picture, proponents of uniform pricing may argue that the only remaining variable for general-experience-demand moviegoers’ decisions is perceived film quality. Faced with choices all of equivalent price, such moviegoers will decide

creation of films of increasingly higher quality. This argument unravels under examination, however, at least from the perspective of *individual* consumers, because uniform pricing only incentivizes producers to make broadly appealing films that bring in the widest viewership possible.<sup>129</sup> Producer–distributors cannot monetize demand in excess of the uniform price, so from a producer–distributor’s perspective, a film’s perceived quality only has to surpass the limited number of options available on any given night. There is no incentive for studios to create films with “excess” quality, because no market mechanism exists to reward the act with an increased profit margin.<sup>130</sup> General-experience-demand moviegoers thus only incentivize the production of films that lots of people like *enough*, rather than films that individuals love.<sup>131</sup> So, for general-experience-demand moviegoers, quality suffers under a uniform pricing regime.

As for cost efficiency, because ticket prices are reduced to a binary concern (a film either fills a seat or not), the margin between costs and uniform pricing levels is not nearly as important as the film’s ability to attract more viewers than other films playing at the same time. Under a pricing system that discriminates between films, a general-experience-demand moviegoer would choose the cheaper option between two films of equal attractiveness. Such a system would thus foster market forces that incentivize reduction of costs at every given level of forecasted consumer demand, because films would be competing on perceived value *and* price point. Under an equal-pricing scheme, however, this efficiency incentive is dulled. Because the selling price is universally fixed, studios compete solely for number of seats filled. With general-experience-demand moviegoers, a reduction in costs may

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solely based upon what film seems best to them.

<sup>129</sup> See *supra* Part III.D.

<sup>130</sup> See *id.* A widely-appealing film is more profitable under uniform pricing than a much higher valued film that appeals only to a more restricted demographic. By way of illustrative example, consider two hypothetical films, *Big Bland* and *Niche*, in a market of 150 general-experience-demand moviegoers. Let us suppose that all of those potential patrons will pay up to \$10 to see *Big Bland*, while a subset of fifty will pay up to \$25 to see *Niche*. Under uniform pricing at \$10 tickets, *Big Bland* brings in \$1000 and *Niche* brings in \$500. Unless *Niche* was considerably cheaper to produce and market than *Big Bland* (i.e., by at least half), producer–distributors are incentivized to make more films like *Big Bland* and less like *Niche*. This system is inefficient, leaving value on the table (and upsetting *Niche* fans). Under a system of differentiated pricing, *Big Bland* would still bring in no more than \$1000, while *Niche* would gross \$1500, increasing total revenues by over 66 percent. Furthermore, at least one third of the movie-going public (the *Niche* fans) are highly likely to witness the creation of more films specifically tailored to their particular tastes and values.

<sup>131</sup> See *id.*

increase ticket-specific profit margin at the expense of number of overall moviegoers. Unless the reduction in cost is sufficient enough to outweigh any corresponding reductions in gross revenues (i.e., because less moviegoers may attend a more cheaply-made film),<sup>132</sup> substantial cost reductions are not economically worthwhile. Where cost reductions may have jeopardized demand for a film, producer–distributors may have to rely on marketing to dupe the consumer into overestimating (*ex-ante*) the value of the film. Ultimately, for general-experience-demand moviegoers, film producers are incentivized to pay whatever costs necessary to attract viewers away from other films released at the same time.<sup>133</sup>

Proponents of uniform pricing might argue that with regards to general-experience-demand moviegoers, uniform pricing promotes competition by encouraging the narrowest margin between costs and ticket prices. With fixed prices and only comparative-demand-based competition, competition should steadily drive up costs until producers are competing on the narrowest possible margins.<sup>134</sup> While such an outcome would indeed mimic some of the results of true competitive pricing, there are a few problems with this argument. First, it presupposes that the uniform price set for movies is the right level at which to minimize margins. In other industries, we rely upon the market to determine what price levels represent the target range(s) for cost efficiency. As a result, we often see tiered pricing levels—various price points at which groups of consumers coalesce (according to preference and economic wherewithal) and drive tier-specific price competition and cost efficiency.<sup>135</sup> Uniform pricing destroys consumers’ ability to express potentially differing degrees of utility associated with going to the theater; general-experience-demand moviegoers may value the general theater experience at different price points, such that some have comparatively much higher expectations and are willing to

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<sup>132</sup> Under uniform pricing, there is a significant correlation between production costs and gross box-office revenues, indicating that more people go to see expensively-made films when all ticket prices are the same. See Orbach & Einav, *supra* note 59 at 135.

<sup>133</sup> Of course, production and advertising costs are still subject to a critical point beyond which even record-breaking attendance numbers at uniform prices cannot render a film profitable.

<sup>134</sup> See Orbach & Einav, *supra* note 59 at 135.

<sup>135</sup> Consider, for example, the automobile market; most major manufacturers produce cars anywhere along the spectrum from so-called economy cars to the most expensive luxury vehicles. As another example of tiered pricing, clothing retailer The Gap, Inc. also owns and operates pocketbook-friendly Old Navy and luxury-line Banana Republic. *Our Brands*, GAP INC, <http://gapinc.com/content/gapinc/html/aboutus/ourbrands.html> (last visited Mar. 8, 2013). See also *infra* note 142.

pay much higher amounts to have those expectations met. Second, the argument that uniform pricing mimics competitive pricing by driving up costs relies on the erroneous assumption that increased spending on a film equals increased value to consumers. That is, it assumes that producers *must* increase costs to increase demand for a film.<sup>136</sup> A pricing system that encourages escalating costs at fixed prices encourages an excess of bloated, big-budget films that are bland at best.<sup>137</sup> So even if the profit margins are reduced, the general-experience-demand moviegoers are not necessarily getting more bang for their buck.

## 2. The Specific-Product-Demand Moviegoer

Producer–distributor incentives based upon the specific-product-demand moviegoer do not yield much better results than their incentives based upon general-experience-demand moviegoers (in terms of quality and cost-efficiency). Quality is not maximally incentivized because prices are fixed and do not vary with demand. Producers need only offer the minimal degree of quality necessary to lure a specific-product-demand moviegoer to the box office. Again, because producer–distributors cannot capitalize on the degree of an individual consumer’s demand by setting a particular film’s price higher or lower than average, they have no incentive to provide any greater quality than necessary to draw in a viewer at the uniform price levels. Uniform pricing thus essentially caps quality levels in a market of only specific-product-demand moviegoers.

Proponents of uniform pricing could argue that cost efficiency does not suffer as much with regards to the specific-product-demand moviegoer. Because uniform prices are fixed, these moviegoers only attend a specific movie when they expect a utility level that exceeds the uniform price. Costs do not always correlate with utility.<sup>138</sup> Consequently, producers are not incentivized to increase spending. Instead, under uniform pricing, the market encourages reduced costs because it max-

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<sup>136</sup> Although correlation does exist between gross revenues and production costs (*see supra* note 132), a correlation does not a necessity make. Furthermore, the correlation has only been proven to exist under current (uniform) pricing practices. There is no evidence to suggest that under differentiated pricing revenue would continue to track production costs.

<sup>137</sup> The reader will likely be familiar with any number of big-budget films that everybody saw and nobody really liked. This author will do his best to refrain from singling any out until he has procured employment as a film critic. Suffice it to say they usually involve robots or aliens, despite the general fascination both inspire.

<sup>138</sup> Consider, for example, the difference between the \$15 million budgeted *The King’s Speech* and the \$150 million budgeted *The Last Airbender*. *See* BOX OFFICE MOJO, *supra* note 12. *See also supra* notes 136-37 and accompanying text.

imizes the profit margin. Producers are incentivized to spend the least amount they can while still drawing people to the box office. The lower the costs of a sufficiently attractive film, the greater the margin of profit producer-distributors will enjoy.

A superficial analysis might thus conclude that these incentives drive the market toward cost efficiency. But that drive is under-fueled as compared to other industries, because it is only motivated by producer-distributor greed (albeit, that is a pretty strong force). Under a uniform pricing regime, only relative attractiveness matters to consumer decision making. In other words, because movie-goers are largely indifferent to production costs, there is no direct competitive force compelling producer-distributors to lower those costs.

Ordinarily, in other industries, cost efficiency results from the consumer's demand for lower prices. Competing manufacturers and retailers are under constant pressure to offer the lowest price, and they thus develop advances enabling lowered costs.<sup>139</sup> These lowered costs in turn enable them to either a) undercut their competitors' prices (driving up sales volume), or b) increase their comparative profit margins by maintaining price levels equivalent to their competition. In a uniform-pricing market, only the ability to maximize profit margins remains, and prices can be uniformly elevated to monopolistic levels; this means that half of the cost efficiency incentive is missing, and cost-efficiency can be simulated by using monopolistic power to raise prices. Finally, where cost efficiency efforts rely upon marketing instead of innovation (i.e., using the savings from cut costs to pay for advertising to make a film appear better than it is, instead of innovating to cut costs without reducing value), any such "cost efficiency" derived comes directly at the expense of the consumer.

To roughly sum things up, uniform pricing in a market of general-experience-demand moviegoers results in decreased cost efficiency and lower quality, bland films designed to appeal to the lowest common denominator. Uniform pricing in a market of specific-product-demand moviegoers results in capped quality levels and lower value per film. As the actual film market is composed of both of these types of moviegoers, the actual incentives under uniform pricing yield results that are accordingly somewhere between bad and terrible.

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<sup>139</sup> See LESLIE, *supra* note 72, at 23-24 (describing how competitive markets promote static and dynamic efficiency); SULLIVAN & GRIMES, *supra* note 4, at 16 (describing how competitive markets promote dynamic efficiency).

*G. The Potential Democratizing Effect of Uniform Pricing*

Another potential argument for uniform pricing touts a democratizing effect.<sup>140</sup> Distributors currently subsidize the cost of many expensive films by overpricing cheaper films, enabling distributors to provide an average price for all films.<sup>141</sup> The democratization effect argument posits that if films were price-differentiated it might negatively affect the ability of economically challenged consumers to watch higher quality (or at least higher budget) films. These consumers would either have to reduce the frequency at which they go to the movies, or they would have to forego higher-priced movies.

But it is not entirely clear that that is how things would actually play out or whether this result would necessarily be undesirable. In part this depends on how elastic demand is for the movie-going experience. If general movie-going utility is high and demand is relatively inelastic (i.e., the average consumer cannot bear not going to the movies), consumers with less economic means will forego other purchases in favor of going to see a movie, and thus will not see fewer films or be priced out of some films. If demand is more elastic (i.e., demand varies according to the price/value ratio consumers assign to a particular film), the choice to go to the movies less often would occur precisely because consumers had decided that the value was not worth the expense. This in turn would put pressure on film producers, distributors, and exhibitors to create quality films at lower costs, thus promoting cost efficiency and competitive pricing while also enabling tiered pricing.

Compare, for example, the coffee industry. Tiers of pricing correlate with perceived differences between various brands and types of coffee.<sup>142</sup> Personal preference, economic means, and utility determinations all inform which tier an individual purchases from at any given moment. This pricing scheme enables all parties to consume more cof-

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<sup>140</sup> See, e.g., JEAN TIROLE, *THE THEORY OF INDUSTRIAL ORGANIZATION* 137-39 (1988) (describing the social benefit of uniform prices to those who otherwise overpay for goods; welfare only increased if output under uniform pricing increases).

<sup>141</sup> See MOORE, *supra* note 95, at 12-13.

<sup>142</sup> A cup of coffee at a convenience mini-mart may sell for as cheap as \$1. Richard Gorelick, *7-Eleven Offers \$1 Coffee Every Wednesday in January*, *BALT. SUN* (Jan. 15, 2013), [http://articles.baltimoresun.com/2013-01-15/entertainment/bal-wednesdays-7-eleven-coffee-1-20130115\\_1\\_full-bodied-coffee-coffee-costs-flavors-and-toppings](http://articles.baltimoresun.com/2013-01-15/entertainment/bal-wednesdays-7-eleven-coffee-1-20130115_1_full-bodied-coffee-coffee-costs-flavors-and-toppings). Compare this price point to those paid at Starbucks, or for by-the-bag premium whole beans. See Hyon Jung Lee, *Most Expensive Coffee*, *FORBES*, (July 20, 2006), [http://www.forbes.com/2006/07/19/priciest-coffee-beans\\_cx\\_hl\\_0720featA\\_ls.html](http://www.forbes.com/2006/07/19/priciest-coffee-beans_cx_hl_0720featA_ls.html) (reporting standard cup at Starbucks in 2006 was \$4). For more examples of tiered pricing, see also *supra* note 135.

fee, if they so desire, or to consume higher quality coffee than would otherwise be available if uniform pricing were imposed. As applied to the film industry, differentiated pricing provides moviegoers with the option of the equivalent of a discount cup of coffee—an admittedly lower-quality movie at a lower price—for times when a consumer is willing to lower his or her quality expectations; the inverse option of a “premium” film offering would also be available at a higher price.

Moreover, there is no evidence that economically strapped moviegoers are currently choosing to benefit from price subsidization by attending only films with higher-than-average budgets or higher value. To the extent that such moviegoers are watching more cheaply made films than costly ones, they are further harmed by the pricing system that some might argue is designed in part to benefit them.<sup>143</sup>

#### H. *Concerns About the Effect of Variable Pricing as a Quality Signal*

Proponents of uniform pricing also argue that under variable pricing “patrons would perceive price as a quality signal.”<sup>144</sup> Producer-exhibitors express concern that lowering the price for a movie will cause consumers to assume that the movie is comparatively cheap because it is comparatively poor, and will accordingly decide not to see such films.<sup>145</sup> In other words, distributors believe they will actually draw *more* people to a film by standardizing prices than they would by dropping a specific price as warranted.

The question of whether lower ticket prices signal lower quality, and accordingly decrease demand for a film, is an empirical one that has never been tested.<sup>146</sup> There are, however, a number of reasons why the concern is misplaced. To begin with, “[c]harging higher prices for event movies is unlikely to have any negative effect on the demand for other movies; patrons clearly distinguish between ‘regular and event movies.’”<sup>147</sup> Similarly, lowering ticket prices for films with a particular target audience (for example, documentaries) would more likely increase demand than shrink it.<sup>148</sup> Most theaters already approximate this practice with children’s films by charging lower ticket rates for children. This child discount naturally results in a lowest-average-ticket-price for family-friendly films because these films typically have the

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<sup>143</sup> See, e.g., TIROLE, *supra* note 140.

<sup>144</sup> Orbach, *supra* note 25, at 359.

<sup>145</sup> *Id.*

<sup>146</sup> *Id.* at 360; see also Orbach & Einav, *supra* note 59, at 146.

<sup>147</sup> Orbach, *supra* note 25, at 360.

<sup>148</sup> *Id.*

highest proportion of children in attendance. So, on average, theaters charge less per ticket for a family film than, for example, an R-rated horror film. If it were true that lowered ticket prices signal lower quality and reduce demand, the discount rate offered to children should signal that films targeted especially to children are of lower quality, resulting in decreased attendance for family films. But this is not the case. In fact, in *spite* of reduced average ticket prices for family films (or more likely, *because of* reduced ticket prices), seven of the ten highest domestically grossing films of 2010 were PG-rated family films.<sup>149</sup>

Furthermore, recent years have proven that concerns that film production costs signal quality are also unfounded, considering the commercial success of independently produced and conspicuously low-budget films like *The Blair Witch Project*, the *Paranormal Activity* franchise, the first half of the *Twilight* franchise, and multiple-Oscar winning *The King's Speech*. Clearly the public is happy to consume lower-budget films, so consumers must be evaluating quality independent from costs. It is only the industry that is unwilling to lower pricing on such films, because the commercial success of a low-budget film is relied upon to cover the commercial failings of other films (including higher-budgeted films).

#### I. *Concerns About the Costs of Variable Pricing*

Another argument against variable pricing is that administering such a system would be costly. Some say that variable pricing would result in complicated price menus that are confusing and would slow down service at the box office.<sup>150</sup> Also, movie theaters would have to carefully monitor moviegoers to make sure that they are not buying tickets to low-priced movies and then slipping into higher-priced films.<sup>151</sup> This is essentially an agency concern,<sup>152</sup> as this type of behav-

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<sup>149</sup> 2010 Domestic Grosses, BOX OFFICE MOJO, <http://boxofficemojo.com/yearly/chart/?yr=2010&p=.htm> (last visited Mar. 8, 2013).

<sup>150</sup> Orbach, *supra* note 25, at 360; Orbach & Einav, *supra* note 59, at 147.

<sup>151</sup> Orbach, *supra* note 25, at 360.

<sup>152</sup> Agency concerns refer to those conflicts of interest that may occur between a principal and his or her agent employed to carry out that principal's business. Although tasked to act solely in accordance with their employer's interests, an agent's own personal interest may sometimes incentivize unethical behavior. For example, a real estate agent may serve the interests of the owner of property by locating a purchaser for that property. In exchange for a bribe from the purchaser, the agent might be tempted to convince the seller to lower the purchase price. As these types of agency concerns are pervasive and applicable to all principal-agent relationships, it is disingenuous to argue that such concerns justify anticompetitive be-

ior affects the producer–distributor more than the exhibitor because the exhibitor makes the majority of its profits from concession sales to moviegoers, independent of what specific films they pay to see.<sup>153</sup>

Accordingly, exhibitors could augment their profits by charging consumers for low-priced films but allowing consumers to sneak into high-priced films, in order to increase the total number of moviegoers in the cinema house (and thus the overall number likely to purchase concessions). Alternately, exhibitors might be tempted to misstate audience statistics regarding which patrons purchased tickets to which movies, pocketing the difference between the number of moviegoers who actually saw a high-priced film and the number the exhibitor *reported* to have seen the high-priced film that actually purchased a ticket to a lower-price one.<sup>154</sup>

In summary, “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.”<sup>155</sup>

But experience suggests that these concerns are unfounded. Orbach and Einav point out that, “[i]n the past, American moviegoers were sophisticated enough to handle non-uniform admission fees and there is no reason to believe that today’s moviegoers are any less sophisticated,” so concerns about confusion and reduced speed at the box-office are historically discountable.<sup>156</sup> Furthermore, exhibitors already have to monitor to make sure moviegoers do not buy tickets for one movie in order to get into another (for example, to take advantage of matinee pricing for a non-matinee film, to get in to see a sold-out film, or to pay for one film but watch two in a row).<sup>157</sup> Similarly, exhibitors can already take advantage of an opportunity to misstate audience statistics simply by understating the total number of moviegoers and pocketing the difference.<sup>158</sup> Finally, variable pricing is already successfully in play via price discrimination between reserved seats in

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havior in the movie industry.

<sup>153</sup> See *supra* note 100; Orbach, *supra* note 25, at 364.

<sup>154</sup> *Id.* at 362.

<sup>155</sup> *Id.*

<sup>156</sup> Orbach & Einav, *supra* note 59, at 147-48.

<sup>157</sup> Orbach, *supra* note 25, at 361; Orbach & Einav, *supra* note 59, at 148.

<sup>158</sup> Orbach, *supra* note 25, at 362 (“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.”).

some theaters in the U.S. and in foreign countries.<sup>159</sup> Indeed, “[p]ut simply, the arbitrage opportunities under a variable-pricing regime are similar to those that already exist today and, therefore, cannot explain a firm uniform pricing regime.”<sup>160</sup>

J. *Additional Explanations for Uniform Pricing*

Beyond those already discussed, there are a few remaining salient explanations for distributors’ objections to variable pricing. First, setting prices on a movie-by-movie basis might trigger an ego war between directors or producers and distributors over which films are most worthy of charging the highest premiums.<sup>161</sup> Second, by reducing the number of variables, uniform pricing might make it easier for distributors to compare neighboring exhibitors and optimize movie allocation accordingly—a task that might be more difficult under variable pricing.<sup>162</sup> Both of these concerns are likely accurate representations of issues that producer–distributors might indeed have to deal with under a variable pricing regime. But the avoidance of inconvenience is not an acceptable justification for anticompetitive behavior, because competition is *inherently* inconvenient to competitors—that is precisely what makes competition beneficial to consumers and the market as a whole. These last potential explanations for distributors’ continued insistence upon uniform pricing at the box office amount to little more than expression of the fear that “changing the status quo could lead to revisions in the customary distribution of box office revenues that would be detrimental to the distributors.”<sup>163</sup> That is to say, those who have grown accustomed to monopolistic power are loath to do anything to threaten that power and its associated benefits.<sup>164</sup>

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<sup>159</sup> Orbach & Einav, *supra* note 59, at 148.

<sup>160</sup> *Id.* Consistent with Orbach & Einav, this Article does “not dismiss the potential significance of menu and monitoring costs.” *Id.* at 147. However, this Article likewise argues that “such costs do not exclude the possibility of devising and policing profitable variable pricing regimes.” *Id.*

<sup>161</sup> Orbach, *supra* note 25, at 363.

<sup>162</sup> *Id.*

<sup>163</sup> *Id.* at 362-63.

<sup>164</sup> This motivation is consistent with the monopolist’s tendency to engage in rent-seeking behaviors to maintain their market power. See *supra* Part III.E.

## IV. A PROPOSAL FOR VARIABLE PRICING

The gold standard for variable pricing would be to base prices on demand. Unfortunately, some of the unique quirks of the movie business make this approach difficult, at least at the box office.<sup>165</sup> The problem boils down to the alleged inability of distributors to forecast the demand for a film:<sup>166</sup> “Industry professionals and scholars commonly use the phrase ‘Nobody Knows Anything’ to describe the unpredictability of movies’ success.”<sup>167</sup>

Following opening weekend, it becomes vastly easier to evaluate the admission price consumers might be willing to pay to see a movie,<sup>168</sup> but adjusting prices at that point would have unsettling consequences. Businessmen and economists alike agree that price changes that consumers see as unfair have an ultimately negative effect on business.<sup>169</sup> In one famous example, Coca-Cola suffered considerable backlash from customers when it introduced a vending machine that adjusted its prices depending upon the surrounding weather conditions.<sup>170</sup> If distributors and exhibitors adjusted prices on a rolling basis following release, they might be able to establish demand-appropriate pricing, but only at the expense of antagonizing their patrons and thus risking a chilling effect because of perceived unfairness.<sup>171</sup> Also, while it is unlikely that *ex-ante* price differentiation would harm demand by signaling quality, lowering the price after a film’s release may cause audiences to second-guess whether the film is worth their time.<sup>172</sup> Finally, it would be hard to develop a stable market with such a practice, because consumers would be incentivized to play the system by show-

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<sup>165</sup> A movie’s success at the box office can lead to continued success and substantial revenues in other forms of exploitation. See Orbach, *supra* note 25 at 357. Prices for on-demand streaming, digital release, cable licensing, and DVD sales can all be informed by box office indication of demand, and accordingly do not suffer from the same pricing difficulties as a new theatrical release.

<sup>166</sup> Orbach & Einav, *supra* note 59, at 147 (“Demand uncertainty is the most studied characteristic of the motion-picture industry and perhaps the most mentioned explanation for uniform pricing . . . . Demand uncertainty arguably prevents pricing individual movies prior to their release because their prospective appeal is unknown.”) (citation omitted).

<sup>167</sup> See Orbach, *supra* note 25, at 355 (quoting WILLIAM GOLDMAN, ADVENTURES IN THE SCREEN TRADE: A PERSONAL VIEW OF HOLLYWOOD AND SCREENWRITING 39 (1983)).

<sup>168</sup> See *id.*; see also Orbach & Einav, *supra* note 59, at 135.

<sup>169</sup> Orbach & Einav, *supra* note 59, at 145.

<sup>170</sup> *Id.*

<sup>171</sup> See *id.*, at 147.

<sup>172</sup> See *id.*

ing up on opening night if they think a movie is underpriced or delaying watching a movie in hopes that distributors and exhibitors will be forced to lower prices. The typical consumer likely watches a film at the theater once, if at all, and a film is only available over the course of a few months at best. Thus, market conditions are too concentrated to support movie-specific price experimentation, as any demand elasticity will yield consumer behavior that makes it impossible to accurately diagnose current demand. Consumers that can wait a week for a significant price drop are too likely to get in the habit of watching films on their second, third, or fourth week at the box office, which would in turn destroy the ability of exhibitors to use opening weekend revenues to determine demand and set ticket prices accordingly.

*A. Using Temporal Factors to Determine Rates Under Variable Pricing*

Because they must forecast the demand for a unique product, distributors are in somewhat of a bind as to first-run box office prices. For this reason, some scholars that argue against uniform pricing offer solutions that fall short of demand-based pricing. Barak Orbach has argued for variable pricing determined almost entirely by temporal factors.<sup>173</sup> Because general movie demand is cyclical and varies according to the day of the week and the calendar season, Orbach calls for elevated prices on weekends and holidays.<sup>174</sup> Because demand is generally higher at those times, he argues that uniformly higher prices during these peak movie-going times, coupled with uniform discounts during periods of lower demand, will result in greater profits.<sup>175</sup> Orbach cites historical examples that evidence his point.<sup>176</sup>

While this suggestion enables movie prices to more closely track demand,<sup>177</sup> it does nothing to treat the anticompetitive concerns that re-

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<sup>173</sup> See, e.g., Orbach, *supra* note 25 at 324.

<sup>174</sup> See *id.*

<sup>175</sup> See *id.*

<sup>176</sup> *Id.* at 326 (“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. 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 [imposed by distributors], which made the practice unprofitable for exhibitors.”) (citation omitted).

<sup>177</sup> For Orbach’s exposition of this argument, see *id.* at 365 (“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.

sult from a lack of differentiation between movies. All the negative effects resulting from a lack of adequate inter-movie competition would remain unchallenged by a system that goes no further than adopting Orbach's proposals. This does not mean that Orbach's proposals are without merit. In fact, some of his peak-demand pricing proposals have already been adopted in some regions of the United States.<sup>178</sup> Nevertheless, these adjustments, even if more widely adopted, would not treat the broader problem of a lack of price differentiation among unique goods.

B. *Using Categorical Factors to Determine Rates Under Variable Pricing*

Orbach does offer some suggestions that begin to approach the broader problem. He calls for price differentiation across general categories of movies, such as discounts for children's movies and documentaries, and premiums for event movies ("blockbusters").<sup>179</sup> This would at least allow for a sort of *generalized* product differentiation and, to a very limited degree, begin to address the problems associated with uniform pricing.

These suggestions, too, have already been implemented to some degree at the box office. Some price discrimination related to category already exists, inasmuch as exhibitors offer ticket pricing based on various socio-economic factors, such as age. This pricing scheme indirectly leads to price differentiation on average for particular genres frequented most typically by currently-discounted demographics.<sup>180</sup> But even within genres, significant differences in production costs and ultimate consumer demand necessitate the introduction of variable pricing to stimulate proper competition. Wider adoption of inter-category price differentiation is a step in the right direction, but it is not a sufficient solution. Like Orbach's other proposals, it does not go far enough.

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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.").

<sup>178</sup> Orbach states that Cinemark and Century Theaters both vary pricing based upon demand patterns corresponding to the day of the week and the time of the day. See Orbach, *supra* note 25, at 367 n.36. See also *id.* at 324.

<sup>179</sup> See, e.g., *id.* at 326-27, 341; Orbach & Einav, *supra* note 59, at 145-46.

<sup>180</sup> See *supra* Part III.H ¶2.

*C. Using Costs to Determine Rates Under Variable Pricing*

If the anticompetitive nature of the film industry is to be remedied, at least as far as theater ticket prices are concerned, it needs a pricing model that more closely tracks demand. Though some see this goal as too much of an intellectual challenge, or as too costly an endeavor,<sup>181</sup> failing to establish price differentiation between unique goods is costly to the consumer and weakens the incentives for the production of truly great intellectual property.<sup>182</sup>

Moreover, empirical evidence shows that it is not actually as difficult as popularly argued to forecast demand for a movie.<sup>183</sup> Production budgets, success of prior films in the same franchise, participation of top actors and directors, MPAA ratings, competition from simultaneously released movies, and advertising are all “significantly related to revenues and thus can be incorporated into pricing decisions.”<sup>184</sup> These factors can and should be used to forecast demand and influence box office ticket prices accordingly.

Of course, it can be difficult to put a number on a qualitative concern, like the value a star actor actually provides to a film. So while these factors are important, and this Article argues for their application to variable pricing, it is helpful to focus on more immediately quantitative factors to determine what price ought to be charged for admission to particular films. Accordingly, this Article proposes reliance on costs as a primary determinant of ticket prices.

*1. Costs May Approximate Forecasted Demand*

Variable pricing is not a novel proposal. “Film grading” was a standard practice in the first half of the twentieth century.<sup>185</sup> Films were designated to particular graded production lines (A, B, or C) based upon budget, popularity of the lead actors, genre, and the quality of the story.<sup>186</sup> Pricing for admission corresponded to the production

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<sup>181</sup> See e.g., Orbach, *supra* note 25, at 327 (“[I]t would probably be impossible to price each movie according to its estimated demand.”).

<sup>182</sup> See Orbach, *supra* note 25, at 366.

<sup>183</sup> See Orbach & Einav, *supra* note 59, at 147.

<sup>184</sup> *Id.* at 134-35, 147 (citation omitted); Orbach, *supra* note 25, at 326-27 (“These factors are not perfect predictors but are reliable enough in the eyes of industry professionals to justify large expenditures for their study.”) (citation omitted).

<sup>185</sup> See e.g., Orbach, *supra* note 25, at 337-87; Orbach & Einav, *supra* note 59, at 139.

<sup>186</sup> *Id.*; Orbach, *supra* note 25, at 337-87.

grade of the film.<sup>187</sup> Although Hollywood is not quite as monopolistic today as it was during the “golden years” of cinema, not that much has changed. *Paramount* resulted in divestiture of exhibition companies by the studio conglomerates, but vertical integration between the major studios and distributors remains, and distributors are still largely in control of whether variable pricing is reintroduced.

It seems disingenuous, then, for producer–distributors to claim that a variable pricing practice that they introduced and successfully maintained for many years is impossible or too costly to be effective. To argue that it is impossible to determine in advance the discrete value of a unique copyrightable work (and to accordingly argue that all such works similarly exhibited should be identically priced) is to overlook the entire process that brought the work to the screen in the first place. If Hollywood does not know the potential value of a movie, how does it set movie budgets, or determine how much to pay writers, actors, and directors, or how much to spend on effects? How does it decide to move forward on a sequel to a movie before the movie’s opening weekend?<sup>188</sup> Furthermore, if all movies were truly of equivalent or at least indeterminable box-office value, one would expect all financing and rights acquisitions deals to occur at equivalent economic scale.

Some will argue that this is an oversimplification of the filmmaking process, which is probably an accurate response. Undoubtedly, different types of films require different budgets to produce. But the determination that a film is “worth” the extra expenditure is a determination that it will inherently be worth more to the studio than a film made on a lower budget.<sup>189</sup> Also, if distributors truly do not know the value of or demand for a film *ex-ante*, how do they decide when to forego theatrical release entirely and cut straight to home-entertainment distribution models, like DVD sales, pay-per-view, or on-demand streaming?

The current system seems to know all about when to cut costs, while feigning ignorance as to when the price is too high or low. This is not an unavoidable paradox, excusable in a unique industry. It is contradictory behavior. Although the fact that each film is a unique

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<sup>187</sup> *Id.*; Orbach & Einav, *supra* note 59, at 139.

<sup>188</sup> See, e.g., Tatiana Siegel, ‘*Star Trek*’ Sequel on Track, VARIETY (Mar. 30, 2009, 8:00 PM), <http://www.variety.com/article/VR1118001885/?refCatId=13>; Borys Kit, ‘*Pacific Rim*’ Sequel Already in the Works with Writer Travis Beachem (Exclusive), THE HOLLYWOOD REP., (Dec. 4, 2012, 12:27 PM), <http://www.hollywoodreporter.com/heat-vision/pacific-rim-sequel-works-writer-397646>.

<sup>189</sup> Production costs and gross box office revenues “are strongly correlated, with simple correlation coefficients of 0.5 to 0.7 for each year between 1985 and 1999.” Orbach, *supra* note 25, at 327; accord Orbach & Einav, *supra* note 59, at 135.

good makes it more difficult for the movie industry to forecast demand for a specific film, that does not mean it is impossible to establish a value-based price, and it certainly does not mean that the industry should be excused from trying.

Using production, budget, and marketing costs to forecast value and set prices accordingly is not a novel idea. The price charged for something in any industry is usually a good representation of what it cost to make it. Down the vertical chain of production and distribution, prices usually go marginally upwards to represent the value added at each stage of the process. The fact that the journey of a good from inception to consumption involves a series of transactions means that several different repeat-player entities are involved in subsequent evaluation of the good—or at least of the component parts that make up the good. By the time it reaches its final price point, a competitive-market good is priced relative to the cost the retailer obtained it at, which cost represents the retailer's estimation of demand, and which in turn represents the wholesaler's estimation of demand, and so on up the chain. Films similarly are developed down a chain that involves repeated estimated valuations of its various components that ultimately determine costs at the final stage.<sup>190</sup> As long as anticompetitive behavior does not skew the results, this final cost can represent not just what was paid to create and market the film, but additionally what the film is worth. Concerns about demand unpredictability are not as severe when costs help determine price, because costs signal forecasted demand.

Costs are not a complete or perfect determination of value or demand; they are not the only factor that should be considered. But costs are a good—and perhaps the best—determiner of forecasted demand. They should accordingly be factored into box-office prices.

## 2. Cost-Based Pricing is More Fair

There are additional reasons why cost-based pricing would be a good idea. Primary among these reasons is fairness. Orbach points out that “price increases based on cost increases are generally accepted as fair.”<sup>191</sup> Consumers understand and appreciate the fairness behind

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<sup>190</sup> For example, front-end film costs include compensation for the writers, the actors, the directors, below-the-line (for example, production) employees, effects studios, and even the producers themselves. In the life of a film's development and production, the studio must negotiate with each of these parties, deciding payment based upon the perceived value of each contribution. These “component parts” or contributions in aggregate make up the film.

<sup>191</sup> Orbach & Einav, *supra* note 59, at 145 (quoting ARTHUR M. OKUN, *PRICES AND QUANTITIES: A MACROECONOMIC ANALYSIS* 170 (1981)).

charging a price that relates to costs.<sup>192</sup> For example, the New York Mets smoothly transitioned into charging different prices for games based upon varying demand for different visiting teams, further supporting the conjecture that audiences are willing to pay different prices where perceptions of utility differ.<sup>193</sup> Considering his recognition of the public's acceptance of cost-based pricing as fair, it is a little ironic that Orbach calls for lower prices across entire categories of films instead of on a film-by-film basis. Such a solution insufficiently addresses the admitted problem, especially considering how costs may vary from film to film even within the same genre. Furthermore, Orbach proposes lowering prices for children's films, when such films are typically among the highest costing and the highest grossing.<sup>194</sup> Discounting tickets for such films intensifies the problem that purchasers of tickets to cheaper films are forced to subsidize the cost of more expensive films. This is an inherently unfair practice that is especially egregious in the case of films targeted exclusively towards adult audiences.<sup>195</sup> Likely the only reason that moviegoers do not already recognize or protest the unfairness of this practice is their acclimation to it: "Uniform prices seem fair because of the system's regularity, not because of any intrinsic justice."<sup>196</sup> Switching to a variable pricing system which factors specific costs into pricing would not only promote competition and market efficiency, with all their associated benefits, but would also be fairer to moviegoers.

### 3. Cost-Based Pricing Promotes Cost Efficiency

Perhaps some might argue that allegedly overpriced films have smaller target demographics, and accordingly justify high comparative prices because they are luxury goods.<sup>197</sup> But these films are often actu-

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<sup>192</sup> See Orbach & Einav, *supra* note 59, at 145 ("All consumers are familiar with the concept of different prices for different products.").

<sup>193</sup> See *id.* at 153 n.47.

<sup>194</sup> Among the 100 highest domestically grossing films of 2010, PG rated films on average were budgeted 42% higher than the general average, and grossed 49% higher than the general average. These statistics were compiled from data available at BoxOfficeMojo.com, and exclude four films for which no estimates have been offered for production budgets. *2010 Domestic Grosses*, BOX OFFICE MOJO, <http://boxofficemojo.com/yearly/chart/?yr=2010&p=.htm> (last visited Mar. 8, 2013).

<sup>195</sup> Among the 100 highest domestically grossing films of 2010, PG rated films on average cost roughly twice as much (204%) to produce as R rated films. These statistics were compiled from data available at BoxOfficeMojo.com, and exclude four films for which no estimate has been offered for the production budgets. See *id.*

<sup>196</sup> Orbach & Einav, *supra* note 59, at 145.

<sup>197</sup> Where some such films actually do have a very small pool of interested consumers, it

ally the opposite of luxury goods, as, by definition, they are merely cheap goods. Where films happen to be cheaper to make, overcharging comparative to costs can have perverse results. That type of market edges out the consumer who is satisfied with cheaper goods at a cheaper price, which means that the economically-challenged moviegoer frequently suffers the most harm (because lower-price-tiered goods are eliminated from the market).

Additionally, cost-based ticket pricing would encourage studios to make films that are worth the amount of money spent making them, whereas uniform pricing only encourages studios to make films worth the average ticket price. Without film-specific cost-based pricing, the consumer who ordinarily avoids luxury items in favor of more cost-efficient goods is forced to pay a premium, while other industries usually reward such cost-efficient behavior with lower prices.

#### 4. Concerns About the Effect on Revenue Participation

One major argument that might be leveled against film-specific cost-based pricing is that such a system does not account for back-end revenue participation. For many films that are made on a cheap budget, talent by necessity must accept smaller front-end compensation than they may otherwise usually expect, perhaps in favor of a larger back-end share of the revenues.<sup>198</sup> They are betting on the film going big. But if we reduce the profit margin on the back-end by reducing prices to correspond to the *upfront* costs (which are lower than usual in the case of a low-budget film), participating parties may never recoup the full value of their labor. The whole point of exchanging fixed fees for profit participation under these circumstances is to capitalize on the increased margin of profit made possible by reducing upfront costs. Cost-based pricing may threaten that possibility by resulting in a lower profit margin. The profit-sharing arrangement enables the creation of particularly risky movies that enough contributors believe in by spreading the risk among participating parties instead of hanging it all around the neck of the financier. Under cost-based pricing, there is a concern, then, that risky movies will not be made, or at least will not be made with big name talent, because producers would have to pay more upfront to secure such talent if the back-end revenues are limited by pric-

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does make sense to proportionately raise prices (to make up for the decrease in volume of sale). Films that garner strong appeal from a small subset of the market should accordingly have higher profit margins than more widely-appealing films.

<sup>198</sup> Lynn Elliot, *Getting Paid (Part 2 of 4)*, THE ACTOR'S NETWORK (Aug. 30, 2010), <http://actors-network.com/blog/getting-paid-part-2-of-3/>.

es kept close to costs.<sup>199</sup> Additionally, disincentivizing larger profit participation undercuts any ability the producer may otherwise have to economically encourage those involved to give their absolute best efforts to ensure a film's success.

This is a valid concern, and is one of the reasons why cost must not be the only factor taken into consideration if a variable pricing system is introduced. But there is no reason why the costs used to formulate a price cannot include adjustment for larger-than-usual back-end participation. That is, such risky films might justify a higher price precisely because they include big talent relying on large back-end compensation. Furthermore, even to the extent that cost-based pricing would result in less big-name talent involved in smaller budget films, it is not clear that this would be an entirely negative result. To some degree, we already rely upon lesser known talent to create lower-budget films. Typically, these films are career vehicles that introduce lesser-known talent to larger audiences, enabling new talent to garner more jobs and greater compensation on future projects.<sup>200</sup> If anything, then, cost-based pricing would open the market to a wider population of talent, which increases competition between talent, which in turns benefits the consumer by improving the market. In short, while the introduction of cost-based pricing would affect current contingent compensation practices for low budget films, the resulting changes are not necessarily undesirable, and certainly do not justify avoiding the practice altogether.

## V. APPLYING ANTITRUST LAW

Exhibitors and distributors are playing a game of chicken, and distributors are consistently winning. Some exhibitors have made feeble

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<sup>199</sup> In roughly analogous terms,

[w]here innovation requires substantial up-front research and development (R&D) costs, a rational firm will elect not to innovate if it anticipates a selling environment that too quickly resolves to marginal cost of production. This problem is sometimes described as the need to recoup R&D costs and an expected profit sufficient to induce firms to direct their capital to risky R&D ventures.

Thomas O. Barnett, Asst. Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Interoperability Between Antitrust and Intellectual Property, Presentation at George Mason University School of Law Symposium: Managing Antitrust Issues in a Global Marketplace (Sep. 13, 2006) (transcript available at <http://www.justice.gov/atr/public/speeches/218316.pdf>).

<sup>200</sup> For example, after receiving an Oscar nomination for the \$9M budgeted *Memento*, Christopher Nolan next directed the \$150M budgeted *Batman Begins*, which established his career as an enormously successful blockbuster director. See *Christopher Nolan (I): Awards*, IMDB, <http://www.imdb.com/name/nm0634240/awards> (last visited Mar. 8, 2013); *Memento (2001)*, BOX OFFICE MOJO, <http://boxofficemojo.com/movies/?id=memento.htm> (last visited Mar. 8, 2013); *Batman Begins (2005)*, BOX OFFICE MOJO, <http://boxofficemojo.com/movies/?id=batmanbegins.htm> (last visited Mar. 8, 2013).

attempts to switch to variable pricing, but have backed down under threats by distributors.<sup>201</sup> It is a simple collective action problem. Each exhibitor is afraid to independently switch to variable pricing, because it will lose distributor business and will accordingly be unable to compete with other exhibitors who stick with uniform pricing and thus maintain access to more films. Furthermore, if exhibitors were to collectively decide to switch to variable pricing, they theoretically might be accused of antitrust behavior for agreeing to act in concert.

This catch-22 makes solving the uniform pricing problem even more difficult. The solution requires a threat of sufficiently detrimental third party intervention to break the current exhibitor stalemate and/or producer–distributor stranglehold. If the Department of Justice (DOJ) could bring antitrust action (or even just convincingly threaten it) against all exhibitors, that would likely lead to a dramatic change away from uniform pricing. An ultimatum could force exhibitors to demand variable pricing terms from distributors, and thus what would otherwise be labeled monopsonistic behavior would suddenly be an acceptable solution to the pricing problem.

But exhibitors are not doing anything wrong, so the DOJ has no legitimate grounds to threaten them. Pricing between exhibitors is competitive, at least to the degree that current quasi-minimum-pricing licenses from distributors allow exhibitors to raise or lower the uniform prices they charge. It is the movies themselves that are not properly competing, even though distributors in a post-*Paramount* world are not supposed to be able to influence movie pricing.

In order to fix the pricing problem courts are going to have to get a little creative. Although the market is clearly and unjustifiably uncompetitive, it would be very difficult to legally point the finger of blame, because, as one film has tauntingly reminded us, “it’s not what you know, it’s what you can prove.”<sup>202</sup> Distributors are only using facially legal, indirect methods to influence exhibitors and ensure uniform pricing. Competition is dead or dying, but without a smoking gun, the DOJ could be hard-pressed to convict distributors of the crime.

Fortunately, there is precedent for enforcing antitrust law in the absence of actual evidence of collusive behavior—*Paramount*. The *Paramount* Court conceded that the distributors’ actions were technically legal, but inferred the existence of an illegal horizontal agreement be-

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<sup>201</sup> See Orbach & Einav, *supra* note 59, at 150 (noting that distributors “enforce uniform pricing by refusing to deal with exhibitors that wish to switch to variable pricing”).

<sup>202</sup> *Training Day* (Warner Bros. Pictures 2001).

tween the distributors because *without* such an agreement prices would be competitive; the fact that prices were not competitive implied conspiracy between competitors.<sup>203</sup>

Now consider the current state of the market: although distributors may not be technically (or at least perceivably) doing anything wrong in their licensing arrangements with exhibitors, there is still no other explanation for the complete absence of variable pricing (and the universal adoption of uniform pricing). It is difficult to pin current pricing practices on exhibitors, as they do not have much of an independent incentive to engage in uniform pricing. Changing to variable pricing would likely increase attendance numbers at the box office and thus likely result in an increase of concessions sales, which is how exhibitors currently make most of their money.<sup>204</sup> So, if distributors are not the ones responsible for uniform pricing, why have exhibitors not switched over? The fact that all exhibitors are engaging in uniform pricing must be attributed in significant part to distributors.<sup>205</sup> And the price-fixing phenomenon is occurring at all theaters across the nation, so the practice cannot be attributed to any single exhibitor or distributor. It follows that uniform pricing is the result of distributor conspiracy, as concerted behavior implies collective agreement.

The Court in *Paramount* looked at an industry-wide price-fixing practice and decided that the existence of the problem was enough to evidence malfeasance and justify enforcing a solution. Distributors today are still engaging in a horizontal agreement—to support uniform pricing—and should be treated the same way they were sixty years ago. Although one cannot necessarily prove the existence of an agreement, one can safely assume it; it can be inferred from the pattern of price-fixing that has been going on for forty years.<sup>206</sup> This price-fixing—playing out as a collective agreement to prevent films from competing on a price-basis—is per se illegal under § 1 of the Sherman Act.<sup>207</sup> The DOJ ought to bring a case against the major distributors al-

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<sup>203</sup> See *supra* note 31 and accompanying text.

<sup>204</sup> See *supra* note 4; *supra* note 100 and accompanying text.

<sup>205</sup> Even if exhibitors are partly to blame, there is precedent for courts to nonetheless hold distributors accountable. The Court in *Paramount* adopted the district court's argument that horizontal price fixing was occurring. See *Paramount*, 334 U.S. at 142. Notably, the district court had observed that "[i]t does not seem important whether the distributor was the more controlling factor in determining the minimum admission prices. Whether it was such a factor or merely acceded to the customary prices of the exhibitors, in either event there was a general arrangement of fixing prices in which both distributors and exhibitors were involved." *Paramount*, 66 F. Supp. at 335.

<sup>206</sup> See *Paramount*, 334 U.S. at 142.

<sup>207</sup> See *id.* at 143.

leging violation of antitrust law and calling for the institution of competitive pricing, enforcing the practice via conduct restrictions in the style of the *Paramount* decrees. Courts do not need to continue to monitor pricing—they just need to get the ball rolling enough to allow competitive forces to start driving prices.

Is this a slam-dunk case against distributors? No, it is not. But the legal argument passes the paper-bag test,<sup>208</sup> and may be the best hope we have for effecting change in an industry desperately clinging to the status quo.

## VI. CONCLUSION

While cost is not a perfect or complete substitute for forecasted demand, it can and should serve a valuable and prominent role in demand-based price-setting for first-run feature films. The current system is suffering from under-application of antitrust law, and the market is growing stagnant. Films, like other copyrighted works, are a strange combination of unique and substitutable goods that accordingly merit a pricing system that simultaneously pushes films to compete while also recognizing the differences between them. Uniform pricing is not that system, and current variances in pricing do not sufficiently recognize that not all films are created equal.

Producer–distributor conglomerates are largely responsible for the current system, and *Paramount*'s lukewarm response may have only aggravated the effects of anticompetitive behavior.

The prevailing forces in the market for film creation and exhibition drag their feet at the prospect of introducing more natural competition to their industry, and for more or less obvious reasons.<sup>209</sup> Hollywood has been operating under the current system for a long time, and may push for an exemption from antitrust law under a line of reasoning similar to *Flood v. Kuhn*.<sup>210</sup> Competition will make studios' jobs harder,

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<sup>208</sup> An argument passes the paper-bag test if an attorney is willing to make the argument in court without wearing a paper bag over his or her head.

<sup>209</sup> See, e.g., Orbach, *supra* note 25 at 364 (“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 . . . . 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.”).

<sup>210</sup> In *Kuhn*, the Supreme Court upheld the legality of a reserve clause provision in a major league baseball contract, despite the fact that such provisions are disallowed under antitrust law

requiring them to offer more to consumers at more reasonable prices. It may not be “good” for Hollywood to allow such pricing, but it would be good for consumers. As the Supreme Court has said, “[i]t is axiomatic that the antitrust laws were passed for the protection of competition, not competitors.”<sup>211</sup> The Court has also said that “[t]he copyright law, like the patent statutes, makes reward to the owner a secondary consideration” to the general benefit derived by the public.<sup>212</sup> Furthermore, “the Court has consistently rejected the notion that naked restraints of trade are to be tolerated because they are well intended or because they are allegedly developed to increase competition.”<sup>213</sup>

It is unwise and unsound to rely upon Hollywood’s determination of what prices are best. Such questions must be answered by the consumer, through the market forces which promote static efficiency, for “[t]he reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow. Once established, it may be maintained unchanged because of the absence of competition secured by the agreement for a price reasonable when fixed.”<sup>214</sup> No amount of industrial paternalism can outperform true competition, so no amount of industrial reticence must be allowed to overcome the rule of law that promotes true price competition at the box office.

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in all other professional sports. *Flood v. Kuhn*, 407 U.S. 258, 285-86 (1972). The Court’s reasoning essentially boiled down to admitting that while reserve clauses do violate antitrust law, the practice of including them had gone on under judicial approval for so long that the industry relied on these clauses and only Congress could justify changing things. *See id.* at 284-85.

<sup>211</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993).

<sup>212</sup> *Paramount*, 334 U.S. at 158.

<sup>213</sup> *United States v. Topco Associates, Inc.*, 405 U.S. 596, 610-11 (1972) (citation omitted).

<sup>214</sup> *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397 (1927).