



**BREAKING THE STUDIOS:  
ANTITRUST AND THE MOTION  
PICTURE INDUSTRY**

**Alexandra Gil\***

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#### DEFINITIONS<sup>1</sup>

**Blind-selling** – A practice whereby a distributor licenses a feature picture before the exhibitor is afforded an opportunity to view it.

**Block-booking** – The practice of licensing, or offering for license, one feature, or group of features, upon condition that the exhibitor shall also license another feature or group of features released by the distributor during a given period.

**Circuit** – A group of more than five theatres controlled by the same person or a group of more than five theatres which combine through a common agent in licensing films.

**Clearance** – The period of time, usually stipulated in license contracts, which must elapse between runs of the same picture within a particular area or in specified theatres.

**Exchange District** – An area in which an office is maintained by a distributor for the purpose of soliciting license agreements for the exhibition of its pictures in theatres situ-

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<sup>1</sup> United States v. Paramount Pictures, Inc., 66 F. Supp. 323 (S.D.N.Y. 1946); United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948).

ated throughout the territory served by the exchange and for the physical distribution of such films throughout this territory.

**Feature** - Any motion picture, regardless of topic, the length of the film of which is in excess of 4,000 feet.

**Franchise** - A licensing agreement, or series of licensing agreements, entered into as part of the same transaction, in effect for more than one motion picture season and covering the exhibition of pictures released by one distributor during the entire period of the agreement.

**Independent** - A producer, distributor, or exhibitor, as the context requires, which is not a defendant in this action or a subsidiary or affiliate of a defendant.

**Master Agreement** - A licensing agreement, also known as a 'blanket deal', covering the exhibition of films in a number of theatres, usually comprising a circuit.

**Motion Picture Season** - A one-year period beginning about September 1 of each year.

**Moveover** - The privilege given a licensee to move a picture from one theatre to another as a continuation of the run at the licensee's first theatre.

**Pooling Agreement** - Whereby normally competitive theatres were operated as a unit, or managed by a joint committee or by one of the exhibitors, the profits being shared according to prearranged percentages.

**Road-show** - A public exhibition of a motion picture in a limited number of theatres, in advance of its general release, at admission prices higher than those customarily charged in first-run theatres in the areas where they are located.

**Runs** – The successive exhibitions of a motion picture in a given area, first-run being the first exhibition in that area, second-run being the next subsequent, and so on.

**Trade-showing** – A private exhibition of a film prior to its release for public exhibition, as required by Section III of the consent decree.

**Underage and Overage** – The practice of using excess film rental earned in one circuit theatre to fulfill a rental commitment defaulted by another.

#### TIMELINE OF CASES

1910	Motion Picture Patents Company v. Laemmle; Motion Picture Patents Company v. Pantograph; Motion Picture Patents Company v. Ullman <i>Refusing to allow antitrust as a defense to patent infringement</i>
1912	MPPC v. Independent Moving Pictures <i>Questioning the validity of the MPPC's Latham Loop patent</i>
1912	Greater New York Film Rental Company v. Motion Picture Patents Company <i>Upholding the MPPC's right of refusal to deal</i>
August, 1912	DOJ begins proceedings against MPPC
January, 1915	Mutual Film Corporation v. Industrial Commission of Ohio <i>Refusing to extend first amendment protection to motion pictures</i>
1915	United States v. MPPC

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	<i>Result of DOJ's attack on MPPC</i>	
1918	United States v. MPPC <i>Supreme Court: MPPC is in violation of §1 of the Sherman Act</i>	
1921	FTC begins proceedings against Famous Players-Lasky	
1927	FTC v. Famous Players-Lasky <i>Result of FTC's inquiry: Famous Players is violating the Sherman Act</i>	
1931	Sono Art World Wide Pictures v. Lando <i>Upholding minimum admission price clause in contract</i>	
1932	FTC v. Paramount Famous-Lasky <i>Refusing to uphold ruling against Paramount</i>	
1934	Rembusch v. MPPDA <i>No antitrust remedy for independent exhibitors against chains</i>	
1935	Glass v. Hoblitzelle <i>Upholding minimum pricing and system of runs</i>	
1936	Shubert Theatre Players v. MGM <i>Recognizing importance of clearance; uniformity not enough to show concert of action</i>	
1938	DOJ begins proceedings against 8 Paramount defendants	
1940	Consent decree signed by 5 "major" defendants	

1942	Consent decree expires
1944	DOJ renews proceedings against 8 Paramount defendants
June 11, 1946	District Court ruling in United States v. Paramount Pictures
June 14, 1946	Hughes Tool Co. v. MPAA <i>MPAA is not an illegal combination under §1</i>
December, 1946	District Court's consent decree and competitive bidding system
May, 1948	Supreme Court ruling in US v. Paramount
November, 1948	RKO signs divorcement agreement
February, 1949	Paramount enters into divorcement decree
July, 1949	Lower Court ruling on remand in US v. Paramount
1952	Joseph Burstyn v. Wilson <i>Extending first amendment protection to motion pictures</i>
1982	United States v. Paramount Pictures <i>Allowing Loew's to re-enter production after a 30 year absence</i>

#### INTRODUCTION

Filmmakers and lawyers tend to disagree about many aspects of Hollywood history. Did New York producers flee to California to escape the raging flu epidemic of 1918 or were they seeking a location close to the border so they could hide in Mexico if Thomas Edison found out they were infringing his patents? Was the 1930 Motion Picture Production Code, or Hays Code, the beginning

of the Golden Age of Hollywood or one in a long series of Hollywood antitrust violations? Perhaps the most contentious of these disagreements between lawyers and filmmakers is the outcome of *United States v. Paramount Pictures* and its subsequent effects on the film industry.

Hollywood was unique from many other industries because its beginnings coincided with the introduction of antitrust law, leading to many interactions between the fledgling industry and the nascent body of law. Because of the novelty of antitrust law, movie producers were eager to involve antitrust in their daily lives to solve conflicts with their competitors. Likewise, the Department of Justice and Federal Trade Commission paid a great deal of attention to Hollywood which, although a highly visible industry, never had a major financial impact on the United States beyond the market for recreational spending. These early interactions with antitrust law played a large part in shaping the film industry, which today constitutes a significant percentage of the United States' economy. Many early antitrust cases are still relevant in defining the way Hollywood does business, more than eighty years later.

Part I will discuss the history of the American film industry and its early clashes with antitrust law. Part II will address the specific holdings of the New York District Court and the Supreme Court in *United States v. Paramount Pictures*. Part III will look at the consequences of the *Paramount* decision, as well as some of Hollywood's later battles with antitrust law. Although factors other than antitrust law's intervention contributed to the downfall of Hollywood's successful studio system, no other individual factor was as significant in shaping the industry.

## I. THE HISTORY OF FILM: A BRIEF OVERVIEW

### A. THE INVENTION OF MOVING PICTURES

Although devices like Zoetropes and Praxinoscopes, which simulated moving images, had been in wide circulation for many years, the American film industry did not really take shape until

Thomas Edison entered the field in 1888.<sup>2</sup> "I am experimenting upon an instrument which does for the Eye what the phonograph does for the Ear, which is the recording and reproduction of things in motion," Edison announced in a patent caveat that year.<sup>3</sup> Edison's Kinetograph did just that. The Kinetograph utilized the principles of still photography, but took pictures at such a rapid speed that, when played on Edison's Kinetoscope, the images appeared to be moving.

As early as 1896, there was public demand for censorship of moving pictures. Like many other aspects of the motion picture industry's early years, this too can be traced back to Thomas Edison. Edison's twenty-second *The Kiss* (1896) was met with hearty criticism of its risqué subject matter. Depicting a man and a woman talking to each other cheek to cheek for about 18 seconds, followed by a kiss, the film was a staged reenactment of a scene from a then popular Broadway comedy, *The Widow Jones*, and was Edison's most popular film. According to Edison's film catalog, "They get ready to kiss, begin to kiss, and kiss and kiss and kiss in a way that brings down the house every time."<sup>4</sup> Despite its crowd pleasing effects, *The Kiss* was seen by some to be an immoral depiction of a man and woman kissing.

During this period, ownership of patent rights to new motion picture technology was enough to vest Edison with a virtual monopoly over the industry. His Kinetograph did not remain the only motion picture device for very long, with audiences seeking longer films and new film delivery methods, but Edison's quick thinking allowed him to maintain his control over the industry. Although he was uneasy about the prospect of changing over from single-viewer Kinetoscopes, which had been incredibly profitable, to a method of screening films for larger audiences, Edison did not want to be left out of a new market. In 1895, the Edison Manufacturing Company acquired the rights to a new motion picture projec-

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<sup>2</sup> See generally CHARLES MUSSEY, THOMAS A. EDISON AND HIS KINETOGRAPHIC MOTION PICTURES (1995); CHARLES MUSSEY, BEFORE THE NICKELODEON: EDWIN S. PORTER AND THE EDISON MANUFACTURING COMPANY (1991).

<sup>3</sup> U.S. Patent Caveat No. 110 (filed Oct. 17, 1888).

<sup>4</sup> Library of Congress American Memories Collection, <http://hdl.loc.gov/loc.mbrsmi/edmp.4038> (last visited Jan. 18, 2008) (the original film can also be found archived at this link).

tion device, the Phantascope. This new device was quickly renamed the Vitascope and marketed as an Edison invention. Soon, however, other companies developed their own film projection systems and began to compete with Edison. To prevent other companies from simply copying his films and selling them as new products, Edison began to copyright his productions.

Audiences soon tired of the novelty of the first moving pictures, which were simply representations of real life: famous people, events, natural disasters, etc. Such films were generally shown in vaudeville houses, preceding the main attraction or playing as the audience left the theater. Following the example of French film pioneers Georges Melies and the Lumiere brothers, Auguste and Louis, Thomas Edison began to produce narrative films. The first American film, *The Great Train Robbery* (1903), was a rousing success, prompting Edison to create a film studio in New Jersey, and other entrepreneurs to enter the motion picture business.

Within the decade, nickelodeons sprang up across the United States, allowing patrons to watch twenty or thirty second films for just five cents.<sup>5</sup> By 1905, nickelodeons were being simultaneously hailed as “theatre democratized,” and criticized for corrupting children. The early “Kinetoscope parlors” were generally converted store-fronts supplied by the Edison Manufacturing Company with viewing devices and hundreds of feet of film. Many films were still representations of real life, but had gained new appeal due to higher production values. Rather than a single static shot lasting twenty or thirty seconds, improved technology allowed Edison and other filmmakers to edit films, even utilizing trick photography to create special effects. In addition, fictional films became tremendously popular in nickelodeons.

## B. THE MOTION PICTURE PATENTS COMPANY

### 1. *Patent Pooling*

In 1908, to quell the rising patent disputes among owners of different motion picture technologies, Edison and nine other film

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<sup>5</sup> See generally DAVID ROBINSON, FROM PEEP SHOW TO PALACE: THE BIRTH OF AMERICAN FILM (1995); DOUGLAS GOMERY, SHARED PLEASURES: A HISTORY OF MOVIE PRESENTATION IN THE UNITED STATES (1992).

patentees formed the Motion Picture Patents Company (MPPC). This new company pooled the patents of the leading film producers, as well as Eastman Kodak, the primary film stock producer at the time. This new company also joined Edison with Biograph, which had been its most direct competitor. The two companies had clashed in Federal court four times between 1904 and 1907 over patent disputes. Though the MPPC was initially seen as a solution to the fights between Edison, Biograph, Selig, Vitagraph, and other patentees who joined the trust, it soon became evident that the MPPC would use any means necessary to retain control over the film industry. With their collective patent rights, the MPPC was able to control nearly all motion picture technology, exacting high license and royalty fees from their competitors for use of cameras, projectors, and film stock.

The MPPC quickly became a force to be reckoned with, frequently and strenuously asserting its patent rights against independent movie producers through litigation. The MPPC also enforced its patent rights through less official channels, refusing film stock and equipment to independents, and often resorting to threats of violence. Beginning in 1909, the MPPC brought patent infringement suits against any competitor not using MPPC-patented film equipment. Between 1909 and 1918, nearly forty of such cases reached Federal court. By this time, Edison and the MPPC had acquired the valuable Latham Loop patent, the technology of which was used in nearly every camera and projector.

What Edison had thought would be a passing fancy had evolved into a full fledged movie industry. Film technology continued to change, with the addition of title cards to help tell stories, and the nascent beginnings of the star system in actress Florence Lawrence. Motion pictures were no longer limited to single-viewer nickelodeons, and could be screened for full theater audiences. Rather than simply being used as opening acts for vaudeville theaters, motion pictures suddenly warranted their own theaters, and permanent motion picture theaters began to open all across the country.

In its early years, the MPPC was responsible for production and distribution of the vast majority of films, either through its member companies or their licensees, but courts refused to allow antitrust claims as a defense to patent infringement for those companies who dared to make films without MPPC approval. In *MPPC*

*v. Laemmle* and *MPPC v. Pantograph*, both decided in March of 1910, a New York court held that “the charge, if established, that the complainant is itself, or is a member of, a combination in violation of the federal anti-trust statute, is not a defense available in an action for the infringement of a patent, and fails to show a defect in the complainant’s title.”<sup>6</sup> Likewise, in *MPPC v. Ullman*, decided later that year, the court found that antitrust violations could not be a defense to a patent infringement claim because, “[s]uch a suit is not based on contract, but on tort, and, of course, the fact that a man has entered into some illegal contract does not authorize others to injure him with impunity.”<sup>7</sup> In spite of such rulings, independent producers continued to make use of the MPPC’s patented film technology because, as one film historian explains, “fines for patent violation were less than profits from filmmaking.”<sup>8</sup> In addition, independents relied on the fact that the MPPC would not be able to catch every infringing action, using such methods of subterfuge as keeping non-infringing cameras close at hand to switch if necessary and hiding infringing camera mechanisms inside non-infringing camera shells.<sup>9</sup>

In 1910, many parties who had been excluded from the MPPC licensing scheme joined with others who had refused to join, acquired cameras abroad and began producing their own films. Ironically, this led to the formation of the Motion Picture Distributing and Sales Company, a distribution conglomerate that began its operations three weeks after the MPPC’s own conglomerate, General Film, was created to distribute MPPC films. Although Sales Co. was nominally independent, by virtue of not being a member of the MPPC, its practices were no different from those of the MPPC. Had events proceeded in this manner, Sales Co. and General Film would have gained duopolistic control over film distribution. However, internal disputes prevented producers and distributors from maintaining any organized system of group distribution or production. Instead, by 1912, there were as many truly independent producers

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<sup>6</sup> *Motion Picture Patents Co. v. Laemmle*, 178 F. 104, 105 (S.D.N.Y. 1910).

<sup>7</sup> *Motion Picture Patents Co. v. Ullman*, 186 F. 174, 175 (S.D.N.Y. 1910).

<sup>8</sup> Janet Staiger, *Combination and Litigation: Structures of U.S. Film Distribution, 1896-1917*, CINEMA J., Winter 1984, at 41, 55.

<sup>9</sup> *Id.*

as MPPC producers, and a great deal of movement between the two groups. Patent pooling had kept the MPPC members together in pursuit of a joint goal, but there was no such unifying tie for producers and distributors without patents; they had little to gain from joining with their competitors.

## 2. *Intervention of Antitrust*

By the time antitrust law got involved, the reign of the MPPC had ended. As one film article explains, "the actual court decision was merely the stone on the tomb."<sup>10</sup> In 1912, Judge Learned Hand invalidated the famous Latham Loop patent, which had previously given the MPPC a near monopoly on motion picture cameras.<sup>11</sup> Suddenly, independent movie producers could use cameras without licensing them from Edison or fearing the wrath of the MPPC. At the same time, New York courts still refused to allow antitrust as a defense to patent infringement. William Fox's Greater New York Film Rental Company, a licensee of the MPPC, refused to acquiesce to the MPPC's demands and suddenly saw its supply of films dry up. When Fox sought an injunction, the court found that the MPPC had the right to cancel Fox's license at any time, despite dicta that the MPPC "may constitute an illegal monopoly and become a restraint of trade."<sup>12</sup> Although Fox was unsuccessful, his case drew national attention to the practices of the MPPC.

In August of 1912, the Department of Justice began antitrust proceedings against the MPPC, but its power had already been taken away with the loss of its patents and the introduction of new technology to the film industry, specifically multiple-reel films. In 1915, a Pennsylvania District Court found the MPPC to be violating §1 of the Sherman Act, though it vacillates between discussion of §1, combination in restraint of trade, and §2 monopolization. The MPPC attempted to defend itself on three grounds: (1) that they were seeking to monopolize an art, rather than a trade, which should not be considered commerce and should not fall under the

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<sup>10</sup> Jeanne Thomas, *The Decay of the Motion Picture Patents Company*, CINEMA J., Spring 1971, at 34, 35.

<sup>11</sup> *Motion Picture Patents Co. v. Indep. Moving Pictures Co. of America*, 200 F. 411 (2d Cir. 1912) (per curiam).

<sup>12</sup> Staiger, *supra* note 8, at 56.

restrictions of antitrust law, (2) that their patents allowed them free reign to engage in the disputed licensing practices, and (3) "that their intentions were as beneficent and have resulted in as much good to the patronage of the art... and that this good bears a fair relation to the profits received by them."<sup>13</sup> The court quickly dispensed of the first and third claims. To the first claim, the court noted that regardless of whether the MPPC was attempting to control a trade or an art, the license and sale of motion picture cameras, projectors, and the films themselves involved interstate commerce.<sup>14</sup> In response to the MPPC's final claim that its intentions were good, the court reminded the MPPC that "If, in the judgment of the law, a contract... is such as to work an undue and unreasonable restraint of trade... the judgment is one of condemnation, no matter how innocent or otherwise praiseworthy the motives of those who had part in it."<sup>15</sup> The MPPC's claim of patent protection merited greater consideration from the court. Ultimately, the court concluded that because the MPPC involved a pooling of patents that did not directly relate to one another in any way other than to jointly control the motion picture industry, the combination was in violation of §1 of the Sherman Act.<sup>16</sup> In 1918, the Supreme Court dismissed the MPPC's appeal. By this time, with the Latham Loop patent freely available to everyone, independent producers had already rendered the MPPC powerless.

The demise of the MPPC paved the way for the studio system that soon became synonymous with Hollywood.<sup>17</sup> Men like William Fox, Carl Laemmle, Adolph Zukor, Jesse Lasky, and Louis B. Mayer were just small independent businessmen during the reign of the MPPC, but they began to see the opportunities available to them. Many, like Mayer and Fox, began as theater owners and exhibitors, but soon realized they liked production better. Louis B. Mayer entered the film industry by purchasing a small theater in Haverhill, Massachusetts in 1907. A keen businessman from the very beginning, he soon owned a chain of theaters throughout New

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<sup>13</sup> United States v. Motion Picture Patents Co., 225 F. 800, 808 (E.D. Pa. 1915).

<sup>14</sup> *Id.* at 803.

<sup>15</sup> *Id.* at 808.

<sup>16</sup> *Id.* at 810.

<sup>17</sup> See generally DOUGLAS GOMERY, THE HOLLYWOOD STUDIO SYSTEM (1986).

England. From there, he entered into distribution, purchasing the exclusive right to distribute the incredibly successful *Birth of a Nation* (1915) for New England and earning himself \$250,000.<sup>18</sup> That same year, Mayer became a film producer and never looked back. Others in the film industry had similar stories.

### C. FIGHT FOR CONTROL

Among the MPPC's enumeration of its good deeds, as recounted by the court in 1915, was the contention that the movie industry was in need of a single regulatory body, the functions of which the MPPC was uniquely suited to perform. The court briefly addressed the MPPC's assertion that: "The United States could not, and the states would not, interpose for the purpose of regulation, and the defendants claim the credit of having performed this neglected duty of the state."<sup>19</sup> The court treated the MPPC as "a single directing a regulating head" and extended its control "even to a censorship of what was shown."<sup>20</sup> The court seemed shocked with the MPPC's hubris in claiming, not only that its intentions were not illegal monopoly, but also that its intentions were commendable. The court did not seem pleased with the stated need of the film industry to have a regulatory body determine quality and standards and perform censorship functions if necessary.<sup>21</sup>

Earlier that same year, however, the Supreme Court had legitimized censorship of motion pictures in *Mutual Film Corporation v. Industrial Commission of Ohio*, which refused to extend first amendment protection to motion pictures. The case, which found the Ohio Censorship Law to be constitutional, found no constitutional problems with state-created motion picture censorship boards.<sup>22</sup> Unsurprisingly, states and local governments, which had already begun to form censorship boards in order to regulate the content of motion pictures, redoubled their efforts. In 1907, Chicago

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<sup>18</sup> See generally BOSLEY CROWTHER, HOLLYWOOD RAJAH: THE LIFE AND TIMES OF LOUIS B. MAYER (1960); SAMUEL MARX, MAYER AND THALBERG: THE MAKE-BELIEVE SAINTS (1975); JESSE L. LASKY, I BLOW MY OWN HORN (1957).

<sup>19</sup> *United States v. Motion Picture Patents Co.*, 225 F. 800, 808 (E.D. Pa. 1915).

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Mut. Film Corp. v. Indus. Comm'n of Ohio*, 236 U.S. 230 (1915).

became one of the first cities to censor motion picture content, requiring exhibitors to obtain a permit before being allowed to screen films. This local censorship scheme was upheld by both the Illinois Supreme Court and the United States Supreme Court. In 1911, Pennsylvania became the first state to enact a film censorship law, creating the Pennsylvania Board of Motion Picture Censors. Motion picture producers also faced pressure from religious groups like the Women's Christian Temperance Union and the Catholic Legion of Decency to censor the content of their films.

In 1922, under pressure from government and religious organizations, many film industry leaders joined together to form the Motion Picture Producers and Distributors of America (MPPDA), helmed by lawyer and former Postmaster General Will Harrison Hays.<sup>23</sup> In an effort to preempt criticism from the local and state censorship boards, the MPPDA issued a list of eleven "Don'ts and Be Carefuls." In his 1955 memoir, Hays describes these as "things which *must not* be done on the screen, and other things which *should not* be done."<sup>24</sup> "Adherence to these Don'ts and Be Carefuls was not mandatory, and filmmakers were free to ignore them. However, this 'Hays Formula' was considered to be a fairly accurate predictor of which elements of a film the censors would find problematic."<sup>25</sup> While producers may not have agreed with the particulars of the Formula, it allowed them to avoid the unnecessary expense of filming scenes that would later be censored and either cut entirely or reshot. The original eleven "Don'ts" were: pointed profanity, licentious or suggestive nudity, illegal traffic of drugs, any inference of sex perversion, white slavery, miscegenation, sex hygiene and venereal diseases, actual childbirth, children's sex organs, ridicule of the clergy, and willful offense to any nation, race, or creed.

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<sup>23</sup> See generally OLGA J. MARTIN, HOLLYWOOD'S MOVIE COMMANDMENTS (1970); RAYMOND MOLEY, THE HAYS OFFICE (1945).

<sup>24</sup> WILL HAYS, THE MEMOIRS OF WILL H. HAYS 433 (1955).

<sup>25</sup> Alexandra Gil, Here Come The Mounties!: Framing *Rose Marie* in 1930s Hollywood 55 (Apr. 2005) (unpublished A.B. thesis, Duke University) (on file with Perkins Library, Duke University).

## D. ANTITRUST'S NEXT CLASH

1. *The Famous Players Case*

In the 1920s, film and antitrust clashed once again. Adolph Zukor and Jesse Lasky had merged their production companies to form Famous Players-Lasky, and later acquired Paramount Pictures to handle the distribution of Famous Players-Lasky films. In 1921, the recently formed Federal Trade Commission accused Famous Players-Lasky of illegally restraining trade through its ownership of Paramount Pictures, in violation of §5 of the FTC Act.<sup>26</sup> The wording of the complaint seems to suggest that the FTC's issue with Paramount was its "conspiracy" to acquire and distribute films "of such quality and popularity that they were in great demand."<sup>27</sup> Despite the FTC's objections, it would certainly have been a bad business strategy to purchase unpopular films. More importantly, the Commission took issue with Famous Players-Lasky expanding its enterprise from production to distribution and exhibition. The ownership of Paramount Pictures, the FTC claimed, gave Famous Players-Lasky unprecedented access to all three phases of the motion picture business: production, distribution, and exhibition.

Famous Players-Lasky was specifically attacked for its use of block booking of films and its attempt to control theaters nationwide. With dubious logic, the Commission noted that Famous Players-Lasky was "the largest theater owner in the world, and in one week in the year 1920 more than 6,000 American theaters, or approximately one-third of all the motion-picture theaters in the United States, showed nothing but Paramount pictures."<sup>28</sup> Certainly, the Commission could not have meant to suggest that Paramount itself owned one-third of all theaters in the United States in 1920, because that was not the case. Paramount's aggressive booking tactics, combined with its extensive theater ownership, accounted for a significant control over the film industry. The FTC additionally took issue with Famous Players-Lasky using dummy corporations to hide the fact that so many theaters and exchanges were, in fact, affiliated with Paramount.

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<sup>26</sup> *In re Famous Players-Lasky Corp.*, 11 F.T.C. 187 (1927).

<sup>27</sup> *Id.* at 192.

<sup>28</sup> *Id.* at 193.

Recalling the intimidation tactics of the old MPPC, exhibitors came forward to accuse Famous Players-Lasky of threatening to get them to book more films than they needed and to lease their theaters for the exclusive showing of Paramount films. Famous Players-Lasky's extensive purchase of theaters during this same period was used as further evidence of an intent to monopolize the production, distribution, and exhibition of films. Specifically, Famous Players-Lasky was said to have threatened to build or lease theaters to compete with uncooperative exhibitors, secretly offered different pricing to exhibitors based on their level of cooperation, and deliberately lowering admission prices of theaters in direct competition with those who refused to cooperate.<sup>29</sup>

Like the many cases that would follow, the 1921 attack on Famous Players-Lasky never clearly defined the relevant market at issue or the specific anticompetitive conduct. Instead, the FTC simply declared that the effects of Famous Players-Lasky's behavior "is to lessen competition and to tend to create a monopoly in the motion picture industry, tending to exclude from the market and the industry small independent producers and distributors of films and denying to exhibitors freedom of choice in leasing of films."<sup>30</sup> The market seems to be defined as broadly as the entire film industry in some contexts and as specifically as the most successful first-run theaters in others. Nevertheless, in 1927, the court ordered Famous Players-Lasky to stop its block booking and refrain from further expanding its theater holdings.

Much of the industry and the moviegoing public was distracted from the Famous Players-Lasky case by the advent of sound in film.<sup>31</sup> Thomas Edison had been toying with the idea of sound to accompany film since 1898. As early as 1913, he had developed a system of sound film, the Kinetophone, but was not enthusiastic about its commercial viability. A Vitagraph vice-president agreed, "The voice is a detriment to almost all styles of pictures. Why have words when any well-made picture tells the complete story?"<sup>32</sup>

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<sup>29</sup> *Id.* at 194.

<sup>30</sup> *Id.* at 207.

<sup>31</sup> See generally SCOTT EYMAN, *THE SPEED OF SOUND: HOLLYWOOD AND THE TALKIE REVOLUTION, 1926-1930* (1997).

<sup>32</sup> DIANA ALTMAN, *HOLLYWOOD EAST: LOUIS B. MAYER AND THE ORIGINS OF THE STUDIO SYSTEM* 142 (1992).

Nonetheless, the Warner brothers and Western Electric introduced the first sound film system, Vitaphone, in 1926. They premiered this new technology in New York, screening *Don Juan* (1926) with built in musical accompaniment from the New York Philharmonic Orchestra. The following year, Fox Studios created a superior sound film system, Movietone, which became popular in the production of newsreels. Later that year, Warner Brothers made history with *The Jazz Singer* (1927), the very first talking picture. That film was followed by *Lights of New York* (1928), the first entirely talking picture and another hit, and theaters all across the country began to install the costly sound projection systems. Though there was competition between Fox and Warner over whose sound system was superior, it was clear that sound on film was here to stay. By 1929, sound had become standard. New technology had created new competition against the MPPC in earlier years and would do so once again, as the introduction of sound prevented Famous Players-Lasky from living up to the FTC's fears and monopolizing the general film industry. In addition, after the stock market crash on October 29, 1929, Famous Players-Lasky, with its extensive theater holdings, became particularly vulnerable to the problems of the Great Depression.

## 2. *The Hays Code*

A new form of industry self-regulation became necessary when the new freedom of sound film and the sudden desperation of the Depression caused many film producers to abandon their prior attempts at morality in favor of ticket sales. Thus, 1930 saw the birth of the Motion Picture Production Code, or Hays Code. The new code was far more extensive than the old "Don'ts and Be Carefuls," discussing nearly every aspect of story, acting, and costume in great detail. However, just as the old Hays Formula had been optional, the new Hays Code had no mechanism for enforcement. The Hays Code was comprehensive in its list of things motion picture producers should not place up on the screen, and motion picture producers were as comprehensive in their efforts to ignore the Code. The period between 1930 and 1934 has come to be known as

Pre-Code Hollywood.<sup>33</sup> During this time, filmmakers were aware of the Hays Code but, unbound by its restrictions, chose to deliberately flout the Code at every opportunity. "Thirty-six states pushed for greater censorship and regulation of films, Catholic organizations threatened to boycott the movies, and Hollywood's effect on national morality was suddenly a hot topic for debate."<sup>34</sup> Most states already had censorship boards in place, and the creation of a Federal system of censoring motion pictures was frequently suggested.

Rather than risk government intervention, Hollywood insiders decided to give the Hays Office more power, creating the Production Code Administration (PCA) in 1934 to enforce the rules promulgated by the 1930 Production Code. Producers who joined the MPPDA agreed to abide by the rulings of the PCA or face a \$25,000 fine. Nonmembers of the MPPDA were also encouraged to submit scripts and films for PCA approval. Between the time of the creation of the PCA and the ruling in the *Paramount* case, over 95 percent of films produced were funneled through the PCA.

#### E. STRANGE BEDFELLOWS: THE MPPDA AND THE DOJ

##### 1. *Great Depression*

During the 1930s, between the MPPDA's relationship with the Attorney General's Office and a number of court rulings blaming restrictive trade practices on theater owners, both film producers and lawyers felt safe in concluding that Hollywood's practices were proper. For example, a practice later viewed as price discrimination in favor of large theater circuits over smaller independent theaters was, in 1936, viewed as "clearly legal as quantity discounts under §2 of the Clayton Act."<sup>35</sup> Communication between the MPPDA and the Antitrust Division of the Attorney General's Office acknowledged the acceptability of clearance and zoning schemes, which limited temporal competition between first-run and subse-

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<sup>33</sup> See generally THOMAS DOHERTY, PRE-CODE HOLLYWOOD: SEX, IMMORALITY, AND INSURRECTION IN AMERICAN CINEMA, 1930-1934 (1999).

<sup>34</sup> Gil, *supra* note 25, at 56.

<sup>35</sup> Note, *The Motion Picture Industry and the Anti-Trust Laws*, 36 COLUM. L. REV. 635, 642 n.48 (1936).

quent-run theaters and limited geographic competition between theaters operating in the same run as one another.<sup>36</sup>

Block booking, an ever-present complaint against film distributors, was alternately viewed as a fault of large theater chains, overbooking films to prevent their competition from acquiring copies of popular prints, and as a fault of movie distributors, brought about by the change in exhibition methods caused by the Depression. In order to attract more customers, many subsequent-run theaters began offering double features, selling tickets to two films for the price of one. While this was a great boon for theater owners, distributors were not as happy with the diminished financial returns on their films. This led to the creation of so-called C-pictures, which had even lower budgets than the former low-budget category of B-pictures. It also led to the implementation of block booking systems, as distributors tried to force subsequent-run theaters to license more films to offset distribution losses from double feature screenings.

Although the court in *Paramount* would find that movie distributors had violated §1 of the Sherman Act simply by acquiescing to the demands of exhibitors, it initially seemed that the potential antitrust risk, if any, fell on owners of theater circuits. Independent theater owners brought a large number of cases against theater chains alleging antitrust violations, among other things, on the grounds that such chains were able to get better films, better contract terms, and have overall better relationships with film distributors. In *Rembusch v. Motion Picture Producers and Distributors of America* (1934), a New York court found that, "although a theatre in competition with a large chain of theatres undoubtedly suffers a competitive disadvantage, the Sherman Anti-Trust Law was not made to redress such inherent disadvantages."<sup>37</sup> However, not all courts were as unsympathetic to the complaints of small theater owners. A 1936 Note in the *Columbia Law Review* explains: "Although most of the inability of smaller exhibitors to obtain an adequate supply of suitable films is the incidental result of necessary purchases by more potent competitors, some small part of it is pur-

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<sup>36</sup> MICHAEL CONANT, ANTITRUST IN THE MOTION PICTURE INDUSTRY 202-03 (1960).

<sup>37</sup> Note, *supra* note 35, at 642 n.49 (citing *Rembusch v. Motion Picture Producers and Distrib. of Am.* (S.D.N.Y. 1934) (unreported)).

posely contrived by theatre managers who adopt operating policies calling for the showing of more pictures than they reasonably need in order to keep them from competitors."<sup>38</sup> Up to 85 percent of complaints against theater chains at this time addressed the complaint of deliberate overbooking of films.

The Federal Trade Commission took a renewed interest in Hollywood in 1938. The impetus for the *Paramount* case can perhaps be traced to the 1935 demise of the widely criticized National Recovery Act, which allowed industries to create and enforce industry-wide "codes of fair competition." Although the government had been willing to cooperate with Hollywood during the Depression, that cooperation was suddenly called into question when the Supreme Court declared the NRA unconstitutional.

The 1938 season was a terrible one for Hollywood, even before the FTC began its assault on the industry. Although 1939 would herald the release of *Gone with the Wind*, *The Wizard of Oz*, and *Mr. Smith Goes to Washington*, to name but a few films, 1938 saw Hollywood studios in a decided slump. The most critically acclaimed and highest grossing film that year was *Snow White and the Seven Dwarfs*, produced by an unknown independent named Walt Disney. Some claimed that Hollywood had run out of ideas for new films, others blamed big studios for stifling creativity. An editorial in *Variety* took the latter view, stating, "The wonder is not the scarcity of outstanding, smashing film hits, but that under the present system of industry operation there are any hits at all."<sup>39</sup> Regardless of who was to blame, the entire industry was hurt by the slump. In March 1938, *Time* reported that box-office receipts were off by 15 percent from the previous year.<sup>40</sup> This decline in revenue was attributed by the "cinemindustry" to a business recession, but *Time* suggested other theories, including double features, the rise of radio (Orson Welles' famous *War of the Worlds* broadcast came in October of 1938), and even bingo as a threat to the movie industry.<sup>41</sup> It was in this atmosphere of public criticism of Hollywood that the De-

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<sup>38</sup> *Id.* at 645.

<sup>39</sup> *Blockbooking Not Showmanship*, VARIETY, Dec. 14, 1938, at 2.

<sup>40</sup> *Hollywood Slump*, TIME, Mar. 21, 1938.

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

partment of Justice began antitrust proceedings against the *Paramount* defendants.

Prior to the *Paramount* decision, industry leaders had every reason to believe that their trade practices were in accordance with the requirements of state and federal antitrust laws. Although the Famous Players-Lasky dispute had been resolved with a decree ordering the company to cease its policy of block booking and refrain from expanding its theater holdings, courts later refused to uphold the decree. Because of its extensive ownership of theaters, Paramount was unable to weather the storm of the Depression as easily as some of its competitors with less influence on exhibition. In 1933, Paramount went into receivership. Banks took control of the company, decentralizing its theater operations and selling many of its theaters. It was in this environment of dwindling Paramount control that New York courts, and later the Supreme Court, refused to bind Paramount to the restrictive practices imposed by the court in the earlier *Famous Players-Lasky* case.

During the Depression, courts and regulatory agencies were generally more sympathetic to the needs of the film industry. A 1930 letter from Assistant Attorney General John O'Brian to MPPDA leader Will Hays reads, "If the new zoning and clearance plan is satisfactory to all of the interests involved, you and your associates are to be congratulated."<sup>42</sup> From the tone of the letter, it is clear that this was not the first communication between the MPPDA and the Antitrust Division.

## 2. *The Honeymoon Is Over*

Although begun in 1938, the *Paramount* case was not first decided until June of 1946. The case was initially resolved through a consent decree in November of 1940. The decree limited blind selling films without prior trade screenings, restricted block booking to no more than five films at a time (when previously many distributors operated in blocks of 13, 26, 52, or 104, enough films to cover a full year of exhibition), placed a prohibition on blanket licenses to geographically diverse theater chains, established a binding arbitration board to determine issues of clearances and other exhibition-

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<sup>42</sup> CONANT, *supra* note 36, at 202-03.

related disputes, and required defendants to notify the Department of Justice before acquiring any new theaters. Of the original eight defendants, only the five “major” defendants – Paramount, Loew’s, Warner Brothers, Twentieth Century Fox, and RKO – participated in the consent decree. The three “minor” defendants – Universal, Columbia, and United Artists – refused to join the agreement, “presumably because of their opposition to the provisions requiring trade-showing and prohibiting block-booking of groups of more than five films.”<sup>43</sup> The minor defendants were differentiated from the major defendants by the fact that the minor defendants did not own any theaters. Thus, block booking and blind selling were more important to their ability to conduct business because they could not count on their own theaters as a guaranteed outlet for their films. By the terms of the consent decree, since the minor defendants had not joined the agreement by a specified date in 1942, the contested portions that dealt with block booking and blind selling were no longer binding on any of the defendants. Nevertheless, the five major defendants continued to operate in accordance with the terms of the consent decree.

At the end of World War II, with movie revenues at an all time high and the consent decree no longer binding studios to approved methods of competition, the Department of Justice was ready to reopen the *Paramount* case. Initially, many in the film industry were able to successfully claim that contested practices like block booking and blind selling were necessary in order to remain competitive in an industry ravaged by the Depression. Many studios had been forced to scale back production, cut jobs, sell theaters, and even declare bankruptcy. However, with the boom in movie attendance caused by World War II, courts and regulators were not longer sympathetic to Hollywood claims of economic necessity for disapproved practices. In June of 1946, the *Paramount* defendants would get their first glimpse of just how unsympathetic courts would be towards their industry.

Although many producers were still happy with the PCA and its services at this time, others saw the organization as yet another method of monopolistic control over the industry. These views came to light as the power of the PCA began to decline in the

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<sup>43</sup> United States v. Paramount Pictures, Inc., 66 F. Supp. 323, 333 (S.D.N.Y. 1946).

shadow of the looming *Paramount* verdict. In 1946, Mary Pickford told *Variety*, "As things stand now, the Big Five are both Congress and the Supreme Court. They not only make the rules, but they sit in judgment on the operation of them, so that an independent has no recourse. Inasmuch as we must live under the Code, we want some say in its content and administration."<sup>44</sup> Further undercutting the effectiveness of the Hays Code, the \$25,000 fines were removed, on the advice of counsel, as potentially violating §1 of the Sherman Act. However, in *Hughes Tool Co. v. Motion Picture Association of America*, a New York court found no antitrust violation in the newly renamed MPAA's process of granting PCA approval. The court states, "The purpose of the approval is in furtherance of the proper purpose of the defendant [MPAA] to censor pictures which it may consider are not up to the highest possible moral and artistic standards. Defendant, I believe, owes that duty to the public."<sup>45</sup>

The court in *Hughes* ruled in favor of the MPAA, but not before highlighting a number of ways in which the PCA could potentially be violating §1 of the Sherman Act. In his complaint, Howard Hughes alleged that the MPAA and its members had entered into an agreement to unreasonably restrain trade. The MPAA, Hughes alleged, controlled over 90 percent of theaters and therefore coerced movie producers to apply for the PCA seal of approval with the threat that, absent the seal, 90 percent of theaters would not screen the film. Hughes claimed the illegal restraint of trade was the MPAA's "group boycott of producers, distributors and exhibitors who do not obtain the seal of approval."<sup>46</sup> The court found that the PCA's censorship rules were, if anything, too cooperative with movie producers, since state censorship boards actually demanded greater deletion of material than the PCA required to earn its seal of approval. Because of its "proper purpose," the court found that if the PCA agreement did constitute a restraint of trade, it was a reasonable one.<sup>47</sup>

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<sup>44</sup> *Favors Big 5 at Expense of Indies*, VARIETY, Sept. 25, 1946, at 3.

<sup>45</sup> *Hughes Tool Co. v. Motion Picture Ass'n of Am.*, 66 F. Supp. 1006, 1013 (S.D.N.Y. 1946).

<sup>46</sup> *Id.* at 1009.

<sup>47</sup> *Id.* at 1013.

## II. UNITED STATES V. PARAMOUNT PICTURES

### A. THE LOWER COURT'S RULING

In *United States v. Paramount Pictures*, the New York District Court addressed the case in much the same way it had addressed previous antitrust situations in the industry. The court ultimately found that the defendants had engaged in restrictive trade practices, identified as block booking, clearances, formula deals, franchises, master agreements, runs, pooling, and blind selling. The defendants were ordered to cease practices deemed unreasonably restrictive, but otherwise allowed to continue to do business in all three spheres of the motion picture industry: production, distribution, and exhibition. The court grappled with a number of different potential §1 and §2 violations. Specifically, the court looked at vertical agreements to restrain trade in the form of price-fixing license agreements, horizontal agreements to restrain trade through the same license agreements as well as clearances and pooling agreements, and attempted monopolization of an ill-defined market through generally restrictive trade practices like formula deals, master agreements, franchises and block booking.

#### 1. *Clearances, Runs, and Block Booking*

The *Paramount* court declined to find a successful claim of per se illegality under §1 in the mere existence of clearances, which had long been held as reasonable restraints of trade in the motion picture industry. Clearances do not expressly fix prices, though they do contribute to the existence of first-run and subsequent-run theaters and the separate price scale for each. The court relied on precedent, finding that “in the absence of an unconscionably long time or too extensive an area embraced by the clearance, or a conspiracy of distributors to fix clearances, there was nothing of itself illegal in their use.”<sup>48</sup> Rather, the court suggested, disputes over clearances would be better decided on an individual basis as the need arose. The court set out seven factors to be considered in determining whether a clearance was reasonable. Those factors included admis-

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<sup>48</sup> *Paramount*, 66 F.Supp. at 342.

sion price, size of theater, competition between theaters, and the revenue derived by the distributor from each theater.

Although the court did not find anything inherently wrong with a system of clearances, it took issue with the uniform nature of the clearance system and attempted to remedy that system. Because clearances were frequently set by the exhibitors, rather than the distributors, it looked like the defendants had colluded to create a single price scale. Indeed, the court extended its theory of horizontal agreement to encompass not only explicit price-fixing, but also clearances and runs.<sup>49</sup> The general sales manager of Columbia explained, "clearance is something we usually find when we arrive there, and we usually negotiate our deal within the clearance we find."<sup>50</sup> In other words, exhibitors knew what their clearance had been in the past and came to the negotiating table expecting it to remain the same. The general sales manager of RKO described it this way: "He usually knows what clearances other distributors are granting. His customer usually tells him what clearance he wants, which is what he is getting from other distributors."<sup>51</sup> Although the distributors had no agreements with one another to maintain a uniform system of clearances, uniformity began to emerge. The court applied the rule of reason test and ultimately concluded that the system of clearances, as it existed, had an anticompetitive effect equivalent to explicitly fixing prices.

In its assessment of block booking, the court discussed both tying arrangements and the improper extension of "copyright monopoly." To view block booking as a tying arrangement presupposes that there is a particular film that exhibitors want that they cannot get without also licensing other inferior films. The court rejected a Second Circuit opinion that found block booking to have the practical effect of forcing exhibitors to take more films than they might otherwise license, but not necessarily films of lesser quality. The Second Circuit opinion explained, "it is as though the owner of ordinary chattels refused to sell a lot to A unless the latter would purchase in a larger quantity than he desired."<sup>52</sup> To a great extent,

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<sup>49</sup> *Id.* at 346.

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 344.

<sup>52</sup> *Id.* at 349.

this assessment, although rejected by the *Paramount* court, is accurate.<sup>53</sup>

Prior to the institution of trade screenings (and to a significant extent afterwards, as well), most exhibitors chose films based only on a short blurb containing the title, lead actors, and basic plot. Even with trade screenings, it was impossible to know which films would be successful until audiences actually saw them. A big star could be enough to create a successful first week, but a film had to be good to sustain a long run. The *Paramount* court, however, chose to look at films as if each constituted a separate and legitimate “copyright monopoly” which could not be extended to support other copyrighted works. In fact, the court viewed the conditioning of acceptance of one film on the acceptance of others as if the distributor was using a single copyrighted work to extend protection to other uncopyrighted works.<sup>54</sup>

Rather than declare block booking entirely illegal, the court found only compulsory block booking illegal. If exhibitors sought out blocks of more than one film, they were free to continue to acquire multiple films in a single license, but distributors had to offer each film individually.<sup>55</sup> Earlier courts had found even this restriction unnecessary. In 1932, a Second Circuit opinion held that as long as there was no monopolization of distribution, block booking was not a problem that courts needed to address. Specifically, the court held that there was no monopolization “and, in fact, lack of ability to achieve a monopoly and therefore [block booking was] not a business operation which would unduly hinder competitors.”<sup>56</sup>

## 2. Price Fixing

The most important issue the court addressed was price fixing, as minimum admission prices had been set by the defendants in their licensing agreements with exhibitors. The industry adopted a minimum admission price system for a number of reasons. First,

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<sup>53</sup> See generally F. Andrew Hanssen, *The Block Booking of Films Reexamined*, 43 J.L. & ECON. 395 (2000).

<sup>54</sup> *United States v. Paramount Pictures, Inc.*, 66 F. Supp. 323, 340 (S.D.N.Y. 1946).

<sup>55</sup> *Id.* at 350.

<sup>56</sup> *Fed. Trade Comm’n v. Paramount Famous-Lasky Corp.*, 57 F.2d 152, 155 (2d Cir. 1932).

where the rental fee paid by the exhibitor was to be a percentage of the revenue earned from screening the film, distributors had an interest in setting minimum admission fees because those fees directly determined how much money the distributor would receive. When asked why he cared how much an exhibitor charged, a Paramount vice-president in charge of distribution and sales explained, "Because the admission price that he charges determines the film rental that I can earn for my pictures."<sup>57</sup> A second reason for predetermining admission price was that it ensured a differentiated pricing scale for first-run and subsequent-run theaters.

On its face, maintaining a differentiated pricing scale for first-run and subsequent-run theaters seems anticompetitive, but there were important reasons for this system of runs. A single black and white print could cost between \$150 and \$300, a Technicolor print between \$600 and \$800. Without a system of subsequent-runs, many theaters would not have been able to afford the price of the films. Because of the run system, distributors were able to rent films to subsequent-run theaters at a lower cost. In order to maintain this system of runs, it was necessary for there to be a differentiated price scale based on whether a theater was first-run or subsequent-run. The court addressed this issue when it looked at clearances, concluding that "[m]uch that has been said about clearance is applicable also to runs; the two are practically alike."<sup>58</sup> A 1936 Note in the *Columbia Law Review* explained the relationship and its necessity: "[Minimum price stipulations] represent an effort, not only to maintain the level of prices, but also to assure stability, important for clearance. Schedules, set up for months in advance largely on the basis of comparative admission prices would be thrown out of gear by sudden price changes."<sup>59</sup> The third reason for fixing admission price was that exhibitors demanded it. While courts had previously found the threat of antitrust to be vested in such exhibitors as possessed geographically diverse theater chains, the court in *Paramount* found that the defendants' acquiescence to a scheme of minimum admission price fixing was enough to make them part of the conspiracy to restrain trade.

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<sup>57</sup> *Paramount*, 66 F.Supp. at 336.

<sup>58</sup> *Id.* at 345.

<sup>59</sup> Note, *supra* note 35, at 649 n.80.

In its consideration of price fixing, the court addressed the concern that copyright law might allow the defendants to set a minimum price for the screening of any films for which they were the copyright owners. In a number of earlier cases, courts had concluded that motion picture copyright owners were entitled to set a minimum price at which their films could be screened.<sup>60</sup> Absent a showing of multiple copyright owners acting in concert with one another to deliberately fix prices, courts fairly consistently upheld minimum price clauses in license agreements.<sup>61</sup> The *Paramount* court concluded that considerations of the rights granted by copyright were purely academic unless it could be shown that the particular copyrighted work was licensed to only one single party, rather than a whole host of exhibitors.<sup>62</sup> In so ruling, the court chose to find concerted action in the conduct of exhibitors where previous courts had restricted their concerns to the actions of copyright owners. The court conceded that each defendant could legitimately fix price for any films screened in its own theaters.

By ignoring precedent, the court was clearly able to demonstrate a vertical agreement that unreasonably restrained trade, embodied in the price-fixing licensing agreements between defendants and exhibitors, but agreement was noticeably absent in its finding of a horizontal agreement between defendants to fix minimum admission prices. In an earlier case against MGM, a federal court in Minnesota refused to find a violation of §1 of the Sherman Act "when the only fact alleged to show conspiracy was the unanimity of action of the defendant distributors."<sup>63</sup> Here, the court instead relied on the idea that, "[t]he whole system presupposed a fixing of prices by all parties concerned in all competitive areas."<sup>64</sup> The implication of this logic is that absent an agreement between all de-

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<sup>60</sup> See, e.g., *Glass v. Hoblitzelle*, 83 S.W.2d 796 (Tex. Civ. App. 1935); *Shubert Theatre Players Co. v. Metro-Goldwyn-Mayer Dist. Corp.* (D. Minn. 1936) (unreported), cited in Note, *supra* note 35, at 638, 646, 650; *Sono Art World Wide Pictures v. Lando* (County Ct., Allegheny County, Pa. 1931) (unreported), cited in Note, *supra* note 35, at 650.

<sup>61</sup> See *Glass*, 83 S.W.2d at 796; *Shubert Theatre Players Co.; Sono Art World Wide Pictures*.

<sup>62</sup> *United States v. Paramount Pictures, Inc.*, 66 F. Supp. 323, 340 (S.D.N.Y. 1946).

<sup>63</sup> Note, *supra* note 35, at 651 n.88.

<sup>64</sup> *Paramount*, 66 F.Supp. at 336.

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. What this supposition ignores is the fact that each defendant was dealing in a wholly separate product. The court talked about individual copyrights as granting separate monopolies, but here chose to think of films as if they were no more distinct from one another than any other market for identical goods. This fails to address the fact that patrons of first-run theaters were generally not driven by price, but by other factors surrounding the specific film they wanted to see. Moviegoers concerned with price had the option of waiting to see the film at a subsequent-run theater. So although any one exhibitor could have charged a lower price, it would not have guaranteed him a larger audience unless he had the more popular film, in which case he would not have needed to lower his price.

The court relied greatly on the uniformity of ticket prices to infer a horizontal agreement to fix prices. In doing this, the court seems to be ignoring its own finding that a price-fixing clause was included in nearly all licensing agreements and was generally determined by the exhibitor. The court seems to be confused by the fact that some defendants have operated as both exhibitors and distributors. Although there are contracts between the defendants with one acting in the role of exhibitor and the other in the role of distributor, there are no agreements in which both parties are exhibitors or both are distributors. This may seem like a trivial difference, but since the court has already found the vertical agreements to be standard contract terms, it is unpersuasive to then say that these standard terms are somehow more meaningful when found in a contract between two defendants.

Although the court successfully demonstrated a *per se* violation of §1 through the vertical agreements to fix minimum admission prices, it also attempted to show a horizontal agreement under §1 and an attempted monopolization of first-run theaters under §2. In addition to its inference of horizontal agreement based on the existence of the price-fixing clauses in contracts between the defendants, the court claimed that: "In effect, the distributor, by the fixing of minimum prices, attempts to give the prior-run exhibitors as near

a monopoly of the patronage as possible.”<sup>65</sup> This logic is counterintuitive. While the court could (and did) use other trade practices to demonstrate a §2 violation, fixing minimum admission price seems to do exactly the opposite of what the court is suggesting. If, as the court stated, moviegoers were ultimately driven by price, a fixed minimum admission price would tend to help the later-run theaters, who could screen the same film at a lower price. Instead, the court found that fixing prices drove consumers to see the film at a first-run theater, thus vesting a near monopoly over ticket sales in the owner of the first-run theater. The court did not elaborate on its reasoning and did not rely heavily on this finding, since it was already able to condemn the same behavior under two different theories of violating §1, but it still bears mentioning.

### *3. Court’s Remedy: Competitive Bidding System*

In an attempt to resolve most of the issues in one broad sweep, the court proposed a system of competitive bidding which, it claimed, would benefit exhibitors, distributors, and the general public. The premise of the bidding system was simple: “if two theaters are bidding and are fairly comparable the one offering the best terms shall receive the license.”<sup>66</sup> The court believed that by making all films freely available to the highest bidder, the temptation to abuse licenses and set unreasonable clearances and runs would be eliminated. The “administrative details” of such a system were left to be determined in a further opinion.<sup>67</sup>

Because of its reliance on an enforced competitive bidding system, the court only briefly addressed the problem of formula deals, master agreements, and franchises. The court quickly found formula deals to be an unreasonable restraint of trade because they allowed a geographically diverse theater chain to negotiate for a film to be screened in each of its theaters without allowing each individual theater’s local competition a chance to outbid the chain. Such deals had long been rationalized as simply good business sense: “The circuit, prized as a large customer, gets first choice of

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<sup>65</sup> *Id.* at 340.

<sup>66</sup> *Id.* at 346.

<sup>67</sup> *United States v. Paramount Pictures, Inc.*, 70 F. Supp. 53 (S.D.N.Y. 1946) (consent decree contemplated by the earlier 1946 S.D.N.Y. ruling).

pictures, even for those of its theatres which are inferior to their immediate competitors, by threatening to withdraw the patronage of its whole chain."<sup>68</sup> Prior to the *Paramount* decision, small exhibitors had been unsuccessful with conspiracy claims under §1, since uniformity of action (created by multiple distributors responding to the same pressure from large theater chains) alone is not sufficient to show conspiracy. Franchises, which had been forbidden under the 1940 consent decree, were dispatched with equal speed, quickly found to be unreasonable restraints of trade because they covered periods of time greater than a single film season. Master agreements were dealt with in a single paragraph, determined to be "open to the same objection as formula deals."<sup>69</sup> Rather than address any of these problems in a substantive way, the court reiterated its assertion that the problems would be solved by an enforced competitive bidding system that allowed each film to be licensed to the highest bidder on an individual basis.

In dealing with pooling agreements, the *Paramount* court looked only at theaters jointly owned or operated by more than one defendant to the exclusion of other, local competition. The court ostensibly declared such agreements to be per se violations of §1, though a fair amount of space was devoted to explaining why that was the case. The problem with pooling agreements, the court decided, was that their "effect is to ally two or more theatres of different ownership into a coalition for the nullification of competition between them and for their more effective competition against theatres not members of the 'pool'."<sup>70</sup> The court's approach to pooling agreements, like its approach to much of the case, was confused by its inability to define the market being considered. In terms of local markets, the joining of multiple competitors would certainly create a local monopoly. The same would not be true of pooling agreements when considered on a larger scale, defining the market as theaters nationwide. Nevertheless, the court concluded that defendants should not be allowed to own theaters jointly under any circumstances, unless ownership was of a less than 5 percent interest in the theater.

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<sup>68</sup> Note, *supra* note 35, at 642 n.48.

<sup>69</sup> *United States v. Paramount Pictures, Inc.*, 66 F. Supp. 323, 347 (S.D.N.Y. 1946).

<sup>70</sup> *Id.* at 351.

While the court quickly disposed of pooling agreements as unreasonable restraints of trade in violation of §1 of the Sherman Act, it did not adopt the Justice Department's view that film distributors should be completely barred from owning theaters. Out of approximately 18,076 theaters in the United States, defendants' aggregated interests constituted 3,137 theaters, or 17.35 percent. Paramount owned the most theaters, with 1,395; Loew's and RKO owned the fewest, with 135 and 109 respectively. Considering these numbers, the court stated, "It is only in certain localities, and not in general, that an ownership even of first-run theatres approximating monopoly exists."<sup>71</sup> Defining the market as first-run theaters in the United States, the court refused to view local monopolies as anti-trust violations without specific evidence of anticompetitive conduct. The court found that, absent the restrictive trade practices which the *Paramount* case aimed to correct, there was competition among almost all theaters nationwide. Limiting its market to first-run theaters in 92 cities with a population over 100,000, the court still found, "In about 91 percent of these cities there is competition in first runs between independents and some of the major defendants or among the major defendants themselves."<sup>72</sup>

Although the court found a high concentration of ownership of the vaguely defined "best" theaters and "best" films among the defendants, this did not translate into monopoly power. Defendants were ordered to withdraw from joint ownership of theaters and illegal pooling agreements, but were entitled to keep their individually owned theaters. The court sometimes seemed to be defining the relevant market as the "best" theaters and "best" films, without specifying what was meant by "best." "Best" could be defined broadly to encompass all first-run theaters or narrowly to include only the most financially successful films. The latter interpretation would be unduly harsh to those defendants who had achieved some merit of commercial success, since the commercial success of any particular film should not be linked to the potential anticompetitive actions of distributors or exhibitors involved in its marketing. As has been previously stated, it is impossible to know

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<sup>71</sup> *Id.* at 353.

<sup>72</sup> *Id.* at 354.

whether a film will be commercially successful until audiences have seen the film and decided for themselves.

#### B. SUPREME COURT RULES

Although the lower court allowed the defendants to keep their theaters, the Supreme Court was not so generous. In a 7-1 opinion, the court ostensibly upheld the lower court's ruling, but ordered the case remanded to determine the appropriate outcome without using the New York court's system of enforced competitive bidding. The court acknowledged that, "the competitive bidding system was perhaps the central arch of the decree designed by the District Court," but still purported to be ruling in accordance with the lower court's views.<sup>73</sup> Because the elimination of the competitive bidding system invalidated a significant portion of the lower court's ruling, the Supreme Court ordered the District Court to reconsider all aspects of the case on remand, rather than just the sections specifically mentioned in the Supreme Court opinion. In addition, the court not-so-subtly suggested that the remand should divest the defendants of their theater interests.<sup>74</sup>

The Supreme Court was able to find monopoly where the District Court concluded there was none. In part, the court did this by considering local monopolies, where the lower court would have left these to individual proceedings on a case by case basis. The court also redefined the relevant markets to consider first-run theaters in cities with a population over 100,000 as a single market, first-run theaters in cities with a population between 25,000 and 100,000 as a single market, and first-run theaters in cities with a population under 25,000 as a single market. Using those numbers, the Supreme Court was able to find an urgent need to divest distributors of their theater holdings. Although the numbers themselves did not change, the Supreme Court was able to adjust its analysis of those numbers in such a way that it was able to dismiss competition as insubstantial.

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<sup>73</sup> United States v. Paramount Pictures, Inc., 334 U.S. 131, 166 (1948).

<sup>74</sup> *Id.* at 175.

## C. REMAND

On remand, the lower court, though clearly upset about the rejection of its proposed competitive bidding system, complied with the Supreme Court's order to divest distributors of their theater holdings. The District Court revisited all the issues of the case, frequently noting that although a competitive bidding system would have solved many of the problems, the Supreme Court had ruled against such a system. Suddenly, the court found itself backpedaling on many of its former statements, reconsidering the implications of numbers it had previously dismissed as unable to constitute a monopoly. This was partly accomplished by dismissing competition in cities where "the position of one defendant was so dominant relative to the others that competition between them was unsubstantial."<sup>75</sup> The court also refused to consider any theaters in New York because those theaters, generally the flagship theaters of the *Paramount* defendants, were not in competition with respect to their source of films.<sup>76</sup> Because these theaters were often the flagship theaters, they primarily screened films produced by their affiliated studio.

When the court still found competing theaters in a particular city, it determined that there was no real competition between the defendants because each theater relied predominantly on a different source of films. Although the court was ostensibly considering a nationwide market, each city was considered on an individual basis. Each separate city, even cities with competition between various theaters, was then found to lack competition, prompting the general conclusion of a nationwide lack of competition. No court had ever denied that each defendant was entitled to screen its own pictures in its own theater. To then hold that such action negated even the appearance of competition in a local market would be illogical. The conclusion was also incorrect because it ignored the fact that even absent any division of film suppliers, clearances would have prevented two theaters in direct competition with each other from showing the same film at the same time.

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<sup>75</sup> United States v. Paramount Pictures, Inc., 85 F. Supp. 881, 892 (S.D.N.Y. 1949).

<sup>76</sup> *Id.*

Even with its readjusted numbers, the court still found competition between the defendants themselves and between defendants and independents, but was determined to find a justification for divesting the defendants of their theaters holdings. In order to do so, the court concluded from the geographic diversity of each of the defendants that there had been an organized plan to divide up the country so that no defendant would be in substantial competition with any other defendant.<sup>77</sup> Most defendants had acquired their theater holding by purchasing pre-existing regional theater chains. Although it appeared to the court that the defendants had agreed to divide the nationwide theater market on geographic lines, this apparent effect was instead a result of each defendant gaining dominance in a particular geographic region by purchasing an already dominant theater chain in that region.

After years of appeals, the movie industry finally surrendered to the court ordered "divorcement" of distribution from exhibition. While other studios attempted to negotiate a new consent decree with the Department of Justice, RKO, under the leadership of Howard Hughes, quickly agreed to divest itself of its theater holdings. By far the weakest of the *Paramount* defendants, with only 109 theaters, RKO had less to lose than its competitors. Paramount was the next to capitulate to the demands of the Department of Justice and agreed to divest itself of its massive theater holdings in February of 1949. The remaining studios were less eager to comply. Although the Supreme Court had ordered production and exhibition divided, no court had found vertical integration alone to be per se illegal. Loew's did not want to lose its control over MGM and Twentieth Century-Fox and Warner Brothers agreed that they would not give up without a fight. They did fight, but ultimately all of the *Paramount* defendants would surrender to the will of the Department of Justice.

### III. THE AFTERMATH

If 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* de-

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<sup>77</sup> *Id.*

cision managed to accomplish the exact opposite of its intended goals. By 1960, over 5,000 theaters across the country had closed, the number of films produced had declined sharply, and ticket prices continued to rise. Over time, theaters would also decrease the size of their screens while increasing their audience capacity. Drive-in theaters, able to serve up to 2,500 cars at a time, flourished despite their poor quality picture and sound. Where once each studio was producing upwards of 60 films a year, with Hollywood averaging about 750 films a year in the 1930s, that number was closer to 300 in the 1950s and has continued to decline. Theaters are no longer designated as first-run and subsequent-run, and as a result audiences now pay the same price on the opening day of a film and the last day of its theatrical run.<sup>78</sup>

The film industry has always been driven by the box office, with production and distribution scaled to fit the revenue derived from exhibition. A 1947 look at the financial organization of the industry estimated that theaters took in 11 cents of profit for every dollar spent at the box office, while the studios themselves only averaged 2 cents of profit on the dollar.<sup>79</sup> Although the public perceived Hollywood as the studios and their productions, nearly all of the money in the industry was centered around exhibition, with production running a distant second, and distribution involving the smallest flow of money. According to one estimate, "More than half the pictures that are produced fail to earn rentals sufficient to recover their production and marketing costs."<sup>80</sup> In 1967, the number of films produced that didn't earn enough money to justify their production was estimated at 75 percent.<sup>81</sup>

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<sup>78</sup> Though some theaters do still provide second run screenings at lower prices, most do not. The number of second run theaters still in existence is estimated to be under 200 (fewer than 700 screens), as compared to the number of first run theaters which is closer to 40,000 screens. See Cinema Treasures, *Movies (Second Run)*, <http://cinematreasures.org/function/36/> (last visited Jan. 18, 2008); Andy Serwer, *Movie Theaters: Extreme Makeover*, FORTUNE, May 23, 2006, [http://money.cnn.com/2006/05/19/magazines/fortune/theater\\_futureof\\_fortune/](http://money.cnn.com/2006/05/19/magazines/fortune/theater_futureof_fortune/) (last visited Jan. 18, 2008).

<sup>79</sup> Floyd B. Odum, *Financial Organization of the Motion Picture Industry*, 254 ANNALS AM. ACAD. POL. & SOC. SCI. 18, 18-21 (1947).

<sup>80</sup> Michael Conant, *The Paramount Decrees Reconsidered*, 44 LAW & CONTEMP. PROBS. 79, 82 (1981).

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

After the *Paramount* decision, the financial structure of the industry did not change, but the divorcement of producer-distributors from their theaters removed the studios' safety net of guaranteed access to box office revenues and led to a decline in innovation, risk-taking, and overall quality of films. One film writer explained, "With no guarantee of exhibition, fewer movies could be made.... The 1950s was a time of bust: of caution."<sup>82</sup> Desperate to attract viewers, producers resorted to gimmicks like Cinemascope, Cinerama, and 3-D movies, but even such gimmicks only had fleeting appeal. A 1957 MGM film, *Silk Stockings*, featured Fred Astaire and Janis Paige in a satirical musical number that poked fun at the desperation of producers: "Today to get the public to attend a picture show, it's not enough to advertise a famous star they know. If you want to get the crowds to come around you've got to have glorious Technicolor, breathtaking Cinemascope and stereophonic sound."<sup>83</sup> Many studios further attempted to eliminate production risk by using only big stars and big budgets, the result of which was the production of even fewer films since money allocated for multiple films was instead spent on one big-budget spectacle.<sup>84</sup>

In 1952, the Supreme Court overturned its decision in *Mutual Film Commission* and found that motion pictures were entitled to first amendment protection. In *Joseph Burstyn v. Wilson*, the Supreme Court reversed nearly forty years of precedent which had relegated motion pictures to the same category as "the theatre, the circus, and all other shows and spectacles" which could be regulated under the police power without regard for freedom of expression.<sup>85</sup> In *Burstyn*, the court held that motion pictures were indeed entitled to first amendment protection, and that there could be no censorship of films on the grounds that censors felt them to be "sacrilegious" since religions did not need state protection from views they found distasteful.<sup>86</sup> This decision allowed Roberto Rossellini's *The Miracle (1948)*, the story of a pregnant peasant woman who believes herself to be the Virgin Mary, to be screened in New York

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<sup>82</sup> ETHAN MORDDEN, *THE HOLLYWOOD STUDIOS: HOUSE STYLE IN THE GOLDEN AGE OF THE MOVIES* 368 (1988).

<sup>83</sup> *SILK STOCKINGS* (MGM 1957).

<sup>84</sup> Conant, *supra* note 80, at 82-83.

<sup>85</sup> *Mut. Film Comm'n v. Indus. Comm'n of Ohio*, 236 U.S. 230, 243 (1915).

<sup>86</sup> *Joseph Burstyn, Inc. v. Wilson*, 343 U.S. 495 (1952).

over the objections of the New York State Board of Regents and the Catholic Church. The Hays Code, hurt by FTC rulings and floundering after this restriction on state censorship boards took away its previous *raison d'être*, was replaced in 1956 with the watered-down version that would become the butt of many jokes, and later eliminated entirely.

In addition to the new costs of operating under the *Paramount* decrees, film attendance continued to decline and producers faced the extra burden of competing with a growing television industry. According to the U.S. Census Bureau, attendance at movie theaters (excluding drive-in theaters) was approximately 3,352 million in 1948, falling to 1,011 million in 1958, and only 553 million in 1967.<sup>87</sup> In 1946, the average American saw 28 movies a year, as compared to 5 movies a year in 2005.<sup>88</sup> Although producers continued to extol the virtue of film over television, emphasized by gimmicks like wider aspect ratios, stereophonic sound far superior to the monophonic sound of television, and Technicolor, potential moviegoers were seduced by the low cost and greater convenience of television. With time, television was even able to match most of the technological feats that had given film an edge of superiority.

Although no court had ever found a monopoly in production, many economists were willing to view an increase in competition on the production end as a victory for antitrust law, despite the lack of increased competition in distribution and exhibition. Economist Michael Conant notes, "In 1970 [the seven former *Paramount* defendants] released 76 percent of the films that earned \$1 million or more in rentals, and in 1978 they released 89 percent of these successful films."<sup>89</sup> However, Conant takes comfort in the fact that there is more competition among film producers than there was prior to the *Paramount* decision. In addition, he notes that "in a freer market, the minor distributors, who had never been part of the illegal exhibition cartel that dictated first-run theater priorities, became equal competitors with the four surviving majors."<sup>90</sup> It seems like small comfort to conclude that the *Paramount* decision created

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<sup>87</sup> Conant, *supra* note 80, at 79.

<sup>88</sup> Serwer, *supra* note 78.

<sup>89</sup> Conant, *supra* note 80, at 90.

<sup>90</sup> *Id.* at 92.

more competition between the defendants themselves, rather than any potential new entrants into the market.

In the 1980s, the *Paramount* case, dormant since 1950, was revisited. In a complete reversal of its original holding, the New York District Court allowed Loew's, which had restricted itself exclusively to exhibition, to produce and distribute films as long as it did not screen any of its own films.<sup>91</sup> The court noted that much had changed in the film industry since the last time it visited the *Paramount* decision: television, home video, and the growth of national theater chains, unrestricted by the consent decrees that hampered the *Paramount* defendants, to name but a few new developments.<sup>92</sup> A 1982 Note in the *Fordham Law Review* described the contemporary motion picture industry in words that could have been lifted straight from the original *Paramount* opinion: "[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>93</sup>

Antitrust law intervened to remove industry leaders from power in 1948, yet the structure of the industry was such that new leaders soon rose to take their place. 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. An independent producer may be able to get his film made, but without connections to a distributor, he will have a hard time getting his film screened. As long as there are national theater chains which deal with large distribution companies, this will always be the case. Whether the studios themselves retained control over the pipeline to theaters or, as has happened in the aftermath of *Paramount*, exhibitors became wholly independent,

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<sup>91</sup> *United States v. Paramount Pictures*, 1980-2 Trade Cas. (CCH) P63, 553.

<sup>92</sup> *Id.*

<sup>93</sup> Mary Elizabeth Kilgannon, Note, *Motion Picture Licensing Acts: An Analysis of the Constitutionality of Their Provisions*, 51 *FORDHAM L. REV.* 293, 294 (1982).

independent producers have gained no leverage in negotiating the release and distribution of their films. 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.