Copyright 2020 by John Paul Stevens
Printed in U.S.A.
Vol. 114, No. 7

# Comments

## Price-Fixing in the Motion Picture Industry

IN 1938 the Justice Department brought an action against the major distributors of motion pictures,[1] alleging that their system of distributing films to exhibitors violated Sections 1 and 2 of the Sherman Act.[2] When the case came on for trial in 1940, the parties negotiated a consent decree which provided for an arbitration system to settle charges of discrimination against independent theaters, prohibited the booking of more than five films in any one block, and required films to be trade shown before being licensed.[3] After the three year period for which the decree was binding, the government reopened the litigation, primarily because it felt that the only effective way to prevent monopolization of the motion picture industry was by requiring the five theater-owning defendants to dispose of their financial interests in theaters, and secondarily to require all eight defendants to discontinue certain unreasonable practices.[4] The three-judge court refused to divest the defendants of their theaters, but enjoined them from entering into agreements with exhibitors fixing minimum thea-

[1] The eight defendants are Paramount Pictures, Inc.; Loew's Incorporated; Radio-Keith-Orpheum; Warner Bros. Pictures, Inc.; Twentieth Century-Fox Film Corporation; Columbia Pictures Corporation; Universal Corporation; and United Artists Corporation. The first five, known collectively as the "Big Five," are engaged in production, distribution, and exhibition of motion pictures; the three minor defendants own no theaters. The government admitted that there was free competition among the defendants in the production of pictures, so the case concerns only the charge of combination among the defendants on the distribution and exhibition levels.

For earlier actions *see* United States v. Motion Picture Patents Company, 225 Fed. 800 (E.D. Pa. 1915), *App. dism.* 247 U.S. 524 (misuse of patent rights enjoined); Motion Pictures Patent Company v. Universal Film Company, 243 U.S. 502 (1917) (infringement suit); Paramount Famous Lasky Corporation v. United States, 282 U.S. 30 (1930) and United States v. First National Pictures, Inc. 282 U.S. 44 (1930) (Companion suits dissolving "Film Boards" through which the distributors dominated independent exhibitors); Federal Trade Commission v. Paramount Famous-Lasky Corp., 57 F. (2d) 152 (C.C.A. 2d, 1932) (Block-booking not unlawful); United States v. Interstate Circuit, Inc. 306 U.S. 208 (1939) (Defendants were enjoined from imposing restrictions in contracts with small exhibitors in response to the request of the most powerful unaffiliated circuit in the Southwest); United States v. Crescent Amusement Co., 323 U.S. 173 (1945) (Unaffiliated circuit which had used unfair methods to acquire monopolistic control of the exhibition business in Tennessee dissolved.)

[2] 26 Stat. 209 (1890), 15 U.S.C.A. §1.

[3] The terms of the Consent decree may be found in 66 F. Supp. 323, 331-333 (1946).

[4] Plaintiff's Brief, 9.

ter admission prices and ordered the defendants to institute a new system of marketing films.[5]

The price fixing agreements were declared illegal on alternative grounds: first, that each distributor was conspiring with exhibitors;[6] second, that even if it was lawful for a distributor and an exhibitor to make such agreements, that they were unlawful because they were the result of a conspiracy among the distributors. The first ground will be referred to as the "vertical" conspiracy; the second as the "horizontal" conspiracy. It is the purpose of this comment to discuss first, the vertical conspiracy, second, the evidence upon which the finding of a horizontal conspiracy is based, and third, the remedy adopted by the court.

### Vertical Price-fixing

IN *Dr. Miles Medical Co. v. Park & Sons*[7] a divided Supreme Court held that contracts fixing resale prices violate the

[5] United States v. Paramount Pictures, Inc. *et al.*, 66 F. Supp. 323 (S.D. N.Y. 1946). Other practices enjoined were: (a) *Unreasonable Clearance Provisions*: When a distributor licenses a picture for a particular run, he usually promises the exhibitor that that film will not be shown in his area, or by certain named theaters, until a specified time has elapsed after the end of the run. This clearance period protects the early run exhibitors from competition by delaying exhibition in low-priced theaters in the same area. The court enjoined unreasonable clearance provisions, but held clearance not to be illegal *per se*, drawing an analogy to an agreement by a vendor of a business not to compete with his vendee for a reasonable time. The analogy is not wholly satisfactory, for the distributor not only agrees that he will not compete, but also has the power to prevent any competition whatsoever. (b) *Block-booking*: The practice of conditioning the licensing of any film on the licensing of any other film or group of films was enjoined. (c) *Joint Ownership or Control of Theaters*: Agreements by which theaters belonging to different defendants were operated as a unit, or individual theaters were jointly owned by more than one defendant, were enjoined. (d) *Discrimination*: The large affiliated and unaffiliated circuits obtained various contract provisions which the small independent exhibitors could not get. For example, franchises were often granted to large circuits which permitted the circuit to allocate playing time and film rental among its theaters as it saw fit. The circuits were sometimes given special privileges in selection of pictures and length of runs. The decree will tend to reduce the competitive advantage which the large circuits enjoy because now each run of each film must be separately licensed to the theater making the highest bid. Moreover contracts discriminating against independent exhibitors are specifically prohibited. In Bigelow v. RKO, Civil Action 4525, N.D. Ill., Oct. 1946, an action by an independent exhibitor against these same defendants, Judge Igoe entered a decree containing many of the above provisions. For discussion of these problems see Comment (1938) 33 Ill. L. Rev. 424; Note (1936) 36 Col. L. Rev. 635; Note (1938) 7 Fordham L. Rev. 189.

[6] "Moreover, irrespective of the conspiracy among distributors to which we have referred, each distributor-defendant has illegally combined with its licensees, for in agreeing to maintain a stipulated minimum admission price, each exhibitor thereby consents to the minimum price level at which it will compete against other licensees of the same distributor whether they exhibit on the same run or not." 66 F. Supp. 323, 339 (1946).

[7] 220 U.S. 373 (1911). Justice Holmes wrote the dissenting opinion.



Originally published 41 ILL. L. REV. 630 (1947)

Sherman Act. As a result of the confusion[8] and controversy[9] which grew out of this and subsequent decisions, Congress passed the Miller-Tydings Amendment to the Sherman Act to legalize resale price maintenance of trade-marked articles.[10] Literally this amendment does not apply to the motion picture industry because the relationship between a distributor and an exhibitor is not that of vendor and vendee; instead it is partly a lessor-lessee, and partly a licensor-licensee relationship. The physical property, consisting of several reels of film is leased to the theater owner, who is also granted a license to exhibit the copyrighted performance to the public for profit. Moreover the ultimate consumer who buys a ticket to see the performance is not a vendee.[11] In the *Paramount* case the defendants contended that since this amendment permits vertical price fixing when actual sales are involved, and in this respect overrules the *Miles* case, it would be anomalous to apply the doctrine of that case to mere licenses.[12] The only answer the court gave to this argument was that the Act does not apply because there is no sale here.[13] Although the court's statement is correct, it is an unsatisfactory answer to the argument. It would have

[8] A troublesome distinction was drawn between fixing resale prices by contract and by a mere refusal to deal with a vendee who sells for less than the resale price suggested by the vendor. United States v. Colgate & Co., 250 U.S. 300 (1919); United States v. A. Schrader's Son, Inc., 252 U.S. 85 (1920); Frey & Son, Inc. v. Cudahy Packing Co., 256 U.S. 208 (1921).

[9] W. H. S. Stevens, Resale Price Maintenance as Unfair Competition, (1919) 19 Col. L. Rev. 265; Rogers, Predatory Price Cutting as Unfair Trade, (1913) 27 Harv. L. Rev. 139; Note (1926) 21 Ill. L. Rev. 389.

[10] "*Provided*, That nothing contained in sections 1-7 of this title shall render illegal, contracts or agreements prescribing minimum prices for the resale of a commodity which bears, . . . the trade mark, brand, or name of the producer or distributor of such commodity and which is in free and open competition with commodities of the same general class produced or distributed by others, when contracts or agreements of that description are lawful as applied to interstate transactions . . . in any State, Territory, or the District of Columbia in which such resale is to be made or to which the commodity is to be transported for such resale, and the making of such contracts or agreements shall not be an unfair method of competition. . . ." 50 Stat. 693, (1937) 15 U.S.C.A. §1. Most states have similar provisions concerning intra-state commerce. See Ill. Rev. Stat. (1945), c. 121½, §§188-191 for the Illinois Fair Trade Act.

[11] The purchaser of a ticket acquires ". . . a license to enter the building and see the spectacle from its commencement until its termination . . ." Hurst v. Picture Theaters, Limited. Law Rep. (1915) 1 K.B. 1.

[12] Defendants' Joint Brief, 41.

[13] To reinforce this legalistic argument the court pointed out that the amendment explicitly does not apply when a horizontal conspiracy has been found. But this supporting point is inconsistent with the court's position that the vertical conspiracy is illegal ". . . irrespective of the conspiracy among distributors . . ." 66 F. Supp. 323, 340 (1946).

been preferable to ask whether the policy which prompted the legislature to permit vertical price fixing for trade-marked articles applies to the motion picture industry.

The proponents of the Miller-Tydings Amendment did not contend that vertical price-fixing was not a restraint of trade, but instead argued that the restraint was necessary to prevent the unfair practice of using widely advertised articles as price "leaders."[14] The large chain retail organizations were able to market certain trade-marked articles at a low price, possibly even at a loss, to increase their general volume of business. This practice lessened the value of the trade-marked article in the eyes of the public, thus harming the manufacturer's good will, and hurting the independent retailer who could not afford to compete on this basis. Although the similarity between an independent exhibitor and an independent retailer suggests the applicability of the Act, there are significant differences between the motion picture industry and other industries. The store owner sells many different articles at various prices, whereas the theater owner offers the public only one program of entertainment at a time, and this necessarily at only one price. A retailer may sell a few articles at a loss and still make a profit on his total sales, but it is impossible for the motion picture exhibitor to do so; he either makes or loses money at the one price. If it is impossible to use a motion picture as a "loss leader," the necessity for resale price maintenance is not present. Moreover, the good will attached to the name of the average trade-marked article is a more significant sales factor than is the name of the producer of a motion picture. And finally, elimination of price competition among exhibitors, who in a sense have only one article for sale, is more restrictive than control of prices on a few of the many articles handled by the average retailer. The decision that the Miller-Tydings Amendment does not apply is therefore sound.

A more difficult problem than that presented by the Amendment is whether the defendants' copyright monopoly exempts the price-fixing agreements from the operation of the Anti-Trust laws. The mere fact that the actions of a copyright holder or patentee contravene the policy of the Sherman Act does not render them unlawful, because every grant of a patent legalizes a monopoly. The problem is to reconcile the conflicting public interests embodied in patent legislation on

[14] See Rogers, *supra* note 9, 151 ff.



Originally published 41 ILL. L. REV. 630 (1947)

the one hand, and the Anti-Trust laws on the other.[15] The purpose of the former is "to promote the progress of science and the useful arts . . .";[16] a free, competitive economy is the aim of the latter. To encourage future invention by making investment in research profitable, the patentee is allowed certain monopoly privileges as a reward for his invention, but he is not privileged to use his monopoly to restrain trade, either in unpatented articles,[17] or in his patented article after he has surrendered control over it.[18] Although a patent does not give the patentee the right to fix the prices at which a vendee may resell,[19] a leading case decided by a unanimous Supreme Court twenty years ago indicates that he may fix the price at which a licensee may sell the patented article.

In *United States v. General Electric*[20] the defendant had monopoly control of the manufacture and sale of electric light-bulbs by virtue of certain patents.[21] General Electric handled 69% of the business through its own agents; Westinghouse, a licensee, sold 16% of the total volume at prices fixed by General Electric, while other licensees and unlicensed manufacturers handled the remainder, apparently free of price control.[22] One of the questions in the case was whether the defendant could grant Westinghouse a license to manufacture and vend the patented article, and retain the right to fix its sale price without violating the Sherman Act.[23] The court held that as long as the patentee retained ". . . the right to make and vend on his own account . . ." and conveyed ". . . less than title to the patent . . .," the price-fixing condition in the agreement was valid.[24] Since a license to exhibit a motion picture conveys less than title to the copyright, and most of the distributors retain the right to exhibit in theaters which they own, the

[15] Havighurst, Legal Status of Industrial Control by Patent (1941) 35 Ill. L. Rev. 445; Feuer, The Patent Monopoly and the Anti-Trust Laws (1938) 38 Col. L. Rev. 1145.

[16] U.S. Const. Art. I, §8 (8).

[17] Mercoid Corp. v. Mid-Continental Investment Co., 320 U.S. 661 (1944).

[18] Bloomer v. McQuewan, 55 U.S. 539, 549 (1852).

[19] Bobbs-Merrill Co. v. Straus, 210 U.S. 339 (1908); Bauer & Cie v. O'Donnell, 229 U.S. 1 (1912).

[20] 272 U.S. 476 (1926).

[21] Two patents covered the tungsten filaments; a third was for the use of gas in the bulb. 272 U.S. 476, 480 (1926).

[22] See note in margin of page 837 of United States v. Vehicular Parking, Ltd., *et al.*, 54 F. Supp. 828, (D.C. Del. 1944).

[23] The other question concerned the validity of the defendant's system of fixing prices at which its agents could sell to the public. Since the court decided that there was no sale to the agents, the price fixing was legal.

[24] 272 U.S. 476, 490 (1926).

court in the *Paramount* case was faced with the problem of distinguishing the *General Electric* case.

Two distinctions were suggested. The first is the distinction between fixing the sale price of a patented article and fixing the price of admission to a program of entertainment, of which the licensed feature is usually only a part.[25] The Supreme Court has already indicated that it might accept this distinction,[26] but it is not convincing for two reasons. The entire lightbulb was not patented, yet General Electric was permitted to fix the price which covered the unpatented as well as the patented parts.[27] And secondly, if it would be legal for the distributor to fix the minimum admission price when the theater showed only a single feature, it would seem strange to permit the exhibitor to deprive the distributor of this right by adding films to his program, since the full program should normally require a higher admission price. The result is especially incongruous if the short subjects are received from the same distributor as the feature picture.

The three judge court in the *Paramount* case did not accept this first distinction, but instead pointed to the fact that General Electric fixed prices for only one licensee, whereas each motion picture distributor controls the prices for several licensees, all of whom know that prices for other licensees are also being controlled.[28] Thus the effect of the agreements resembles a horizontal conspiracy among the exhibitors, except that instead of fixing the prices themselves, they have delegated the responsibility to the distributor.

In thus distinguishing the *General Electric* case the three-judge court relied on *United States v. Masonite Corporation*,[29] a recent decision which has limited the *General Electric* case to an uncertain extent. Patent litigation between Masonite and several competitors was settled when the competitors agreed to market Masonite's patented hardboard at prices fixed by Masonite, and consequently stopped production of their competing products. In holding the "agency" agreements invalid, the Supreme Court emphasized, first, that each "agent" knew

[25] Plaintiff's Brief, 10-12.

[26] "Because a patentee has power to control the price at which his licensee may sell the patented article, it does not follow that the owner of a copyright can dictate . . . the admission price which shall be paid for an entertainment which includes features other than the particular picture licensed." Interstate Circuit, Inc. v. United States, 306 U.S. 208, 228 (1939).

[27] *Cf.* United States v. United States Gypsum Co., 67 F. Supp. 397, 431 (1946).

[28] 66 F. Supp. 323, 340 (1946).

[29] 316 U.S. 265 (1942).



Originally published 41 ILL. L. REV. 630 (1947)

that his agreement with Masonite was ". . . not an isolated transaction but part of a larger arrangement,"[30] and second, that all of the defendants were competitors before making the agreements.[31] This second factor is not present in the *Paramount* case because exhibitors of motion pictures are not always competitors of the distributors from whom they receive pictures. For example the independent exhibitors never compete with the non-theater owning distributors. Thus if the significant point of the *Masonite* case is that *competitors* may not use a patent controlled by one of them as a means of cooperating in a price fixing scheme, that principle is not broad enough to invalidate all the vertical price fixing in the *Paramount* case. If, however, the point of the *Masonite* case is that a price fixing license agreement is unlawful whenever the licensee knows that other licensees are making similar agreements, the *Paramount* case is correct.

It is not clear that the distinction between fixing prices for several licensees instead of for just one is valid,[32] hence even though the *Paramount* decision be correct, an appeal may induce the Supreme Court to reconsider the *General Electric* case. On the same day that the *Paramount* decision was handed down, another three judge court specifically rejected this distinction. In that action against the U.S. Gypsum Company the court felt that it would require an "irrational fixation" to construe the *General Electric* case ". . . as limiting licensing under price fixing restrictions to one competitor, since the public is equally excluded and equally subjected to the patentee's price whether there is no licensee, one licensee, or many."[33]

[30] 316 U.S. 265, 275-6 (1942).

[31] "And when it is clear, as it is in this case, that the marketing systems utilized by means of *del credere* agency systems are those of competitors of the patentee, and that the purpose is to fix prices at which the competitors may market the product, the device is, without more, an enlargement of the limited patent privilege and a violation of the Sherman Act." 316 U.S. 265, 279 (1942).

[32] "Furthermore, what a patent owner may exact from one licensee, he may exact from any number of non-exclusive licensees, and he may therefore fix uniform prices at which sales of the article manufactured by various licensees under his patent are to be made. . . ." Feuer, The Patent Monopoly and the Anti-Trust Laws. (1938) 38 Col. L. Rev. 1145, 1169.

[33] United States v. United States Gypsum Co., 67 F. Supp. 397, 431 (Dist. Ct. D.C. 1946). In the Gypsum case the licensor and the licensees were all manufacturers of building materials, who would normally have been expected to compete with one another, and each licensee knew of the "larger arrangement" of which he was a part. The rationale of the Masonite Case therefore suggests that the Gypsum case was decided incorrectly. But in the Masonite case the court had distinguished the General Electric case by pointing out that a license to manufacture and sell was given to Westinghouse whereas Masonite's "agents" could only sell. 316 U.S. 265, 277. Since Gypsum's licensees could manufacture

In support of the position taken in the *Gypsum* case it should be noted that General Electric had several licensees. Although the prices for only one were fixed, this price-fixing protected the other licensees as well as the patentee from price cutting. Therefore the fact that the price-fixing in the *Paramount* case not only protects the distributor's theaters from competition, but also interferes with competition among other exhibitors, does not adequately distinguish the *General Electric* case. And furthermore, it would seem to be equally contrary to the policy of the Sherman Act for a distributor to suppress competition with his own theaters as to interfere with competition among other exhibitors.

Looking at the problem from the point of view of reward to the inventor, there is good reason for saying that the price fixing in the *Paramount* case is *more* justifiable than in the *General Electric* case. It is difficult to predict in advance just how successful a new picture will be. Therefore both distributors and exhibitors often prefer to figure the license fees in terms of a percentage of theater gross receipts. Then if a picture is surprisingly successful, the distributor gets a fair return and if it is an unexpected failure, the exhibitor does not stand the loss. Since the license fee is based on a percentage of the gross receipts of the theater, the distributor has a definite interest in admission prices, whether or not he owns any competing theaters. In the *General Electric* case, where the patentee wanted to control the licensees' sale prices for the sole purpose of protecting himself from competition, there was no similar justification for the price control. Moreover, General Electric had virtually complete monopoly control of the industry involved in that case, whereas each of the defendants in the *Paramount* case has seven powerful competitors in the production of new pictures, and, for the purpose of considering the validity of the license terms, are assumed to have as many other distributors in competition.

Although it does not seem possible to distinguish the *General Electric* case from the *Paramount* case on any satisfactory basis, it does not therefore follow that the latter decision is incorrect.[34] Even though great risk be involved in the motion

as well as sell, the three-judge court decided that the General Electric case controlled its decision. Whether this distinction between a license to sell and a license to manufacture and sell should compel a difference in result is a question which may require the Supreme Court to reconsider the General Electric case if the Gypsum case is appealed.

[34] The unsatisfactory distinction adopted by the court may indicate disagreement with a case which it does not have the power to overrule. The real issue is whether a patentee may grant a license to sell the pat-



Originally published 41 ILL. L. REV. 630 (1947)

picture industry, it seems reasonable to conclude that the distributors will continue to make a fair profit even though they be denied the privilege of fixing theater admission prices. Their monopoly control of the copyrighted pictures still entitles them to set whatever minimum rental terms they feel a given picture is worth, and these terms may still provide for payment on a percentage of gross receipts basis, or even on the basis of a royalty for each admission ticket sold.[35] As long as the industry is sufficiently profitable "to promote the useful art" of making high quality (or at least high cost) motion pictures, the purpose of the copyright privilege has been satisfied. Therefore, since this price-fixing clearly restrains competition among the exhibitors, which in turn deprives the theater going public of the benefits of competition, the three judge court correctly decided that it violated the Sherman Act. If the decision cannot be reconciled with the *General Electric* case, it is hoped that the Supreme Court will take this opportunity to reconsider that case.[36]

---

ented article, and at the same time qualify that right by fixing the price. In General Talking Pictures Corp. v. Western Electric, *et al.*, 304 U.S. 175 (1938) the Supreme Court held that a patentee may qualify the licensee's right to sell by limiting the uses for which the article may be sold. Although the point directly involved was the effect of the license restriction on the licensee's vendee (who was held liable as an infringer) language pertinent here is found in the dissenting opinion of Mr. Justice Black, the only member of the present court who participated in the decision of that case. "A license to sell a widely used merchantable chattel must be as to prospective purchasers—if anything —a transfer of the patentee's entire right to sell; . . ." (page 186). If a license to sell transfers the entire right, it would seem to follow that the right cannot be qualified by fixing the sale price. ". . . there are strong economic reasons for invalidating all license limitations and conditions, other than those which confine the licensee to one or two of the three basic rights, viz., to make, to use and to vend." Havighurst, Legal Status of Industrial Control by Patent (1941) 35 Ill. L. Rev. 495, 515.

[35] Although exaction of a royalty on each ticket would enable the distributor to force exhibitors to keep admission prices above the amount of the royalty, this is quite different from fixing the minimum admission price. In order for the exhibitor to make a profit, his admission price must be substantially higher than the royalty. How much higher it must be depends on competitive factors which will vary from theater to theater. Thus two competing exhibitors may pay the same royalty, but the more efficient theater could afford to charge a lower admission price.

[36] "[If] the increase in profits made possible by fixing the price at which licensed manufacturers may sell . . . means . . . greater encouragement for invention, it also means higher prices to the consumer in many instances where the profits obtainable through unrestricted licensing would have provided ample encouragement for the inventor and sufficient attraction for the capital needed to develop it. Indeed this is plainly the situation exhibited by the facts of the General Electric case." Havighurst, Legal Status of Industrial Control by Patent (1941) 35 Ill. L. Rev. 495, 511.

### The Horizontal Conspiracy

AS an alternative ground for its holding that the price fixing agreements are unlawful, the court found that the motion picture distributors were engaged in a "horizontal" conspiracy. Three sorts of evidence established this conspiracy: (1) exhibitors usually obtained the same admission price terms from all the distributors; (2) each distributor licensed pictures to theaters owned by other distributors; and (3) in some cities theaters were under the joint control of more than one defendant, or a defendant and an independent. The third type of evidence proved the existence of express agreements to maintain prices between exhibitors who would normally be in competition. It provides an adequate basis for voiding such agreements, and for compelling the distributors to relinquish their joint interests in theaters. To establish the nationwide conspiracy, however, the other evidence is more significant.

Without questioning the accuracy of the finding, it seems proper to suggest that less evidence of conspiracy was present in the *Paramount* case than has been required in other cases. It has been said that mere uniformity of action is no proof of conspiracy,[37] but *dicta* in the case usually cited for that proposition indicated that the Supreme Court would rely on such evidence under proper circumstances.[38] Such circumstances were present in *Interstate Circuit, Inc. v. United States*[39] where all the distributors required a large number of independent theaters to raise their admission prices to 25 cents and to stop showing double features. But there the simultaneous affirmative conduct raised a much stronger inference of joint action than does the evidence in this case. In the *Interstate* case the fact that responsible executives were not called to the stand to

[37] "And the fact that competitors may see proper, in the exercise of their own judgment, to follow the prices of another manufacturer, does not establish any suppression of competition or show any sinister domination." United States v. International Harvester Co., 274 U.S. 693, 708 (1927). *See* United States v. United States Gypsum Co., 67 F. Supp. 397, 458, 473 (1946); Note (1936) 36 Col. L. Rev. 635, 643.

[38] "We realize also that uniformity of price may be the result of agreement or understanding, and that an artificial price level not related to the supply and demand of a given commodity may be evidence from which such agreement or understanding, or some concerted action of sellers operating to restrain commerce, may be inferred." Cement Manufacturers Protective Association v. United States, 268 U.S. 588, 606 (1925). In that case the court emphasized the fact that cement was a standardized product, so price uniformity was the natural result of free competition. Motion pictures are certainly not standardized. *Cf.* American Tobacco Co. *et al.* v. United States, —— U.S. ——, 66 S. Ct. 1125 (1946) where the finding of conspiracy was based entirely on circumstantial evidence.

[39] 306 U.S. 208 (1939).



Originally published 41 ILL. L. REV. 630 (1947)

testify was considered strong evidence of conspiracy.[40] They did testify in the *Paramount* case, but the court said: "Such uniformity of action spells a deliberately unlawful system, the existence of which is not dispelled by the testimony of interested witnesses . . ."[41] The admission prices are generally fixed at the figure customarily charged by the theaters,[42] and the distributors seldom require the exhibitors to change prices.[43] Each defendant is interested in maintaining stable admission prices, partly because pictures are often paid for by a percentage of the theater gross,[44] and partly because the distributors are also theater owners who, like other exhibitors, want to protect themselves from low-priced competition. The court considered this common interest as an indication of joint action,[45] but it is also possible to conclude that it merely explains why the results of independent actions are so similar.[46]

The finding of conspiracy is most strongly supported by the licenses issued by one distributor to theaters owned by another distributor. The parties referred to these licenses as "diagonal" licenses. They are vertical in the sense that the agreements are between distributors and exhibitors; yet they are also horizontal because the parties to the agreements are competitors on the exhibition level and on the distribution level. Since these license agreements fix admission prices, competitors are collectively fixing prices every time such a license is granted. This sort of diagonal agreement always suggests joint action by enterprises that should be in competition, for it can be reasonably inferred that when Warner as a distributor licenses pictures to Loew's theaters, such licenses will, to some extent, be influenced by the terms which Loew as a distributor negotiates with Warner's theaters. It is difficult to estimate the

[40] *Id.* 225-226.

[41] 66 F. Supp. 323, 337 (1946).

[42] If no admission price was stipulated, there was an implied understanding that the prices currently charged would continue.

[43] For special pictures such as "Woodrow Wilson" or "Gone With the Wind," however, the distributors required the theaters to charge higher admission prices.

[44] The distributors also want to mantain stable prices in theaters paying a flat rental for pictures, because price-cutting by those theaters would reduce the income of theaters that rent pictures on a percentage basis.

[45] 66 F. Supp. 323, 335-6 (1946).

[46] But even if there were no express agreements among the defendants, should the decision be altered? Whether the distributors act independently or in concert is of little consequence, because in either case an unnaturally stable price structure results. Perhaps it is good legal doctrine to say that "Such uniformity of action spells a deliberately unlawful system . . ." but it is just as unhealthy for the economy whether the conduct is deliberate or not.

importance which should be attached to this natural tendency to favor affiliated theaters which results from diagonal licensing. The year in which Warner theaters paid the most ($4,-574,114) for Loew's pictures was the same year in which Loew's theaters paid the least ($179,204) for Warner pictures. In 1931-32 Warner theaters paid Loew 40% *less* than in the prior year while Loew theaters paid Warner 43% *more* than in the prior year. These examples are by no means unique.[47] So many factors may contribute to these figures, however, that it is difficult to argue from them. For example, it is possible that Warner's pictures in 1931 and 1932 were unusually good, whereas Loew's productions were relatively unsuccessful, and that the variations in the payments by one to the other would have been even more extreme if there had been no diagonal licensing. The court used this evidence only to support the finding of a conspiracy to fix prices, and did not indicate that it established any other unlawful conduct. Even if these diagonal licenses should be considered proof of conspiracy among the five theater-owning defendants, the evidence is irrelevant insofar as the other three defendants are concerned.

### The Remedy

IN deciding against the harsh remedy of divestiture the court emphasized the fact that none of the defendants had achieved or proposed to achieve a national monopoly.[48] It would seem, however, that having found a violation of the Sherman Act, the court would have the power to apply whatever remedy is necessary to prevent future violations.[49] At least the court should have the power to order divestiture in any locality where one of the defendants had a monopoly of the first run theaters.[50] Therefore the decision indicates, not a lack of power to order divestiture, but instead that the court felt that the remedy which it decreed would be more desirable.

As an abstract proposition there is nothing illegal about vertical integration of an industry.[51] Such integration in the

[47] Brief for the Warner Defendants 32-37.

[48] 66 F. Supp. 323, 353 (1946).

[49] Standard Oil Co. v. United States, 221 U.S. 1, 77-78 (1911).

[50] "To support the verdict it was not necessary to show power and intent to exclude *all* competitors, or to show a conspiracy to exclude *all* competitors. The requirement . . . was only that the offenders shall 'monopolize any part of the trade or commerce among the several States, or with foreign nations.'" American Tobacco Co. *et al.* v. United States, —— U.S. ——, 66 S. Ct. 1125, 1129 (1946).

[51] "It is as lawful for one corporation to make every part of a steam engine and to put the machine together as it would be for one to make the boilers and another to make the wheels." United States v. Winslow, 227 U.S. 202, 217 (1913). But it is unlawful for a railroad to own a

motion picture industry is specifically protected by the terms of the film copyrights, which give the distributors the "right to exhibit the picture."[52] Therefore, when the plaintiff argued that this integration enabled the distributors to subsidize their poor pictures by assuring them a market and similarly to protect their theaters by assuring them pictures, it did not prove anything illegal. It is only when one distributor licenses his pictures to theaters owned by another distributor that the problem arises. Justice Stone has suggested that the use of monopoly power on one level to dominate another phase of an industry would be illegal.[53] Here it is possible for the defendants, who control the distribution of motion pictures, to use their power to dominate the exhibition business by adopting a consistent policy of giving preference to affiliated theaters. Whether they have adopted a policy of discrimination in favor of affiliated theaters would therefore seem to have an important bearing on the remedy to be granted. The court specifically avoided this issue,[54] however, because it felt that the danger of such discrimination in the future would be obviated under the licensing system which it decreed. Henceforth no distributor may exhibit a film, except in its own theaters, without first "offering the license at a minimum price" and granting it "to the highest responsible bidder having a theater of a size and equipment adequate to show the picture upon the terms offered."[55] In denying the plaintiff's prayer for relief the court

coal company: ". . . for the violation of the commodity clause, as well as for its violation of the Anti-Trust Act, the combination between the Reading Railway Company and the Reading Coal Company must be dissolved." United States v. Reading Co., 253 U.S. 26, 62 (1920). And a company that becomes too powerful through vertical organization may violate the Sherman Act even though its unlawful practices produce lower prices for the consumer. United States v. New York Great Atlantic & Pacific Tea Company, Inc., *et al.*, 67 F. Supp. 626 (E.D. Ill. 1946).

[52] 35 Stat. 1075 (1909), 17 U.S.C.A. §1 (d).

[53] "We may lay aside the question whether one already possessing monopoly power in one field, . . . may make use of his strategic position to dominate all phases of the industry from production to consumption." Federal Trade Commission v. Eastman Kodak Co., 274 U.S. 619, 629 (1927). *Cf.* United States v. Klearflax Linen Looms, Inc., 63 F. Supp. 32 (D.C. Minn., 1945). Note (1946) 41 Ill. L. Rev. 132; United States v. Aluminum Co. of America, 148 F. (2d) 416, 436-438 (C.C.A. 2d, 1945).

[54] "It seems unnecessary to decide whether the record before us justifies a reasonable inference that the distributor-defendants have conspired among themselves to discriminate among their licensees, for each discriminating contract constitutes a conspiracy between the licensee and licensor." 66 F. Supp. 323, 352 (1946).

[55] *Id.* at 358.

substituted a remedy which neither party had requested and which both may attack on appeal.[56]

The plaintiff had contended that the consent decree was inadequate because: (1) Sherman Act criteria were not used as a test of violation;[57] (2) there were no provisions for punishment of a distributor who violated the decree;[58] (3) it did not touch ". . . the source of power by which these defendants collectively dominate the industry."[59]

Disputes over clearance provisions were most frequent under the consent decree,[60] and probably will continue to be the most difficult type of problem in the future. The court carefully delineated criteria for determining the reasonableness of clearance.[61] Whether a distributor has attempted to fix admission prices, or has refused to sell films separately, are questions of fact. So the plaintiff's first complaint about the consent decree is now satisfied.

The court's contempt power is an adequate basis for punishment of violations, but enforcement of the decree involves serious administrative difficulties. Violations may occur anywhere in the United States and the disputes may be too numerous for one court to handle. Even with all parties acting in good faith many problems will require decision by an arbitration board. For example, what is a reasonable clearance? When is a theater of such poor quality that a distributor may refuse to license it? Extensive arbitration machinery will still be necessary.

The defendants' "source of power" may not be destroyed without divestiture, but their ability to restrain trade has been seriously curtailed. The exhibitors have the right to compete with one another for each run of each film, may fix their own admission prices, and can bargain for clearance provisions with each film rented. If a distributor must license the highest bidder, it will be difficult for him to discriminate in favor of affiliated theaters. One of the strongest arguments in favor of divestiture was the fact that diagonal licensing could be elim-

[56] The remedy is somewhat like that adopted in United States v. Terminal Railroad Assn. of St. Louis, 224 U.S. 383 (1912), where, instead of decreeing dissolution of the defendant association, the court ordered it to make its facilities available to all railroads equally.

[57] Plaintiff's Brief, 123.

[58] *Id.*, 124.

[59] *Id.*, 125.

[60] For an explanation of "clearance" see note 5 *supra*. *Cf.* Westway Theater v. 20th Century Fox, 30 F. Supp. 830 (D.C. Md. 1940); Mid-West Theaters Co. v. Co-Operative Theaters Co. of Mich. 43 F. Supp. 216 (E.D. Mich. 1941); Gary Theaters Co. v. Columbia Pictures Co. *et al.*, 120 F. (2d) 891 (C.C.A. 7th, 1941).

[61] 66 F. Supp. 323, 343, 358.



Originally published 41 ILL. L. REV. 630 (1947)

inated only by this means,[62] and that such licensing inevitably led to discrimination in favor of affiliated theaters. Under the new system the large circuits will undoubtedly have an economic advantage in bidding for pictures, but this advantage cannot be unfairly increased by conditioning one diagonal license on another. Thus the advantage which the affiliated circuits will enjoy should not differ from that of the large unaffiliated circuits. Since the latter are also a great danger to the independent exhibitor, an additional reason for denying the remedy of divestiture is that sale of the defendants' theaters might just enable the unaffiliated circuits to increase their power and to stifle competition even more than the present defendants.[63] Nevertheless it is significant that the court enjoined the defendants from acquiring any new theater interests.[64] It is legal for a distributor to own a theater, but illegal for him to buy one. This apparent inconsistency suggests that the power which the defendants wield is not so much less than the amount which would impel a court to grant the harsh remedy of divestiture. The order directing the defendants to dispose of all their interests in theaters owned jointly with independents[65] also suggests that the court is concerned about the distributors' "source of power." If the distributor and the independent each own other theaters in the same area, joint ownership of one theater might promote cooperation instead of competition, but the reason for the prohibition is not clear where other theaters are not involved. It seems unlikely that requiring the distributor to sell his interest would benefit the independent joint owner. But if the sale hurts the independent because he loses a partner who gave him certain advantages, does this not imply that affiliated theaters are preferred over independents, and hence that complete divestiture is desirable?

The new bidding system will prevent the distributors from giving the large circuits more advantageous terms than the individual theaters. Since it is common business practice to give

[62] No one distributor is able to keep its own theaters completely supplied with its own films, because none produces as many as 50 features a year. See Table 66 F. Supp. 323, 355 (1946).

[63] *Cf.* United States v. Crescent Amusement Co., 323 U.S. 173 (1945); Mid-West Theatres Co. v. Co-operative Theaters Co. of Michigan, 43 F. Supp. 216 (E.D. Mich. 1941); United States v. Schine Chain Theaters, Inc., 63 F. Supp. 229 (W.D. N.Y. 1945).

[64] "Each of the defendants shall be enjoined from expanding its theater holdings . . ." 66 F. Supp. 323, 359 (1946). The court did not discuss this provision in the opinion.

[65] "Each defendant shall cease and desist from ownership, jointly with an independent, of an interest in any theater, greater than five per cent, unless such interest is ninety-five per cent or more . . ." 66 F. Supp. 323, 359 (1946).

a better price for a large order than for a small one,[66] the fact that the distributors can now license only one picture at a time to only one theater at a time denies them the advantages of this common practice. Nor may a distributor refuse to license a theater for purely arbitrary reasons.[67] The defendants may therefore attack the decree on the ground that it treats the motion picture industry as a public utility. The court did not suggest that the motion picture industry was affected with any more of a "public interest" than any other industry, so the power to grant this particular remedy apparently depends on the violations of the Sherman Act which it found. The injunction is a complete remedy for the vertical price fixing, hence the horizontal conspiracy must provide the basis for requiring the distributors to sell to the highest bidder. Insofar as this remedy is a means of guaranteeing that diagonal licensing will not lead to further violations of the Sherman Act, the theater owning defendants cannot complain. But if such a guarantee is necessary, the decision implies that diagonal licensing in itself unreasonably restrains competition among exhibitors of motion pictures. This suggests that whenever a small group of enterprises have substantially complete control of one level of an industry, that they may not engage in business on another level and do business with one another "diagonally." Such a situation restrains competition if it is assumed that the powerful distributors will discriminate in favor of one another. There is no basis for applying this assumption to an enterprise which is active on only one level of the industry. As applied to the three defendants who own no theaters, therefore, it is not clear that the remedy is necessary to prevent further violation of the Anti-Trust laws. In order to support the decision as to these three it may be necessary to decide that the motion picture industry requires greater control than does the average industry.

In his concurring opinion in *Associated Press v. United States*[68] Justice Frankfurter pointed out that whether a par-

[66] This practice is lawful. 49 Stat. 1526 (1936) 15 U.S.C.A. §13. Goodyear Tire & Rubber Co. v. Federal Trade Commission, 101 F. (2d) 620 (C.C.A. 6th, 1939). *Cert. den.* 308 U.S. 557 (1939).

[67] "It must be borne in mind that one engaged in private enterprise may select his own customers, and in the absence of an illegal agreement, may sell or refuse to sell to a customer for good cause or for no cause whatever. The Clayton Act itself specifically provides: 'That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade.' 15 U.S.C.A. §13." Johnson v. J. H. Yost Lumber Co., 117 F. (2d) 53, 61 (C.C.A. 8th, 1941). *Cf.* United States v. Colgate & Co., 250 U.S. 300 (1919).

[68] 326 U.S. 1, 27 (1946).



Originally published 41 ILL. L. REV. 630 (1947)

ticular restraint of trade is unreasonable depends not only on the character of the restraint, but also on the nature of the business involved. Thus because the public has such a great interest in free access to news, the Associated Press was violating the Sherman Act by excluding new members, although a similar policy in a different industry might be perfectly lawful. The distribution of newsreels is hardly important enough to justify the identical argument in the motion picture industry, but there is reason for saying that the public interest in this powerful industry is somewhat unique. Motion pictures are a great potential medium for the dissemination of propaganda; they play an important part in the education of the people.[69] It is possible that a few producer-distributors could achieve extreme political as well as economic power through monopoly. Granting this possibility, it does not seem unreasonable to conclude that the public has a greater interest in free competition in this industry than in others, and therefore that slight restraints will be considered unreasonable.

[69] "The motion picture commenced as a novel and pleasing type of entertainment, but it has evolved into an important social and cultural force. In some senses it provides a common denominator to the feelings and aspirations of an entire people. Its importance must then be measured in terms other than the conventional one of dollars and cents." TNEC, Monograph No. 43 (1941), The Motion Picture Industry—A Pattern of Control, 56. ". . . by reason of the tremendous concentration of resources that are in the power and control of these defendants they are able to absolutely dictate their own terms and conditions upon which an exhibitor may do business with them . . . The motion picture industry, next to the church and school, touches our people most intimately." Perelman v. Warner Bros. Pictures *et al.*, 9 F. Supp. 729, 730 (E.D. Pa. 1935).

Originally published 41 ILL. L. REV. 630 (1947)