

Interstate Circuit and (Other) Antitrust Myths

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Interstate Circuit v. United States, 306 U.S. 208 (1939), is one of the U.S. Supreme Court's most known antitrust opinions. The case involves a powerful movie exhibitor that allegedly orchestrated a cartel of film distributors to raise its competitors' prices. It is taught in every basic antitrust course in the United States. Numerous judicial opinions, articles, and books summarize the decision. The summaries omit several material facts and, consequently, present an account whose economic logic is unsound and is at odds with rudimentary knowledge of law and history.

Interstate Circuit is a leading precedent in three important antitrust contexts: collusion inference, vertical restraints, and exclusionary practices. It serves as a "seminal case" in several important topics related to these contexts.

The case emerged in an era with several similarities to present days: an industrial revolution transformed the economy, leading to the elimination of jobs and the rise of large business entities with which small businesses could not compete. Interstate Circuit defendants were technological companies that gained control over the motion picture industry. The Article studies the formation of a cartel in an industry transforming through an industrial revolution and affected by a deep recession (the Great Depression). It shows that, for about eight decades, judicial and expert depictions of the cartel have persistently neglected relevant factors related to relationships among firms, industry practices, and technological change.

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[T]he *Interstate Circuit* case continues to fascinate the cognoscenti and to mislead the unwary. The fascination lies in working one's way through the conspiracy finding. Equally intriguing and potentially misleading is the Court's language that traditional conspiracy is unnecessary for a Shearman Act Section 1 violation.

-- Areeda & Hovenkamp¹

INTRODUCTION

What are the odds that, for decades, courts, scholars, and practitioners would use a relatively uniform and misguided summary of a Supreme Court's landmark decision? *Interstate Circuit*,² a 1939 Supreme Court's opinion that has been taught in every antitrust course since the 1940s and is known for its facts, demonstrates that the phenomenon is possible.

This Article contrasts the inability of several generations of antitrust experts to adequately identify the relevant findings stated in *Interstate Circuit* with the use of the misguided summary

¹ PHILLIP E. AREEDA & HERBERT HOVENKAMP, 6 ANTITRUST LAW ¶ 1426, at 200 (3d ed. 2010) (Hereinafter: "AREEDA & HOVENKAMP").

² *Interstate Circuit v. United States*, 306 U.S. 208 (1939).

of the case to advance antitrust concepts, primarily related to conspiracy inference.³ Simplified summaries and hypotheticals serve many valuable purposes. The Article argues that the traditional account of *Interstate Circuit* does not have such qualities. It presents a flawed story of cartel formation and offers the story as a foundation for the development and explanation of various antitrust theories.

Interstate Circuit emerged in an era with several similarities to present days: an industrial revolution transformed the economy, leading to the elimination of jobs and the rise of large business entities with which small businesses could not compete. In the motion picture industry, the companies that gained dominance in the newly formed markets engaged in cooptation: they coordinated and collaborated in some dimensions and competed in others.⁴ These companies were *Interstate Circuit* defendants. The Article, thus, studies the formation of a cartel in an industry transforming through an industrial revolution and affected by a deep recession (the Great Depression). It shows that, for about eight decades, judicial and expert depictions of the cartel have persistently neglected relevant factors related to relationships among firms, industry practices, and technological change.

Interstate Circuit is a leading precedent, often treated as a “seminal case,” in three important antitrust contexts: collusion inference, vertical restraints, and exclusionary practices. The case serves the discussion and teaching in seven topics related to these contexts.

(1) The “agreement requirement” of Section 1 of the Sherman Act, which means that proof of unlawful conspiracy requires evidence that tends to exclude the possibility that the defendants acted independently or interdependently.⁵ In *Interstate Circuit*, the Supreme Court found that it was “beyond the range of probability” that the defendants’ parallel conduct was “the result of mere

³ See, e.g., KEITH N. HYLTON, *ANTITRUST LAW: ECONOMIC THEORY & COMMON LAW EVOLUTION* (2003) (“Modern inference doctrine more or less begins with *Interstate Circuit*.”); William E. Kovacic, *The Identification and Proof of Horizontal Agreements under the Antitrust Laws*, 38 *ANTITRUST BULL.* 5, 22 (1993) (“The foundation of modern judicial efforts to define the elements of a Section 1 agreement . . . [began] in 1939 with *Interstate Circuit*.”); STANFORD H. KADISH ET AL., *CRIMINAL LAW AND ITS PROCESS: CASES AND MATERIALS* 709 (9th ed. 2012) (“*Interstate Circuit* is a landmark in the law of conspiracy, not only for antitrust cases but also for the general problem of establishing the existence of conspiratorial relationship.”)

⁴ See Rockwell D. Hunt, *Co-opetition*, L.A. TIMES, Nov. 20, 1937, at 4 (“[T]he maintenance of competition does not presuppose the absence of cooperation, nor does the existence of cooperation demand the overthrow of competition.”); ADAM M. BRANDENBURGER & BARRY J. NALEBUFF, *CO-OPETITION* (1996). See also Terry Ramsay, *Plain Talk*, MOTION PICTURE HERALD, June 3, 1933, at 9, 12 (quoting a letter from Warner Bros. President stating that “[w]e, in the motion picture business, have come to realize that our own business success is wrapped up in the success of others.”)

⁵ See *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 554 (2007); *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986); *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 768 (1984); *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*, 346 U.S. 537, 541 (1954); *In re Ins. Brokerage Antitrust Litig.*, 618 F.3d 300, 331-32 (3d Cir. 2010) (hereinafter: “*Insurance Brokerage*”); *In re Travel Agent Comm’n Antitrust Litig.*, 583 F.3d 896, 906 (6th Cir. 2009) (hereinafter: “*Travel Agent*”); *Toys “R” Us, Inc. v. F.T.C.*, 221 F.3d 928, 934 (7th Cir. 2000) (hereinafter: “*TRU*”) (“When circumstantial evidence is used, there must be some evidence that ‘tends to exclude the possibility’ that the alleged conspirators acted independently.”); *Nat’l ATM Council, Inc. v. Visa Inc.*, 922 F. Supp. 2d 73, 94-95 (D.D.C. 2013) (“It is true that an agreement can be shown by either direct or circumstantial evidence. . . . But when the agreement is purely circumstantial, there must be some evidence that tends to exclude the possibility that the alleged conspirators acted independently.”)

chance.”⁶ The Court, however, also stated that agreement was “not a prerequisite to an unlawful conspiracy.”⁷ The discrepancy between the Court’s findings and language produced considerable confusion and made the opinion useful for the teaching of the agreement requirement.

(2) *The “communication requirement,”* which refers to the reluctance of courts to infer the existence of unlawful conspiracy without evidence of communication.⁸ This requirement is somewhat inconsistent with the recognition that direct evidence of conspiracy is often unavailable.⁹ *Interstate Circuit* stands for the “proposition that an actionable horizontal conspiracy does not require direct communication among the competitors,” and may be inferred from vertical communication with a third party.¹⁰

(3) *“Plus factors,”* which refer to evidence beyond proof of parallel conduct that may establish unlawful conspiracy in the absence of direct evidence; namely, facts and factors showing that parallel conduct is inconsistent with independent or interdependent conduct.¹¹ *Interstate Circuit*

⁶ *Interstate Circuit*, 306 U.S. at 223.

⁷ *Id.* at 226.

⁸ See, e.g., *Twombly*, 550 U.S. at 565 n. 10 (noting that when the plaintiffs’ pleadings do not mention “specific time, place, or person involved in the alleged conspiracies,” the defendants “would have little idea where to begin.”); *Kendall v. Visa U.S.A., Inc.*, 518 F.3d 1042, 1047 (9th Cir. 2008) (suggesting that evidence of communication is needed because “a bare allegation of a conspiracy is almost impossible to defend against, particularly where the defendants are large institutions with hundreds of employees entering into contracts and agreements daily.”); *In re Text Messaging Antitrust Litigation*, 782 F.3d 867, 872 (2015) (Posner, J.) (hereinafter: “*Text Messaging II*”) (stating that, in discovery, Section 1 plaintiffs must “find evidence that the defendants had colluded expressly . . . rather than tacitly”); *In re High Fructose Corn Syrup Antitrust Litig.*, 295 F.3d 651, 654 (7th Cir. 2002) (Posner, J.) (“[I]t is generally believed . . . that an express, manifested agreement . . . involving actual, verbalized communication, must be proved in order for a . . . conspiracy to be actionable under the Sherman Act.”). See generally William H. Page, *Twombly and Communication: The Emerging Definition of Concerted Action Under the New Pleading Standards*, 5 J. COMPETITION L. & ECON. 439 (2009).

⁹ See, e.g., *Interstate Circuit*, 306 U.S. at 221 (“As is usual in cases of alleged unlawful agreements . . . , the government is without the aid of direct testimony . . . [and] is compelled to rely on the inferences.”); *E. States Retail Lumber Dealers’ Ass’n v. United States*, 234 U.S. 600, 612 (1914) (“It is elementary . . . that conspiracies are seldom capable of proof by direct testimony, and may be inferred from the things actually done.”); *MM Steel, L.P. v. JSW Steel (USA) Inc.*, 806 F.3d 835, 843 (5th Cir. 2015) (“An antitrust conspiracy is rarely shown by direct evidence, and usually is proved by inference and suspicion.”); *Anderson News, L.L.C. v. Am. Media, Inc.*, 680 F.3d 162, 183 (2d Cir. 2012) (“conspiracies are rarely evidenced by explicit agreements, but nearly always must be proven through inferences that may fairly be drawn from the behavior of the alleged conspirators.”); *Gen. Chemicals, Inc. v. Exxon Chem. Co., USA*, 625 F.2d 1231, 1233 (5th Cir. 1980) (“Even a successful antitrust plaintiff will seldom be able to offer a direct evidence of a conspiracy and such evidence is not a requirement.”); *C-O-Two Fire Equip. Co. v. United States*, 197 F.2d 489, 494 (9th Cir. 1952) (“It is . . . well established that the proof and evidence in an antitrust conspiracy case is, in most cases, circumstantial.”)

¹⁰ *Insurance Brokerage*, 618 F.3d at 331-32. See also *United States v. Masonite Corp.*, 316 U.S. 265, 275 (1942); *White v. R.M. Packer Co.*, 635 F.3d 571, 576 (1st Cir. 2011); *Dickson v. Microsoft Corp.*, 309 F.3d 193, 217 (4th Cir. 2002); *Ambook Enterprises v. Time Inc.*, 612 F.2d 604, 613-14 (2d Cir. 1979).

¹¹ See, e.g., *In re Nexium (Esomeprazole) Antitrust Litig.*, 842 F.3d 34, 57 (1st Cir. 2016); also *United States v. Apple, Inc.*, 791 F.3d 290, 319-20 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 1376 (2016) (hereinafter: “*eBook*”); *White*, 635 F.3d at 576; *Insurance Brokerage*, 618 F.3d at 331-32; *Southway Theatres, Inc. v. Georgia Theatre Co.*, 672 F.2d 485, 501 (5th Cir. 1982); *Gainesville Utilities Dep’t v. Florida Power & Light Co.*, 573 F.2d 292, 301 (5th Cir. 1978); *In re Mid-Atl. Toyota Antitrust Litig.*, 560 F. Supp. 760, 772-74 (D. Md. 1983). See generally William E. Kovacic et al., *Plus Factors and Agreement in Antitrust Law*, 110 MICH. L. REV. 393 (2011); *In re Musical Instruments & Equip. Antitrust Litig.*, 798 F.3d 1186, 1194 (9th Cir. 2015) (defining “plus factors” as “economic actions and outcomes that

inspired the concept of plus factors. Courts cite the case as a precedent for four key plus factors: conformity to a contemplated scheme,¹² abrupt departure from past practices,¹³ motive to conspire,¹⁴ and acts against self-interest.¹⁵ The first factor, conformity to a contemplated scheme, means that the parallel conduct was in compliance with some plan of which all parties were aware. Such a plan may constitute a plus factor. The second factor, abrupt departure from past practices, requires context suggesting that the departure was for collusive purposes, not in response to market conditions. The two other factors—motive to conspire and acts against self-interest—are synonymous with interdependence. They may not necessarily show that parallel conduct is inconsistent with interdependent behavior. Courts typically rely on the absence of these factors to preclude inference of conspiracy.¹⁶

(4) “*Conscious parallelism*,” which means interdependency resulting in parallel conduct and loosely refers to the economic term of “tacit collusion.”¹⁷ In economics, “tacit collusion” means an equilibrium that is formed and maintained without communication.¹⁸ The legal understanding

are largely inconsistent with unilateral conduct but largely consistent with explicitly coordinated action.”)

¹² *Interstate Circuit*, 306 U.S. at 222 (“It was enough that, knowing that concerted action was contemplated and invited, the [defendants] gave their adherence to the scheme and participated in it.”). For courts’ reliance on *Interstate Circuit* for this factor see, e.g., *United States v. Masonite Corp.*, 316 U.S. 265, 275 (1942); *Nexium*, 842 F.3d at 57; *White*, 635 F.3d at 576; *Travel Agent*, 583 F.3d at 906; *Dickson*, 309 F.3d at 217; *United States v. MMR Corp. (LA)*, 907 F.2d 489, 495 (5th Cir. 1990); *Barry v. Blue Cross of California*, 805 F.2d 866, 869 (9th Cir. 1986); *Meyer v. Kalanick*, 174 F. Supp. 3d 817, 824 (S.D.N.Y. 2016).

¹³ *Interstate Circuit*, 306 U.S. at 218, 222 (referring to “important” and “radical” departure” from past practices). For courts’ reliance on *Interstate Circuit* for this factor see, e.g., *TRU*, 221 F.3d at 935-36; *National ATM Council*, 922 F.Supp.2d at 94-95.

¹⁴ *Interstate Circuit*, 306 U.S. at 222, 225 (referring to “strong motive for concerted action.”) For courts’ reliance on *Interstate Circuit* for this factor see, e.g., *First Nat’l Bank Ariz. v. Cities Serv. Co. v. Cities Serv. Co.*, 391 U.S. 253, 287-88 (1968) (hereinafter: “*First National Bank*”); *E.I. du Pont de Nemours & Co. v. F.T.C.*, 729 F.2d 128, 140 (2d Cir. 1984); *Betaseed, Inc. v. U & I Inc.*, 681 F.2d 1203, 1234-35 (9th Cir. 1982); *In re Nexium (Esomeprazole) Antitrust Litig.*, 42 F. Supp. 3d 231, 253 (D. Mass. 2014), *aff’d*, 842 F.3d 34 (1st Cir. 2016); *In re Med. X-Ray Film Antitrust Litig.*, 946 F. Supp. 209, 218 (E.D.N.Y. 1996).

¹⁵ “Action against self-interest” means act that that would be unprofitable, unless all rivals take similar measures. For courts’ reliance on *Interstate Circuit* for this factor see, e.g., *Nexium*, 842 F.3d at 57; *eBook*, 791 F.3d at 319-20; *Insurance Brokerage*, 618 F.3d at 331-32; *Ambook Enterprises*, 612 F.2d at 614; *Southway Theatres, Inc. v. Georgia Theatre Co.*, 672 F.2d 485, 501 (5th Cir. 1982); *Modern Home Inst., Inc. v. Hartford Acc. & Indem. Co.*, 513 F.2d 102, 111 (2d Cir. 1975).

¹⁶ AREEDA & HOVENKAMP, *supra* note 1, ¶ 1434c2.

¹⁷ *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993):

Tacit collusion, sometimes called . . . conscious parallelism, describes the process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions.

See also *Twombly*, 550 U.S. at 552; *Text Messaging II* 782 F.3d at 871 (“[C]onscious parallelism,’ as lawyers call it, ‘tacit collusion’ as economists prefer to call it[,] . . . means [price coordination] . . . without an actual agreement to do so.”); *City of Tuscaloosa v. Harcros Chemicals, Inc.*, 158 F.3d 548, 570 (11th Cir. 1998) (“[C]onscious parallelism is the practice of interdependent pricing in an oligopolistic market by competitor firms that realize that attempts to cut prices usually reduce revenue without increasing any firm’s market share, but that simple price leadership in such a market can readily increase all competitors’ revenues.”)

¹⁸ See Edward J. Green et al., *Tacit Collusion in Oligopoly*, 2 OXFORD HANDBOOK OF INTERNATIONAL ANTITRUST ECONOMICS 465 (Roger D. Blair and D. Daniel Sokol eds., 2015); Carl Shapiro, *Theories of Oligopoly Behavior*, 1

of the term is different.¹⁹ Courts interpret the term as situations of oligopolistic markets, where firms develop mutual understanding that they would benefit from factoring their interdependence and act upon this understanding. As understood by courts, such interdependence does not exclude the possibility of coordination. Thus, courts sometimes state that conscious parallelism accompanied by plus factors permits inference of unlawful conspiracy.²⁰ Stated simply, conscious parallelism is not in itself unlawful but together with plus factors may be unlawful. In *Interstate Circuit*, vertical communication with a third party allegedly formed mutual understanding among competitors that changing their practices simultaneously and uniformly would benefit all. The Court's inference of unlawful conspiracy rested, among other things, on the defendants' interdependence. The Court observed that each competitor "was aware that all were in active competition and that without substantially unanimous action . . . was risk of a substantial loss . . . but that with it there was the prospect of increased profits."²¹ The ruling inspired a short-lived enforcement policy targeting conscious parallelism and a lengthy academic debate over the topic.²²

(5) "*Tacit agreement*," which is a term that courts use infrequently to describe an unlawful conspiracy agreement that is inferred from parallel conduct and plus factors.²³ Courts use *Interstate*

HANDBOOK OF INDUSTRIAL ORGANIZATION 329, 330 (1989).

¹⁹ The source of this interpretation is Donald Turner's seminal article: Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655 (1962).

²⁰ See, e.g., *Merck-Medco Managed Care, LLC v. Rite Aid Corp.*, 201 F.3d 436 (4th Cir. 1999) ("In order to infer a conspiracy, conscious parallelism must be accompanied by . . . plus factors, such as 'motive to conspire,' 'opportunity to conspire,' 'high level of inter-firm communications,' irrational acts or acts contrary to a defendant's economic interest, but rational if the alleged agreement existed, and departure from normal business practices."); *Todorov v. DCH Healthcare Auth.*, 921 F.2d 1438, 1456 (11th Cir. 1991) (citing *Interstate Circuit* to support the proposition that "an agreement is properly inferred from conscious parallelism only when 'plus factors' exist."); *Southway Theatres*, 672 F.2d at 501 (referring to the "rule of conscious parallelism and plus factors.") See also AREEDA & HOVENKAMP, *supra* note 1, ¶ 1434, at 263 ("With rare exceptions, the courts have been very clear that mere parallelism, including interdependent conscious parallelism, cannot support a conspiracy finding unless there are additional or 'plus' factors.")

²¹ *Interstate Circuit*, 306 U.S. at 222.

²² See, e.g., REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 36-42 (1955) (hereinafter: 1955 AG REPORT) (describing the rise and decline of the conscious parallelism in antitrust law); Michael Conant, *Consciously Parallel Action in Restraint of Trade*, 38, MINN. L. REV. 797, 801-802 (1954) (arguing that *Interstate Circuit* contributed to the development of the "doctrine of conscious parallelism"); HYLTON, *supra* note 5, at 77, 134-38; LOUIS KAPLOW, COMPETITION POLICY AND PRICE FIXING 77-80 (2013) (arguing that *Interstate Circuit* involved "interdependent oligopoly behavior, where words may be lacking but a meeting of the minds is central."); James A. Rahl, *Conspiracy and the Anti-Trust Laws*, 44 ILL. L. REV. 743, 759 (1950) (noting that *Interstate Circuit*'s language suggests that "conspiracy formation may be ambulatory[,] . . . creep into existence from the merging of unilateral actions upon a common course."); Bernard R. Sorkin, *Conscious Parallelism*, 2 ANTITRUST BULL. 281, 286 (1957) ("[T]o *Interstate Circuit*, . . . we are indebted for the most off-quoted language in support of the doctrine of conscious parallelism.")

²³ See, e.g., *Twombly*, 550 U.S. at 553 (distinguishing between "tacit" and "express" agreements that may form unlawful Section 1 conspiracy); *United States v. Container Corp. of Am.*, 393 U.S. 333, 340 (U.S. 1969) (concluding that information exchange may be a plus factor that could require inference of a tacit agreement); *Mid-Atl. Toyota*, 560 F. Supp. at 772-75 (attempting to explain the meaning of "tacit agreement"); *Apex Oil Co. v. DiMauro*, 822 F.2d 246, 254 (2d Cir. 1987) (explaining that a court may infer tacit agreement from parallel conduct and plus factors). Cf. *Fructose*, 295 F.3d at 661 (Posner, J.) ("[T]acit agreement . . . is not actionable under section 1 of the Sherman Act.")

Circuit to illustrate the meaning of tacit agreement.²⁴ The interpretation of the term proved confusing, as courts tried to explain the relationship between “tacit agreement” and “conscious parallelism” (“tacit collusion”). Several courts argued that tacit agreement is conscious parallelism that is preceded with communication or accompanied with other plus factors.²⁵ *Interstate Circuit* served as an authority for this interpretation.

(6) “*Hub-and-spoke conspiracies*,” which are cartels in which a firm (the “hub”) organizes collusion (the “rim”) among upstream or downstream firms (the “spokes”) through vertical restraints.²⁶ *Interstate Circuit* is the seminal hub-and-spoke conspiracy case.²⁷ Courts interpreted *Interstate Circuit* and its progeny to mean that a hub-and-spoke conspiracy is per se unlawful, where the horizontal collusion among the rims is per se illegal.²⁸ This legal rule is controversial in circumstances where the arrangement also promotes efficiency through the vertical restraints.²⁹

(7) “*Raising rivals’ costs*” (RRC), which is an exclusionary strategy, whereby a dominant firm exerts its power to persuade upstream or downstream firms to adopt vertical restraints intending increase its competitors’ costs.³⁰ Whenever a dominant firm secures from upstream or downstream firms vertical restraints that allegedly raise its rivals’ costs, the question is whether the restraints advance efficiency or merely exclude competition. Collusion among the firms that adopt the restraint is not a necessary condition for the strategy, although is sometimes needed to secure their

²⁴ See, e.g., *United States v. Citizens & S. Nat’l Bank*, 422 U.S. 86, 112 (1975); *First National Bank*, 391 U.S. at 287-88; *Nexium*, 842 F.3d at 57-58; *White*, 635 F.3d at 576; *DM Research, Inc. v. Coll. of Am. Pathologists*, 170 F.3d 53, 56 (1st Cir. 1999); *Barry*, 805 F.2d at 869; *E.I. du Pont de Nemours & Co. v. F.T.C.*, 729 F.2d 128, 143 (2d Cir. 1984); *Betaseed*, 681 F.2d at 1234-35.

²⁵ See, e.g., *Brown v. Pro Football, Inc.*, 518 U.S. 231, 241 (1996); *Nexium*, 842 F.3d at 56; *White*, 635 F.3d at 576; *In re Baby Food Antitrust Litigation*, 166 F.3d 112, 121-22 (7th Cir. 1999).

²⁶ See generally Barak Orbach, *Hub-and-Spoke Conspiracies*, 16 ANTITRUST SOURCE 1 (Apr. 2016).

²⁷ See Edward R. Johnson & John Paul Stevens, *Monopoly or Monopolization—A Reply to Professor Rostow*, 44 ILL. L. REV. 269, 295 (1949):

[T]he principle of . . . *Interstate Circuit* [is] that individual participation, with knowledge that competitors are also participating, in a plan which necessarily results in a restraint of trade, is sufficient to establish an unlawful conspiracy. In [*Interstate Circuit*], the defendants joined a well-defined program to put an end to existing competition. Though each company negotiated independently, each made an express agreement to stifle competition; these express agreements, like the spokes of a wheel, all had a common hub. The rim of the wheel was supplied by the desire to participate even with full knowledge of the scope of the enterprise.

See also *eBook*, 791 F.3d at 319-20; *Howard Hess Dental Labs. Inc. v. Dentsply Int’l, Inc.*, 602 F.3d 237, 255 (3d Cir. 2010); *Insurance Brokerage*, 618 F.3d at 331-32; *Nat’l ATM Council*, 922 F. Supp. 2d at 94-95; *Howard Hess Dental Labs. Inc. v. Dentsply Int’l, Inc.*, 602 F.3d 237, 255 (3d Cir. 2010); *Total Benefits Planning Agency, Inc. v. Anthem Blue Cross & Blue Shield*, 552 F.3d 430, 436 (6th Cir. 2008); *TRU*, 221 F.3d at 935-36; *Kalanick*, 174 F. Supp. 3d at 824.

²⁸ Orbach, *Hub-and-Spoke Conspiracies*, *supra* note 26.

²⁹ See, e.g., *eBook*, 791 F.3d at 320-325, 345-54 (discussing the standard of review for hub-and-spoke conspiracies).

³⁰ Aaron Director & Edward E. Levi, *Trade Regulation*, 51 NW. L. REV. 281, 290 (1956) (describing the strategy); Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power over Price*, 96 YALE L.J. 209, 238-39 (1986) (formulating and labeling the strategy); John Asker & Heski & Bar Isaac, *Raising Retailers’ Profits: On Vertical Practices and the Exclusion of Rivals*, 104 AM. ECON. REV. 672 (2014) (discussing applications of the strategy).

willingness to adopt the restraint.³¹ *Interstate Circuit* is also a seminal case used to illustrate RRC strategies.³²

Interstate Circuit arose from growing tensions between vertically integrated and independent firms in the motion picture industry. In the 1920s, eight movie distributors that integrated distribution, production, and exhibition established their control over the industry. During the Great Depression, the vertically integrated distributors reorganized their theater chains, moving from a model of centralized management to a model of passive ownership in partially owned subsidiaries. This transition further intensified tensions among the vertically integrated and independent firms in the industry. A newly formed partially-owned subsidiary of one of the distributors—Interstate Circuit, Inc.—formulated a package of two vertical restraints for movie licensing agreements that it negotiated with the distributors. The negotiated restraints—a restriction on minimum admission prices and a ban on double features (the offering of two movies for the price of one)—had been debated in the industry for about three years. They served the vertically integrated companies and were disadvantageous to independent companies. One restraint served the distributors and the other served vertically integrated exhibitors, like Interstate Circuit. The trade association of the vertically integrated exhibitors used the deal formulated by Interstate Circuit as a model it promoted among its members.³³ *Interstate Circuit* tested the industry’s legal theory that copyright law protected vertical restraints used to advance the film distribution system from the reach of antitrust law.

The case, therefore, was not about a local contractual arrangement, but about industry practices. The trade press closely followed the government investigation and the litigation. For example, in September 1935, when the federal government announced that it was investigating the contractual restrictions formulated by Interstate Circuit, *Motion Picture Daily* wrote that the investigation could have a bearing on the legality of the “contract riders” promoted by the trade association of the vertically integrated exhibitors.³⁴ In September 1937, immediately after the district court delivered its decision, *Film Bulletin* described the alleged conspiracy in the spirit of the time—an exhibition unit of one of the distributors advanced a scheme to exclude from the market its small competitors:

Paramount and its associated stooges have forced dozens of [independent exhibitors] into a position from which the only retreat was to sell out. Several years ago [the] situation was made intolerable by the introduction of a new independent-crushing scheme.

In brief, this plan compelled all independent exhibitors to sign film contracts which

³¹ Ben Klein’s seminal study of Standard Oil illustrates the point. See Benjamin Klein, *The “Hub-and-Spoke” Conspiracy That Created the Standard Oil Monopoly*, 85 S. CAL. L. REV. 459 (2012); Elizabeth Granitz & Benjamin Klein, *Monopolization by “Raising Rivals’ Costs”: The Standard Oil Case*, 39 J. L. & ECON. 1 (1996). See also George L. Priest, *Rethinking the Economic Basis of the Standard Oil Refining Monopoly: Dominance Against Competing Cartels*, 85 S. CAL. L. REV. 499 (2012) (arguing that business acumen best explains Standard Oil’s rise to dominance).

³² See Krattenmaker & Salop, *supra* note 30, at 238-39 (“In *Interstate Circuit* . . . , a company that operated motion picture theaters throughout Texas, obtained from movie distributors the promise that the distributors would, in effect, raise the costs of exhibitors competing with Interstate Circuit.”)

³³ See *infra* Section V.C and Appendix B.

³⁴ *Texas Control of Admissions Being Probed*, MOTION PICTURE DAILY, Sept. 9, 1935, at 1.

required them (1) to charge no less than 25 cents admission for any film which played a Paramount first run charging 40 cents or more, and (2) to show only single features.

Perhaps the Paramount chains used their buying power to force their scheme on the other distributors; perhaps they found the majors [namely, the other large distributors] willing accomplices. Whatever the answer, no justification can be found for the seven distributors who joined this conspiracy, for it amounted to a death sentence for many small independents.³⁵

Interstate Circuit, however, is known for different facts. During the past eight decades, courts, scholars, and practitioners have been using a relatively uniform set of facts to summarize the case.³⁶ This account, which may be called the “traditional account of *Interstate Circuit*” (or the “traditional account”), consists of four key elements:

- (1) *A Letter*. A powerful movie exhibitor in Texas sent a letter to eight film distributors. Copies of the letter named all addressees, so that each recipient knew about the other seven.
- (2) *A Demand to Adopt New Policies*. The letter required the distributors to add to their distribution agreements a restriction on minimum admission prices and a ban on double features. The restrictions were beneficial to the exhibitor because they were disadvantageous to its rivals. The restrictions could be profitable for the distributors only if all adopted them and unprofitable otherwise.
- (3) *Compliance*. All distributors adopted the restrictions, which involved “a radical departure from the previous business practices of the industry and a drastic increase in admission prices.”³⁷

³⁵ *Texas Independents Win an Important Victory!*, FILM BULL., Sept. 25, 1937, at 1.

³⁶ See AREEDA & HOVENKAMP, *supra* note 1, ¶ 1426, at 200-204. For examples of the account in court decisions see, e.g., *First National Bank*, 391 U.S. at 286-87; *Nexium*, 842 F.3d at 57-58; *White*, 635 F.3d at 576; *Insurance Brokerage*, 618 F.3d at 331; *Travel Agent*, 583 F.3d at 906; *TRU*, 221 F.3d at 935; *Mid-Atl. Toyota*, 560 F. Supp. at 772-73; *Ambook Enterprises*, 612 F.2d at 613-14; *Milgram v. Loew's, Inc.*, 192 F.2d 579, 592 (3d Cir. 1951); *Schad v. Twentieth Century-Fox Film Corp.*, 136 F.2d 991, 996 (3d Cir. 1943); *Westway Theatre v. Twentieth Century-Fox Film Corp.*, 30 F. Supp. 830, 837 (D. Md. 1940), *aff'd*, 113 F.2d 932 (4th Cir. 1940); *Kalanick*, 174 F. Supp. at 824. For examples of the account in antitrust literature, e.g., AM. BAR ASS'N, 1 ANTITRUST LAW DEVELOPMENTS 9-10 (7th ed. 2012); 1955 AG REPORT, *supra* note 22, at 37-38; M.A. Adelman, *Effective Competition and the Antitrust Laws*, 61 HARV. L. REV. 1289, 1324 (1948); DANIEL BERTRAND ET AL., THE MOTION PICTURE INDUSTRY—A PATTERN OF CONTROL 45-47 (Temp. Nat'l Econ. Comm., Monograph No. 43, 1941) (hereinafter: “A PATTERN OF CONTROL”); David A. Butz & Andrew N. Kleit, *Are Vertical Restraints Pro- Or Anticompetitive? Lessons from Interstate Circuit*, 44 J. L. & ECON. 131 (2001); Michael Conant, *Consciously Parallel Action in Restraint of Trade*, 38, MINN. L. REV. 797, 801-802 (1954); Hillary Green, *Antitrust Censorship of Economic Protest*, 59 DUKE L.J. 1037, 1092-93 (2010); George A. Hay, *Oligopoly, Shared Monopoly, and Antitrust Law*, 67 CORNELL L. REV. 439, 457-59 (1982); HERBERT HOVENKAMP, FEDERAL ANTITRUST LAW 224 (5th ed., 2015); HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE 129 (2005); HYLTON, *supra* note 5, at 134; Johnson & Stevens, *supra* note 36, at 295; Kovacic, *The Identification and Proof of Horizontal Agreements under the Antitrust Laws*, *supra* note 5, at 32; William H. Page, *Communication and Concerted Action*, 38 Loy. U. Chi. L.J. 405, 437-38 (2007); Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L. REV. 1562, 1577 (1969); Barak D. Richman, *The Antitrust Reputation Mechanisms: Institutional Economics and Concerted Refusal to Deal*, 95 VA. L. REV. 325, 343-44 (2009); Gregory J. Werden, *Economic Evidence On the Existence of Collusion: Reconciling Antitrust Law With Oligopoly Theory*, 71 ANTITRUST L.J. 719, 738 (2004).

³⁷ *Interstate Circuit*, 306 U.S. at 222.

(4) *A Finding of Unlawful Conspiracy.* The Supreme Court held that the adoption of the restrictions constituted an acceptance of the exhibitor's proposal and, as such, formed a conspiracy in violation of Section 1 of the Sherman Act.

The traditional account is inconsistent with the Supreme Court's opinion, unsound in its economic logic, and at odds with what antitrust lawyers and economists know about antitrust and the motion picture industry in the relevant era.

(a) *The Supreme Court's Opinion.* A reading of the Supreme Court's opinion immediately reveals that the traditional account omits several material facts. First, the exhibitor, Interstate Circuit, was a partially-owned subsidiary of Paramount, one of the distributors.³⁸ Thus, the case involved a company that allegedly aligned certain policies of its parent company and rivals of that parent company.³⁹ This setting may fall short of a horizontal conspiracy (a collusion among competitors), yet is quite different from the hub-and-spoke conspiracy that the traditional account portrays. Second, Interstate Circuit sent two letters, not one.⁴⁰ The letters were sent about ten weeks apart, during which Interstate Circuit expanded and modified its demands. The Court describes "negotiations" leading to "modifications of the proposals resulted in substantially unanimous action of the distributors."⁴¹ Thus, the traditional account's depiction of offer and acceptance departs from the opinion, which presents efforts to develop an agreement that all distributors were willing to adopt.

(b) *Economic Logic.* The traditional account suggests that a single act of communication (a letter) without additional coordination could form mutual understanding among a diverse group of distributors directing all to adopt new distribution policies. In a market for highly-differentiated products, such as movies, with eight distributors that differ in size and portfolio of products, a restriction on minimum retail prices is likely to impact market shares.⁴² Such distributors are unlikely to amend their distribution agreements without coordination related to market shares. Indeed, such coordination was a key aspect of the vertical coordination.⁴³

(c) *Rudimentary Antitrust Knowledge.* The events leading to *Interstate Circuit* took place in 1934, when the National Industrial Recovery Act ("NIRA") was in effect. NIRA required industries to negotiate "codes of fair competition," exempted such codes from antitrust law, and provided that violations of such agreements would be deemed "an unfair method of competition" within the meaning of Section 5 of the FTC Act.⁴⁴ Thus, in 1934, the motion picture industry operated under

³⁸ *Interstate Circuit*, 306 U.S. at 214, 219; *infra* Section III. Several studies do mention the vertical integration but do not attribute any significance to this relationship. See, e.g., Butz & Kleit, *id.*, at 138; MICHAEL CONANT, ANTITRUST IN THE MOTION PICTURE INDUSTRY 87 (1960); BERTRAND ET AL., A PATTERN OF CONTROL, *supra* note 36, at 45.

³⁹ When *Interstate Circuit* was decided, under what later became known as the intraenterprise doctrine, a firm could conspire with its subsidiary. See *infra* Section V.B.2.

⁴⁰ *Interstate Circuit*, 306 U.S. at 216.

⁴¹ *Interstate Circuit*, 306 U.S. at 222.

⁴² Several studies try to examine the relationships between cartel stability and product differentiation. See, e.g., Thomas W. Ross, *Cartel Stability and Product Differentiation*, 10 INT'L J. INDUST. ORGANIZATION 1 (1992); Raphael Thomadsen & Ki-Eun Rhee, *Costly Collusion in Differentiated Industries*, 26 MARKETING SCI. 660 (2007).

⁴³ See *infra* Sections IV.B and V.C.2.

⁴⁴ National Industrial Recovery Act of 1933, Pub. L. No. 73-67, 48 Stat. 195 §§ 3-5 (1933) (hereinafter: "NIRA"). On May 27, 1935, the Supreme Court declared NIRA unconstitutional. *A.L.A. Schechter Poultry Corp. v. United*

a government-sponsored industrywide agreement, NIRA's Code of Fair Competition for the Motion Picture Industry (the "Motion Picture Code").⁴⁵ Such circumstances are relevant to the understanding and analysis of the case. Further, numerous antitrust cases and vast literature examine various vertical practices of the eight film distributors and, specifically, their relationships with powerful exhibitors.⁴⁶ It is virtually impossible to develop expertise in antitrust law without gaining some appreciation of the significance of the vertical practices in the motion picture industry during the second quarter of the twentieth century.

The flaws of the traditional account are unsettling: they are so conspicuous that students learning the case should identify some of them, economists should reject the account's storyline as unreliable, and antitrust experts ought to question the validity of the account. Nonetheless, for almost eight decades, the traditional account has defied doubts.

The Article makes several contributions to the understanding of antitrust law. First, the traditional account of *Interstate Circuit* is a popular teaching instrument and lies at the foundation of the framework courts use for conspiracy inference. The Article shows that the account has the qualities of a flawed textbook hypothetical. It addresses the flaws. Second, the Article offers a detailed study of cartel formation. It shows that industries may use complex mechanisms to set limited collusions among competitors; collusions that apply only to limited dimensions of operations. Third, the Article offers a study of a cartel using partial ownership and vertical restraints. The existing literature completely disregards the transition to partial ownership in the motion picture industry. Fourth, the study explains why rapid technological change tends to intensify antitrust tensions in society.

I. INDUSTRY TRANSFORMATION THROUGH TECHNOLOGICAL CHANGE

A. Preliminaries: The Second Industrial Revolution

Interstate Circuit involved a rivalry between a monopoly and its small competitors that was complicated by additional tensions between large and small firms. *Billboard* vividly described the tensions writing that the film distributors were "putting the screws to the nabe houses [neighborhood theaters] on double features and admissions and the little fellows [were] burning plenty."⁴⁷ The traditional account dramatizes contrasts between small and large firms, while trivializing the context and neglecting the role that technological progress played in the case. This neglect or simplification compromises the understanding of the relevant issues. In the 1930s, the motion picture industry symbolized changes in the economy brought about by technological progress.⁴⁸ The distributors that dominated the industry were innovative companies—

States, 295 U.S. 495 (1935). See discussion *infra* Section II.B.

⁴⁵ Code of Fair Competition for the Motion Picture Industry (Code No. 124, Approved by President Roosevelt on Nov. 27, 1933) (hereinafter: the "Motion Picture Code").

⁴⁶ See, e.g., *United States v. Loew's Inc.*, 371 U.S. 38 (1962); *Theatre Enterprises*, 346 U.S. 537; *United States v. Paramount Pictures*, 334 U.S. 131 (1948); *Schine Chain Theatres v. United States*, 334 U.S. 110 (1948); *United States v. Griffith*, 334 U.S. 100 (1947); *United States v. Crescent Amusement Co.*, 323 U.S. 173 (1944); *FTC v. Paramount Famous-Lasky Corporation*, 57 F.2d 152 (2d Cir. 1932); *Paramount Famous Lasky Corp. v. United States*, 282 U.S. 30 (1930); MICHAEL CONANT, *ANTITRUST IN THE MOTION PICTURE INDUSTRY* (1960).

⁴⁷ *Texas Independents Burned Over Majors' Doubles Stand*, *BILLBOARD*, Feb. 23, 1935, at 20.

⁴⁸ See, e.g., *Color and Sound on Film*, 2 *FORTUNE* 33 (Oct. 1930).

technological giants. The principal issue in *Interstate Circuit* was the industry's legal position that copyright law protected its distribution practices from antitrust scrutiny.⁴⁹

Between 1870 and 1914, the United States saw a spike in inventive activities, known as the "Second Industrial Revolution" for the large number of technologies invented during the period, which contributed to productivity growth in the economy until the 1970s.⁵⁰ Technological advancements enabled the development of mass production and mass distribution, leading to a fast transformation of the economy. The developments also sparked considerable public anxieties for the rise of large firms and a long delay between the elimination of jobs by technology and the creation of new ones.⁵¹

Descriptions of rivalries between small and large firms in the literature and judicial opinions often portray contrasts between "traditional American firms" and the "modern business enterprise" of the twentieth century, which emerged during the Second Industrial Revolution. The traditional firm was an independent, single-unit business, which was owned by "an individual or a small number of owners," who operated "a shop, factory, bank, or transportation line, out of a single office."⁵² By contrast, the modern business enterprise was a multiunit firm that utilized economies of scope and scale and was operated by salaried professionals.⁵³ For example, "chain stores" were threatening modern business enterprises that utilized economies of scale and scope to offer a large variety of products at low prices with which "independent stores" could not compete.⁵⁴ Antitrust law was born in a populist reaction to the Second Industrial Revolution led by farmers and small business owners.⁵⁵ A related wave of populism was an anti-chain store movement that swept the United States in the 1920s and 1930s.⁵⁶ *Interstate Circuit* grew out of these trends.

⁴⁹ See Thurman Arnold, *Fair and Effective Use of Present Antitrust Procedure*, 47 YALE L.J. 1294, 1298 (1938) (stating that *Interstate Circuit* involved a typical use of a legal privilege (the copyright) in such a way as to restrict the outlets for moving pictures and actually to destroy competition. Arnold headed the Justice Department's Antitrust Division when the case was argued before the Supreme Court).

⁵⁰ See Andrew Atkeson & Patrick J. Kehoe, *Modeling the Transition to a New Economy: Lessons from Two Technological Revolutions*, 97 AM. ECON. REV. 64 (2007); Alfred D. Chandler, Jr., *Industrial Revolutions and Institutional Arrangements*, 33 BULL. AM. ACAD. ARTS & SCI. 33 (1980); Robert J. Gordon, *U.S. Economic Growth since 1870: One Big Wave?*, 89 AM. ECON. REV. 123 (1999).

⁵¹ See Joel Mokyr et al., *The History of Technological Anxiety and the Future of Economic Growth: Is This Time Different?*, 29 J. ECON. PERSP. 31 (2015); Barak Orbach, *Antitrust Populism*, NYU J. L. & BUS. (forthcoming 2017).

⁵² ALFRED D. CHANDLER JR., *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* 3 (1977).

⁵³ *Id.*, at 1-5.

⁵⁴ GODFREY M. LEBHAR, *CHAIN STORES IN AMERICA, 1859-1950* (1952); John T. Flynn, *Chain Store Menace Or Promise?*, NEW REPUBLIC, I (Apr. 15, 1931 at 223), II (Apr. 22, 1931 at 270), III (Apr. 29, 1931 at 298), IV (May 6, 1931 at 324), V (May 13, 1931 at 350); MARC LEVINSON, *THE GREAT A&P AND THE STRUGGLE FOR SMALL BUSINESS IN AMERICA* (2011).

⁵⁵ See Orbach, *Antitrust Populism*, *supra* note 51. See also Thomas W. Hazlett, *The Legislative History of the Sherman Act Re-Examined*, 30 ECON. INQ. 263 (1992); Thomas J. DiLorenzo, *The Origins of Antitrust: An Interest-Group Perspective*, 5 INT'L REV. L. & ECON. 73, 74 (1985); George J. Stigler, *The Origin of the Sherman Act*, 14 J. L. STUD. 1 (1985). See generally JOHN D. HICKS, *THE POPULIST REVOLT* (1931).

⁵⁶ See Daniel Scroop, *The Anti-Chain Store Movement and the Politics of Consumption*, 60 AM. Q. 925 (2008). See also *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 541-80 (1933) (Brandeis, J., dissenting) (endorsing anti-chain

The motion picture industry was born during the Second Industrial Revolution through three significant developments. First, a group of inventors with limited interest in entertainment created the industry by introducing technologies of moving pictures. Second, entertainment entrepreneurs took over the industry with business models for large-scale production and distribution of a high-quality movies. Third, large theater chains emerged as extension of dominant film distributors. *Interstate Circuit* defendants were the companies that developed products and distribution models for large-scale entertainment. Their growth adversely affected numerous small competitors.

The defendants developed systems of mass production and mass distribution of films during the 1910s and 1920s. In a race for dominance, they also expanded into exhibition, built national theater chains, and acquired all significant independent exhibitors across the United States. This model of vertical integration proved to have drawbacks that required adjustments.⁵⁷ The national theater chains suffered from meaningful operational inefficiencies, as well as from a populist “chain stigma” that affected all retail chains. The chain stores that emerged during the Second Industrial Revolution utilized scale, scope, and standardization to reduce costs and lower prices. Movie theater chains could not harness these advantages. Their success built on charging high prices for marketing glamour and in small communities the viability of theaters required the ability to design programs for local preferences (“showmanship”). The national theater chains, therefore, lost money. The Great Depression forced the industry giants to reorganize their exhibition businesses and break up the vast theater chains. *Interstate Circuit*, the company, was formed in this process.⁵⁸

Interstate Circuit, thus, concerns an alleged conspiracy among technological companies in a period of rapid technological advancements that disrupted markets. The defendants, innovating companies, argued that copyright law protected their products and gave them the legal right to adopt contractual restrictions that were exempted from the reach of antitrust law.⁵⁹

B. The Formation of the Motion Picture Industry

Moving pictures were first commercialized in 1894 with the introduction of peepshow machines that offered very short clips.⁶⁰ The success was sensational and drew many companies

store laws); Flynn, *supra* note 54; LEVINSON, *supra* note 54.

⁵⁷ See *infra* Sections II.A-B.

⁵⁸ See *infra* Part IV.

⁵⁹ See, e.g., Brief for the Appellants, *Interstate Circuit v. United States* (filed with the U.S. Supreme Court, Dec. 5, 1938); *President Asks Congress to Probe Monopoly and Investment Trusts*, MOTION PICTURE HERALD, May 7, 1938, at 28 (quoting Thurman Arnold stating that *Interstate Circuit* illustrated “a typical use of a legal privilege (the copyright) . . . to destroy competition.”); Francis L. Burt, *Dallas Case to U.S. Supreme Court*, MOTION PICTURE HERALD, Feb. 5, 1938, at 57 (“The right of distributors of copyrighted films to dictate the admission prices and practices to be adopted by exhibitors, under the copyright laws, will be interpreted by the United States Supreme Court.”); *Gov’t Sues Circuits & Major Distributors in Texas*, FILM BULL. Dec. 23, 1938, at 3 (“The chief argument of the defense is expected to be the right of manufacturers of patented or copyrighted products to fix the sale price of their merchandise.”); *Distributors Deny Anti-Trust Charge*, MOTION PICTURE HERALD, Feb. 13, 1937, at 44 (summarizing the defendants’ answers to the government lawsuit, writing that the answers claimed that since motion pictures were copyrighted they had the legal right to require exhibitors show them at certain terms and that such requirements were “not in restraint of trade.”)

⁶⁰ See GORDON HENDRICKS, *THE KINETOSCOPE: AMERICA’S FIRST COMMERCIALY SUCCESSFUL MOTION PICTURE EXHIBITOR* (1966).

to develop projectors, improved cameras, and related technologies.⁶¹ Yet, until 1912, movies were short—typically, one-reel films of ten minutes, relatively homogeneous, and primarily served as a working-class amusement.⁶² Between 1908 and 1912, a cartel of companies—the Motion Picture Patents Company (“MPPC”)—controlled all essential technologies and standardized film production.⁶³ During this period, the public developed preferences for variety and quality.⁶⁴ Nonetheless, MPPC leaders insisted that “the single reel photo-drama [was] the keystone of the motion picture industry” and that multi-reel films had no prospects.⁶⁵ The two dominant types of one-reel films were “scene films” that offered sights from remote places and “chaser pictures,” which presented simple stories ending by a chase.⁶⁶ For chaser pictures and other creative films, MPPC’s policies required producers to keep the identity of the creative team anonymous. These policies forestalled progress in the United States,⁶⁷ while European film producers were already competing with the “legitimate stage” by “paying fabulous sums” to actors “for performances of their plays.”⁶⁸

C. Innovation and Decline of Small Businesses

In 1912, a flux of entrepreneurial companies started entering the industry with “features films,” which were multi-reel movies that offered a meaningful product differentiation.⁶⁹ The term

⁶¹ See *Kinematography in the United States*, MOTION PICTURE WORLD, July 11, 1914, at 175; CHARLES MUSSER, THE EMERGENCE OF THE CINEMA: THE AMERICAN SCREEN TO 1907, in 1 HISTORY OF THE AMERICAN CINEMA 91-108 (1990).

⁶² See, e.g., BENJAMIN B. HAMPTON, A HISTORY OF THE MOVIES 49-82 (1931); Adolph Zukor, *Origin and Growth of the Industry*, in THE STORY OF THE FILMS 55, 57 (Joseph P. Kennedy ed. 1927) (explaining that the first generation of industry pioneers were “all concentrated on the mechanical end of the business.”). See also Jan Olsson, *Pressing Matters: Media Crusades Before the Nickelodeons*, 27 CINEMA HIST. 105 (2015); Ben Singer, *Manhattan Nickelodeons: New Data on Audiences and Exhibitors*, 34 CINEMA J. 5 (1995).

⁶³ MPPC pooled the patents of the pioneering companies in the motion-picture industry, resolved conflicts among these companies, and used the control over the technology to dominate the industry. MPPC formed in 1908 and was dissolved in 1918 after losing in court a key patent. MPPC’s decline began in 1912, when courts started invalidating its licenses and entrepreneurial companies started distributing “feature films.” See *Important Patent Decision*, MOVING PICTURE WORLD, Feb. 17, 1912, at 560; Ralph Cassady, Jr., *Monopoly in Motion Picture Production and Distribution: 1908-1915*, 32 S. CAL. L. REV. 325 (1959); Jeanne Thomas, *The Decay of the Motion Picture Patents Company*, 10 CINEMA J. 34 (1971).

⁶⁴ See, e.g., *The Charm of Variety*, MOTION PICTURE WORLD, July 31, 1909, at 151 (criticizing the “uniformity” of movies enforced by the industry); *Larger Programs to Select From*, MOTION PICTURE WORLD, May 27, 1911, at 1173 (observing that “the trend is to spread out in *quantity* instead of to concentrate on *quality*.”); *Facts and Comments*, MOTION PICTURE WORLD, Aug. 5, 1911, at 268, 270 (criticizing “the policy of the competing groups of manufacturers” that intended to kill “competition of quality.”)

⁶⁵ William N. Selig, *Present Day Trend in Film Lengths*, MOTION PICTURE WORLD, July 11, 1914, at 181; Carl Laemle, *Doom Long Features Predicted*, MOTION PICTURE WORLD, July 11, 1914, at 185.

⁶⁶ *The Cult of Motion Picture*, MOVING PICTURE WORLD, Sept. 5, 1908, at 176;

⁶⁷ See, e.g., George Rockhill Crow, *The Technique of the Picture Play*, MOVING PICTURE WORLD, Jan. 21, 1911, at 126.

⁶⁸ *The Cult of Motion Picture*, *supra* note 66, at 177; Zukor, *Origin and Growth of the Industry*, *supra* note 62, 56-57 (Joseph P. Kennedy ed. 1927).

⁶⁹ EILEEN BOWSER, THE TRANSFORMATION OF CINEMA, 1907-1915, in 2 HISTORY OF THE AMERICAN CINEMA 191-215 (Charles Harpole ed. 1990); HAMPTON, *supra* note 62, at 101-120; Ben Singer, *Feature Films, Variety Programs*,

“feature” came from the vaudeville world, where the “feature act” was the special item on the program. “Feature films” had “superior quality” and, thus, were more than a multi-reel film.⁷⁰

The transition from relatively homogeneous films to highly differentiated multi-reel movies was a complex process with significant economic and social implications. The industry shifted its emphasis from quantity to quality and expanded its target audience from the working class to the entire population. Feature films were considerably longer and more sophisticated than the one-reel films they replaced. They were produced on expensive sets with large creative and technical crews, featured established actors who were promoted as “movie stars,” were shown in movie theaters, and were heavily advertised.⁷¹ These changes significantly increased the costs of production, distribution, and exhibition.

With the increasing demands for capital, the industry entered into a massive wave of consolidation. By the early 1920s, most significant independent companies disappeared and large multiunit firms took over the industry.⁷² Many small businesses that operated in communities as providers of entertainment went bankrupt. The one-reel films played in three primary venues: vaudevilles, nickelodeons, and traveling exhibitions. Vaudevilles were inexpensive theaters that offered programs of a variety types and styles—musicians, singers, comedians, dancers, trained animals, acrobats, lecturers, and so forth (and, hence, were known as “variety theaters”).⁷³ First appeared in the 1860s, vaudevilles were popular in the United States especially from the early 1880s to the early 1930s. Vaudevilles were operationally advanced in the entertainment world as they created programs tailored for local communities, used complex booking systems, and some were organized as chains and controlled by strong operating companies.⁷⁴ Vaudevilles were the first venue to offer motion pictures to the public. They used one-reel films to fill their programs.⁷⁵ Nickelodeons were popular theaters for one-reel films that had a variety of types from a projector in a converted stores to deluxe amusement halls in theater districts in major cities. First appeared in 1905, nickelodeons gained their name for the common admission fee of the inexpensive ones that targeted the working class and kids.⁷⁶ Traveling exhibitors were entertainers who owned or

and the Crisis of the Small Exhibitor, in *AMERICAN CINEMA’S TRANSITIONAL ERA* 76 (Charlie Keil & Shelley Stamp eds., 2004).

⁷⁰ See Michael Quinn, *Distribution, the Transient Audience, and the Transition to the Feature Film*, 40 *CINEMA J.* 35 (2001); W. Stephen Bush, *Gradation in Service*, *MOVING PICTURE WORLD*, May 2, 1914, at 645; Hugh Hoffman, *The Father of the Feature*, *MOVING PICTURE WORLD*, July 11, 1914, at 272.

⁷¹ See BOWSER, *supra* note 69, at 103-119; HAMPTON, *supra* note 69, at 83-100.

⁷² BERTRAND ET AL., *A PATTERN OF CONTROL*, *supra* note 36, at 6. See also H.E. Shumlin, *It Strikes Me*, *BILLBOARD*, Sept. 23, 1923, at 58 (“The exhibition end of the motion picture industry—the retail end—is rapidly going the way of other retail businesses. Like the chain grocery stores, cigar stores, butcher shops and shirt shops, the picture theater circuit are continuously expanding. . . . [T]he country’s movie houses will all be owned by a few big corporations . . . [and] the individually owned and operated theater will no longer exist.”)

⁷³ See DOUGLAS GILBERT, *AMERICAN VAUDEVILLE: ITS LIFE AND TIMES* (1940); Edwin Milton Ryole, *The Vaudeville Theatre*, 16 *SCRIBNERS* 485 (Oct. 1899).

⁷⁴ See, e.g., ARTHUR FRANK WERTHEIM, *VAUDEVILLE WARS* (2006).

⁷⁵ Robert C. Allen, *The Movies in Vaudeville: Historical Context of the Movies as Popular Entertainment*, in *THE AMERICAN FILM INDUSTRY* 57 (Tino Bali ed., rev. ed., 1985).

⁷⁶ See Russell Merritt, *Nickelodeon Theaters, 1905-1914: Building an Audience for the Movies*, in *THE AMERICAN FILM INDUSTRY* 83 (Tino Bali ed., rev. ed., 1985); Joseph Mendill, *The Nickelodeons*, *MOVING PICTURE WORLD*, Jan.

rented projectors and reached their audiences with moving pictures.⁷⁷ Together, vaudevilles, nickelodeons, and traveling exhibitors created demand for movies, but had no viable existence in the world of feature films that were shown in designated theaters. Vaudevilles slowly declined as they gradually converted into movie theaters. Nickelodeons vanished with the advent of feature films, as their low-cost model could not accommodate experience-oriented entertainment. The traveling exhibitors were not cost-effective for mass distribution of films.

By the time that feature films appeared, quite a few vaudeville and nickelodeon operators had already opened theaters in premium locations in cities and were competing against the “legitimate theaters” by offering quality programs in attractive facilities.⁷⁸ Interstate Theaters Circuit, the predecessor of Interstate Circuit, was among these pioneering companies.⁷⁹

D. The Rise of the Large Distributors

By the end of the 1920s, eight distributors established their dominance in the industry through control of the production, licensing, and distribution of “more than 80% of the high class feature films available for exhibition in the United States.”⁸⁰ These eight distributors were able to secure enough talent and capital to build viable capacity to produce and distribute feature films.⁸¹ Five distributors, known as the “majors,” vertically integrated production, distribution, and exhibition of motion pictures.⁸² Three additional large distributors vertically integrated production and distribution and had a limited presence in exhibition.⁸³ These eight distributors were the distributor defendants in *Interstate Circuit*. Paramount Pictures was the largest distributor and vertically integrated more theaters than all other distributors combined.⁸⁴

Critically important to the understanding of *Interstate Circuit*, Adolph Zukor, the founder and

11, 1908, at 21; *The Nickelodeon as a Business Proposition*, MOVING PICTURE WORLD, July 25, 1908, at 59.

⁷⁷ See CHARLES MUSSER & CAROL NESLON, *HIGH CLASS MOVING PICTURES* (1991).

⁷⁸ See Allen, *supra* note 75; Merritt, *supra* note 76.

⁷⁹ See *infra* Section III.

⁸⁰ Petition, *United States v. Interstate Circuit, Inc., et al.*, In Equity No. 3736-992 (N.D. Tex., Dec. 15, 1936), ¶ 20 (hereinafter: “Interstate Circuit Complaint”). In 1934, during the events leading to *Interstate Circuit*, the eight distributors concentrated about 80% of film production in the United States measured by production budget and revenues. DANIEL BERTRAND, *THE MOTION PICTURE INDUSTRY STUDY* 11 (Office of the National Recovery Administration, Study No. 34, 1936) (hereinafter: “THE MOTION PICTURE INDUSTRY STUDY”). The eight large distributors were Paramount Pictures Distributing Co., Inc. (“Paramount Pictures”), Metro-Golden-Mayer, Inc. (“MGM”), RKO Distributing Corp. (“RKO”), Vitagraph Inc., the distribution arm of Warner Bros. Pictures, Inc. (“Warner Bros.”), Twentieth Century-Fox Film Corporation (“Twentieth Century”), Columbia Pictures Corp. (“Columbia”), Universal Film Exchanges, Inc. (“Universal”), and United Artists Corporation (“United Artists”).

⁸¹ Adolf Zukor, *Famous Players in Famous Plays*, MOVING PICTURE WORLD, July 11, 1914, at 186 (describing his idea to depart from “the old routine” “engage the highest salaried, the most highly respected, the most artistic in the world to pose in their greatest successes before the camera, and to follow that film with those of other in their theatrical triumphs.”).

⁸² Paramount, MGM, RKO, Twentieth Century, and Warner Bros.

⁸³ Universal vertically integrated distribution, and production, but was not as big as the majors. United Artists specialized in independent productions of movie stars and vertically integrated a relatively small number of theaters. Columbia vertically integrated production and distribution and did not operate at the exhibition level.

⁸⁴ See Sime Silverman, *Paramount’s Position*, VARIETY, AUG. 7, 1929, at 3.

president of Paramount Pictures, conceived and developed the business model for feature films,⁸⁵ their classifications, and the use of vertical restraints for their distribution. In 1912, Zukor formed a production company, “Famous Players Films Company,” that hired known actors to play in films.⁸⁶ To enter the market that was controlled by MPPC, Zukor created a national distribution system with “a regular program of releases,” initially marketed as “30 Famous Features a Year.”⁸⁷ The concept of programs—the licensing of bundles of movies—was not new.⁸⁸ The distribution of one-reel films was primarily through daily programs.⁸⁹ Zukor’s model of annual programs allowed production companies “to know what amount could be spent in producing a picture without gambling too much.”⁹⁰ The practice quickly became known as “block booking.”⁹¹ Unlike the daily programs of one-reel films, block booking required exhibitors to commit to annual programs of unknown feature films and considerably reduced their capacity to license films from other distributors. As discussed below, *Interstate Circuit* concerned negotiations for the season of 1934-35.

The vertical integration of exhibition began and evolved as arms race. In the era of feature films, the location of theaters and their attractiveness were the key to success. Thus, in a very short period of time, access to capital and economies of scale became critical to successful operation in exhibition, as exhibitors had to invest in theaters and their operational costs considerably increased.⁹² Concerns regarding dependence on one supplier of films—Zukor—motivated one of the first theater chains, First National Exhibitors’ Circuit, to develop its own production arm.⁹³ Zukor responded by expanding into exhibition.⁹⁴ These acts of vertical integration set the model for leading industry players,⁹⁵ turning the “struggle for supremacy in the industry” into “a fierce

⁸⁵ Adolph Zukor, *Famous Players in Famous Plays*, MOTION PICTURE WORLD, July 11, 1914, at 186. See also Douglas Gomery, *What Was Adolph Zukor Doing in 1927?*, 17 FILM HIST: INT. J. 205 (2005); Quinn, *supra* note 70.

⁸⁶ Zukor, *Famous Players in Famous Plays*, *supra* note 62.

⁸⁷ Zukor, *Famous Players in Famous Plays*, *id.* See also Zukor, *Origin and Growth of the Industry*, *id.*

⁸⁸ See, e.g., HOWARD T. LEWIS, THE MOTION PICTURE INDUSTRY 146-53 (1933) (describing attempts of the industry to compare the practices).

⁸⁹ See HAMPTON, *supra* note 62, at 49-82.

⁹⁰ Zukor, *Famous Players in Famous Plays*, *supra* note 85. See also Zukor, *Origin and Growth of the Industry*, *supra* note 62.

⁹¹ LEWIS, *supra* note 88, at 142-80.

⁹² See HOWARD THOMPSON LEWIS, *First National Exhibitors’ Circuit, Incorporated*, in CASES ON THE MOTION PICTURE INDUSTRY 13 (1930). The consolidation trend gained momentum after exhibitors learned that cooperation through a buying agent might be an antitrust violation. See, e.g., FTC v. Stanley Booking Corp., 1 F.T.C. 212 (1918) (discussing the use of a “booking agent” by exhibitors who tried to adjust to the changes in the competitive landscape).

⁹³ LEWIS, *First National Exhibitors’ Circuit*, *supra* note 92; Zukor, *Origin and Growth of the Industry*, *supra* note 62.

⁹⁴ Douglas Gomery, *The Movies Become Big Business: Publix Theatres and the Chain Store Strategy*, 18 CINEMA J. 26 (1979); Zukor, *Origin and Growth of the Industry*, *id.*; *Paramount May Control Chain of Theatres Over the Country*, VARIETY, Jan. 11, 1918, at 1.

⁹⁵ Marcus Loew, *The Motion Picture and Vaudeville*, in THE STORY OF THE FILMS 285, 289 (Joseph P. Kennedy ed. 1927) (explaining that Loew’s Theatres entered into production because Zukor “was buying theaters,” so the company founders felt that they had to protect themselves by the predecessor of MGM.)

battle for theaters.”⁹⁶ Influenced by trends in the economy, the industry organized its retail arms, exhibition in large chains.⁹⁷

Reports from the era of expansion that lasted until 1931, describe how the large distributors, most prominently Paramount under the leadership of Zukor, used vertical integration with exhibition as an instrument of intimidation and retaliation. For example, the distributors often threatened to build, acquire, or lease theaters in competition with independent exhibitors who challenged the booking practices of the distributors.⁹⁸ Under certain circumstances they carried out the threats.⁹⁹

E. Vertical Integration and Vertical Practices

The eight large distributors used a set of vertical restraints—rules and classifications—that facilitated distribution and but also erected barriers to entry.¹⁰⁰ *Interstate Circuit* concerned arrangements related to these vertical restraints:

Vertical Restraints in the Motion Picture Industry

1. Affiliations:

- The Eight Large Distributors
- Affiliated Exhibitors
- Independent Companies

2. Theater Classifications:

- First vs. Subsequent Theaters
- Downtown vs. Neighborhood Theaters

3. Movie Classifications:

- “Runs”
- A, B, and C Movies

4. Facilitating Vertical Restraints:

- Zones and Clearances
- Block booking

1. *Affiliations.* By 1930, the rise of the large distributors shaped alliances and divided the industry among (1) the eight large distributors and their production companies, (2) “affiliated exhibitors” that were exhibition businesses wholly- or partially-owned by the large distributors, and (3) “independent companies” in which the eight distributors did not hold equity.¹⁰¹

2. *Theater Classifications: First vs. Subsequent Theaters; Downtown vs. Neighborhood Theaters.* By the arrival of feature films, nickelodeons and vaudevilles evolved to neighborhood theaters that targeted working-class audiences and “deluxe” theaters in downtown in cities that drew wealthier audiences. The differentiation proved profitable, as the downtown theaters charged higher admission prices. The differentiation continued to evolve with the development of movie theaters that showed feature films. In cities, especially large ones, the

downtown theaters were typically affiliated, upscale theaters. Such theaters were known as “Class

⁹⁶ BERTRAND ET AL., A PATTERN OF CONTROL, *supra* note 36, at 6.

⁹⁷ Gomery, *The Movies Become Big Business*, *supra* note 94; Shumlin, *It Strikes Me*, *supra* note 72 (describing the organization of chains); *Wall Street Itself Directing Vast Chain of Film Theatres*, VARIETY, Dec. 19, 1919, at 1 (same); *1st Natl. Exhibitors to Operate Their Own Chain of Theatres*, VARIETY, Nov. 28, 1919, at 1 (same).

⁹⁸ See, e.g., *In Matter of Famous Players-Lasky Corp.*, 11 F.T.C. 187 (1927).

⁹⁹ *Id.*

¹⁰⁰ See, e.g., Ralph Cassadi Jr., *Some Economic Analysis of Motion Picture Production and Marketing*, 6 J. BUS. 113, 116 (1933).

¹⁰¹ See, e.g., W. Ray Johnston, *Independents Are Necessary*, BILLBOARD, Apr. 14, 1934, at 41 (describing the struggle of independent film companies).

A theaters”—upscale theaters in downtown.

3. *Movie Classifications: (a) “Runs”* During the one-reel film era, the demand for some variation established a distinction among “classes” of films, which was mostly about the age of the movie. “First run” pictures were those that were shown for the first time after their released, the “second run” pictures played after already exhibited as first run, and “junk” pictures included “old subjects.”¹⁰² Correspondingly, “first Class theaters”—high class vaudeville and nickelodeons—showed primarily first run films.¹⁰³ In the era of feature films, the distributors formalized the distinction between first- and subsequent-run films.

(b) *A, B, and C Movies.* When Zukor first released the annual program of “30 Famous Features,” he also introduced three classes of films: A, B, and C.¹⁰⁴ This product differentiation grading was tied to production budget. It facilitated the allocation of product in the industry. By the late 1920s, the industry norm was that only “Class A theaters” could show first runs of A movies.

4. *Facilitating Vertical Restraints: (a) Zones and Clearances.* To facilitate an effective system of runs and product differentiation, the industry developed various forms of vertical restraints. The two primary practices were “zones” and “clearances.” A “zone” was a territory that defined priorities for exclusivity rights for local exhibitors. Typically, the first-run theater in a zone had an exclusive right to show first an A movie, then a second-run theater had such exclusive right, and so forth. A “clearance” was a period between “runs” during which no theater in a zone had a contractual right to show a film.¹⁰⁵

(b) *Block Booking.* By 1927, seven of the eight large distributors licensed movies only through annual programs; that is, they dealt only with exhibitors that accepted their block booking policies.¹⁰⁶ The eighth large distributor, United Artists, licensed each movie separately or used blocks of several movies but did not use annual contracts.¹⁰⁷ The blocks each of the seven distributors offered were so large that with one or two contracts, an exhibitor was left with a limited booking capacity for the year.

II. THE GREAT DEPRESSION AND INDUSTRY REORGANIZATION

A. Contraction, Price Wars, and Double Features

The expansion of the motion picture industry during the 1920s resulted in overcapacity in exhibition that, by the end of the decade, required adjustments. In 1927, technological change once again shook the industry: sound films arrived. Additional capital investments were required to

¹⁰² *The Nickelodeon as a Business Proposition*, *supra* note 76, at 61.

¹⁰³ *Id.* See also W. Stephen Bush, *Hints to Exhibitors*, MOVING PICTURE WORLD, Oct. 24, 1908, at 316; W. Stephen Bush, “First Runs,” MOVING PICTURE WORLD, Aug. 22, 1914, at 1072.

¹⁰⁴ See, e.g., *Famous Players Co. Angling for David Belasco’s Pieces*, VARIETY, Apr. 3, 1914, at 18; *Legit Rod Booking System by Big Feature Film Firms*, VARIETY, June 26, 1914, at 16. See also Terry Ramsaye, *The Rise and Place of the Motion Picture*, 254 ANN. AM. ACAD. POL. & SOC. SCI. 1, 6 (1947).

¹⁰⁵ LEWIS, *supra* note 88, at 201-229.

¹⁰⁶ See *Paramount Famous Lasky Corp. v. United States*, 282 U.S. 30 (1930) (holding that an agreement among the distributors regarding the terms of block booking violated the antitrust laws).

¹⁰⁷ See TINO BALIO, *UNITED ARTISTS: THE COMPANY BUILT BY THE STARS* 101-102, 107-109 (1976).

convert theaters to the new technology.¹⁰⁸ Experts recognized the overcapacity and estimated that, for the investments required to convert theaters to sound, about 25% of the theaters holding no more than 10% of the seat capacity in the United States would close within two years.¹⁰⁹ Thus, the predictions were that the advent of sound films would disproportionately affect small exhibitors. Sound films also led to elimination of about 30,000 jobs around the country, as theaters no longer needed musicians to play during the shows.¹¹⁰ Sound in films, therefore, presented a set of technological advancements that produced both public excitement and anxieties over change. The Great Depression magnified anxieties and increased pressures for adjustments of the industry.

Between 1929 and 1933, during the Depression years, operating theaters converted to sound and about one third of US theaters closed.¹¹¹ During the same period, the average admission price in the United States fell by 33%, with sporadic price wars in various cities accelerating the decline, exceeding the decline in the consumer price index by ten points.¹¹²

In the first year of the Depression, the average admission price dropped by about 6.5%, but box-office revenues did not decline because of a considerable increase in attendance (attributed to excitement about “talkies” that were still new).¹¹³ In 1930-33, however, the average admission price kept declining and attendance plummeted.

¹⁰⁸ *Color and Sound on Film*, *supra* note 48, at 33 (noting that the advent of sound films was “beyond comparison the fastest and most amazing revolution in the whole history of industrial revolutions.”)

¹⁰⁹ *See Reducing Theatres 25%*, VARIETY, July 11, 1928, at 5.

¹¹⁰ BERTRAND, THE MOTION PICTURE INDUSTRY STUDY, *supra* note 80, at 133-34; Maurice Mermey, *The Vanishing Fiddler*, 227 N. AM. REV. 301 (1929).

¹¹¹ BERTRAND, THE MOTION PICTURE INDUSTRY STUDY, *supra* note 80, at 36; DANIEL BERTRAND, THE MOTION PICTURE INDUSTRY: EVIDENCE STUDY 38 (Office of the National Recovery Administration, Evidence Study No. 25, Nov. 1935).

¹¹² In the 1930s, large theaters used to have “lower floor” and “balconies.” When the balcony was open to the audience, tickets were offered at a lower price. The phrase “admission price” in this Article refers to the lower floor price or the general price in theaters that did not have balconies.

¹¹³ *See, e.g.,* Fred Ayer, *1,422 New Independent Accounts Are Created*, MOTION PICTURE HERALD, June 17, 1933, at 9 (“The talking picture was . . . a . . . novelty to the public, and the film industry was enjoying one of its greatest booms. . . . [I]t was not until 1931 that this industry began to feel acutely the general business retrogression. Suddenly the public stopped spending and theatre closings started overnight.”)

THE GREAT DEPRESSION AT THE BOX OFFICE			
Year	Avg. Admission Price (cents)	Attendance (millions)	Box Office Revenues (millions)
1929	30	3,660	1,100
1930	28	3,920	1,100
1931	24	3,330	880
1932	22	2,840	625
1933	20	2,800	560
1934	20	3,250	650
Source: Bertrand (1936). ¹¹⁴			

Facing dwindling demand during the Depression, theaters reduced admission prices and experimented with various “giveaway” marketing schemes.¹¹⁵ One of the most popular practices was “double features.”¹¹⁶ The practice escalated price wars in the industry and proved to benefit independent producers.¹¹⁷ To reduce the costs of double-features, exhibitors bundled “indies” with movies of the large distributors, rather than offering two “studio movies” for a price of one.¹¹⁸ For the large distributors, therefore, double features were a source of concern because of negative effects on revenues and because of the challenge they created in “halting indies from getting into first and second runs.”¹¹⁹

The industry tried to address the trends through open and extensive negotiations within and among the various trade associations. For example, in late 1931, Allied States Association, the trade association of independent exhibitors, announced that reductions in admissions prices were

¹¹⁴ BERTRAND, THE MOTION PICTURE INDUSTRY STUDY, *supra* note 80, at 35.

¹¹⁵ See, e.g., *Rage for Giveaways Diminishing*, MOTION PICTURE HERALD, Oct. 1, 1932, at 10 (describing the practices).

¹¹⁶ See *Producers Favor Longer Running Pix to Combat Duals*, VARIETY, Feb. 27, 1934, at 5 (describing efforts to curb double features); *Anti-Dual Movement Reversed*, MOTION PICTURE HERALD, Dec. 31, 1932, at 12 (describing forces in the industry for and against double features); *Most Trade Leaders Denounce Double Featuring as a Menace*, MOTION PICTURE HERALD, Nov. 21, 1931, at 13; *Spreading of Double Feature Alarm Leaders of Industry*, MOTION PICTURE HERALD, Nov. 14, 1931, at 9 (noting that industry leaders describe the practice as a “dangerous and malignant disease”); *Double Feature Dangers*, VARIETY, Apr. 8, 1931, at 11 (describing the concerns that “spreading policy” creates among the distributors); *Double Feature Playing More Plentiful and Spreading*, VARIETY, Oct. 8, 1930, at 4 (same); *Double Talkers on One Bill*, VARIETY, Apr. 2, 1930, at 12 (describing a strong rise in the offering of double features across the country); *Double-Feature Plan Costly With Talkies*, BILLBOARD, May 25, 1929, at 21 (describing the bundling). See generally Edward R. Beach, *Double Features in Motion-Picture Exhibition*, 10 HARV. BUS. REV. 505 (1932); Gary D. Rhodes, “The Double Feature Evil”: Efforts to Eliminate the American Dual Bill, 23 FILM HIST. 57 (2011).

¹¹⁷ See *100 Features From Independents in New Season As Market Opens*, MOTION PICTURE HERALD, May 2, 1931, at 12; *Curtailment By Larger Studios Prompts Independents to Expand*, MOTION PICTURE HERALD, Jan. 9, 1932, at 9.

¹¹⁸ See, e.g., *Double Bills*, BILLBOARD, Apr. 7, 1934, at 19; *Strong Stand for Duals*, VARIETY, Sept. 5, 1933, at 7; *Dual Bills Indies’ Hope*, VARIETY, Dec. 13, 1932, at 7.

¹¹⁹ *Major Up Prod. to Keep Indies Out of 1st Runs*, VARIETY, Apr. 24, 1934, at 5.

necessary to draw audiences.¹²⁰ Exhibitor leaders argued that “any concerted effort to maintain prices” might adversely affect box office revenues.¹²¹ The large distributors saw things differently. Their executives had a series of meetings to discuss double features.¹²² The press reported that they received a legal opinion saying that “any collective effort . . . to regulate the practice could be construed as conspiracy and would stand little chance if contested in the courts.”¹²³ The distributors, therefore, *agreed* that each would unilaterally punish exhibitors for offering double features.¹²⁴ To assure effectiveness of the plan, the exhibitors publicly announced their agreement. The distributors also believed that a national ban on double features could be attacked as an unlawful conspiracy and, therefore, the plan would be used in local markets.¹²⁵ The distributors indeed promoted such policies and encouraged local exhibitors to adopt agreements (“codes of ethics”) against double features.¹²⁶ *Interstate Circuit* concerned such a plan.

B. Decentralization

By 1927, it became clear that the majors’ chains required reorganization.¹²⁷ The distributors acquired theaters as operating businesses, leased the underlying properties, and managed all theaters from their New York “home offices.” This system of centralized management offered certain efficiencies but its inefficiencies were greater. In the race to acquire theaters, the distributors committed to costly leases under the premise that they could increase revenues in local markets. In reality, the home offices lacked the expertise needed to serve diverse communities and local markets.¹²⁸ Thus, already before the market crash of 1929, losses persuaded Paramount to give away 150 theaters in small towns and persuaded one of the small distributors to exit exhibition and sell its theaters to Paramount.¹²⁹ Nonetheless, the five majors continued to acquire theaters

¹²⁰ *Reductions of Admission Price Adopted in Most Large Cities*, MOTION PICTURE HERALD, Oct. 24, 1931, at 9.

¹²¹ *Id.*

¹²² *Exhibitors Must Decide Problem of Double Bill, Say Distributors*, MOTION PICTURE HERALD, Dec. 5, 1931, at 14.

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ See, e.g., *Subrubs Drop Doubling By Agreement*, VARIETY, Jan. 5, 1932, at 7 (describing the “first concerted step on the part of the exhibitors themselves to . . . [address] the double-feature disease.”); *Double Bills Code Is Adopted By Exhibitors At Kansas City*, MOTION PICTURE HERALD, Feb. 27, 1932, at 72 (“The motion picture industry succeeded . . . in laying a foundation for a solution to double featuring in towns where it is considered to be an ‘evil.’ Exhibitors at Kansas City agreed to a ‘Code of Ethics’ regulating the practice.”); *Indies and Twin Bills Out*, VARIETY, June 14, 1932, at 5 (describing concerted efforts against double features).

¹²⁷ See, e.g., *Complete Reform Move*, VARIETY, June 22, 1927, at 5; *Chain Operation Unproductive When Attempted By Producers*, VARIETY, July 27, 1927, at 9; *Chain Operation Holes*, VARIETY, June 13, 1928, at 11; *Reducing Theatres 25%*, *supra* note 109; *More Liberty Allowed in Local Theatre Operation*, VARIETY, Feb. 13, 1929, at 16.

¹²⁸ See, e.g., *Division of All Territory and Local-Pooled Operation by Major Chains May Come About*, VARIETY, July 30, 1930, at 5; *Film Salesmen Vanishing As Chains Absorb Independents*, VARIETY, Jan. 23, 1929, at 4.

¹²⁹ See *150 Theatres Given Away*, VARIETY, Feb. 6, 1929, at 5; *Universal Giving Up House Operation*, VARIETY, Oct. 16, 1929, at 7.

even after the crash of 1929, when the industry started contracting.¹³⁰ The majors practically acquired all significant chains around the country.¹³¹

By the summer of 1931, the chains' heavy losses forced the majors to reevaluate the profitability of vertical integration with exhibition. It was broadly believed that local managements could improve operation and reduce the "chain stigma" that harmed business.¹³² Three of the five majors adopted formal "decentralization" plans conceding that local control of theaters by regional companies might be more efficient than vertical integration with centralized management.¹³³ The majors broke up the national chains and formed partnerships with regional operators, in which they retained 15% to 75% ownership interest and transferred management responsibilities to the local partners. The reorganization allowed the companies to reduce debt and liabilities by divesting less profitable assets and renegotiating long-term leases. The three majors that adopted formal decentralization plans also threw their exhibition units into bankruptcy to renegotiate debt and reduce liabilities.¹³⁴ In March 1933, the Motion Picture Producers and Distributors of America (MPPDA), the trade association of the large distributors, adopted a plan calling for "the readjustment of much of the industry's theatre structure in order that decentralization of ownership and management might result in greater economy and greater flexibility."¹³⁵

"Decentralization" practically meant partnerships with influential local operators.¹³⁶ The decentralized theaters remained affiliated with the majors that held ownership interest in those theaters. The reorganization of the national chains, however, created beliefs and hopes that the distributors were leaving exhibition and that the era of theater chains ended.¹³⁷ For example, a *New*

¹³⁰ See, e.g., *Circuit Map Changing*, VARIETY, May 7, 1930, at 11 (discussing the expansion of the "Big Four," Paramount, Fox, Warner Bros., and RKO); *Warner Acquire 7 Chains in Drive for 1,000 Theatres*, VARIETY, Apr. 23, 1930, at 3.

¹³¹ *Circuit Map Changing*, *id.*

¹³² See, e.g., *Decentralization's Benefits*, VARIETY, Dec. 27, 1932, at 4. For the chain stigma see "Circuit" Advised for Theatre Sting Rather than "Chain", VARIETY, Apr. 30, 1930, at 4.

¹³³ The three distributors were Paramount, Twentieth Century-Fox, and RKO. Fox Theatres, the exhibition unit of Twentieth Century, announced "decentralization" plan August 1931, but the five distributors were experimenting with decentralization initiatives since 1929. See *Splitting Up Fox Chain*, VARIETY, Aug. 11, 1931, at 5; *Fox Theatre Chain to Run on Unit Plan*, N.Y. TIMES, Aug. 12, 1931, at 21. Other distributors followed. See *Fox Chain Break Up Effective Aug. 31*, MOTION PICTURE DAILY, Aug. 13, 1931, at 1; *Chain Decentralization May Reach Into Other Large Theatre Circuit If Fox-East Experiment Stands Up*, VARIETY, Aug. 18, 1931, at 5; Don B. Reed, *Home Control of Picture Houses Gains Momentum*, WASH. POST, Aug. 23, 1931, at A3; *Publix Chain Called Complete With Decentralization Finished*, VARIETY, Jan. 1, 17, 1933, at 29; Ayer, *1,422 New Independent Accounts Are Created*, *supra* note 113 (reviewing the decentralization programs).

¹³⁴ See ROBERT T. SWAINE, 2 THE CRAVATH FIRM AND ITS PREDECESSORS 533-40 (1948) (discussing the reorganization of the distributors); *Theatre Receiverships*, VARIETY, Jan. 31, 1933, at 5 ("The involved companies are seeking mostly relief from too expensive theatres."); *Receiverships for P-P, RKO*, BILLBOARD, Feb. 4, 1933, at 1 ("In all these receiverships and bankruptcies there has been a spirit of friendliness."); *Trustees Sue Paramount Board for \$12,237,071*, MOTION PICTURE DAILY, Apr. 26, 1934, at 1 (describing a lawsuit against Paramount's board to recover investments in exhibition).

¹³⁵ *Hays Submit Rehabilitation Program*, FILM DAILY, March 28, 1933, at 1.

¹³⁶ Ayer, *1,422 New Independent Accounts Are Created*, *supra* note 113.

¹³⁷ See, e.g., *Indies On Rise Throughout U.S.*, BILLBOARD, Apr. 29, 1933, at 7; *See De-Chaining As a Windfall for All Indies*, VARIETY, Apr. 25, 1933, at 7; Martin Quigley, *A Turn in the Road*, MOTION PICTURE DAILY, Aug. 13,

York Times editorial praised the “new management policy”:

Great economies are predicted, and at the same time the standard of amusement offered to the public will be raised. Individual exhibitors will be emancipated from the tyranny of the producers, who will . . . have to sell their wares on merit. . . . Two years ago it . . . was the time when the only synonym for Better was Bigger. This belief, of course, was not confined to the show business. It inspired the mad dance . . . in which all American Business was engaged. Such Reasoning as did operate at the time took the form of a pathetic faith in the limitless “economies” and profits that were assured by mergers, combinations, and other forms of Bigger Business. To combine, to centralize, to harmonize, to eliminate, to save—that was the way to build quality and profit.

Today the system from which the [motion picture industry] . . . expects great economies in management and a notable improvement in standards is “decentralization.” It is a return to the quest of profit and quality through the opposite of mass production.¹³⁸

The beliefs caused disappointments.¹³⁹ Decentralization formed powerful affiliated chains and improved the positioning of the majors in local markets.¹⁴⁰ It was reorganization of the vertically integrated chains, not empowerment of independent exhibitors. In many markets, the organizational improvements resulted in strong affiliated chains and weakened even further the local independent exhibitors. This was the situation in Texas, where Interstate Circuit, the company, emerged as one of the strongest regional chains in the country.

C. NIRA

In June 1933, Congress passed NIRA responding to a “national emergency . . . of widespread unemployment and disorganization of industry, which burden[ed] interstate commerce . . . , affect[ed] the public welfare, and undermine[d] the standards of living of the American people.”¹⁴¹ NIRA intended to reinvigorate the economy, among other ways, by inviting industry associations to adopt “codes of fair competition.”¹⁴² To facilitate such collaborations among competitors, NIRA exempted industry codes and any other agreements approved under the statute from the antitrust laws.¹⁴³ Signing NIRA, President Roosevelt explained:

We are relaxing some of the safeguards of the anti-trust laws . . . [and] are putting in place of old principles of unchecked competition some new Government controls. . . . Their purpose is to free business, not to shackle it. . . . Let me make it clear, however, that the anti-trust laws still stand firmly against monopolies that

1931, at 1; *Independent Exhibits Speeding Comeback*, MOTION PICTURE DAILY, Aug. 5, 1931, at 1; *Decentralization Trend Is Spreading*, FILM DAILY, July 8, 1931, at 1.

¹³⁸ *Older Methods*, N.Y. TIMES, Aug. 13, 1931, at 18.

¹³⁹ See, e.g., *Chains Not Giving Away Any Melons in Theatres*, VARIETY, Feb. 21, 1933, at 31.

¹⁴⁰ Ayer, *1,422 New Independent Accounts Are Created*, *supra* note 113.

¹⁴¹ NIRA, § 1.

¹⁴² *Id.* § 3.

¹⁴³ *Id.* § 5.

restrain trade and price-fixing which allows inordinate profits or unfairly high prices.¹⁴⁴

NIRA created hopes in the motion picture industry that its prospective code would end the decline in revenues and reverse the trend.¹⁴⁵ The trade press interpreted NIRA to mean that changes in antitrust laws would not allow monopolies but would eliminate “cut-throat competition.”¹⁴⁶ For example, when NIRA was finalized, *Variety* wrote that the “moratorium on antitrust law” was welcomed by all in the industry and that the distributors believed that it would allow them to engage in concerted action.¹⁴⁷ The suspension of the antitrust laws was praised, as experts believed that “trade groups [would] be able to fix prices and enter into other compacts considered necessary.”¹⁴⁸

The drafting of the Motion Picture Code required intense negotiations among industry leaders with participation of NIRA administrators.¹⁴⁹ It was approved in November 1933 and was the longest and most complex NIRA code.¹⁵⁰ The Code expressly distinguished between “affiliated” and “unaffiliated” exhibitors and supposedly tried to protect the interests of both groups.¹⁵¹ Charles Roos, the research director of the National Recovery Administration (“NRA”) and an eminent scholar, argued that the Motion Picture Code “represented the NRA’s outstanding effort to protect the small operator.”¹⁵² The large distributors believed that the Code allowed small exhibitors to operate as “price cutters.” Small exhibitors, however, felt that the “Code Authority” primarily served the large distributors and their affiliates, as it was controlled by studio executives.¹⁵³

¹⁴⁴ Franklin D. Roosevelt, *Statement on N.I.R.A.*, in 2 *The Public Papers and Addresses of Franklin D. Roosevelt* 251, 253 (1938).

¹⁴⁵ See, e.g., *Exhibitors Prepare to Raise Prices to Cover NRA Burden*, BILLBOARD, Oct. 7, 1933, at 24 (describing an anticipation for price increases); *Unfair Competition Out*, BILLBOARD, Dec. 16, 1933, at 20 (describing the expectations from the Code); *That Code Authority Board*, VARIETY, Jan. 2, 1934, at 4 (arguing that the implementation of the Code will prohibit competition among exhibitors).

¹⁴⁶ *Gait of Industry Is Quicken By Improvement of Business*, MOTION PICTURE HERALD, May 13, 1933, at 9, 10.

¹⁴⁷ *Moratorium on Anti-Trust Law Proceedings Welcomed All Around*, VARIETY, May 9, 1933, at 25.

¹⁴⁸ *Id.*

¹⁴⁹ See, e.g., *WASHINGTON HEARS INDUSTRY ON FILM CODE*, MOTION PICTURE HERALD, Sept. 16, 1933 (issue dedicated to the debates over the code); *Split in Code Parley*, MOTION PICTURE DAILY, Oct. 6, 1933, at 1 (describing disagreements between the studios and independent producers over the negotiated code); *Code Displeases Everyone*, BILLBOARD, Oct. 21, 1933, at 24.

¹⁵⁰ President Roosevelt approved the Motion Picture Code in November 1933. See Code of Fair Competition for the Motion Picture Industry (Code No. 124, Approved by President Roosevelt on Nov. 27, 1933) (hereinafter: “MP Code”); *President Signs Film Code*, VARIETY, Nov. 28, 1933, at 1; LOUIS NIZER, *NEW COURTS OF INDUSTRY: SELF-REGULATION UNDER THE MOTION PICTURE CODE xvii-xviii* (1935) (arguing that the Motion Picture Code was the most longest and most complex code).

¹⁵¹ The Code defined “affiliated exhibitors” as exhibitors “owned, controlled, or managed by a producer or distributor or in which a producer or a distributor has a financial interest in the ownership, control, or management.” It defined “unaffiliated exhibitors” as exhibitors in which no producer or distributor held such interests. MP Code, *id.*, Art. I, §§ 2-4, 10-11. See also James P. Cunningham, *De-Coding the Film Code* (Part 1), MOTION PICTURE HERALD, Dec. 23, 1933, at 23 (explaining the definitions and their meaning).

¹⁵² CHARLES F. ROOS, *NRA ECONOMIC PLANNING* 404 (1937).

¹⁵³ See *Code Authority Named*, MOTION PICTURE DAILY, Nov. 29, 1933, at 1, 3. See also Statement of Melvin

The Motion Picture Code prohibited marketing schemes that effectively reduced admission fees but did not create a framework to set minimum prices or prohibit double features.¹⁵⁴ The economic recovery began in the second quarter of 1933, before the enactment of NIRA.¹⁵⁵ Prices began rising. For members of the motion picture industry, the Code supposedly met expectations. In 1934, the average admission price did not decline and box-office revenues went up. Nonetheless, the Code disappointed the industry. Price wars were mitigated but did not disappear.

III. THE HOBLITZELLE ENTERPRISES

A. *The Hoblitzelle-Paramount Partnership*

In the entertainment world, “Interstate Circuit” meant the theater business owned and operated by Karl Hoblitzelle with partnership of R.J. O’Donnell. Hoblitzelle was known as the “most influential man in commercial theatre of Dallas and the Southwest” and was regarded by many as “the number one citizen” of Dallas.¹⁵⁶ In *Interstate Circuit*, the district court described Hoblitzelle as one of Dallas’ “finest characters.”¹⁵⁷ In 1904, Hoblitzelle formed a vaudeville company, Interstate Theaters Circuit.¹⁵⁸ His business model focused on building large premium theaters in large cities in the south and offering the best show in town.¹⁵⁹ O’Donnell, joined him in 1925, served as his right hand, held the title “general manager,” and was known as the “Boss Man.”¹⁶⁰ Together, Hoblitzelle and O’Donnell managed first-run “vaudefilm” theaters, which showed programs of movies and vaudeville shows, were located in premium locations and had a vast seat capacity.

By 1929, Hoblitzelle operated “one of the largest theater chains in the South” that included

Albert, Independent Theatre Owners Association of New York, U.S. Senate Committee on Finance, 2 Investigation of the National Recovery Administration 1310, 1311 (1935) (“[T]he Motion Picture Code is the only vertical code. . . . The producer and the distributor are one . . . on all local clearance boards, local grievance boards, and the code authority [and] if there is any . . . independent exhibitor representation . . . he is outnumbered.”) See also *Indie Exhibits Charge Rosenblatt Ignores Them, Code Gives ‘Big 8’ Stronger-Than-Ever Dominance*, VARIETY, Apr. 3, 1934, at 7 (discussing concerns of independents exhibitors regarding the positions of Sol Rosenblatt, NRA Compliance Director for the Code of Fair Competition for the Motion Picture Industry); *Indies Call Code Unjust*, BILLBOARD, Apr. 7, 1934, at 18 (same).

¹⁵⁴ *MP Code*, *supra* note 150, Art. V., Sec. E., Part. 3. See also *M. P. Code Affects Promotion Schemes*, BILLBOARD, Dec. 16, 1933, at 41. See also James P. Cunningham, *De-Coding the Film Code* (Part 3), MOTION PICTURE HERALD, Jan. 20, 1934, at 37 (explaining the Code’s attempt to establish “fair competitive and contractual relations and fair trade practices between distributors and exhibitors and among distributors and among exhibitors.”)

¹⁵⁵ See Christina D. Romer, *What Ended the Great Depression?*, 59 J. ECON. HIST. 757 (1992); Peter Temin & Barrie A. Wigmore, *The End of One Big Deflation*, 27 EXPLORATIONS ECON. HIST. 483 (1990).

¹⁵⁶ JOHN WILLIAM ROGERS, *THE LUSTY TEXANS OF DALLAS* 221 (1951). See also *Karl Hoblitzelle Dead in Dallas*, N.Y. TIMES, March 10, 1967, at 39; *Hoblitzelle of Interstate Dies at 87*, VARIETY, March 15, 1967, at 4.

¹⁵⁷ *Interstate Circuit* (district court), 20 F.Supp. at 875.

¹⁵⁸ See Jane Lenz Elder, *Karl Hoblitzelle and the Inauguration of Interstate Theaters*, HIST. J. DALLAS & N. CENTRAL TEXAS 4 (fall 1994).

¹⁵⁹ Elder, *id.*; ROGERS, *supra* note 156, at 221-28; *Hoblitzelle Outstanding Figure in History of the Theater in Texas*, WICHITA DAILY TIMES, Aug. 19, 1941, at 8.

¹⁶⁰ See *Biography of R.J. O’Donnell*, BRECKENRIDGE AM., Aug. 2, 1941, at 4; *Karl Hoblitzelle Creates Bob O’Donnell Award*, BOXOFFICE, Apr. 12, 1962, at 15; Gene Arneel, *Death of a Many-Splendored Showman*, VARIETY, Nov. 18, 1959, at 17.

seven upscale theaters in Texas, Alabama, and Arkansas.¹⁶¹ In May 1930, Hoblitzelle sold his exhibition business to RKO, one of five majors, and retired.¹⁶² Under the terms of the transaction, RKO bought Interstate Circuit as an operating business and leased the theaters from Hoblitzelle. RKO, however, did not maintain the management team. Hoblitzelle retired and O'Donnell moved to Publix, Paramount's exhibition arm.¹⁶³

In early 1933, three of the large majors—Paramount, RKO, and Twentieth Century-Fox—threw their theaters into bankruptcy to restructure their debt and advance decentralization plans.¹⁶⁴ Hoblitzelle returned from retirement, agreed to relieve RKO of certain liabilities under the lease agreements, and take control of three theaters in Texas that he sold three years earlier.¹⁶⁵ With the return of Hoblitzelle, O'Donnell moved back to Interstate Circuit.¹⁶⁶ Together, Hoblitzelle and O'Donnell turned the business around and reported profits within a few months.¹⁶⁷

Publix, Paramount's exhibition arm, operated in Texas about 90 theaters, which were previously owned by two local chains, Southern Enterprises and Dent. Southern Enterprises had about 20 theaters in major cities and Dent had about 70 theaters in smaller cities in Texas and a few in Albuquerque, New Mexico. After Hoblitzelle return to business in 1933, Paramount began negotiating with him a partnership to set up a new Interstate Circuit company that would operate Hoblitzelle's and Southern Enterprises' theaters.¹⁶⁸ The partnership expanded to include Dent theaters in a sister chain, Texas Consolidated Theaters, Inc.¹⁶⁹ Before the deal was finalized, the trade press described Hoblitzelle as “generalissimo of Interstate Circuit, Inc. and Consolidated Theaters, Inc.”¹⁷⁰ The successful recovery of the theaters allowed Hoblitzelle to acquire and build additional theaters and strengthen his positioning in Texas. In December 1933, Terry Ramsay, an influential film scholar and reporter, described the transformation of the exhibition business in Texas:

¹⁶¹ *Interstate May Go to RKO*, BILLBOARD, May 17, 1930, at 9.

¹⁶² *Interstate Chain Bought by RKO*, BILLBOARD, May 17, 1930, at 1. *Karl Hoblitzelle Retires*, BILLBOARD, Feb. 28, 1931, at 29.

¹⁶³ See *O'Donnell of Interstate With Publix Home Office*, VARIETY, Oct. 2, 1929, at 28; *Publix Transfers Walsh; O'Donnell Steps Up*, VARIETY, June 4, 1930, at 33; *O'Donnell Elevated to Important Post in Publix House Chain Staff*, VARIETY, Jan. 30, 1931, at 7; *O'Donnell Takes Over All South for Publix*, VARIETY, Aug. 30, 1932, at 7.

¹⁶⁴ *Theatre Receiverships*, VARIETY, Jan. 31, 1933, at 5; *Receiverships for P-P, RKO*, BILLBOARD, Feb. 4, 1933, at 1.

¹⁶⁵ See *RKO's Grief, Houses Stick*, BILLBOARD, Dec. 31, 1932, at 12; *Interstate Back to Hoblitzelle*, BILLBOARD, Jan. 7, 1933, at 7; *RKO to Turn Back 3 to Hoblitzelle*, VARIETY, March 21, 1933, at 25.

¹⁶⁶ *Hoblitzell's Circuit Plans*, BILLBOARD, Apr. 1, 1933, at 7.

¹⁶⁷ *Interstate Circuit Shaping Up Well*, BILLBOARD, May 6, 1933, at 6; *Interstate Units Jump Grosses 300%*, VARIETY, Jan. 6, 1934, at 49. See also *Dropping Early Bird Matinees*, VARIETY, Apr. 18, 1933, at 39 (describing Hoblitzelle's campaign professional men back to the theaters and increase admission prices).

¹⁶⁸ *South Theatre Deal in Sight*, VARIETY, Feb. 7, 1933, at 31.

¹⁶⁹ Dent theaters were decentralized in 1932, but the deal collapsed when the local partner died in a car accident. See *Paschall's 50-50 Pulix-Dent Deal May Chop Losses*, VARIETY, July 5, 1932, at 4 (reporting that Dent theaters were losing \$6,000 a week under Publix management); *Par's Texas Houses to Hoblitzelle and O'Donnell Gives 'Em 80 Spots*, VARIETY, Aug. 1, 1933, at 31.

¹⁷⁰ *Decentralization Is Hoblitzelle's Theme at Dallas*, BILLBOARD, Jan. 20, 1934, at 19.

As all the motion picture world knows, there was the typical chain theatre invasion of Texas along with the wave of distributor ownership of theatres that swept the nation. Now what we have euphemistically called “decentralization” . . . has largely turned the amusement business of Texas back to Texas.

Conspicuous in the Texas scene stands . . . Karl Hoblitzelle . . . and at his right hand, R. J. O'Donnell. . . . A while back Mr. Hoblitzelle sold his theatres . . . to RKO. . . . Now [Hoblitzelle and O'Donnell] are busy sorting out the fruits of “decentralization” and the turn-back into two divisions, both of them Hoblitzelle organizations under a single management. . . . This means a total of some ninety-six houses. . . . Mr. Hoblitzelle is very much a home-ruler for the amusement business in Texas.¹⁷¹

Finalized in April 1934, the partnership positioned Hoblitzelle as one of the nation's largest affiliated exhibitors with a chain of almost 100 theaters. The Paramount-Hoblitzelle partnership agreement was relatively complex for decentralization plans.¹⁷² The parties formed a holding company, Interstate Circuit, Inc. (“IC”) that held several subsidiaries, including two newly formed corporations: Texas Consolidated Theatres, Inc. (“TC”) and Interstate Circuit Theatre Operating Corporation (“ICTO”).¹⁷³ Paramount transferred to IC the ownership of Southern Enterprises theaters and assigned the leases of chain's theaters to ICTO. This allowed to Hoblitzelle to renegotiate the leases and reduce costs. Hoblitzelle transferred to IC his three theaters. Additionally, Paramount transferred the ownership of Dent theaters to TC. As a result, the partnership agreement formed a theater operating business: A holding company (IC) operated two theaters chains, one also known as “Interstate Circuit” although legally organized through a subsidiary and the other was Texas Consolidated. IC issued equal number of two classes of stocks that gave each party 50% in profits: Class A stocks, which were held by Hoblitzelle and his associates, and Class B stocks, which were held by Paramount. Class B stocks were preferred and gave Paramount a buyback option to acquire Class A stocks. Each party had two seats on the board. Hoblitzelle committed to operate the theaters for salary and committed to pay Paramount \$1,500,000 in 20 years.¹⁷⁴ By the time the partnership agreement was approved by the bankruptcy trustees and executed, Hoblitzelle and O'Donnell “managed to achieve more than \$1,000,000 savings in the operation of the theaters” and Paramount considered “the improvement . . . as the best comparative score achieved by any of its partners.”¹⁷⁵ In January 1936, Paramount announced that it would relinquish its stock buyback option and, instead, formalized a permanent partnership agreement with Hoblitzelle.¹⁷⁶ By that time, IC was “one of the largest and most important of

¹⁷¹ Terry Ramsay, *Texas Rolls Her Own; That Goes in the Theatre Too, Says Ramsay*, MOTION PICTURE HERALD, Dec. 23, 1933, at 11.

¹⁷² *Balban-Trendle Status Quo*, VARIETY, Oct. 10, 1933, at 4.

¹⁷³ *Incorporations*, VARIETY, Sept. 25, 1934, at 31; *Windup of RKO-Par's Bankruptcy and Rcvship in Southern Houses*, VARIETY, May 1, 1934, at 4; *Reorg. of Par. Theatre Links Soon*, VARIETY, March 27, 1934, at 6; *Balban-Trendle Status Quo*, *id.*

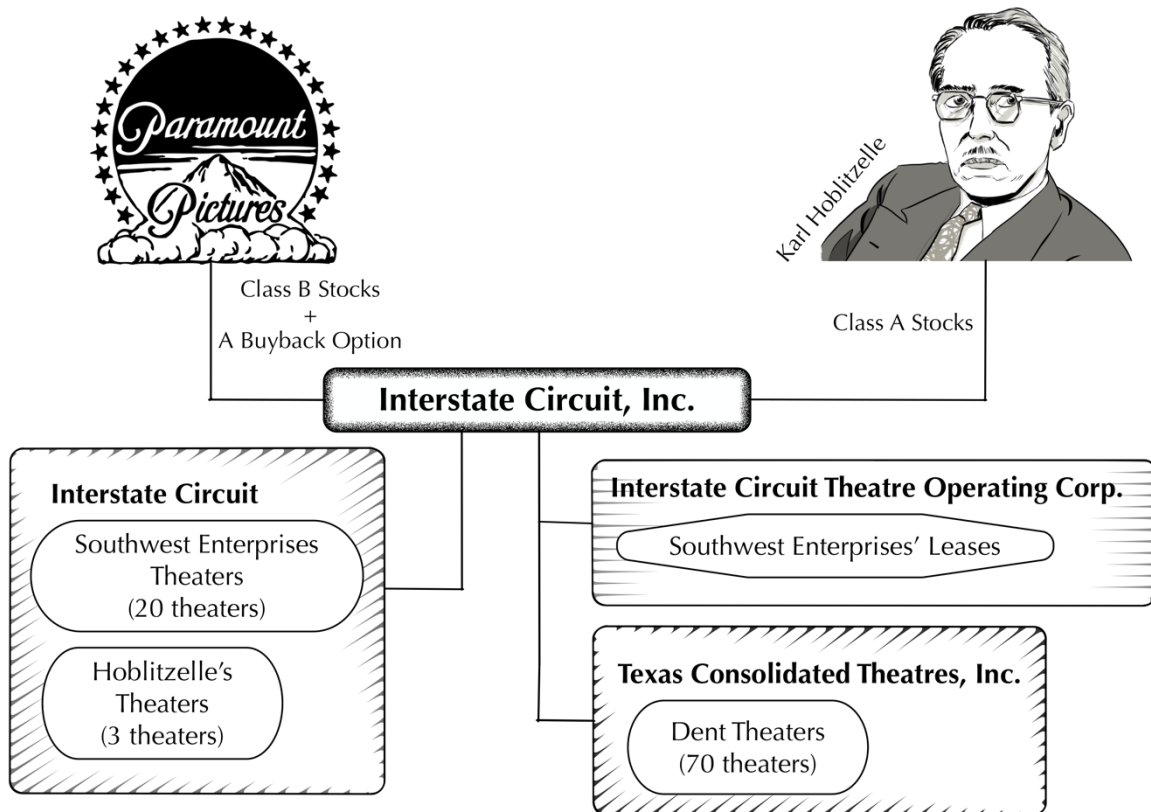
¹⁷⁴ *Reorg. of Par. Theatre Links Soon*, *id.*

¹⁷⁵ *Windup of RKO-Par's Bankruptcy and Rcvship in Southern Houses*, *supra* note 173.

¹⁷⁶ *See Partner Stays*, MOTION PICTURE HERALD, Jan. 4, 1936, at 9; *Paramount, Hoblitzelle in New Pact*, MOTION PICTURE DAILY, Dec. 11, 1936, at 1; *Hoblitzelle to Pay Para. \$600,000 to Kill Buy Back*, MOTION PICTURE DAILY, Dec. 16, 1936, at 1; *Par Drops Buy-Back Right*, VARIETY, Dec. 16, 1936, at 7.

Paramount theatre units.”¹⁷⁷

Interstate Circuit, Inc.: The Hoblitzelle-Paramount Partnership (April 1934)



Thus, when the events leading to *Interstate Circuit* took place, Paramount held 50% of the equity of IC and TC with an option to acquire the other 50%. When the government filed its complaint in December 1936, Interstate Circuit operated 109 theaters. IC operated 43 first- and subsequent-run theaters in Texas' six largest cities (Austin, Dallas, Fort Worth, Galveston, Houston, and San Antonio). In these cities, IC operated all first-run theaters, with the exception of one first-run theater in Houston that was operated by another affiliated exhibitor. In Galveston, IC operated all theaters, with no competition from other exhibitors. TC operated 66 theaters. 60 theaters in 21 towns in Texas, where IC did not operate. In five of these towns, TC operated the first-run theaters. Additionally, TC operated 6 first- and subsequent run theaters in Albuquerque, New Mexico.

B. Integration With Paramount

Hoblitzelle's partnership with Paramount was organic, not limited to Paramount's ownership of equity in IC. While the partnership agreement was still negotiated, Hoblitzelle joined Paramount's leadership team. In January 1934, Paramount announced that it would form a

¹⁷⁷ *Hoblitzelle's Deal Extended to Year's End*, MOTION PICTURE DAILY, Nov. 20, 1935, at 1.

“National Theater Advisory Committee” to support the operation of its decentralized theaters.¹⁷⁸ Hoblitzelle was one of the six Committee members,¹⁷⁹ who headed large regional chains. Paramount set up the Committee “for the purposes of exchanging information, confirming policies and maintaining closer contact between Paramount theater partners and associates and the home office.”¹⁸⁰ Specifically, consistent with the logic of decentralization, Paramount declared that the Committee members would be “in constant communication with one another and with the home office.”¹⁸¹ In December 1934, Hoblitzelle was also appointed to the board of directors of Paramount.¹⁸²

In February 1934, after NIRA’s Motion Picture Code was signed, the Code Authority appointed “Clearance and Zoning Boards” and Grievance Boards” in major cities. Hoblitzelle and O’Donnell were appointed to these boards for their relationships with Paramount.¹⁸³ Hoblitzelle represented affiliated exhibitors on the Grievance Board in Texas and O’Donnell represented affiliated first-run exhibitors on the Board of Clearance and Zoning in Texas.¹⁸⁴ Further, as “partners,” Hoblitzelle and O’Donnell participated in corporate events of Paramount. For example, in June 1934, they participated in Paramount’s International Sales Convention, which focused on self-censorship and the problem of double features.¹⁸⁵

Thus, in 1934, during the events leading to *Interstate Circuit*, IC was an important subsidiary of Paramount though not operated by employees. IC’s top managers, Hoblitzelle and O’Donnell, had direct relationships with Paramount people. Hoblitzelle held a senior position at Paramount intending to maintain communication between affiliated exhibitors and Paramount management.

IV. THE CONSPIRACY

In the spring of 1934, as the industry was preparing to negotiate the 1934-35 season, Hoblitzelle emerged as one of the largest exhibitors in the United States, affiliated with the largest and most influential distributor. Together with O’Donnell, Hoblitzelle formulated a deal that

¹⁷⁸ *Nat’l Theater Advisory Board Is Being Formed By Paramount*, FILM DAILY, Jan. 12, 1934, at 1.

¹⁷⁹ *Hoblitzelle Is Named for Post at Para.*, MOTION PICTURE DAILY, Jan. 24, 1934, at 1; *Advisory Group to Contact Operating Partners of Publix*, MOTION PICTURE HERALD, Jan. 27, 1934, at 11 (“Karl Hoblitzelle, Paramount partner [in] Dallas, was selected by all company’s operating partners in the Southwest as their representative on the committee”).

¹⁸⁰ *Paramount Sets Up National Theater Advisory Committee*, BILLBOARD, Jan. 20, 1934, at 20. *See also Schaefer Virtually Paramount Head*, MOTION PICTURE HERALD, May 12, 1934, at 11 (“Th[e] national advisory committee is designed to serve as the intermediary between the home office and Paramount’s theatre operating partners in the field, and will be comprised of six operating partners, elected by the partners in the six principal territories of the company’s theatre operations.”)

¹⁸¹ *Paramount Sets Up National Theater Advisory Committee*, *Id.* *See also Zukor Appoints Barney Balaban, N.L. Nelson and E.V. Richards as Executive Committee for Par*, VARIETY, July 31, 1934, at 5 (describing the work of the Committee and the appointment of its first members).

¹⁸² *Set 9 on New Par Board*, VARIETY, Dec. 4, 1934, at 5.

¹⁸³ *Names of Local Board Members Approved by the Code Authority*, MOTION PICTURE HERALD, Feb. 24, 1934, at 10.

¹⁸⁴ *Who? What? When?*, MOTION PICTURE DAILY, Feb. 23, 1934, at 1, 6.

¹⁸⁵ *Theatre Group to Join Para. Sales Session*, MOTION PICTURE DAILY, June 12, 1934, at 3; *Par Confabists Promise Clean Pix, but No Curb for Dual Bills*, VARIETY, June 26, 1934, at 4.

resolved a problem for the industry: the affiliated exhibitors sought to protect admission prices, while the distributors were interested in eliminating double features.¹⁸⁶ Inspired by the success of the arrangement, MPTOA, the trade association of the affiliated exhibitors, recommended this formula to its members.

A. *Rising Tensions Toward the 1934-35 Season*

When block booking governed movie distribution, the industry negotiated annual deals every summer. The negotiations for the seasons of 1933-34 and 1934-35 were delayed because of the reorganization of the chains and complications caused by NIRA. The tensions in the industry between the vertically integrated and independent firms were high, because of disillusioned expectations that the Motion Picture Code and decentralization would empower independent companies. As explained, the integrated firms were concerned that low admission prices and the offering of double features were harming their interests.¹⁸⁷ By contrast, the independent firms complained that the vertically integrated firms used the Motion Picture Code to exclude competition.¹⁸⁸ There was considerable uncertainty about the scope of the suspension of the antitrust laws. For example, in early April 1934, *Motion Picture Daily* wrote:

Some current speculation centers on whether or not concerted action by distributors on including minimum admission clauses in new season contracts would be permitted under the National Recovery Administration Act under those provisions relaxing antitrust laws. . . . The industry code, itself, neither prohibits nor authorizes the inclusion of minimum admission clauses in contracts. Some viewpoints hold that distributor action might be approved on the ground that the maintenance of . . . minimum admission benefitted the entire industry and in doing so aided it in meeting increased costs under NRA.

If concerted action is prohibited, . . . distributors will have several avenues open to them for individual action. One . . . is the addition of a . . . minimum admission clause to the standard contract form. [Another is] urging all exhibitors in single territories to agree among themselves to maintain [the designated admission price].¹⁸⁹

The doubts were not unique to the motion picture industry. Agreements among competitors targeting price cutters were common in many industries during the Great Depression. These agreements left Courts grappling with the tension between NIRA and the antitrust's ban on price

¹⁸⁶ Correspondingly, the defeat in *Interstate Circuit* created concerns among the distributors about their ability to fight double features. See *Home-Offices Fear Dallas Setback May Open Way for More Duals*, VARIETY, Sept. 29, 1937, at 6.

¹⁸⁷ See, e.g., *Schaeffer Says Theatres Must Be Stabilized*, MOTION PICTURE DAILY, May 1, 1934, at 1 (summarizing comments of George Schaeffer, Paramount general sale manager); *MPTO and Allied Sponsor Protest Sessions Against Sales Policies*, MOTION PICTURE HERALD, May 5, 1934, at 9.

¹⁸⁸ See, e.g., *Oppression of "Little Man" Under Code Charged at Darrow Hearing*, MOTION PICTURE HERALD, Apr. 7, 1934, at 43 (discussing a hearing before the National Recovery Review Board headed by Clarence Darrow); *Indies Call the Code Unjust*, BILLBOARD, Apr. 7, 1934, at 18 (same).

¹⁸⁹ *Discussion Renewed on 20¢ Minimum Admissions*, MOTION PICTURE DAILY, Apr. 2, 1934, at 1.

fixing.¹⁹⁰

Thus, in April 1934, toward the negotiations of the 1934-35 season, MPTOA and the large distributors began negotiating industrywide contractual restrictions on double features and minimum admission prices.¹⁹¹ The discussions quickly focused on double features and concluded in late June 1934,¹⁹² when the “distributors declared that they were unwilling to incorporate a ban on double featuring in their contracts unless all distributors did the same.”¹⁹³ Specifically, “[f]ear of losing sales to competitors not enforcing a double featuring ban in some territories was given as the reason for the distributors’ unwillingness to take the action.”¹⁹⁴ *Variety* described the effort as “[t]he industry’s heaviest offensive against double features.”¹⁹⁵ The trade press also reported that the independent firms prepared to fight contractual bans on double features, “charging the [large] distributors with coercion in restraint of trade.”¹⁹⁶

B. The Negotiations

1. The Letters

In April 1934, Hoblitzelle and O’Donnell finalized a partnership agreement with Paramount. Interstate Circuit’s first-run theaters generated for the distributors 70% of the revenues in the cities in which the company operated theaters.¹⁹⁷ IC operated Interstate Circuit’s most profitable theaters: Class A theaters in Texas’ six largest cities. The admission price in these theaters were 40¢ or more. Admission prices in IC’s other theaters were at least 25¢.¹⁹⁸ The admission prices at independent subsequent theaters in these cities were considerably lower, in the range of 15¢ to 20¢,¹⁹⁹ and in some it was as low as 10¢.

¹⁹⁰ See, e.g., *Cleaners' & Dyers' Bd. of Trade v. Spotless Dollar Cleaners*, 270 N.Y.S. 153 (Sup. Ct. 1934) (holding that the price fixing standards were unreasonable); *United States v. Spotless Dollar Cleaners*, 6 F. Supp. 725 (S.D.N.Y. 1934) (upholding a conviction of a price cutter). See also *Nebbia v. People of New York*, 291 U.S. 502 (1934) (criticizing the regulation of milk prices and repudiating the “affected with public interest” doctrine).

¹⁹¹ See *Discussion on 20¢ Minimum Admissions*, MOTION PICTURE DAILY, Apr. 2, 1934, at 1; Red Kann, *Chance Seen in Contracts to Kill Duals*, MOTION PICTURE DAILY, Apr. 19, 1934, at 1; *MPTOA Moves Against Duals to Start Soon*, MOTION PICTURE DAILY, May 1, 1934, at 1; *Majors Settling Dual Policy Now*, MOTION PICTURE DAILY, May 4, 1934, at 1; *Several Distributors May Bar Double Bills*, MOTION PICTURE HERALD, June 2, 1934, at 12; *‘Restricted’ Anti-Duals*, VARIETY, June 5, 1934, at 25.

¹⁹² See *Major Pacts Not to Have Ban on Duals*, MOTION PICTURE DAILY, June 15, 1934, at 1; *No General Ban on Double Bills*, MOTION PICTURE HERALD, June 23, 1934, at 74.

¹⁹³ *Major Pacts Not to Have Ban on Duals*, id., at 22.

¹⁹⁴ *Id.*

¹⁹⁵ *‘Restricted’ Anti-Duals*, *supra* note 191.

¹⁹⁶ *Double Bill User May Appeal to Government*, MOTION PICTURE HERALD, May 12, 1934, at 9.

¹⁹⁷ For the season of 1934-35, IC and TC paid about 80% of the licensing fees the distributors collected in cities in which they operated. The lion share of the fees 70% of the distributors’ collections were for first run-shows exhibited by IC and TC. *Interstate Circuit*, 306 U.S. at 215.

¹⁹⁸ *United States v. Interstate Circuits*, Agreed Statement of Facts ¶ 7 (Dec. 11, 1937) (hereinafter: “Agreed Statement of Facts”).

¹⁹⁹ *United States v. Interstate Circuit, Inc.*, In Equity No. 3736-992 ¶ 23 (May 17, 1938) (Special Findings of Fact and Conclusions of Law) (Hereinafter: “Findings of Facts”); *United States v. Interstate Circuit, Inc.*, In Equity No.

In late April 1934, O'Donnell sent an identical letter to the eight large distributors, declaring a new policy toward the negotiations for the 1934-35 season: For IC's Class A theaters, Interstate Circuit would purchase films, only if those would never play at any theater for an admission price lower than 25¢.²⁰⁰ The stated policy had no practical effect for Galveston, where IC owned all theaters and thus set their admission prices.

The distributors' local branch managers had no authority to approve the demands and forwarded O'Donnell's letters to the home offices in New York.²⁰¹ As one of the branch manager testified: "I never made a deal with O'Donnell without an official [from] the home office if the deal amounted to anything."²⁰² The government produced evidence showing that at least three branch managers expressed in writing strong objections to the plan.²⁰³

O'Donnell apparently did not receive any reaction to the April letter from any distributor other than Paramount.²⁰⁴ Three days after sending the April letter, Hoblitzelle and O'Donnell started negotiating their proposal with Paramount executives.²⁰⁵ The discussions with Paramount continued through the company's sales convention in late June.²⁰⁶ One of the convention's topics was double features.²⁰⁷ At the convention, O'Donnell assured Paramount executives that the proposal would include a ban on double features.²⁰⁸ After reaching to an agreement with Paramount, O'Donnell sent a second letter in early July. At trial, Paramount branch manager explained the spirit of the negotiations:

[Paramount] is interested in these two exhibitors companies [Interstate Circuit and Consolidated Theatres]. It is true that anything that works for the benefit of Intestate in Texas, works to the benefit of Paramount, and it is correct that when I say negotiating with Mr. O'Donnell and Mr. Hoblitzelle . . . , I was really negotiating with our partners.²⁰⁹

3736-992 10 (N.D. Tex. Dec. 11, 1937) (Testimony of H. A. Cole's Testimony, President of the Allied Theatre Owners of Texas) (hereinafter: "Cole's Testimony").

²⁰⁰ See Appendix A.

²⁰¹ *Findings of Facts*, *supra* note 199, ¶ 15.

²⁰² United States v. Interstate Circuit, Inc., In Equity No. 3736-992 6 (N.D. Tex. Dec. 20, 1937) (Testimony of Doak Roberts, United Artists Branch Manager in Dallas, Testimony) (hereinafter: "Roberts' Testimony").

²⁰³ *Findings of Facts*, *supra* note 199, ¶ 15; *Interstate Circuit (district court)*, 20 F.Supp. at 873.

²⁰⁴ United States v. Interstate Circuit, Inc., In Equity No. 3736-992 102-103 (N.D. Tex. Dec. 20, 1937) (Testimony of R.J. O'Donnell) (hereinafter: "O'Donnell's Testimony").

²⁰⁵ *Id.* at 100-102.

²⁰⁶ United States v. Interstate Circuit, Inc., In Equity No. 3736-992 94-95 (N.D. Tex. Dec. 20, 1937) (Testimony of Karl Hoblitzelle) (hereinafter: "Hoblitzelle's Testimony"); *O'Donnell's Testimony*, *supra* note 204, at 101. At the convention, Hoblitzelle and O'Donnell discussed the restrictions with George Schaeffer, who at the time effectively headed Paramount. *Schaeffer Virtually Paramount Head*, MOTION PICTURE HERALD, May 12, 1934, at 11.

²⁰⁷ See *supra* note 185 and accompanying text.

²⁰⁸ *O'Donnell's Testimony*, *supra* note 204, at 102 (stating that in response to a question of Paramount executives O'Donnell promised the inclusion of double billing in the proposal).

²⁰⁹ United States v. Interstate Circuit, Inc., In Equity No. 3736-992 4, 129, 130 (N.D. Tex. Dec. 11, 1937) (Testimony of J.B. Dugger, Paramount branch manager in Dallas) (hereinafter: "Dugger's Testimony"). Both Hoblitzelle and O'Donnell stated that they discussed the restrictions with senior Paramount executives at the

The July letter, or at least the existing records of the letter, lists the names of eight individuals, who in 1934 were employees of seven distributors.²¹⁰ The trial record, however, indicates that all distributors got copies of the letter and that the distributors' branch managers and executives believed that the letter was sent to "all distributors."²¹¹ The letter improved the policy announced by the April letter: Interstate Circuit added a ban on double features for all movies to which the restriction on minimum admission price applied and committed that the Hoblitzelle's theaters would comply with both restrictions.²¹² Stated simply, the July letter offered the distributors a deal: a ban on double features in all Class A theaters in Texas' six largest cities in exchange for a restriction on a minimum admission prices in subsequent theaters in these cities.

The ban on double feature was a concession that Interstate Circuit was willing to make. Hoblitzelle's theaters were offering double features, but used the practice less heavily than independent exhibitors. The July letter also included a firm threat: Interstate Circuit would not to negotiate with any distributor who was unwilling to comply with the policy.²¹³ The July letter concluded with a demand to impose the 25¢ price restriction in the Rio Grande Valley, where TC operated theaters.

The July letter inspired the traditional account of *Interstate Circuit*. It reflects an agreement between Interstate Circuit and its parent company, Paramount. The agreement resolved concerns of two related groups in the industry—the large distributors and their affiliated exhibitors—by protecting the distributors with a ban on double features and serving the affiliated exhibitors with a restriction on minimum admission prices.

2. *Negotiations With Paramount's Rivals*

The branch managers also expressed objections when they transmitted copies of the July letter to their home offices. For example, RKO district sales manager wrote to the home office that O'Donnell July letter "was sent to all distributors" and was "trying to set up a model arrangement for the United States without giving us anything to say about it."²¹⁴ Similarly, MGM branch manager wrote to his company's home office that O'Donnell was "imposing conditions of which he [was] a flagrant violator" and that O'Donnell's demands were "unfair" because Hoblitzelle's theaters offered double features (MGM started banning double features in the 1933-34 season).²¹⁵ Universal branch manager described Hoblitzelle and O'Donnell as "tough," expressed the view

Paramount's International Sales Convention of June 1934. *Hoblitzelle Testimony*, *supra* note **Error! Bookmark not defined.**, at 94-95, 98; *O'Donnell's Testimony*, *supra* note 204, at 101.

²¹⁰ The letter lists the name of seven branch managers and the name of the district sales manager. It does not list any individual who, in 1934, worked for Warner Bros. (or its distribution company, Vitagraph).

²¹¹ See, e.g., Agreed Statement of Facts, *supra* note 198, at ¶ 11 (listing nine individuals to whom the letter was sent, including W. E. Callaway, Warner Brothers' branch manager in Dallas); *United States v. Interstate Circuit, Inc.*, In Equity No. 3736-992 78 (N.D. Tex. Dec. 20, 1937) (Testimony of Herbert MacIntyre, RKO southern district sales manager) (Hereinafter: "MacIntyre's Testimony") (discussing the receipt of O'Donnell July letter).

²¹² See Appendix A.

²¹³ *Id.* ("In the event that a distributor sees fit to sell his product to subsequent runs in violation of this request, it definitely means that we cannot negotiate for his product to be exhibited in our 'A' theatres at top admission prices.")

²¹⁴ *MacIntyre's Testimony*, *supra* note 211, at 79.

²¹⁵ *United States v. Interstate Circuit, Inc.*, In Equity No. 3736-992 5, 74, 74 (N.D. Tex. Dec. 11, 1937) (Testimony of Le Roy Bickle's Testimony, MGM branch manager in Dallas) (hereinafter: "Bickle's Testimony").

that their demands were “extremely dangerous,” and recommended to reject them.²¹⁶ The distributors tried to exclude the letters from the evidence.²¹⁷

Immediately after sending the July letter, O'Donnell and Hoblitzelle commenced direct negotiations with the distributors. These negotiations continued until October, mostly took place at Interstate Circuit's offices but also involved several trips,²¹⁸ and included discussions with executives of the distributors that the branch managers attended.²¹⁹ For the distributors, the appeal of the proposal was Interstate Circuit's willingness to commit to cease offering double-features. For example, after sending the July letter, O'Donnell first negotiated with Warner Bros. that had already banned double features and “constantly protested” because Hoblitzelle and O'Donnell violated the restriction.²²⁰ The willingness to ban double features at Hoblitzelle theaters made Warner executives very “receptive” to the idea.²²¹ Similarly, an MGM executive wrote to O'Donnell: “My first reaction is that people living in glass houses should not throw any stones [referring to the use of double features]. Will you subscribe to it 100% in all your situations?”²²² The question was discussed during the negotiations with MGM. Like Warner Bros., MGM failed to enforce a ban on double feature. O'Donnell persuaded the Warner Bros. to enter into a “deal.”

At least one of the smaller distributors, Universal, used the negotiations to improve access to Class A theaters.²²³ In exchange for accepting the proposal, Universal demanded that IC would show more of its films in Class A theaters (namely, first run shows that charged admission price of 40¢ or more). O'Donnell committed that they would play at least eight Universal movies a year.

At trial, Hoblitzelle and O'Donnell emphasized that they negotiated the restrictions with each company separately and that they did not threaten any distributor.²²⁴ They also denied any knowledge of direct communication among the distributors.²²⁵ The representatives of the distributors confirmed in their testimonies that Hoblitzelle and O'Donnell negotiated with each company separately. Nonetheless, the record shows that the companies were mindful of the fact that both letters were sent to “all distributors” and that each company knew that Hoblitzelle and O'Donnell were negotiating with the other companies as well. For example, the MGM executive who wrote to O'Donnell, sent a copy of the letter to the company's local representative in Dallas noting that the company's approach to O'Donnell letter that was “addressed to all Distributors” was “self-explanatory.”²²⁶ Additionally, the branch managers saw each other daily and had “shop

²¹⁶ *United States v. Interstate Circuit, Inc., In Equity No. 3736-992* 9, 71, 72 (N.D. Tex. Dec. 11, 1937) (Testimony of E. S. Oldsmith's Testimony, Universal branch manager in Dallas) (hereinafter: “Oldsmith's Testimony”).

²¹⁷ *Distributors' Letters Go in Dallas Trial*, MOTION PICTURE DAILY, Sept. 23, 1937, at 1.

²¹⁸ *O'Donnell's Testimony*, *supra* note 204, at 123-123a.

²¹⁹ *Id.*, at 100-109.

²²⁰ *Id.* at 103.

²²¹ *Id.*

²²² *Bickle's Testimony*, *supra* note 215, at 75.

²²³ *O'Donnell's Testimony*, *supra* note 204, at 105-106 (discussing the negotiations with Universal).

²²⁴ *Hoblitzelle's Testimony*, *supra* note 206, at 90; *O'Donnell's Testimony*, *supra* note 204, at 109.

²²⁵ *Hoblitzelle's Testimony*, *id.*, at 94.

²²⁶ *Bickle's Testimony*, *supra* note 215, at 75.

talk” about the issue in “casual conversations.”²²⁷ The trial court, thus, pointed out that the “positions were well known . . . to all of the agents.”²²⁸

The negotiations concluded with changes in distribution agreements in four cities: Dallas, Fort Worth, Houston, and San Antonio. In Galveston, IC owned all theaters and there was no need to change the distribution agreements. In Houston, Warner Bros. owned a first-run theater and chose not to participate in the arrangement in that city. Paramount also adopted the restrictions in the Rio Grande Valley. The distributors, therefore, generally complied with the demands related to IC.

C. Private Lawsuits and Hoblitzelle’s Rider

In November 1934, an independent exhibitor, Robert Glass, filed a class action lawsuit against Interstate Circuit and the distributors, arguing that their actions violated Section 1 of the Sherman Act.²²⁹ Additionally, Glass argued that Hoblitzelle and O’Donnell controlled the local NIRA institutions and abused that control.²³⁰ The lawsuit was filed in a state court and was dismissed. Both the trial and appeal court concluded that only NIRA tribunals had the jurisdiction over the claims made by the plaintiffs.²³¹ The court of appeals also declared that motion picture distribution agreements were outside the scope of the antitrust laws because movies were copyrighted.²³² At trial, Hoblitzelle did not deny the allegations, but argued that his actions would benefit the independent exhibitors.²³³

The industry emphasized the significance of *Glass* as an important victory.²³⁴ There were other conspiracy cases in which independent exhibitors won. For example, in a case brought by independent exhibitors from Philadelphia, a federal court held that the large distributors conspired to exclude competition by using their contracts to bans double features.²³⁵

In May 1935, shortly after the *Glass* appeal was decided, the Supreme Court held that NIRA

²²⁷ *Dugger’s Testimony*, *supra* note 209, at 131.

²²⁸ *Interstate Circuit* (district court), 20 F.Supp. at 873.

²²⁹ *Price Fixing Issue Up in Texas Court*, MOTION PICTURE DAILY, Nov. 15, 1934, at 1; *Exhibitor Names Texas Circuit in Restraint Action*, MOTION PICTURE HERALD, Dec. 8, 1934, at 24. Glass was among the leaders of the trade association of the independent exhibitors in Texas. *United States v. Interstate Circuit, Inc.*, In Equity No. 3736-992 64, 67-68 (N.D. Tex. Dec. 11, 1937) (Testimony of Robert Z. Glass).

²³⁰ *Exhibitor Names Texas Circuit in Restraint Action*, *id.*

²³¹ *Glass v. Hoblitzelle*, 83 S.W.2d 796 (Civ. App. Tex. 1935). *See also Two-Bit Minimum Stands in Dallas*, BILLBOARD, Dec. 22, 1934, at 19; *Rule Texas Laws Cannot Apply to Film Contracts*, MOTION PICTURE DAILY, May 10, 1935, at 1. *Glass Loses Suit Against Hoblitzelle*, MOTION PICTURE HERALD, Dec. 15, 1934, at 39.

²³² *Glass*, 83 S.W.2d at 797-799.

²³³ *Hoblitzelle Testifies in Price-Fixing Suit*, MOTION PICTURE DAILY, Dec. 7, 1934, at 10.

²³⁴ *See Rule Texas Laws Cannot Apply to Film Contracts*, *supra* note 231.

²³⁵ *Perelman v. Warner Bros Pictures*, 9 F.Supp. 729 (E.D.Pa. 1935), *aff’d*, *Vitagraph, Inc. v. Perelman*, 95 F.2d 142 (3d. Cir. 1936). *See also Philadelphia Contract Dual Bans Enjoined*, MOTION PICTURE DAILY, Feb. 1, 1935, at 1; *Producers Are Guilty of Conspiracy*, FILM BULL., Feb. 5, 1935, at 3; *Philly Indies Bubbling Over Because of Anti-Duals Decision*, VARIETY, Feb. 5, 1935, at 21; *U.S. Court Holds Double Bill Restriction in Contract Illegal*, MOTION PICTURE HERALD, Feb. 9, 1935, at 27.

was unconstitutional.²³⁶ The industry considered the possibility of adopting a “voluntary code,”²³⁷ but “[a]ntitrust laws and decisions in film cases” appeared as “formidable obstacles to any new code basis.”²³⁸ Instead, the large distributors and the trade association of the affiliated exhibitors considered adopting a “model agreement.”²³⁹ Inspired by Hoblitzelle’s model and legal success, the trade association of the affiliated exhibitors developed a standard “rider” as a recommended approach for its members.²⁴⁰ The proposal was printed in the association’s bulletin emphasizing that Hoblitzelle won in court and explaining the that the rider’s purpose was:

To protect the so-called deluxe operations in competitive spots, and to prevent the cheapening and demoralizing of the business in such competitive areas, . . . we suggest the use of a provision in the license agreements by exhibitors operating Class “A” theatres.²⁴¹

The “ranking executives of major distribution companies” stated to the trade press that they “would be willing to make use of the rider” “[o]nly in local situations which exhibitors themselves agreed in advance by majority action to restrict the trade practices which the rider seeks to control” or in “so-called closed towns, where exhibition is dominated by one theatre organization.”²⁴² “[S]ales executives” of the large distributors were “convinced that any general use of the rider would be illegal.”²⁴³

By October 1936, “cut-rate admissions, including the use of double features and giveaways, [were] curbed in approximately 50 cities [for] the use . . . of a [Hoblitzelle’s] contract rider” by first-run theaters.²⁴⁴

²³⁶ A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935).

²³⁷ See, e.g., *Sales Heads for Keeping Present Code Contracts*, MOTION PICTURE DAILY, May 31, 1935, at 1; Clarence Linz, *Voluntary Use of Codes Seen As a Stop Gap*, MOTION PICTURE DAILY, May 31, 1935, at 1; *Move Studied for Voluntary Industry Code*, MOTION PICTURE DAILY, June 4, 1935, at 1; Red Kann, *Voluntary Code Delayed By Trade’s Legal Doubts*, MOTION PICTURE DAILY, June 12, 1935, at 1; *Slight Chance for Code Seen By Kuykendall*, MOTION PICTURE DAILY, June 20, 1935, at 1; *Voluntary Code Drafted*, MOTION PICTURE HERALD, July 6, 1935, at 13.

²³⁸ *Voluntary Code Drafted*, *id.* at 13; *Doubt Voluntary Code This Year*, MOTION PICTURE HERALD, July 20, 1935, at 51.

²³⁹ *Voluntary Code Drafted*, *supra* note 237, at 13-15.

²⁴⁰ *The M.P.T.O.A. Plan*, MOTION PICTURE DAILY, June 12, 1935, at 10. See also *MPTOA Calls on Exhibitors to Act on 10-Point Voluntary Code Idea*, MOTION PICTURE HERALD, July 20, 1935, at 52 (“All exhibitors units are being urged . . . to launch negotiations locally with distributors for regulatory trade practice provisions. Large circuits are . . . planning to use a rider in contracts . . . imposing a ban on double bills and on cut-rate admission plans.”); *Distributors Shy Clear of Contract Move*, MOTION PICTURE DAILY, July 22, 1935, at 1, 2 (explaining that the rider was inspired by Hoblitzelle’s rider that was upheld in court). A copy of the rider is available in Appendix B.

²⁴¹ *The M.P.T.O.A. Plan*, *Id.* See also Red Kann, *Voluntary Code Delayed By Trade’s Legal Doubts*, MOTION PICTURE DAILY, June 12, 1935, at 1 (discussing the adoption of the “rider” by the trade association).

²⁴² *Distributors Shy Clear of Contract Move*, *supra* note 240.

²⁴³ *Id.*

²⁴⁴ *Cut-Rates and Duals Curbed by Contracts*, MOTION PICTURE DAILY, Oct. 2, 1936, at 1. See also *MPTOA and Philadelphia Units Act on Trade Practice Issue*, MOTION PICTURE HERALD, Oct. 10, 1936, at 32.

V. THE GOVERNMENT ACTION

A. *The Government Complaint*

In December 1936, the federal government filed a complaint against the *Interstate Circuit* defendants.²⁴⁵ It was part of a broad effort to revive Section 1 enforcement and address perceived problems in the motion picture industry. In January 1935, the Department of Justice launched the “most far-reaching antitrust action in many years,” which was approved by President Roosevelt, directed against an alleged conspiracy among the large distributors.²⁴⁶ The effort was understood as “an ‘anti-monopolistic’ campaign . . . to convince all American business that the antitrust laws had not been entirely suspended through the liberties granted by the National Industrial Recovery Act.”²⁴⁷ A grand jury indicted three of the five majors (namely, distributors that vertically integrated exhibition) and their senior executives on charges of conspiracy to exclude competition from independent exhibitors.²⁴⁸ The government produced evidence that independent exhibitors in St. Louis could not obtain first-run films from the distributors defendants, but failed to prove conspiracy.²⁴⁹ The trade press argued that “[t]he verdict was a stunning blow to the Government which felt confident after the . . . trial, which attracted nation-wide attention.”²⁵⁰

The complaint in *Interstate Circuit* was filed about a year after the defeat in St. Louis. The *Interstate Circuit* complaint attacked contractual practices that were important to the large distributors and their affiliated exhibitors, but was considerably more moderate than the 1935 government action in St. Louis: the government did not seek to secure a verdict for criminal charges, but sought to secure an “injunction restraining the distributor defendants from enforcing or attempting to enforce the provisions in their . . . license agreements.”²⁵¹

B. *Judicial Analysis*

Interstate Circuit was tried at the district court in Dallas and appealed directly to the Supreme Court.²⁵² The Supreme Court affirmed the district court’s decision in a five-to-three decision.

²⁴⁵ *Interstate Circuit Complaint*, *supra* note 80.

²⁴⁶ *U.S. Government Starts Anti-Trust Suits Against Producers in St. Louis*, *FILM BULL.*, Jan. 8, 1935, at 2. *See also St. Louis Probe As Test if Trust Laws Live*, *MOTION PICTURE DAILY*, Jan. 8, 1935, at 1 (“Fortified by President Roosevelt’s support, the Department of Justice is out to show industry and the nation at large that the anti-trust laws have survived the New Deal”); *Jury Acquits Defendants in St. Louis Trust Case*, *MOTION PICTURE DAILY*, Nov. 12, 1935, at 1 (noting that “[e]very resource of the Department of Justice has been brought to bear to prove conspiracy in restraint of trade.”)

²⁴⁷ *St. Louis Grand Jury Quiz Based on “Freezing” Films*, *MOTION PICTURE HERALD*, Jan. 12, 1935, at 11.

²⁴⁸ *Text of Indictment Against Movie Concerns*, *N.Y. TIMES*, Jan. 12, 1935, at 5; *St. Louis Indicts Warners, Para., RKO*, *MOTION PICTURE DAILY*, Jan. 12, 1935, at 1. The charges arose from alleged attempts of Warner Brothers to regain control over theaters in St. Louis that it had sold to independent exhibitors to recover from bankruptcy during the Great Depression. The defendants were Warner Brothers, Paramount, and RKO, some of their subsidiaries, and several executives of these companies.

²⁴⁹ *Jury Acquits Defendants in St. Louis Trust Case*, *supra* note 246; *WB-RKO-Par Win in St. L.*, *VARIETY*, Nov. 13, 1935, at 5.

²⁵⁰ *WB-RKO-Par Win in St. L.*, *id.*

²⁵¹ *Interstate Circuit Complaint*, *supra* note 80, at ¶ 10.

²⁵² Section 2 of the Antitrust Expediting Act provided for direct appeal to the Supreme Court in civil antitrust

Justice Harlan Stone wrote the decision for the Court. Justice Owen Roberts wrote the dissent. Justice Felix Frankfurter took no part in the consideration or decision of the case. Several points in the opinions deserve emphasis.²⁵³

1. *Intellectual Property and Antitrust.*

Interstate Circuit examined the legality of vertical restraints that a group of technological companies adopted to protect their interests in a period of change. The principal question that the case raised was whether copyright law exempted the scheme that the companies adopted from the reach of antitrust law. The defendants argued that a general legal standard answered the question positively: it was broadly understood that, under copyright law, a licensor (e.g., distributor) could set up in a license agreement terms and conditions for the licensee (exhibitor).²⁵⁴ Hoblitzelle's attorney had arguably advised him that, for this legal standard, he would not violate the antitrust laws by sending the letters.²⁵⁵ The eight distributors used the approach—suggesting that this general standard protected all policies—in numerous antitrust cases.²⁵⁶

Both courts rejected the industry's attempt to use copyright as a shield.²⁵⁷ The district court ruled and the Supreme Court affirmed that copyright holders had the legal right to impose unilateral restrictions on licensees, but not restrictions that were developed with the intervention of a third party.²⁵⁸ The Supreme Court also stated that a license agreement that with vertical restraints intending to protect the licensee was not be more "valid than a like agreement between two copyright owners or patentees."²⁵⁹ The dissent was critical of the interpretation that barred manufacturers from agreeing with customers about restrictions that would be imposed on their rivals.²⁶⁰

2. *The Findings of Facts*

The discussion of the evidence in both opinions is abbreviated and somewhat confusing. The district court rested its opinion on an agreed statement of facts that was not published.²⁶¹ When the case reached the Supreme Court, the Court remanded it back to the district court asking for a statement of findings.²⁶² The district court then issued a detailed statement of findings that was not

cases brought by the federal government.

²⁵³ *Interstate Circuit (district court)*, 20 F.Supp. at 873-74.

²⁵⁴ BERTRAND, THE MOTION PICTURE INDUSTRY STUDY, *supra* note 80, at 12. *See also* United States v. General Electric Co., 272 U.S. 476 (1926).

²⁵⁵ *Hoblitzelle's Testimony*, *supra* note 206, at 95-96.

²⁵⁶ *See, e.g.*, United States v. Paramount Pictures, 334 U.S. 131, 144 (1948); Westway Theatre v. Twentieth Century-Fox Film Corporation, 30 F.Supp. 830 (D.C.MD. 1940); FTC v. Paramount Famous-Lasky Corp., 57 F.2d 152 (1932) (successfully defending block booking); Motion Picture Patents Co. v. Universal Film Mfg. Co., 235 F. 398 (2d Cir. 1916) (the standard referred to patent law rather than copyright law); United States v. Motion Picture Patents Co., 225 F. 800 (D.C.Pa. 1915) (same).

²⁵⁷ For copyright law as the central defense argument *see supra* note 59 and accompanying text.

²⁵⁸ *Interstate Circuit (district court)*, 20 F.Supp. at 873; *Interstate Circuit*, 306 U.S. at 227-30.

²⁵⁹ *Interstate Circuit*, 306 U.S. at 230.

²⁶⁰ *Id.* at 236-37 (Roberts, J., dissenting).

²⁶¹ *Agreed Statement of Facts*, *supra* note 198.

²⁶² *Interstate Circuit v. United States*, 304 U.S. 55 (1938). *See also High Court Delays Dallas Ruling*, MOTION

published as well.²⁶³ The Supreme Court relied on this unpublished statement of findings and felt that it was “unnecessary to discuss in great detail the evidence.”²⁶⁴ Perhaps the traditional account would not have emerged with a more detailed discussion of the evidence, yet the existing discussion does not accommodate the traditional account. As explained at the outset, the traditional account omits material facts—Interstate Circuit’s affiliation with Paramount and the negotiations that persuaded the distributors to adopt the restrictions.

The Supreme Court identified that IC and TC were “affiliated with each other and with Paramount.”²⁶⁵ The Court also observed that the distributors acted to serve their affiliated exhibitors. For example, the Court pointed out that “Paramount, which was affiliated with [Texas] Consolidated, agreed to impose the restrictions in certain . . . Texas and New Mexico cities,” where other distributors did not impose those restrictions.²⁶⁶ Similarly, the Court explained that another distributor did not adopt the restraints in Houston, where “its own affiliate,” “a subsidiary,” operated through a subsidiary a first run theatre.²⁶⁷ The Court, however, did not attribute any particular significance to Paramount’s partial ownership of Interstate Circuit. The approach is hardly surprising, as in the 1930s, courts took the position that firms affiliated under common ownership were capable of conspiring in violation of the Sherman Act.²⁶⁸ This view became known as the “intraenterprise conspiracy doctrine.”²⁶⁹ In the 1940s, the Supreme Court applied the doctrine to affiliated companies in the motion picture industry.²⁷⁰ It withdrew from this legalistic position in the 1980s.²⁷¹ The traditional account treats Paramount and Interstate Circuit as separate companies and, thus, implicitly invokes the spirit of the intraenterprise conspiracy doctrine.

The district court’s discussion of the negotiations is more detailed than the discussion in the Supreme Court’s opinion. The court found that “the record justifies the conclusion that the months over which the 1934-35 contracts were incubated were, to some extent, occupied in the reconciliation of the differences between the eight distributors.”²⁷² Specifically, the district court found that the bilateral negotiations were important to the distributors because, in addition to the discussion of the restrictions, the discussions addressed confidential terms of the license

PICTURE HERALD, Apr. 30, 1938, at 26.

²⁶³ *Findings of Facts*, *supra* note 199.

²⁶⁴ *Interstate Circuit*, 306 U.S. at 222.

²⁶⁵ *Interstate Circuit*, 306 U.S. at 214.

²⁶⁶ *Id.* at 219.

²⁶⁷ *Id.* at 218 n.5, 223.

²⁶⁸ *See, e.g.*, *Appalachian Coals v. U.S.*, 288 U.S. 344, 377 (1933) (holding that “corporate integration” does not affect the analysis of Section 1 of the Sherman Act.)

²⁶⁹ *See United States v. Yellow Cab Co.*, 332 U.S. 218 (1947). *See generally* Phillip Areeda, *Intraenterprise Conspiracy in Decline*, 97 HARV. L. REV. 451 (1983).

²⁷⁰ *See, e.g.*, *United States v. Griffith*, 334 U.S. 100 (1948), *overruled*, *Copperweld Corp. v. Indep. Tube Corp.*, 467 U.S. 752 (1984); *Schine Chain Theatres v. United States*, 334 U.S. 110 (1948), *overruled*, *Copperweld Corp. v. Indep. Tube Corp.*, 467 U.S. 752 (1984); *United States v. Crescent Amusement Co.*, 323 U.S. 173 (1944).

²⁷¹ *Copperweld*, 467 U.S. 752.

²⁷² *Id.*

agreements.²⁷³ Thus, the court ruled that the fact that Hoblitzelle and O'Donnell negotiated with each company separately was "immaterial."²⁷⁴

3. *Inference of Agreement from Vertical Communication*

The Supreme Court affirmed the trial court's "inference of agreement" from the existence of parallel conduct, the nature contemplated scheme, the manner in which the scheme was communicated to the distributors, and several other additional factors. Today, this inference framework is interpreted to mean that, in the absence of direct evidence, to establish the existence of conspiracy agreement, plaintiffs provide evidence showing parallel conduct, communication, and plus factors.

As described by the courts, the parallel conduct included the adoption of two vertical restraints by eight competitors in Texas' four largest cities. The communication was exclusively vertical and consisted of O'Donnell's two letters and the negotiations that Hoblitzelle and O'Donnell held with each distributor. The most significant plus factor was that the parallel conduct was in compliance with a "contemplated plan." The distributors adopted the restrictions that were negotiated with them in a uniform manner. The case emphasizes additional plus factors that were discussed at the outset: radical departure from prior practices, motive to conspire, acts against self-interest, and failure to call as witnesses senior executives.

4. Conscious Parallelism

Both the district court and the Supreme Court expressly stated that mutual understanding, which might not form an "agreement," could still establish an unlawful Section 1 conspiracy. The district court argued that "a contract—agreement, conspiracy—is merely the meeting of the minds . . . [that] may be evidenced by a written instrument, or by identical action."²⁷⁵ Affirming, the Supreme Court stressed that an agreement is "not a prerequisite to an unlawful conspiracy."²⁷⁶ The Court maintained that it was "elementary" that "an unlawful conspiracy may be and often is formed without simultaneous action or agreement on the part of the conspirators."²⁷⁷ Instead, the Court ruled that "[a]cceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act."²⁷⁸ Specifically, the Court ruled that--

It was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it. Each distributor was advised that the others were asked to participate; each knew that cooperation was essential to successful operation of the plan. They knew that the plan, if carried out, would result in a restraint of commerce, which, we will presently point out, was unreasonable within the meaning of the Sherman Act, and

²⁷³ *Id.* at 873.

²⁷⁴ *Id.* at 873.

²⁷⁵ *Interstate Circuit (district court)*, 20 F.Supp. at 874.

²⁷⁶ *Interstate Circuit*, 306 U.S. at 226.

²⁷⁷ *Id.* at 227.

²⁷⁸ *Id.*

knowing it, all participated in the plan. The evidence is persuasive that each distributor early became aware that the others had joined. With that knowledge they renewed the arrangement and carried it into effect for the two successive years.²⁷⁹

The language inspired many commentators to argue that *Interstate Circuit* outlawed a form of conscious parallelism.²⁸⁰ For example, the leading treatise argues that “the distributors’ actions were interdependent” and concludes that the Court’s language outlawed such conduct through a four-element formula: “(1) invitations or mutual awareness of the plan, (2) parallel acceptance, (3) common action necessary for success of the plan, and (4) a resulting restraint of trade.”²⁸¹ This interpretation, however, reads the language in light of the traditional account, not in light of the evidence that the Court considered.

5. *Consumer Welfare and Welfare Transfers*

Both the district court and the Supreme Court emphasized the effects of the restraints on the inexpensive theaters and their customers, who could not afford the more admission fees of *Interstate Circuit*.²⁸² This point reflected social discontent caused by the Second Industrial Revolution and the Depression. In the words of the district court: “Constantly we view with concern the congregation of the less fortunate, who, for the time, are unable to enjoy the higher-priced luxuries. . . . We must not, by any sort of a construction of contract or law, keep away from them that which they should have, and which we enjoy, if they are entitled to it.”²⁸³

VI. CAUTIONARY LESSONS

Studies of old judicial opinions raise justified concerns that they have no significance for contemporary policy and theory. The traditional account of *Interstate Circuit* raises concerns about the learning from actual events. The present study offers several lessons to contemporary antitrust law and policy.

A. *A Revisited Summary for Interstate Circuit*

The traditional account of *Interstate Circuit* is a highly-simplified summary of the Supreme Court’s opinion. Simplified summaries and hypotheticals provide useful illustrations for many purposes. The traditional account of *Interstate Circuit*, however, presents an implausible story about cartel formation and offers the story as a foundation for the development, explanation, and teaching of several antitrust theories.

Interstate Circuit could be summarized in many ways. Yet, adequate summaries of the case should materially differ from the traditional account in two elements: (1) the powerful exhibitor was partially owned by one of the distributors, and (2) the exhibitor negotiated the contemplated plan with the distributors (vertical coordination). For example, the case may be summarized as followed:

²⁷⁹ *Interstate Circuit*, 306 U.S. at 226-27.

²⁸⁰ See *supra* note 22 and accompanying text.

²⁸¹ AREEDA & HOVENKAMP, *supra* note 1, ¶ 1426, at 204-205.

²⁸² *Interstate Circuit*, 306 U.S. at 231; *Interstate Circuit (district court)*, 20 F.Supp. at 874-75.

²⁸³ *Interstate Circuit (district court)*, 20 F.Supp. at 874.

A movie exhibitor that dominated first-run exhibition in Texas was partially owned by a film distributor. The exhibitor secured movies from eight film distributors—its parent company and its seven competitors. In 1934, the exhibitor demanded from the distributors to impose in six cities in which it operated theaters two restrictions: a restriction on minimum admission prices in second run theaters and a ban on double features. The exhibitor subsequently negotiated the restrictions with each distributor separately. Each distributor knew that the exhibitor was negotiating the demands with all others. The distributors adopted the restrictions but only in four cities. The trial court ruled that the exhibitor had formed a conspiracy among the distributors. The Supreme Court upheld.

B. *Rapid Technological Change and Antitrust Pressures*

The present study illustrates why rapid technological change is likely to lead to antitrust conflicts. The existing literature generally does not address these expected pressures on courts and antitrust agencies. The problem is not theoretical. We are in the midst of an industrial revolution, often described as the transition from the “old economy” to the “new economy.”²⁸⁴ The present industrial revolution dramatically has been reshaping the organization of firms and labor markets.²⁸⁵ These developments, amplified by and the effects of the Great Recession, gave new life to populist ideas from the early days of antitrust law, such as “trust-busting,” the protection of small businesses, “fair competition,” fears of bigness, concerns that “everything is rigged,” and hostility to “robber barons.”²⁸⁶

Traditionally, antitrust scholars examined the effects of antitrust policies on technological change. These inquiries are different from the question of how rapid technological change is likely

²⁸⁴ See, e.g., Ryan Avent, *Special Report: The Third Great Wave*, *ECONOMIST*, Oct. 4, 2014; *The New Economy: Work in Progress*, *ECONOMIST*, July 24, 1999, at 21. See also Alfred D. Chandler, Jr., *Industrial Revolutions and Institutional Arrangements*, 33 *BULL. AM. ACAD. ARTS & SCI.* 33 (1980) (describing the First and Second Industrial Revolution and depicting the likely characteristics of the Third Industrial Revolution).

²⁸⁵ See, e.g., Tom Standage, *Special Report: The Return of the Machinery Question*, *ECONOMIST*, June 25, 2016; *There's an App for That*, *ECONOMIST*, Jan. 3, 2016, at 17; Cynthia A. Montgomery et al., *The On-Demand Economy*, Harvard Business School Technical Note 716-405 (Sept. 2015).

²⁸⁶ See, e.g., Derek Thompson, *America's Monopoly Problem*, *ATLANTIC*, Oct. 2016, at 26; Adrian Wooldridge, *Special Report: The Rise of Superstars*, *ECONOMIST*, Sept. 17, 2016; Steven Davidoff Solomon, *Tech Giants Gobble Start-Ups in a Regulatory Blind Spot*, *N.Y. TIMES*, Aug. 17, 2016, at B3; Paul Krugman, *Robber Baron Recessions*, *N.Y. TIMES*, Apr. 18, 2016, at A21; *The Problem With Profits*, *ECONOMIST*, March 26, 2016, at 11; *Too Much of a Good Thing*, *ECONOMIST*, March 26, 2016, at 23; Theo Francis & Ryan Knuston, *Wave of Megadeals Tests Antitrust Limits in U.S.*, *WALL ST. J.*, Oct. 19, 2015, at A1; Greg Ip, *Why Corporate America Needs Some More Competition*, *WALL ST. J.*, July 9, 2015, at A2; *Should Digital Monopolies Be Broken Up?*, *ECONOMIST*, Nov. 29, 2014, at 11; *Everybody Wants to Rule the World*, *ECONOMIST*, Nov. 29, 2014, at 19; Rana Foroohar, *Call in the Trustbusters*, *TIME*, Aug. 18, 2014, at 16; Steven Davidoff Solomon, *Changing Old Antitrust Thinking for a New Gilded Age*, *N.Y. TIMES*, July 23, 2014, at B5; *Robber Barons and Silicon Sultans*, *ECONOMIST*, Jan. 3, 2015, at 54; Matt Taibbi, *Everything Is Rigged*, *ROLLING STONE*, MAY 9, 2013, at 32; *Survival of the Biggest*, *ECONOMIST*, Dec. 1, 2012, at 11; Barry C. Lynn, *Killing the Competition*, *HARPER'S*, Feb. 2012, at 27; Thomas Catan, *Trustbusters Try to Reclaim Decades of Lost Ground*, *WALL ST. J.*, Feb. 1, 2010, at A2. See also Sen. Elizabeth Warren, *Reigniting Competition in the American Economy*, Keynote Remarks (American Antitrust Institute, June 29, 2016) (calling for “a revival of the movement that created the antitrust laws” to protect small businesses and fight large ones.)

to influence antitrust conflicts and antitrust policies.²⁸⁷

C. Vertical Relations: Vertical Integration, Partial Ownership, and Vertical Restraints

During much of the twentieth century, antitrust analysis did not distinguish between horizontal and vertical agreements. It was also excessively hostile to vertical relationships, perceiving vertical integration and vertical restraints as threats to competition. The approach reflected both misunderstanding of the business enterprise that emerged during the Second Industrial Revolution and hostility to those business enterprises. Since the late 1970s, antitrust law draws a sharp distinction between horizontal and vertical agreements and identifies that vertical integration and vertical restraints may serve many procompetitive purposes. Today, it is quite difficult to prove that vertical integration or vertical restraints violated the antitrust laws. Thus, despite changes over time, antitrust policies for to vertical integration and vertical restraints generally do not require meaningful analysis of competitive effects.²⁸⁸

Interstate Circuit challenges the formalistic approach to vertical restraints. Even the traditional account illustrates that the distinction between vertical and horizontal relationships may blur: Vertical relationships may facilitate horizontal agreements.²⁸⁹ The present study demonstrates how industries may use vertical integration and vertical restraints to facilitate collusion.

Anticompetitive effects of partial ownership are mostly a theoretical topic in antitrust law.²⁹⁰ The Article discusses a transition to partial ownership (“decentralization”) that shaped the motion picture industry in the early 1930s. Despite the extensive writing about vertical integration in the motion picture industry, this industrial reorganization that was the impetus for *Interstate Circuit* has not been studied. The Article demonstrates that structures of partial ownership may be conducive for collusion.

D. Conspiracy Inference

Interstate Circuit inspired the analytical framework that courts use for conspiracy inference in the absence of direct evidence. Today, this framework means that, in the absence of direct evidence, proof of unlawful conspiracy requires evidence showing parallel conduct, communication, and plus factors. The Article adds clarity to various elements of the framework.

²⁸⁷ See generally Orbach, *Antitrust Populism*, *supra* note 51.

²⁸⁸ See generally Barak Orbach, *The Durability of Formalism in Antitrust*, 100 IOWA L. REV. 2197 (2015); Barak Orbach, *Antitrust Stare Decisis*, 15 ANTITRUST SOURCE 1 (Oct. 2015).

²⁸⁹ See generally Barak Orbach, *Hub-and-Spoke Conspiracies*, *supra* note 26; Margaret C. Levenstein & Valerie Y. Suslow, *How Do Cartels Use Vertical Restraints? Reflections on Bork’s The Antitrust Paradox*, 57 J.L. & ECON. S33 (2014).

²⁹⁰ See, e.g., Einer Elhague, *Horizontal Shareholding*, 129 HARV. L. REV. 1267 (2015); David Gilo et al., *Partial Cross Ownership and Tacit Collusion*, 37 RAND J. ECON. 81 (2006); Daniel P. O’Brien & Steven C. Salop, *Competitive Effects of Partial Ownership: Financial Interest and Corporate Control*, 67 ANTITRUST L.J. 559 (2000); David Gilo, *The Anticompetitive Effects of Passive Investment*, 99 MICH. L. REV. 1 (2000); Joseph Farrell & Carl Shapiro, *Asset Ownership and Market Structure in Oligopoly*, 21 RAND J. ECON. 275 (1990); B. Douglas Bernheim & Michael D. Whinston, *Common Marketing Agency as a Device for Facilitating Collusion*, 16 RAND J. ECON. 269 (1986).

VII. CONCLUSION

Several generations of judges and antitrust experts summarized *Interstate Circuit*, a relatively influential antitrust precedent. The summaries have been generally quite uniform. This Article raises the questions of why the summaries were so wrong and what the flaws say about antitrust thinking. The Article does not answer the questions directly and, instead, offers a study of the cartel examined in *Interstate Circuit*.

APPENDIX A: O'DONNELL'S LETTERS

INTERSTATE CIRCUIT, INC.

Majestic Theatre Building

Dallas, Texas

April 25, 1934

Gentlemen:

As the present season is drawing to a close, we want to go on record with your organization in notifying you that we would like to discuss the purchase of subsequent runs in Dallas, Fort Worth, Houston, San Antonio, Austin, and Galveston, for your product.

We also want to go on record that we will expect certain clearance next season as regards our first run programs which are presented at a minimum price of 40¢ or more. In these situations, we are going to insist that subsequent run prices be held to a minimum scale of 25¢.

As an example, we feel that if we are to continue to pay outstanding first run film rentals for "A" houses such as the Palace Theatre, Dallas, these same pictures must not be exhibited in the subsequent runs at less than 25¢ at any future time. We also want you to bear in mind that we are operating second and subsequent run theatres in most of those towns and it is quite possible that we will have additional subsequent run theatres.

The writer would like to discuss this with you as soon as possible.

Very truly yours,

R. J. O'Donnell

INTERSTATE CIRCUIT, INC.

Majestic Theatre Building
Dallas, Texas

July 11, 1934

Mssrs.:	J. B. Dugger [Paramount]	Leroy Bickel [MGM]
	Herbert MacIntyre [RKO]	J. B. Underwood [Columbia]
	Sol Sachs [RKO]	E. S. Olsmyth [Oldsmith, Universal]
	C. E. Hilgers [Twentieth Century-Fox]	Doak Roberts [United Artists]

Gentlemen:

On April 25th, the writer notified you that in purchasing product for the coming season 34-35, it would be necessary for all distributors to take into consideration in the sale of subsequent runs that Interstate Circuit, Inc., will not agree to purchase produce to be exhibited in its 'A' theatres at a price of 40¢ or more for night admission, unless distributors agree that in selling their product to subsequent runs, that this 'A' product will never be exhibited at any time or in any theatre at a smaller admission price than 25¢ for adults in the evening.

In addition to this price restriction, we also request that on 'A' pictures which are exhibited at a night admission price of 40¢ or more-they shall never be exhibited in conjunction with another feature picture under the so-called policy of double-features.

At this time the writer desires to again remind you of these restrictions due to the fact that there may be some delay in consummating all our feature film deals for the coming season, and it is imperative that in your negotiations that you afford us this clearance.

In the event that a distributor sees fit to sell his product to subsequent runs in violation of this request, it definitely means that we cannot negotiate for his product to be exhibited in our 'A' theatres at top admission prices.

We naturally, in purchasing subsequent runs from the distributors in certain of our cities, must necessarily eliminate double featuring and maintain the maximum 25¢ admission price, which we are willing to do.

Right at this time the writer wishes to call your attention to the Rio Grande Valley situation. We must insist that all pictures exhibited in our 'A' theatres at a maximum night admission price of 35¢ must also be restricted to subsequent runs in the valley at 25¢. Regardless of the number of the days which may intervene, we feel that in exploiting and selling the distributors' product, that subsequent runs should be restricted to at least 25¢ admission scale.

The writer will appreciate your acknowledging your complete understanding of this letter.

Sincerely,

R. J. O'Donnell

* In 1934, Herbert MacIntyre served as RKO district sales manager and Sol Sachs served as RKO branch manager in Texas. The Agreed Statement of Facts provides that a copy of the letter was also sent to W. E. Callaway, Warner Brothers' branch manager in Dallas.

APPENDIX B: HOBLITZELLE'S RIDER

A standard "rider" distributed to the members of the trade association of the affiliated exhibitors, inspired by the clauses used by Hoblitzelle. Source: *The M.P.T.O.A. Plan*, MOTION PICTURE DAILY, June 12, 1935, at 10.

(1) The distributor agrees to require by contract with any exhibitor to whom a license is granted to exhibit any of the feature motion pictures specified in the contract to which this rider is attached and made a part thereof, for exhibition at any theatre situated within the territorial limits specified in the Schedule in connection with the "run" and "clearance period" therein provided for, that during the exhibition thereof of any of said pictures such exhibitor will

- (a) charge for adult admissions to said theatre an actual admission fee of not less than (*twenty-five) cents for the evening performances after (*6:00 P.M.) and/or not less than (*fifteen) cents for matinee performances prior to (*6:00 P.M.); or
- (b) will not lower the prices publicly announced or advertised for admission thereto by giving rebates in the form of premiums, gifts, prizes, chances on anything of value, or by means of reduced script books, coupons, throw-away tickets or "two-for-one" admissions or any other thing of value or by any other method or device of a similar nature which directly or indirectly lowers or tends to lower such publicly announced admission prices; and will not conduct or operate any lottery, drawing, gamble or any other form of hazard at such theatre; or
- (c) will not exhibit any of the said motion pictures together with another feature length motion picture for the same admission charge. (Any motion picture originally made and released in more than 3,000 linear feet of film shall be deemed a feature motion picture.)

If the distributor shall exhibit or grant to any exhibitor a license to exhibit any of said motion pictures for exhibition at any theatre situated within the said territorial limits in violation of the provisions hereof, the rental specified in the schedule provided to be paid by the exhibitor to the distributor for each of said motion pictures so exhibited shall be reduced by a sum equal to (*25%) of such rental and, if paid by the exhibitor, the distributor shall repay to or credit the account of the exhibitor with the amount of such reduction.

(2) During the whole of the licensed exhibition period of each of the said motion pictures, the exhibitor agrees to and shall charge for admission to the theatre designated not less than the admission prices specified in said contract; and agrees to refrain from doing or permitting any of the acts specified in the paragraphs of this rider designated as (b) and (c).

If, during any such period of exhibition, less than said admission prices be charged, or if the exhibitor shall do or permit any of the acts specified in said paragraphs (b) and (c), the provisions of this rider con-

If the distributor shall exhibit or grant to any exhibitor a license to exhibit any of said motion pictures for exhibition at any theatre situated within the said territorial limits in violation of the provisions hereof, the rental specified in the schedule provided to be paid by the exhibitor to the distributor for each of said motion pictures so exhibited shall be reduced by a sum equal to (*25%) of such rental and, if paid by the exhibitor, the distributor shall repay to or credit the account of the exhibitor with the amount of such reduction.

(2) During the whole of the licensed exhibition period of each of the said motion pictures, the exhibitor agrees to and shall charge for admission to the theatre designated not less than the admission prices specified in said contract; and agrees to refrain from doing or permitting any of the acts specified in the paragraphs of this rider designated as (b) and (c).

If, during any such period of exhibition, less than said admission prices be charged, or if the exhibitor shall do or permit any of the acts specified in said paragraphs (b) and (c), the provisions of this rider contained in paragraph (1) thereof shall be deemed null and void and of no effect and the distributor shall be relieved of any further obligation to comply therewith and in addition the distributor shall have the right to waive or to eliminate from any contract made with any other exhibitor operating a theatre situated within the said territorial limits the provisions thereof made in compliance with the provisions of said paragraph (1); but the rights of the distributor under all other provisions of said contract shall remain unimpaired.

.....
Exhibitor

Approved:

.....
Distributor

*The minimum admission for evening and matinee performances; the time indicating when such performances begin and end respectively; and the percentage by which rentals shall be reduced, are matters for individual negotiation with each separate distributor. The figures here used are by way of examples only.