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## INTERSTATE CIRCUIT AND CONSPIRACY THEORIES

Barak Orbach\*

*An antitrust conspiracy is an unlawful horizontal agreement in restraint of trade. Proof of antitrust conspiracy requires evidence that tends to exclude the possibility of independent conduct. In most conspiracy cases, however, direct evidence is not available. Instead, circumstantial evidence is used to prove the existence of the alleged conspiracy. Interstate Circuit v. United States (1939), one of the most known Supreme Court antitrust opinions, laid the foundation of conspiracy inference in antitrust law. Hundreds of judicial opinions, books, monographs, and articles summarize and interpret the facts of the case. With some minor variations, the summaries of Interstate Circuit are similar in their details, yet materially incomplete and erroneous.*

*As summarized in judicial opinions and the literature, Interstate Circuit concerned a powerful retailer who sent a letter to eight suppliers requiring them to amend their distribution policies to raise his rivals' costs. The letter named all recipients, informing each supplier that its competitors received the same letter. The suppliers' compliance was partial but uniform. This account raises the question of whether parallel compliance with an invitation to collude permits the inference of conspiracy. It became the paradigmatic illustration of hub-and-spoke conspiracies, the agreement requirement, conscious parallelism, tacit agreement, and the raising rivals' costs strategy.*

*Interstate Circuit, however, presents a very different set of factual findings: a powerful retailer, which was a partially-owned subsidiary of one of its suppliers, negotiated a deal with its parent company and its rivals.*

*This Article explores the Interstate Circuit myth. It offers a detailed study of cartel formation in an industry with intricate relationships among the colluding parties. The study finds that the extensive use of an incorrect account of Interstate Circuit by courts and commentators explains, in part, some of the flaws of antitrust's conspiracy doctrines. It, thus, refines four*

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*antitrust concepts whose origins are in Interstate Circuit: the agreement requirement, conscious parallelism, plus factors, and tacit agreement. The Interstate Circuit myth, this Article argues, demonstrates that erroneous myths may last long and influence policies.*

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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 & Hovenkamp<sup>1</sup>

## I. INTRODUCTION

What are the odds that, for eight decades, courts, scholars, and practitioners would use a relatively uniform but quite misguided summary of a Supreme Court’s landmark decision to develop and illustrate doctrinal concepts? *Interstate Circuit v. United States* (1939),<sup>2</sup> one of the most known antitrust decisions of the U.S. Supreme Court, demonstrates such reliance on myths. *Interstate Circuit* concerned proof of conspiracy with circumstantial evidence.<sup>3</sup> Hundreds of judicial opinions, books, monographs, and articles summarize the facts of *Interstate Circuit*.<sup>4</sup> Excerpts or summaries of the opinion appear in most antitrust

1. PHILLIP E. AREEDA & HERBERT HOVENKAMP, 6 ANTITRUST LAW 200 (3d ed. 2010).

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

3. See KEITH N. HYLTON, ANTITRUST LAW: ECONOMIC THEORY & COMMON LAW EVOLUTION 134 (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 AREEDA & HOVENKAMP, *supra* note 1, at 200–04. For examples of the account in court decisions, see *First Nat’l Bank Ariz. v. Cities Serv. Co.*, 391 U.S. 253, 286–88 (1968) (“*First National Bank*”); *In re Nexium (Esomeprazole) Antitrust Litigation*, 842 F.3d 34, 57–58 (1st Cir. 2016) (“*Nexium*”); *White v. R.M. Packer Co.*, 635 F.3d 571, 576 (1st Cir. 2011); *In re Insur. Brokerage Antitrust Litig.*, 618 F.3d 300, 331–32 (3d Cir. 2010) (“*Insurance Brokerage*”); *In re Travel Agent Comm’n Antitrust Litig.*, 583 F.3d 896, 906 (6th Cir. 2009); *Toys “R” Us, Inc. v. FTC*, 221 F.3d 928, 934–35 (7th Cir. 2000); *Ambook Enters v. Time*, 612 F.2d 604, 613–14 (2d Cir. 1979); *Milgram v. Loew’s, Inc.*, 192 F.2d 579, 592 (3d Cir. 1951); *Meyer v. Kalanick*, 174 F. Supp. 3d 817, 824 (S.D.N.Y. 2016); *Nat’l ATM Council, Inc. v. Visa Inc.*, 922 F. Supp. 2d 73, 94 (D.D.C. 2013); *Dahl v. Bain Capital Partners, LLC*, 983 F. Supp. 2d 185, 188 (D. Mass. 2013); *Wright v. S. Mono Hosp. Dist.*, 631 F. Supp. 1294, 1319 (E.D. Cal. 1986); *In re Mid-Atl. Toyota Antitrust Litig.*, 560 F. Supp. 760, 772–74 (D. Md. 1983); *United States v. CIBA GEIGY Corp.*, 508 F. Supp. 1118, 1148 (D.N.J. 1976); *Dipson Theatres v. Buffalo Theatres*, 86 F. Supp. 716, 726 (W.D.N.Y. 1949).

For examples of the account in antitrust literature, see A.B.A., PROOF OF CONSPIRACY UNDER FEDERAL ANTITRUST LAWS 22–23 (2018); A.B.A., 1 ANTITRUST LAW DEVELOPMENTS 9–10 (8th ed. 2017); REPORT OF THE ATTORNEY GENERAL’S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 37–38 (1955) (1955 AG REPORT”); Edward B. Rock & Daniel L. Rubinfeld, *Antitrust for Institutional Investors*, 82 ANTITRUST L.J. 221, 225 (2018); William H. Page, *Tacit Agreement Under Section 1 of the Sherman Act*, 81 ANTITRUST L.J. 593, 621–22 (2017); Benjamin Klein, *The Apple E-Books Case: When Is a Vertical Contract a Hub in a Hub-And-Spoke Conspiracy?*, 13 J. COMPETITION L. & ECON. 423, 430–32 (2017); Ariel Ezrachi & Maurice E. Stucke, *Artificial Intelligence & Collusion: When Computers Inhibit Competition*, 2017 U. Ill. L. Rev. 1775, 1788 n.72 (2017); HERBERT HOVENKAMP, FEDERAL ANTITRUST LAW 224 (5th ed. 2015); JOHN J. FLYNN ET AL., ANTITRUST: FREE ENTERPRISE AND ECONOMIC ORGANIZATION 578–80 (7th ed. 2014); Hillary Green, *Antitrust Censorship of Economic Protest*, 59 DUKE L.J. 1037, 1092–93 (2010); Barak D. Richman, *The Antitrust Reputation Mechanisms: Institutional Economics and Concerted Refusal to Deal*, 95 VA. L. REV. 325, 343–44 (2009); ERNEST GELLHORN ET AL., ANTITRUST LAW & ECONOMICS 271–73 (5th ed. 2004); Gregory J. Werden, *Economic Evidence On the Existence of Collusion: Reconciling Antitrust Law With Oligopoly Theory*, 71 ANTITRUST L.J. 719, 738 (2004);

casebooks. The summaries of the case are very similar in their details. This is hardly surprising. *Interstate Circuit* is known for the analysis of its factual findings. Summaries of the case, therefore, are expected to be relatively uniform. But the uniformity in this instance is conformity with an account that is plainly incorrect. Any serious reading of the Supreme Court's opinion should conclude that the popular account omits material factual findings and presents events that are unlikely to happen.

Old myths die hard, and the debunking of some myths serves no meaningful purpose. The examination of the *Interstate Circuit* myth, this Article argues, sheds light on the flaws of several important antitrust doctrines and highlights certain aspects of antitrust analysis that require refinement.

Simplified summaries, stylized facts, and hypotheticals often offer useful representations of events, reality, and complex texts.<sup>5</sup> The popular account of *Interstate Circuit*, this Article shows, does not have such qualities. Its extensive use in judicial opinions and the literature contributed to confusion about the essence of antitrust conspiracies and the legal standards that courts may use to infer conspiracy from circumstantial evidence.

## II. THE POPULAR ACCOUNT: ITS LEGACY AND FLAWS

### A. The Popular Account

The popular account of *Interstate Circuit* describes a dominant firm that weaponized its suppliers to undermine the competitiveness of its small rivals. Surfaced shortly after the Supreme Court handed down the opinion,<sup>6</sup> the popular account consists of four key elements:

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HYLTON, *supra* note 3, at 134–38; David A. Butz & Andrew N. Kleit, *Are Vertical Restraints Pro- Or Anticompetitive? Lessons from Interstate Circuit*, 44 J. L. & ECON. 131 (2001); Kovacic, *supra* note 3, at 32; LEO KATZ, *BAD ACTS AND GUILTY MINDS* 267–68 (1987); ROGER D. BLAIR & DAVID L. KASERMAN, *ANTITRUST ECONOMICS* 207–08 (1985); George A. Hay, *Oligopoly, Shared Monopoly, and Antitrust Law*, 67 CORNELL L. REV. 439, 457–59 (1982); Donald Arthur Washburn, *Price Leadership*, 64 VA. L. REV. 691, 702 (1978); Richard E. Day, *New Theories of Agreement and Combination*, 42 ANTITRUST L.J. 287, 292–93 (1973); Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L. REV. 1562, 1577 (1969); Joseph Taubman, *The Performing Arts and the Anti-Trust Laws*, 43 CORNELL L.Q. 428, 433 (1958); Bernard R. Sorkin, *Conscious Parallelism*, 2 ANTITRUST BULL. 281, 286–87 (1957); John Purington Dunn, *Conscious Parallelism Reexamined*, 35 B.U. L. REV. 225, 229–30 (1955); Michael Conant, *Consciously Parallel Action in Restraint of Trade*, 38, MINN. L. REV. 797, 801–02 (1954); *The Nature of a Sherman Act Conspiracy*, 54 COLUM. L. REV. 1108, 1110 (1954); Edward R. Johnson & John Paul Stevens, *Monopoly or Monopolization—A Reply to Professor Rostow*, 44 ILL. L. REV. 269, 295 (1949); M.A. Adelman, *Effective Competition and the Antitrust Laws*, 61 HARV. L. REV. 1289, 1324 (1948); E. Compton Timberlake, *Standardization and Simplification Under the Antitrust Laws*, 29 CORNELL L.Q. 301, 321 (1943); *Sherman Anti-Trust Law—Agreements in Restraint of Trade*, 27 GEO. L.J. 580 (1939).

5. See, e.g., Lawrence A. Boland, *Stylized Facts*, in *THE NEW PALGRAVE DICTIONARY OF ECONOMICS* (Steven N. Durlauf & Lawrence E. Blume eds., 2d ed. 2008).

6. Early examples of the use of the popular account include *Schad v. Twentieth Century-Fox Film Corp.*, 136 F.2d 991, 996 (3d Cir. 1943); *Westway Theatre v. Twentieth Century-Fox Film Corporation*, 30 F.Supp. 830, 837 (D. Md. 1940); DANIEL BERTRAND ET AL., *THE MOTION PICTURE INDUSTRY—A PATTERN OF CONTROL* 45–47 (Temp. Nat'l Econ. Comm., Monograph No. 43, 1941) (“A PATTERN OF CONTROL”); *Sherman Anti-Trust*

(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 that his seven competitors had received the same letter.

(2) *A Demand to Adopt New Policies*. The letter demanded each distributor to add to its exhibition agreements (contracts between film distributors and exhibitors concerning the licensing of movies for exhibition) a restriction on minimum admission prices and a ban on double features (the offering of two movies for the price of one). The restrictions were beneficial to the distributors because they protected box office revenues and advantageous for the exhibitor because they were disadvantageous to its rivals.

(3) *Partial and Uniform Compliance*. The distributors partially complied with the demands. Their partial compliance was largely uniform, although not entirely simultaneous. The adopted restrictions involved “a radical departure from the previous business practices of the industry” and led to “a drastic increase in admission prices.”<sup>7</sup>

(4) *A Finding of Unlawful Conspiracy*. The Supreme Court upheld the trial court’s finding that the adoption of the restrictions formed a conspiracy in violation of Section 1 of the Sherman Act.<sup>8</sup>

The case raised the question of whether the exhibitor orchestrated an unlawful conspiracy among the eight film distributors or entered into eight separate agreements.<sup>9</sup>

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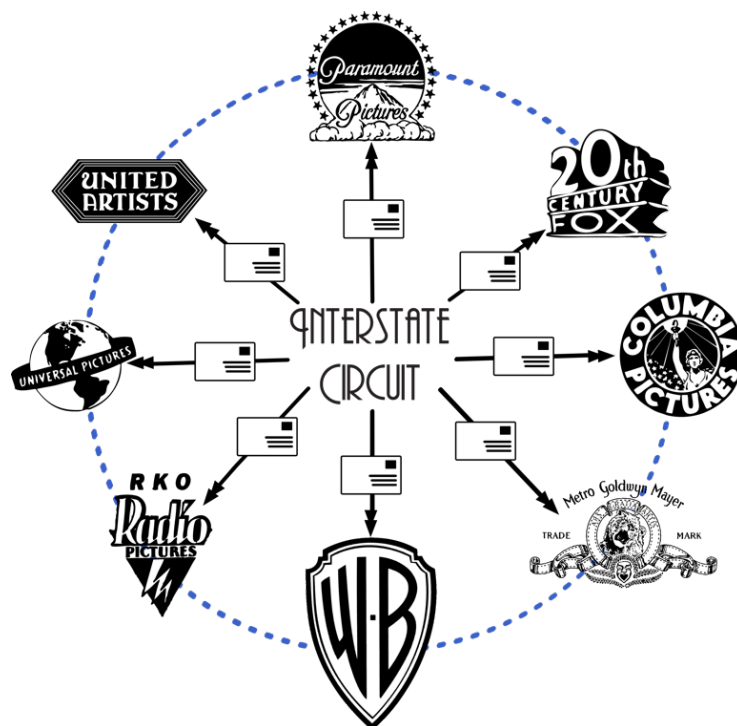
*Law—Agreement in Restraint of Trade*, *supra* note 4, at 580; *Arnold Theory Meets Test in Highest Court*, AM. L. & LAW., Feb. 18, 1939, at 5.

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

8. *Id.* at 232.

9. *Id.* at 220–21.

FIGURE 1: THE POPULAR ACCOUNT OF INTERSTATE CIRCUIT



Stripped to its essentials, the popular account provides that the factfinder may infer the existence of an antitrust conspiracy from evidence showing competitors' compliance with an invitation to collude, when all competitors were aware of the scheme.<sup>10</sup> Courts and commentators often quote two sentences from the Supreme Court's opinion that express this idea: (1) "It was enough that, knowing that concerted action was contemplated and invited, the [defendants]

10. HERBERT HOVENKAMP, *THE ANTITRUST ENTERPRISE* 129 (2005) ("[I]n the famous *Interstate Circuit* case, . . . an express offer communicated simultaneously to eight firms plus their silent but factually clear acceptance was held to constitute a Sherman Act conspiracy among the firms."); *United Mine Workers of America v. Pennington*, 381 U.S. 657, 673 (1965); *United States v. Paramount Pictures*, 334 U.S. 131, 142 (1948) (attributing to *Interstate Circuit* the proposition that, for conspiracy inference, it "is enough that a concert of action is contemplated and that the defendants conformed to the arrangement"); *Kalanick*, 174 F. Supp. 3d at 824 (interpreting *Interstate Circuit* to mean that competitors' compliance with an invitation to collude may serve as evidence of unlawful conspiracy); *Valspar Corp. v. E.I. Du Pont De Nemours & Co.*, 873 F.3d 185, 194 n.3 (3d Cir. 2017) (interpreting *Interstate Circuit* to permit inference of conspiracy "when Company A proposes a parallel price increase to Company B, and Company B does not explicitly agree but then follows suit when Company A raises its prices"); *United States v. MMR Corp.* (LA), 907 F.2d 489, 495 (5th Cir. 1990) (citing *Interstate Circuit* in support of the proposition that to establish conspiracy, it is enough to show "the defendants accepted an invitation to join in a conspiracy whose object was unlawfully restraining trade"); *Moore v. James H. Matthews & Co.*, 473 F.2d 328, 330 (9th Cir. 1973); *Milgram v. Loew's, Inc.*, 192 F.2d 579, 592 (3d Cir. 1951); *In re Delta/Airtran Baggage Fee Antitrust Litig.*, 245 F. Supp. 3d 1343, 1372 (N.D. Ga. 2017) (citing *Interstate Circuit* to recognize that "an invitation to collude can serve as evidence of a conspiracy").

gave their adherence to the scheme and participated in it.”<sup>11</sup> (2) “Acceptance 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.”<sup>12</sup>

*B. The Opinion’s Factual Findings*

*Interstate Circuit* was tried on stipulated facts, as well as additional evidence and testimonies not inconsistent with the stipulated facts.<sup>13</sup> The material factual findings listed in *Interstate Circuit* may be summarized as follows.

A powerful movie exhibitor faced competition from low-price exhibitors.<sup>14</sup> The exhibitor, a partially-owned subsidiary of a large film distributor, sought to curb the competition by persuading the eight largest movie distributors to amend their exhibition agreements.<sup>15</sup> The exhibitor’s plan required the distributors to add to the agreements a restriction on minimum admission prices for likely blockbusters.<sup>16</sup> The exhibitor circulated the idea among its suppliers—its parent company and seven other film distributors—through an identical letter sent to the local branch managers of the distributors.<sup>17</sup> The exhibitor managers then discussed the idea with the parent company’s executives, revised the plan, and sent the revised plan to the film distributors in a letter that named all addressees, local representatives of the eight distributors.<sup>18</sup> The exhibitor, then, proceeded with negotiations of the revised plan with the parent company’s competitors.<sup>19</sup> It persuaded them to adopt new terms for their exhibition agreements.<sup>20</sup>

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

12. *Id.* at 227.

13. *Interstate Circuit v. United States*, 304 U.S. 55, 56 (1938).

14. *Interstate Circuit*, 306 U.S. at 215.

15. *Id.* at 215–17.

16. *Id.* at 217.

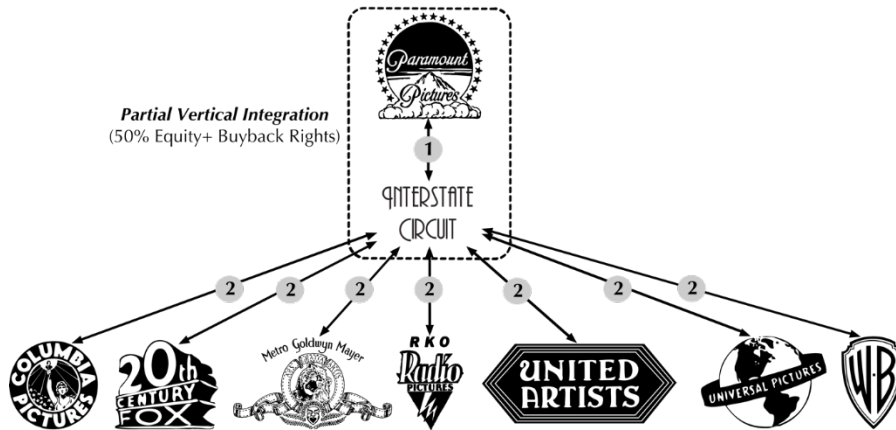
17. *Id.* at 215–16.

18. For copies of the letters, see Appendix.

19. *Interstate Circuit*, 306 U.S. at 218.

20. *Id.* at 218–19.

FIGURE 2: THE FORMATION OF THE INTERSTATE CIRCUIT CONSPIRACY



### C. The (Obvious) Flaws of the Popular Account

The popular account of *Interstate Circuit* suffers from three perplexing flaws: mischaracterization of factual findings, unsound economic logic, and disregard of relevant historical events.

(a) *Mischaracterization of the Court's Factual Findings.* The popular account is consistent with a passage in the Supreme Court's opinion, when this passage is read out of context.<sup>21</sup> Any serious reading of the opinion, however, ought to conclude that the popular account omits material factual findings.

First, the opinion describes the powerful exhibitor as an arm of one of the distributors. It describes a group of "corporations and individuals engaged in exhibiting motion pictures,"<sup>22</sup> which consisted of "Interstate Circuit, Inc., and Texas Consolidated Theatres, Inc., and Hoblitzelle and O'Donnell, who [were] respectively president and general manager of both [corporations] and in active charge of their business operations."<sup>23</sup> It states that the two corporations—Interstate Circuit, Inc. ("Interstate"), and Texas Consolidated Theatres, Inc. ("Texas Consolidated")—were "affiliated with each other and with Paramount Pictures . . . , one of the distributor defendants."<sup>24</sup> Summaries of the opinion sometimes stumble on the relationship between Interstate and Texas Consolidated but typically ignore the affiliation of the companies with one of the distributors.<sup>25</sup> As a

21. *Id.* at 222 ("The O'Donnell letter named on its face as addressees the eight local representatives of the distributors, and so from the beginning each of the distributors knew that the proposals were under consideration by the others. Each was aware that all were in active competition and that without substantially unanimous action with respect to the restrictions . . . there was risk of a substantial loss of the business . . . , but that with it there was the prospect of increased profits. There was, therefore, strong motive for concerted action . . . [presented] to all in a single document.").

22. *Id.* at 214.

23. *Id.*

24. *Id.*

25. Several summaries refer to the affiliation. *See, e.g.,* *Schad*, 136 F.2d, at 996; Butz & Kleit, *supra* note 4, at 138; MICHAEL CONANT, *ANTITRUST IN THE MOTION PICTURE INDUSTRY* 87 (1960); BERTRAND ET AL., *supra*



result, the popular account neglects the fact that Interstate was a partially-owned subsidiary of one of the distributors.

Second, Interstate sent two letters, not one.<sup>26</sup> The letters were sent about ten weeks apart, during which Interstate modified its demands. The opinion includes a copy of the second letter, which begins with a reference to the first letter.<sup>27</sup> The opinion also describes “negotiations” leading to “modifications of the proposals [that] resulted in substantially unanimous action of the distributors.”<sup>28</sup>

The differences between the popular account’s offer-and-acceptance formula and the stated factual findings are striking. The popular account portrays (1) demands that an important customer delivered to its suppliers through a single act of communication (a letter), and (2) a parallel compliance of the suppliers. By contrast, the stated factual findings describe a partially-owned subsidiary that negotiated an arrangement with its parent company and competitors of the parent company.

(b) *Unsound Economic Logic.* The formation, operation, and enforcement of cartels are challenging tasks.<sup>29</sup> D.K. Osborne summarized the challenges, writing that cartels face “one external and four internal problems. The external problem . . . is to predict (and if possible, discourage) production by nonmembers. The internal problems are, first, to locate the contract surface; second, to choose a point on that surface (the sharing problem); third, to detect; and fourth, to deter, cheating.”<sup>30</sup> The popular account suggests that a single act of communication may form a viable cartel. This scenario is not compatible with the economic understanding of cartels.

The popular account serves two lines of economic intuitions. First, it inspired several economic theories related to cartel facilitation by third parties. Second, it focuses the attention on the possibility of cartel formation with limited coordination.

Courts and scholars often use *Interstate Circuit* to illustrate cartel facilitation by third parties. The centralization of collusive functions, such as formation and enforcement, may reduce coordination costs. Cartels, therefore, sometimes rely on third parties that provide them with centralized collusive functions.<sup>31</sup> The popular account describes how cartel members may pay a third party for the facilitation of the cartel by adopting policies that raise its rivals’ costs. It is, however, unclear why the film distributors were interested in such a cartel. In a market for highly differentiated products, such as movies, with eight distributors

note 6, at 45; GIULIANA MUSCIO, HOLLYWOOD’S NEW DEAL 153 (1997) (“Another suit against an affiliated chain was *United States v. Interstate Circuit*, filed in Texas in 1936.”).

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

27. For a copy of the letter, see Appendix.

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

29. See Joseph E. Harrington, *How Do Cartels Operate?*, 2 FOUNDATIONS & TRENDS IN MICROECONOMICS 2 (2006); Margaret C. Levenstein & Valerie Y. Suslow, *What Determines Cartel Success?*, 46 J. ECON. LIT. 43 (2006); George J. Stigler, *A Theory of Oligopoly*, 72 J. POL. ECON. 44 (1964).

30. D. K. Osborne, *Cartel Problems*, 66 AM. ECON. REV. 835, 835 (1976).

31. See generally Barak Orbach, *Hub-and-Spoke Conspiracies*, 16 ANTITRUST SOURCE 1 (Apr. 2016); David Rahman & Ichiro Obara, *Mediated Partnerships*, 78 ECONOMETRICA 285 (2010).

that differ in size and portfolio of products, a substantial increase in retail prices may not necessarily result in increased revenues for all distributors. Similarly, a ban on double feature may serve some distributors but adversely affect distributors whose movies typically served as the “second feature.”

The idea that limited coordination may suffice to persuade competitors to change distribution policies is even more dubious.<sup>32</sup> The popular account suggests that a single act of communication without any additional coordination could form mutual understanding among a diverse group of suppliers, leading all to modify their distribution policies in a similar fashion. This scenario is unrealistic.

(c) *Disregard of Relevant Historical Events.* The popular account suggests that collaborations among competitors were unlawful during the relevant period. The events leading to *Interstate Circuit* took place in a peculiar phase in the evolution of antitrust law.<sup>33</sup> During that period, national economic policies, antitrust policies included, were influenced by theories of “new competition” that rested on the belief that civic associations, such as trade associations, were effective mechanisms to combat the illnesses of industrialization and protect democracy.<sup>34</sup> The federal government, thus, encouraged collaborations among competitors to promote “fair trade” and avoid “ruinous competition.”<sup>35</sup> The National Industrial Recovery Act (“NIRA”), which was in effect when the alleged *Interstate Circuit* conspiracy formed, was a product of the period.<sup>36</sup> NIRA required industries to negotiate “codes of fair competition,” exempted the codes from antitrust law, and provided that violations of codes would be deemed “an unfair method of competition” within the meaning of Section 5 of the Federal Trade Commission Act.<sup>37</sup> In the motion picture industry, for more than a decade before Congress passed NIRA, the eight largest distributors standardized their exhibition agreements.<sup>38</sup> The legality of this standardization under antitrust law was litigated and even reached the Supreme Court. NIRA’s Code of Fair Competition for the Motion Picture Industry (“Motion Picture Code”) adopted such a standardized agreement.<sup>39</sup> Thus, during the relevant period, the motion picture industry operated under a government-sponsored industrywide agreement, NIRA’s Motion Picture Code, and had significant experience with coordination through standard agreements.

32. See, e.g., Yu Awaya & Vijay Krishna, *On Communication and Collusion*, 106 AM. ECON. REV. 285 (2016); Yuliy Sannikov & Andrzej Skrzypacz, *Impossibility of Collusion under Imperfect Monitoring with Flexible Production*, 97 AM. ECON. REV. 1794 (2007); David Genesove & Wallace P. Mullin, *Rules, Communication, and Collusion: Narrative Evidence from the Sugar Institute Case*, 91 AM. ECON. REV. 379 (2001).

33. See generally Barak Orbach, *The Present New Antitrust Era*, 60 WM. & MARY L. REV. 1439 (2019); LAURA PHILLIPS SAWYER, *AMERICAN FAIR TRADE* (2018).

34. See Generally Orbach, *The Present New Antitrust Era*, *supra* note 33.

35. *Id.* at 1448–49.

36. National Industrial Recovery Act of 1933, Pub. L. No. 73-67, 48 Stat. 195 §§ 3–5 (1933) (“NIRA”). On May 27, 1935, the Supreme Court declared NIRA unconstitutional. *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935).

37. See *infra* Section IV.

38. See *infra* notes 67–70 and accompanying text.

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

Further, many antitrust cases and vast literature examine various vertical practices of the eight film distributors and, specifically, their vertical integration with powerful exhibitors.<sup>40</sup> It is virtually impossible to gain expertise in antitrust law without acquiring appreciation of the significance of the vertical practices in the motion picture industry during the second quarter of the twentieth century. The popular account ignores the existence of vertical arrangements in the motion picture industry.

#### D. *Interstate Circuit as an Antitrust Precedent*

*Interstate Circuit* has served three lines of antitrust precedents. First, the case introduced an evidentiary framework for conspiracy inference under Section 1 of the Sherman Act.<sup>41</sup> Second, the case inspired the development of several antitrust concepts concerning the architecture and functioning of cartels.<sup>42</sup> Third, *Interstate Circuit* addressed the thorny relationship between antitrust and intellectual property, holding agreements concerning intellectual property rights are not exempted from antitrust scrutiny.<sup>43</sup> *Interstate Circuit* is also credited for formulating a general evidentiary standard providing that the “production of weak evidence when strong is available can lead only to the conclusion that the strong would have been adverse.”<sup>44</sup>

*Conspiracy Inference.* An antitrust conspiracy in violation of Section 1 of the Sherman Act is a “conscious commitment to a common scheme designed to achieve an unlawful objective.”<sup>45</sup> Direct evidence of an antitrust conspiracy proves the existence of such a scheme without inference.<sup>46</sup> Direct evidence of conspiracy, however, is often not available because secrecy and concealment are basic features of unlawful conspiracies. Recognizing this practical challenge, courts had recognized that, in the absence of direct evidence, circumstantial evidence, which requires inference of the alleged facts, may prove the existence of

40. See, e.g., *United States v. Loew's Inc.*, 371 U.S. 38 (1962); *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*, 346 U.S. 537 (1954); *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 (1948); *United States v. Crescent Amusement Co.*, 323 U.S. 173 (1944); *Paramount Famous Lasky Corp. v. United States*, 282 U.S. 30 (1930); *FTC v. Paramount Famous-Lasky Corp.*, 57 F.2d 152 (2d Cir. 1932); MICHAEL CONANT, *ANTITRUST IN THE MOTION PICTURE INDUSTRY* (1960).

41. *Interstate Circuit*, 306 U.S. at 221 (“[I]n cases of alleged unlawful agreements to restrain commerce, the [plaintiff] is without the aid of direct [evidence] . . . and is compelled to rely on inferences drawn from the course of conduct of the alleged conspirators.”); see sources cited *supra* note 3.

42. Joseph E. Harrington, Jr. & Patrick T. Harker, *How Do Hub-and-Spoke Cartels Operate? Lessons from Nine Case Studies*, 10 (forthcoming).

43. *Interstate Circuit*, 306 U.S. at 227–28.

44. *Id.* at 226; see *Valjean Mfg., Inc. v. Michael Werdiger, Inc.*, 589 Fed. Appx. 4, 5 (2d Cir. 2014); *Huthnance v. District of Columbia*, 722 F.3d 371, 378 (D.C. Cir. 2013); *Riley v. Taylor*, 277 F.3d 261, 283 (3d Cir. 2001); *Thelma C. Raley, Inc. v. Kleppe*, 867 F.2d 1326, 1329 (11th Cir. 1989); *Colonial Stores, Inc. v. FTC*, 450 F.2d 733, 741 (5th Cir. 1971); *Smith v. Van Gorkom*, 488 A.2d 858, 878 (Del. 1985).

45. *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 768 (1984); see also *Am. Tobacco Co. v. United States*, 328 U.S. 781, 810 (1946) (defining an antitrust conspiracy “a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement”).

46. See *In re Baby Food Antitrust Litigation*, 166 F.3d 112, 118 (3d Cir. 1999) (noting that direct evidence is “evidence that is explicit and requires no inferences to establish the proposition or conclusion being asserted”).

conspiracy.<sup>47</sup> *Interstate Circuit* reaffirmed the general principle and formulated an evidentiary framework for conspiracy inference: in the absence of direct evidence, proof of conspiracy requires evidence of conscious parallelism supplemented with “plus factors,” which are circumstantial evidence that is consistent with concerted action but is largely inconsistent with independent conduct.

*Interstate Circuit* articulated four plus factors: (1) communication,<sup>48</sup> (2) an abrupt departure from past practices,<sup>49</sup> (3) a motive to conspire,<sup>50</sup> and (4) acts against self-interest (actions that would be unprofitable, unless all rivals take similar measures).<sup>51</sup> The case has also served as a leading precedent for three core terms concerning conspiracy inference: “agreement requirement,” “conscious parallelism,” and “tacit agreement.” Additionally, courts and scholars credit *Interstate Circuit* with establishing two additional inference standards: (1) conscious parallelism and the acceptance of an invitation to collude may establish conspiracy,<sup>52</sup> and (2) “parallel conduct” does not necessarily mean simultaneous action.<sup>53</sup>

*Antitrust Concepts.* *Interstate Circuit* is a leading precedent for “hub-and-spoke conspiracies,” “raising rivals’ costs,” and “cartel ringmaster.”<sup>54</sup> Hub-and-spoke conspiracies are cartels in which a firm (the “hub”) organizes a cartel (the “rim”) among upstream or downstream firms through vertical restraints (the “spokes”).<sup>55</sup> Most discussions of hub-and-spoke conspiracies refer to *Interstate*

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47. The key decision before *Interstate Circuit* was *E. States Retail Lumber Dealers’ Ass’n v. United States*, 234 U.S. 600 (1914), where the Court wrote that “[i]t is elementary . . . that conspiracies are seldom capable of proof by direct testimony, and may be inferred from the things actually done.” *Id.* at 612. See also *Maple Flooring Mfrs. Ass’n v. United States*, 268 U.S. 563, 584–85 (1925); *Frey & Son v. Cudahy Packing Co.*, 256 U.S. 208, 218–20 (1921); *Thomsen v. Caysen*, 243 U.S. 66, 84 (1917); *Baush Mach. Tool Co. v. Aluminum Co. of Am.*, 72 F.2d 236, 241 (2d Cir. 1934).

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

49. *Id.* at 218, 222.

50. *Id.* at 222, 225.

51. *Id.* at 222.

52. See *infra* notes 10–12 and accompanying text.

53. See, e.g., *United States v. Masonite Corporation*, 316 U.S. 265, 275 (1942); *United States v. Williams*, 428 F. Appx. 134, 138 (3d Cir. 2011); *King & King Enterprises v. Champlin Petroleum Co.*, 657 F.2d 1147, 1153 (10th Cir. 1981); *In re Broiler Chicken Antitrust Litigation*, 290 F. Supp. 3d 772, 791 (N.D. Ill. 2017).

54. In their seminal paper about exclusionary practices, Thomas Krattenmaker & Steven Salop used *Interstate Circuit* to illustrate the terms “raising rivals’ costs” and “cartel ringmaster.” See Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power over Price*, 96 YALE L.J. 209, 238–40, 260–61 (1986).

55. Orbach, *Hub-and-Spoke Conspiracies*, *supra* note 31, at 1; Harrington Jr. & Harker, *supra* note 42, at 2; Benjamin Klein, *Antitrust Analysis of Hub-and-Spoke Conspiracies 1* (Jan. 31, 2017) (unpublished manuscript) (available at SSRN: <https://ssrn.com/abstract=2909341>).

*Circuit* as the paradigmatic hub-and-spoke conspiracy case.<sup>56</sup> There is no shortage of examples of hub-and-spoke conspiracies.<sup>57</sup> *Interstate Circuit* may illustrate a specific type of such cartels, but not the paradigmatic one: the partial vertical integration of the hub (Interstate) and one of the upstream firms (Paramount) makes the case similar to a horizontal conspiracy in which one firm (the “ring-master”) facilitates the conspiracy.

*Antitrust and Intellectual Property.* Throughout the history of antitrust law, intellectual property right holders have argued that the exclusionary scope of their rights immunizes agreements concerning such rights from antitrust scrutiny. The Supreme Court has persistently rejected the argument that horizontal agreements in restraint of trade were within the exclusionary scope of intellectual property rights.<sup>58</sup> *Interstate Circuit* is one of the first Supreme Court decisions to establish this point.

### III. INDUSTRY STRUCTURE AND PRACTICES

#### A. Modern Corporations vs. Independent Firms

*Interstate Circuit* is one of numerous antitrust cases that addressed the relationships between “modern corporations” and “independent firms” in the motion picture industry. Such tensions were common in many industries throughout the twentieth century.<sup>59</sup>

56. See Johnson & Stevens, *supra* note 4, at 295 (“[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 United States v. Apple, Inc., 791 F.3d 290, 319–20 (2d Cir. 2015); Howard Hess Dental Labs, Inc. v. Dentsply Int’l, Inc., 602 F.3d 237, 255 (3d Cir. 2010); In re Ins. Brokerage Antitrust Litigation, 618 F.3d 300, 331–33 (3d Cir. 2010); Total Benefits Planning Agency, Inc. v. Anthem Blue Cross & Blue Shield, 552 F.3d 430, 436 (6th Cir. 2008); Toys “R” Us, Inc. v. F.T.C., 221 F.3d 928, 935–36 (7th Cir. 2000); Meyer v. Kalanick, 174 F. Supp. 3d 817, 824 (S.D.N.Y. 2016); Nat’l ATM Council, Inc. v. Visa, Inc., 922 F. Supp. 2d 73, 94–95 (D.D.C. 2013).

57. Ben Klein wrote some of the definitive works about hub-and-spoke conspiracies. See, e.g., Klein, *supra* note 55; Klein, *The Apple E-Books Case*, *supra* note 4, at 429–74; Benjamin Klein, *The “Hub-and-Spoke” Conspiracy that Created the Standard Oil Monopoly*, 85 S. CAL. L. REV. 459, 459–97 (2012).

58. See, e.g., FTC v. Actavis, Inc., 570 U.S. 136 (2013); United States v. Paramount Pictures, 334 U.S. 131, 144 (1948); United States v. Line Material Co., 333 U.S. 287, 306 (1948); Morton Salt Co. v. G. S. Suppiger Co., 314 U.S. 488, 491 (1942); Watson v. Buck, 313 U.S. 387, 404 (1941).

59. See, e.g., Douglas Oil Co. v. Petrol Stops Northwest, 441 U.S. 211 (1979) (reviewing an antitrust action that “independent gasoline dealers” brought against “large oil companies”); United States v. Philadelphia Nat’l Bank, 374 U.S. 321, 325 (1963) (reviewing potential effects of consolidation in the banking industry on “independent, local banks”); Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962) (stating that the expansion of “large national chains” “is not rendered unlawful by the mere fact that small independent stores may be adversely affected” but emphasizing the “desire to promote competition through the protection of viable, small, locally owned business”); *Paramount Pictures*, 334 U.S. at 140–41 (examining tensions between the large film distributors and independent exhibitors); Bigelow v. RKO Radio Pictures, 327 U.S. 251 (1946) (same); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940) (reviewing a rivalry between “major oil companies” and “independent refiners”).

Modern corporations were large businesses that emerged in the United States at the turn of the nineteenth century. They utilized economies of scale and scope; operated multiple business units, often vertically integrated production and distribution; and were operated by professional managers. Many modern corporations, though certainly not all, were publicly-traded companies. Their decentralized structures established “affiliations” among business units and firms. For example, in 1932, Loew’s, Inc., the parent company of Metro-Goldwyn-Mayer (“MGM”), was a large conglomerate. It vertically integrated production, distribution, and exhibition of films through 124 subsidiaries.<sup>60</sup>

Traditional businesses were small businesses that were typically managed by the owners. With the rise of the modern corporations, such small businesses became known as “independent firms” because they were not affiliated with large businesses. To illustrate, chain stores and department stores were modern corporations. They utilized economies of scale and scope and offered a large variety of products for low prices.<sup>61</sup> By contrast, the traditional mom-and-pop stores were independent businesses. Similarly, in the motion picture industry, theater chains were modern corporations and “independent exhibitors” were traditional businesses. Interstate, an exhibition business that operated two theater chains, was one of the largest and most successful theater chains in the United States.

Alfred Chandler’s seminal study of the rise of modern corporations summarizes the pattern that appeared in many industries:

The first entrepreneurs to create [modern business] enterprises acquired powerful competitive advantages. Their industries quickly became oligopolistic, that is, dominated by a small number of first movers. These firms, along with the few challengers that subsequently entered the industry, no longer competed primarily on the basis of price. Instead, they competed for market share and profits through functional and strategic effectiveness. They did so *functionally* by improving their product, their processes of production, their marketing, their purchasing, and their labor relations, and strategically by moving into growing markets more rapidly, and out of declining ones more quickly and effectively, than did their competitors.<sup>62</sup>

In the motion picture industry, eight film distributors established an oligopolistic control during the 1920s.<sup>63</sup> Five distributors, known as the “majors,” vertically integrated production, distribution, and exhibition of motion pictures.<sup>64</sup>

60. *Metro-Goldwyn-Mayer*, in THE AMERICAN FILM INDUSTRY 311, 311 (Tino Balio ed., 1985).

61. See, e.g., GODFREY M. LEBHAR, CHAIN STORES IN AMERICA, 1859–1950 (1952); MARC LEVINSON, THE GREAT A&P AND THE STRUGGLE FOR SMALL BUSINESS IN AMERICA (2011); *Chain Stores Have Grown Rapidly Since 1912*, WALL ST. J., Feb. 5, 1923, at 3; 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).

62. ALFRED D. CHANDLER, JR., SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM 8 (1990).

63. The eight large distributors were Paramount Pictures Distributing Co., Inc. (“Paramount Pictures”), Metro-Goldwyn-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”).

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

The other three distributors, known as the “minors,” vertically integrated production and distribution and had a limited presence in exhibition.<sup>65</sup> In 1934, during the events leading to *Interstate Circuit*, the eight distributors controlled the production and distribution of about 80% of feature films in the United States.<sup>66</sup> The eight distributors competed among themselves over market shares and revenues, and cooperated on issues related to trade practices. From 1923 to 1932, the eight distributors used a standard exhibition agreement that their trade association developed.<sup>67</sup> In 1932, after several legal defeats,<sup>68</sup> the distributors abandoned the standard exhibition agreement for concerns regarding antitrust liabilities.<sup>69</sup> Instead, they adopted a model for an exhibition agreement, the “Optional Standard License Agreement.”<sup>70</sup>

*Interstate Circuit* defendants, thus, were modern corporations: a powerful exhibitor and eight dominant distributors. The victims of the alleged conspiracy were independent exhibitors that operated in the territories of the powerful exhibitor, Interstate.

### B. Affiliations, Classifications, and Trade Practices

The eight film distributors developed a business model that consisted of three core elements: (1) feature films for (2) shared consumption in (3) convenient physical facilities. Feature films were high quality movies that lasted eighty-five minutes or more, which were produced on expensive sets with creative and technical crews, cast professional actors who were promoted as “movie stars,” were shown in movie theaters, and were heavily advertised.<sup>71</sup> They replaced the one-reel films that were short (about ten minutes), relatively homogeneous, primarily targeted working-class audiences, and kept the identity of the creative

65. The minors were Columbia, United Artists, and Universal. United Artists and Universal vertically integrated a relatively small number of movie theaters. Columbia did not operate movie theaters.

66. TEMPORARY NATIONAL ECONOMIC COMM., 75TH CONG., INVESTIGATION OF CONCENTRATION OF ECONOMIC POWER: MONOGRAPH NO. 43: THE MOTION PICTURE INDUSTRY, A PATTERN OF CONTROL 11 (Comm. Print 1941) [hereinafter THE MOTION PICTURE INDUSTRY STUDY].

67. See generally HOWARD T. LEWIS, THE MOTION PICTURE INDUSTRY 262–98 (1933); Richard Maltby, *The Standard Exhibition Contract and the Unwritten History of the Classical Hollywood Cinema*, 25 FILM HIST. 138, 141–42 (2013).

68. See, e.g., *Paramount Famous Lasky Corp. v. United States*, 282 U.S. 30, 43 (1930); *United States v. First Nat'l Pictures, Inc.*, 282 U.S. 44, 53–55 (1930).

69. See *Attorneys for Major Firms Reject 5-5-5*, VARIETY, May 17, 1932, at 5.

70. *Optional Standard License Agreement*, VARIETY, Nov. 22, 1932, at 34; LEWIS, *supra* note 67, at 294–98.

71. See EILEEN BOWSER, THE TRANSFORMATION OF CINEMA 1907–1915, in 2 HISTORY OF THE AMERICAN CINEMA 191–215 (Charles Harpole ed., 1990); BENJAMIN B. HAMPTON, A HISTORY OF THE MOVIES 101–20 (1931); Ben Singer, *Feature Films, Variety Programs, and the Crisis of the Small Exhibitor*, in AMERICAN CINEMA'S TRANSITIONAL ERA 76 (Charlie Keil & Shelley Stamp eds., 2004); 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; Michael Quinn, *Distribution, the Transient Audience, and the Transition to the Feature Film*, 40 CINEMA J. 35, 37 (2001).

team anonymous.<sup>72</sup> One-reel films were typically produced, distributed, and exhibited by small firms. It was the introduction of feature films that drove the development of movie theaters.

To advance the business model of feature films, the distributors developed several practices that defined the operation and organization of the industry during the relevant period.

1. *Affiliations.* By 1934, the motion picture industry consisted of three categories of firms: (1) the eight large distributors and their production companies, (2) “affiliated exhibitors” that were exhibition businesses wholly-owned or partially-owned by the large distributors, and (3) “independent companies” in which the eight distributors did not hold equity.<sup>73</sup> Interstate was an affiliated exhibitor of one of the large distributors.

2. *Movie Classifications:* (a) “Runs.” “First run” pictures were movies that were shown for the first time after their release. “Subsequent run” pictures were movies that previously had been exhibited elsewhere, and were typically classified as second- or third-run movies.

(b) “A” and “B” Movies. Feature films were introduced with a classification of A, B, and C films, which were loosely related to the production budget of a film.<sup>74</sup> Class A pictures featured “strictly famous players in famous plays,” Class B included “well known picture players,” and Class C were “made of odds and ends.”<sup>75</sup> With the proliferation of double features in the early 1930s, the classification gained a new meaning. In the era of double features, “A movies” were high-budget films, whereas “B movies” were low-budget, low-quality movies that primarily supplemented A movies in double-feature programs.<sup>76</sup>

3. *Theater Classifications: First- vs. Subsequent-run Theaters; Downtown vs. Neighborhood Theaters.* During the relevant period, first-run A movies played primarily in upscale theaters located in the downtowns of cities.<sup>77</sup> These theaters were commonly known as “first-run” theaters. In the industry lingo, they were known as “Class A theaters.” Inexpensive theaters whose facilities were less glamorous typically were unable to secure first-run A movies. These theaters were known as “second-run” or “subsequent-run theaters.” The least expensive

72. See HAMPTON, *supra* note 71, at 49–82; 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 FILM HIST. 105, 112 (2015); Ben Singer, *Manhattan Nickelodeons: New Data on Audiences and Exhibitors*, 34 CINEMA J. 5, 19 (1995).

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

74. 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; *V-L-S-E Classification Approved*, MOTION PICTURE WORLD, July 17, 1915, at 504; see also Terry Ramsaye, *The Rise and Place of the Motion Picture*, 254 ANNALS AM. ACAD. POL. & SOC. SCI. 1, 6 (1947).

75. TERRY RAMSAYE, A MILLION AND ONE NIGHTS 621 (1926).

76. See Brian Taves, *The B Film: Hollywood’s Other Half*, in GRAND DESIGN: HOLLYWOOD AS A MODERN BUSINESS ENTERPRISE, 1930–1939, 313 (Tino Balio ed., 1993).

77. DANIEL BERTRAND ET AL., *supra* note 6, at 46.



theaters were subsequent-run theaters that were located in residential neighborhood and, thus, were known as “neighborhood theaters.” Affiliated exhibitors operated the overwhelming majority of Class A theaters in the United States, as well as subsequent-run theaters. Independent exhibitors typically operated subsequent-run and neighborhood theaters. With the exception of one theater, Interstate operated all first-run theaters in Texas’s six largest cities.

4. *Facilitating Vertical Restraints.* To facilitate a system of runs and product differentiation, the distributors developed several types of vertical restraints. The three primary practices were “zones,” “clearances,” and “block booking.”

(a) *Zones and Clearances.* A “zone” was a territory that defined priorities for exclusivity rights of local exhibitors. Typically, a 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” of a film during which no theater in a zone had the right to show the film.<sup>78</sup> Disputes over zones and clearances between affiliated and independent theaters greatly contributed to the tensions among exhibitors.

(b) *Block Booking.* To finance the production of feature films, the distributors licensed annual programs of films before production. This practice was known as “block booking.” By 1927, seven of the eight large distributors licensed movies only through block booking.<sup>79</sup> The eighth large distributor, United Artists, licensed each movie separately or used blocks of several movies but did not use annual contracts.<sup>80</sup> The blocks that each of the seven distributors offered were so large that most exhibitors satisfied their annual needs with one or two contracts.

### C. Decentralization

Firms integrate economic activities to attain efficiencies and market power. The efficiencies are enhanced through internal allocations of tasks, including control and oversight. To improve such allocations of tasks, large businesses create business units and form subsidiaries. At the turn of the nineteenth century, businesses had little expertise with the management of diffuse responsibilities. The rise of large businesses popularized methods of “decentralization.”<sup>81</sup> During the Great Depression, pressures to improve performance turned decentralization theories into a managerial fad. In the motion picture industry, “decentralization” had a particular meaning—a transition from centralized management of

78. LEWIS, *supra* note 67, at 201–29.

79. See *Paramount Famous Lasky Corp. v. United States*, 282 U.S. 30, 43 (1930) (holding that an agreement among the distributors regarding the terms of block booking violated the antitrust laws).

80. See TINO BALIO, *UNITED ARTISTS: THE COMPANY BUILT BY THE STARS* 101–02, 107–09 (1976).

81. See generally Alfred D. Chandler Jr., *Management Decentralization: An Historical Analysis*, 30 BUS. HIST. REV. 111 (1956); Edwin G. Rust, *Centralization Versus Decentralization in Management*, 85 ANNALS AM. ACAD. POL. & POL. SCI. 100 (1919); Bernard Kilgore, *Decentralization: Move by Drug, Inc., Directors Emphasizes Industrial Planning Difficulties Suggests A New Trend*, WALL ST. J., July 1, 1933, at 1; William H. Whyte Jr., *The Transients*, FORTUNE, May 1953, at 112 (discussing the rise of mid-level management in the United States).

exhibition through national theater chains to regional circuits operated by local managers.

Pretty much from their formation until 1931, the large distributors competed over access to premium exhibition outlets.<sup>82</sup> This competition led to excessive investments in extravagant movie palaces and acquisition of all significant independent chains across the United States.<sup>83</sup> Throughout this period, even after the market crash of 1929, the majors invested in exhibition, although experts, including industry leaders, publicly acknowledged that the industry operated at overcapacity and that the operation costs of theaters were too high.<sup>84</sup>

There were many warning signs the distributors' investments in exhibition were excessive and the vertical integration with exhibition was inefficient.<sup>85</sup> In the race to acquire theaters, the distributors entered into costly leases believing that they could increase revenues in local markets. They typically acquired theaters as operating businesses, leased the underlying properties, and managed all theaters from their New York headquarters (the "home offices"). This system of centralized management offered certain efficiencies, but its inefficiencies were greater. The home offices lacked the expertise needed to serve the preferences of local markets ("showmanship").<sup>86</sup> Chain stores utilized scale, scope, and standardization to reduce costs and lower prices. Movie theater chains could not harness these advantages effectively. Their success built on charging high prices for glamour. Thus, already before the market crash of 1929, losses in exhibition persuaded Paramount to give away 150 theaters in small towns and persuaded one

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82. For a concise summary of the integration with exhibition, see *United States v. Paramount*, 70 F. Supp. 53 (S.D.N.Y. 1947).

83. See, e.g., *Building to Surpass All Records*, MOTION PICTURE NEWS, Jan. 21, 1927, at 217 (noting that investments in theater construction in 1927 will be at least 25% higher than in 1926 and stating that there was "no danger of overbuilding"); *Circuit Map Changing*, VARIETY, May 7, 1930, at 11 (discussing the acquisition of all independence chains); *Millions for Theaters*, in THE FILM YEAR BOOK 31 (Maurice Kann ed., 1927) (describing the increase in investments in theaters across the United States in 1925 and 1926); Abram F. Myers, *The Extermination of the Independent Picture Houses*, BILLBOARD, June 29, 1929, at 21.

84. See, e.g., *Leaders See Prosperity for 1927*, THE 1927 FILM YEAR BOOK 411 (John W. Alicoate ed., 1927) (providing statements of industry leaders rationalizing investments in exhibition despite warning signs); *Leaders See Prosperity for 1928*, THE 1928 FILM YEAR DAILY BOOK 501 (John W. Alicoate ed., 1928) (same); *How Leaders View '29*, 1929 FILM YEAR DAILY BOOK 513 (1929); *Outlook for 1930*, 1930 FILM YEAR DAILY BOOK 559 (1930) (same); *Reducing Theatres 25%*, VARIETY, July 11, 1928, at 5.

85. See, e.g., *The Independent Exhibitor*, VARIETY, Jan. 4, 1928, at 31 ("With the acknowledged failure of theatre operation, . . . the independent exhibitor gets a new lease of life."); *More Liberty Allowed in Local Theatre Operation Saves Million for Chain*, VARIETY, Feb. 13, 1929 at 16; *Publix Shifts Brains to Field for Close Contact with Public*, EXHIBITORS HERALD-WORLD, Nov. 22, 1930, at 25 (reporting about decentralization of operation); *Division of All Territory and Local-Pooled Operation by Major Chains May Come About*, VARIETY, July 30, 1930, at 5.

86. See, e.g., *Division of All Territory and Local-Pooled Operation by Major Chains May Come About*, *supra* note 85, at 5; *Film Salesmen Vanishing As Chains Absorb Independents*, VARIETY, Jan. 23, 1929, at 4.

of the minors (Universal) to exit exhibition and sell its theaters to Paramount.<sup>87</sup> Nonetheless, the five majors continued to acquire theaters until 1931.<sup>88</sup>

By the summer of 1931, the chains' heavy losses forced the majors to reevaluate the profitability of vertical integration with exhibition.<sup>89</sup> Many industry practitioners believed that decentralization of the national theater chains would improve operation and reduce the "chain stigma."<sup>90</sup> Three of the five majors, thus, adopted formal "decentralization" plans conceding that local control of theaters by regional companies might be superior to the centralized management of national chains.<sup>91</sup>

Reports about decentralization plans initially created mistaken beliefs that the distributors were exiting exhibition.<sup>92</sup> Decentralization, however, had the opposite meaning: the distributors adopted new managerial policies to enhance efficiencies. The majors broke up the national chains and formed partnerships with regional operators, in which the majors retained 15% to 75% ownership interest and transferred management responsibilities to the local partners. This reorganization allowed the distributors to reduce debt and liabilities by divesting less profitable assets and renegotiating long-term leases. The three majors that adopted formal decentralization plans threw their exhibition units into bankruptcy to renegotiate debt and reduce liabilities.<sup>93</sup> In March 1933, the trade association of the large distributors adopted a plan calling for "the readjustment of

87. See *150 Theatres Given Away*, VARIETY, Feb. 6, 1929, at 5; *Universal Giving Up House Operation-Selling 150 or More Theatres to Publix*, VARIETY, Oct. 16, 1929, at 7.

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

89. See, e.g., *Cinema: State of the Industry*, TIME, June 27, 1932, at 24 ("Fundamental difficulty in the cinema industry lies not in production, but in the cost of maintaining chains of theaters.").

90. 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.

91. 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 *Fox Theatre Chain to Run on Unit Plan*, N.Y. TIMES, Aug. 12, 1931, at 21; *Splitting Up Fox Chain*, VARIETY, Aug. 11, 1931, at 5. Other distributors followed. See Fred Ayer, *Decentralizing in Paramount Publix, Fox and RKO Circuits Presents Wider Field for Distributors Next Season*, MOTION PICTURE HERALD, June 17, 1933, at 9 (reviewing the decentralization programs); Don B. Reed, *Home Control of Picture Houses Gains Momentum*, WASH. POST, Aug. 23, 1931, at A3; *Chain Decentralization May Reach Into Other Large Theatre Circuits If Fox-East Experiment Stands Up*, VARIETY, Aug. 18, 1931, at 5; *Fox Chain Break-Up Effective Aug. 31*; *New Setup Outlined*, MOTION PICTURE DAILY, Aug. 13, 1931, at 1; *Publix Chain Called Complete With Decentralization Finished*; *H.O. Staffs Trimmed Away Down*, VARIETY, Jan. 17, 1933, at 29.

92. See, e.g., *Indies On Rise Thruout U.S.*, BILLBOARD, Apr. 29, 1933, at 7; see also *Chains Not Giving Away Any Melons in Theatres—If Good They Keep 'Em*, VARIETY, Feb. 21, 1933, at 31; *Decentralization: A Business Boon*, BILLBOARD, Dec. 3, 1932, at 28; *Decentralization Trend Is Spreading*, FILM DAILY, July 8, 1931, at 1; *De-Chaining As a Windfall for All Indies*, VARIETY, Apr. 25, 1933, at 7; *Independent Exhibs Speeding Comeback*, MOTION PICTURE DAILY, Aug. 5, 1931, at 1; Martin Quigley, *A Turn in the Road*, MOTION PICTURE DAILY, Aug. 13, 1931, at 1; *Older Methods*, N.Y. TIMES, Aug. 13, 1931, at 18.

93. See ROBERT T. SWAINE, 2 THE CRAVATH FIRM AND ITS PREDECESSORS 533–40 (1948) (discussing the reorganization of the distributors); *Receiverships for P-P, RKO*, BILLBOARD, Feb. 4, 1933, at 1 ("In all these receiverships and bankruptcies there has been a spirit of friendliness."); *Theatre Receiverships*, VARIETY, Jan. 31, 1933, at 5 ("The involved companies [were] seeking mostly relief from too expensive theatres."); *Trustees*

much of the industry's theatre structure in order that decentralization of ownership and management might result in greater economy and greater flexibility."<sup>94</sup>

Paramount, the distributor that operated the largest number of theaters, used bankruptcy proceedings to renegotiate liabilities for its "over-burdened chain operation."<sup>95</sup> The company formed partnerships with local theater operators, kept "a certain amount of supervision . . . , especially on the financial end and in film booking matters," and used funds paid by the partners for their equity to pay creditors 30¢ on the dollar.<sup>96</sup> Interstate was one of these partnerships. Like other partnerships, Interstate did not use the Paramount brands.<sup>97</sup>

In many markets, decentralization resulted in strong affiliated chains and further weakening of the local independent exhibitors.<sup>98</sup> This was the situation in Texas, where Interstate formed and emerged as one of the strongest regional chains in the country.

#### IV. THE GREAT DEPRESSION: ADMISSION PRICES, DOUBLE FEATURES, AND LEGAL UNCERTAINTY

The Great Depression devastated the U.S. economy from October 1929 to March 1933.<sup>99</sup> The recovery was slow and continued throughout the 1930s. During the Depression years, theaters converted to sound and about one third of U.S. theaters closed.<sup>100</sup> Facing dwindling demand, exhibitors experienced increased competition for patronage, resulting in a widespread reduction of admission prices and a growing use of various marketing schemes, such as giveaways, raffles, free ladies' nights, and double features.<sup>101</sup> From 1930 to 1933, the average admission price fell by 33%, exceeding the decline in the consumer price index by ten points.<sup>102</sup> In the first year of the Depression, the average admission price

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*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).

94. *Hays Submit Rehabilitation Program*, FILM DAILY, Mar. 28, 1933, at 1.

95. *Theatre Receiverships*, *supra* note 93, at 5.

96. *About 30¢ on the \$ By P.E.*, VARIETY, Dec. 12, 1933, at 9; *Famous Theatres' \$1,800,000 Bid for P.E.'s Assets Formally Approved*, VARIETY, Dec. 26, 1933, at 4. Mae Huettig's seminal study of the motion picture industry reports that, in the early 1940s, it was difficult to evaluate the relationships between the majors and their affiliated theaters.

97. *About 30¢ on the \$ By P.E.*, *supra* note 96, at 22.

98. See Fred Ayer, 1,422 NEW INDEPENDENT ACCOUNTS ARE CREATED, June 17, 1933, at 9.

99. Peter Temin & Barrie A. Wigmore, *The End of One Big Deflation*, 27 EXPLORATIONS ECON. HIST. 483 (1990).

100. THE MOTION PICTURE INDUSTRY STUDY, *supra* note 66, at 36.

101. See, e.g., H.O. Kusell, *Bank Night*, NEW REPUBLIC, May 6, 1936, at 363; *Bank Night*, TIME, Feb. 3, 1936, at 57; *Bank Night Bans*, TIME, Jan. 11, 1937, at 55; *Rage for Giveaways Diminishing*, MOTION PICTURE HERALD, Oct. 1, 1932, at 10; *85 Different Games Now in Use in Theatres Cost Industry Millions*, MOTION PICTURE HERALD, Nov. 12, 1938, at 31.

102. 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.

dropped by 6.5%, but box office revenues did not decline because the introduction of sound films contributed to increased attendance.<sup>103</sup> In 1931–1933, however, the average admission price kept declining and attendance plummeted.<sup>104</sup>

Of all practices adopted during the Depression, double features was “the exhibition scheme that made the greatest impact on the industry.”<sup>105</sup> Double features were a marketing tool fashioned after the popular scheme of “two for the price of one,” which, notwithstanding the name, permits charging for a bundle of products a price that is higher than the price that could be charged for a single product.<sup>106</sup> A double-feature program typically included a high-budget film and a low-budget film, a flop, or an old movie.<sup>107</sup> Exhibitors began offering double features with the emergence of feature films.<sup>108</sup> Throughout the 1910s and 1920s, theaters in competitive markets offered double features. The practice, however, became widespread only in the early 1930s, with the collapse of the demand for films.<sup>109</sup>

The rapid spread of double features reduced the demand for expensive productions and boosted the demand for low-budget films, which served as the “second feature.”<sup>110</sup> There were disagreements among exhibitors over the effects of double features on exhibition,<sup>111</sup> but exhibitors typically felt compelled to adopt the practice once their competitors did so. Six large distributors that specialized

103. See, e.g., Ayer, *1,422 New Independent Accounts Are Created*, *supra* note 98, 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.”).

104. THE MOTION PICTURE INDUSTRY STUDY, *supra* note 66, at 35.

105. Taves, *supra* note 76, at 28.

106. See, e.g., *FTC v. Mary Carter Paint Co.*, 382 U.S. 46, 49 (1965) (holding that the practice of “buy one, get one free” may be misleading). See generally William D. Diamond, *Just What Is a “Dollar’s Worth”? Consumer Reactions to Price Discounts vs. Extra Product Promotion*, 68 J. RETAILING 254 (1992); Indrajit Sinha & Michael F. Smith, *Consumers’ Perceptions of Promotional Framing of Price*, 17 PSYCH. & MARKETING 257 (2000).

107. 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).

108. Beach, *supra* note 107, at 505.

109. *Id.* at 505; see also *Anti-Dual Movement Reversed as Many Disregard Ban on Doubles*, MOTION PICTURE HERALD, Dec. 31, 1932, at 12; *Double Feature Film Days Disappearing Generally*, VARIETY, Oct. 30, 1929, at 20 (arguing that the practice, which was “nearly as old as the picture industry itself,” was “riding for a fall that may mean complete extinction”); *Double-Feature Plan Costly With Talkies*, BILLBOARD, May 25, 1929, at 21 (explaining an anticipated “demise of the double-feature practice”); *Double Feature Playing More Plentiful and Spreading, Good Only for Distributors*, VARIETY, Oct. 8, 1930, at 4; *Double Featuring Discussed By All Sides and from Many Angles*, VARIETY, Apr. 22, 1931, at 5; *Double Talkers on One Bill Coming Back Strongly with Chain and Indie Houses*, VARIETY, Apr. 2, 1930, at 12; *Spreading of Double Feature Alarm Leaders of Industry*, MOTION PICTURE HERALD, Nov. 14, 1931, at 9; *75% of Chicago Theaters Playing Double Features*, FILM DAILY, March 2, 1931, at 1.

110. Taves, *supra* note 76, at 28–30; Beach, *supra* note 107, at 508–09; Robert W. Chambers, *The Double Feature as a Sales Problem*, 16 HARV. BUS. REV. 226, 236 (1938); *H’Wood’s ‘Forgotten Men’*, VARIETY, July 8, 1936, at 5; *Need Twice as Many Pix*, VARIETY, Aug. 14, 1934, at 5.

111. See, e.g., Bosley Crowther, *Double Feature Trouble*, N.Y. TIMES, July 14, 1940, at 86; *Double Trouble*, TIME, Feb. 21, 1938, at 55; *Indie Exhibs Favor Flexible Pic Policy*, VARIETY, Apr. 17, 1934, at 29.

in high-quality films (the five majors and United Artists) strongly opposed double features, describing the practice as a “dangerous trade policy,” an “illness,” a “dangerous and malignant disease,” a “major problem,” “fallacious,” “unethical,” “evil,” and “cancer.”<sup>112</sup> Two minors, Columbia and Universal, produced mostly low-budget films and apparently benefitted from the increase in the demand for B films.<sup>113</sup> The primary beneficiaries of double features, however, were independent producers.<sup>114</sup> They had expertise in low-cost productions and until the Depression had a limited access to exhibition for the centralized booking practices of the national chains and the dominance of block booking.

Thus, with the exception of the independent producers, all industry groups engaged in efforts to eliminate double features.<sup>115</sup> Throughout the 1930s, the distributors and exhibitors negotiated initiatives to ban the practice.<sup>116</sup> Attempts to

112. See, e.g., *Chicago Exhibitors to Curb Double Features*, BILLBOARD, Nov. 29, 1930, at 33; *Double Bill Situations*, VARIETY, Apr. 15, 1931, at 9; *Double Feature Dangers*, VARIETY, Apr. 8, 1931, at 1; Samuel Goldwyn, *Hollywood Is Sick*, SAT. EVE. POST, July 13, 1940, at 18; *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*, *supra* note 109, at 9.

113. Taves, *supra* note 76, at 319, 326.

114. See *100 Features from Independents in New Season as Market Opens*, MOTION PICTURE HERALD, May 2, 1931, at 12; *250 Features from Indies*, VARIETY, March 1, 1932, at 5; Fred Ayer, *Independents Planning Larger Feature Output*, MOTION PICTURE HERALD, Apr. 7, 1934, at 9; “B” Films Become Issue of Studio and Theatre, MOTION PICTURE HERALD, Feb. 13, 1937, at 13, 18; *Double Bills*, BILLBOARD, Apr. 7, 1934, at 19; *Double Talkers on One Bill Coming Back Strongly*, *supra* note 109 (“[D]ouble feature houses are using an indie . . . to go along with a [film] from a national distributor . . .”); *Dual Bills Indies’ Hope*, VARIETY, Dec. 13, 1932, at 7; *Dual Film Tenacity Insures Them Market Indefinitely, Say Indies*, VARIETY, Apr. 26, 1932, at 5; Walter Greene, *The Indies and Duals*, VARIETY, Jan. 6, 1937, at 12; *Indie Producers Set for Unusual Opportunities as Several Chains Reach for All Available Films*, VARIETY, July 5, 1932, at 5; *Indies and Twin Bills Out*, VARIETY, June 14, 1932, at 5; *Indies Puzzled by Uncertainty of Double Bills*, VARIETY, May 16, 1933, at 4; *Majors Up Prod. to Keep Indies Out of 1st Runs*, VARIETY, Apr. 24, 1934, at 5 (noting that double features undermined efforts to “halt[] indies from getting into first and second runs”); George McCall, *The Quickie Film Producer*, VARIETY, Dec. 31, 1930, at 8; Leo Meehan, *Curtailment by Larger Studios Prompts Independents to Expand*, MOTION PICTURE HERALD, Jan. 9, 1932, at 9; *Notice Given Indie Studio Staffs in Hollywood, Pending Outcome of Double Features’ Future Via Codes*, VARIETY, Sept. 5, 1933, at 7; *Seven New Indie Producers Start on Coast in One Week; Double Features Responsible*, VARIETY, Apr. 15, 1931, at 11; *Small Neighborhood House Better Off than Big Ones*, VARIETY, Jan. 4, 1928, at 11; *Spreading of Double Feature Alarms Leaders of Industry*, MOTION PICTURE HERALD, Nov. 14, 1931, at 9.

115. Beach, *supra* note 107, at 514; Chambers, *supra* note 110, at 226; Rhodes, *supra* note 107, at 58–59; Jack Alicote, *Double-Feature?—Depression Dynamite*, FILM DAILY, Apr. 28, 1931, at 1; *Most Trade Leaders Denounce Double Featuring as a Menace*, *supra* note 112, at 13; *Producers’ Poll on Double Bills Jolts Twin Feature Ideas; Many Reasons for Public’s Antipathy*, VARIETY, Feb. 28, 1933, at 6; *Strong Stand for Duals*, VARIETY, Sept. 5, 1933, at 7.

116. See Rhodes, *supra* note 107, at 59; *Chicago Fights to Halt Double Bills*, MOTION PICTURE HERALD, Apr. 4, 1931, at 24; *Chicago Film Deals Await Filing of Suit*, MOTION PICTURE HERALD, Oct. 10, 1936, at 80; *Chicago Follows Kansas City, Detroit in Banning Double Bills*, MOTION PICTURE HERALD, Oct. 8, 1932, at 31; *Considering Wide Campaign to Discourage Double Bills*, FILM DAILY, May 21, 1931, at 1, 8; *Denver Exhibits Vote Against Twin Bills*, VARIETY, June 14, 1932, at 23; *Detroit Ends Double Bills*, BILLBOARD, Sept. 9, 1933, at 22; *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.”); *Double Features Losing on Coast*, MOTION PICTURE HERALD, Nov. 26, 1932, at 20; *Double Featuring Discussed by All Sides*, *supra* note 109, at 5; *Double Featuring May Be Ended with Opening of the New Season*, MOTION PICTURE HERALD, July 8, 1933, at 9; *Independents Act to End Twin Bills in New York Area*, MOTION PICTURE HERALD, June 11, 1932, at 22; *New War Brewing over Dual Features*, Sept. 1, 1934, at 29;

eradicate the practice, however, failed.<sup>117</sup> Among other reasons, the legality of agreements to ban double features was questionable.<sup>118</sup> For example, in December 1931, the distributors *agreed* that each would unilaterally punish exhibitors for offering double features, after receiving a legal opinion advising them that “any collective effort . . . to regulate the practice could be construed as conspiracy and would stand little chance if contested in the courts.”<sup>119</sup>

Congress passed NIRA in June 1933 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.”<sup>120</sup> NIRA intended to reinvigorate the economy, among other ways, by inviting industries to adopt “codes of fair competition.”<sup>121</sup> To facilitate such collaborations among competitors, NIRA exempted industry codes and any other agreements approved under the statute from the antitrust laws.<sup>122</sup> NIRA did not suspend the antitrust ban on horizontal restraints of trade. Rather, it created an exemption for government-sponsored industry arrangements. Nonetheless, the statute’s spirit instilled beliefs that it suspended antitrust enforcement.<sup>123</sup> These beliefs proved correct in part. When NIRA was in effect, the government invested little in antitrust enforcement and courts were reluctant to hold that private arrangements violated the antitrust laws. But with the repeal of NIRA, the government and courts adopted aggressive approaches to alleged antitrust violations.

In the motion picture industry, NIRA created hopes that the industry’s code would eliminate “cut-throat competition” and end the decline in box office revenues.<sup>124</sup> *Variety* called NIRA the “moratorium on antitrust law” and reported that all industry groups believed that the statute would allow them “to fix prices

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*Ousting Double Features*, VARIETY, Feb. 23, 1932, at 7; *Oppose Twin Bills*, VARIETY, May 17, 1932, at 23; *Suburbs 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”).

117. See, e.g., *Vitagraph, Inc. v. Perelman*, 95 F.2d 142, 147–48 (3d. Cir. 1936); *Anti-Dual Movement Reversed as Many Disregard Ban on Doubles*, MOTION PICTURE HERALD, Dec. 31, 1932, at 12; *Double Features Receive Sanction of Distributors*, MOTION PICTURE NEWS, Oct. 18, 1930, at 66; *Exhibitors Must Decide Problem of Double Bill, Say Distributors*, MOTION PICTURE HERALD, Dec. 5, 1931, at 14; *Midwest 2-Feature Panic*, VARIETY, Apr. 3, 1934, at 25; *Woodhull Is for Freedom*, BILLBOARD, Sept. 30, 1933, at 42.

118. See *Distributors May Direct Theatre Policy, Is Ruling*, MOTION PICTURE HERALD, Feb. 15, 1936, at 13 (“Thousands of exhibitors the country over, for many years privately or otherwise, have challenged the right of distributing companies to control theatre policy in the manner at issue.”).

119. *Exhibitors Must Decide Problem of Double Bill, Say Distributors*, *supra* note 117, at 14.

120. NIRA § 1.

121. *Id.* § 3.

122. *Id.* § 5.

123. See Gene M. Gressley, *Thurman Arnold, Antitrust, and the New Deal*, 38 BUS. HIST. REV. 214 (1964).

124. See, e.g., *Exhibitors Prepare to Raise Prices to Cover NRA Burden*, BILLBOARD, Oct. 7, 1933, at 24 (describing an anticipation for price increases); *Gait of Industry Is Quickened By Improvement of Business*, MOTION PICTURE HERALD, May 13, 1933, at 9, 10 (discussing anticipated effects on the cutthroat competition); *That Code Authority Board*, VARIETY, Jan. 2, 1934, at 4 (arguing that the implementation of the Code will prohibit competition among exhibitors); *Unfair Competition Out*, BILLBOARD, Dec. 16, 1933, at 20 (describing the expectations from the Motion Picture Code).

and enter into other compacts considered necessary.”<sup>125</sup> President Roosevelt approved the Motion Picture Code in November 1933.<sup>126</sup> It was the longest and most complex NIRA code.<sup>127</sup> Double features and price restrictions were two of the most contested topics in the negotiations over the code. For a lack of resolutions, the Motion Picture Code avoided both issues.<sup>128</sup>

The alleged *Interstate Circuit* conspiracy advanced policies addressing two of the most pressing issues in the industry in 1934: admission prices and double features. At the time, there was some uncertainty concerning the legality of contractual arrangements that regulated prices and double features. More precisely, there was some uncertainty concerning the possibility that the government would prosecute such arrangements or that courts would hold that such arrangements violated the antitrust laws.

## V. THE ALLEGED CONSPIRACY

*Interstate Circuit* raised the question of whether a decentralized theater chain orchestrated an unlawful conspiracy among the distributors. The events took place during the negotiations for the 1934–1935 season, when NIRA was still in effect.

### A. *Interstate Circuit, Inc.*

#### 1. *The Hoblitzelle-Paramount Partnership*

In the entertainment world, “Interstate Circuit” used to mean the theater business that was owned and operated by Karl Hoblitzelle with partnership of R.J. O’Donnell. Hoblitzelle was the “most influential man in commercial theatre of Dallas and the Southwest” and “the number one citizen” of Dallas.<sup>129</sup> In *Interstate Circuit*, the District Court described Hoblitzelle as one of Dallas’s “finest characters.”<sup>130</sup> In 1904, Hoblitzelle entered the exhibition business by forming a vaudeville company, Interstate Theaters Circuit.<sup>131</sup> His business model focused on building large premium theaters in large cities in the south and offering the best show in town.<sup>132</sup> O’Donnell, joined Hoblitzelle in 1925, served as his right

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

126. See Code of Fair Competition for the Motion Picture Industry (Code No. 124, Approved by President Roosevelt on Nov. 27, 1933).

127. LOUIS NIZER, *NEW COURTS OF INDUSTRY: SELF-REGULATION UNDER THE MOTION PICTURE CODE* xvii–xviii (1935) (arguing that the Motion Picture Code was the longest and most complex code).

128. *Right to Buy, Scores, Duals Out of NRA Code*, MOTION PICTURE DAILY, Oct. 5, 1933, at 1.

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

130. *United States v. Interstate Circuit*, 20 F. Supp. 868, 875 (N.D. Tex. 1937).

131. See Jane Lenz Elder, *Karl Hoblitzelle and the Inauguration of Interstate Theaters*, HIST. J. DALL. & N. CENT. TEX., Fall 1994, at 4.

132. *Id.* at 7–8; ROGERS, *supra* note 129, at 221–28; *Hoblitzelle Outstanding Figure in History of the Theater in Texas*, WICHITA DAILY TIMES, Aug. 19, 1941, at 8.



hand, held the title “general manager,” and was known as the “Boss Man.”<sup>133</sup> The large film distributors often used O’Donnell’s endorsement of films in advertisements that targeted exhibitors. 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 (over 1,000 seats per theater).

By 1929, Hoblitzelle operated one of the largest independent theater chains in the South that included seven deluxe theaters in Texas, Alabama, and Arkansas.<sup>134</sup> In May 1930, when the majors still acquired theater chains, Hoblitzelle sold his exhibition business to RKO, one of five majors, and retired.<sup>135</sup> Under the terms of the transaction, RKO bought Interstate as an operating business and leased the theaters from Hoblitzelle. O’Donnell moved to Publix, Paramount’s exhibition arm.<sup>136</sup> The economics of the deal is illustrative. During the Great Depression, Hoblitzelle exited the industry while securing himself a flow of income from costly leases, whereas a large distributor, RKO, expanded and entered into costly financial commitments.

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.<sup>137</sup> Hoblitzelle returned from retirement, agreed to relieve RKO of certain liabilities under the lease agreements, and took control of three theaters in Texas that he had sold three years earlier.<sup>138</sup> With the return of Hoblitzelle, O’Donnell moved back to Interstate.<sup>139</sup> Together, Hoblitzelle and O’Donnell turned the business around and reported profits within a few months.<sup>140</sup>

During the years of expansion, Publix, Paramount’s exhibition arm, acquired in Texas two large theater chains, Southern Enterprises and Dent. Southern Enterprises had about twenty theaters in Texas’s six largest cities and Dent had about seventy theaters in smaller cities in Texas and a few in Albuquerque, New Mexico. After Hoblitzelle returned to exhibition in 1933, Paramount began negotiating with him a partnership to set up a new Interstate Circuit company

133. See ROGERS, *supra* note 129, at 225; Gene Arneel, *Death of a Many-Splendored Showman*, VARIETY, Nov. 18, 1959, at 17; *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.

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

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

136. 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.

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

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

139. *Hoblitzelle’s Circuit Plans*, BILLBOARD, Apr. 1, 1933, at 7.

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

that would operate the theaters of Southern Enterprises, Dent, and Interstate Circuit.<sup>141</sup> Before the deal was finalized, the trade press described Hoblitzelle as “generalissimo of Interstate Circuit, Inc. and Consolidated Theaters, Inc.”<sup>142</sup> The successful recovery of the chains allowed Hoblitzelle to acquire and build additional theaters. In December 1933, Terry Ramsaye, a legendary film reporter, described the transformation of the exhibition business in Texas:

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.<sup>143</sup>

Finalized in April 1934, the Paramount-Hoblitzelle partnership positioned Hoblitzelle as one of the nation's largest affiliated exhibitors with a chain of almost 100 theaters.<sup>144</sup> 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”).<sup>145</sup> Paramount transferred to IC the ownership of Southern Enterprises theaters and assigned the leases of the chain's theaters to ICTO. 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) that operated two theaters chains, one was also known as “Interstate Circuit” and the other was TC.

141. *See Par's Texas Houses to Hoblitzelle and O'Donnell Gives 'Em 80 Spots*, VARIETY, Aug. 1, 1933, at 31 (reporting about the transfer of Dent theaters to Hoblitzelle and O'Donnell); *Paschall Buys Half of Publix-Dent Circuit*, FILM DAILY, July 1, 1932, at 1 (reporting the details of the decentralization partnership in Dent theaters); *Paschall's 50-50 Publix-Dent Deal May Chop Losses*, VARIETY, July 5, 1932, at 4 (reporting that Dent theaters were losing \$6,000 a week under Publix management).

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

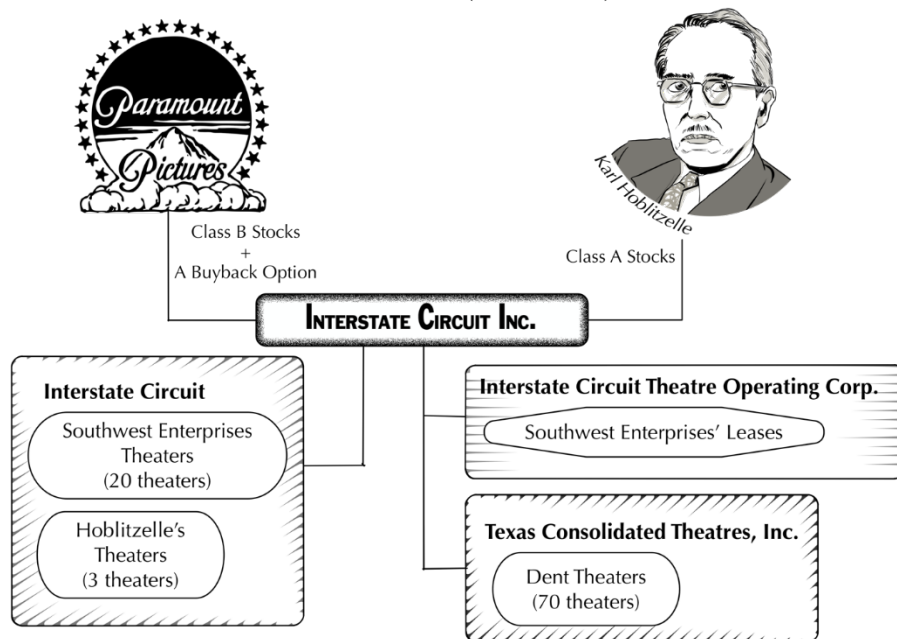
143. Terry Ramsaye, *Texas Rolls Her Own; That Goes in the Theatre Too*, SAYS RAMSAYE, MOTION PICTURE HERALD, Dec. 23, 1933, at 11.

144. *Windup of RKO-Par's Bankruptcy and Rcvrship in Southern Houses*, VARIETY, May 1, 1934, at 4 [hereinafter *Windup*].

145. *Balaban-Trendle Status Quo, but Par Sets 3 New Partnerships Incl. 50 Houses to Hoblitzelle*, VARIETY, Oct. 10, 1933, at 4 [hereinafter *Balaban-Trendle*]; *Incorporations*, VARIETY, Sept. 25, 1934, at 31; *Reorg. of Par. Theatre Links Soon; Texas Publix Out of Receivership*, VARIETY, March 27, 1934, at 6, 57 [hereinafter, *Reorg. of Par.*]; *Windup*, *supra* note 144, at 4.

IC issued two classes of stocks that gave each party a right to 50% of the company's profit: Class A stocks, which were held by Hoblitzelle and his associates, and Class B stocks, which were held by Paramount. The Class B stocks were preferred. Paramount had a buyback option to acquire Hoblitzelle's Class A stocks. Each party had two seats on the company's board of directors. Hoblitzelle committed to operate the theaters for salary and to pay Paramount \$1,500,000 over a period of twenty years.<sup>146</sup> When the bankruptcy trustees approved the partnership agreement, Hoblitzelle and O'Donnell had already "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."<sup>147</sup> In January 1936, Paramount announced that it would relinquish its buyback option and, instead, formalized a permanent partnership agreement with Hoblitzelle.<sup>148</sup> By that time, IC was "one of the largest and most important of Paramount theatre units."<sup>149</sup>

FIGURE 3: 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 Interstate Circuit with an option to acquire the other

146. Balaban-Trendle, *supra* note 145, at 4; *Reorg. of Par.*, *supra* note 145, at 6, 57.

147. Windup, *supra* note 144, at 4.

148. See *Par Drops Buy-Back Right*, VARIETY, Dec. 16, 1936, at 7; *Paramount Closes Partnership Deals*, MOTION PICTURE HERALD, Dec. 19, 1936, at 34; *Paramount, Hoblitzelle in New Pact*, MOTION PICTURE DAILY, Dec. 11, 1936 at 1, 14; *Partner Stays*, MOTION PICTURE HERALD, Jan. 4, 1936, at 9.

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

50%. When the government filed its complaint in December 1936, Interstate operated 109 theaters.<sup>150</sup>

## 2. *The Integration with Paramount*

Hoblitzelle's partnership with Paramount was organic, not limited to Paramount's ownership of equity in Interstate. While the partnership agreement was negotiated, Hoblitzelle joined Paramount's leadership team. In January 1934, Paramount announced that it would form a "National Theater Advisory Committee" to support the operation of its decentralized theaters.<sup>151</sup> Hoblitzelle was one of the six Committee members, who headed large decentralized chains.<sup>152</sup> Paramount created the Committee "for the purposes of exchanging information, confirming policies and maintaining closer contact between Paramount theater partners and associates and the home office."<sup>153</sup> 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."<sup>154</sup> In December 1934, Hoblitzelle was also appointed to the board of directors of Paramount.<sup>155</sup>

In February 1934, after NIRA's Motion Picture Code was signed, the Code Authority created "Clearance and Zoning Boards" and "Grievance Boards" in major cities. Hoblitzelle and O'Donnell were appointed to these boards for their relationships with Paramount.<sup>156</sup> 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.<sup>157</sup> Further, as affiliated exhibitors, 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.<sup>158</sup>

150. *Par Drops Buy-Back Right*, *supra* note 148, at 1, 14.

151. *Nat'l Theater Advisory Board Is Being Formed by Paramount*, *FILM DAILY*, Jan. 12, 1934, at 1, 8.

152. *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.").

153. *Paramount Sets Up National Theater Advisory Committee*, *BILLBOARD*, Jan. 20, 1934, at 20; *see also Schaefer Virtually Paramount Head: Agnew Sales Manager*, *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.").

154. *Paramount Sets Up National Theater Advisory Committee*, *supra* note 153, at 20; *see also Zukor Appoints Barney Balaban, N.L. Nelson and E.V. Richards as Executive Committee for Par*, *VARIETY*, July 31, 1934, at 5, 28 (describing the work of the Committee and the appointment of its first members).

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

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

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

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

In sum, when Hoblitzelle and O'Donnell advanced the idea of persuading the distributors to adopt new contractual restrictions, Interstate was an important subsidiary of Paramount that was operated by strategic partners of the company. Interstate's top managers, Hoblitzelle and O'Donnell, had direct relationships with Paramount's executives and access to executives of the other distributors.

*B. Rising Tensions Toward the 1934–1935 Season*

When block booking governed movie distribution, the industry negotiated annual deals every summer. The negotiations for the seasons of 1933–1934 and 1934–1935 were delayed because of the reorganization of the theater chains and complications caused by NIRA.<sup>159</sup> Price wars among exhibitors in various cities and the growing use of double features intensified tensions between the vertically integrated and independent firms.<sup>160</sup>

In late March 1934, examining an arrangement in the dry-cleaning industry, the Southern District of New York held that fixing minimum prices by contract or other means was lawful under NIRA.<sup>161</sup> The press reported that the decision applied to all industries.<sup>162</sup> In the motion picture industry, the trade press wrote that the decision gave a green light to fix minimum admission prices.<sup>163</sup>

Encouraged by the belief that concerted action was lawful, the distributors and the trade association of the affiliated exhibitors negotiated plans to ban double feature and raise admission prices.<sup>164</sup> In prior negotiations, the distributors and their affiliated exhibitors were unable to agree on a policy for minimum admission prices because of considerable quality differences across movies.<sup>165</sup> The negotiations, therefore, primarily focused on double features.<sup>166</sup> But, in mid-June

159. See, e.g., *Delayed Selling Liked*, VARIETY, Aug. 1, 1933, at 9; *Film Selling Decentralized; Sales Conventions Postponed*, MOTION PICTURE HERALD, May 6, 1933, at 15; *Late Selling Seems Sure*, VARIETY, Mar. 6, 1934, at 5; *Many '35 Sales Obstacles*, VARIETY, June 26, 1934, at 7; *Selling Season vs. NRA*, VARIETY, Jan. 9, 1934, at 5, 55.

160. See, e.g., *Demands for Admissions Above Dime Likely from 5 Companies*, MOTION PICTURE HERALD, Aug. 20, 1932, at 19; *Indies and Twin Bills Out*, VARIETY, June 14, 1932, at 5; *Triple Bills Concern Industry Heads; Estimate 100 Houses Adopt Policy*, VARIETY, Mar. 13, 1934, at 4; *What Executives Say on Price Cuts*, MOTION PICTURE HERALD, Jan. 21, 1933, at 10.

161. *United States v. Spotless Dollar Cleaners*, 6 F. Supp. 725, 730 (S.D.N.Y. 1934).

162. See, e.g., *Federal Judge Says U.S. Can Fix Minimum Price*, CHI. DAILY TRIB., Apr. 1, 1934, at 7; *NRA Price-Fixing Upheld by Court*, N.Y. TIMES, Apr. 1, 1934, at 1; *U.S. Court Backs NRA Price Fixing*, WASH. POST, Apr. 1, 1934, at 1; *U.S. Court Rules Price Cutting Illegal*, ATLANTA CONST., Apr. 1, 1934, at 1A.

163. See, e.g., *Hold Decision Legalizes 20¢ Minimum Scale*, MOTION PICTURE DAILY, Apr. 3, 1934, at 1; *Independent Planning Larger Feature Output*, MOTION PICTURE HERALD, Apr. 7, 1934, at 9.

164. See, e.g., *Red Kann, Chance Seen in Contracts to Kill Duals*, MOTION PICTURE DAILY, Apr. 19, 1934, at 1; *Figure 200 Out 1934-5's Pix*, VARIETY, June 5, 1934, at 25; *Majors Settling Dual Policy Now*, MOTION PICTURE DAILY, May 4, 1934, at 1; *MPTOA Moves Against Duals to Start Soon*, MOTION PICTURE DAILY, May 1, 1934, at 1; *Pros.—Exhibs Agree*, HOLLYWOOD REP., Apr. 17, 1934, at 1; *Several Distributors May Bar Double Bills*, MOTION PICTURE HERALD, June 2, 1934, at 12.

165. See, e.g., *Flexible Admission Prices Take Place of Exclusives As Practice*, MOTION PICTURE HERALD, Jan. 28, 1933, at 9.

166. See, e.g., *Majors Settling Dual Policy Now*, *supra* note 164; *Majors Will Force Exhibs to Single-Feature Policy*, HOLLYWOOD REP., June 12, 1934, at 1.

1934, the discussions collapsed.<sup>167</sup> There were fears of “losing sales to competitors not enforcing a double featuring ban.”<sup>168</sup> Thus, some distributors “declared that they were unwilling to incorporate a ban on double featuring in their contracts unless all distributors did the same.”<sup>169</sup> As noted, two minors—Columbia and Universal—benefitted from double features. They specialized in low-budget production and their A movies were equivalent to B movies of the other studios.

Two additional factors apparently contributed to the failure of the negotiations. First, the independent firms—producers, distributors, and exhibitors—declared that the plan to ban double features was “conspiracy in restraint of trade” and prepared for a legal battle.<sup>170</sup> Second, in May 1934, the National Recovery Review Board (“Darrow Board”) issued a report charging the National Recovery Administration with fostering cartels, favoring large businesses, and disregarding the interests of small business owners.<sup>171</sup> The Board used the motion picture industry as a prime example. It found that the Motion Picture Code was “designed to eliminate and oppress small businesses” and empowered the “Big Eight” that “cruelly oppressed” small firms.<sup>172</sup> With the Darrow Report stirring a national debate,<sup>173</sup> the distributors’ use of the Motion Picture Code to collude would have been unwise.

Hoblitzelle and O’Donnell first approached the distributors in April 1934, while the industry was negotiating ideas to impose restrictions on double features and minimum admission prices. They improved the proposed scheme shortly after the collapse of the negotiations. In effect, Hoblitzelle and O’Donnell successfully negotiated for their territories contractual restrictions that the distributors had considered but were unable to formulate.

### C. *The Arrangement*

In April 1934, Interstate circulated among the distributors a plan for minimum admission prices for likely box office hits (A movies playing in deluxe downtown theaters). In July 1934, after discussions with Paramount, Interstate improved the plan by adding a ban on double features and a commitment to comply with this ban. Subsequently, over a period of a few months, Interstate negotiated with each distributor separately. It persuaded the eight distributors to adopt restrictions on minimum admission prices and double features.

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167. *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.

168. *Major Pacts Not to Have Ban on Duals*, *supra* note 167, at 22.

169. *Id.*

170. *Allied Sees Plot to Kill 10-15¢ Spots*, MOTION PICTURE DAILY, May 16, 1934, at 1; *Double Bill Users May Appeal to Government*, MOTION PICTURE HERALD, May 12, 1934, at 9; *Independents Plan Fight to Protect Duals*, MOTION PICTURE DAILY, May 10, 1934, at 1.

171. See generally Lowell B. Mason, *Darrow v. Johnson*, 238 N. AM. REV. 524 (1934).

172. *The Financial Situation*, COM. & FIN. CHRON., May 26, 1934, at 3500.

173. See, e.g., *Investigation of the National Recovery Administration*, Hearings on S. Res. 79 Before the S. Comm. on Finance, 74th Cong. 298 (1935) (including a statement of Clarence Darrow).

*1. The Letters*

On April 25, 1934, shortly after the Hoblitzelle-Paramount partnership was finalized, O'Donnell sent an identical letter to the branch managers of the eight distributors, declaring a new policy toward the negotiations of the 1934–1935 season.<sup>174</sup>

The letter stated that Interstate would book films for its Class A theaters, only if these films would not play at any subsequent-run theater in the same city for an admission price lower than 25¢. This price restriction protected high-quality movies—first run movies that played in Class A theaters for an admission price of 40¢ or more. Unlike general minimum price restrictions, this restriction did not protect low-quality movies.

The branch managers, who received the letter, had no authority to approve such agreements and forwarded the letters to the home offices. At least three branch managers expressed strong objections to the plan.<sup>175</sup> The objections were hardly surprising. The branches had worked primarily with the independent exhibitors. Paramount's branch manager was an exception. He understood that “anything that work[ed] for the benefit of Interstate . . . work[ed] to the benefit of Paramount.”<sup>176</sup> O'Donnell testified that only Paramount had responded to his letter.<sup>177</sup>

Three days after sending the letter, Hoblitzelle and O'Donnell started negotiating the proposal with Paramount executives.<sup>178</sup> The discussions with Paramount continued through the company's sales convention in late June that addressed the “problem of double features.”<sup>179</sup> At the convention, O'Donnell and Hoblitzelle talked about the proposal with Paramount's general sales manager, who was second to Adolph Zukor, the company's founding president.<sup>180</sup> After the convention, Paramount's Eastern Sales Manager came from the home office to Dallas to close the deal.<sup>181</sup>

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174. See Appendix A.

175. *United States v. Interstate Circuit, Inc.*, In Equity No. 3736-992 ¶ 15 (May 17, 1938) (Special Findings of Fact and Conclusions of Law); *Interstate Circuit*, 20 F. Supp. at 873.

176. Testimony of J.B. Dugger, Paramount Branch Manager in Dallas at 129–30, *United States v. Interstate Circuit, Inc.*, In Equity No. 3736-992 4 (N.D. Tex. Dec. 11, 1937).

177. Testimony of R.J. O'Donnell at 102–03, *United States v. Interstate Circuit, Inc.*, In Equity No. 3736-992 (N.D. Tex. Dec. 20, 1937) [hereinafter “O'Donnell's Testimony”].

178. *Id.* at 100–02.

179. See *supra* Section I.A.2; Testimony of Karl Hoblitzelle, *United States v. Interstate Circuit, Inc.*, In Equity No. 3736-992 94-95 (N.D. Tex. Dec. 20, 1937) [hereinafter Hoblitzelle's Testimony]; O'Donnell's Testimony, *supra* note 177, at 101.

180. O'Donnell's Testimony, *supra* note 177, at 102 (referring to a discussion with George Shaefer, Paramount's general sales manager). Hoblitzelle could not remember that double features were discussed at the convention or any discussion of the proposal with a Paramount person. Hoblitzelle's Testimony, *supra* note 179, at 94–95; see also *Schaeffer Virtually Paramount Head; Agnew Sales Manager*, MOTION PICTURE HERALD, May 12, 1934, at 11.

181. O'Donnell's Testimony, *supra* note 177, at 102–03.

On July 11, 1934, after reaching an agreement with Paramount, O'Donnell sent a second letter.<sup>182</sup> As noted, in June 1934, negotiations among the distributors over a ban on double features ended unsuccessfully.<sup>183</sup> The July letter modified the policy stated in the April letter: (1) Interstate added a ban on double features; (2) the company committed that the Hoblitzelle's theaters would comply with both restrictions; (3) the letter emphasized that Interstate would negotiate films for its Class A theaters only with distributors that comply with its "request"; and (4) Interstate introduced a demand to impose the 25¢ price restriction in the Rio Grande Valley, where Texas Consolidated operated first-run theaters.

## 2. *The Negotiations*

The branch managers forwarded the July letter to the home offices, expressing strong objections. For example, RKO district sales manager wrote that O'Donnell's 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."<sup>184</sup> MGM branch manager wrote 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 1933-1934 season).<sup>185</sup> Universal branch manager warned the home office that Hoblitzelle and O'Donnell were "tough" and their demands were "extremely dangerous."<sup>186</sup>

Immediately after sending the July letter, O'Donnell and Hoblitzelle commenced direct negotiations with the distributors. These negotiations continued until late October; took place mostly at Interstate's offices in Dallas but also involved several trips;<sup>187</sup> and included discussions with executives from the home offices as well as branch managers.<sup>188</sup> At trial and on appeal, the defendants emphasized that Hoblitzelle and O'Donnell negotiated the restrictions with each company separately and did not threaten any distributor.<sup>189</sup> The record, however, shows that, at the very least, the distributors were mindful that Hoblitzelle and O'Donnell were negotiating with "all distributors."<sup>190</sup> More importantly, in effect, Paramount's rivals negotiated with a Paramount company.

Beyond concerns about antitrust risks, separate negotiations were inevitable. With the exception of the early discussions with Paramount, Hoblitzelle and

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182. See *infra* Appendix A.

183. See *infra* Section V.B.

184. Testimony of Herbert MacIntyre, RKO Southern District Sales Manager, Interstate Circuit, Inc., In Equity No. 3736-992 78 (N.D. Tex. Dec. 20, 1937).

185. Testimony of Le Roy Bickle, MGM Branch Manager in Dallas, United States v. Interstate Circuit, Inc., In Equity No. 3736-992 5, 74, 74 (N.D. Tex. Dec. 11, 1937) [hereinafter Bickle's Testimony].

186. Testimony of E.S. Oldsmith, Universal Branch Manager in Dallas, United States v. Interstate Circuit, Inc., In Equity No. 3736-992 9, 71, 72 (N.D. Tex. Dec. 11, 1937) [hereinafter Oldsmith's Testimony].

187. O'Donnell's Testimony, *supra* note 177, at 123.

188. *Id.* at 100-09.

189. Hoblitzelle's Testimony, *supra* note 179, at 90; O'Donnell's Testimony, *supra* note 177, at 109.

190. See, e.g., Bickle's Testimony, *supra* note 185, at 75 (describing a letter to O'Donnell from MGM referring to his letter "addressing all Distributors").



O'Donnell negotiated the restrictions while they were negotiating the contracts for the season of 1934–1935.<sup>191</sup>

### 3. *Compliance*

The exhibition agreements for the season of 1934–1935 were generally similar in substance, including the pattern of partial compliance with the letters. The letters demanded the restrictions in the six cities in which Interstate operated (Dallas, Fort Worth, Houston, San Antonio, Austin, and Galveston) and in Rio Grande Valley. The distributors adopted the restrictions in four cities: Dallas, Fort Worth, Houston, and San Antonio. In Houston, one of the majors, MGM, owned a first-run theater and did not adopt the restrictions. Instead, in Houston, MGM licensed subsequent runs only to Interstate. Paramount, Interstate's parent company, adopted the restrictions in the Rio Grande Valley. In Galveston, the demand had no practical purpose because Interstate owned all theaters. It is unclear why the distributors did not adopt the restrictions in Austin. In any event, the partial compliance with the demands stated in the July letter emerged from the negotiations.

After adopting a ban on double features, Hoblitzelle became a strong opponent of the practice. Six Interstate employees arguably reviewed the company's programs to assure that no theater was playing double features.<sup>192</sup> Seventeen months after the Supreme Court handed down *Interstate Circuit*, Samuel Goldwyn, a legendary producer and industry executive, wrote that double features were "killing the industry,"<sup>193</sup> but not in Texas: "Texas is immune because two brilliant showmen, Karl Hoblitzelle and Robert J. O'Donnell, have had sufficient wisdom and foresight to inoculate their theaters throughout Texas against the double-bill virus."<sup>194</sup>

### 4. *Why Letters?*

There were good reasons against sending letters to the branch managers. First, the letters were incriminating evidence. Second, Hoblitzelle and O'Donnell had direct communication channels to the distributors' home offices. Third, the branch managers had no authority to approve Interstate's demands. O'Donnell possibly ignored such considerations, but this seems unlikely.

The letters, which inspired the popular account, were apparently written for Hoblitzelle's commitment to the idea of decentralization. Before decentraliza-

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191. See, e.g., Bickle's Testimony, *supra* note 185, at 105–06 (discussing the negotiations with Universal); O'Donnell's Testimony, *supra* note 177, at 104 ("By commitments I mean we agreed to play a certain number of their pictures in our preferred 'A' theatres at the highest admission price.").

192. ROGERS, *supra* note 129, at 224.

193. Samuel Goldwyn, *Hollywood Is Sick*, SATURDAY EVENING POST, July 13, 1940, at 18.

194. *Id.* at 19.

tion, the branch managers negotiated deals exclusively with independent exhibitors and the home offices negotiated the deals for the national chains.<sup>195</sup> Decentralization required delegation of additional responsibilities to the branches that began negotiating deals with the decentralized chains.<sup>196</sup> Hoblitzelle was nationally known for his commitment to decentralization. For example, in January 1934, Hoblitzelle organized a “managerial conference” for the theater managers of the two Paramount chains that he operated.<sup>197</sup> The conference theme was decentralization and it addressed the changes in booking practices.<sup>198</sup> The guest speakers included representatives of the distributors: senior executives from the home offices and branch managers from Dallas.<sup>199</sup>

The choice to send letters to the branch managers, therefore, appears to reflect an effort to build relationships with the distributors’ branches. Such relationships did not exist before the industry adopted decentralization plans.

## VI. ANTITRUST ACTIONS

### A. *Private Actions and the Hoblitzelle’s Rider*

In November 1934, an independent exhibitor, Robert Glass, filed a class action lawsuit against Interstate and the distributors, arguing that they conspired in violation of Section 1 of the Sherman Act.<sup>200</sup> Additionally, Glass argued that Hoblitzelle and O’Donnell controlled the local NIRA institutions and abused that control.<sup>201</sup> The lawsuit was filed in a state court and was dismissed. Both the trial and appellate court concluded that only NIRA tribunals had the jurisdiction to adjudicate the claims.<sup>202</sup> The court of appeals also declared that exhibition agree-

195. See, e.g., *Film Salesmen Vanishing as Chains Absorb Independents*, VARIETY, Jan. 23, 1929, at 4.

196. See, e.g., *550 Publix Theaters Being Booked Locally*, Feb. 4, 1933 (reporting that, for the season of 1932–1933, Publix, Paramount’s exhibition arm, booked for about 600 theaters from the home office in New York and that, for the season of 1933–1934, the company would book for about fifty theaters from the home office); *Decentralization and Theatre Turnbacks Mean More Salesmen in the Field to Sell the Exhibs*, VARIETY, May 2, 1933, at 4; *Film Selling Decentralized; Publicity Men See Wide Demand for Their Work in New Field Situations*, VARIETY, Dec. 20, 1932, at 12; *Sales Conventions Postponed*, MOTION PICTURE HERALD, May 6, 1933, at 15.

197. Ann Bradshaw, *Decentralizing Entire Industry Urged by Hoblitzelle*, FILM DAILY, Jan. 19, 1934, at 1; *Decentralization Is Hoblitzelle’s Theme at Dallas Theater Meeting*, *supra* note 142, at 19; *Interstate Confab*, VARIETY, Jan. 16, 1934, at 25.

198. Bradshaw, *supra* note 197, at 1; *Decentralization Is Hoblitzelle’s Theme at Dallas Theater Meeting*, *supra* note 142, at 19; *Distrib—Exhib Sales Meets Locally*, VARIETY, Jan. 16, 1934, at 4.

199. *New Yorkers Attend Hoblitzelle Session*, MOTION PICTURE DAILY, Jan. 12, 1934, at 6.

200. *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. Testimony of Robert Z. Glass at 64, 67–68, *United States v. Interstate Circuit, Inc.*, In Equity No. 3736–992 64, 67–68 (N.D. Tex. Dec. 11, 1937).

201. *Exhibitor Names Texas Circuit in Restraint Action*, *supra* note 200, at 24.

202. *Glass v. Hoblitzelle*, 83 S.W.2d 796, 803 (Tex. Civ. App. 1935); see also *Glass Loses Suit Against Hoblitzelle*, MOTION PICTURE HERALD, Dec. 15, 1934, at 39; *Rule Texas Laws Cannot Apply to Film Contracts*, MOTION PICTURE DAILY, May 10, 1935, at 1; *Two-Bit Minimum Stands in Dallas*, BILLBOARD, Dec. 22, 1934, at 19.

ments were outside the scope of the antitrust laws because movies were copyrighted.<sup>203</sup> Independent exhibitors in other states filed lawsuits concerning similar arrangements in federal courts. They prevailed in some cases and lost in others.<sup>204</sup>

In May 1935, a few weeks after the *Glass* appeal was decided, the Supreme Court held that NIRA was unconstitutional.<sup>205</sup> The distributors and their affiliated exhibitors considered the possibility of adopting a “voluntary code,” to maintain the contract forms that were used under NIRA.<sup>206</sup> Legal experts, however, advised the distributors and their affiliated exhibitors that the “[a]ntitrust laws and decisions in film cases” were “formidable obstacles to any new code.”<sup>207</sup> Since a voluntary code appeared impractical, the trade association of the affiliated exhibitors, the Motion Picture Theatre Owners Association (“MPTOA”), changed course and developed a plan to protect “‘deluxe operations’ and ‘Class A’ theaters in competitive areas” that faced “cut-rate competition” from rivals who had “little or no investment to protect,” paid “peanuts for their film service,” had “a few low-wage employees,” and were “unscrupulous and irresponsible.”<sup>208</sup> The plan introduced a “contract rider” to exhibition agreements, which was inspired by “the new wrinkle written into many . . . contracts at the insistence of Karl Hoblitzelle.”<sup>209</sup> Under the provisions of the rider, the distributors committed to require rivals of affiliated exhibitors to charge minimum admission prices of 25¢, offer only single features, and not to engage in any price-cutting scheme.<sup>210</sup> The sanction to distributors that failed to meet the requirements listed in the “rider” was to refund the affiliated exhibitor 25% of the contracted rental.<sup>211</sup> It was estimated that the rider was used in about fifty major cities across the country.<sup>212</sup>

203. *Glass*, 83 S.W.2d at 797–99.

204. See, e.g., *Shubert Theatre Players Co. v. Goldwyn-Mayer Distribution Corp.* (D. Minn. 1936) (unpublished opinion, printed in *MOTION PICTURE HERALD*, Feb. 15, 1936, at 59) (holding that the plaintiff did not prove conspiracy); *Vitagraph, Inc. v. Perelman*, 95 F.2d 142, 142–48 (3d Cir. 1936) (holding that the distributors conspired to ban double features in Philadelphia).

205. *Schechter Poultry Corp. v. United States*, 295 U.S. 495, 550 (1935).

206. See, e.g., Clarence Linz, *Voluntary Use of Codes Seen as a Stop Gap*, *MOTION PICTURE DAILY*, May 31, 1935, at 1; *Sales Heads for Keeping Present Code Contracts*, *MOTION PICTURE DAILY*, May 31, 1935, at 1.

207. *Voluntary Code Drafted*, *MOTION PICTURE HERALD*, July 6, 1935, at 13; see also Red Kann, *Voluntary Code Delayed by Trade's Legal Doubts*, *MOTION PICTURE DAILY*, June 12, 1935, at 1; *Doubt of Voluntary Film Code Grows*, *MOTION PICTURE HERALD*, Sept. 7, 1935, at 38; *Doubt Voluntary Code This Year*, *MOTION PICTURE HERALD*, July 20, 1935, at 51.

208. James P. Cunningham, *MPTOA Asks Contract [to] Stabilize Admissions, [and] Control Practices*, *MOTION PICTURE HERALD*, July 15 1935, at 9; see also *MPTOA Calls on Exhibitors to Act on 10-Point Voluntary Code Idea*, *MOTION PICTURE HERALD*, July 20, 1935, at 52.

209. *Lengthy Doubts Delay Voluntary Code Start*, *MOTION PICTURE DAILY*, June 12, 1935, at 10.

210. *The MPTOA Plan*, *MOTION PICTURE DAILY*, June 12, 1935, at 10.

211. *Id.*

212. *Cut-Rates and Duals Curbed by Contracts*, *MOTION PICTURE DAILY*, Oct. 2, 1936, at 1.

### B. *The Government Complaint*

In September 1935, the Justice Department announced that it was investigating the contractual restrictions that Interstate promoted.<sup>213</sup> The investigation and subsequent lawsuit responded, in part, to broad pressures to revive Section 1 enforcement and address perceived problems in the motion picture industry.<sup>214</sup>

Eight months earlier, in January 1935, the Justice Department launched the “most far-reaching antitrust action in many years” and was approved by President Roosevelt. The action directed against an alleged conspiracy among several large distributors.<sup>215</sup> The action was “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.”<sup>216</sup>

The charges concerned an alleged attempt of Warner Bros. to regain control over theaters in St. Louis that, a few years earlier, the majors had sold to independent exhibitors as part of their decentralization plans.<sup>217</sup> A grand jury indicted three of the five majors and their senior executives on charges of conspiracy to exclude competition.<sup>218</sup> The government produced evidence that independent exhibitors in St. Louis could not obtain first-run films from the distributors, but failed to prove conspiracy.<sup>219</sup> The trade press reported that “[t]he verdict was a stunning blow to the Government which felt confident after the . . . trial, which attracted nation-wide attention.”<sup>220</sup>

In December 1936, about a year after the defeat in St. Louis, the federal government filed a complaint alleging that that Hoblitzelle and O'Donnell orchestrated a conspiracy with and among the distributors.<sup>221</sup> By challenging the legality of the arrangement in Texas, the government sought to attack the legality

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

214. *U.S. Marking Time but Admits Film Probes ‘Going On All the Time’*, VARIETY, Dec. 4, 1935, at 4; *see, e.g., Expect More Indictments*, BILLBOARD, Jan. 26, 1935, at 19; *‘Trust Busting’ Suit Up*, VARIETY, Jan. 8, 1935, at 5 (writing that the action was “virtually a complete duplicate” of the charges made against the industry in the Darrow Report and was “the government answer to repeated indie complaints that the major firms have ganged up on them”); *Washington Hears of Another Big Justice Dept. Suit vs. Pix*, VARIETY, Mar. 24, 1937, at 5.

215. *U.S. Government Starts Anti-Trust Suits Against Producers in St. Louis*, FILM BULL., Jan. 8, 1935, at 2; *see also 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”); *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.”); *‘Trust Busting’ Suit Up*, VARIETY, Jan. 8, 1935, at 5 (“Case reported to have been approved by President Roosevelt after prominent industry officials . . . sought to apply political pressure to . . . block the probe.”).

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

217. *‘Trust Busting’ Suit Up*, *supra* note 214, at 5.

218. *St. Louis Indicts Warners, Para., RKO*, MOTION PICTURE DAILY, Jan. 12, 1935, at 1; *Text of Indictment Against Movie Concerns*, N.Y. TIMES, Jan. 12, 1935, at 5.

219. Sam X. Hurst, *WB-RKO-Par Win in St. L.*, VARIETY, Nov. 13, 1935, at 5; *Jury Acquits Defendants in St. Louis Trust Case*, *supra* note 215, at 1.

220. Hurst, *supra* note 219.

221. Petition ¶ 20, *United States v. Interstate Circuit, Inc.*, 20 F. Supp. 868 (N.D. Tex. 1937), [hereinafter *Interstate Circuit Complaint*].

of the “contract riders.”<sup>222</sup> *Motion Picture Daily* wrote that the lawsuit was a “new test of the regulation of double featuring by means of contract provisions.”<sup>223</sup> *Variety* reported that the “Hoblitzelle case” was part of a “crusade against the motion picture industry” and raised the question of whether first-run exhibitors and the distributors had the legal right to set terms for subsequent-run exhibitors.<sup>224</sup> Learning from the loss in St. Louis, the government did not bring criminal charges. Instead, it sought to secure an “injunction restraining the distributor defendants from enforcing or attempting to enforce the provisions in their . . . license agreements.”<sup>225</sup>

### C. *The Interstate Circuit Opinions*

*Interstate Circuit* was tried at the District Court in Dallas and was appealed directly to the Supreme Court.<sup>226</sup> Eight Justices served at the Court when the case was argued, after the death of Justice Cardozo and before Justice Frankfurter was sworn in. The Court affirmed the District Court’s decision in a five-to-three decision. Justice Harlan Stone wrote the decision for the Court. Justice Owen Roberts wrote the dissent. Several points in the opinions deserve emphasis and clarification.

#### 1. *The Findings of Facts*

a. *The Abbreviated Summaries.* The District Court failed to issue a statement of facts. The Supreme Court’s first opinion, therefore, instructed the District Court to issue a formal statement of facts.<sup>227</sup> The Court’s analysis of the case relied on this statement of facts that was not published.<sup>228</sup> As a result, the discussion of facts in both opinions is very abbreviated and somewhat confusing.

b. *The Relationship Between Interstate Circuit and Paramount Pictures.* The Supreme Court’s opinion states that Interstate and Texas Consolidated were “affiliated with each other and with Paramount.”<sup>229</sup> It also recognizes that the distributors protected their affiliated exhibitors.<sup>230</sup> When *Interstate Circuit* was litigated, the affiliation of Interstate with Paramount was common knowledge. For example, in September 1937, immediately after the District Court delivered its decision, *Film Bulletin* described the alleged conspiracy in the spirit of the

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222. *Texas Control of Admissions Being Probed*, *supra* note 213.

223. *Double Billing Regulation Up in Texas Suit*, *MOTION PICTURE DAILY*, Dec. 18, 1936, at 1.

224. *U.S. Crackdown On Pix?*, *VARIETY*, Apr. 28, 1937, at 3, 54.

225. *Interstate Circuit Complaint*, *supra* note 221, ¶ 10.

226. Section 2 of the Antitrust Expediting Act provided for direct appeal to the Supreme Court in civil antitrust cases brought by the federal government.

227. *Interstate Circuit*, 306 U.S. at 214–15.

228. See Agreed Statement of Facts, *United States v. Interstate Circuits, Inc.*, 20 F. Supp. 868 (N.D. Tex. 1937) (No. 3736-992); see also *High Court Delays Dallas Ruling*, *MOTION PICTURE HERALD*, Apr. 30, 1938, at 26.

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

230. The Court believed that Paramount agreed to impose the restrictions in Rio Grande Valley because of its affiliation with TC. *Id.* at 219. The Court explained that MGM did not adopt the restrictions in Houston, where “its own affiliate,” “a subsidiary,” operated a theater. *Id.* at 218 n.5, 223.

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 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 willing accomplices. Whatever the answer is, no justification can be found for the seven distributors who joined this conspiracy, for it amounted to a death sentence for many small independents.<sup>231</sup>

c. *The Negotiations*. Both courts emphasized that Interstate engaged in negotiations with the distributors.<sup>232</sup> The District Court's description of the negotiations is more detailed than the discussion in the Supreme Court's opinion. For example, the court concluded that "the months over which the 1934–1935 contracts were incubated were, to some extent, occupied in the reconciliation of the differences between the eight distributors."<sup>233</sup>

## 2. *Conspiracy Inference*

The trial judge firmly believed that the "facts" "conclusively" showed that the defendants "conspired together" and that "[t]o hold otherwise would be to ravish the power to reason [and] to overthrow and disregard syllogism."<sup>234</sup> The Supreme Court affirmed the District Court's "inference of agreement" from the "substantial unanimity" of action taken by the distributors and additional factors.<sup>235</sup> The additional factors that the Court listed were (1) communication, (2) an abrupt departure from past practices, (3) a motive to conspire, and (4) acts against self-interest.<sup>236</sup>

Alongside with the described framework, the Supreme Court made two additional statements related to the standard of conspiracy inference. First, the Court declared twice that conspiracy may be inferred from competitors' conscious compliance with an invitation to collude.<sup>237</sup> Second, the Court wrote that an agreement is "not a prerequisite to an unlawful conspiracy."<sup>238</sup>

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

232. *Interstate Circuit*, 306 U.S. at 218–19; *United States v. Interstate Circuit*, 20 F.Supp. 868, 873–74 (N.D. Tex. 1937).

233. *Interstate Circuit*, 20 F. Supp. at 873.

234. *Id.*

235. *Interstate Circuit*, 306 U.S. at 221.

236. *Id.* at 221–26.

237. See *supra* notes 8–9 and accompanying text.

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

### 3. *Intellectual Property*

Thurman Arnold, who headed the Justice Department's Antitrust Division when *Interstate Circuit* was litigated, said that the case presented "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."<sup>239</sup>

Hoblitzelle's attorney had arguably advised him that, because movies were copyrighted, he would not violate the antitrust laws by sending the letters.<sup>240</sup> The eight distributors used this thesis in numerous antitrust cases.<sup>241</sup> For the distributors, the battle over this theory was the key issue the case presented.<sup>242</sup>

Both courts rejected the industry's attempt to use copyright as a shield. 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.<sup>243</sup> The dissent was critical of the interpretation that barred manufacturers from agreeing with customers about restrictions that would be imposed on their rivals.<sup>244</sup>

## VII. IMPLICATIONS FOR ANTIRUST ANALYSIS

*Interstate Circuit* presents a situation in which a large retailer devised a plan that resolved failed collusive negotiations, and negotiated the adoption of the plan with its suppliers. One of the suppliers was the retailer's parent company. The plan was advantageous to the retailer and suppliers but detrimental to their competitors—small retailers and suppliers. This scenario is markedly different from the popular account of *Interstate Circuit*.

Properly understood, *Interstate Circuit* holds that evidence of parallel compliance with a plan that resolves failed coordination among competitors permits inference of conspiracy, when other types of circumstantial evidence support

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239. Thurman Arnold, *Fair and Effective Use of Present Antitrust Procedure*, 47 YALE L.J. 1294, 1298 (1938); *President Asks Congress to Probe Monopoly and Investment Trusts*, MOTION PICTURE HERALD, May 7, 1938, at 28.

240. Hoblitzelle's Testimony, *supra* note 179, at 95–96.

241. See, e.g., *United States v. Paramount Pictures*, 334 U.S. 131, 144 (1948); *Fed. Trade Comm'n v. Paramount Famous-Lasky*, 57 F.2d 152 (2d Cir. 1932); *Westway Theatre v. Twentieth Century-Fox Film Corp.*, 30 F.Supp. 830 (D. Md. 1940).

242. See, e.g., Brief for the Appellants, *Interstate Circuit Inc. v. United States* 306 U.S. 208 (1939) (No. 3736-992); 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").

243. *Interstate Circuit*, 306 U.S. at 227–30; *United States v. Interstate Circuit*, 20 F. Supp. 868, 873 (N.D. Tex. 1937).

244. *Interstate Circuit*, 306 U.S. at 236–37 (Roberts, J., dissenting).

such conclusion. The flaws of the popular account invite a reexamination of the doctrines that the account inspired.

A. *The Agreement Requirement*

At the heart of all antitrust conspiracy cases lies the concept of “agreement.” *Interstate Circuit* upheld the Trial Court’s “inference of agreement” and declared an agreement is “not a prerequisite to an unlawful conspiracy.”<sup>245</sup> The apparent discrepancy between the opinion’s ruling and language illustrates that the word “agreement” has a specific meaning in antitrust law. Courts and commentators often cite *Interstate Circuit* for the propositions that (1) proof of unlawful conspiracy under Section 1 of the Sherman Act requires evidence of “agreement” (“concerted action”); (2) a conspiracy agreement need not be formal, written, or even express; and (3) a conspiracy agreement may be inferred from circumstantial evidence.<sup>246</sup> This set of evidentiary standards is sometimes called the “agreement requirement.”

As noted, an unlawful conspiracy agreement in the meaning of Section 1 is “a conscious commitment to a common scheme designed to achieve an unlawful objective.”<sup>247</sup> The facts of *Interstate Circuit* illustrate such an agreement.

Today, the agreement requirement includes two additional elements: (1) the defendants must have the capacity to conspire,<sup>248</sup> and (2) proof of unlawful conspiracy must include evidence that tends to exclude the possibility that the defendants acted independently.<sup>249</sup> The first element generally means that a firm and its subsidiaries are not capable of conspiracy, but the law is somewhat unclear about situations of partial ownership, especially when partial ownership

245. *Id.* at 221, 226.

246. See, e.g., *Paramount Pictures*, 334 U.S. at 142; *White v. R.M. Packer Co.*, 635 F.3d 571, 576 (1st Cir. 2011); *DM Research, Inc. v. Coll. of Am. Pathologists*, 170 F.3d 53, 56 (1st Cir. 1999); *Fed. Trade Comm’n v. Lukens Steel Co.*, 454 F. Supp. 1182, 1189 (D.D.C. 1978); 1 ANTITRUST LAW DEVELOPMENTS, *supra* note 4, at 9–10; Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655, 683–84, 695–96 (1962).

247. *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 768 (1984).

248. See, e.g., *Am. Needle, Inc. v. NFL*, 560 U.S. 183, 189 (2010); *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984); *Siegel Transfer, Inc. v. Carrier Exp., Inc.*, 54 F.3d 1125, 1131 (3d Cir. 1995); *Capital Imaging Assocs., P.C. v. Mohawk Valley Med. Assocs., Inc.*, 996 F.2d 537, 544 (2d Cir. 1993); see also PROOF OF CONSPIRACY, *supra* note 4, at 19 (“The touchstone of all Section 1 cases is an agreement between two or more separate entities.”).

249. 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*, 465 U.S. at 764; *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*, 346 U.S. 537, 541 (1954); *In re Insurance Brokerage Antitrust Litigation*, 618 F.3d 300, 331–32 (3d Cir. 2010); *In re Travel Agent Comm’n Antitrust Litig.*, 583 F.3d 896, 906 (6th Cir. 2009); *Toys “R” US, Inc. v. Fed. Trade Comm’n*, 221 F.3d 928, 934 (7th Cir. 2000) (“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.”).



does not offer control.<sup>250</sup> Accordingly, under present law, Interstate could not conspire with Paramount, but both companies could unlawfully conspire with the other distributors. The second element, evidence that tends to exclude the possibility of independent conduct, requires evidence beyond and above proof of parallel conduct. The showing of “conscious parallelism” and “plus factors” satisfies this standard. Thus, even under today’s standards, an analysis of the alleged conspiracy should conclude that Interstate and the distributors negotiated and entered into an unlawful agreement in restraint of trade.

### B. *Conscious Parallelism*

“*Conscious parallelism*” means interdependence that results in parallel conduct. These are situations in which competitors develop a mutual understanding that they would benefit from lessened competition and act upon this understanding. To establish conscious parallelism, a plaintiff must show parallel conduct and that the defendants were conscious of each other’s conduct.<sup>251</sup> Importantly, evidence of conscious parallelism, without more, is insufficient to prove an unlawful conspiracy agreement.<sup>252</sup>

Courts sometimes mistakenly treat the legal term of “conscious parallelism” and the economic concept of “tacit collusion” as synonymous.<sup>253</sup> In economics, “tacit collusion” means a diminished competition equilibrium that is

250. See, e.g., B. Douglas Bernheim & Michael D. Whinston, *Common Marketing Agency as a Device for Facilitating Collusion*, 16 RAND J. ECON. 269, 280–81 (1986); Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1305–06 (2016); Joseph Farrell & Carl Shapiro, *Asset Ownership and Market Structure in Oligopoly*, 21 RAND J. ECON. 275, 290 (1990); David Gilo, *The Anticompetitive Effect of Passive Investment*, 99 MICH. L. REV. 1, 29–45 (2000); David Gilo et al., *Partial Cross Ownership and Tacit Collusion*, 37 RAND J. ECON. 81, 93 (2006); Daniel P. O’Brien & Steven C. Salop, *Competitive Effects of Partial Ownership: Financial Interest and Corporate Control*, 67 ANTITRUST L.J. 559, 566–68 (2000).

251. See, e.g., *Petruzzi’s IGA Supermarkets, Inc. v. Darling-Delaware Co.*, 998 F.2d 1224, 1242 (3d Cir. 1993); *Schoenkopf v. Brown & Williamson Tobacco Corp.*, 637 F.2d 205, 208 (3d Cir. 1980).

252. See, e.g., *Theatre Enterprises*, 346 U.S. at 540–41; *In re Chocolate Confectionary Antitrust Litig.*, 801 F.3d 383, 398 (3d Cir. 2015); *Mayor of Baltimore v. Citigroup, Inc.*, 709 F.3d 129, 136 (2d Cir. 2013); *White v. R.M. Packer Co.*, 635 F.3d 571, 577 (1st Cir. 2011); *In re Flat Glass Antitrust Litig.*, 385 F.3d 350, 360 (3d Cir. 2004) (*Flat Glass*); *Williamson Oil Co. v. Philip Morris USA*, 346 F.3d 1287, 1301 (11th Cir. 2003); *In re Baby Food Antitrust Litig.*, 166 F.3d 112, 121 (3d Cir. 1999); *Merck-Medco Managed Care, LLC v. Rite Aid Corp.*, 201 F.3d 436, \*9 (4th Cir. 1999) (unpublished table decision); *City of Tuscaloosa v. Harcros Chemicals, Inc.*, 158 F.3d 548, 571 (11th Cir. 1998) (“The requirement of ‘plus factors’ is necessary because evidence of consciously parallel behavior alone leaves the circumstantial evidence of collusion in equipoise[.]”); *Todorov v. DCH Healthcare Authority*, 921 F.2d 1438, 1456 n.30 (11th Cir. 1991).

253. *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; *In re Text Messaging Antitrust Litig.*, 782 F.3d 867, 871 (7th Cir. 2015) (*Text Messaging II*) (“‘[C]onscious parallelism,’ as lawyers call it, ‘tacit collusion’ as economists prefer to call it[.]”); *Harcros*, 158 F.3d at 570 (“[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.”). The source of this interpretation is Donald Turner’s seminal article *The Definition of Agreement Under the Sherman Act*. Turner, *supra* note 246.

formed and maintained without any communication.<sup>254</sup> In antitrust analysis, however, conscious parallelism may be accompanied by communication and coordination.

*Interstate Circuit* is “the foundation and source” of the conscious parallelism doctrine.<sup>255</sup> The opinion articulates a paradigmatic conscious parallelism: “Each [distributor] was aware that all [distributors] were in active competition and that without substantially unanimous action . . . there was risk of a substantial loss . . . , but that with it there was the prospect of increased profits.”<sup>256</sup> The Court inferred a conspiracy from evidence of conscious parallelism and additional types of circumstantial evidence. A misreading of *Interstate Circuit* inspired a short-lived enforcement policy targeting conscious parallelism and a lengthy academic debate over the topic.<sup>257</sup> The argument that in *Interstate Circuit* the Supreme Court was close to infer conspiracy from conscious parallelism is incorrect.

254. See Edward J. Green et al., *Tacit Collusion in Oligopoly*, in 2 OXFORD HANDBOOK OF INTERNATIONAL ANTITRUST ECONOMICS 465 (Roger D. Blair & D. Daniel Sokol eds., 2015); Carl Shapiro, *Theories of Oligopoly Behavior*, in 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 329, 330 (Richard Schmalensee & Robert Willig eds., 1989).

255. Milton Handler, *Anti-Trust—New Frontiers and New Perplexities*, 6 REC. ASS’N B. CITY N.Y. 59, 63 (1951); see also *Brown v. Pro Football, Inc.*, 518 U.S. 231, 241 (1996) (citing *Interstate Circuit* to support the proposition that “[a]ntitrust law . . . sometimes permits judges or juries to premise antitrust liability upon little more than uniform behavior among competitors, preceded by conversations implying that later uniformity might prove desirable, . . . or accompanied by other conduct that in context suggests that each competitor failed to make an independent decision”); *Todorov*, 921 F.2d at 1456 n.30; *Wright v. S. Mono Hosp. Dist.*, 631 F. Supp. 1298, 1319 (E.D. Cal. 1986) (describing *Interstate Circuit* as the “leading case on conscious parallelism”); *United States v. O.M. Scott & Sons Co.*, 303 F. Supp. 141, 152 (D.D.C. 1969) (“A loose interpretation of the dictum in *Interstate [Circuit]* might lead one to believe that any ‘conscious parallelism’ . . . is unlawful. Subsequent decided cases do not go so far.”) (italics added); Richard E. Day, *New Theories of Agreement and Combination*, 42 ANTITRUST L.J. 287, 292 (1973) (describing *Interstate Circuit* as “the seminal case on the relevance of conscious parallelism to proving a conspiracy”).

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

257. See, e.g., U.S. ATT’Y GEN.’S NAT’L COMM. TO STUDY THE ANTITRUST LAWS, FINAL REPORT 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, 797, 801–02 (1954) (arguing that *Interstate Circuit* contributed to the development of the “doctrine of conscious parallelism”); HYLTON, *supra* note 3, at 77, 134–38; LOUIS KAPLOW, COMPETITION POLICY AND PRICE FIXING 76–80 (2013) (arguing that *Interstate Circuit* involved “interdependent oligopoly pricing behavior, where words may be lacking but a meeting of the minds is central”); John Purinton Dunn, *Conscious Parallelism Reexamined*, 38 B.U. L. REV. 225, 229–30 (1955) (arguing that *Interstate Circuit* relaxed “the tests for finding a conspiracy”); 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 oft-quoted language in support of the doctrine of conscious parallelism . . . .”); CONANT, *supra* note 25, at 183 (arguing that *Interstate Circuit* relaxed “the evidence required for the inference of conspiracy in antitrust cases”).

### C. *Plus Factors*

“*Plus factors*” are circumstantial evidence that is consistent with concerted action but is largely inconsistent with independent conduct.<sup>258</sup> Standing alone, a plus factor is insufficient to prove conspiracy, but in context, together with evidence of conscious parallelism, plus factors may prove conspiracy. The term “plus factor” first appeared in a 1952 decision, *C-O-Two Fire Equipment*. There, the Ninth Circuit wrote that a “plus factor” is circumstantial evidence that may prove the existence of unlawful conspiracy, “when viewed as a whole, in their proper setting,” but not “when standing alone and examined separately.”<sup>259</sup>

*Interstate Circuit* established four types of plus factors: (1) communication, (2) an abrupt departure from past practices, (3) a motive to conspire, and (4) acts against self-interest. Courts often refer to these plus factors, citing *Interstate Circuit* or other judicial opinions that cite *Interstate Circuit*.<sup>260</sup>

Courts and scholars frequently express dissatisfaction with the concept of plus factors because they are inherently inconclusive.<sup>261</sup> For example, evidence of communication may serve as plus factor, where its content is unknown or merely suggestive.<sup>262</sup> Thus, trade association activities may produce evidence of

258. See, e.g., *Quality Auto Painting Ctr. of Roselle, Inc. v. State Farm Indem. Co.*, 870 F.3d 1262, 1272 (11th Cir. 2017) (defining plus factors as circumstantial evidence that “tends to exclude the possibility of independent action”) (internal quotation omitted); *In re Musical Instruments & Equip. Antitrust Litig.*, 798 F.3d 1186, 1194 (9th Cir. 2015) (defining “plus factors” as “economic actions and outcomes that are largely inconsistent with unilateral conduct but largely consistent with explicitly coordinated action”); *Nexium*, 842 F.3d 34, 57 (1st Cir. 2016); *United States v. Apple, Inc.*, 791 F.3d 290, 319–20 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 1376 (2016) (*eBook*); *White v. R.M. Packer Co.*, 635 F.3d 571, 576 (1st Cir. 2011); *Insurance Brokerage*, 618 F.3d 300, 331–32 (3d Cir.); *Flat Glass*, 385 F.3d 350, 360 (3d Cir. 2004) (describing plus factors as “proxies for direct evidence of an agreement”); *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).

259. *C-O-Two Fire Equip. Co. v. United States*, 197 F.2d 489, 493 (9th Cir. 1952).

260. See, e.g., *Mayor & City Council of Balt., Md. v. Citigroup, Inc.*, 709 F.3d 129, 136 (2d Cir. 2013); *In re Travel Agent Comm’n Antitrust Litigation.*, 583 F.3d 896, 907 (6th Cir. 2009); *Battipaglia v. N.Y. State Liquor Auth.*, 745 F.2d 166, 175 (2d Cir. 1984); *In re Med. X-Ray Film Antitrust Litig.*, 946 F. Supp. 209, 221 (E.D.N.Y. 1996); *FTC v. Lukens Steel Co.*, 454 F. Supp. 1182, 1190 (D.D.C. 1978).

261. See, e.g., *Valspar Corp. v. E.I. Du Pont De Nemours & Co.*, 873 F.3d 185, 193 (3d Cir. 2017) (arguing that “in the case of oligopolies the . . . factors [of motive to conspire and acts against self-interest] are deemphasized because they largely restate the phenomenon of interdependence”); *Evergreen Partnering Group, Inc. v. Pactiv Corp.*, 832 F.3d 1, 1–14 (1st Cir. 2016); *Chocolate Confectionary*, 801 F.3d 383 at 397; *Guitar Center*, 798 F.3d at 1194–96 (explaining why common motive, action against self-interest, and departure from past practices may be consistent with interdependence); *Flat Glass*, 385 F.3d at 360 (arguing that the factors motive to collude and acts against self-interest “largely restate the phenomenon of interdependence” and stating that these “factors are important to a court’s analysis, because their existence tends to eliminate the possibility of mistaking the workings of a competitive market . . . with interdependent, supracompetitive pricing”); *In re Baby Food Antitrust Litig.*, 166 F.3d 112, 122 (3d Cir. 1999) (“The concept of ‘action against self-interest’ is ambiguous and one of its meanings could merely constitute a restatement of interdependence.”); *Barry v. Blue Cross of Cal.*, 805 F.2d 866, 869 (9th Cir. 1986). See generally Kovacic et al., *Plus Factors*, *supra* note 258.

262. See, e.g., *Baby Food*, 166 F.3d at 126 (“[C]ommunications between competitors do not permit an inference of an agreement to fix prices unless those communications rise to the level of an agreement, tacit or otherwise.”).

communication among competitors, but standing alone do not prove conspiracy.<sup>263</sup> Similarly, information sharing among competitors is probably more suggestive than trade association meetings but, standing alone, is insufficient to prove conspiracy.<sup>264</sup> In *Interstate Circuit*, there was evidence of vertical communication between a company and its suppliers. Such vertical communication is ordinarily necessary to conduct business. Much more is needed to show that such communication facilitated a cartel among the suppliers. A single letter from a retailer to its suppliers is probably insufficient to prove an agreement among the suppliers. Extensive vertical communication between a retailer and its suppliers is a more persuasive plus factor. In *Toys R Us*, supposedly the “modern equivalent of the old *Interstate Circuit*,”<sup>265</sup> the Seventh Circuit concluded that an extensive record of communications between a powerful retailer and its suppliers made the case “more compelling . . . for inferring horizontal agreement than did *Interstate Circuit*.”<sup>266</sup> In the same fashion, each of the other factors is inconclusive without context.<sup>267</sup> An abrupt departure from market practices may be a response to changing market conditions. A motive to conspire means a temptation to increase profits through an unlawful conspiracy but does not show conspiracy. And the plus factor of acts against self-interest describes conscious parallelism.

Plus factors present the context of the alleged conspiracy. Out of context, conscious parallelism means little and the available plus factors are inconclusive. For contemporary antitrust analysis, *Interstate Circuit* should be used to illustrate a situation in which evidence of conscious parallelism in context permits inference of unlawful conspiracy. In the context of intricate relationships among competitors, which include extensive negotiations over collusive practices, the adoption of such practices leads to the conclusion that the parties formed an unlawful conspiracy in violation of Section 1 of the Sherman Act.

The popular account of *Interstate Circuit* demonstrates a tendency to disregard or discount context. This tendency is somewhat paradoxical: it is inconsistent with the notion of circumstantial evidence.

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263. See, e.g., *Musical Instruments*, 798 F.3d at 1196–97; *Travel Agent*, 583 F.3d at 911.

264. See, e.g., *United States v. U.S. Gypsum Co.*, 438 U.S. 422 (1978); *In re Ins. Brokerage Antitrust Litigation*, 618 F.3d 300 (3d Cir. 2010); *Todd v. Exxon Corp.*, 275 F.3d 191 (2d Cir. 2001).

265. *Toys “R” Us, Inc. v. FTC*, 221 F.3d 928, 935 (7th Cir. 2000).

266. *Id.*

267. See, e.g., *Valspar Corp. v. E.I. Du Pont De Nemours & Co.*, 873 F.3d 185, 193 (3d Cir. 2017) (arguing that “in the case of oligopolies the . . . factors [of motive to conspire and acts against self-interest] are deemphasized because they largely restate the phenomenon of interdependence”); *Musical Instruments*, 798 F.3d at 1194–96 (explaining why common motive, action against self-interest, and departure from past practices may be consistent with interdependence); *Flat Glass*, 385 F.3d at 360 (arguing that the factors motive to collude and acts against self-interest “largely restate the phenomenon of interdependence” and stating that these “factors are important to a court’s analysis, because their existence tends to eliminate the possibility of mistaking the workings of a competitive market . . . with interdependent, supracompetitive pricing”); *Baby Food*, 166 F.3d at 122 (“The concept of ‘action against self-interest’ is ambiguous and one of its meanings could merely constitute a restatement of interdependence.”); *Barry v. Blue Cross of Cal.*, 805 F.2d 866, 869 (9th Cir. 1986).

*D. Tacit Agreement*

Courts infrequently use the term “tacit agreement” to describe a conspiracy agreement that is inferred from circumstantial evidence.<sup>268</sup> The term captures *Interstate Circuit*’s holding that proof of express agreement is not necessary to establish the existence of an unlawful conspiracy. Courts, therefore, sometimes use the case to illustrate the meaning of tacit agreement.<sup>269</sup> For example, in *White v. R.M. Packer Co.*, the First Circuit defined “tacit agreement” as an arrangement “in which only the conspirators’ actions, and not any express communications, indicate the existence of an agreement.”<sup>270</sup> Similarly, several courts held that tacit agreement is conscious parallelism that is accompanied with plus factors.<sup>271</sup>

## VIII. CONCLUSION

In antitrust parlance, a “conspiracy” is an unlawful agreement in restraint of trade. In most conspiracy cases, circumstantial evidence is used to prove the existence of the alleged conspiracy. Proof of unlawful conspiracy requires evidence that tends to exclude the possibility of independent conduct. During the past 130 years, courts and scholars have advanced and tested numerous conspiracy theories—models, premises, and intuitions explaining various aspects of collusive behavior that may constitute an unlawful conspiracy under Section 1 of the Sherman Act.

Certain theories and doctrines are rational and useful. But together, as a body of law, antitrust’s conspiracy theories and their doctrinal applications are disjointed and deficient. Specifically, the legal standards that apply to conspiracy inference are rather confusing.

*Interstate Circuit* laid the foundation of conspiracy inference in antitrust law. A flawed account of *Interstate Circuit* is still used to illustrate certain antitrust concepts. No research is needed to conclude that the account is misguided and implausible. The longevity of the account, however, requires a study to dispel the myth. The extensive use of the account by courts and commentators explains, in part, some of the flaws and deficiencies of antitrust’s conspiracy theories. This Article seeks to correct the record.

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268. See, e.g., *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 553 (2007) (stating that in conspiracy cases “[t]he crucial question is whether the challenged anticompetitive conduct stem[s] from independent decision or from an agreement, tacit or express.”). See generally Page, *supra* note 4.

269. See, e.g., *United States v. Citizens & S. Nat’l Bank*, 422 U.S. 86, 112 (1975); *First Nat’l Bank Ariz. v. Cities Serv. Co.*, 391 U.S. 253, 287–88 (1968); *Theatre Enters., Inc. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 540–41 (1954); *In re Nexium (Esomeprazole) Antitrust Litig.*, 842 F.3d 34, 57–58 (1st Cir. 2016); *White v. R.M. Packer Co.*, 635 F.3d 571, 576 (1st Cir. 2011); *DM Research, Inc. v. Coll. of Am. Pathologists*, 170 F.3d 53, 56 (1st Cir. 1999); *Barry v. Blue Cross of Cal.*, 805 F.2d 866, 869 (9th Cir. 1986); *E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128, 143 (2d Cir. 1984); *Betaseed, Inc. v. U & I, Inc.*, 681 F.2d 1203, 1234–35 (9th Cir. 1982).

270. *White*, 635 F.3d at 576.

271. See, e.g., *Brown v. Pro Football, Inc.*, 518 U.S. 231, 241 (1996); *Nexium*, 842 F.3d at 56–57; *White*, 635 F.3d at 576; *In re Baby Food Antitrust Litigation*, 166 F.3d 112, 121–22 (7th Cir. 1999).

In *Chicago Board of Trade*, Justice Brandeis famously wrote that, to evaluate the reasonableness of an agreement in restraint of trade, courts must consider “the facts peculiar to the business to which the restraint is applied,” the “nature of the restraint,” its “history,” and other factors.<sup>272</sup> The study of *Interstate Circuit* suggests that the nature and history of the relationships among competitors may serve as powerful circumstantial evidence for proof of conspiracy. This insight is rather intuitive. Nonetheless, it does not guide antitrust law. Courts emphasize contextual factors which, to their understanding, were used in other antitrust cases. For this approach, courts do not always see the wood for the trees.

The flawed account of *Interstate Circuit* became a part of important conspiracy concepts in antitrust law—the “agreement requirement,” “conscious parallelism,” “plus factors,” and “tacit agreement.” Accounting for the flaws, the Article offers refined explanations of these concepts:

*The Agreement Requirement.* A legal conclusion that the alleged conspirators consciously entered into or consciously participated in an anticompetitive scheme, which was designed to advance anticompetitive goals.

*Conscious Parallelism.* A conscious participation in anticompetitive scheme, which may form with or without communication. Evidence showing conscious parallelism is necessary to satisfy the agreement requirement, but standing alone is insufficient. In the absence of direct evidence, the evaluation of conscious parallelism in context may satisfy the agreement requirement.

*Plus Factors.* Circumstantial evidence concerning the context of conscious parallelism. Where evidence of conscious parallelism in context tends to exclude the possibility of independent conduct, the factfinder may conclude that the plaintiff satisfied the agreement requirement.

*Tacit Agreement.* A conspiracy agreement inferred from circumstantial evidence.

A legal conclusion that the plaintiff satisfied the agreement requirement does not mean that the agreement is an unreasonable restraint of trade. Once the existence of a conspiracy agreement is established, the factfinder must evaluate the reasonableness of the agreement.

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272. *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918).

## APPENDIX: 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,
	C. E. Hilgers [Twentieth	Universal]
	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 [*sic?*] 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.

