

2006

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### Recommended Citation

Ahmed E. Taha, *Controlling Conflicts of Interest: A Tale of Two Industries*, 37 Loy. U. Chi. L. J. 753 (2006).  
Available at: <http://lawcommons.luc.edu/lucj/vol37/iss4/4>

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# Controlling Conflicts of Interest: A Tale of Two Industries

Ahmed E. Taha\*

## I. INTRODUCTION

Increasing conglomeration is occurring in many industries. A conglomerate can have synergies between its businesses, which allow the production of better goods or services or lower prices.<sup>1</sup> However, conglomeration can also create conflicts of interest within a corporation, resulting in harm to consumers.

For example, the public spotlight has recently focused on the conflicts of interest faced by research analysts who work for financial institutions that also have investment banking departments. Investors rely on research analysts for investment advice.<sup>2</sup> Many of these research analysts work for brokerage firms and write research reports regarding various companies for the brokerages' clients and other investors.<sup>3</sup> A research report contains facts and opinions about the company that is the subject of the report, and is typically accompanied

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1. Thomas Ruffner, *The Failed GE/Honeywell Merger: The Return of Portfolio-Effects Theory?*, 52 DEPAUL L. REV. 1285, 1318 (2003).

2. Jill E. Fisch & Hillary A. Sale, *The Securities Analyst as Agent: Rethinking the Regulation of Analysts*, 88 IOWA L. REV. 1035, 1079 (2003) ("Investors rely on analyst research, in part, because they believe that analysts have both superior information and an incentive to convey that information to the marketplace accurately.").

3. *Id.* at 1041. These research analysts are called "sell-side analysts." *Id.* There are also "buy-side analysts" who are employed by institutions that invest money, such as mutual funds and pension funds. U.S. SECURITIES AND EXCHANGE COMMISSION, ANALYZING ANALYST RECOMMENDATIONS, June 20, 2002, <http://www.sec.gov/investor/pubs/analysts.htm>. Sell-side analysts have the conflicts of interest that are the focus of this Article.

by a recommendation regarding whether the company's stock is a good investment.<sup>4</sup>

Although investors expected to receive unbiased stock recommendations from research analysts, these analysts often faced great pressure to give positive recommendations of companies' stocks to help their firms secure investment banking business from those companies.<sup>5</sup> As a result, research analysts often gave biased investment advice, causing "untold millions of individual investors [to lose] vast sums of money."<sup>6</sup> In response to this bias, the Securities and Exchange Commission (SEC), other regulatory organizations and consent decrees approved by courts have recently imposed billions of dollars in fines and civil settlements in addition to a number of rules and regulations on research analysts and their employers.<sup>7</sup> These reforms are targeted at reducing and publicly disclosing analysts' conflict of interests.

Media conglomeration can cause similar problems. For example, there is fear that news outlets that are part of conglomerates will be reluctant to report unflattering news—or overeager to report positive news—regarding their corporate parent.<sup>8</sup> In addition, for publicity, the products of one of a conglomerate's subsidiaries may be unduly featured in the conglomerate's media outlets.<sup>9</sup> This Article examines another area in which media conglomeration creates significant conflicts of interest: a number of media conglomerates own both movie studios and media outlets that review movies.<sup>10</sup> As a result, many prominent movie critics now regularly review movies distributed by

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4. Fisch & Sale, *supra* note 2, at 1040–41.

5. David Schepp, *Wall Street Analysts Under Fire*, BBC NEWS, June 14, 2001, available at <http://news.bbc.co.uk/1/hi/business/1387192.stm>.

6. *Hearing on Corporate Governance Before the S. Comm. on Consumer Affairs, Foreign Commerce, and Tourism*, 107th Cong. 9 (2002) [hereinafter Spitzer Testimony] (statement of Eliot Spitzer, Attorney General, State of New York) (testifying that "investment advice has been compromised by a desire to win investment banking clients."), available at <http://commerce.senate.gov/hearings/062602spitzer.pdf>.

7. See *infra* Part III for a description of these reforms.

8. Dmitri Williams, *Synergy Bias: Conglomerates and Promotion in the News*, 46 J. BROADCASTING & ELECTRONIC MEDIA 453, 453 (2002).

9. Allison Fass, *Two Cable Networks Cooperate in a Bid to Cut Through Clutter*, N.Y. TIMES, Apr. 4, 2002, at C5 (discussing cross-promotions by cable television channels, A&E and The Weather Channel, which are both partially owned by Disney); Steve Johnson, *A Tangled Web*, CHI. TRIB., July 7, 2002, at C1 (noting cross-promotions by AOL and *Time Magazine* following the merger of AOL and Time Warner); *Reporters Rap Commercial Plugs in Broadcast News*, O'DWYER'S PR SERVICES REPORT, Jan. 1997, at 14 (discussing "plugging" of Fox movies and television programs by Fox News).

10. The Columbia Journalism Review maintains a list of the businesses owned by major media companies. *Who Owns What*, COLUM. JOURNALISM REV., Dec. 14, 2005, <http://www.cjr.org/tools/owners/index.asp>.

subsidiaries of the parent companies of the critics' employers.

Similar to users of research analysts' stock recommendations, consumers use critics' movie reviews to decide which movies to see.<sup>11</sup> Thus the potential for bias in movie reviews is strong. For example, the movie critics and editors of *Entertainment Weekly* likely understand that Time Warner—*Entertainment Weekly's* and Warner Brothers Pictures' parent company—financially benefits from a favorable review by *Entertainment Weekly* of a Warner Brothers film.

This Article empirically examines whether these conflicts of interest result in biased movie reviews. It finds that these movie critics' reviews are generally unbiased despite these conflicts of interest. Thus, critics working for some of the largest corporations in the country are able to maintain their objectivity even when doing so hurts their parent companies financially. This finding stands in stark contrast to the systematic bias exhibited by research analysts who issue reports on companies from which their employers seek investment banking business.

This finding also raises an important question: why do some conflicts of interest (like those facing research analysts in large financial conglomerates) result in biased opinions and harm to consumers, while others (like those facing movie critics in large media conglomerates) do not? Differences in the structure of the organizations in which movie critics and research analysts work, and differences in the direct financial incentives facing movie critics and research analysts are responsible for the different outcomes.

This conclusion has important implications for policymakers seeking to control conflicts of interest. For example, many of the recent reforms directed at research analysts should create an organizational structure and financial incentives more like those experienced by movie critics, thus this Article provides empirical support for inferring that some of these reforms will significantly reduce research analysts' bias. Other reforms, however, such as those mandating disclosure of analysts' conflicts of interest, are unnecessary; movie critics do not disclose their conflicts of interest, yet they do not produce biased reviews. Policymakers interested in controlling particular conflicts of interest should focus on eliminating or reducing the conflicts of interest rather than on requiring public disclosure of the conflicts. Indeed, recent

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11. People may also use reviews of a movie for help in understanding elements of the movie, to reinforce their own opinion of the film, and to be able to discuss the movie with other people more intelligently. Bruce Austin, *A Longitudinal Test of the Taste Culture and Elitist Hypotheses*, 10 J. POPULAR FILM & TELEVISION 156, 158 (1983).

research finds that requiring disclosure of conflicts of interest can actually be harmful to those who receive the disclosure.

Part II of this Article describes the organizational and incentive structure in which movie critics operate and the resulting conflicts of interest they face.<sup>12</sup> Part III discusses the organizational and incentive structure in which research analysts have operated, the resulting conflicts of interest and the bias caused by these conflicts, and how recent reforms attempt to address these conflicts.<sup>13</sup> The empirical assessment of whether movie critics' conflicts of interest result in biased movie reviews is set out in Part IV.<sup>14</sup> Part V discusses the lessons regarding controlling conflicts of interest that can be learned from the behavior of movie critics and research analysts.<sup>15</sup> Part VI summarizes and concludes the Article.<sup>16</sup>

## II. CONFLICTS OF INTEREST FACING MOVIE CRITICS

Conglomeration and consolidation in the media has created enormous media giants that are among the world's largest corporations. For example, Time Warner Inc. is the world's largest media and entertainment company, and ranks thirty-second in the Fortune 500,<sup>17</sup> with revenue of almost \$44 billion in 2005.<sup>18</sup> Among its most-well known operations are the Internet service provider America Online; Time Warner Cable; the CNN cable channel; popular magazines such as *Time*, *People*, *Entertainment Weekly*; and the production and distribution of films through businesses including Warner Brothers Pictures.<sup>19</sup>

Similarly, The Walt Disney Company, the second largest media and entertainment conglomerate, had almost \$32 billion in revenue in fiscal year 2005,<sup>20</sup> and ranks fifty-fourth in the Fortune 500.<sup>21</sup> Among its

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12. See *infra* Part II (examining three media conglomerates and how favorable movie reviews can increase their profits).

13. See *infra* Part III (describing bias in research analyst reports and discussing the subsequent legislation and regulation).

14. See *infra* Part IV (presenting empirical analyses demonstrating that movie critics do not exhibit a systematic bias in favor of affiliated movies).

15. See *infra* Part V (concluding that bias is attributable to financial incentives and lack of independence, but that disclosure is ineffective in reducing bias).

16. See *infra* Part VI (arguing that policymakers should focus on reducing the existence of conflicts of interest, rather than publicly disclosing them).

17. *Ranked Within Industries*, FORTUNE, Apr. 18, 2005, at F46.

18. Time Warner Inc., Annual Report (Form 10-K), at 253 (Feb. 27, 2006).

19. *Who Owns What*, *supra* note 10.

20. Disney's fiscal year ends on October 1. The Walt Disney Co., Annual Report (Form 10-K), at 76 (Dec. 7, 2005).

most well known media operations are the ABC television network; the ESPN cable channel; and the production and distribution of movies through studios including Walt Disney Pictures, Touchstone Pictures, and Miramax Films.<sup>22</sup>

The News Corporation Limited is an international media conglomerate headed by Rupert Murdoch with almost \$24 billion in revenue in fiscal year 2005,<sup>23</sup> ranking ninety-eighth in the Fortune 500.<sup>24</sup> Among its businesses are the Fox News Channel; a large number of newspapers; and the production and distribution of movies through its 20th Century Fox and Fox Searchlight Pictures subsidiaries.<sup>25</sup>

The large size and scope of such conglomerates has raised concerns. Many fear that news outlets owned by a conglomerate will not fully cover stories that generate negative publicity for their corporate parent, and will give too much coverage to stories that give positive publicity to it.<sup>26</sup> For example, ABC News may be reluctant to report on the newsworthy problems at The Walt Disney Company because Disney owns ABC. Such reluctance would decrease the quality of the news that viewers receive.

Indeed, the behavior of these conglomerates indicates that they use some of their businesses to maximize the profits of their other businesses. For instance, they use their media outlets to promote the products and services produced by other companies within the conglomerate.<sup>27</sup> For example, ABC's *Good Morning America* television show covered Disney World's twenty-fifth anniversary for two hours, which included an interview of then-Disney CEO Michael Eisner.<sup>28</sup>

Many media conglomerates have another way to increase their profits. These conglomerates own both movie studios and major media outlets that review movies. For example, The Walt Disney Company owns Walt Disney Pictures and other movie studios and also owns Buena Vista Television, the distributor of the popular *Ebert & Roeper and the Movies* (*Ebert & Roeper*) television program, which each week

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21. *Ranked Within Industries*, *supra* note 17.

22. *Who Owns What*, *supra* note 10.

23. News Corporation's fiscal year ends on June 30. News Corp., Annual Report (Form 10-K), at 125 (Sept. 1, 2005).

24. *Ranked Within Industries*, *supra* note 17.

25. *Who Owns What*, *supra* note 10.

26. Williams, *supra* note 8, at 453.

27. *See supra* note 9 (detailing various sources outlining how media conglomerates cross-promote among their various media sections).

28. Williams, *supra* note 8, at 453.

features movie critics Roger Ebert and Richard Roeper reviewing movies.<sup>29</sup> *Ebert & Roeper* appears on more than 200 television stations and is the “top-rated first-run weekly syndicated half-hour on television.”<sup>30</sup>

The world’s largest media company, Time Warner Inc., owns movie studios such as Warner Brothers Pictures and magazines that review movies, including *Entertainment Weekly*, *Time*, and *People*.<sup>31</sup> In addition, The News Corporation Limited produces and distributes movies through its 20th Century Fox and Fox Searchlight Pictures subsidiaries<sup>32</sup> and owns media outlets, such as the *New York Post* newspaper, that regularly review movies.<sup>33</sup>

Because consumers use critics’ reviews to decide which movies to see,<sup>34</sup> if the conglomerate’s media outlets give positive reviews of movies distributed by the conglomerate’s movie studios, then the studios’ profits will increase. Thus, these movie critics face a conflict of interest creating the potential for bias in their movie reviews: although readers of their reviews expect the critics’ sincere opinions about the movies, these critics can financially benefit their affiliated studios by giving positive reviews to movies distributed by those studios.

There is much evidence that studios greatly value positive reviews. Most studies have found that favorable movie reviews result in more people seeing a movie than do unfavorable reviews.<sup>35</sup> Even positive reviews from individual critics can have a significant effect on a movie’s success. For example, having a movie receive a “thumbs up” from Roger Ebert and Richard Roeper is “worth millions to the studios.”<sup>36</sup>

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29. *Id.*

30. *Ebert & Roeper*, MOVIES.COM, <http://tvplex.go.com/buenavista/ebertandroeper/bios/ebert.html> (last visited Feb. 6, 2006).

31. *Who Owns What: Time Warner*, *supra* note 10.

32. *Id.*

33. *Id.*

34. Austin, *supra* note 11, at 158.

35. See Suman Basuroy, Subimal Chatterjee, S. Abraham Ravid, *How Critical are Critical Reviews? The Box Office Effects of Film Critics, Star-Power, and Budgets*, 67 J. MARKETING 103, 107 (2003) (citing studies and discussing film critics’ influence on box office revenue); David A. Reinstein & Christopher M. Snyder, *The Influence of Expert Reviews on Consumer Demand for Experience Goods: A Case Study of Movie Critics*, 53 J. INDUS. ECON. 27, 29 (2005) (finding a positive relationship between favorable reviews and box office revenue); cf. S. Abraham Ravid, *Information, Blockbusters, and Stars: A Study of the Film Industry*, 72 J. BUS. 463, 482 (1999) (finding that positive reviews do not significantly affect the revenue earned by a movie).

36. Lorenza Munoz, *Credibility on the High Seas*, L.A. TIMES, Mar. 3, 2002, at F10.

Critics' reviews can significantly impact the success of even the most heavily advertised films, especially if critics state that such a movie goes beyond typical expectations for movies of that genre.<sup>37</sup> For example, movies including *Men in Black*, *Saving Private Ryan*, *Scream*, and *The Terminator*, were transformed from being "hits" to being "mega-hits" by critics informing moviegoers that these hit movies were also actually good movies.<sup>38</sup>

Also, the behavior of movie studios clearly demonstrates that studios believe that positive reviews are important. Advertising for movies routinely contains favorable quotes from critics. Positive statements from well-known critics, such as Roger Ebert, are featured especially prominently in advertising.<sup>39</sup> Studios also sometimes eliminate or delay advance screenings of a movie for critics if the studios believe that the movie will receive bad reviews.<sup>40</sup>

In addition, studios have misused movie reviews in advertising movies. In 2001, two Sony advertising executives were suspended for thirty days when it was discovered that Sony had created quotes from a fictitious movie critic to use in advertisements for four movies of "questionable-quality:" *The Animal*, *Hollow Man*, *A Knight's Tale*, and *Vertical Limit*.<sup>41</sup> Many in the movie industry feared that this transgression would result in governmental regulation.<sup>42</sup> However, the

37. David Shaw, *Thumbs Up or Down on Movie Critics?*, L.A. TIMES, Mar. 20, 1999, at A1.

38. *Id.*

39. See, e.g., Dade Hayes, *Two Thumbs Way Up!*, VARIETY, Jan. 5, 2004, at 11 (noting that Newmarket, the distributor of the movie *Monster*, which starred actress Charlize Theron, "plastered Roger Ebert's rave—'[Charlize Theron gives o]ne of the best performances in the history of cinema'—all over print ads"); Richard Natale, *When His Thumb Turned, Millions Got the Message; Responding to Movies Like a Couple of Guys at the Water Cooler, Siskel and Ebert Gained Power in Hollywood Marketing Circles*, L.A. TIMES, Feb. 24, 1999, at F1 (referring to the *Siskel and Ebert* television show—the predecessor of *Ebert & Roeper*—the head of distribution of Sony Pictures states that "[i]t was always a major plus to get their approval, . . . I can't think of a case where we got two thumbs up that we didn't use it in TV ad spots[']").

40. See, e.g., James Sanford, *James Sanford Chooses the Best and Worst Films of 2002*, <http://www.interbridge.com/jamesanfor/bestof2002.html> (last visited Feb. 6, 2006) (noting that Warner Brothers canceled advanced critical screenings of *The Adventures of Pluto Nash* due to concerns that the movie would receive poor reviews).

41. Robert W. Welkos, *Untruths and Consequences*, L.A. TIMES, June 24, 2001, at 5; Emanuella Grinberg, *Moviegoers to Settle with Studio After Being Lured by Phony Critic*, CNN, Mar. 9, 2004, <http://edition.cnn.com/2004/LAW/03/09/phony.critic>; Matthew Hays, *The Trouble with Junkets*, MONTREAL MIRROR, June 14, 2001, <http://www.montrealmirror.com/archives/2001/061401/film1.html>. Studios have also misrepresented testimonials from other sources. Four major studios have admitted to using employees or actors posing as ordinary moviegoers to provide testimonials in advertisements for certain movies. Welkos, *supra*. A studio has also constructed a phony fan web site for a movie. *Id.*

42. Wayne Friedman, *Sony Woes Stir Studio Concerns: Executives Fear an Invitation for*



Federal Trade Commission did not take any action against Sony, citing higher priorities for the agency and the disciplining effect of the bad publicity that Sony received from the incident.<sup>43</sup>

However, Sony did not completely escape direct punishment for its transgression. Sony settled (for \$1.5 million) a class action suit filed on behalf of persons who allegedly were persuaded by the phony reviews to see the movies.<sup>44</sup> Also, it paid a \$326,000 fine to the State of Connecticut for claiming that the fictitious critic worked for a local Connecticut newspaper.<sup>45</sup> In addition, it paid \$25,000 to the consumer protection and education fund of the Oregon Department of Justice to settle deceptive advertising charges.<sup>46</sup>

More evidence of the importance of positive reviews is that studios sometimes misuse excerpts from even legitimate reviews. For example, advertisements for the movie *Hoodlum*, starring actor Laurence Fishburne, quoted *Los Angeles Times* movie critic David Turan as having called the movie “[I]rresistible,” when actually he had written that “[e]ven [Laurence Fishburne’s] incendiary performance can’t ignite *Hoodlum*, a would-be gangster epic that generates less heat than a nickel cigar. . . . Fishburne’s Bumpy is fierce, magnetic, irresistible. . . . But even this actor . . . can only do so much.”<sup>47</sup> In 2003, the Federal Trade Commission began reviewing its guidelines regarding how studios can use reviews to promote movies.<sup>48</sup> These rules prevent using part of a review out of context to suggest that the critic gave a more positive review than the critic actually gave.<sup>49</sup>

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*Regulation Looms*, ADVERTISING AGE, June 25, 2001, at 4 (quoting an industry executive discussing increased scrutiny on the industry’s policy of self-regulation).

43. Nat Ives, *The U.S. Plans to See if There is Misleading Marketing of Movies*, N.Y. TIMES, Jan. 14, 2003, at C12 (quoting the Federal Trade Commission’s Associate Director for Advertising Practices as explaining that “[w]e get many, many complaints about many issues, including serious health and safety issues, or significant monetary loss to consumers”).

44. Lawrence Van Gelder, *Arts, Briefly*, N.Y. TIMES, Aug. 4, 2005, at E2.

45. Andrew Gumbel, *Sony Penalised for Faking Film ‘Blurbs’*, THE INDEPENDENT, Mar. 13, 2002, at 3.

46. Media Release, State of Oregon Dep’t of Justice, Attorney General Files Action Against Sony Pictures for Deceptive Advertising of Movies (Aug. 13, 2001), available at <http://www.doj.state.or.us/releases/rel081301.htm>. These Oregon charges also involved Sony’s use of employees posing as ordinary moviegoers to provide testimonials in advertisements for certain movies. *Id.*

47. Leora Broydo, *(Not Such a Thriller!)*, MOTHER JONES, Nov.–Dec. 1997, available at <http://www.motherjones.com/new/outfront/1997/11/broydo.html> (describing studios distorting critic’s words in advertisements as “a practice as old as show biz itself”).

48. Ives, *supra* note 43; Pamela McClintock, *FTC Reviewing Movie Blurb Guidelines*, DAILY VARIETY, Jan. 10, 2003, at 8.

49. A Federal Trade Commission Advertising Guide warns that “any alteration in or quotation from the text of the review which does not fairly reflect its substance would be a violation of the

There is also evidence that studios try to bias the reviews of some critics. Studios have sometimes retaliated against critics who have given particularly bad reviews of the studios' movies. This retaliation has often taken the form of temporarily banning the offending critic from pre-opening screenings of the studios' movies.<sup>50</sup>

In addition, studios routinely hold press junkets in which reporters and movie critics are invited to attend the screening of an upcoming movie and to interview the movie's stars, directors, and/or producers.<sup>51</sup> The hosting studio often pays for the airfare, expensive hotel rooms, meals, and even spending money for some critics who attend.<sup>52</sup> Many observers have expressed concern that such payments bias critics.<sup>53</sup> They point to the fact that press junket attendees are often the source of the positive blurbs that are featured in advertising for movies that the vast majority of critics dislike.<sup>54</sup> Indeed, at the junkets, studio employees sometimes have even tried to get critics who attend to consent to being quoted as giving a positive blurb that was actually written by the studio.<sup>55</sup>

In response to these concerns, a consumer group filed a lawsuit against ten studios that provide such junkets, claiming that the junkets were in essence payoffs to have the critics write positive reviews of the

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standards . . .” FTC GUIDES CONCERNING USE OF ENDORSEMENTS AND TESTIMONIALS IN ADVERTISING §255.0(d), available at <http://www.ftc.gov/bcp/guides/endorse.htm>.

50. Glenn Lovell, *Movies and Manipulation*, COLUM. JOURNALISM REV., Jan./Feb. 1993, <http://archives.cjr.org/year/97/1/movies.asp>. For example, even Roger Ebert and Gene Siskel were banned from screenings by 20th Century Fox for a couple of weeks because they spoke badly of the movie *Nuns on the Run* during their appearance on the *Live with Regis and Kathie Lee* television show. *Id.*

51. Robert W. Welkos & Rachel Abramowitz, *Scathing Reviews of Junkets*, L.A. TIMES, July 20, 2001, at A1.

52. Hays, *supra* note 41.

53. Tom Alesia, *Film's Press Event Sends Him Reeling*, WIS. ST. J., July 12, 2002, at D1 (wondering, upon seeing rave reviews of a movie by junket attendees, whether “the post-screening party, featuring boomerang-sized shrimp and filet mignon, influence[d] critics tastes?”); John Horn et al., *The Reviewer Who Wasn't There*, NEWSWEEK, June 11, 2001, at 8 (referring to the junket circuit as a “scandal” and as a “gravy train where the studios give journalists free rooms and meals at posh hotels and the reporters return the favor with puffy celebrity profiles and enthusiastic blurbs”); Dana Kennedy, *Where a Nose for News May be Out of Joint*, N.Y. TIMES, May 13, 2001, at 2A (“[Some] journalists maintain that junket reporters cannot remain objective.”); Welkos & Abramowitz, *supra* note 51 (“Media critics brand [the junket attendees] ‘blurbmeisters’ because the studios often splash quotes from their pieces in movie ads.”).

54. Welkos & Abramowitz, *supra* note 51.

55. Roger Ebert, *Columbia Fakes it to the Next Level*, CHI. SUN TIMES, June 5, 2001, at 35 (“In one [documented] case . . . a publicist wrote up several ‘sample’ quotes and asked the junketeers to sign up for the ones they liked.”); Telephone Interview with Dann Gire, President, Chicago Film Critics Association (Apr. 14, 2004).

movies.<sup>56</sup> Others have called on the Federal Trade Commission to investigate the propriety of these junkets.<sup>57</sup> As a result of such concerns, critics from major publications generally refuse payments from studios for attending the junkets, and sometimes their employers do not even permit them to attend at all.<sup>58</sup>

In Part IV, this Article will empirically examine whether another source of movie reviews should also be treated skeptically: reviews from media outlets affiliated with the studio that distributed the movie.<sup>59</sup> Indeed, within the community of movie critics, there is awareness of the conflict of interest that critics from such media outlets face.<sup>60</sup>

Even if such bias in movie reviews exists, some observers might be less concerned if consumers were aware of this conflict of interest. Then, consumers might be skeptical of reviews from critics affiliated with the movie's distributor. However, consumers are unlikely to know that such a conflict of interest exists. To be aware of such a conflict, consumers would have to know (1) which studio distributes the movie, (2) the parent company of that studio, and (3) the parent company of the media outlet that produced the movie review. Although no such study of consumers' knowledge could be found, the author's personal experience is that, with the exception of some animated Disney movies, consumers are generally unaware even of which studios are involved with particular movies.

Of course, this lack of consumer knowledge could be remedied if the media outlets that carry reviews disclose to consumers when a conflict of interest exists. However, no disclosure policy exists for movie critics. While collecting the data for this Article, no movie review was found that disclosed the critic's affiliation with the movie's distributor.<sup>61</sup> In addition, as will be discussed later in this Article, other

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56. The suit claimed that advertisements using quotes from junket attendees constitute fraudulent concealment, unfair business practices, and false and misleading advertising, in violation of California law. *Watch Out, David Manning: Blurbmeisters Get Sued*, CNN, July 3, 2001, <http://archives.cnn.com/2001/SHOWBIZ/News/07/03/film.junkets.reut/index.html>. The suit has since been dismissed. Telephone Interview with Anthony Sonnet, plaintiff's lead attorney (Aug. 3, 2004).

57. Steve Persall, *This Column is Wickedly Smart! A Must-Read!*, ST. PETERSBURG TIMES, Feb. 14, 2003, at 1D (claiming that "[f]rankly, some movie reviewers' opinions seen in ads are purchased. . . [Junket attendees who attend at the studio's expense] know if they keep saying nice things and doing puff pieces, they'll be invited back[,] and calling for the Federal Trade Commission to investigate this phenomenon).

58. Kennedy, *supra* note 53.

59. See *infra* Part IV (explaining empirical data demonstrating that movie critics do not exhibit a systematic bias in favor of affiliated movies).

60. Telephone Interview with Dann Gire, *supra* note 55.

61. In its news stories about Warner Brothers movies, CNN.com—the website of the Cable

research indicates that disclosure may be unhelpful, and sometimes even harmful, to consumers.

Like movie critics who work for media conglomerates, research analysts who work for financial services conglomerates face conflicts of interest that can bias these analysts' investment recommendations. The next Part of this Article discusses the conflicts facing these research analysts, how the conflicts have harmed investors, and how Congress, the Securities and Exchange Commission, and the courts have attempted to regulate the conflicts.

### III. CONFLICTS OF INTEREST FACING RESEARCH ANALYSTS

Research analysts can face significant conflicts of interest. One type of conflict of interest exists when analysts own stock in the companies they cover. Because an analyst's recommendation regarding a stock can cause its price to rise or fall,<sup>62</sup> the analyst has an incentive to recommend stocks that the analyst owns because the analyst will personally financially benefit from the price rise.

Research analysts who work for the research department of a financial conglomerate that has both a research department and an investment banking department face an additional conflict of interest. Investors seek the research department's sincere recommendations regarding the investment potential, or forecasts of the financial performance, of specific companies. In addition, companies pay for underwriting and other services provided by the investment banking department. A conflict of interest exists because a recommendation by the research department to investors to purchase a stock can help the research analyst's firm secure investment banking business from the stock's issuer.<sup>63</sup> Research analysts' compensation was sometimes even explicitly based upon the amount of investment banking business the analyst helped bring in.<sup>64</sup>

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News Network, which is also owned by Time Warner—discloses its conflicts of interest. For example, in a news story about the future of the Harry Potter movie series, CNN.com explained the corporate relationship: "AOL Time Warner, which happens to be the parent of both the Potter-presenting Warner Bros. movie studio and this very news network." Todd Leopold, *Looking into Harry Potter's crystal ball*, CNN, Nov. 14, 2002, <http://archives.cnn.com/2002/SHOWBIZ/Movies/11/14/whither.potter/>. Strangely, however, in its reviews of Warner Brothers movies, CNN.com makes no such disclosure.

62. D. Casey Kobi, *Wall Street v. Main Street: The SEC's New Regulation FD and Its Impact on Market Participants*, 77 IND. L.J. 551, 583 (2002).

63. U.S. SECURITIES AND EXCHANGE COMMISSION, *supra* note 3 ("Firms must compete with one another for investment banking business. Favorable analyst coverage of a company may induce that company to hire the firm to underwrite a securities offering.").

64. *Id.*; Randall Smith, *Will Investors Benefit from Wall Street Split?—Regulators Set Accord*

This conflict of interest has become more common in recent years as consolidation in the financial services industry has increasingly brought research departments and investment banking departments under the same roof in a financial conglomerate.<sup>65</sup> In addition, the pressures on research analysts that result from this conflict have increased as firms' investment banking businesses have become more important; falling prices for brokerage services have caused investment banking profits to become a greater percentage of financial institutions' income.<sup>66</sup>

Unfortunately, many research analysts succumbed to this conflict of interest. These analysts gave positive forecasts and recommendations regarding certain companies' stocks to secure investment banking business from those companies.<sup>67</sup> As a result, readers of the research analysts' reports were unknowingly obtaining biased forecasts and recommendations,<sup>68</sup> causing millions of "[r]egular people . . . [to lose] a collective fortune by relying on the tainted advice of the biggest and most trusted names in the world of finance."<sup>69</sup>

On April 8, 2002, New York Attorney General Eliot Spitzer captured headlines when his office secured a court order requiring Merrill Lynch to provide increased disclosure of its research analysts' conflicts of

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*With Securities Firms, But Some Issues Persist*, WALL ST. J., Dec. 23, 2002, at C1.

A troubling pattern regulators found was that [investment] bankers and [research] analysts would pitch for deals as "a team" . . . . "The pitch to issuers was, 'You're getting us as investment bankers, and you're getting so-and-so as the analyst,' and corporate executives could 'meet and touch and feel' the analysts. It became collusive and there's simply no hiding that the analysts were paid in part for bringing in the business, and they weren't going to keep getting that business with negative ratings[.]"

*Id.* (quoting Mary Schapiro, NASD's Vice Chairman and President of Regulatory Policy and Oversight).

65. Christine M. Bae & Carlton R. Asher, Jr., *Chinese Walls—Procedures and Remedies for Dealing with Conflicts of Interest and Other Abuses by Broker-Dealers in Connection with Conduct by Their Securities Analysts*, PRACTICING L. INST., CORP. L. & PRAC. COURSE HANDBOOK SERIES, 123, 146, PLI Order No. B0-01A6 (Aug. 2002).

66. *Id.* at 146–47.

67. See Patricia M. Dechow, Amy P. Hutton & Richard G. Sloan, *The Relation Between Analysts' Forecasts of Long-Term Earnings Growth and Stock Price Performance Following Equity Offerings*, 17 CONTEMP. ACCT. RES. 1 (2000) (examining the role of sell-side analysts' long-term earnings growth forecasts in the pricing of common equity offerings); Roni Michaely & Kent L. Womack, *Conflict of Interest and the Credibility of Underwriting Analyst Recommendations*, 12 REV. FIN. STUD. 653 (2000) (discussing the internal conflicts of interest at investment banks).

68. SEC Final Rule: Regulation Analyst Certification, 17 C.F.R. § 242 (2003), available at <http://www.sec.gov/rules/final/33-8193.htm> (stating that the SEC is "particularly concerned that many investors who rely on analysts' recommendations may not know, among other things, that favorable research coverage could be used to market the investment banking services provided by an analyst's firm[.]").

69. Spitzer Testimony, *supra* note 6, at 12.

interest.<sup>70</sup> The court ordered Merrill Lynch, in its public research reports or ratings of any company, to disclose any recent or prospective investment banking relationship that it had with the subject company of the report or rating.<sup>71</sup>

Attorney General Spitzer's ten-month investigation leading to the order found that Merrill Lynch's research department had issued positive public recommendations of certain companies' stocks to secure investment banking business from those companies.<sup>72</sup> An affidavit Spitzer's office filed with the court provided documents showing that Merrill Lynch had publicly recommended that investors purchase a number of internet stocks while, at the same time, famed internet industry analyst Henry Blodget and other Merrill Lynch research analysts were privately disparaging the investments. For example, in internal e-mails, Merrill's research analysts were saying that some of the recommended stocks were "piece[s] of junk," "piece[s] of shit," and had underlying businesses that were "falling apart."<sup>73</sup>

These revelations focused the public spotlight on how the desire for investment banking revenue was causing bias in research analysts' reports and ratings. However, many who were familiar with the industry were already aware of the problem. Academic studies had uncovered much evidence of bias. For example, finance professors Roni Michaely and Kent Womack found that stocks recommended by the underwriters' research analysts perform worse than stocks recommended by unaffiliated research analysts.<sup>74</sup> Also, Professors Dechow, Hutton, and Sloan found that research analysts employed by the lead managers of equity offerings make more overly optimistic long-term growth forecasts of the offering company than do other research analysts.<sup>75</sup>

In addition, Congress had recently held hearings to investigate the role of research analysts in the creation—and subsequent bursting—of

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70. Charles Gasparino, *Merrill Lynch Analysts Told to Change Ways*, WALL ST. J., Apr. 9, 2002, at C1.

71. In addition, Merrill Lynch was ordered to disclose, in all its public research reports and ratings, the percentage of stocks in the subject company's sector or industry that it placed in each of the rating categories it used. *Id.*

72. Press Release, Office of New York State Attorney General Eliot Spitzer, *Merrill Lynch Stock Rating System Found Biased by Undisclosed Conflicts of Interest* (Apr. 8, 2002), [http://www.oag.state.ny.us/press/2002/apr/apr08b\\_02.html](http://www.oag.state.ny.us/press/2002/apr/apr08b_02.html).

73. Affidavit of Eric R. Dinallo in Support of Application for an Order Pursuant to General Business Law Section 354, at 11–13 (Apr. 8, 2002), *available at* <http://www.oag.state.ny.us/press/2002/apr/MerrillL.pdf> [hereinafter *Dinallo Affidavit*].

74. Michaely & Womack, *supra* note 67, at 653.

75. Dechow et al., *supra* note 67.

the Internet stock price bubble.<sup>76</sup> In July 2001, then acting SEC Chair Laura Unger testified before a congressional subcommittee that “there is a mood of skepticism about analysts’ stock recommendations. This skepticism is due, in large part, to a blurring of the lines between research and investment banking.”<sup>77</sup>

In response to such concerns, limited steps toward investigating and addressing research analysts’ conflicts of interest were being taken. The SEC conducted on-site examinations of a number of financial institutions that had both investment banking departments and research departments.<sup>78</sup> These examinations focused on the conflicts of interest that research analysts face because of their “financial interests in companies they cover, reporting structures, and compensation arrangements.”<sup>79</sup>

Also, the Securities Industry Association—a trade organization composed of more than 600 securities firms—produced a set of “Best Practices for Research” guidelines.<sup>80</sup> These “best practices” included separating research departments from investment banking departments and disclosing analysts’ personal financial interests in the companies they cover.<sup>81</sup> Despite these “best practices” guidelines being voluntary and unenforceable,<sup>82</sup> some members of the Securities Industry Association officially adopted at least some of the guidelines.<sup>83</sup> In addition, in July 2001, Merrill Lynch became the first major securities firm to prohibit its research analysts from owning stock of companies the analysts cover.<sup>84</sup>

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76. Karen Contoudis, *Analyst Conflicts of Interests: Are the NASD and NYSE Rules Enough?*, 8 FORDHAM J. CORP. & FIN. L. 123, 124 (2003) (discussing how the public’s trust in so-called “experts” led Congress to investigate financial analysts).

77. *Written Testimony Concerning Conflicts of Interest Faced by Brokerage Firms and Their Research Analysts: Hearings on the Quality of Wall Street Research Before the H. Subcomm. on Capital Markets, Insurance and Gov’t Sponsored Enterprises*, 106th Cong. (2001) (testimony of Laura S. Unger, Acting Chairman, U.S. Securities and Exchange Commission), available at <http://www.sec.gov/news/testimony/073101tslu.htm> [hereinafter Unger Testimony].

78. *Id.*

79. *Id.*

80. Information about the Securities Industry Association is available at [http://www.sia.com/about\\_sia](http://www.sia.com/about_sia) (describing the organization and articulating its values).

81. Kelly S. Sullivan, Comment, *Serving Two Masters: Securities Analyst Liability and Regulation in the Face of Pervasive Conflicts of Interest*, 70 UMKC L. REV. 415, 429–30 (2001).

82. *Id.* at 430–31 (explaining how the Securities Industry Association lacks enforcement power over its members).

83. Jeff D. Opdyke, *Guidelines Aim to Polish Analysts’ Image*, WALL ST. J., June 13, 2001, at C1.

84. Charles Gasparino & Jeff D. Opdyke, *Merrill Lynch Alters a Policy on Analysts*, WALL ST. J., July 11, 2001, at C1.

Following Spitzer's suit against Merrill Lynch, more dramatic actions followed. Congress passed the Sarbanes-Oxley Act, which in part gave the SEC the mandate to promulgate rules, or to direct national securities exchanges and associations to create rules, to address research analysts' conflicts of interest.<sup>85</sup>

The Sarbanes-Oxley Act specified that these rules should focus on a number of areas. First, they should restrict the prepublication clearance or approval of research reports by persons who are not directly responsible for such research, and especially by persons engaged in investment banking.<sup>86</sup> Second, they should prevent investment bankers from supervising, or determining the compensation of, research analysts.<sup>87</sup> Third, they should prevent actual or threatened retaliation by investment bankers against research analysts who issue unfavorable research reports about a company that is a current or prospective investment banking client.<sup>88</sup> Fourth, they should define periods of time around a company's public offering of securities during which research analysts who work for brokers or dealers cannot issue research reports relating to that issuer.<sup>89</sup> Fifth, the rules should "establish structural and institutional safeguards within [the firms] to assure that [research] analysts are separated by appropriate informational partitions within the firm from the review, pressure or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision."<sup>90</sup>

Sarbanes-Oxley also requires the adoption of rules requiring the disclosure, when a research analyst issues a research report or makes a public appearance, of the analyst's conflicts of interest.<sup>91</sup> These disclosures must include the extent to which the analyst has investments in the securities of the company that is the subject of the report or appearance,<sup>92</sup> whether either the analyst or the analyst's employer has

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85. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 501, 116 Stat. 745 (to be codified at 15 U.S.C. § 78o-6) (West 2002). Congress passed Sarbanes-Oxley in the wake of Enron and other corporate scandals. Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2542 (2005).

86. Sarbanes-Oxley Act § 501(a)(1)(A).

87. *Id.* § 501(a)(1)(B).

88. *Id.* § 501(a)(1)(C).

89. *Id.* § 501(a)(2).

90. *Id.* § 501(a)(3). The statute also allows the SEC or association or exchange to "address such other issues as the Commission, or such association or exchange, determines appropriate." *Id.* § 501(a)(4).

91. *Id.* § 501(b).

92. *Id.* at § 501(b)(1).



received compensation from the company,<sup>93</sup> the extent to which the company has been a client of the analyst's employer during the last year,<sup>94</sup> and whether the analyst's compensation for the research report was based at least partly on the analyst's employer's investment banking revenues.<sup>95</sup>

To satisfy these dictates of Sarbanes-Oxley, the SEC approved a number of changes to the rules of the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD). On May 10, 2002, the SEC approved amendments to NYSE Rules 472 (Communications with the Public) and 351 (Reporting Requirements) and approved a new NASD Rule 2711 (Research Analysts and Research Reports).<sup>96</sup> In December 2002 and May 2003, the NYSE and NASD filed proposed amendments to their research analyst conflict of interest rules with the SEC.<sup>97</sup> In July 2003, the SEC approved these additional changes as well.<sup>98</sup> In the same month, the NYSE and NASD filed additional proposed amendments to their rules, which the SEC also approved.<sup>99</sup>

These rules and regulations can be grouped into three broad categories: (1) those designed to make research analysts independent, especially from their firms' investment bankers; (2) those designed to prevent research analysts from having a personal financial stake in the effect of their coverage on the companies they cover; and (3) those requiring public disclosure of research analysts' conflicts of interests.

Several of these rules are aimed at ensuring that research analysts work independently, especially from their firm's investment bankers. For example, NASD Rule 2711 and NYSE Rule 472 mandate that research analysts cannot be "subject to the supervision or control" of an employee of the investment banking department.<sup>100</sup> Also, no one involved with investment banking activities may "directly or indirectly, retaliate against or threaten to retaliate against" a research analyst who makes an unfavorable research report or public appearance that might

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93. *Id.* § 501(b)(2).

94. *Id.* § 501(b)(3).

95. *Id.* § 501(b)(4). The statute also requires that the SEC or the association or exchange mandate disclosure of any other "material" conflicts of interest that it deems appropriate. *Id.* § 501(b)(5).

96. NASD and NYSE Rule Making, Exchange Act Release No. 34-45908, 77 SEC Docket 1737 (May 10, 2002), available at <http://www.sec.gov/rules/sro/34-45908.htm>.

97. Samuel Winer, Amy N. Kroll & Adam J. Eisner, *Recent SRO Rules Regarding Research Analyst Conflicts of Interest* 203, 205 (A.L.I.-A.B.A. Cont. Leg. Edu.) (Jan. 8-9, 2004).

98. *Id.*

99. *Id.*

100. NASD MANUAL § 2711(b)(1) (2005); NYSE RULE 472(b)(1) (2002).

adversely affect the firm's current or potential investment banking relationship with the subject company.<sup>101</sup> In addition, except to verify the accuracy of facts in the report or to identify a potential conflict of interest, nonresearch personnel may not review a research report before its publication.<sup>102</sup> Also, research analysts are forbidden to participate in the solicitation of investment banking business.<sup>103</sup>

To assure their independence, research analysts' communications with the companies they cover are also restricted. Except to verify a report's factual accuracy, the subject company of a research report may not be sent a copy of the report before its publication.<sup>104</sup> In addition, the subject company cannot be given significant advance notice of a research analyst's intent to change the analyst's rating of the company.<sup>105</sup>

Other rules prohibit firms from promising favorable coverage of a company in exchange for compensation or that company's investment banking business. Research analysts are generally forbidden from publishing or distributing research reports, and from making public appearances, regarding a company soon after the analyst's firm was a manager or co-manager of a securities offering by that company.<sup>106</sup> There is a similar prohibition for a period after an initial public offering in which the analyst's company participates, or agrees to participate, as an underwriter or dealer.<sup>107</sup> In addition, if coverage of a company is terminated, the firm must give notice of this termination and generally must produce a final research report on the company.<sup>108</sup>

Other rules are focused on preventing research analysts from having direct financial incentives to help their investment banking departments. Research analysts cannot receive any compensation based upon a specific investment banking services transaction.<sup>109</sup> In addition, a firm's committee that approves analysts' compensation cannot have a representative of the investment banking department.<sup>110</sup> Also, the

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101. NASD MANUAL § 2711(j); NYSE RULE 472(g)(2).

102. NASD MANUAL § 2711(b)(2)–(3); NYSE RULE 472(b)(2)–(3).

103. NASD MANUAL § 2711(c)(4); NYSE RULE 472(b)(5).

104. NASD MANUAL § 2711(c)(1)–(2); NYSE RULE 472(c)(4).

105. NASD MANUAL § 2711(c)(3); NYSE RULE 472(c)(4)(iii).

106. NASD MANUAL § 2711(f)(1); NYSE RULE 472(f)(1)–(2). An exception is made for reports and public appearances concerning significant events that happen to the company. NASD MANUAL § 2711(f)(1)(B)(i); NYSE RULE 472(f)(5).

107. NASD MANUAL § 2711(f)(2); NYSE RULE 472(f)(3).

108. NASD MANUAL § 2711(f)(5); NYSE RULE 472(f)(6).

109. NASD MANUAL § 2711(d)(1); NYSE RULE 472(h)(1).

110. NASD MANUAL § 2711(d)(2); NYSE RULE 472(h)(2).

analyst's contribution to the firm's investment banking business, and the views of the firm's investment banking department regarding the analyst, cannot be a factor in the analyst's compensation.<sup>111</sup>

To prevent analysts from having a personal financial interest in how their reports affect the securities prices of the companies they cover, restrictions are also put on research analysts' personal trading of securities. For example, an analyst is prohibited in general from buying or selling any security of a company around the time that the analyst's firm publishes a research report on the company or changes the rating or price target of the company's securities.<sup>112</sup> In addition, a research analyst may not acquire a company's securities before its initial public offering if the issuer is "principally engaged in the same types of business" as companies that the research analyst follows.<sup>113</sup> Also, in general, a research analyst may not transact in any security in a manner inconsistent with the analyst's most recently published report regarding the issuer.<sup>114</sup> For example, in general, an analyst may not sell a stock if the analyst's most recent report recommends that investors purchase the stock. Furthermore, legal or compliance personnel of the research analyst's employer must preapprove any transactions by persons who oversee research analysts if the transactions are of equity securities of a company covered by those analysts.<sup>115</sup>

The last type of new rule requires disclosure of a research analyst's conflicts of interest. These disclosures must be "clear, comprehensive, and prominent."<sup>116</sup> Some of the rules require the disclosure of the analyst's personal financial interest in the subject company or in the analyst's firm's investment banking revenues. They require research reports<sup>117</sup> to disclose the existence and nature of any financial interest the analyst or a member of the analyst's household has in the securities of the subject company;<sup>118</sup> whether the analyst or a member of the

111. NASD MANUAL § 2711(d)(2); NYSE RULE 472(h)(2).

112. Such purchases are prohibited from thirty days before the report or change in rating or price target is issued until five days after its issuance. An exception exists for transactions in the thirty days preceding the issuance of a report or rating or price change made in response to significant news regarding the company. NASD MANUAL § 2711(g)(2); NYSE RULE 472(e)(2).

113. NASD MANUAL § 2711(g)(1); NYSE RULE 472(e)(1).

114. NASD MANUAL § 2711(g)(3); NYSE RULE 472(e)(3).

115. NASD MANUAL § 2711(g)(6); NYSE RULE 472(e)(5).

116. NASD MANUAL § 2711(h)(10); NYSE RULE 472(k)(1). In addition, the disclosures either must be on the front page of the research report, or the front page of the report must refer to the page where the disclosures are located. *Id.*

117. The disclosure requirements for public appearances by research analysts are similar to the disclosure requirements for research reports.

118. NASD MANUAL § 2711(h)(1)(A); NYSE Rule 472(k)(1)(iii)(b).

analyst's household is a director, officer, or advisory board member of the subject company;<sup>119</sup> and any other "actual, material conflict of interest" of the analyst or the analyst's firm.<sup>120</sup> In addition, research reports must disclose if the analyst has received compensation based on the analyst's firm's investment banking revenues or from the subject company of the report.<sup>121</sup>

The analyst's firm's business with the subject company must also be disclosed. Generally, disclosure is required when the analyst's firm has recently managed or co-managed a public offering of the subject company or if the firm or an affiliate of the firm has recently received or expects to soon receive or seek compensation from the subject company for investment banking and/or other services and products.<sup>122</sup> It must also be disclosed if the firm is making a market in the subject company's securities.<sup>123</sup>

Finally, information related to the rating system the analyst uses to rate securities must also be disclosed in the research reports. Each rating used in the rating system—such as "Strong Buy," "Neutral," and "Sell"—must be defined.<sup>124</sup> These definitions must be "consistent with [the ratings'] plain meaning."<sup>125</sup> Second, the report must provide information about the distribution of ratings given by all the employer's analysts. Specifically, it must state both the percentage of covered companies, and the percentage of covered companies for which the employer has recently provided investment banking services, that would receive "Buy," "Hold/Neutral," or "Sell" ratings (even if the analyst uses a different rating system).<sup>126</sup> The report also must contain a graph that displays the security's past daily closing prices and the analyst's rating and price target changes.<sup>127</sup>

In addition to approving these changes in the rules of the NYSE and NASD, the SEC adopted Regulation Analyst Certification (Regulation AC), which also requires certain disclosures.<sup>128</sup> Regulation AC requires

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119. NASD MANUAL § 2711(h)(3); NYSE RULE 472(k)(1)(iii)(c).

120. NASD MANUAL § 2711(h)(1)(C); NYSE RULE 472(k)(1)(iii)(d).

121. NASD MANUAL § 2711(h)(2)(A)(i); NYSE RULE 472(k)(1)(ii)(a).

122. NASD MANUAL § 2711(h)(2)(A)(ii); NYSE RULE 472(k)(1)(i)(a).

123. NASD MANUAL § 2711(h)(8); NYSE RULE 472(k)(1)(i)(b).

124. NASD MANUAL § 2711(h)(4); NYSE RULE 472(k)(1)(i)(f).

125. NASD MANUAL § 2711(h)(4); NYSE RULE 472(k)(1)(i)(f).

126. NASD MANUAL § 2711(h)(5)(A)–(B); NYSE RULE 472(k)(1)(i)(g).

127. NASD MANUAL § 2711(h)(6); NYSE RULE 472(k)(1)(i)(h). This requirement only exists for securities that have been rated for at least one year. *Id.* The graph must contain data for the lesser of three years or the period for which the company has been rated. *Id.*

128. Press Release, Securities and Exchange Commission, SEC Amends Definition of "Dealer" for Banks, Adopts Analyst Certification Rule (Feb. 6, 2003),

that research reports disclose whether the analyst received any payments in connection with the specific recommendations or views expressed in the report.<sup>129</sup> The research analyst must also certify that the views expressed in the report accurately reflect the analyst's own views.<sup>130</sup>

In addition to these rule and regulation changes, a number of lawsuits were filed in response to research analysts' bias. First, private suits have sought damages on behalf of investors who allegedly lost money by relying on biased research reports.<sup>131</sup> Also, on April 28, 2003, the SEC, the NYSE, the NASD, the North American Securities Administrators Association, the New York Attorney General, and state securities regulators settled joint enforcement actions against ten large securities firms and two individuals.<sup>132</sup> These actions alleged that all the firms had "supervisory deficiencies" and "engaged in acts and practices that created or maintained inappropriate influence by investment banking over research analysts, thereby imposing conflicts of interest on research analysts that the firms failed to manage in an adequate or appropriate manner."<sup>133</sup>

As part of the global settlement, the firms paid a total of approximately \$1.4 billion in fines, disgorgement, and the funding of independent research and investor education.<sup>134</sup> Other terms of the settlement agreement required structural changes in the firms to increase their research analysts' independence from their investment bankers. These changes are consistent with the recently adopted SEC, NYSE, and NASD rules and regulations discussed above. Among the most important changes is the creation of firewalls and physical separation between research and investment banking departments of the firms, including prohibiting research analysts from participating in the

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<http://www.sec.gov/news/press/2003-21.html>.

129. 17 C.F.R. § 242.501(a)(2) (2003).

130. 17 C.F.R. § 242.501(a)(1). Recall that some Merrill Lynch analysts had issued reports recommending certain investments at the same time that those analysts were privately disparaging those same investments. *Supra* note 73 and accompanying text. Similar disclosure requirements exist for views expressed in public appearances by an analyst. 17 C.F.R. § 242.502.

131. Margo McCall, *NY Probe Spurs New Brand of Lawsuit*, WIRELESS WEEK, July 22, 2002, available at <http://www.wirelessweek.com/article/CA234275.html>.

132. Joint Press Release, SEC, New York Attorney General, North American Securities Administrators Association, NASD, NYSE, and state securities regulators, Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking (Apr. 28, 2003), <http://www.sec.gov/news/press/2003-54.htm> [hereinafter Joint Press Release].

133. *Id.* Other charges specific to particular firms were also made. *Id.*

134. This was composed of \$487.5 million in penalties, \$387.5 million in disgorgement, \$432.5 million to fund independent research, and \$80 million to fund investor education. *Id.*

solicitation of investment banking business.<sup>135</sup> Also, the firms' investment bankers are prevented from having input into the determination of the research departments' budgets.<sup>136</sup> In addition, the investment bankers are prohibited from evaluating research analysts' performance and from having even indirect input into research analysts' compensation.<sup>137</sup> Also, research analysts' compensation cannot be even indirectly based on the firms' investment banking revenues.<sup>138</sup>

The global settlement also imposed a disclosure requirement. The ten firms must make available publicly historical information on the ratings and stock price target forecasts their research analysts gave.<sup>139</sup> This disclosure is intended to "enable investors to evaluate and compare the performance of analysts."<sup>140</sup>

In summary, the combination of the reforms imposed by the SEC, NASD, NYSE, and the global settlement are causing significant changes in the industry. However, the rationale for these reforms are based upon assumptions regarding what causes bias in research reports and harm to investors: (1) research analysts lacking independence, (2) research analysts having personal financial stakes in how their reports affect the prices of the securities of the subjects of their reports, and (3) insufficient disclosure of analysts' conflicts of interest. This Article empirically analyzes the experience of movie critics, who face a situation similar to those facing research analysts, for evidence of whether these assumptions are correct, and thus whether these reforms are likely to actually reduce analysts' bias.

#### IV. TESTING FOR BIAS IN MOVIE REVIEWS

This Article empirically studies whether there is bias in the movie reviews of media outlets affiliated with movie studios. To do this, the Article examines three media conglomerates that own movie studios and own media outlets that review movies: The Walt Disney Company, Time Warner Inc., and The News Corporation Limited. First, this Part describes the data used in this study.<sup>141</sup> The second section of this Part describes the empirical methodology used to test for bias and presents

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135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

139. SEC FACT SHEET ON GLOBAL ANALYST RESEARCH SETTLEMENTS, NASD, NYSE, AND STATE SECURITIES REGULATORS (Apr. 28, 2003), *available at* <http://www.sec.gov/news/speech/factsheet.htm>.

140. Joint Press Release, *supra* note 132.

141. *See infra* Part IV.A (outlining the media outlets, movie critics, and movie studios).

the results of this analysis.<sup>142</sup>

### A. Data

The media outlets, movie critics, and the primary movie studios involved in this study are summarized in Table 1.

TABLE 1:  
MOVIE STUDIO OWNERSHIP

Critics' Media Outlet	Primary Critics	Parent Company	Movie Companies Owned by Parent
Ebert & Roeper	Roger Ebert	Walt Disney Co.	Walt Disney Pictures
	Richard Roeper		Touchstone Pictures Miramax Films Dimension Films
Entertainment Weekly	Owen Gleiberman	Time Warner Inc.	Warner Bros. Pictures
	Lisa Schwarzbaum		New Line Cinema Fine Line Features
New York Post	Jonathan Foreman	News Corp. Ltd.	20th Century Fox
	Lou Lumenick		Fox Searchlight Pictures

As noted earlier, the Walt Disney Company is the world's second largest media and entertainment conglomerate.<sup>143</sup> It includes several film production and distribution companies, as well as Buena Vista Television, home of the weekly *Ebert & Roeper* program.<sup>144</sup> *Ebert & Roeper* appears on more than 200 television stations and is the "top-rated first-run weekly syndicated half-hour on television."<sup>145</sup>

Time Warner Inc., the world's largest media and entertainment

142. See *infra* Part IV.B (describing the empirical methodology and explaining the results).

143. *Supra* note 20 and accompanying text.

144. *Who Owns What: The Walt Disney Company*, *supra* note 10.

145. *Ebert & Roeper*, *supra* note 30.

company, also owns several film companies and news outlets, including *Entertainment Weekly* magazine, CNN, *Time* magazine, and *People* magazine.<sup>146</sup> However, limits on the availability of data restrict this Article to analyzing *Entertainment Weekly*'s movie reviews.

*Entertainment Weekly* is a weekly national magazine focusing on the entertainment industry and has a paid circulation of approximately 1.8 million.<sup>147</sup> In addition to reporting movie reviews made by certain outside reviewers, it also carries the reviews of its own staff of reviewers. During the time period encompassed by this study, five critics reviewed movies for *Entertainment Weekly* itself, however, two of them—Owen Gleiberman and Lisa Schwarzbaum—accounted for more than ninety percent of the reviews.

Finally, the News Corporation Limited owns 20th Century Fox and Fox Searchlight Pictures, as well as numerous print and broadcast news outlets, including the *New York Post*.<sup>148</sup> The *New York Post*, a daily newspaper with a circulation of approximately 673,000,<sup>149</sup> regularly prints movie reviews by its critics. During the time period encompassed by this study, five critics reviewed movies for the *New York Post*, however, two of them—Jonathan Foreman and Lou Lumenick—accounted for more than ninety-five percent of the reviews.<sup>150</sup>

To test whether bias exists in media conglomerates' movie reviews, this Article empirically examines whether *Ebert & Roeper*'s reviews are biased in favor of Disney movies, whether *Entertainment Weekly*'s reviews are biased in favor of Time Warner movies, and whether the *New York Post*'s reviews are biased in favor of News Corporation movies.

This Article uses the 1,082 movies that appeared in the "Crix Picks" section of *Variety* magazine and opened in the United States from January 1, 2000, through March 31, 2003. *Variety* magazine is sometimes referred to as the "bible" of the show business industry and

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146. *Who Owns What: Time Warner*, *supra* note 10.

147. Michael Learmonth, *Sagging TV Guide Gets Glossy Makeover*, DAILY VARIETY, July 27, 2005, at 1.

148. *Who Owns What: News Corporation*, *supra* note 10.

149. Julie Bosman, *Daily News Editor Resigns After Less Than a Year*, N.Y. TIMES, Dec. 3, 2005, at C13.

150. The News Corporation Limited also owns many local television stations in the United States, some of which broadcast movie reviews occasionally as part of their news broadcasts. *Who Owns What: News Corporation*, *supra* note 10. However, access to these reviews is unavailable so they are not included in this study.



is not affiliated with any movie studio.<sup>151</sup> Each week, *Variety*'s Crix Picks section tabulates movie reviews from many of the best-known movie critics in the United States<sup>152</sup> for approximately six movies opening that week.<sup>153</sup> These movies include at least the two largest "blockbusters" and at least one smaller "niche" movie released that week.<sup>154</sup> Although there are over 100 critics in the pool from which *Variety* collects reviews,<sup>155</sup> the number of reviews compiled for any particular movie is much less. For the movies used in this Article, *Variety* collected between one and fifty-one reviews, with an average of seventeen. The number of reviews varies because the number of critics who review a movie differ; significant films from major studios are generally reviewed by more critics than are smaller "niche" films.<sup>156</sup> Crix Picks includes all reviews that its pool of critics sends to *Variety*, and occasionally *Variety* will solicit reviews from critics who have not sent their reviews to *Variety* in some time.<sup>157</sup>

Each review collected by Crix Picks is labeled as giving the movie a favorable review (Pro), an unfavorable review (Con), or a mixed review (Mixed). The vast majority of the reviewers designate for Crix Picks which category their review is in.<sup>158</sup> For the few critics who do not choose a category, *Variety*'s editorial staff reads the reviews and makes the designation.<sup>159</sup>

### B. Empirical Methodology and Results

Bias in favor of an affiliated studio's movies can take two forms. First, bias might exist in the selection of which movies a critic reviews. Second, bias could exist in the grades a reviewer gives to affiliated studios' movies. This Article tests for both forms of bias.

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151. See, e.g., Anthony DeBarros & Susan Wloszczyna, *Movie Critics, Fans Follow Surprisingly Similar Script*, USA TODAY, Feb. 25, 2004, at A1 (describing the results of a 2003 study of movies' critical reviews compared to their gross revenues).

152. It also compiles reviews from many British critics, however those reviews are not used in this study.

153. On rare occasions, Crix Picks is not published in a particular week, however, typically the next Crix Picks' is expanded to also cover movies released during that skipped week. Telephone Interview with Jill Feiwell, Assistant Editor, *Variety* (July 16, 2003).

154. *Id.* Niche movies are specialized films, which traditionally have been targeted at narrower audiences and have been less expensive to make. Dana Harris, *Hollywood Renews Niche Pitch*, VARIETY, Apr. 7, 2003, at 1, 54.

155. Interview with Jill Feiwell, *supra* note 153.

156. *Id.*

157. *Id.*

158. *Id.*

159. *Id.*

### 1. Bias in the Selection of Movies to Review

Bias in the selection of which movies are reviewed may also take one of two forms. A media outlet may be more likely to review an affiliated studio's films to increase publicity for those films. On the other hand, the media outlet might be more likely to review good films from that studio, but less likely to review bad films from that studio to avoid adding to negative publicity regarding the bad movies. This would allow a critic who wants to give sincere reviews to still be more likely to give positive reviews, and less likely to give negative reviews, to affiliated films than do other critics.

Table 2 presents the number and percentage of movies listed in *Variety's* Crix Pix—broken down by the parent company of the distributing studio—that were reviewed by each media outlet.

TABLE 2:  
PERCENTAGE OF MOVIES REVIEWED

		Parent Company of Distributing Studios		
	Parent	Disney (118 movies)	Time Warner (123 movies)	News Corp. (56 movies)
Ebert & Roeper (612 movies reviewed)	Disney	78.8%	84.6%	87.5%
Entertainment Weekly (776 movies reviewed)	Time Warner	96.6%	95.9%	96.4%
New York Post (1014 movies reviewed)	News Corp.	99.2%	100.0%	100.0%

Chi-squared = 4.06, Degrees of freedom=10 (Not Statistically Significant)

This Table shows that critics are no more likely to review movies distributed by an affiliated studio than movies distributed by an unaffiliated studio. In fact, Disney-owned *Ebert & Roeper* reviewed a smaller percentage of the Disney-distributed movies (78.8%) than of the Time Warner (84.6%) or the News Corporation movies (87.5%).

Similarly, *Entertainment Weekly*, which is owned by Time Warner was no more likely to review the Time Warner movies (95.9%) than the Disney movies (96.6%) or the News Corporation movies (96.4%) and the *New York Post* was no more likely to review the News Corporation movies (100%) than Time Warner (100%) or Disney movies (99.2%). Indeed, there is no statistically significant difference between the percentage of affiliated movies and the percentage of unaffiliated movies that are reviewed by these media outlets.<sup>160</sup>

As noted above, bias in the selection of movies to review may instead take the form of choosing to review higher quality movies from affiliated studios than from unaffiliated studios. To test for this form of bias, Table 3 displays the average quality of the movies reviewed by each media outlet, broken down by the parent of the distributing studio. The quality of a particular movie is measured as the average grade, as calculated from *Variety's* Critic Picks that the movie received from critics with no affiliation to the studio that distributed the movie. Thus, a movie's quality is calculated as the number of favorable reviews minus the number of unfavorable reviews, divided by the total number of reviews. For example, if a movie had eight favorable reviews, three unfavorable reviews, and nine mixed reviews, the movie's quality would be 0.25.<sup>161</sup> Quality ranges from -1 for a movie with only unfavorable reviews to +1 for a movie with only favorable reviews; the quality of a movie with an equal number of favorable and unfavorable reviews would be 0.

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160. Statistical significance is determined by first positing a null hypothesis. Here, the null hypothesis is that the percentage of movies reviewed is independent of the parent company of the movies' distributor. To test the validity of the null hypothesis, a test statistic is then calculated from the data by assuming that the null hypothesis is true. In this case, the test statistic is a chi-square statistic with 10 degrees of freedom. If the value of the test statistic is sufficiently extreme, then the null hypothesis can be rejected, or in other words, there would be a statistically significant relationship between the between the percentage of movies reviewed and the parent company of the movies' distributor. However, as noted in Table 2, the null hypothesis cannot be rejected because the chi-squared statistic is only 4.06.

161.  $(8 \text{ favorable reviews} - 3 \text{ unfavorable reviews}) / (8 \text{ favorable reviews} + 3 \text{ unfavorable reviews} + 9 \text{ mixed reviews}) = 0.25$ . Note that this methodology is identical to calculating the value of the average review, where a favorable review has a value of +1, an unfavorable review has a value of -1, and each mixed review has a value of 0.

TABLE 3:  
AVERAGE QUALITY OF MOVIES REVIEWED

Parent Company of Distributing Studios				
	Parent	Disney	Time Warner	News Corp.
Ebert & Roeper	Disney	.1710 (93 movies)	-.0588 (104 movies)	.0916 (49 movies)
Entertainment Weekly	Time Warner	.1407 (114 movies)	-.0719 (118 movies)	.0224 (54 movies)
New York Post	News Corp.	.1283 (117 movies)	-.0792 (123 movies)	.0132 (56 movies)

As shown in Table 3, critics do not review better affiliated movies than unaffiliated movies. Although the average Disney movie reviewed by *Ebert & Roeper* is higher quality (.1710) than the average Time Warner (-.0588) or News Corporation movie (.0916) it reviews, that appears to be because the average Disney movie made was of higher quality, not because of a bias by *Ebert & Roeper* in favor of Disney movies. Indeed, the average Disney movie reviewed by *Entertainment Weekly* and the *New York Post* were also higher quality than the average Time Warner or News Corporation movie that those publications reviewed.

*Ebert & Roeper* reviewed fewer movies (612 movies) than *Entertainment Weekly* (776 movies), which reviewed fewer movies than the *New York Post* (1014 movies). It appears that the outlets that reviewed fewer movies often chose not to review lower quality movies, regardless of who the distributor was. For each distributor, the average quality of movie reviewed by *Ebert & Roeper* was higher than the average quality of movie reviewed by *Entertainment Weekly*, which was higher than the average quality of movie reviewed by the *New York Post*. Thus, although *Ebert & Roeper* and *Entertainment Weekly* were more likely to review higher quality movies than lower quality movies, this decision was independent of which studio distributed the movie.

For example, the difference between the average quality of Disney and News Corporation movies reviewed was not more for *Ebert & Roeper* (.0794)<sup>162</sup> than it was for the *New York Post* (.1151).<sup>163</sup> If there is bias in the selection of movies to review, *Ebert & Roeper* should exhibit a bigger gap in the quality of Disney and News Corporation movies it reviews than does the *New York Post*. Indeed, an examination of Table 3 demonstrates that, relative to the other media outlets, none of the media outlets discriminated in favor of higher quality affiliated movies.

Thus, Tables 2 and 3 provide support for the conclusion that there is no bias in the selection of which movies are reviewed. However, additional analysis is necessary to control for other factors that may be preventing the detection of bias. Thus, a multiple regression analysis is used in which number of quantifiable, explanatory variables are examined that may affect the probability that a particular movie is reviewed.<sup>164</sup> The definitions of these variables are summarized in Table 4.

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162. As displayed in Table 3, for *Ebert & Roeper*, the average quality of Disney movies reviewed was .1710, and the average quality of News Corporation movies was .0916. Thus, there was a .0794 difference in the average quality of Disney and News Corporation movies reviewed.

163. As displayed in Table 3, for the *New York Post*, the average quality of Disney movies reviewed was .1283, and the average quality of News Corporation movies was .0132. Thus there was a .1151 difference in the average quality of Disney and News Corporation movies reviewed.

164. Multiple regressions are used to determine the relationship between a particular variable (the "dependent variable") and more than one "explanatory" or "independent" variables.

TABLE 4:  
DEFINITION OF VARIABLES

VARIABLE	DEFINITION
<b>Independent Variables</b>	
#_REVIEWS	Number of reviews of movie by unaffiliated critics
NICHE	Movie is distributed by a "niche" studio (1=yes, 0=no)
AFFILIATE	Movie is affiliated with the critic (1=yes, 0=no)
QUALITY	Average grade given to movie by unaffiliated critics
AFFILIATE*QUALITY	Interaction term of AFFILIATE and QUALITY variables (AFFILIATE multiplied by QUALITY)
<b>Dependent Variables</b>	
REVIEW	Movie is reviewed by the particular media outlet (1=yes, 0=no)
GRADE	Grade given to movie by the critic

### a. Independent Variables Explained

This Section briefly explains the variables listed in the foregoing table.

#### *i. Number of Unaffiliated Reviews*

The first explanatory variable, #\_REVIEWS, is the number of reviews reported in *Variety's* Critic Picks by reviewers with no affiliation to the studio that distributed the movie. Specifically, it excludes reviews in Disney media outlets of films distributed by Disney studios, reviews in Time Warner media outlets of films distributed by Time Warner studios, and reviews in News Corporation media outlets of films distributed by News Corporation studios.

Many of the same factors that lead unaffiliated critics to review a

movie—pre-release publicity, etc.—should also cause affiliated critics to review it. Thus, all else equal, the more unaffiliated reviewers who reviewed a certain movie, the more likely that a particular affiliated reviewer should have reviewed it also.

### ii. *Niche Studio Movie*

NICHE is a dummy variable that denotes whether the film is distributed by a niche movie studio.<sup>165</sup> NICHE has a value of 1 if the film was distributed by a niche studio and a value of 0 if it was distributed instead by a major studio.<sup>166</sup> Films from major studios tend to be higher profile, have more pre-release publicity, and have wider intended audiences. Thus, mass-market media outlets, such as *Ebert & Roeper*, *Entertainment Weekly*, and the *New York Post*, may be less likely to review movies from niche studios than are media outlets with a narrower target audience.

### iii. *Affiliated Movie*

AFFILIATE is a dummy variable that denotes whether the movie is distributed by a studio affiliated with the media outlet in which the review appears. AFFILIATE has a value of 1 if a movie is an affiliated movie and a value of 0 otherwise. For example, for *Entertainment Weekly*, AFFILIATE has a value of 1 if the movie is distributed by a studio owned by Time Warner and a value of 0 otherwise. If media outlets are more likely to review films of affiliated studios then, all else equal, AFFILIATE should be positively correlated with whether a movie is reviewed (REVIEW).<sup>167</sup>

### iv. *Quality of Movie*

As noted above, bias in choosing which movies to review may take another form instead. Reviewers may be more likely to review good affiliated movies and less likely to review lower quality affiliated

165. A dummy variable is an artificially constructed variable that has a value of 1 when the particular characteristic of interest is present and a value of 0 if the characteristic is absent.

166. The major studios are those owned by The Walt Disney Company, DreamWorks LLC, Fox Entertainment Group Inc., Metro-Goldwyn-Mayer Inc., Paramount PLC, Sony Corporation, NBC Universal Inc., and Time Warner Inc., with the exception of their niche film studios. The niche studios of these companies are Miramax Zoe (Disney), Fox Searchlight (News Corp.), United Artists (MGM), Paramount Classics (Paramount), Screen Gems (Sony), Sony Pictures Classics (Sony), Universal Focus (Universal), Cinemax (Time Warner), Fine Line Features (Time Warner), and HBO (Time Warner). Dana Harris, *Hollywood Renews Niche Pitch*, VARIETY, Apr. 7, 2003, at 1.

167. Two variables are positively correlated if, when the value of one variable increases, generally the value of the other variable increases as well.

movies. This would allow a critic who wants to give sincere reviews to still be more likely to give positive reviews, and less likely to give negative reviews, to affiliated films. To test for this alternative type of bias, two other explanatory variables are also used: QUALITY and AFFILIATE x QUALITY.

As discussed above, QUALITY is the average grade given to the movie by unaffiliated reviewers, as calculated from *Variety's* Critic Picks. It is calculated as the number of favorable reviews minus the number of unfavorable reviews, divided by the total number of reviews.

#### v. *Affiliation and Quality Interaction Term*

An interaction term (AFFILIATE x QUALITY) equal to AFFILIATE multiplied by QUALITY is also included.<sup>168</sup> It is used to test whether media outlets are more likely to review a good affiliated movie than a good unaffiliated movie, and whether they are less likely to review a bad affiliated movie than a bad unaffiliated movie. This interaction variable will be greater than zero for an affiliated movie that has generally received positive reviews, less than zero for an affiliated movie that has generally received negative reviews, and zero for an unaffiliated movie. If reviewers are more likely to write reviews for good affiliated movies than for good unaffiliated movies, but less likely to write reviews for bad affiliated movies than for bad unaffiliated movies, then, all else equal, this interaction term should be positively correlated with whether a movie is reviewed.

#### b. Review Bias Explored

To test which of these independent variables help explain which movies are reviewed, the dependent variable REVIEW—whether a particular movie is reviewed—is regressed against these independent variables and an intercept term. This regression is conducted for each of the media outlets: *Ebert & Roeper*, *Entertainment Weekly*, and the *New York Post*. Because the dependent variable (REVIEW) has only two possible values (i.e., a movie is either reviewed or not reviewed), logistic regressions are used.<sup>169</sup> The results from these regressions are

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168. Interaction terms in multiple regressions are used to account for more complex relationships between variables. For example, this Article is interested in determining whether reviewers are more likely to review affiliated movies than unaffiliated movies. However, the answer to this question may depend upon an additional variable—the quality of the movie. In other words, reviewers may be more likely to review high quality affiliated movies than high quality unaffiliated movies, but less likely to review low quality affiliated movies than low quality unaffiliated movies. An interaction term can be used to test whether this more complicated relationship between the variables exists.

169. A logistic regression is an appropriate type of multiple regression when, as here, the



displayed in Table 5.

TABLE 5:  
DETERMINANTS OF DECISION TO REVIEW  
LOGIT ESTIMATES  
(P-VALUES IN PARENTHESES)

	Intercept	#_REVIEW	NICHE	AFFILIATE	QUALITY	AFFILIATE x QUALITY	Pseudo R <sup>2</sup>
Ebert & Roeper (612 movies)	-0.1369 (.5475)	0.1241 *** (<.0001)	-2.2573 *** (<.0001)	-0.5477 * (.0739)	0.6588 *** (.0001)	0.0556 (.9121)	.3498
Ent. Weekly (776 movies)	1.405 *** (.0006)	0.1707 *** (<.0001)	-3.3278 *** (<.0001)	0.7261 (.2390)	0.5145 *** (.0033)	1.0298 (.2682)	.4361
N.Y. Post (1014 movies)	0.4813 (.3797)	0.3856 *** (<.0001)	-0.7186 (.1700)	Positive (>.2500)	0.0657 (.7685)	N/A N/A	.3624

\* Statistically significant at the 10 percent level

\*\* Statistically significant at the 5 percent level

\*\*\* Statistically significant at the 1 percent level

As expected, the estimated coefficients of the #\_REVIEWS variable are positive and statistically significant for all three media outlets. As noted, many of the same factors that lead unaffiliated critics to review a movie, such as pre-release publicity, should also cause affiliated critics to review it. The results confirm that, all else equal, the more unaffiliated reviewers who review a certain movie, the more likely that a particular affiliated reviewer will review it also.

Also, all three media outlets were less likely to review movies distributed by niche studios, which are represented by the NICHE variable. For *Ebert & Roeper* and *Entertainment Weekly*, this result was

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dependent variable can have only two possible values. See G. S. MADDALA, LIMITED-DEPENDENT AND QUALITATIVE VARIABLES IN ECONOMETRICS 22-27 (1st ed. 1983) (describing logistic regressions).

statistically significant. As noted above, this result was not unexpected, because all three media outlets have wide intended audiences and thus may be less likely to review niche films than are other media outlets.

The estimated coefficients of the other explanatory variables indicate that there is not bias in the selection of movies to review, confirming the conclusions from Tables 2 and 3. As the estimated coefficients of the AFFILIATE variable show, all else equal, none of the media outlets are significantly more likely to review affiliated movies than unaffiliated movies.<sup>170</sup> In fact, all else equal, *Ebert & Roeper* is actually less likely to review Disney movies than movies from other sources.<sup>171</sup>

In addition, the estimated coefficients of the QUALITY variable demonstrate that, all else equal, all the media outlets are more likely to review higher quality movies than lesser quality movies.<sup>172</sup> For *Ebert & Roeper* and *Entertainment Weekly* this result is statistically significant. However, as the estimated coefficients of the AFFILIATE x QUALITY interaction variable show, none of the media outlets are significantly more likely to review higher quality affiliated movies than unaffiliated movies.<sup>173</sup>

The results for the *New York Post* require some additional

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170. None of the estimated coefficients of the AFFILIATE variable are positive and statistically significant. Also, note that because of the presence of the AFFILIATE x QUALITY interaction term in the regressions, the proper interpretation of the coefficient of AFFILIATE is the effect of affiliation on the dependent variable when QUALITY=0 (i.e., when a movie receives the same number of positive and negative reviews from unaffiliated reviewers).

171. The combination of the findings that niche studios' movies are less likely to be reviewed and affiliated movies are not more likely to be reviewed could be consistent with another type of bias: a "scratching each other's back" bias. For example, *Entertainment Weekly* (a Time Warner publication) might be more likely to review other major studios' films believing that, in exchange, media outlets affiliated with those other studios will be more likely to review Time Warner's films. However, it is unlikely that this type of bias is occurring. All else equal, the examined critics are not more likely to review the films of major studios that are part of conglomerates with movie critics than they are to review the films of major studios that lack affiliated critics. The empirical analyses that show this are available from the author.

172. All of the estimated coefficients of the QUALITY variable are positive. Because of the presence of the AFFILIATE x QUALITY interaction term in the regressions, the proper interpretation of the coefficient of QUALITY is the effect of movie quality on the dependent variable when AFFILIATE=0 (i.e., when the movie is reviewed by an unaffiliated reviewer).

173. None of the estimated coefficients of the AFFILIATE x QUALITY variable are positive and statistically significant. Note also that a film's genre (comedy, action, etc.) might affect the probability that a movie is reviewed. For example, if *Entertainment Weekly's* readers enjoy action movies more than do readers of other publications, then *Entertainment Weekly's* critics might be more likely to review an action movie than are other reviewers. To control for this factor, the regressions were rerun including, as explanatory variables, dummy variables for the movies' genres, as listed in the Internet Movie Database, <http://www.imdb.com> (last visited Feb. 6, 2006). However, controlling for genre did not markedly change any of the results. The full logistic results when genre variables are included are available from the author.

explanation. Because the *New York Post* reviewed all fifty-six movies distributed by News Corporation, there is quasi-complete separation of the data,<sup>174</sup> and thus the coefficient of the AFFILIATE variable cannot be estimated. However, it can be determined that the coefficient is positive (i.e., greater than zero) and statistically insignificant.<sup>175</sup> In addition, because of the quasi-complete separation, all the other estimated coefficients for that regression should be interpreted as the estimated coefficients for movies that are not distributed by News Corporation.<sup>176</sup> Because of this interpretation, and because for the *New York Post* regression the AFFILIATE x QUALITY interaction variable has a value of zero for all movies not distributed by a News Corporation subsidiary,<sup>177</sup> the AFFILIATE x QUALITY variable is not included in the *New York Post* regression.

In summary, the empirical results presented in this section indicate that movie critics are not biased in selecting which movies to review. All else equal, in general they are no more likely to review affiliated movies than unaffiliated movies, nor are they more likely to review higher quality affiliated movies than unaffiliated movies.

## 2. Bias in the Review Itself

The second question this Article examines is whether critics exhibit a bias in favor of affiliated movies in the grades they give to the movies. To help answer this question, Table 6 presents the percentage of reviews given by each media outlet that are favorable,<sup>178</sup> broken down

174. Quasi-complete separation occurs when some linear function of the explanatory variables can perfectly predict one possible outcome of the dependent variable. In this particular regression, one outcome of the dependent variable—a particular movie is not reviewed by the *New York Post*—can be fully explained by the AFFILIATE variable; all of the movies that are not reviewed by the *New York Post* were also not distributed by a News Corporation subsidiary. See Paul Allison, *Convergence Problems in Logistic Regression*, in NUMERICAL ISSUES IN STATISTICAL COMPUTING FOR THE SOCIAL SCIENTIST 238, 240–51 (Micah Altman et al. eds., 2004) (discussing quasi-complete separation in logistic regressions and methods for handling the problem).

175. *Id.* at 249.

176. *Id.* The intuition for this is that because *all* movies distributed by News Corporation subsidiaries were reviewed by the *New York Post*, the effect of the other independent variables on the likelihood that a movie distributed by a News Corporation subsidiary would be reviewed by the *New York Post* cannot be determined. Therefore, for the *New York Post* regression, the estimated coefficients of these independent variables should be interpreted as the effect on the likelihood that the *New York Post* reviews a particular movie that is not distributed by a News Corporation subsidiary.

177. Recall that AFFILIATE has a value of zero for all movies not distributed by a subsidiary of the critic's parent company. Thus AFFILIATE x QUALITY—the AFFILIATE variable multiplied by the QUALITY variable—will also have a value of zero for such movies.

178. Each media outlet uses a different rating system. *Ebert & Roeper* gives a “Thumbs Up”

by the parent company of the studio distributing the movie. To make a fair comparison, only those movies that were reviewed by all three outlets are included.

TABLE 6:  
PERCENTAGE OF REVIEWS THAT ARE POSITIVE

	Parent Company of Distributing Studio			
	Parent	Disney (92 movies)	Time Warner (102 movies)	News Corp. (48 movies)
Ebert & Roeper	Disney	64.7%	48.0%	59.4%
Entertainment Weekly	Time Warner	59.8%	47.1%	45.8%
New York Post	News Corp.	71.7%	48.0%	54.2%

Chi-squared = 4.76, Degrees of freedom=10 (Not Statistically Significant)

Based on Table 6, critics do not appear to favor affiliated movies over unaffiliated movies. For example, *Ebert & Roeper* is no more likely to give favorable reviews to Disney movies than are *Entertainment Weekly* and the *New York Post*. Similarly, *Entertainment Weekly* does not give better reviews to Time Warner movies than do the other media outlets, and the *New York Post* does not give better reviews to News Corporation movies than do the other media outlets. Indeed, there is no statistically significant difference between the percentage of reviews, given by the three media outlets to a particular parent's movies, that are favorable.<sup>179</sup>

(favorable review) or a "Thumbs Down" (unfavorable review). Wikipedia: Ebert & Roeper, [http://en.wikipedia.org/wiki/Ebert\\_&\\_Roeper](http://en.wikipedia.org/wiki/Ebert_&_Roeper) (last visited Feb. 6, 2006). *Entertainment Weekly* gives a letter grade ranging from A to F; reviews giving at least a B- are generally favorable. See Rotten Tomatoes: *Entertainment Weekly* Reviews, <http://www.rottentomatoes.com/source-150/> (last visited Feb. 6, 2006) (displaying the letter grades given by *Entertainment Weekly* to many films). The *New York Post* gives a grade ranging from 4 stars to 0 stars; reviews giving at least 2.5 stars are generally favorable. See Rotten Tomatoes: *New York Post* Reviews, <http://www.rottentomatoes.com/source-336/> (last visited Feb. 6, 2006) (displaying star grades given by the *New York Post* to many films).

179. The null hypothesis tested is that the percentage of reviews of a particular parent's

Although Table 6 suggests that no bias exists in the grades critics give to movies, further analysis is necessary to control for other factors that may be obscuring bias. For example, *Ebert & Roeper*, *Entertainment Weekly*, and the *New York Post* each have multiple movie critics. Thus, a multiple regression analysis is again used in which a number of quantifiable, explanatory variables are examined that may affect the probability that a movie receives a particular grade from a particular critic.

#### a. Explanatory Variables Defined

##### i. *Quality of Movie*

Recall that the variable QUALITY is the average grade given to a movie by reviewers with no affiliation to the studio that distributed it. Although critics often disagree about a movie's merit, it is likely that, in general, the grade a particular critic gives a particular movie will be positively correlated with the grades that other critics give the movie. Thus, all else equal, the variable QUALITY should be positively correlated with the grade that a particular reviewer gives a movie.

##### ii. *Affiliated Movie*

As noted above, AFFILIATE is a binary dummy variable that denotes whether the film is distributed by a studio affiliated with the media outlet in which the review appears. It has a value of 1 if it is an affiliated movie and a value of 0 otherwise. If critics are more likely to give favorable reviews to films of affiliated studios then, all else equal, AFFILIATE should be positively correlated with the grade that a critic gives a particular movie.

#### b. Grade Bias Explored

To test whether these variables help explain the grades critics give movies, the dependent variable GRADE—the grade a critic gives a particular movie—is regressed against these two independent variables and an intercept term. This regression is conducted for each of the primary critics: Roger Ebert and Richard Roeper of *Ebert & Roeper*; Owen Gleiberman and Lisa Schwarzbaum of *Entertainment Weekly*; and Jonathan Foreman and Lou Lumenick of the *New York Post*.

Different critics use different grading systems. Critics for

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movies that are favorable is independent of the media outlet. As noted in Table 6, this null hypothesis cannot be rejected because the chi-squared statistic is only 4.76, with 10 degrees of freedom.

*Entertainment Weekly* give movies letter grades ranging from A to F; critics for the *New York Post* give grades ranging from four stars to zero stars, in half-star increments.<sup>180</sup> Thus, because the dependent variable GRADE is an ordered, categorical variable, an ordered logistic regression is used for the *Entertainment Weekly* and the *New York Post* reviewers.<sup>181</sup> On the *Ebert & Roeper* television show, reviewers Roger Ebert and Richard Roeper give movies either a “Thumbs Up” (a positive review) or a “Thumbs Down” (a negative review).<sup>182</sup> Thus, because the dependent variable GRADE has only two possible values for them, 1 (for a positive review) or 0 (for a negative review), a simple logistic regression is used for Ebert and for Roeper. The regression results are presented in Table 7.

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180. Rotten Tomatoes: *Entertainment Weekly* Reviews, *supra* note 178; Rotten Tomatoes: *New York Post* Reviews, *supra* note 178.

181. The dependent variable, GRADE, is categorical because only certain values are possible (A, A-, etc. for *Entertainment Weekly* and 4 stars, 3.5 stars, etc. for the *New York Post*), and it is ordered because these categories are ordered (e.g., an A is a higher grade than an A-, which is higher than a B+, etc.).

182. Wikipedia: Ebert & Roeper, *supra* note 178.

TABLE 7:  
DETERMINANTS OF REVIEW GRADE  
(LOGIT ESTIMATES; INTERCEPTS NOT DISPLAYED)

Critic	QUALITY	AFFILIATE	Pseudo R <sup>2</sup>
<i>EBERT &amp; ROEPER</i>			
Roger Ebert (612 movies)	3.4571 *** (<.0001)	0.0268 (.9269)	.3245
Richard Roeper (567 movies)	1.9619 *** (<.0001)	0.5528 ** (.0400)	.1502
<i>ENTERTAINMENT WEEKLY</i>			
Owen Gleiberman (364 movies)	2.4320 *** (<.0001)	-0.2757 (.2885)	.0922
Lisa Schwarzbaum (355 movies)	3.4371 *** (<.0001)	-0.0718 (.7791)	.1513
<i>NEW YORK POST</i>			
Jonathan Foreman (367 movies)	2.9108 *** (<.0001)	0.2010 (.6199)	.1478
Lou Lumenick (494 movies)	2.6960 *** (<.0001)	0.7199 ** (.0315)	.1261

\* Statistically significant at the 10 percent level

\*\* Statistically significant at the 5 percent level

\*\*\* Statistically significant at the 1 percent level

Table 7 supports the conclusion that, in general, critics are not biased in the grades they give movies. Only four of the six critics examined gave more favorable reviews to affiliated movies, and for only two of these critics, Richard Roeper and Lou Lumineck, was the result

statistically significant.<sup>183</sup> Taken as a whole, however, the six critics are not statistically significantly more likely to give a favorable review to an affiliated movie than to an unaffiliated movie.<sup>184</sup> Unlike research analysts, critics do not exhibit a systematic bias in favor of affiliated movies.<sup>185</sup>

## V. DISCUSSION AND IMPLICATIONS OF RESULTS

This Article's empirical analyses show that movie critics are not systematically biased in favor of affiliated movies, either in their selection of which movies to review or in the grades they give the movies. Thus, movie critics working for the world's largest media conglomerates appear to be forsaking an opportunity to increase the profits of their conglomerates. This is particularly interesting given the efforts, discussed above, of media conglomerates to use their subsidiaries to promote the products of other subsidiaries.<sup>186</sup>

In addition, this finding also stands in stark contrast to the systematic bias of research analysts in favor of current and potential investment banking clients.<sup>187</sup> It also raises an important question: why do some conflicts of interest (like those facing research analysts in large financial conglomerates) result in biased opinions and harm to consumers, while

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183. The regression results imply that there is a 48.1% probability that Roeper will give a favorable review to an unaffiliated movie that has received an equal number of favorable and unfavorable reviews from other critics, but a 61.7% probability that he will give a favorable review to a similar quality affiliated movie. Also, the results imply that there is a 46.6% probability that Lumenick will give a favorable review to an unaffiliated movie that has received an equal number of favorable and unfavorable reviews from other critics, but a 64.2% probability that he will give a favorable review to a similar quality affiliated movie.

184. The regression results obtained from using all six critics together are available from the author.

185. It is possible that a film's genre (comedy, action, etc.) may affect the grade that a particular critic gives a movie. Critics may differ in the genres they prefer, and these preferences may be reflected in the grades they give to a particular studio's movies. Thus, a critic might give higher ratings to affiliated movies because the affiliated studio makes more movies of genres that that critic prefers rather than because that critic is biased in favor of affiliated movies. For example, if Roger Ebert likes romantic comedies more than other critics do, and if a greater percentage of Disney's movies are romantic comedies than are other studios' films, then, all else equal, he will give better reviews to Disney films, even if he is not biased in favor of Disney. To control for this factor, the regressions were rerun including dummy variables for the movies' genres, as listed in the Internet Movie Database. However, controlling for genre did not markedly change any of the results. The full regression results including genre variables are available from the author.

186. See sources cited *supra* note 9 (discussing how conglomerates use their media outlets to cross-promote products and services provided by other companies within the conglomerate to maximize the profits of these other businesses).

187. See *supra* Part III (describing how research analysts' conflicts of interest have led to biased research reports).



others (like those facing movie critics in large media conglomerates) do not? Determining what factors account for this difference can provide insight into what causes conflict of interests to actually result in bias and how regulators can reduce research analysts' bias.

One possible explanation for this Article's finding little evidence of movie critics' bias may be that high-profile critics may wish to protect their reputations for being unbiased; all of the critics examined in this Article work for large media outlets.<sup>188</sup> Research in many fields has demonstrated that the desire to protect one's reputation can cause a person to engage in behavior that is against that person's short-term interest.<sup>189</sup>

There is evidence that movie critics of the stature examined in this Article are aware of their reputations for being unbiased. For example, Roger Ebert and Richard Roeper annually host a film festival on a Disney cruise and their attendance is highlighted in Walt Disney Cruise Line's advertising of the cruise.<sup>190</sup> When Ebert was asked by a reporter if he worried his attendance would create the appearance of a conflict of interest when he reviewed Disney movies, Ebert replied that he was not worried about such a perception because in his decades of reviewing movies he had developed a reputation for being unbiased.<sup>191</sup> He noted, as an example, that he had given very negative reviews to two recent major Disney movies: *Pearl Harbor* and *The Princess Diaries*.<sup>192</sup> In addition, he argued that the importance of maintaining his reputation would prevent him from being biased: "I have much more to lose than Disney has to gain. . . . If anybody perceives that I'm not telling the truth as I see it, I'm out of business."<sup>193</sup>

Other critics for major publications echo similar professionalism standards. For example, Owen Gleiberman, a critic for *Entertainment*

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188. Data regarding the reviews of little-known critics is much less accessible.

189. See, e.g., Daniel M. Covitz & Paul Harrison, *Testing Conflicts of Interest at Bond Ratings Agencies with Market Anticipation: Evidence that Reputation Incentives Dominate*, FEDERAL RESERVE BOARD FINANCE AND ECONOMICS DISCUSSION SERIES 2003-68, at 1 (2003), available at <http://www.federalreserve.gov/pubs/feds/2003/200368/200368pap.pdf> ("The findings strongly indicate that rating changes do not appear to be importantly influenced by rating agency conflicts of interest, but, rather, suggest rating agencies are motivated primarily by reputation-related incentives.").

190. Munoz, *supra* note 36, at F10.

191. *Id.* Ebert also stated that before agreeing to host the festival, he and Roeper insisted that there be no pressure put on them to show Disney films at the festival. *Id.* In addition, to avoid the appearance of a conflict of interest, both he and Roeper are not paid to host the film festival. Jessica Shaw, *All Thumbs on Deck*, ENT. WKLY., Mar. 14, 2003, at 40.

192. Munoz, *supra* note 36, at F10.

193. *Id.*

*Weekly*—and one of the critics examined in this Article—has complained that “[t]oo many puff critics, quote whores . . . and bland, lily-livered critics are drowning out the serious critics.”<sup>194</sup>

However, reputation concerns are likely not largely responsible for the lack of bias found in this Article. First, bias would be very difficult for moviegoers to detect for a number of reasons. As noted above, it is very unlikely that moviegoers know whether a particular movie’s distributor and the critic’s media outlet have the same parent company. In addition, because each studio distributes only a fraction of the movies released, the vast majority of a critic’s reviews would be unaffected by bias.<sup>195</sup> For these reasons, it is very unlikely that a bias toward affiliated movies would be detected, absent the types of empirical analyses used in this Article. The bias would affect only a small percentage of the critic’s reviews and because the public is unaware of which movies are affiliated with a particular critic, the public would not be aware that it was bias in favor of affiliated movies.

In addition, reputation concerns by critics would be unable to prevent unintentional bias. At most law schools, professors grade exams blind—i.e., without knowing who wrote the exam—in part to avoid unintentional bias in grading.<sup>196</sup> Similarly, a critic may subconsciously look more favorably on a movie because it is distributed by an affiliated studio.

Finally, the fact that similar reputation concerns did not prevent bias in research analysts, also suggests that reputation concerns would not be sufficient to prevent bias in movie critics. Research analysts’ bias occurred despite the fact that analysts’ reputations for providing accurate forecasts can be important to their success.<sup>197</sup> In addition, the accuracy of analysts’ forecasts can be objectively measured, unlike the accuracy of movie reviews. If a research analyst recommends a particular stock or issues an estimate of a company’s quarterly earnings, then it will be clear in hindsight whether the analyst was correct, and his

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194. Shaw, *supra* note 37, at A1.

195. For example, Time Warner studios distributed only 11.4% of the movies examined in this Article, the most of any parent company.

196. Judith G. Greenberg, *Erasing Race From Legal Education*, 28 U. MICH. J.L. REFORM 51, 69 (1994).

197. Harrison Hong & Jeffrey D. Kubik, *Analyzing the Analysts: Career Concerns and Biased Earnings Forecasts*, 58 J. FIN. 313, 345–48 (2003) (empirical study finding that forecasting accuracy affects research analysts’ career success). Hong and Kubik’s study also found that for stocks underwritten by analysts’ employers, forecasting accuracy has less impact—and optimism in the forecasts has a greater impact—on career advancement. *Id.* This demonstrates that conflicts of interest can outweigh an analyst’s concern for having a reputation of being an accurate forecaster. *Id.*

or her reputation could be affected accordingly. In contrast, a critic's judgment regarding the quality of a particular movie is inherently subjective, so although a critic might hold a minority view regarding certain movies, one cannot objectively conclude that the critic was inaccurate.<sup>198</sup>

The primary explanations for the differences in bias exhibited by movie critics and research analysts are differences in the structures of the organizations in which they work, and differences in the financial incentives that they face. These differences also suggest that many of the recent reforms targeted at research analysts are likely to be successful in reducing analysts' bias.

As discussed above, these reforms fall into three categories: (1) reforms designed to make research analysts independent, especially from their firms' investment bankers; (2) reforms designed to eliminate research analysts' financial interests in the effect of their reports on the companies they cover; and (3) reforms that require disclosure of research analysts' conflicts of interest.<sup>199</sup> This Article's empirical analyses suggest that the first two sets of reforms are likely to reduce bias, but the disclosure requirements are unnecessary.<sup>200</sup>

#### A. *Increasing Research Analysts' Independence*

The first type of reform aims to increase research analysts'

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198. A counterargument could be made that reputation would have a stronger effect on movie critics than on research analysts because the quality of an analyst's forecast is less verifiable than is the quality of a critic's review. For example, unlike a movie review, an analyst's forecast of a company's earnings may end up being inaccurate for reasons beyond the analyst's control, such as due to an unforeseeable slowdown in the economy. Ultimately, the question of whether a research analyst's erroneous forecast harms the analyst's reputation more than a flawed movie review harms a critic's reputation is an empirical question beyond the scope of this Article. Nevertheless, it is not obvious that a critic's reputation would be harmed more. A viewer who disagrees with a critic's review might attribute part of that disagreement simply to differences in taste, not to a critic's incompetence or bias. In addition, people who regret having relied on a critic's review will only have lost a couple of hours of their time and the cost of their movie tickets; on the other hand, investors who regret relying on an analyst's research reports may have lost large sums of money.

199. See *supra* notes 100–127 and accompanying text (listing the NYSE and NASD rules approved by the SEC).

200. Although this Article provides support for many of the structural reforms, it does not necessarily endorse the view that these reforms should come from a particular source, such as the SEC. For example, the independence of movie critics from affiliated movie studios has not been imposed from outside the media industry. In addition, as discussed above, some of the reforms directed at research analysts came into effect through the global settlement or were even adopted voluntarily by firms. See *supra* notes 134–40 and accompanying text (describing reforms agreed to in the global settlement); Gasparino & Opdyke, *supra* note 84 and accompanying text (noting that Merrill Lynch voluntarily adopted a policy prohibiting its research analysts from owning stock in companies that they cover).

independence from their firms' investment bankers. As discussed above, research analysts gave more favorable coverage to companies with which their employer had or hoped to secure investment banking business. This is unsurprising in light of the pressure on these research analysts to write positive reports about such companies. For example, companies threatened to end lucrative investment banking relationships with the employers of research analysts who wrote unfavorable reports about them.<sup>201</sup> Sometimes these threats resulted in a particular research analyst being removed from covering the complaining company.<sup>202</sup>

There were also other sources of pressure to produce biased recommendations. Research analysts often worked under the supervision of the investment banking department.<sup>203</sup> In addition, some research analysts' compensation was directly based in part on the investment banking business that they helped bring in.<sup>204</sup> In fact, investment banking departments' pitches for business from a company sometimes included a promise that a particularly well-known research analyst at the investment bank's firm would cover the company's stock.<sup>205</sup> Sometimes the research analyst would even attend these pitches.<sup>206</sup>

The situation is very different for movie critics working for media conglomerates. There is no evidence that these critics or their parent companies view part of the critics' jobs as the promotion of affiliated movies. Also, critics' supervisors are editors of the media outlet for which they work, not executives of affiliated studios.<sup>207</sup> In addition, critics' compensation is not based on how affiliated movies perform at the box office.<sup>208</sup> For all these reasons, critics do not face the great pressure to give favorable reviews to affiliated movies that research analysts felt to give favorable coverage to actual or potential investment

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201. See, e.g., Jeremy Kahn, *Frank Quattrone's Heavy Hand*, FORTUNE, Dec. 30, 2002, at 78 (noting that the Chief Executive Officer of EarthLink threatened to move Earthlink's investment banking business from Credit Suisse First Boston (CSFB) because of CSFB's research reports on Earthlink).

202. *Id.*

203. See, e.g., Landon Thomas Jr., *U.S. Accuses a Top Banker of Obstruction*, N.Y. TIMES, Apr. 24, 2003, at C1 (noting that Frank Quattrone, while he was global head of technology banking for Credit Suisse First Boston, also had "direct control over his research analysts").

204. Smith, *supra* note 64, at C1; U.S. SECURITIES AND EXCHANGE COMMISSION, *supra* note 3.

205. See, e.g., Dinallo Affidavit, *supra* note 73, at 24 (indicating that to secure an investment banking deal with GoTo.com, Merrill Lynch investment bankers promised that famous Merrill Lynch research analyst Henry Blodget would begin covering GoTo.com's stock).

206. Smith, *supra* note 64, at C1.

207. Telephone Interview with Dann Gire, *supra* note 55.

208. *Id.*

banking clients.

This contrast between research analysts and movie critics also indicates the importance of an individual having a personal stake in the creation of bias for a conflict of interest to result in actual bias. This Article's findings indicate that, to create bias, it is not enough that that individual's parent company benefits from bias; instead the bias must also benefit the individual research analyst or critic personally. Research analysts who gave negative coverage to investment banking clients risked reducing their own compensation. However, movie critics who give unfavorable reviews to affiliated movies face no such sanctions. The result of these differing incentives appears to be that stock recommendations were often biased but movie reviews were not. This strongly suggests that reforms that increase research analysts' independence from investment bankers should reduce bias in research analysts' reports.<sup>209</sup>

*B. Eliminating Research Analysts' Stake in How Their Reports Affect the Companies They Cover*

Another way that research analysts can have a personal financial stake is by actually owning a financial interest in the companies they cover. Obviously, a research analyst with a financial stake in a company the analyst covers will have a conflict of interest. For example, if the analyst owns stock in a company, the analyst will have a direct personal financial incentive to not issue a negative report on the company because the report may adversely affect the value of the analyst's stockholding.<sup>210</sup> Thus, the second type of reform is directed at eliminating research analysts' personal financial interests in how their coverage affects the companies they cover. As discussed above, these reforms consist of rules limiting the types and timing of transactions that analysts can make in the securities of the companies they cover.

This Article's finding of little evidence of bias by movie critics

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209. Some have argued that, because sell-side research analysts' reports suffer from a public good problem (i.e., research analysts are unable to capture the full benefit of their research through marketplace transactions), preventing investment banking departments from subsidizing research analysts will result in too little research being produced. Stephen J. Choi & Jill E. Fisch, *How to Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries*, 113 YALE L.J. 269, 283-92 (2003). However, as discussed in the present Article, the subsidization results in biased research that is harmful to investors. See *supra* Part III (discussing the conflicts of interest facing research analysts and the effects of these conflicts on investors who rely upon research analysts' reports). For a creative approach to subsidizing research without using investment banking revenue, see Choi & Fisch, *supra*, proposing a shareholder voucher system to fund research analysts and other securities intermediaries.

210. U.S. SECURITIES AND EXCHANGE COMMISSION, *supra* note 3.

suggests that these reforms are also warranted. Unlike some research analysts, movie critics do not have direct financial interests in the movies they review. Some critics are involved in the production of particular movies, but these critics do not review movies with which they are involved.<sup>211</sup> For example, the Ethics Policy of the Chicago Film Critics Association explicitly prohibits critics from “participating (regardless of compensation) in productions that will be reviewed by the critic.”<sup>212</sup>

The importance of having a personal financial stake in the creation of bias is further illustrated by the effect of press junkets on some movie critics. As discussed above, studios give many critics who attend these junkets free airfare, expensive hotel rooms and meals, spending money, and access to movie stars. In addition, studios have sometimes temporarily blackballed critics who were critical of the studios’ movies.<sup>213</sup> As discussed above, there is at least strong anecdotal evidence that some regular junket attendees respond to these incentives by making positive statements about the movies shown at the junkets.<sup>214</sup> Regular junket attendees often provide the positive blurbs that appear in advertising for movies that received widespread poor reviews.<sup>215</sup>

The behavior of some junket attendees provides more support for the conclusion that preventing critics from having a personal financial interest in the creation of bias is a key to preventing bias. Similarly, it indicates that eliminating research analysts’ personal financial stake in how their reports affect the stock price of the companies they cover is a key to eliminating bias in their reports.<sup>216</sup>

### C. Disclosure Requirements

This final type of recent reform requires the public disclosure of the

211. Telephone Interview with Dann Gire, *supra* note 55.

212. CHICAGO FILM CRITICS ASS’N, ETHICS POLICY OF THE CHICAGO FILM CRITICS ASS’N (on file with the author).

213. See *supra* note 50 and accompanying text (discussing how critics Roger Ebert and Gene Siskel were banned temporarily from 20th Century Fox screenings).

214. Hays, *supra* note 41 (“How do you qualify as a Quote Whore? You give good quote. Freebie junketeers sometimes scribble down words of praise and pass them to publicists right there at the junket.”).

215. Welkos & Abramowitz, *supra*, note 51.

216. It is also possible that, as a group, the personalities of people who choose to become movie critics may not be the same as those who choose to become research analysts. For example, as a group, research analysts may be more motivated by financial reward than are movie critics. If this is true, then it would be even more necessary to ensure that research analysts not have personal financial incentives to produce biased research reports than to ensure that movie critics lack personal financial incentives to produce biased movie reviews.

conflicts of interests that research analysts face. Disclosure requirements may serve two purposes. First, disclosure may make it less likely that investors will rely upon biased reports. Disclosure alerts investors to a research analyst's conflict of interests so that they may view the analyst's report with more skepticism.<sup>217</sup> Second, because investors will be aware of the conflicts, disclosure may encourage research analysts to not be biased, because disclosure may cause their recommendations and forecasts to be viewed more suspiciously.<sup>218</sup>

However, this Article's results indicate that the disclosure requirements are unnecessary. As noted above, movie critics do not disclose when they are reviewing a movie distributed by a studio with which they are affiliated. Despite this lack of disclosure, movie critics do not show systematic bias toward affiliated movies. Because critics work independently from those who distribute the affiliated movies, and because critics lack a personal financial interest in the success of affiliated movies, they do not exhibit the bias displayed by research analysts. Thus no disclosure of movie critics' conflicts of interests appears necessary.

This also suggests that requiring research analysts to disclose their conflicts of interest would be unnecessary if the other reforms are successful in keeping analysts independent from their firms' investment bankers and in keeping analysts from having a personal stake in how their coverage affects the securities of the companies they cover.

This conclusion is especially important because other research has shown that disclosure may have unintended, undesirable effects.<sup>219</sup> One such effect is that, if forced to disclose their conflicts of interest, research analysts may react strategically by making forecasts and recommendations exhibiting even greater bias.<sup>220</sup> For example, if an analyst believes that disclosure of the firm's investment banking relationship will cause investors to discount the analyst's recommendation to purchase a particular stock, the analyst might intentionally give an even more exaggerated recommendation to offset this discounting. In other words, "[w]hile disclosure might warn an

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217. Daylian M. Cain, George Loewenstein & Don A. Moore, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*, 34 J. LEGAL STUD. 1, 5 (2005).

218. *Id.* at 5-6.

219. These potential undesirable effects, and the psychological studies underpinning them, are thoroughly discussed in Daylian M. Cain, George Loewenstein & Don A. Moore, *Coming Clean but Playing Dirty: The Shortcomings of Disclosure as a Solution to Conflicts of Interest*, in CONFLICTS OF INTEREST: CHALLENGES AND SOLUTIONS IN BUSINESS, LAW, MEDICINE, AND PUBLIC POLICY 104 (Don A. Moore et al. eds., 2005).

220. Cain et al., *supra* note 217, at 6-7.

audience to cover its ears, it may also encourage advisors to yell even louder.”<sup>221</sup>

In addition, disclosure might increase bias by making some research analysts feel that disclosure gives them an ethical green light to give biased advice.<sup>222</sup> An analyst may believe that because disclosure warns investors to beware of bias, the analyst is relieved of the ethical responsibility of being unbiased. The results of some psychology experiments indicate that this concern is justified.<sup>223</sup>

A related problem of disclosure is that it may reduce the likelihood that policy-makers take other steps to actually reduce or eliminate the existence of the conflict of interest. Because disclosure warns consumers to be wary of the advice, disclosure may be perceived as reducing policy-makers’ responsibility for any harm resulting from the conflict, and thus may lessen the political pressure on policymakers to reduce or eliminate the conflict of interest.<sup>224</sup>

In addition, investors may not react to the disclosure in the way that the SEC intends them to. For example, if analysts disclose their conflicts of interest, investors might perceive this very act of disclosure as evidence that the analysts are honest, and thus might lead to even greater reliance on the conflicted analysts’ forecasts and recommendations.<sup>225</sup>

Also, even if investors do react to disclosure by being more skeptical of conflicted research analysts’ advice, for several reasons investors are very unlikely to discount sufficiently that conflicted advice. First, there is no reason to believe that investors are aware of the amount by which conflicted analysts’ forecasts should be discounted. In fact,

221. Cain et al., *supra* note 219, at 115.

222. *Id.* at 115–16.

223. Donald G. Dutton & Robert A. Lake, *Threat of Own Prejudice and Reverse Discrimination in Interracial Situations*, 28 J. PERSONALITY & SOC. PSYCHOL. 94 (1973) (persons who were falsely told that they had exhibited a racist reaction to a particular stimulus were more likely to subsequently take actions to demonstrate that they are not racist); Benoit Monin & Dale T. Miller, *Moral Credentials and the Expression of Prejudice*, 81 J. PERSONALITY & SOC. PSYCHOL. 33, 40 (2001) (persons who were given the opportunity to show they are not prejudiced were more likely to subsequently take actions that are prejudiced).

224. Cain et al., *supra* note 219, at 107–08.

225. Daniel T. Gilbert & Patrick S. Malone, *The Correspondence Bias*, 117 PSYCHOL. BULL. 21, 21 (1995).

Three decades of research in social psychology have shown that many of the mistakes people make are of a kind: When people observe behavior, they often conclude that the person who performed the behavior was predisposed to do so—that the person’s behavior corresponds to the person’s unique dispositions—and they draw such conclusions even when a logical analysis suggests they should not.

*Id.*



psychological research indicates that people are likely to underestimate the bias resulting from conflicts of interest.<sup>226</sup> Second, other psychological experiments have long demonstrated that because of an anchoring and insufficient adjustment effect, people will give too much weight to advice, even if it is disclosed to them that the advice is randomly generated.<sup>227</sup> In addition, other experiments have demonstrated the failure of evidentiary discreditation; people have difficulty disregarding information (such as stock forecasts that they have seen), even if they learn that the information is inaccurate.<sup>228</sup>

The combination of disclosure requirements causing analysts' research reports possibly to be even more biased, and investors being unable to sufficiently discount the research reports for this bias, means that investors might even be made worse off by disclosure requirements. Indeed, a recent experiment found that when forced to disclose their conflict of interest, conflicted advisors' advice was much more biased than when they did not have to disclose their conflict.<sup>229</sup> Although the receivers of the advice discounted the advice in response to the disclosure, they did so insufficiently.<sup>230</sup> As a result, overall, the receivers of the advice were worse off than they would have been if the conflict had not been disclosed.<sup>231</sup>

These possible adverse effects of disclosure support the conclusion that the reforms directed at research analysts should focus on reducing their conflicts of interest rather than on mandating the disclosure of the conflicts.<sup>232</sup>

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226. See Cain et al., *supra* note 219, at 113–14 and the studies cited therein (“Estimating the extent to which advice has been biased by an advisor’s conflict of interest necessitates estimating the effect of a situational inducement on behavior; and such situational effects generally tend to be underestimated.”).

227. Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 *SCIENCE* 1124, 1124–25 (1974).

228. Timothy D. Wilson & Nancy Brekke, *Mental Contamination and Mental Correction: Unwanted Influences on Judgments and Evaluations*, 116 *PSYCHOL. BULL.* 117, 137 (1994).

229. The experiment involved persons (“estimators”) who had to guess from a distance the amount of money that was in a jar of coins. They received advice from other persons (“advisors”) who were given the opportunity to more closely study the jar. However, the advisors had a conflict of interest because the higher the estimators guessed, the more compensation the advisors received. Cain et al., *supra* note 217, at 9.

230. *Id.* at 14–17.

231. *Id.* at 18.

232. Cain et al., *supra* note 219, at 114 (“In sum, a substantial body of research suggests that it is unlikely that [receivers of advice] will be able to use disclosures of conflict of interest to correctly discount advice from biased sources, even if those disclosures are honest and thorough.”). Despite its problems, disclosure remains a popular approach to dealing with conflicts of interest. This is likely, at least partly, because it is often the preferred remedy of policymakers and the persons with the conflicts because disclosure requires little disruption of the

## VI. CONCLUSION

Conglomerates have the opportunity to exploit synergies among their businesses to offer better products or services or lower prices. However, they also can create conflicts of interests for their employees. This Article has examined two industries in which certain professionals face similar conflicts of interests because of the conglomerates in which they work.

Millions of investors rely on the investment advice of research analysts who work in brokerages. However, those research analysts whose employers are part of financial institutions that also have investment banking departments face a conflict of interest because giving positive recommendations regarding particular stocks can help these financial conglomerates secure lucrative investment banking business.

Similarly, millions of consumers rely on movie critics for sincere advice regarding which movies to see. However, those movie critics whose employers are part of media conglomerates that also own movie studios have a conflict of interest because giving positive reviews of those studios' movies can cause more people to see the movies.

Despite the similarities in the conflicts of interest facing these two sets of professionals, each has responded very differently to the conflicts. Previous research has demonstrated that research analysts' reports have been biased by their conflict of interest. However, this Article's empirical analyses have found no systematic bias in movie critics' reviews.

The difference can be attributed to the organizational structure and financial incentives facing movie critics differing significantly from those faced by many research analysts. Critics are not supervised by studio executives, nor do critics personally profit from how much money their reviews make for affiliated studios. On the other hand, many research analysts were being supervised by their firms' investment bankers, compensated partly upon how much investment banking business they helped bring in, and were able to personally financially benefit from how their reports affected the prices of the securities they covered.

This Article's findings provide guidance for policymakers tasked with controlling conflicts of interest. Their focus should be on reducing the existence of the conflicts of interests, not on publicly disclosing

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status quo and places on others the primary responsibility for dealing with the consequences of the conflicts. Cain et al., *supra* note 217, at 2-3.

them. This conclusion is especially important given recent research showing that, at least in some contexts, disclosure can harm those it is intended to protect.

This conclusion also provides support for many of the rules and regulations the Securities Exchange Commission and others have recently imposed on research analysts and their employers. Because many of these reforms will make the organizational structure and financial incentives facing research analysts more like those facing movie critics, this Article provides support for the conclusion that such reforms will likely reduce analysts' bias. However, it also suggests that the reforms that mandate public disclosure of the analysts' conflicts of interests are unnecessary. Movie reviews do not disclose when the critic is reviewing an affiliated movie, yet these reviews are still not biased.