



Vue Entertainment Holdings (UK) Ltd and A3 Cinema Limited

A report on the completed acquisition of A3 Cinema Limited by Vue Entertainment Holdings (UK) Ltd

24 February 2006

© Competition Commission 2006

Website : www.competition-commission.org.uk

Members of the Competition Commission who conducted this inquiry

Dame Barbara Mills (*Chairman of the Group*)

Professor John Cubbin

Jill Hill

Professor David Parker

Professor Sudi Sudarsanam

Chief Executive and Secretary of the Competition Commission

Martin Stanley

The Competition Commission has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by ✂.

Completed acquisition by Vue Entertainment Holdings (UK) Ltd of A3 Cinema Limited

Contents

	<i>Page</i>
1. The reference.....	6
2. The companies involved in the merger	6
Vue.....	6
Ster.....	6
3. The merger and the relevant merger situation	7
Outline of merger situation	7
The rationale for the merger.....	7
Jurisdiction	8
4. The cinema exhibition industry.....	9
5. Market definition.....	10
Product market.....	10
Demand-side substitution.....	11
Supply-side substitution	13
Geographic market.....	14
Data analysis.....	15
Conclusions on market definition	16
6. Assessment of the competitive effects of the merger.....	16
Introduction	16
The nature of competition in the market.....	17
Underlying factors affecting existing rivalry in the relevant markets.....	17
The impact of different films on competition.....	17
Market concentration and entry/exit	18
Price and non-price competition.....	18
Counterfactual.....	19
Effects of the merger	20
Effect on national strategies	20
Effect of the merger in local markets.....	20
Other competitive constraints which might offset effects of the merger.....	31
Barriers to entry or expansion	31
Countervailing buyer power	32
Conclusions on the SLC test.....	32
7. Remedies	33
Remedy options	33
Behavioural remedies	33
Divestment	35
Divestment of the Vue Leisure Park or former Ster Festival Place cinema.....	35
Sale and leaseback of the Vue Leisure Park cinema.....	37
Conclusion on divestment remedies	42
Relevant customer benefits.....	43
Conclusion on remedies.....	44

Appendices

- A Terms of reference and conduct of the inquiry
- B Summary financial analysis and the transaction
- C Industry background

- D Market definition
- E Counterfactual
- F Local competition
- G Area maps

Glossary

Summary

1. On 23 September 2005 the Office of Fair Trading (OFT) referred to the Competition Commission (CC) for investigation and report under section 22(1) of the Enterprise Act 2002 (the Act) the completed acquisition by Vue Entertainment Holdings (UK) Limited (Vue) of A3 Cinema Limited (A3), including its sole operating entity Ster Century (UK) Limited (Ster). Our terms of reference are set out at Appendix A. We published our provisional findings on 20 December 2005.
2. Vue is the third-largest operator of cinemas in the United Kingdom (UK). Prior to the merger, Vue owned and operated 42 cinemas in the UK, with 409 screens. Ster was, prior to the merger, the owner and operator of seven multiplex cinemas in the UK and the Republic of Ireland, with 87 screens. One of these cinemas, with 14 screens, is located in the Republic of Ireland and is outside our jurisdiction. The other cinemas operated by Ster were at Basingstoke, Cardiff, Edinburgh, Leeds, Norwich and Romford.
3. On 29 April 2005 Vue acquired all the issued share capital of A3, amongst whose subsidiaries was Ster. The acquisition was a relevant merger situation over which we have jurisdiction.
4. We concluded that the relevant product market primarily affected by the merger was no wider than cinema exhibition. We received conflicting evidence on whether there were distinct markets within this broad definition for multiplex and non-multiplex cinemas. We did not need to reach a view on whether this was the case; instead we looked on a case-by-case basis at the non-multiplex cinemas put to us as being competitors with the acquired cinemas, and reached a view on each one as to whether it was a competitive constraint. We concluded that the relevant geographic market was local. We did not need to reach a firm view on the limits of the geographic market. We focused primarily on cinemas within a 20-minute drive-time isochrone of the acquired cinemas (drive-time isochrones are areas within which it is possible to drive to the cinema within the specified time), which the parties argued was the relevant geographic market. Vue also told us that many cinemas outside the 20-minute isochrone compete with its cinemas, so we also considered these cinemas.
5. Available evidence suggests that cinema-goers generally choose to see a film, and then choose where to go to see it. They usually go to their closest cinema. Cinemas seek to distinguish themselves from their competitors on a number of levels, including both ticket price and quality of the offer. These can be inter-related; a cinema exhibitor may price tickets low to attract custom, recognizing that its cinema has an inferior-quality offer to that of its competitors.
6. In considering the effects of the merger, we focused first on whether the merger would have any adverse effects at a national level, and whether it would have adverse effects in any of the four markets where Vue and Ster were both present before the merger (Vue had not been present in Cardiff or Norwich before the merger).
7. At a national level the merger increased Vue's share of cinema seats in the UK by 2.2 per cent to 16 per cent. We did not consider that such a small increment would have a substantial impact on Vue's negotiating position with screen advertising contractors, distributors, or suppliers of food and drink for sale at concession points.

We concluded, therefore, that there were no adverse effects at a national level arising from the merger.

8. We looked at the effects of the merger in Basingstoke, where, as a result of the merger, Vue owns the only two cinemas within a 20-minute drive of Basingstoke. Vue told us that the cinemas in Basingstoke faced competition from non-multiplex cinemas in Winchester and Alton, and multiplex cinemas in Bracknell, Reading and Woking. We considered whether these cinemas did compete with the cinemas in Basingstoke, constraining the ability of Vue to raise prices or lower the quality of its offer.
9. We looked at the non-multiplex cinemas in Winchester and Alton, and concluded that they did not offer a competitive constraint on the cinemas in Basingstoke. We looked at how many people were within a 20-minute drive of the acquired cinema in Basingstoke and the multiplex cinemas in Bracknell, Reading or Woking. For Reading and Woking the overlaps were 5 per cent or less each, and we considered, therefore, that Vue would not feel any competitive pressure from the multiplex cinemas in Reading and Woking, as there were too few overlapping potential customers. The population overlap for Bracknell was larger, at over 28 per cent. However, once we considered where the population overlap was and how many people in that area were registered for internet updates of films showing at either Basingstoke cinema, we concluded that the cinema in Bracknell did not provide a significant competitive constraint on the cinemas in Basingstoke.
10. We concluded, therefore, that Vue's acquisition of the Ster cinema in Basingstoke had removed the strongest, and only substantial, competitive constraint on it as a cinema exhibitor in Basingstoke. We conclude that there is therefore a substantial lessening of competition (SLC).
11. We concluded that the SLC may be expected to result in higher prices for cinema tickets, and a reduced incentive to maintain the quality of the offer at the Basingstoke cinemas than would have been the case if the merger had not taken place.
12. In addition, we concluded that if the merger were allowed to proceed, Vue will close the Basingstoke Leisure Park site and change its use. We therefore expect that there would be a third detriment resulting from the merger, namely a reduction in choice for consumers in Basingstoke. This reduction in choice would take the form of having only one cinema to visit, and having fewer screens on which to see films.
13. We looked at the effects of the merger in Edinburgh, and concluded that, after the merger, there are still a significant number of competing cinemas and screens in Edinburgh. We conclude that the merger does not result in an SLC in Edinburgh.
14. We considered whether the merger may be expected to produce adverse effects on competition in Leeds. We concluded that, whilst the merger brought under common ownership the only two multiplex cinemas in the City of Leeds, there were at least three multiplex cinemas which offered constraints of varying degrees on the ability of Vue to raise prices or lower the quality of offer in their cinemas. These would together offer a constraint on Vue's Leeds cinemas, and we therefore conclude that the merger may not be expected to give rise to an SLC in Leeds.
15. We looked at the effect of the merger in Romford. We concluded that the post-merger situation was not significantly different from the situation had the merger not taken place, and conclude that the merger does not give rise to an SLC in Romford.

16. We considered whether there were any competitive constraints which might offset the adverse effects of the merger. We did not expect actual new entry, or the threat of new entry, to offer a competitive constraint in the Basingstoke market in the short to medium term. We did not expect any countervailing buyer power to be exerted by customers or groups of customers.
17. For the reasons set out above, we conclude that the merger has resulted in an SLC in the market for cinema exhibition services in Basingstoke, and that this may be expected to result in higher prices for cinema tickets, a reduced incentive to maintain the quality of the offer at the Basingstoke cinemas, and a reduction in choice for consumers in Basingstoke. We do not conclude that the merger may be expected to give rise to an SLC in any other market.
18. On the question of remedies, we considered two types of remedies: divestment of one of the cinemas in Basingstoke, and a package of behavioural remedies put to us by Vue.
19. We concluded that the behavioural remedies offered by Vue would satisfactorily remedy only one of the three adverse effects identified (loss of choice). We concluded that they would not satisfactorily remedy two of the three adverse effects identified, and would not, therefore, be effective.
20. We concluded that divestment of either cinema in Basingstoke, to a purchaser who we were satisfied would operate it as a multiplex cinema specializing in showing mainstream films, would remedy both the SLC and adverse effects identified. We further concluded that Vue should be allowed to attempt to carry out either a straight divestment or a sale and leaseback with concurrent disposal of the sublease on its Leisure Park cinema as part of the divestment process for that cinema. In the event of a sale and leaseback we would require specific undertakings to ensure that the sublease did not contain any non-standard terms. In either case the divestment process would need to be completed in a specific timeframe.
21. We conclude therefore that the action that should be taken for the purpose of remedying, mitigating or preventing the SLC was the divestment of one cinema in Basingstoke, to an existing or new cinema operator which the CC is satisfied has the resources, expertise, incentive and business plan to operate the cinema as a multiplex cinema specializing in showing mainstream films.

Findings

1. The reference

- 1.1 On 23 September 2005 the OFT referred to the CC for investigation and report (under section 22(1) of the Act) the completed acquisition by Vue of A3, including its sole operating entity Ster. We were asked to report by 9 March 2006. Our terms of reference are at Appendix A.
- 1.2 This document (together with its appendices) constitutes our final report which we are required to publish under section 38(1) of the Act. Non-sensitive versions of the main-party and third-party submissions are on our website, along with a number of other documents relevant to this inquiry, including our provisional findings (which we published on 20 December 2005). We cross-refer to them where appropriate.

2. The companies involved in the merger

Vue

- 2.1 The Vue Entertainment group was formed in May 2003 when the Spean Bridge Group acquired from Time Warner Inc and Village Roadshow Limited certain operating companies and assets of Warner Village Cinemas in the UK.
- 2.2 Prior to the merger, Vue owned and operated 42 cinemas in the UK, with 409 screens. At the time of the reference, Vue owned and operated 48 cinemas (including the Ster cinemas acquired) in the UK, with 482 screens. It also managed five cinemas owned by Village Roadshow Limited. In addition to its UK operations, Vue owned one cinema in each of Ireland (Ster Dublin), Portugal and Taiwan. In the year ended 25 November 2004 Vue generated a profit before tax of £4.4 million on turnover of £169.4 million. Vue has grown since then, through the acquisition of the six Ster cinemas (with 73 screens) in the UK, plus Ster's Dublin cinema in Ireland. In October 2005 Vue also acquired a nine-screen multiplex cinema in Oxford. In November 2005 Vue opened a new cinema in Blackburn. Summary financial information is provided in Appendix B.
- 2.3 Vue has four major shareholders:
- Boston Ventures Limited Partnerships V and VI (36.6 per cent);
 - Legal & General Ventures Partners Limited (31.2 per cent);
 - Clarity Partners LP (23.7 per cent); and
 - Lloyds TSB Development Capital Limited (8.4 per cent).

Ster

- 2.4 Ster Century, an offshoot of the South African cinema exhibitor Ster Kinekor Films (PTY) Ltd (Ster Kinekor), entered the international cinema exhibition market in the late 1990's. Ster Kinekor opened cinemas in several European countries, including the UK and Ireland. It began selling its cinemas in Europe when the South African shareholders decided to focus on the South African market. In 2003, Ster Century exited the UK market by selling its UK assets to a private equity-backed management

team led by Mike Ross and Theo Fonternel, who had been senior executives in Ster Kinekor's European operations. In July 2004 there was a secondary management buy-out, backed by Hutton Collins Mezzanine Partners LLP, which resulted in the creation of A3 as the ultimate parent company of Ster.

- 2.5 The accounts for the operating entity, Ster, show that in the year ended 30 June 2004 it generated a profit before tax of £2.1 million on a turnover of £33.4 million. Summary financial information can be found in Appendix B.
- 2.6 At the time of its acquisition by Vue, Ster operated seven cinemas in the UK and Ireland, in:
- Dublin (14 screens, opened August 1999);
 - Norwich (eight screens, opened June 2000);
 - Romford (16 screens, opened April 2001);
 - Edinburgh (12 screens, opened October 2001);
 - Leeds (13 screens, opened March 2002);
 - Basingstoke (10 screens, opened October 2002); and
 - Cardiff (14 screens, opened April 2003).

3. The merger and the relevant merger situation

Outline of merger situation

- 3.1 On 29 April 2005 Vue Entertainment Holdings (UK) Limited (part of the Vue Entertainment Group referred to in paragraph 2.1) acquired all the issued share capital of A3, amongst whose indirect subsidiaries was Ster, the operator of the seven UK and Irish cinemas listed in paragraph 2.6. Details of the transaction, along with an organization chart and description of the acquired group and a summary post-merger organization chart of Vue, are included at Appendix B.

The rationale for the merger

- 3.2 Vue told us that its interest in acquiring Ster was driven by the quality of the assets – recently constructed cinemas with stadium seating. Vue believed that the Ster cinemas would be a good fit with its existing circuit. Vue also told us that the transaction would give Vue the opportunity to enter the Irish market.
- 3.3 Vue's internal assessment of the Ster chain noted that the acquisition offered Vue the opportunity to dispose of its non-stadium seating first generation multiplex cinema in Basingstoke, provide it with a second location in Edinburgh and Leeds, and open up new markets for Vue in East London (through the acquisition of the cinema in Romford), Norwich, Cardiff and Dublin.

Jurisdiction

- 3.4 Under our terms of reference (Appendix A), we are required to investigate and report whether a relevant merger situation has been created. A relevant merger situation exists where two or more enterprises have ceased to be distinct within the relevant statutory period and where either the share of supply test or the turnover test specified in the Act is met.
- 3.5 As a result of the transaction described in paragraph 3.1, enterprises formerly carried on separately within the Vue and A3 groups have ceased to be distinct enterprises.
- 3.6 The share of supply test is met if the merger creates or increases a share of at least one-quarter in the supply of goods or services of any description in the UK, or in a substantial part of the UK. Section 23 of the Act affords the CC the discretion to apply such criteria as it considers appropriate to decide whether the 25 per cent share of supply test is met in relation to both the particular supply of services on which jurisdiction rests and the measure by which the share of supply is assessed.
- 3.7 In referring the merger to us, the OFT decided that the share of supply test was met in relation to the supply of cinema exhibition services, measured both by seats and screens in Edinburgh. The OFT considered that Edinburgh is a substantial part of the UK and we understand that in reaching that conclusion, OFT had regard to the population of Edinburgh, being around 490,000, and to its importance as the capital city of Scotland. We believe that Vue did at one point dispute with OFT whether OFT had the power to refer the merger to us because of objections to the CC's jurisdiction. However Vue has accepted that we have jurisdiction to assess the competitive effects of the merger.
- 3.8 We note that in addition to Edinburgh, the share of supply test is met in relation to the supply of cinema exhibition services measured by screens and seats in at least each of Basingstoke, Norwich and Romford (based on populations within a 20-minute drive of the acquired cinemas in the locations set out in paragraph 2.6 or, where precise data is not available, on approximations of those populations). These four areas have a combined population in the region of 1.17 million. Vue told us that these four areas have a combined population in the region of 1.4 million. If there is any doubt whether Edinburgh is a substantial part of the UK, there is no doubting that these areas are collectively a substantial part of the UK.
- 3.9 We also looked at the four areas in which we have considered the local competition effects of the merger: Edinburgh, Basingstoke, Leeds and Romford. If these are considered in combination, Vue has as a consequence of the merger at least 25 per cent, or an increase of a share already in excess of 25 per cent, of the share of supply of cinema exhibition services in the combined areas measured by seats and screens. When these four areas are combined, Vue has 40 per cent of all cinema screens and Vue told us it has 40 per cent of all cinema seats. The population affected in these four areas is at least 1.75 million. Vue told us that the population affected in these four areas is at least 2.4 million.
- 3.10 Because this merger meets the share of supply test, we do not have to consider the turnover test.
- 3.11 There is one further question that is relevant in this case, namely whether the reference was made in time. Under section 24(1) of the Act, the reference must be made within four months of the enterprises ceasing to be distinct. In this case the merger was completed on 29 April 2005. However, the Act provides for an extension

to the four-month limit to be made, and in this case the period for making a reference was extended by agreement between Vue and the OFT to 26 September 2005. The reference was made on 23 September 2005. The reference was, therefore, made in time.

- 3.12 We therefore find that the acquisition by Vue of A3 resulted in the creation of a relevant merger situation.

4. The cinema exhibition industry

- 4.1 There have been public performances of films before paying audiences (cinema exhibition) in Great Britain since 1896. The popularity of cinema-going has experienced several peaks and troughs since then. There were 171.3 million cinema admissions in 2004, the second-highest figure for 32 years.
- 4.2 Cinema exhibitors show films which they rent from distributors. Distributors are responsible for the marketing of the films they handle; their aim is to maximize a film's profitability through promotional and press activity, the timing of the film's theatrical release and the subsequent exploitation of DVD and television rights. The distributors of the majority of mainstream films are aligned to, or controlled by, the major Hollywood film studios. Around 450 new films are released for cinema exhibition in the UK each year.
- 4.3 Not all cinemas show the same mix of films. Generally speaking, the major cinema operators in the UK concentrate on showing predominantly mainstream films (films largely produced by the main Hollywood studios) from their date of release ('on-date'), with variations to take account of local factors (for example, if a cinema is close to a specific customer group, it may screen more films likely to appeal to that group than a cinema which is not). Some smaller cinema chains and individual cinemas focus more on showing films which are not produced with the intention of appealing to a mass audience, such as subtitled foreign-language films, documentaries and low-budget films ('arthouse films'), either showing solely arthouse films, or a mix of mainstream and arthouse films. Others will focus on showing mainstream films, but will start showing at least some of these films several weeks after the release date ('off-date'). Some cinemas also show Bollywood films.
- 4.4 There are several different types of cinema. Many older (pre-1980s) cinemas are located in town centres. Many (but not all) of these older cinemas originally had one large screen, which has subsequently been split into several smaller auditoria, or a small number of screens. In 1985 the UK's first multiplex cinema opened. Multiplex cinemas are cinema buildings with multiple screens (Vue told us it considered a multiplex as being a cinema with at least four or five screens). There does not appear to be one accepted definition of a multiplex cinema; for the purposes of this report we assume that pre-1980's cinemas which have been split into smaller auditoria are not multiplexes. For the purposes of our economic analysis, we used the Dodona definition of a multiplex, which is a purpose-built cinema of five or more screens. However, our competition analysis is not dependent on this definition.
- 4.5 Originally, auditoria within multiplex cinemas had sloped floors. From the mid-1990s onwards multiplex cinemas tended to be built with stadium seating—where each row of seats is on a different step, offering improved sight lines. By the end of 2004 there were 3,342 cinema screens in the UK, in 646 cinemas. Most of those screens (73 per cent) are located in multiplex cinemas.

- 4.6 The majority of a cinema exhibitor's revenue comes from box office takings, which are shared with distributors. Net box office sales in 2004 amounted to £650 million.
- 4.7 Cinema exhibitors also gain revenue from two other main funding streams: concessions and advertising. The term 'concessions' covers the sale of food and drink within the cinema. Net concession revenue in 2004 was £204 million. Cinema exhibitors contract with screen advertising contractors to provide advertisements on screen and in the cinema foyers. Revenue from cinema advertising in 2004 was £63 million.
- 4.8 There have been several recent mergers in the cinema exhibition industry, apart from Vue's acquisition of the Ster cinema circuit. In September 2004, Odeon Equity Co. Limited (Odeon), which operated 95 cinemas, was acquired by Terra Firma Investments (GP) 2 Ltd (Terra Firma). In October 2004 Terra Firma also acquired United Cinemas International (UK) Limited and Cinema International Corporation (UK) Limited (collectively UCI), which operated 32 cinemas. The merger was cleared by the OFT, subject to Terra Firma selling 11 cinemas where the OFT identified local competition concerns. On 27 October 2005, those cinemas were sold to Cinema Holdings Ltd (Cinema Holdings), a company controlled by Mr Thomas Anderson, a member of the Ward Anderson family (which runs cinemas in Northern Ireland and the Republic of Ireland).
- 4.9 In October 2004 The Blackstone Group (Blackstone) acquired the Cine UK Ltd cinema chain, which operated 34 cinemas. In December 2004 it also acquired UGC Cinema Holdings Limited (UGC), which operated 41 cinemas, forming Cineworld UK Limited. Again, this merger was cleared by the OFT subject to Blackstone selling six cinemas where the OFT identified local competition concerns. On 20 December 2005, the OFT decided that the proposed acquisition of the six cinemas by Cinema Holdings 2 Ltd, another company controlled by Mr Thomas Anderson, did not meet the qualifying thresholds for investigation under the Act.
- 4.10 Following these mergers, at the end of December 2004 there were four main cinema exhibitors in the UK: the Terra Firma-owned Odeon and UCI circuits with 924 screens; Cineworld, with 787 screens (before divestment of six cinemas to meet OFT's requirements); Vue, with 409 screens; and National Amusements (operators of Showcase cinemas), with 237 screens. Since then there have been a number of changes. Those relating to Vue are set out in paragraph 2.2; the other most relevant development, for the purposes of this inquiry, occurred in October 2005 when Terra Firma sold 11 cinemas to Cinema Holdings.
- 4.11 Further details on the cinema exhibition industry and its interaction with distributors and advertisers can be found in Appendix C.

5. Market definition

- 5.1. We considered the relevant product and geographic markets for this inquiry.

Product market

- 5.2. In considering the relevant product market definition we looked at demand-side and supply-side substitution, following the approach set out in Chapter 2 of our

Guidelines.¹ Where products are substitutable, they are likely to be in the same product market, in that a small but significant non-transitory increase in the price (SSNIP) of one of the products by a hypothetical monopolist is likely to be rendered unprofitable by substitution to one or more of the other products. This is referred to as the SSNIP test. As noted in paragraph 2.7 of the Guidelines, a price increase of 5 per cent is normally used by the CC.

- 5.3. We considered four main possible definitions of the product market: multiplex cinemas (see paragraph 4.4); all cinemas; all ways of watching films (including cinemas, DVDs and pay-television); and all ways of using discretionary spend (including films, going to pubs, clubs or other ways of spending time and money in or out of the home).
- 5.4. Defining the product market as multiplex cinemas was the narrowest market definition we considered. This would be the correct market definition if non-multiplex cinemas and wider non-cinema activities did not constrain prices of multiplex cinemas. The OFT, in considering the recent mergers in the cinema exhibition industry (including the Vue–Ster merger) defined the relevant market as including all cinemas. However, within this broad market it considered in general that only those cinemas with at least three screens and 696 seats were effective competitors to a multiplex cinema.
- 5.5. The next-narrowest market definition we considered was that of all cinemas. Vue put to us that the narrowest possible relevant product market was that of cinema exhibition. It also argued that the market was clearly subject to competitive constraints, in particular alternative ways of viewing films (for example DVD, pay-television), and the broader market of consumer leisure discretionary spend.
- 5.6. The two widest product market definitions we considered were those of all ways of watching films and all ways of using a consumer’s discretionary spend. Some of the large cinema exhibitors told us that cinemas were competing for consumers’ time and money with a wide range of other leisure activities, including watching DVDs, going to pubs or restaurants, and bowling. One competitor argued that within this broader competition it competed on a title-by-title basis with other cinemas; however, another contended that, despite the wider leisure options available, there was no substitute for the cinema experience.

Demand-side substitution

- 5.7. Demand-side substitution occurs when an increase in price makes a product less attractive to customers, who then purchase less of it and more of substitute products.
- 5.8. We considered first whether all cinemas competed with each other, or whether non-multiplex cinemas did not offer a competitive constraint. There were some non-multiplex cinemas located in the four particular areas on which we focused. We spoke to the management (and in one case former management) of four non-multiplex cinemas of particular interest to us in order to reach a view on whether the individual cinemas competed with, and offered a constraint on the prices of, the multiplex cinemas nearest them. This analysis can be found in paragraphs 6.43 to 6.50 and 6.75 to 6.80.

¹Merger References: *Competition Commission Guidelines (CC2)*, June 2003.

- 5.9. In general terms, we noted that a cinema with a small number of screens and seats can only win a limited number of customers away from the much bigger multiplex cinemas. In this sense it could only ever provide a limited constraint on a multiplex cinema's offer. Vue argued that the collective competitive effect in an area of the non-multiplex cinema which exhibit mainstream commercial film is material. Furthermore, some non-multiplex cinemas may be older and offer a lower quality offering, in which case their competitiveness would be further limited. However, we did not seek to reach a general view on whether non-multiplex cinemas constrained multiplex cinemas. Our analysis looked at all cinemas within the geographic market of an acquired cinema (and some outside the geographic market) and considered the individual cinemas on a case-by-case basis, in order to reach a view on the effects of the merger on competition.
- 5.10. We considered next whether other ways of watching films competed with cinema exhibition. DVD and pay-television were the two main alternatives put to us. Vue argued that the DVD market is a growing constraint on cinema exhibition, and some other cinema exhibitors commented on the constraint imposed on them by DVDs, other ways of watching films and other leisure activities. DVD sales have increased rapidly over the last few years and film distributors now generate significantly more revenue from DVD sales than from cinema exhibition. Vue also told us that distributors now spend more on advertising DVD release than cinema release.
- 5.11. On prices of DVDs, Vue highlighted evidence to show that the price of new releases had risen between 1998 and 2000. Vue also told us that DVD player prices have come down over the past few years and were now as low as £30. However, nobody suggested to us that DVD prices have been consistently rising over the last five years, whereas cinema ticket prices have been rising over this period. This evidence suggested that the price trends of DVDs and cinema tickets are not moving in the same direction, and may be diverging, suggesting that the price of DVDs does not constrain the price charged by cinemas.
- 5.12. We were told that the window between release of a film for cinema exhibition and its release on DVD has shrunk recently from six months to nearer four months, reducing the timeframe for cinemas to make profit on films.
- 5.13. Whilst the shortening of the cinema release window does restrict the amount of time cinema exhibitors have to realize revenue from a film, most box office revenue (BOR) is gained early in a film's run: during 2004, films released in the UK earned on average 27.2 per cent of their BOR in their opening week; similarly, the top 20 films released in 2002 earned 75 per cent of their BOR in their first four weeks. It is therefore unlikely that the reduction of the DVD release window to around four months for many films has had a significant effect on BOR for films. If the window shrunk further there might be more significant effects, but we saw little evidence of plans to shrink the window further in the foreseeable future (see paragraph 6.8).
- 5.14. Vue told us that it thought consumers who were major viewers of DVDs were also frequent cinema visitors. This may indicate some complementarity between DVD and cinema-going. Furthermore, the experience of watching a film on a big screen has very different characteristics from home viewing. For example films, although with varying degrees, rely on big screens for effect. Also, some people may prefer the communal watching experience and may want to be able to discuss the latest release with others who may have seen the film around the same time and within a similar viewing environment.

- 5.15. Further, in its main submission Vue showed us evidence that attendance at the cinema is driven by the films on offer (see paragraph 27 and Figure 7 of Appendix D). At the time of a release, and for the duration of the release window, any given film can only be viewed at the cinema. Customers who go to the cinema in order to view a particular film would not therefore have substitutes in other channels of watching films (including DVDs). Consistent with this analysis, Vue told us that, for the biggest-grossing films, DVDs were not substitutes for cinemas. However, Vue told us that in its view there was substitutability for the whole basket of other titles now, and this would increase if the cinema exhibition window shrunk further or relative pricing of DVDs and cinema tickets continued to diverge.
- 5.16. Internal papers provided by Vue suggested that DVDs and home cinema are complementary to cinema exhibition rather than substitute goods. A commercial due diligence analysis was undertaken by AMR on behalf of Vue's shareholders in respect of the acquisition by Vue of Warner Village cinemas. Part of that analysis stated that home cinema/DVD are a growth driver for cinema exhibition and are complementary rather than substitutes. It specifically stated that 'home cinema and DVD is considered a growth driver, not a threat' and quotes the Dodona report's view that 'home video can credibly be credited with providing the marketing impetus that turned round the long post-war decline in cinema going [...] DVD looks likely to continue this tradition'. Whilst this represents views put forward by AMR and Dodona, Vue told us that it did not agree with these views, and did not consider DVD to be a driver for cinema growth.
- 5.17. Another possible constraint that was mentioned by Vue was the one provided by film piracy. However, we received no evidence from any cinema exhibitor that piracy has directly affected how it set ticket prices.
- 5.18. We then considered whether other non-leisure activities should be considered to be in the same product market. Some of the evidence put to us suggested that non-film leisure activities were more complementary to cinema-going than in competition with it, although there may be circumstances in which there is a degree of substitutability. In its main submission, Vue showed that six of the ten highest-grossing cinemas in the UK in 2004 are in, or close to, major shopping or leisure centres. We were told of the advantages of this, in terms of offering consumers the opportunity to combine a visit to the cinema with dinner or a drink as an evening out. Further, whilst it was suggested to us that other leisure activities constrained cinema prices, as set out in paragraph 6.17, such a suggestion was not underpinned by any firm evidence.
- 5.19. Taken as a whole, the evidence put to us on demand-side substitutability indicated that neither non-film leisure activities, nor other ways of watching films, represented a sufficiently close substitute to cinemas' offering for them to be considered as part of the relevant product market for this inquiry. This indicated to us that the product market was no wider than cinemas.

Supply-side substitution

- 5.20. Supply-side substitution occurs when a small but significant price rise prompts other firms to start supplying an effective substitute to the product in question, at short notice (which we normally take to be within one year, see paragraph 2.21 of our Guidelines) and with little or no investment.
- 5.21. Vue told us that it did not consider switching an auditorium to cinema exhibition from another use to be a relevant consideration. Vue also told us that the costs of converting a building for use as a cinema, as for the cost of building a new cinema,

was several million pounds: [X]. We were told that the timeframe for opening a multiplex cinema in a specific location was typically in the range of 18 months to three years (though if a building already exists it could be opened in a year), and that for Vue, the average length of time from board approval to the opening of a cinema was in the middle of this range—[X]. In some areas there may be additional issues arising from the planning application process.

- 5.22. Supply-side substitution from suppliers not already active in the cinema exhibition market did not, therefore, appear to offer a competitive constraint to an existing cinema exhibitor.

Geographic market

- 5.23. We considered the relevant geographic market, namely whether it was local (as Vue and competitors argued), and if so what an appropriate measure might be.

5.24. In its main submission, Vue said that it considered that the relevant geographic market was local, measured by a drive-time isochrone based on a 20-minute journey time. Vue argued that there was an extension in that journey time for certain limited cases, namely cinemas in, or next to, major regional shopping and leisure centres. It cited the Showcase cinema at the Bluewater Centre in Kent as a leading example of a cinema with a catchment area significantly bigger than a 20-minute drive-time. Vue told us that a 20-minute drive-time isochrone was applied throughout the cinema exhibition industry in the UK.

5.25. We received evidence on geographic market from other cinema exhibitors. One based its assessment of cinema locations on 10- and 20-minute drive-time isochrones centred on the cinema. It also said that within an isochrone, the quality of a competitor cinema's facilities impacted on its importance as a competitor. Another said that it considered 15- and 20-minute drive-time isochrones when looking at a potential site, and that, generally, 80 per cent of its revenue was generated from customers within a 5-mile radius of a cinema. A third provided us with data on the postcodes of people booking tickets over the internet. This showed that, typically, 75 per cent of customers booking in this way lived within a 20-minute drive of the cinema.

5.26. Two cinema exhibitors commented to us on the question of whether there was an extended drive-time for cinemas attached to major regional shopping and leisure centres. Showcase agreed with Vue's assessment that the catchment area for its Bluewater cinema was greater than 20 minutes. Cineworld thought that customers from the centre of Leeds would not be frequent visitors to its Castleford cinema (see paragraph 6.89). On the other hand, Vue told us that X-scape, the developer of the Castleford centre, had told Vue that the average journey time and distance for its customers were [X] minutes and [X] miles.

5.27. We also received submissions from some cinema exhibitors and a member of the public that the geographic market for Leeds was the city centre (which they considered covered the area including both Vue's cinemas in Leeds), but did not include surrounding areas (see paragraphs 6.71 and 6.72).

5.28. Vue told us that the cinema exhibition industry was unique, in that cinemas were not price-constrained by the number and location of other cinemas. We do not accept this argument. Evidence from surveys (see paragraph 6.4) indicates that cinema-goers prefer to go to their closest cinema. If there is a second cinema very close to a population's nearest cinema then the cinemas will share most of their actual and

potential customers, with the result that they will have higher incentives to be in direct competition for those customers. The further away the second cinema is, the lower the population overlap between the two cinemas will be and there will be progressively less incentive to compete directly for those customers. It is reasonable to conclude that the further away a competing cinema is, the less effective a competitor it will be.

- 5.29. We looked at what happened to cinema ticket prices when a new cinema was opened nearby. As can be seen in Appendix D, the effects of new entry into a market are always local. Following an analysis of the price series published in the Dodona Report submitted by Vue, we noted that entry in some, but not all, cases is associated with either a reduction in prices or prices growing less quickly over time. This is more frequently the case if entry occurs in close proximity (less than 10 minutes' drive-time) of the incumbent cinema compared to when entry occurs in a location which is further away (between 10 and 20 minutes' drive-time) from the incumbent cinema.
- 5.30. The evidence indicated to us that the geographic market was local, and that an appropriate starting point would be to consider all the cinemas within a 20-minute drive-time isochrone of the cinema under consideration. We also considered whether the market should be defined differently in Leeds (see paragraphs 6.69 onwards).

Data analysis

- 5.31. In order to see whether there was any additional evidence to confirm our analysis of product and geographic markets, we conducted a price concentration analysis of two datasets provided by Vue which contained data on the price charged by multiplex cinemas as well as the number and ownership of cinemas in the same area. We considered whether the data indicated that the price rose as either the number of multiplex competitors or the number of competing fascias within 10- or 20-minute drive-times reduced. Vue commented that this was not the case for the sub-set of its cinemas. However, our analysis of the data suggested that there may be a negative relationship. Further details on this can be found in paragraphs 3 to 12 of Appendix D.
- 5.32. To build on this, we also conducted an econometric analysis of the data to study in more detail any relationship between price and competition from cinemas in a given area. We considered different model specifications and used different methodologies.² The results turned out to depend significantly on the specification used. [§]. However, neither Vue nor any other cinema operator showed us evidence that it had used 'deprivation indices' in setting or changing a ticket price. If this variable is included in the equation, Vue's analysis shows that the number of competing cinemas no longer appears significant. If the deprivation index is not included as a variable, the analysis identifies price effects from competition that are stronger the geographically closer is the competition. Further details on this can be found in [§].
- 5.33. Our econometric analysis was consistent with our earlier findings that the product market was no wider than all cinemas (see paragraph 5.19) and that the geographic market was local, with the closest cinemas providing the strongest constraint (see paragraphs 5.28 and 5.30). Vue's analysis suggested that the number of competing

²In particular we considered both a standard OLS regression and an instrumental variable two-stage least squares approach.

cinemas was not significant. We considered both sets of econometric analysis, but overall we found neither set was conclusive in establishing the market definition.

Conclusions on market definition

5.34. We therefore conclude that:

- the relevant product market is no wider than all cinemas. Within this, the closest constraint on a multiplex cinema appears to be other multiplex cinemas, but for the purposes of this analysis we considered all cinemas within local markets on a case-by-case basis; and
- the relevant geographic market is local. The size of the market should be based on a drive-time isochrone around the acquired cinema, considering cinemas primarily within a 20-minute drive-time isochrone and bearing in mind that the closer a competitor is, the greater the constraint it is likely to offer.

5.35. We used this market definition as guidance for our analysis, rather than as a rigid rule. For each location where Vue and Ster overlapped before the merger, we considered the cinemas that Vue put to us as being competitors with its cinemas, and considered whether they should be included within the relevant market.

5.36. In analysing the relevant product market we noted that the film industry is going through a period of rapid technological change. This may have a significant impact on cinema exhibition if, for example, digital projectors become commonplace. Further, we noted that there is an increasing reliance on non-cinema revenues in generating profit from a film. Vue told us that distributors are considering whether there are other, more profitable, ways of maximizing revenue from a film, such as reducing or eliminating the period of time between release of a film in cinemas and its release on DVD (see paragraph 6.7). There may be changes in the industry over the next few years which could lead to cinema exhibition being in more direct competition with other ways of viewing films. However, no evidence put to us led us to conclude that this will happen in the short to medium term, so we did not broaden our market definition beyond cinema exhibition for the purposes of this inquiry.

6. Assessment of the competitive effects of the merger

Introduction

6.1 In order to assess the competitive effects of the merger, we considered first the nature of competition in the market for cinema exhibition. We then looked at entry and exit from the market, and pricing. We looked next at what we expected would have happened had the merger not taken place (the counterfactual). We then focused on the effects of the merger. First we looked at the effect of the merger at a national level, focusing on Vue's ability to negotiate with distributors, screen advertising contractors and suppliers of products for sale at concessions points. We then looked at the competitive situation in each of the geographical areas where the parties overlapped before the merger. We did not look at the effects of the merger in Cardiff or Norwich, as Vue had had no presence in these local markets before the acquisition, and so the merger did not reduce the number of competing cinema exhibitors in either city. We did not consider the competitive effects of the acquisition of the Dublin cinema, as it was located outside our jurisdiction.

- 6.2 Finally we assessed barriers to entry and expansion, focusing on the areas where the parties overlapped before the merger, in order to see if new entry (or threat of entry) into a relevant market would prevent cinema exhibitors raising ticket prices or lowering the quality of the offer.

The nature of competition in the market

Underlying factors affecting existing rivalry in the relevant markets

- 6.3 Consumers have many ways to spend their discretionary income. Some choose to go to the cinema. We were told that most people visit a cinema to see a particular film; they choose the film first, and then decide where to go to see it. However, it was put to us that this is not the case for everyone; many 14- to 24-year olds would arrive at a cinema and only then choose a film, based on what films were about to start.
- 6.4 Having decided to see a film, most cinema-goers prefer going to their nearest cinema. Vue provided us with research which suggested that most respondents always went to their local cinemas, that the most popular reason for choosing a cinema was that it was the closest or most convenient one, and that the main reason for not visiting a particular cinema was that it was too far away.
- 6.5 As shown in Figure 2 of Appendix C, cinema attendances have been on an upward trend for the last 20 years, since the first multiplex opened in the UK. As noted in paragraph 4.1, cinema attendances in 2004 were the second-highest in 32 years. Whilst cinema attendance has been growing, Vue argued that this was driven by the opening of new cinemas, and that attendance per screen had in fact been falling for several years. Our analysis of attendance per screen data (see Figure 3 of Appendix C) suggested that it had been on a slight downward trend between 1995 and 2000, but on a slight upward trend between 2000 and 2004.
- 6.6 However, Vue and a third party told us that 2005 had, to date, been a poor year for cinema exhibitors. This was blamed primarily on the films on offer, though a competitor suggested that the poor attendances might in part be a symptom of an increasing constraint being imposed on cinema exhibition by other leisure activities, and in particular the DVD market.
- 6.7 As noted in paragraph 5.10, Vue argued that the DVD market is a growing constraint on cinema exhibition, and commented on the shrinking window for cinema exhibition.
- 6.8 Distributors we spoke to saw value in maintaining a window for cinema exhibition, and told us that they remained committed to maintaining a window. Vue brought to our attention a report of comments made by Robert Iger, the chief executive officer (CEO) of Disney. Mr Iger was reported as saying that the windows for release of films in general need to compress, and that he did not think that it was out of the question that a DVD could be released in the same window as a film was released in cinemas. He said that the 'old rules' for how films are marketed 'should be called into question'. Mr Iger's comments appear to be aimed at starting a debate on the subject of release windows; we do not believe they amount to a statement that Disney has decided to further compress, or remove, the cinema release window for its films.

The impact of different films on competition

- 6.9 Vue provided us with evidence in its main submission to show that films performed equally well, and equally badly, at different multiplex cinemas. The parties argued

that this showed that the films on offer are the main driver on demand. When there are popular films, cinema BOR is high for all cinemas showing the films. This is consistent with the proposition that most cinema-goers first choose a film to see and then decide which cinema to go to (paragraph 6.3).

Market concentration and entry/exit

- 6.10 As noted in paragraph 4.10, there has been some important consolidation in the cinema exhibition market recently, such that there are now four main national cinema exhibition chains. There remain several smaller players, such as Apollo Cinema Ltd and City Screen Ltd (City Screen) (see Table 1 of Appendix C for a more detailed list of cinema exhibitors present in the UK).
- 6.11 Several cinema exhibitors have entered and exited the market over the last 20 years. In its main submission Vue provided a list of 11 companies which had operated in the UK since 1985. Several of these companies had since exited the market (for example, Warner Brothers International Cinemas exited by selling its circuit to SBC (forming Vue); Hoyts Cinemas Ltd sold its Bluewater cinema to Showcase).
- 6.12 The most recent entrant to the market is Cinema Holdings, though this is linked to the Ward Anderson group which is already present in Northern Ireland. Vue also told us that there were a number of former senior cinema executives who had secured financial backing and were looking for opportunities to enter the cinema exhibition market. The evidence put to us suggested that entry through acquisition, and exit through selling cinemas, had been fairly common, and that there was no reason to expect this to change.

Price and non-price competition

- 6.13 Vue argued that ticket pricing was not the leading factor affecting competition. It cited evidence that showed that, when respondents were asked why they did not go to the cinema more regularly, tickets being too expensive was only the fifth most-frequently given response. However, we also need to understand what informs the decisions of people who do go to the cinema.
- 6.14 Vue has a process called weekly trend monitoring, in which it compares the performance of its cinemas with competitors. It compares the weekly BOR of each of its cinemas with up to a small number (no more than three) of other multiplex cinemas (data for cinemas which are not owned by the major multiplex owners are not readily available). However, it does not monitor all the cinemas it has told us compete with Vue cinemas (for example, see paragraph 6.36). Vue told us that these reports were just 'directional indicators' and that it focuses more on reports on key performance indicators for monitoring how cinemas are performing.
- 6.15 We looked at how ticket prices were set. The evidence we received from Vue and the other major national players indicated that, when setting ticket prices for their cinemas, they took into account the ticket prices of other cinema exhibitors in the locality. Vue told us that it increasingly had regard to [redacted] when looking at ticket price. However, no cinema operator, including Vue, showed us evidence that it had used [redacted] in setting or changing a ticket price.
- 6.16 We spoke to operators of four non-multiplex cinemas which the parties had put to us were competitors with their cinemas in either Basingstoke or Leeds. Three of these cinemas told us that when they set their ticket prices they took account only of the

ticket prices of the nearest multiplexes, and priced below the average multiplex price. They did this because they believed a lower price offer was needed to encourage customers to use their cinemas rather than the multiplexes. The fourth cinema owner told us that he set prices with a view to maximizing return visits, and did not price in comparison to any other cinema.

- 6.17 We were offered little evidence that ticket pricing was affected by non-cinema offers. One cinema exhibitor told us that its family ticket was priced so that it was comparable with the cost of alternative entertainment options, such as a day out at a theme park. The same exhibitor told us that it had responded to the falling price of DVDs through increased use of special promotions, or two-for-one ticket offers, rather than changing its ticket pricing policy. Apart from such special offers, no cinema exhibitor told us that it took account of DVD prices in setting its standard ticket prices.
- 6.18 We were told that cinemas competed on features other than ticket price. Vue told us that price was not the leading competitive factor and that factors such as service and cleanliness are more important. All the major cinema chains we spoke to told us that they competed through providing a high-quality offer. Vue told us that there are many different facets to the quality of an offer, including cleanliness and tidiness, quality of service, comfort of seats and quality of sight lines, and quality of projection and sound. Cinemas are regularly refurbished to update their offer.
- 6.19 Other areas where cinemas can seek to distinguish their offer from those of competitors include the availability of car parking (either free or paid for), and the quality of concession offer within the cinema. Some cinemas also have a licensed bar. Vue told us of changes it was introducing to improve the quality of the cinema experience, [REDACTED].

Counterfactual

- 6.20 In considering the competitive effects of a completed merger, we must compare the effects of the merger with what we expect would have happened had the merger not taken place (the counterfactual). We therefore considered what would have happened to Ster in the absence of the merger.
- 6.21 As shown in paragraphs 1 to 10 of Appendix E, before the merger Ster was generating positive cashflows. It was meeting or exceeding its financial commitments with regard to its funding structure, and was expected to continue to do so for the foreseeable future. Ster was not, therefore, under any immediate financial pressure to sell the business.
- 6.22 Ster's former management told us that, if the merger had not taken place, it intended to run the business for another three to five years, during which period it would either have sought to expand the company through acquisition, or would have sold it if a suitable offer was made.
- 6.23 As set out in paragraphs 11 to 15 of Appendix E, the timing of the sale of Ster to Vue appears to have been a reaction by Ster to recent merger activity within the sector (see paragraphs 4.8 to 4.10). In addition to Vue, there were a number of other potential bidders who were approached by Ster, although we do not know the level of interest shown by them. The recent activity in the cinema exhibition sector suggested that there are other potential acquirers (both cinema exhibitors and private equity investors) who would have been interested in Ster had it not been sold to Vue. [REDACTED].

6.24 We conclude, therefore, that if the merger had not taken place Ster's cinemas would have remained a competitive force in the relevant markets, either under the management of Ster or under the control of an existing cinema exhibitor or a new entrant to the market.

Effects of the merger

Effect on national strategies

6.25 We considered whether the merger would have any effect at a national level. We identified three main areas where Vue (like other cinema exhibitors) might be expected to adopt a strategy at a national level and for which an increase in size might have an effect: sale of advertising space, negotiations with distributors, and purchasing of goods for sale at concessions points.

6.26 The acquisition by Vue of the Ster cinemas in the UK resulted in Vue's share of cinema seats in the UK increasing by 2.2 per cent, to 16 per cent.³ We did not consider that such a small increment would have a substantial impact on Vue's negotiating position with screen advertising contractors, distributors or food and drink producers.

6.27 We spoke to the screen advertising contractors supplying UK multiplexes; they expressed no concerns about the merger. We received no comments on the merger from producers of food and drink for sale at concession points we contacted.

6.28 We spoke to one distributor who did not have any significant concerns about the merger. Another distributor did not think that the market share increment at a national level was a cause for concern. However, it noted that at a local level the merger did result in Vue's share of certain markets, based on percentage of BOR, being significant. It expressed a concern that Vue would be able to demand better rental terms from the distributor for cinemas in those markets as a result of the merger.

6.29 It is possible that Vue might, after the merger, seek better film rental terms for cinemas in areas where it is the predominant, or sole, exhibitor. Vue told us that holding a significant share of the local BOR would not be relevant to discussions. However, it was not obvious to us that this would be to the detriment of consumers, and therefore give rise to an adverse finding. We agreed with distributors that the increment in market share nationally would not significantly affect Vue's negotiating position.

6.30 We conclude, therefore, that there were no adverse effects at a national level arising from the acquisition.

Effect of the merger in local markets

6.31 We next considered whether the merger would have adverse effects in any local market. We looked at the four locations where Vue had bought cinemas and where it already had a cinema nearby: Basingstoke, Edinburgh, Leeds and Romford. When we refer to an individual location we are referring to the local geographic market where the former Ster cinema operates. We considered whether the competitive situation created by the merger was different from that expected in the absence of

³Including Village Roadshow Limited Cinemas.

the merger, and, if so, whether the difference amounted to an SLC in the market in question. Further information can be found in Appendix F.

- 6.32 As noted in paragraph 6.1, we did not look at the Cardiff and Norwich markets as Vue was not present there prior to the merger and so the merger did not reduce the number of competitors in those cities.

Basingstoke

- 6.33 As a result of the merger Vue owns both the cinemas in Basingstoke—adding Ster's Festival Place cinema to Vue's existing Leisure Park cinema. Both of these cinemas are multiplexes with ten screens. The two cinemas are only 1.5 miles apart; Vue's drive-time isochrone analysis places them a 5-minute drive apart. As noted in paragraph 5.34, the closer two cinemas are together, the more strongly they compete. According to Vue's isochrone analysis there are no other cinemas within a 20-minute drive of either the Festival Place or Leisure Park cinemas.
- 6.34 The former Ster cinema at Festival Place is able to provide a high-quality offer; it is only three years old, has stadium seating and is well located. When it opened it quickly took a significant market share from the Vue Leisure Park cinema, which is older and only offers sloped floor auditoria.
- 6.35 Notwithstanding the absence of other cinemas within 20 minutes of Basingstoke, Vue proposed that there were several cinemas which competed with its Basingstoke cinemas, and that the merger did not, therefore, give rise to an SLC. The closest of these (all just within a 30-minute drive according to the isochrone analysis provided by Vue) were The Screen, a two-screen cinema in Winchester operated by City Screen; The Odeon, Bracknell (a ten-screen sloping-floor multiplex); and The Palace, a two-screen cinema in Alton. Cinemas in Reading and Woking were also cited as competitors. Figure 1 of Appendix G shows the location of relevant cinemas in the Basingstoke area.
- 6.36 We noted that in its weekly trend monitoring reports (see paragraph 6.14) for each of its Basingstoke cinemas, Vue only monitored the performance of the two Basingstoke cinemas against each other. It did not compare them with multiplex cinemas in other towns to see what audience share they are achieving, even though Vue could do so if it considered it worthwhile to do so (as it did in other locations). In particular, Vue does not monitor its Basingstoke cinemas against the BOR of cinemas in Bracknell and Reading, even though Vue told us that they were competing cinemas.
- 6.37 As a starting point for our analysis, we looked at whether the two cinemas in Basingstoke had competed with each other prior to the merger. When the Ster Festival Place cinema opened in 2002 it quickly took a large proportion of the (then Warner Village Cinema) Leisure Park audience share. Vue told us that Basingstoke had been a single trading market for 15 years, and had only had two cinemas under different ownership for two years. It did not think that customers had benefited when they had the choice of competing cinemas, and that returning to a position of a single trading market would not cause customers to suffer.
- 6.38 As can be seen in Figure 2 of Appendix F, ticket prices at the Leisure Park cinema were reduced by £1 (18 per cent) around the time Ster first opened in Basingstoke. Vue told us that this was, in its view, an attempt by the Leisure Park's then owners to compete with the new Ster cinema at Festival Place. Whilst ticket prices were subsequently raised to above their former levels when Vue acquired the Leisure Park

site from Warner Village Cinemas, the rate of increase in ticket price at the Leisure Park was lower in the period from Ster's entry into Basingstoke leading up to the merger with Ster (just over 2 per cent per year on average) compared to when there was only one cinema in Basingstoke (an average yearly growth rate of 6.7 per cent between 1995 and 2001).

- 6.39 Vue told us that the prices at the Basingstoke cinemas were broadly in line with national averages both before the Ster cinema opened in Basingstoke, and afterwards. Although we are interested in the effect of Ster's entry on Vue's pricing in Basingstoke and not in how its prices compared to the national average, we note that before Ster's entry, Vue's prices were higher than the average and that post entry, Vue's prices first fell below the average and then were raised to be only marginally above the average in January 2005.
- 6.40 As part of our analysis of whether the cinemas competed we also looked at their population overlaps—how many people were within both a 20-minute drive of the former Ster Festival Place and the Vue Leisure Park cinemas. Vue told us that there is a population of about 210,000 living within a 20-minute drive-time isochrone of the former Ster Festival Place site. If a significant proportion of the people within a 20-minute drive of the former Ster Festival Place cinema were also within a 20-minute drive of the Vue Leisure Park cinema, they might switch between cinemas in response to a SSNIP of cinema tickets in one. If the number of customers who could switch to the rival cinema was large, then a price rise might be unprofitable, and we could conclude that ticket prices in Basingstoke were constrained before the merger.
- 6.41 As shown in Figure 1 of Appendix F, the population overlap for the two cinemas was over 90 per cent.
- 6.42 The evidence in paragraph 6.38 indicated to us that the Ster cinema's presence in the market had introduced competition into the Basingstoke market, and that there was evidence that it had imposed an effective price constraint on the Vue cinema. The very significant population overlap between the two cinemas noted in paragraph 6.41 indicated that the two cinemas had virtually identical catchment areas. The evidence therefore indicated that the Basingstoke cinemas were competing with each other before the merger.
- 6.43 We then considered whether the two cinemas in Basingstoke would have remained competitors in the absence of the merger. As set out in paragraph 6.24 we concluded that the former Ster cinema at Festival Place would have continued as an active cinema, either under the control of Ster or another cinema exhibitor.
- 6.44 We considered whether the Vue Leisure Park cinema would have continued to operate in the absence of the merger. The Leisure Park cinema was included in a strategic review [REDACTED]. We have seen no conclusion of the review for the Leisure Park site, but documents we saw suggested that [REDACTED] was the most likely option.
- 6.45 We concluded that the Vue Leisure Park cinema would have been maintained as a going concern had the merger not taken place. It is a profitable cinema ([REDACTED]), and consistently achieves a 30 per cent share of BOR in the Basingstoke market. Moreover, Vue would incur some ongoing costs if it closed the cinema and did not put it to alternative use.
- 6.46 As the evidence indicated that the cinemas competed before the merger (see paragraph 6.42), and, as explained in paragraph 6.45, we expected both cinemas to continue operating in the absence of the merger, we concluded that it was

appropriate to consider our analysis of the competitive effects of the merger in Basingstoke against a scenario where there are two competing cinemas in Basingstoke under different ownership.

- 6.47 We considered whether the non-multiplex two-screen cinemas in Winchester and Alton constrained ticket prices at Vue's Basingstoke cinemas. We received evidence from the owners of both these cinemas, non-sensitive versions of which can be found on our website. The Screen's pricing policy was to price below that of the nearest multiplexes in order to encourage customers to use its cinema. However, it considered its primary competitor to be a similar-sized cinema in Southampton rather than a multiplex in either Basingstoke or Southampton. It did think that if Vue expanded its range of films in Basingstoke to include more of an arthouse offering then it might become more of a competitor with The Screen, but that this would be more likely to constrain The Screen's ability to raise ticket prices.
- 6.48 Vue told us that The Screen was in competition with its Basingstoke cinemas. Vue argued that if The Screen was not there, then at least some of its customers would go to the cinemas in Basingstoke. In our view The Screen's presence means that any significant competition between cinemas in Basingstoke and Winchester would be for people living between the two towns. There is not a significant population centre between Winchester and Basingstoke over which Vue and The Screen would appear to find it worth competing.
- 6.49 The evidence therefore indicated that The Screen was not competing with, or constraining the prices of, the cinemas in Basingstoke.
- 6.50 We were told that The Palace cinema in Alton was a very small cinema, often shows films off-date, shows a mix of mainstream and arthouse films, and, unusually for a cinema, was busier in the week (in particular Wednesday) than at weekends. The evidence we received led us to conclude that The Palace would not constrain cinema ticket prices in Basingstoke. Vue argued that any cinema showing the same films was taking custom away from its cinemas. However, we were confident that The Palace did not have the scale, and was too far away, to constrain the prices of Vue's Basingstoke cinemas.
- 6.51 We then considered whether any of the multiplex cinemas mentioned by Vue would be able to constrain ticket prices in Basingstoke, even though they were outside the geographic market as defined in Chapter 5, and indeed outside the geographic market proposed by Vue (as set out in paragraph 5.24). We looked at cinemas in Bracknell, Reading and Woking, as these were the multiplex cinemas put to us by Vue as being in competition with its Basingstoke cinemas. Vue did not suggest that the cinemas in Basingstoke, Bracknell, Reading or Woking were in major regional shopping centres and should therefore be considered to have a wider geographic market (see paragraphs 5.24 and 5.26).
- 6.52 We looked at population overlaps, as explained in paragraph 6.40. As shown in Figure 1 of Appendix F, only 28.2 per cent of people within a 20-minute drive of the Vue Basingstoke cinema were also within 20 minutes of the Bracknell Odeon. Vue also submitted that, roughly speaking, there were 59,000 people (approximately 29 per cent of the number of people living within 20 minutes of the former Ster Festival Place cinema) within the 20-minute drive-time isochrone who also lived in an area with a Guildford postcode. Vue told us that these people were midway between Bracknell, Basingstoke and Guildford, and clearly had the choice of going to the cinema in those areas.

- 6.53 The largest population centres between Bracknell and Basingstoke are significantly closer to Bracknell than to Basingstoke. As people tend to choose their closest cinemas (see paragraph 6.4), this indicates that the majority of people within 20 minutes of both cinemas would probably choose to go to the Bracknell cinema.
- 6.54 Vue provided us with web membership data for its Basingstoke cinemas. Vue told us that this showed a [X]. Our analysis of this data showed that the areas with the biggest web membership were the postcodes around [X]. We looked at how many web members there were living in the Guildford postcodes highlighted by Vue. Less than 5 per cent of web members lived in the Guildford postcodes highlighted by Vue as containing over 28 per cent of the Basingstoke cinemas' audience. This indicated that most people living in the area where there is an overlap between Basingstoke and Bracknell catchment areas do not choose to use the Basingstoke cinemas as their first choice.
- 6.55 This was in line with other evidence. The survey evidence in paragraph 6.4, along with the evidence that most customers come from within a 20-minute drive of a cinema (see paragraph 5.25 and Figure 3 of Appendix F) showed that, generally, there are more customers as a proportion of population towards the centre of a drive-time isochrone centred on a cinema than at the edge. This means that the 29 per cent population overlap with Bracknell is likely to be an over-estimate of the proportion of the number of potential customers of the former Ster Festival Place cinema (and the Vue Leisure Park cinema) who could switch between the Basingstoke and Bracknell cinemas.
- 6.56 In sum, the evidence indicated to us that there were insufficient people who might switch to the Odeon, Bracknell from a Basingstoke cinema for us to conclude that the Odeon, Bracknell constrained Vue's ticket prices in Basingstoke.
- 6.57 We also looked at population overlap between the former Ster Festival Place cinema and the Showcase cinema in Reading. Only 5 per cent of people within a 20-minute drive of the former Ster Festival Place cinema were also within a 20-minute drive of the Showcase, Reading. Again, this suggested that there were insufficient people who might switch to a Reading cinema from a Basingstoke cinema for us to conclude that cinemas (both multiplex and non-multiplex) in Reading constrained Vue's ticket prices in Basingstoke.
- 6.58 Similarly, we looked at population overlap for the Ambassadors Cinema in Woking. Only 4.2 per cent of people within a 20-minute drive of the former Ster Festival Place cinema were also within a 20-minute drive of the Ambassadors cinema. Again, this indicated that there were insufficient people between the Basingstoke and Woking cinemas to be worth competing for, and hence the cinemas were not in competition.
- 6.59 We conclude therefore that the merger bringing the former Ster Festival Place and Vue Leisure Park cinemas under common ownership has removed the strongest, and only substantial, competitive constraint on Vue as a cinema exhibitor in Basingstoke, causing an SLC.
- 6.60 We considered what the adverse effects of the merger would be. Firstly, we have already noted that the opening of the Ster cinema in 2002 led to a reduction in ticket price at the Vue Leisure Park cinema, and subsequently a slower rate of increase in ticket price than had been seen before Ster's entry (see paragraph 6.38). We therefore believe that the loss of the competitive constraint imposed by Ster on Vue, and by Vue on Ster, may be expected to allow Vue to raise ticket prices at its

cinemas in Basingstoke at a greater rate than if the two cinemas remained under separate ownership.

- 6.61 Second, removing the strongest, and only substantial, competitive constraint may also be expected to reduce the incentive to maintain the quality of the offer at the Basingstoke cinemas compared to the standard that may be expected in the absence of the merger. For example, Vue has less incentive to refurbish its Leisure Park site, including possibly converting the auditoria to contain stadium seating, as a result of the merger.
- 6.62 We also considered whether there may be a third detriment to consumers, in addition to the detriments identified in paragraph 6.59 and 6.61. As noted in paragraph 6.45, in the absence of the merger we expect that the Vue Leisure Park site would have remained operating as a cinema under Vue's control. With respect to plans should the merger be allowed to proceed, Vue told us that it had not yet reached a decision on what to do with the Leisure Park site. The evidence available to us indicated that Vue would seek to change the Leisure Park site to alternative use. We believed this to be the case primarily because [redacted] includes proceeds from the disposal of the site and an increased audience at the former Ster Festival Place site as a result of closure of the Vue Leisure Park site. We also noted that in considering whether to acquire Ster, Vue had seen the merger as an opportunity to exit the Leisure Park site (see paragraph 3.3). We are not aware of anything that has happened since the merger which we believe would cause Vue to view changing the site to non-cinema use in a less favourable light.
- 6.63 The evidence indicated to us that if the merger were allowed to proceed, the Leisure Park cinema would cease to operate as a cinema. In the absence of the merger we expected the cinema to remain operating (see paragraph 6.45). We therefore expect that there will be a third detriment resulting from the merger, namely a reduction in choice for consumers in Basingstoke compared to the situation in the absence of the merger. This reduction in choice would take the form of having only one cinema to visit, and having fewer screens on which to see films. This would, for example, reduce the number of screenings of films which would otherwise have been seen in two cinemas, reducing the ability of consumers to see the film they want to see when they want to see it.

Edinburgh

- 6.64 As a result of the merger, Vue acquired Ster's Ocean Terminal cinema in Edinburgh, to add to its existing Omni Centre site in Edinburgh. The merger gave Vue 37 per cent of cinema seats within a 10-minute drive of the Ocean Terminal cinema, and 31 per cent of seats within a 20-minute drive. Vue told us that the figure was 40 per cent. We were shown evidence by a distributor, however, that after the merger Vue had a larger share of the Edinburgh market (50 per cent), based on revenue earned in Edinburgh. Figure 2 of Appendix G shows the locations of the cinemas in Edinburgh.
- 6.65 Vue monitors the weekly revenue of [redacted] cinemas: [redacted]. EDI data from 2004 indicate that the Vue Omni Centre, UGC and former Ster Ocean Terminal cinemas have BOR market shares in the region of 25 to 30 per cent while the UCI cinema has over 15 per cent. These shares tend to vary widely week by week, but stay within the same range. As noted in paragraph 6.14, Vue told us that these reports were just directional indicators and that it focused more on reports on key performance indicators for monitoring of how cinemas are performing

- 6.66 There are three other multiplex cinemas within a 10-minute drive of the former Ster Ocean Terminal cinema. There is another multiplex cinema which is a 15-minute drive from Ocean Terminal. In addition, there are three smaller cinemas within 10-minutes of the Ocean Terminal cinema, all with three or four screens. We did not need to reach a view on whether they were big enough individually to offer some constraint on the neighbouring multiplexes. When considered together they added another ten screens to the Edinburgh market. Figure 2 of Appendix G shows the location of cinemas around Edinburgh.
- 6.67 The Vue Omni Centre is the closest cinema to the former Ster Ocean Terminal cinema. However, evidence from competitors of where people who buy tickets live, based on post code data, indicated that all cinemas in the city competed for people who lived in and around Edinburgh.
- 6.68 There are still a significant number of competing cinemas and screens in Edinburgh, and we do not think that the merger results in an SLC in Edinburgh compared to the situation in the absence of the merger.

Leeds

- 6.69 As a result of the merger, Vue acquired The Light cinema in Leeds. Vue already owned the Kirkstall Road multiplex in Headingley. The merger brought under Vue's control the only two multiplexes in Leeds. There are also two one-screen cinemas within a 10-minute drive of The Light. In addition, there are another five multiplexes within a 20-minute drive from The Light. Two of these (the Showcase in Birstall and the Odeon in Pudsey) are only just outside the 10-minute drive-time isochrone centred on The Light. Figures 3 and 4 of Appendix G show the location of cinemas in Leeds, and in the wider West Yorkshire area.
- 6.70 We received views from a number of parties on the level of competition in and around Leeds. Vue argued that there were 15 cinemas competing with the Vue cinemas in Leeds, with cinemas as distant as Hebden Bridge and York constraining Vue's ability to raise prices in Leeds.
- 6.71 On the other hand we received representations that the geographic market for Leeds' cinemas was just the city, and did not include surrounding areas at all. The only member of the public to contact us about the merger argued that there were only two multiplex cinemas in Leeds, with one company having a virtual monopoly of the Leeds cinema market. He argued that for alternatives one had to travel to Bradford, Wakefield or Harrogate.
- 6.72 A multiplex cinema exhibitor told us that Leeds' residents rarely went outside the city to smaller towns for their entertainment (especially students, who may have less access to private transport), that the city centre was a destination in itself, offering a wide variety of activities to complement a visit to the cinema, and that people in Leeds would not normally go to Bradford for an evening out. We also received evidence from operators of single screen cinemas to this effect. The operator of the Hyde Park Picture House and former owner of the Cottage Road cinema also told us that it considered that the Showcase cinema in Birstall was unlikely to compete with the city centre cinemas, given its location in a different town. However, the new owner of the Cottage Road cinema thought that there might be competition between Vue's cinemas and the Showcase at Birstall.
- 6.73 As previously noted (see paragraph 6.4) Vue also provided us with survey results which suggested that a consumer's choice of cinemas was mainly driven by its

location, with most people choosing a cinema because it is their closest cinema. This indicated that people who lived in Leeds would opt for a cinema in Leeds rather than travel outside Leeds to see a film, unless a cinema outside Leeds were closer.

- 6.74 We started our analysis by considering whether the two Vue cinemas competed with each other. We were given postcode data for people who had booked tickets over the internet. [REDACTED]. This indicated that the two cinemas had the same customer base, and that, therefore, they would be in competition with each other. Vue told us that use of this evidence would produce flawed and misleading results, though it later used the same data as evidence on the spread of their customers. Whilst we accepted that the data related to people who wanted updates on films rather than people actually buying tickets, we considered that it was reasonable to place at least some reliance on the data as a proxy for the spread of Vue's customers. In this respect we noted that Vue had argued that web membership data for their Basingstoke cinemas did show trends worth taking into account (see paragraph 6.54).
- 6.75 We noted that in its weekly trend monitoring reports (see paragraph 6.14) for each of its Leeds cinemas, Vue monitored the performance of the two Leeds cinemas against each other and against [REDACTED]. It did not compare them with other multiplex cinemas such as those in [REDACTED], even though Vue could compare a cinema with up to [REDACTED] competitors at a [REDACTED].
- 6.76 We looked next at whether the cinemas within a 10-minute drive of The Light would constrain Vue's ticket prices in Leeds. The only cinemas within 10 minutes were the two single-screen cinemas in Leeds: the Hyde Park Picture House and the Cottage Road cinema. We spoke to the manager of the Hyde Park Picture House and the owner and former proprietor of the Cottage Road cinema. Non-sensitive summaries of their evidence are on our website.
- 6.77 The Hyde Park Picture House specializes in showing non-mainstream films. For example, during the 2005 autumn half-term holiday it was one of the few cinemas not showing Wallace & Gromit: the Curse of the Were-Rabbit; we were told that this was because a film such as Broken Flowers would be more popular in that cinema, and people would not expect the Hyde Park Picture House to show the Wallace & Gromit film. We were told the Hyde Park Picture House appealed to a more independently-minded audience. It priced relative to other cinemas in Leeds, but charged less than multiplexes as it could not offer the degree of comfort offered in a multiplex, and could not offer car parking. We were told that most of its audience came from within walking distance of the cinema.
- 6.78 This evidence indicated that the Hyde Park Picture House did not constrain Vue's prices, given its single screen, its different target audience and limited catchment area.
- 6.79 The Cottage Road cinema shows mainstream films, some from their date of release and some off-date; we were told that it had shown Wallace & Gromit on-date, followed by showing Corpse Bride and Oliver Twist off-date, and would then show Harry Potter and the Goblet of Fire on-date. We were told it drew its audience mainly from the north of Leeds and the Headingley area. Its owner priced tickets below multiplex prices to encourage people to use his cinema. He believed that the Cottage Road was in competition with the Vue cinemas in Leeds but that they would not be constrained by the Cottage Road cinema. This is because of their ability to show a wider range of films and the option of showing the biggest films on several screens, putting on perhaps three times more screenings of a film per day than the Cottage Road cinema could manage.

- 6.80 The Cottage Road cinema does offer mainstream films, and shows some of them (including the two highest-grossing films during the first two months of this inquiry) from their date of release. This indicates that, at least to an extent, it is competing for customers with Vue. However, the evidence indicated that the Cottage Road cinema was not a constraint on Vue's offering—it has only one screen, does not always show a film from its date of release, and its lack of parking facilities reduces its catchment area. These factors significantly limit the constraint it could place on other cinemas showing that film from its date of release, and its ability to constrain a cinema showing films it is not showing.
- 6.81 We considered next the [redacted], Leeds cinema at [redacted]. We received conflicting evidence on the level of competition it might offer Vue's cinemas in Leeds. Vue argued that it was a competitor of its cinemas, and we noted that Vue did compare the performance of its two cinemas in Leeds with the [redacted] cinema on a weekly basis (see paragraph 6.75). It provided us with postcode data (see Figure 5 of Appendix F) which showed that nearly all the population within a 20-minute drive of The Light cinema in Leeds were also within a 20-minute drive of the [redacted] cinema at [redacted].
- 6.82 On the other hand, we received submissions suggesting that the Showcase did not compete for customers with the Vue cinemas in Leeds, due to its location (see paragraphs 6.71 and 6.72).
- 6.83 National Amusements told us that when each of the city centre cinemas opened it saw a drop in its BOR at Birstall, and suggested that this was evidence that it competed with these cinemas. It also told us that 80 per cent of its customers came from within a 5-mile radius of the cinema. It told us that its audience was predominantly from the outlying towns and the edges of Leeds.
- 6.84 The Showcase, Birstall appeared to be easily accessible from the city by car, and may well attract customers from across much of the catchment area of the two Vue cinemas in Leeds. Its location next to a retail park may also encourage some trade from shoppers from Leeds. The evidence indicated that the cinema was close enough to the city to compete with, and constrain the prices of, Vue's Leeds cinemas.
- 6.85 We then considered whether the Odeon cinema in Pudsey and the Cineworld Bradford constrained ticket prices at Vue's Leeds cinemas. Neither cinema is in Leeds, which means that the argument that the market is a city centre market is relevant to consideration of these cinemas.
- 6.86 Data we received from Odeon (see Figure 6 of Appendix F) showed that most of its customers for its Pudsey cinema, located between Leeds and Bradford, came from within a 20-minute drive of the cinema. There is therefore a significant degree of overlap between its 20-minute drive-time isochrone and that of Vue's The Light cinema. We heard from Cineworld that, in defining its catchment area, it assumed that any customers from Leeds would go to the Odeon cinema rather than the more distant Cineworld Bradford.
- 6.87 It is not clear how many people living in Leeds would leave the city, with its two cinemas, and travel to the Pudsey or Bradford cinemas. However, the Odeon cinema in particular is reasonably close to the Vue cinemas, and if faced with a SSNIP in cinema ticket prices, or a reduction in quality of offer in Leeds, price-sensitive customers on the western side of Leeds should be able to travel to the Odeon cinema easily. It is therefore likely that the Odeon cinema in Pudsey would constrain

Vue's ability to retain price-sensitive customers from the west of Leeds in the event of a SSNIP in ticket prices.

- 6.88 Vue put to us that the Cineworld cinema in Castleford was a competitor with its Leeds cinemas, and argued that it was located in a major regional shopping and leisure centre, so would benefit from a larger catchment area. [36]. Vue told us that the X-scape facility and the cinema were very popular with students studying in Leeds, who would visit it regularly—Vue suggested they might visit once or twice a month. Vue showed us data from X-scape showing that over 20 per cent of X-scape's customers were students.
- 6.89 Cineworld, which operates a cinema at the X-scape facility in Castleford, said that its cinema would pick up some business from the centre of Leeds, as some people would use the cinema as part of a day out in the area, but that these customers would not be regular users of that cinema, perhaps visiting it once a year.
- 6.90 The location of the Cineworld Castleford at the X-scape centre does appear suited to attracting some custom from the city centre. We were not convinced that significant numbers of students from Leeds would visit the Castleford cinema with the sort of frequency envisaged by Vue, but this point of disagreement was not important for our analysis. The cinema's main catchment area is likely to include the south of Leeds, due to its easy access from the M62. It is therefore likely to be in direct competition with the Showcase, Birstall, which is a short drive west along the M62 from Castleford. The evidence indicated to us that the Cineworld, Castleford was unlikely to draw enough custom from the areas around the city centre to act as a direct competitive constraint on The Light cinema.
- 6.91 However, the evidence did indicate to us that the Cineworld, Castleford would be in a position to compete for The Light's customers who came from south and south-east Leeds. It also indicated that the Cineworld, did directly compete with, and may be expected to constrain, prices at the Showcase, Birstall. Hence the Cineworld, Castleford would be likely to offer a constraint on Vue's ability to retain price-sensitive customers in south and south-east Leeds in response to a SSNIP in ticket price, and would be likely to constrain the ability of the Showcase, Birstall to raise prices. As noted in paragraph 6.84, we expected that the Showcase cinema in Birstall would directly compete with the Vue cinemas in Leeds.
- 6.92 We considered whether other cinemas outside Leeds, in locations such as Wakefield, Huddersfield and Harrogate, would constrain Vue's pricing in Leeds. The evidence we saw (see paragraph 34 of Appendix F) suggested to us that they would not, due to their essentially local audiences and their increasing distance from Leeds. However, this was not an important issue for our analysis.
- 6.93 In sum, Vue owns the only two multiplex cinemas in Leeds, and the evidence indicated that the single-screen cinemas in Leeds did not constrain Vue's cinemas. However, the evidence indicated that there were at least three multiplex cinemas which offered constraints of varying degrees on the ability of Vue to raise prices or lower the quality of offer in their cinemas: the Showcase, Birstall was close enough to the city to constrain Vue's cinemas; the Odeon in Pudsey (and perhaps the Cineworld in Bradford) would offer an alternative for customers living to the west and north-west of the city centre; and the Cineworld, Castleford would offer an alternative to customers living to the south and south-east of the city centre. In addition, the Cineworld, Castleford was sufficiently close to the Showcase, Birstall to act as a direct competitor to that cinema, and constrain its ability to raise prices.

- 6.94 We concluded that the presence of these cinemas, offering alternatives for significant areas of Leeds, would together offer a constraint on Vue's Leeds cinemas, in that if Vue raised prices, there were enough people with access to alternative cinemas to make it unclear that the price rise would be profitable. We therefore conclude that the merger may not be expected to give rise to an SLC in Leeds.

Romford

- 6.95 As a result of the merger, Vue acquired the former Ster cinema in Romford. Vue already owned two cinemas in the area around Romford, in Dagenham and West Thurrock (at the Lakeside Shopping Centre).
- 6.96 Vue's isochrone analysis showed that there were no other cinemas within a 10- or 20-minute drive of Romford. However, there were several cinemas just beyond the 20-minute drive-time isochrone, Vue told us that, despite the lack of cinemas within 20 minutes of Romford, it considered there were nine cinemas which competed with the Romford cinema. Figure 5 of Appendix G shows the location of cinemas in the Romford area.
- 6.97 As noted in paragraph 6.95, two of the cinemas closest to the former Ster Romford cinema were owned by Vue. One of these, at Dagenham, appeared to be the closest cinema to Romford. The Vue cinema at West Thurrock was only slightly more distant.
- 6.98 The key questions to be answered were: whether, before the merger, the then Ster Romford cinema was constrained by one or both of the Vue cinemas at Dagenham and West Thurrock, but not by the other cinemas around it; and whether, before the merger, the Dagenham or West Thurrock cinemas were constrained by the Romford cinema but not by other cinemas around them. If either scenario was in place, then the post-merger change of ownership of the Romford cinema might be expected to relax the competitive pressures on Vue to the detriment of consumers.
- 6.99 We considered first whether the Vue cinema at Dagenham would have continued to operate had the merger not taken place. [REDACTED] we were content that the Dagenham cinema would have continued to be a potential competitor for the former Ster Romford cinema if the merger had not taken place.
- 6.100 Similarly, we considered whether the Vue cinema at West Thurrock would have continued to operate had the merger not taken place. [REDACTED]. On balance we thought that the Vue, West Thurrock would not have shut had the merger not taken place. However, our analysis of the competitive effects of the merger in Romford does not turn on this judgement.
- 6.101 Having satisfied ourselves that the Vue Dagenham and West Thurrock cinemas would have remained operating absent the merger, we considered the questions in paragraph 6.98. We did not think that the Vue cinemas at Dagenham or West Thurrock were uniquely well-placed to constrain prices at the former Ster Romford cinema. As shown in Figure 9 of Appendix F, analysis of postcode data shows that the catchment areas of the Romford and Dagenham cinemas overlap significantly more than those of the Romford and West Thurrock cinemas. As a result the Vue West Thurrock cinema would be expected to be less of a constraint on the former Ster Romford cinema than the Vue Dagenham cinema. But the evidence (from the cinemas Vue compared Romford's performance with, and the local geography) suggested that cinemas in locations such as Ilford and Woodford offered as much of a constraint on ticket prices at the former Ster Romford as the Vue cinemas in Dagenham.

- 6.102 The Vue Dagenham had several cinemas closer to it than the Romford cinema, and was likely to be constrained from raising its ticket prices primarily by cinemas in Newham and Ilford. We also considered that Vue's West Thurrock cinema faced a strong competitive constraint from the Showcase cinema at Bluewater, as well as constraints from cinemas such as that in Basildon, and any constraint it felt from the Romford cinema was not significant in comparison.
- 6.103 The evidence put to us indicated, therefore, that the competitive situation around Romford would not be substantially different after the merger compared to the expected situation had the merger not taken place, and that Vue would not be able to raise ticket prices in Romford, Dagenham or West Thurrock as a result of the merger. We conclude therefore that the merger may not be expected to result in an SLC in Romford.

Other competitive constraints which might offset effects of the merger

Barriers to entry or expansion

- 6.104 We considered what the barriers to entry or expansion were in the relevant markets, in order to determine whether new entry or expansion, or the threat of it, would constrain cinemas from raising prices.
- 6.105 New competitor entry into a local market can occur in three ways: the acquisition of an existing cinema, the conversion of a building to use as a cinema, and the building of a new cinema. Vue told us that entry through the acquisition of an existing cinema was something that current cinema exhibitors and potential entrants were able to do (see paragraph 6.12) and that it could be completed very quickly—it cited its acquisition of the Ster chain and a cinema in Oxford of examples where deals were completed very quickly. We saw no evidence to contradict this. However, the only type of new entry with which we were concerned for this inquiry was the opening of new sites, creating new competition in the areas under consideration.
- 6.106 We found that the lead times for planning and building a new cinema were long—as set out in paragraph 5.21, we were told that the time required to plan and build a new cinema is typically in the range of 18 months to three years. Vue told us that, the length of time between board approval for a site and a cinema opening was a matter of years not months and on average [REDACTED]. Vue also told us that the costs of both building a new cinema and converting an existing building for use as a cinema were several million pounds: [REDACTED].
- 6.107 As noted in paragraph 11 of Appendix C, there have been a considerable number of multiplex cinemas opened since 1999, although the rate of cinema openings has slowed in the last two years, with only six opening in 2004. Vue showed us a large database of possible cinema openings over the next four years. This indicated that cinema exhibitors are aware of plans for possible cinema sites which might open over the next few years. We had no reason to doubt that this was an accurate and complete picture.
- 6.108 Vue told us that it was aware of possible plans for new cinemas to be built in two of the geographical markets we focused on. It told us that there were definite plans to create a new cinema in the geographic market surrounding Romford. In light of our finding on the competitive situation there, we did not have to reach a view on the likelihood and possible impact of this entry.

- 6.109 Vue also told us that it was aware of plans to develop new cinema sites in Newbury and [redacted], for opening in 2008. It told us that its own estimate of the likelihood of the planned cinema in [redacted] opening was [redacted], and that the proposed new cinema in Newbury was ‘very likely’ to go ahead, with an expected opening in early 2008. Vue told us that both of these cinemas, if opened, would provide a competitive constraint on Vue’s Basingstoke cinemas. It is currently unclear which cinema exhibitors would operate at these sites.
- 6.110 We did not consider the possible opening of a cinema in [redacted] in 2008 to be important for this analysis. If that cinema were to operate as a competitive constraint it would be most likely to constrain possible new cinemas in [redacted] and [redacted], which Vue had previously brought to our attention, rather than cinemas in Basingstoke which are approximately 30 minutes away (according to Vue’s drive-time isochrone analysis).
- 6.111 We considered whether the possible opening of a cinema in Newbury in 2008 would in itself act as a competitive constraint on Vue’s Basingstoke cinemas. According to Vue’s analysis, Newbury is on the edge of a 30-minute drive-time isochrone centred on the former Ster Festival Place site in Basingstoke, and therefore outside the 20-minute drive-time isochrone Vue proposed as the relevant geographic market. We accepted that the web membership data suggested that the Basingstoke cinemas received some custom from Newbury, and that if the Newbury cinema did open the Basingstoke cinemas might be expected to lose some customers to it, as people tend to go to their closest cinema (see paragraph 6.4).
- 6.112 However, for the possible creation of a cinema in Newbury to act as a constraint on the Basingstoke cinemas there needs to be a population between the two towns that the cinemas would compete to attract. The largest population centre between the two towns is Kingsclere, which is approximately half way between Newbury and Basingstoke. Kingsclere has a population of around 4,900. The evidence indicated to us that there was insufficient population between the two towns for cinemas in Newbury and Basingstoke to compete for, and hence we concluded that neither the threat of new entry in Newbury, nor the opening of a cinema in Newbury if it occurred, would act as a competitive constraint on Vue’s Basingstoke cinemas.
- 6.113 In summary, we did not expect new entry or the threat of it to offer a constraint on ticket prices or any other aspect of a cinema’s offer in the Basingstoke market in the short to medium term. We did not need to reach a conclusion on whether any possible new entry would affect competition in the other areas where Vue had acquired cinemas.

Countervailing buyer power

- 6.114 The customers of cinema exhibitors are members of the public. We saw no evidence to suggest that they had the ability to group together to exert buyer power in order to keep prices low.

Conclusions on the SLC test

- 6.115 We conclude that the completed acquisition by Vue of A3 was a relevant merger situation under section 23 of the Act and that we therefore have jurisdiction to consider the competitive consequences of the merger.
- 6.116 For the reasons set out in paragraphs 6.59 to 6.63 we conclude that the merger has resulted in an SLC in the market for cinema exhibition services in Basingstoke. This

may be expected to result in higher prices for cinema tickets, a reduced incentive to maintain the quality of the offer at the Basingstoke cinemas, and a reduction in choice for consumers in Basingstoke.

6.117 We do not conclude that the merger may be expected to result in an SLC in any other market.

7. Remedies

7.1 Having determined that the merger gives rise to an SLC in the market for cinema exhibition services in Basingstoke, we now turn to remedies.

7.2 Section 36 of the Act requires us to consider three questions:

(a) whether action should be taken by the CC for the purpose of remedying, mitigating or preventing the SLC concerned or any adverse effects which may be expected to arise;

(b) whether the CC should recommend the taking of action by others (eg regulators, government departments); and

(c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

7.3 In this case the only remedy options appear to be actions for the CC rather than for other bodies.

Remedy options

7.4 In our notice of possible remedies published on 20 December 2005, we suggested that the divestment of one of Vue's two cinemas in Basingstoke was the only remedy which appeared appropriate, but that we were willing to consider any practical alternative remedies put to us. We received no comments from third parties on our remedies notice, though we subsequently sought and received comments from several third parties and an independent surveyor on divestment processes.

7.5 In addition to commenting on the structural remedy suggested, Vue proposed a series of behavioural remedies, which it said would remedy the SLC identified. We consider the behavioural remedies offered, and divestment remedies, in turn. We then consider customer benefits arising from the merger.

Behavioural remedies

7.6 Vue told us that the optimal remedy was a behavioural one which would allow Vue to continue to operate both cinemas in Basingstoke. It told us that this would allow cinema-goers to benefit from a broader choice of films across the two cinemas than would be seen if the cinemas were under different ownership. We considered carefully the proposed undertakings offered. In doing so, we noted that, as set out in the CC's guidelines,⁴ structural remedies were likely to be preferable to behavioural

⁴*Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8) December 2004, paragraph 1.8.*

remedies, as they address the effects of a merger directly and require comparatively little, if any, monitoring or enforcement of compliance.

- 7.7 We consider below the proposed undertakings offered by Vue in relation to each adverse effect identified.
- 7.8 Vue told us that the adverse effect on prices that we have identified could be addressed by a price cap. It proposed an undertaking to cap percentage ticket price rises at both cinemas in Basingstoke, so that they were no higher than the average percentage ticket price rise across the Vue cinema circuit for each type of ticket. It told us that such a price cap would reflect the competitive pressures felt by Vue across its circuit, and that it was an easy undertaking to monitor.
- 7.9 We considered that a price cap is likely to be more effective when addressing an adverse effect which is time-limited than if the adverse effect is expected to continue indefinitely. However, we saw no evidence to suggest that the adverse effects identified in this case were time-limited; in particular we saw no evidence of potential new entry into the Basingstoke cinema market which could reintroduce any level of competition into the market. We did not think that a price cap, which would require monitoring both of compliance and of the continuing appropriateness of the cap on an indefinite basis, was the best-available solution.
- 7.10 An example of the difficulty in finding a suitable method for fixing a long-term price cap is that the price cap would only be effective in reflecting the competitive pressures felt across Vue's circuit if it took account of all price changes in a year. Vue told us that it only had one annual price rise round, though we noted that when Vue acquired the Ster cinemas it increased prices in those cinemas a month after the acquisition, as well as in its annual price round. However, there is nothing to stop Vue changing this policy, and changing ticket prices for different cinemas at different times, either through choice or to react to changing circumstances. Whilst we thought there were probably ways of dealing with this, they would inevitably be more complicated solutions, which would require more detailed and regular surveillance.
- 7.11 More generally, the effectiveness of the method of setting the price cap might be expected to degrade over time, as the competitive pressures facing the industry inevitably develop. In a few years' time the circuit average price rise might not reflect the competitive pressures on Vue in the same way it does today. Moreover, the competitive pressures reflected in a price cap would not necessarily reflect the competitive pressures Vue would have faced in Basingstoke had one cinema been divested to a competitor.
- 7.12 We were unable to conclude that a price cap was an effective remedy to the adverse effect on price identified, for the reasons set out in paragraphs 7.9 to 7.11.
- 7.13 In relation to our adverse finding on quality, Vue told us in its written response to our remedies notice that it did not differentiate between competitive and non-competitive locations on service and other quality factors, and that it would maintain high levels of customer service and site maintenance in the normal course of business. It subsequently offered to provide us with an undertaking that it would calculate the average spend on site maintenance across its circuit and spend at least that much annually on each cinema in Basingstoke.
- 7.14 We did not consider that the undertaking proposed clearly addressed the adverse effect identified. Spend on maintenance is not uniform—refurbishments are subject to rolling programmes, so a site will typically have a lot of money spent on it one year,

when it is refurbished, and then have less money spent on it for a few years until its next refurbishment is due. Offering to spend the average maintenance cost across the circuit each year on the Basingstoke cinemas would not guarantee that either site would be refurbished to the quality level of other sites in the circuit. So whilst the proposed undertaking offered might address maintenance issues in the short term, it would not guarantee that they would be addressed once the cinemas reached the point where refurbishment would normally be appropriate.

- 7.15 We noted that such an undertaking would not address other aspects of quality, such as cleanliness of various parts of the building and general service levels. We accepted Vue's assertion that its image is based on a high quality offer across the circuit. As noted in paragraph 7.9. we saw no evidence to suggest that the adverse effects identified in this case would diminish in time. We would, therefore, be reliant on Vue's management (and any future management of the circuit) maintaining indefinitely an adherence to the principle of an equal quality offer across the circuit.
- 7.16 On balance we concluded that the proposed undertaking offered did not remedy the adverse effect on quality.
- 7.17 Finally, in relation to the adverse finding on choice identified, Vue offered to undertake to keep both cinemas open, maintaining the number of screens necessary to offer the broader range of films referred to in paragraph 7.6. We considered that an undertaking to keep both cinemas open would be needed to address the adverse effect on choice that we identified. The proposed undertaking offered by Vue to keep the Leisure Park cinema open would, we believed, remedy this adverse effect.
- 7.18 Having considered the behavioural remedies put forward by Vue, we conclude that they would not satisfactorily remedy two of the three adverse effects identified, and would not, therefore, be effective.

Divestment

Divestment of the Vue Leisure Park or former Ster Festival Place cinema

- 7.19 We considered whether divestment of one of Vue's two cinemas in Basingstoke (through the sale of the cinema with the headlease) would remedy the SLC and the adverse effects identified.
- 7.20 The SLC identified (paragraph 6.59) resulted from the loss of the strongest, and only substantial, competitive constraint on Vue—the competitive constraint imposed by Ster on Vue, and by Vue on Ster—in Basingstoke. We looked at whether (if one of the cinemas were divested to a third party who would operate it as a multiplex cinema specializing in mainstream films) the competitive constraint in Basingstoke would be re-introduced, remedying the SLC and the adverse effects identified.
- 7.21 Vue told us that divestment of the Vue Leisure Park site would unequivocally address the SLC. However, it told us that divesting the former Ster Festival Place cinema would not meet our objectives, as there remained a strong possibility that, if we required Vue to divest that cinema, Vue would then dispose of the Vue Leisure Park site for an alternative use.
- 7.22 We agreed with Vue that divestment of the Leisure Park site would address the SLC, if divestment were made to a new or existing cinema operator who may be expected to operate it as a multiplex cinema specializing in showing mainstream films. The divestment would return the market to the pre-merger situation of two competing

fascias. We did not, however, accept Vue's argument that divestment of the former Ster cinema would not address the SLC. We concluded (paragraph 6.45) that had the merger not taken place, Vue would have kept its Leisure Park cinema open. Requiring Vue to divest the former Ster cinema would most accurately recreate the pre-merger situation. We saw no reason why Vue would act differently after divestment than if it had not acquired the Ster Festival Place cinema. We concluded, therefore, that divesting the former Ster Festival Place cinema to a suitable purchaser would re-establish competition between the cinemas in Basingstoke, and remedy the SLC.

- 7.23 We concluded, therefore, that divestment of either cinema in Basingstoke to a third party who would operate it as a multiplex cinema specializing in showing mainstream films would remedy the SLC identified.
- 7.24 We went on to consider whether divestment of either cinema to a third party for continued operation as a multiplex cinema would remedy the adverse effects identified in paragraphs 6.60 to 6.63.
- 7.25 The first adverse effect identified (paragraph 6.60) was that the merger may be expected to allow Vue to raise ticket prices at its cinemas in Basingstoke at a greater rate than if the two cinemas remained under separate ownership. We considered that divestment of one cinema for continued operation as a mainstream multiplex cinema would return the market to the pre-merger situation, remedying this adverse effect. However, we noted that the merger was completed in April 2005, and prices at the Festival Place site have risen twice since then (in May 2005 and December 2005), and prices at the Leisure Park site have risen once (in December 2005). We noted that the December 2005 price rises were part of Vue's review of prices at all of its sites; however, the price rises in Basingstoke were above the average for all Vue sites. We consider it is important, therefore, that if divestment is the appropriate route, it should be effected quickly, to reintroduce the level of price constraint that was in place prior to the merger before there are any further price rises. The reintroduction of competition may also exert a downward pressure on prices (see paragraph 5.29), countering the above-average price rises already seen in Basingstoke since the merger.
- 7.26 The second adverse effect identified (paragraph 6.61), was that the loss of the competitive constraint would reduce the incentive to maintain the quality of the offer at the Basingstoke cinemas compared to the standard that may be expected in the absence of the merger. Once again, we considered that having the two cinemas under different ownership and in competition with each other would remedy this adverse effect.
- 7.27 The third adverse effect identified (paragraph 6.63) was a reduction in choice for consumers in Basingstoke compared to the situation in the absence of the merger. The evidence indicated to us that if the merger were allowed to proceed, Vue would move the Leisure Park cinema to alternative use, leaving only one cinema in Basingstoke. We concluded (paragraph 6.45) that if the merger had not taken place, the Vue Leisure Park cinema would have been maintained as a going concern. We considered that the factors relevant to that judgement were also relevant to whether the Leisure Park cinema would be maintained as a going concern if it was divested to a suitable purchaser, or retained by Vue (with the Festival Place site being divested to a suitable purchaser). We concluded, therefore, that divestment would remedy this adverse effect.

- 7.28 We conclude, therefore, that divestment of either cinema to a suitable purchaser would remedy both the SLC and the adverse effects identified. We think therefore that Vue should have the choice of whether to seek to divest the Vue Leisure Park cinema or the former Ster Festival Place cinema. We also think that Vue should be allowed a reasonable period of time to bring about the disposal of the cinema of its choice before a divestiture trustee is appointed to bring about a sale of one or other cinema.
- 7.29 In accordance with our guidelines⁵ we consider that a suitable purchaser should be an existing or new cinema operator who the CC is satisfied has the resources, expertise, incentive and business plan to operate the cinema as a multiplex cinema specializing in showing mainstream films.

Sale and leaseback of the Vue Leisure Park cinema

- 7.30 Vue proposed that, should divestment of a cinema be required, it should be allowed to carry out a sale and leaseback of the Vue Leisure Park cinema, prior to disposing of its interest in the cinema to a third party. The arrangement it proposed was the sale to a third party (probably an institutional purchaser) of the headlease for the Leisure Park cinema; the leasing back of the property, on a sublease; and the assignment of the new sublease to an appropriate purchaser. It proposed that the sale and leaseback and assignment of the sublease would take place concurrently. At the end of the process Vue would have disposed of all its interests in the property.
- 7.31 Vue told us that it wished to carry out a sale and leaseback prior to disposal as it would be financially more attractive to it. Vue told us that cinema operators, when deciding how much to bid for a cinema, base their valuations on a multiple of the cinema's cashflow. Cinema operators did not take full account of the value of the lease terms when bidding for a cinema. Vue argued, therefore, that the value of the long-term lease with [~~£~~] rent would not be fully realized through a straight sale of the headlease. Vue estimated that it would receive £[~~£~~] million more if it was allowed to conduct a sale and leaseback before divesting its interest in the Leisure Park site. We asked Vue for evidence to validate the figures, including the cashflow multiples, used in its calculations. We did not receive any such evidence. Vue's statements about financial losses were, therefore, assertions rather than evidence.
- 7.32 We were sceptical of Vue's analysis. In our view, Vue should be able to gain as much value from its assets through a straight sale as through conducting a sale and leaseback and then selling the sub-lease. However, our analysis did not turn on the question of whether Vue would suffer any financial disadvantage if it was not allowed to conduct a sale and leaseback.
- 7.33 We considered whether a sale preceded by a sale and leaseback would remedy the SLC and adverse effects identified, and whether it would have an effect on how long divestment would take. As part of this consideration we spoke to several other cinema operators about the factors they considered when looking at possible acquisitions, including their preferences for properties with freehold, long-term leases or short-term leases. We also received expert advice from two surveyors on issues relating to possible terms and conditions, and timing, of the type of sale and leaseback agreement proposed.

⁵Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8) December 2004, paragraph 4.1.

Effects of sale and leaseback on remedying the SLC

- 7.34 We looked at whether carrying out a sale and leaseback prior to divesting the cinema would remedy the SLC and the adverse effects identified.
- 7.35 We looked first at the SLC, which resulted from the loss of the most significant, and only substantial, competitive constraint on Vue in Basingstoke. To remedy the SLC the divested cinema would have to act as a competitive constraint on Vue, and have the capability to continue to act as a competitive constraint on Vue going forward.
- 7.36 If Vue carried out a sale and leaseback, the terms of the new sub-lease created would be very important in determining the future effectiveness and viability of the cinema as a competitive constraint. The higher the initial rent in the sub-lease, and the more onerous the periodic rent uplifts, the more capital Vue would stand to receive from the sale and leaseback. We were concerned, therefore, that Vue's financial interests would be best served by agreeing a sale and leaseback with terms beyond or at the very top end of what might otherwise be considered to be the market value of the property. This would maximize the return for Vue, but would minimize the cashflow for the new operators of the Leisure Park cinema. This may, in turn, adversely affect the ability of the Leisure Park cinema's new operators to run the cinema profitably, and reduce the chances of it being able to continue to operate the cinema in the longer-term. However, the independent surveyor advised us that if a sale and leaseback was effected then it was most likely to be at a market rent and with market rates for rent uplifts. It suggested that starting at a higher rent would create additional risk for the acquirer of the long lease.
- 7.37 Vue calculated the average cashflow of the cinema over the last three years and offered to undertake to set the initial rent at such a level that would leave the average after-rent cashflow at £[£]. It told us that, with the rent set at this level, a cinema operator purchaser could be confident that, based upon achieving 'normalized' or average levels of attendance, the cashflow after rent from the cinema would be in excess of £[£], a level at which considerable interest in the cinema would be expected.
- 7.38 We asked other cinema operators whether there was a cashflow level below which, as a rule of thumb, they would have concerns about whether they could operate the cinema successfully. Those operators who did have such a figure in their minds gave answers which appeared to corroborate Vue's suggestion that a cinema with a cashflow of £[£] would be of interest (though in one case on the lower limit of being of interest) to them.
- 7.39 We spoke to the independent surveyor about market rents. We were told that the rent (in per square foot) being proposed by Vue was not unreasonable.
- 7.40 We considered that the terms of the rent reviews in the sub-lease would be extremely important in ensuring the viability of the cinema. Other cinema operators we spoke to said they preferred fixed uplifts, rather than uplifts negotiated every five years. Vue showed us a draft prospectus it had had prepared ready for the sale and leaseback of the Leisure Park site, which assumed five-yearly rent reviews, subject to a minimum fixed uplift of [£] per cent annual compound growth. This level of rent uplift was in line with the level of rent uplift described to us as normal for the industry by one cinema operator. However, another cinema operator expressed a concern that for an older cinema, such as at the Leisure Park, rent uplifts needed to be looked at in light of the initial rent, and very small uplifts, with reference to market values at the time of the rent reviews, might be more appropriate. The independent surveyor said

that the rent uplifts proposed were not unreasonable, but also told us that only the first two rent reviews would normally be subject to the fixed rent uplifts. We noted that allowing Vue to undertake a sale and leaseback prior to the sale would, in effect, allow Vue to set the future rent for its competitor acquiring the site. It might also prevent the acquirer from deciding how best to organize its business in order to compete in Basingstoke—whether it wanted to conduct a sale and leaseback itself or maintain a [X] rent.

- 7.41 A cinema operator also suggested to us that other terms of the lease could be important in determining the attractiveness of a lease, and how it would impact on a cinema's future viability. We agreed that there are many conditions in a lease which could cause problems. We therefore considered that it was important that, should a sale and leaseback be permitted, an independent property lawyer and an independent surveyor, both with experience of the cinema industry and funded by Vue, should study the sale and leaseback terms (including proposed rent and rent uplifts). They should report to us on whether there were any terms they considered not to be industry standard or they considered might impede the effective running of the cinema as a competitor to Vue (non-standard terms). If they find any such terms they should provide us with recommendations on what, if any, changes should be made. We would then require any recommended changes be made unless good reason was put to us as to why they should not be made. It would be important for sufficient time to be built into the timetable for the lawyer and surveyor to study the documents and property, and for any non-standard terms identified to be addressed.

Effects of the sale and leaseback on remedying the adverse effects of the merger

- 7.42 We turned next to the adverse effects identified. The first adverse effect related to higher ticket prices. We considered that the factors set out in paragraphs 7.36 to 7.41. were also relevant to whether the Leisure Park cinema's ticket prices post-merger would constrain Vue's ability to raise prices at its Festival Place cinema.
- 7.43 The second adverse effect was a lower incentive to maintain quality. Vue explained that the incentive to upgrade a cinema would be determined by the predicted increase in cashflow resulting from a proposed investment, and that an investment would need to show a payback within four years to be worthwhile. Vue told us that the level of investment required to bring the Leisure Park site up to the standard of the latest multiplexes was high. Vue did not think that it, or an independent operator, could make a return on the investment, and told us that it would not make that level of investment in the Leisure Park cinema if it was able to retain it. Vue argued that, whether the cinema was acquired with a long- or short-term lease, it was simply a question of running the cinema the way that it is now. From this we understood Vue's position to be that the way the divestment was conducted would not change the incentives for the purchaser to invest in refurbishing or upgrading the cinema.
- 7.44 Evidence from cinema operators we spoke to did not support Vue's contention that an operator's incentive to invest in the Leisure Park cinema would not be changed by a sale and leaseback being carried out by Vue before divestment. A cinema operator told us that it would prefer to acquire the long-term lease, and conduct its own sale and leaseback. If it received the appropriate consents it could then re-invest the sale and leaseback capital in redeveloping the site, including upgrading the cinema. If it acquired the cinema after the sale and leaseback this project was less likely to take place. This evidence appeared to contradict Vue's assertion that nobody could make a return on any additional investment for upgrading the cinema.

- 7.45 The operator also told us that, in its view, if a sale and leaseback were conducted prior to divesting the cinema, the purchasers would be more likely to be small independent chains; the larger chains would be more likely to be interested in acquiring the long-term lease, with the financial flexibility that allowed. Another operator also told us that it would prefer to acquire a long-term rather than a short-term lease, as this gave it more control over what it could do with the property. A third operator thought that the incentive to refurbish would be reduced by having a short-term lease with a market rent compared to having a long-term lease with a [redacted] rent.
- 7.46 We found the logic behind the views expressed by the other cinema operators to be convincing, and concluded that allowing sale and leaseback could reduce the ability of an acquirer to upgrade the Leisure Park cinema immediately following acquisition, and thereby potentially reduce the effectiveness of the remedy in addressing the adverse effect on quality. However, we also accepted Vue's argument that the incentive to invest in a property is primarily the prospect of sufficient return on the investment, and that the existing cashflow is unlikely to be the determining factor in deciding whether to invest in a property.
- 7.47 On balance, we concluded that conducting a sale and leaseback prior to disposing of the cinema might dissuade some cinema operators from seeking to acquire the Leisure Park cinema. Despite this, we believed that there would still be a sufficient number of potential purchasers with the incentive and ability to maintain quality.
- 7.48 The third adverse effect related to choice, and the conclusion that if Vue were allowed to retain both cinemas, it would move the Leisure Park cinema to alternative use. The longer-term viability of the cinema in another operator's hands would be largely dependent on the terms of the sub-lease it operated under, and its willingness to invest in the cinema to maintain it as an attractive destination for customers. As noted in paragraph 7.41, we would need expert advice to ensure that the terms of the sale and leaseback would not impose overly onerous conditions on a purchaser.

Effects of the sale and leaseback on how long divestment would take

- 7.49 We then turned to whether there was any difference in how long it would take to achieve divestment with or without a prior sale and leaseback.
- 7.50 We were concerned that Vue would not be able to complete a sale and leaseback in the timetable that we considered appropriate for a straight divestment, and we considered it important that there should be no unnecessary delay in remedying the adverse effects of the merger. Our guidelines⁶ state that normally we would expect the disposal of the divestiture package to a suitable purchaser to be effected within a maximum period of six months. Vue initially told us that it could enter into a binding sale agreement in [redacted], and complete the sale within a further [redacted]. Other cinema operators we spoke to did not offer a firm view on how long the total divestment period should be, but suggested that, whilst the due diligence on one cinema should be quicker than conducting due diligence on several cinemas, acquiring a single cinema was unlikely to be achieved noticeably more quickly than acquiring a group of cinemas. However, we noted that Vue had acquired the Ster circuit of seven cinemas very quickly; we were told that Vue had approached Ster in early 2005, and the sale was completed in April 2005. Vue also told us that it had recently reached agreement

⁶Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8) December 2004, paragraph 5.5.

to acquire a cinema in Oxford in a couple of weeks. We concluded, therefore, that Vue should have an initial divestiture period [REDACTED].

- 7.51 Our concerns were focused on the difficulties associated with trying to conduct the sale and leaseback in parallel with the disposal, and negotiating clauses in the sale and leaseback agreement in the knowledge that the sub-lease would be disposed of immediately to a third party.
- 7.52 We put our concerns to Vue. In response, Vue offered a proposed undertaking to meet our concerns. It offered to spend up to [REDACTED] agreeing terms for both a straight divestment of the sale and a sale and leaseback with concurrent disposal of the sub-lease. If it had agreed heads of terms within [REDACTED] for both a sale and leaseback with concurrent disposal of the sub-lease and for a straight disposal, then Vue would have [REDACTED] to exchange contracts approved by the CC and [REDACTED] to complete the divestment (a total of [REDACTED] in which to complete the divestment). It proposed that if it failed to agree heads of terms for a straight divestment within [REDACTED] then, irrespective of progress towards achieving divestment with a sale and leaseback, a divestiture trustee would be appointed to effect disposal of one of the cinemas in Basingstoke.
- 7.53 We considered that the proposal put forward by Vue addressed our timing concerns. We considered a period of [REDACTED] to complete the divestment a reasonable timeframe, and we concluded that the framework suggested (including the involvement of the divestiture trustee, if needed) should enable disposal to a suitable purchaser to be effected within [REDACTED], even if there were delays in arranging a sale and leaseback.

Conclusions on the sale and leaseback proposal

- 7.54 We conclude that, with specific safeguards in place, Vue should have the opportunity at least to try to achieve disposal of the Leisure Park cinema as part of a sale and leaseback arrangement. The two safeguards we consider necessary are to ensure that the acquirer is not prevented from running the cinema as an effective competitor because of non-standard terms in the sub-lease, and to ensure that the divestment to a suitable purchaser occurs in a reasonable timeframe.
- 7.55 The first safeguard required is that an independent property lawyer and an independent surveyor, paid for by Vue, should review drafts of all the contracts and any other arrangements or agreements relevant to the sale and leaseback and to the subsequent disposal. If the advice received by the CC is that the terms and conditions are at market rates and standard for the industry (see paragraph 7.33), the CC will approve the disposal. It is most important that the disposal is effected quickly and the SLC remedied promptly. Consequently Vue should market the property both for a straight disposal with a long lease and for disposal following a sale and leaseback with an industry-standard length of lease. In this case it should achieve heads of terms on both disposal routes within [REDACTED], and exchange of contracts within [REDACTED] (see paragraph 7.52).
- 7.56 The second safeguard is the requirement to achieve divestment within the initial divestiture period according to the following timetable. Vue will be allowed a preliminary period of [REDACTED] to agree heads of terms for (a) an outright disposal of the Leisure Park cinema and (b) a disposal through the sale and leaseback of the Leisure Park cinema followed by an assignment of Vue's interest in the underlease arising out of the sale and leaseback. Vue will then be allowed a contract period of [REDACTED] to reach exchange of contracts with a suitable purchaser on whichever of the two methods of disposal it prefers. If Vue prefers a disposal pursuant to a sale and leaseback the terms of the relevant contracts and agreements must be approved by

the CC acting on the advice of an independent surveyor and lawyer. Following the expiry of the contract period, Vue will be allowed a [X] completion period to complete the disposal to a suitable purchaser. The preliminary period, the contract period and the completion period are together the initial divestiture period. The duration of the initial divestiture period, and of its constituent elements, will remain confidential to prevent potential acquirers from taking advantage of the timetable.

- 7.57 If Vue fails to complete the divestment within the initial divestiture period then the CC will appoint a divestiture trustee, charged with effecting the prompt sale of either cinema without a reserve price, unless the CC considers that the appointment of a divestiture trustee would inhibit the early disposal of one or the other cinema. The initial divestiture period, together with the period in which the divestiture trustee effects the disposal of one or other of the cinemas, is the divestiture period.
- 7.58 If (a) during the preliminary period the CC forms the view that Vue is not using its best efforts to reach agreement on heads of terms with a suitable purchaser before the end of the preliminary period, or (b) on the conclusion of the preliminary period Vue has not reached heads of terms with a suitable purchaser for both an outright disposal and a disposal pursuant to a sale and leaseback (including the sale and leaseback arrangements) arrangement or (c) on the conclusion of the contract period Vue has not exchanged contracts with a suitable purchaser on all the agreements that are necessary to give effect to its preferred method of disposal then in each case the CC will appoint a divestiture trustee, charged with effecting the prompt sale of cinema without a reserve price, unless the CC considers that the appointment of a divestiture trustee would inhibit the early disposal of one or the other cinema. Alternatively, the Commission may appoint a monitoring trustee to ensure that Vue complies with its obligations.
- 7.59 Throughout the divestiture period Vue will be required to maintain the competitive capability of the cinemas and their current ownership structure. Vue will report weekly to the CC on compliance with the undertakings and the progress of the divestment process. If evidence emerges that Vue is not maintaining the capability of these cinemas, the CC will consider appointing a monitoring trustee to monitor Vue's compliance with the undertakings, and reserves the right to appoint a divestiture trustee on the terms set out above.
- 7.60 Should Vue wish to abandon its sale and leaseback proposals, we would expect it to reach exchange of contracts on the disposal of either cinema within [X], with completion of the disposal within [X].

Conclusion on divestment remedies

- 7.61 We conclude that divestment of either cinema, subject to the conditions set out in paragraphs 7.28 to 7.29, will remedy the SLC and adverse effects identified. As set out in paragraph 7.54, we conclude that Vue should be permitted to attempt to carry out a sale and leaseback on the Vue Leisure Park cinema as long as the safeguards specified in paragraphs 7.55 to 7.59 are built into the disposal process.

Relevant customer benefits

- 7.62 In accordance with our guidance,⁷ we considered whether there are any relevant customer benefits arising from the merger which we should take into account in our consideration of remedies. Vue put to us that there were two types of customer benefits arising from the merger: benefits relating to quality of service, and an increased choice in films showing in Basingstoke.
- 7.63 Vue told us that there were a number of customer benefits arising as a result of the merger. It told us that quality of service had improved at all Ster cinemas since the merger, in terms of better service, shorter queues and better trained staff. It also told us that its new booking system was being rolled out across all its cinemas, including the former Ster cinemas.
- 7.64 We were not able to verify Vue's assertion that customer service levels had improved as a result of the merger, as the merger was completed nearly five months before it was referred to us for investigation. The Vue cinemas we saw were clean and we saw no reason to doubt that there were good levels of service generally. However, we were offered no evidence as to how these service levels were notably different to, or better than, those generally offered in the industry (as noted in paragraph 6.18, all cinema operators we spoke to—including the former operators of the Ster circuit—told us that they competed through providing a high-quality offer).
- 7.65 Moreover, we concluded (paragraph 6.61) that we expected the merger to reduce the incentive to maintain the quality of the offer in Basingstoke. This would suggest that, over time, service levels would suffer as a result of the loss of local competition
- 7.66 We concluded that Vue's customer service levels did not constitute a customer benefit as defined in the Act.
- 7.67 On the question of number of films showing, in its written response to our remedies notice, Vue set out that a divestment remedy was sub-optimal because keeping both cinemas open allowed it to offer a broader choice of films across the two cinemas than would be seen if the two cinemas were under different ownership. Vue provided us with evidence, based on a sample of films showing at the Ster and Vue cinemas in a four-week period before the merger (covering January and February 2005), and at the two cinemas under Vue's ownership in a four-week period during the autumn of 2005 and a three week period in January 2006. Vue told us that this showed that there were on average three more films showing per week in Basingstoke after the merger than before the merger.
- 7.68 We noted Vue's evidence on the increase in the number of films showing in Basingstoke. We also noted this evidence was based on a very limited period of time (comparing a four-week period with a four-week period and a three-week period), and was therefore unlikely to be a reliable indication of a customer benefit accruing. We did not consider that the evidence put to us showed unequivocally a clear benefit to consumers in terms of greater choice. In one of the post-merger weeks Vue analysed there were no extra films showing, so no customer benefit accrued in that week; in a further two of the post-merger weeks there was only one extra film showing. We were not convinced that the evidence offered showed a clear customer benefit. Any benefit that may be accruing to customers now appears to be small, and would probably require an undertaking to ensure that it would accrue consistently in

⁷Merger References: *Competition Commission Guidelines (CC2)*, June 2003, Section 4.

future. It was not clear to us how an undertaking on showing more films could be framed in a way that would be unambiguous and easily verifiable.

- 7.69 For the reasons set out in paragraphs 7.64 to 7.68, we conclude that relevant customer benefits (as defined in the Act) accruing from the merger are not proven and small at best. We did not, therefore, modify the remedy we would otherwise put in place in light of customer benefits arising from the merger.

Conclusion on remedies

- 7.70 We conclude that there are no behavioural remedies which would adequately remedy the SLC or adverse effects identified.
- 7.71 We conclude that divestment of either of the two cinemas in Basingstoke to a suitable purchaser would remedy both the SLC and the adverse effects identified, and is the only effective remedy. The divestment should be subject to the conditions set out in paragraphs 7.29 and 7.50. If Vue chooses to divest the Leisure Park cinema and wishes to try and effect a sale and leaseback prior to disposal then the conditions set out in paragraphs 7.55 to 7.59 should also apply.
- 7.72 We expect to be able to conclude undertakings with Vue to give effect to our requirements. In default of such an agreement we will order a divestment to be made.