Anticipated acquisition by the Rank Group plc of Gala Casinos Limited

ME/5491-12

The OFT's decision on reference under section 33(1) given on 20 August 2012. Full text of decision published 3 September 2012.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **The Rank Group Plc** (**Rank**) is listed on the London Stock Exchange. It is active in betting and gaming, primarily in Great Britain, Belgium and Spain. In addition to casinos, in Great Britain it operates Mecca bingo halls and gambling websites. Rank is controlled by Guoco Group Limited (Guoco), an investment holding and management company listed on the Hong Kong stock exchange. Guoco also has casino activities in the UK. In the financial year ended 31 December 2010 Rank's turnover was £567.8 million and its operating profit was £62.0 million.

2. **The Gala Coral Group Limited (Gala)** is active in betting and gaming, primarily in the UK and Italy. Gala Casinos Limited (the target business in this transaction) is a wholly owned subsidiary of Gala. It owns and operates Gala's bricks and mortar casinos. Gala is ultimately owned by a number of investment funds managed or advised by Apollo Global Management, LLC, Cerberus Capital Management, L.P., York Capital Management Global Advisors, LLC, Park Square Capital, LLP, Goldman Sachs International Bank and Anchorage Capital Partners.

3. The following assets will be removed from the target business prior to the completion of the transaction: its Dundee casino, its Gibraltar casino and its unused (or 'cold') licence in Westminster. The transaction thus concerns the transfer of 23 casinos and three cold licences. In the financial year ending 24 September 2011, the target business's turnover (excluding revenue from its casinos in Dundee and Gibraltar) was £[ ] and its operating loss was £[ ].

TRANSACTION

4. On 12 May 2012, Rank and Gala signed a share purchase agreement under which Rank will acquire 100 per cent of the shares in Gala Casinos Limited. The consideration is £205 million. The transaction is conditional upon OFT clearance.
5. A satisfactory submission was received on 24 May 2012. The OFT's administrative deadline was 30 July 2012.

JURISDICTION

6. The OFT believes that the proposed transaction would result in two or more enterprises ceasing to be distinct under section 23(1) of the Enterprise Act 2002 (the **Act**).

7. The OFT considers that the turnover test under section 23(1)(b) of the Act will be satisfied because the target business's UK turnover in its last financial year was £[ ] million.[1]

BACKGROUND

8. The casino sector is regulated and it is not possible to operate a casino without a licence.

9. Casinos in the UK have historically been licensed under the Gambling Act 1968 (the **1968 Act**). Licences were awarded by local authorities and can only be used in the awarding local authority area. No further licence applications under the 1968 Act were permitted after 28 April 2006. There

[1] The transaction is not subject to EU Council Regulation 139/2004 because the turnover thresholds contained in Article 1 are not satisfied.

are a total of 186 1968 Act Licences in existence. Of these, 146 are operational and 40 are unused cold licences.

10. Under the Gambling Act 2005 (the **2005 Act**) 16 local authority areas were granted permission to each issue one new casino licence. Eight local authorities are able to issue a 'large casino' licence and eight local authorities are able to issue a 'small casino' licence.[2] Currently only one 2005 Act casino is operational (the Aspers casino in Stratford).

FRAME OF REFERENCE

Introduction

11. In *Guoco/Rank*[3] the OFT assessed the sector by reference to bricks and mortar casinos, but did not reach a conclusion on market definition.

12. In *LCI/Capital Corporation*[4] the Monopolies and Mergers Commission (MMC) considered that London casinos were distinct from casinos outside London. Within London, the MMC segmented the market between 'high-end' casinos and other casinos.

Product Scope

13. Rank submits[5] that bricks and mortar casinos face significant constraints from other gambling and leisure operators. In particular, Rank submits that:

    - many customers of a bricks and mortar casino will consider online gaming as a viable alternative to the bricks and mortar channel

    - many customers will consider other gambling venues as viable

[2] The licence sets limits on gaming floor space, number of gaming tables and number of machines.

[3] Anticipated acquisition by Guoco Group Limited of Rank Group Plc, 27 June 2011.

[4] London Clubs International Plc and Capital Corporation Plc: A report on the merger situation, MMC report 1997.

[5] Information provided by the parties is referred to as a submission by Rank, as the notifying party.

alternatives to casinos. For example, Rank submits that licensed betting offices (**LBOs**), adult gaming centres (**AGCs**) and family entertainment centres (**FECs**) provide gambling alternatives and, in particular, their electronic gaming machines constrain the electronic games element of casinos' operations, and

- many customers visit a casino as a 'night out' and are willing to consider other leisure options such as cinemas, nightclubs and restaurants.

14. The evidence in respect of each of these submissions is considered below.

Online Gaming

15. In support of its submission that online gaming constrains bricks and mortar casinos, Rank provided data showing that a group of customers [ ] on Rank's online gaming sites. However, the OFT was unable to place significant evidential weight on the data as it was based on a very small sample of customers and was heavily influenced by the behaviour of a small number of 'high-roller' customers.

16. Most third party casino operators stated that online gaming places only a limited constraint on bricks and mortar casinos. In particular third parties have told the OFT that the following factors limit the constraint imposed on bricks and mortar casinos:

- customers value the social interaction, personal service and overall ambience of a casino, factors which are not well-replicated by online gaming, and

- customers value the ancillary offerings of casinos such as bar, restaurants and live entertainment.

17. The parties' internal documents contain only limited reference to competition from online gambling. In contrast, the parties' internal documents contain detailed analysis of the threat posed by other bricks and mortar casinos.

18. Accordingly, the OFT considers that there is insufficient evidence for online gaming to be considered a sufficiently strong constraint on bricks and mortar casinos to warrant inclusion in the product scope.

Other Gambling Venues (LBOs, AGCs, FECs)

19. Several third party casino operators have stated that non-casino gambling venues impose only a limited constraint on casinos. In particular third parties have told the OFT that the following factors limit the constraint imposed on bricks and mortar casinos:

    - alternative venues do not offer table gaming – which is the core attraction of most casinos

    - casinos offer a very different environment to other physical gambling venues. In particular, the ambience, social opportunities and ancillary facilities provided by casinos create a leisure offering not replicated by LBOs, AGCs or FECs, and

    - even in respect of machine gaming, machines in casinos generally have much higher betting limits than those available in other venues.

20. The parties' internal documents contain little reference to competition from non-casino gambling venues.

21. Accordingly, the OFT considers that there is insufficient evidence for other gambling venues to be considered a sufficiently strong constraint on bricks and mortar casinos to warrant inclusion in the product scope.

Other Leisure Venues

22. Third party operators told the OFT that other leisure venues may present an alternative for certain aspects of casinos' offering, for example, casinos' food and beverage offering. However, third party operators also stated that non-gambling venues lack the gaming opportunities that are the core attraction of a casino, such that they are a relatively weak constraint.

23. The parties' internal documents contain only limited reference to competition from non-gambling leisure venues.

24. Accordingly, the OFT considers that there is insufficient evidence for non-gambling leisure venues to be considered a sufficiently strong constraint on bricks and mortar casinos to warrant inclusion in the product scope.

High-end versus standard casinos

25. Rank submits that six high-end London casinos form a distinct market since they appeal to a distinct segment of high-roller customers. Rank states that distinct characteristics of these high-end casinos include:

    - higher average drop per head (around £10,000) (in comparison, the average drop in the parties' London casinos is around £625)

    - they tend to have restrictive membership requirements (for example, they often only invite known players to join), and

    - a range of additional free services (for example, they may pay customers' flight and hotel expenses).

26. The parties' submission is consistent with the MMC's finding in *LCI/Capital Corporation* that high-end casinos formed a distinct market. Most third parties have also confirmed that there is limited competitive interaction between high-end and standard casinos in London.

27. The parties submit that the high-end group contains the following six casinos: Aspinalls, The Clermont, Les Ambassadeurs, The Ritz Club, Crockfords and Maxims. This excludes four clubs that the MMC had identified as high-end: Park Tower (owned by Rank), Playboy Club, Palm Beach and Colony Club.

28. One third party suggested that the Playboy Club and Colony Club should also be treated as high-end casinos. However, most third parties agreed with the parties' classification of high-end casinos. Furthermore, the Park Tower, Playboy Club, Colony Club and Palm Beach are noted as competitors in business plans for the parties' standard casinos. Therefore, the OFT has included the Playboy Club and Colony Club in the relevant

frame of reference, but the competitive assessment will reflect the relative positioning of each club.

29. Accordingly, the frame of reference for London casinos will exclude Aspinalls, The Clermont, Les Ambassadeurs, The Ritz Club, Crockfords and Maxims. There is no overlap between the parties in respect of high-end casinos as Gala does not have a high-end casino.

Geographic scope

30. The merger would result in the reduction of large national casino operators from three to two in the UK as a whole and a reduction in fascia in a number of local areas within the UK. The OFT has considered the impact of the merger on both national and local dimensions.

National competition

31. Rank submits that competitive interaction between rival casino operators takes place exclusively at local level, such that it is not relevant to consider the transaction by reference to national competition. Rank submits that even in respect of matters that are managed at national level, any competitive constraint will be driven by local conditions only. However, the evidence available to the OFT indicates that several important parameters of competition may be subject to national competition.[6]

32. No third party casino operators supported Rank's submission that competition occurred exclusively at a local level. One or more third party operators stated that the following were wholly or partly determined nationally:

- gambling pricing
- range of games
- service levels
- marketing (including loyalty schemes)

[6] The OFT/CC retail mergers commentary notes that local competition may take place where commercial strategies are set at a national level. This does not, however, preclude the existence of national competition; competition can, and often does, take place at national and local level.OFT/CC commentary on retail mergers, paragraph 3.1.

- betting limits
- branding
- casino ambience, and
- procurement.

33. The OFT has set out the aspects of the parties' activities that may be determined wholly or partly at national level:

    - gambling pricing: pay-out ratios on slot machines and poker rake (the casino's levy on stakes wagered in poker games)

    - marketing: the parties undertake national level marketing/promotion. In particular, both parties operate national customer loyalty schemes. The earning and redemption rate on these schemes are determined nationally (albeit local management have discretion to award additional points)

    - range of games: the range of games available on each type of electronic machines is determined nationally

    - betting limits: Rank sets betting limits at national level – in line with national risk management policies (albeit local management have discretion to impose lower betting limits)

    - branding: Rank and Gala determine overall brand strategy and positioning at national level. Related to branding is strategy on customer experience, including casino presentation and improvement, which is partly determined at national level

    - service levels: Rank has national policies setting out minimum service standards. Gala also has national service initiatives, and

    - food and beverage offering: Rank and Gala determine bands of pricing and menu range at national level (albeit with local conditions affecting the band to which each casino is allocated).

34. The nature of national competition in respect of these parameters is considered further in the competitive assessment below.

35. Third party evidence and the evidence that the parties make decisions on important competitive parameters at national level indicates that there may

be a national dimension to competition. In particular, even if national decisions are driven to a degree by local conditions, they may also be driven by a national response to the actions of competitors. Accordingly, the OFT believes it is appropriate to assess the current transaction using a national frame of reference to determine whether it may result in a loss of competition at national level.

Local competition

36. As outlined above, Rank submits that all competition occurs at local level. The evidence available to the OFT indicates that there is local competition between casinos. Rank has submitted admissions and cash drop data which demonstrates that a casino's performance is often affected by the opening/closing of other casinos in the area. Furthermore, the parties' internal documents confirm that several key parameters of competition are flexed in response to local conditions, for example, increasing promotions, improving service levels or investing in refurbishment in response to competitor activity in the local area.

37. As regards delineating the geographic scope of local competition, the parties have provided data to the OFT on the geographic distribution of the customer visits to each of their casinos.

38. As a starting point for delineating the scope of local competition, the OFT will often consider the area which captures 80 per cent of customers visiting the parties' sites.[7] In this case, the average area which captures 80 per cent of customer visits to the parties' casinos is a drive time of between 30 and 45 minutes. However, adopting a cautious approach the OFT has considered, at least, catchment areas of 30-, 45- and 60-minute drive times (with isochrones centred on the each of the parties' casinos and competitor casinos) in order to identify competitive overlaps.

39. These catchment areas represent only the starting point for local market analysis. For example, catchment areas do not reflect other important factors such as the relative proximity of casinos within a catchment area. Furthermore, special considerations arise in respect of London where the population distribution and transport mix mean drive time based catchment

[7] OFT/CC commentary on retail mergers, paragraph 2.14.

areas may be less probative than in other areas. Accordingly, the OFT's competitive assessment in respect of each overlap area considers other factors relevant to the competitive dynamics in the area.

Conclusion on frame of reference

40. The OFT has assessed the merger on the basis of the following frames of reference:

- product scope: supply of casino services, based on standard (non-high-end) bricks and mortar casinos, and

- geographic scope: national and local areas (using 30-, 45-, and 60-minute drive time isochrones as a starting point to identify overlaps).

THEORIES OF HARM

41. The OFT considers it appropriate to examine the transaction by reference to the following theories of harm in respect of the supply of casino services:

- horizontal unilateral effects arising from loss of competition at a national level

- horizontal unilateral effects arising from loss of competition between the parties' operational casinos in local areas

- horizontal unilateral effects arising from the loss of competition in local areas based on non-development of the cold licences, and

- coordinated effects arising at a national level.

COMPETITIVE ASSESSMENT

Unilateral effects in the supply of casino services (national)

Shares of supply

42. The merger would result in a major structural change to the casino sector. The merger would, in effect, lead to a reduction of large national competitors from three (Rank, Gala and Genting) to two (Rank/Gala and Genting). **Table 1** below shows the parties' position at a national level.

Table 1 Standard (Non-High End) Casinos in the UK

	Standard casinos	Per cent of Total Casinos	Cash Drop (£m)	Per cent of Cash Drop	Admissions (000s)	Per cent of Admissions
Rank[8]	34	26 per cent	£[ ]	[20-30] per cent	[ ]	[30-40] per cent
Gala[9]	23	18 per cent	£[ ]	[10-20] per cent	[ ]	[20-30] per cent
Combined	**57**	**44 per cent**	£[ ]	**[40-50] per cent**	[ ]	**[50-60] per cent[10]**
Genting	38	29 per cent	-	-	-	-
LCI	10	8 per cent	-	-	-	-
A&S	6	5 per cent	-	-	-	-
Aspers[11]	4	3 per cent	-	-	-	-
Independents[12]	15	12 per cent	-	-	-	-
Total	130	100 per cent	£3,606	-	17,420	-

Source: Parties and Gambling Commission.

43. As illustrated in **Table 1**, Rank and Gala are currently the second and third largest casino operators in the UK. The merged entity will be the largest casino operator and will account for [50-60] per cent of casino admissions, [40-50] per cent of cash drop and 44 per cent of casino numbers, owning 57 casinos.

[8] Rank's figures excludes the high-end Clermont Club (owned by Guoco) but includes the five cold licences held by Guoco.

[9] Gala's figures exclude its casino in Dundee and cold licence in Westminster, which are not included in the Target assets.

[10] Parties' figures don't sum due to rounding.

[11] Aspers has announced that it will close one of its four casinos (Swansea).

[12] The 'Independents' figure includes the Dundee casino that Gala is not selling.

44. The only other large national operator is Genting which owns 38 casinos (and which will account for 29 per cent of casinos by number). Each of the other casino operators is significantly smaller, the largest being LCI with 10 casinos. Post-merger, the two largest operators would operate over 70 per cent of all the casinos in the UK.

45. The merger therefore combines two of the three large national operators and involves a substantial increment to Rank's share of supply at national level. The merger will remove competition between Rank and Gala and will reduce to one the number of large national competitors faced by each of Rank and Genting. Absent countervailing factors, this degree of consolidation gives rise to competition concerns.

46. Combining two of the three large national operators is of particular concern given the features of this market. To the extent that there is a loss of competition arising from the merger at national level, that loss of competition is potentially irreversible. As outlined in detail below in paragraphs 165 to 171, the casino sector is regulated and casino operators must have a licence in order to trade from premises. There are a finite number of unused casino licences and new licences that could be created by the Gambling Act 2005. This makes it difficult for entry or expansion to replace the competition lost by the merger. Furthermore, the distribution of the unused licences (with no operator other than Genting owning a large number of unused licences) would make it difficult for any operator to expand to create a new large national operator.

National effects

47. Rank submits that competition occurs only at the local level and that national consolidation does not give rise to any competition concerns aside from concerns arising in specific areas of local overlap. As outlined at paragraph 30, Rank submits that, even in respect of matters that are managed at national level, any competitive constraint will be driven by local conditions only.

48. Given the size of the industry, the scale of the concentration arising from the merger and the barriers to entry/expansion, the OFT has considered carefully whether it can exclude the prospect of the merger giving rise to a substantial lessening of competition at a national level. In this assessment the OFT is mindful that:

- no third party casino operator confirmed Rank's submission that competition is exclusively local, and

- evidence provided by the parties and third parties highlighted a number of competitive parameters which are determined at least partly at national level with limited flex at local level and, in respect of which, there may be national competitive constraints.

Gambling prices

49. Rank submits that it is not possible to flex price on the majority of its gambling revenue because the odds are intrinsic to the game. However, Rank accepts that it is possible to change the pay-out ratio on gaming machines (other than electronic roulette). Rank also told the OFT that casinos can vary poker rake (the casino's levy on stakes wagered in poker games).

50. Rank submits that these gambling prices are not subject to active competition, with pay-out ratios and poker rake rarely changing. However, mindful of its role as a first phase merger authority, the OFT considers that the fact prices change rarely does not exclude the prospect that those prices are constrained by pre-merger competition and might increase in response to a reduction in competition. Therefore, even if it is the case that prices have not regularly varied pre-merger, the OFT has considered whether a merger of two of the large national operators could result in a loss of competition in respect of these prices.

51. The OFT does not have evidence that either pay-out ratios or poker rake vary in response to local conditions. If competition were exclusively local, the OFT would expect to observe variation in response to local competitive conditions. Absent evidence of variation in response to local conditions, it is not clear that the competitive constraint on pay-out ratios and poker rake is driven only by local conditions.

Machine pay-out ratios

52. Rank and Gala both determine pay-out ratios for particular machines at national level. Rank has not submitted any evidence of pay-out ratios varying across the country in response to different competitive conditions in local areas. Indeed the parties stated that each type of machine will have the same pay-out ratio across the country.

53. Rank submits that the lack of variation in pay-out ratio is the result of (i) the fact that pay-out ratios are not an active parameter of competition (see above), and (ii) the costs of having machines re-programmed to a bespoke ratio different from one of the manufacturer settings. However, it is clear from the evidence provided that pay-out ratios can be flexed. In fact, both Rank and Gala have conducted trials to assess the commercial benefits of reducing pay-out ratios; Gala's trial is ongoing.[13] Accordingly, the OFT considers pay-out ratios could be flexed in response to competition, such that it is relevant to consider whether the merger diminishes the competitive constraints.

54. Taking the evidence in the round, the OFT believes that it is not unrealistic to expect that a decision by one large operator to reduce its nationwide pay-out ratios could influence another operator's decisions on pay-out ratios. Accordingly, the OFT considers that national competition may be an important part of the competitive constraint on pay-out ratios and that the merger of two large national operators could reduce competition in this respect and may therefore result in a reduction in pay-out ratios on a national basis.

Poker rake

55. Poker rake is another element of pricing that could be flexed by casino operators. The OFT does not have evidence of poker rake varying across the country in response to different competitive conditions in local areas. Rank submits that poker rake is generally uniform across the country. However, the reasoning outlined at paragraph 48 above applies equally here. The OFT considers that it is relevant to consider whether the merger

[13] [ ].

diminishes the competitive constraints, even if poker rake has not changed frequently in the past.

56. The OFT believes that it is not unrealistic to expect that a decision by one large operator to change its nationwide poker rake could influence another operator's decisions on poker rake. Accordingly, the OFT considers that national competition may be an important part of the competitive constraint on poker rakes and that the merger of two large national operators could reduce competition in this respect and lead to an increase in poker rake on a national basis.

Marketing

57. Rank submits that virtually all of its marketing occurs at local level and in response to local conditions. However, the evidence available to the OFT suggests that significant marketing and promotional activity occurs on a national basis.

58. Both parties operate national loyalty schemes. Such schemes, including spend on redemption of loyalty points, account for at least [0-10] per cent of Rank's total marketing budget (and could be up to [40-50] per cent) and at least [10-20] per cent of Gala's total marketing budget (and could be up to [30-40] per cent).[14] Loyalty schemes are an important element of competition between casinos, since they assist in attracting and retaining customers. The transaction documents relating to the merger also suggest that loyalty schemes are important. One of the benefits of the merger identified in a board paper was the opportunity to combine the parties' loyalty schemes.[15] In addition a major third party casino operator told the OFT that loyalty schemes and national promotions were a significant part of its strategy and were partly driven by national competition.

59. Rank submits that the key function of the schemes is to obtain customer insights and that, at national level, its scheme [ ]. However, evidence

[14] The Rank spend on redemption of loyalty points could not be separated out from certain other types of marketing spend from the information provided. Rank's total spending on its loyalty scheme could be up to [40-50] per cent of its total marketing budget. Data provided by Gala suggest that its loyalty scheme accounts for [30-40] per cent of its total marketing budget.

[15] Project Bolt Recommendation to Acquire, April 2011.

available to the OFT indicates that the actions of other casinos may influence casino operators' decisions in respect of loyalty schemes. At least one of the factors that caused Rank to introduce a loyalty scheme was the fact that competitors were rolling out schemes. A Rank internal document states that [ ].[16] Accordingly, the OFT believes it is not unrealistic to expect that casinos' loyalty scheme offering will be affected by competition from other casino operators. Furthermore, competition between casino chains may be especially important in this respect, as the parties only identified one single-site operator that offers a sophisticated swipe-card-based loyalty scheme.

60. Rank submits that, to the extent the parties' loyalty schemes respond to competition from casinos, this occurs at local level, with local managers having discretion to award additional points. However, the evidence available to the OFT indicates that competition in respect of loyalty schemes is not purely local:

- the earning and redemption rate on the parties' loyalty schemes are determined nationally. Although Rank submits that local managers have discretion to award additional loyalty points, the OFT does not have evidence on significance of locally-awarded points or the extent to which the frequency and quantum of local points awards varies in response to local competition, and

- the schemes are used to implement national as well as local promotions. For example, Rank's 'Aim for Triple' and 'Aim Higher' promotions offered extra loyalty points to customers visiting casinos in any area. Such nationwide promotions are not obviously responsive only to local competition.

61. In addition to loyalty schemes, around [0-10] per cent of Rank's marketing budget is spent on centralised marketing activity and the equivalent figure for Gala is [10-30] per cent over the past three years. Rank submits that some of this spending relates to [ ]. However, the parties have both engaged in bricks and mortar national marketing activities in recent years, including Rank's national poker tournament and Gala's national progressive

[16] Grosvenor Loyalty Scheme Roll-out Phase 1, June 2008.

blackjack game. It is not clear that these nationwide promotions are driven by local market conditions.

62. Accordingly, the OFT considers that national competition may be an important driver of marketing activity and that the merger of two large national operators could reduce competition in this respect and may therefore result in, for example, less generous loyalty schemes on national basis.

Range of electronic games

63. The range of electronic games available on particular machines is determined at national level, based on national procurement decisions.[17]

64. Rank submits that the range of electronic games is not driven by competition. Rank submits that it [ ], such that technology and regulation (not competition) are the relevant constraints on range of games.

65. However, a major third party operator told the OFT that its decisions on procuring and updating electronic games are partly driven by national competition. Furthermore, absent evidence of variation in response to local conditions, it is not clear that the competitive constraint on range of games is driven only by local conditions.

66. The OFT believes that it is not unrealistic to expect that national level decision-making on whether and when to invest in a new range of machine games could be influenced by whether or not other large operators have decided to invest in new games. Accordingly, the OFT considers that national competition may be an important part of the competitive constraint on range of games and that the merger of two of the three large national operators could reduce competition in this respect and may therefore result in a poorer range of electronic games on a national basis.

[17] Rank submits that the mix of gaming machines can be varied locally. However, the OFT does not have evidence on the extent of the local variation in the mix of machines.

Betting limits

67. Rank submits that its betting limits are set [ ]. Rank submits that there is no national competition constraining betting limits and that it has no incentive to reduce betting limits.

68. However, given that Rank and least one other major casino operator determine betting limits at national level (with some local variation), the OFT believes it is not unrealistic to expect that a national decision by one large operator to change its betting limits could influence another operator's decisions on betting limits. Therefore, the OFT considers that there may be a national dimension to competition on betting limits.

69. Third party evidence suggests that large chains may be able to offer high limits as a result of holding broader estates which help diversify risk. Accordingly, the merger is likely to remove one of the competitors best-placed to offer high betting limits. It is not unrealistic to expect that casinos might respond at national level to such an important change in the competitive landscape and that the merger may therefore result in less favourable betting limits.[18]

Brand/customer experience

70. Rank submits that brand is not an important parameter of competition in the casino sector. It has provided evidence that [ ]. However, other evidence indicates that brand may be important, not only in the narrow sense of the brand names and logo but in the wider sense of the development of the overall casino customer experience. For example:

- a major third party casino operator told the OFT that branding is a significant element of its competitive strategy, and

[18] It might be argued that the merged entity would be able to offer higher betting limits because the merger would broaden its estate and further diversify risk. However, it is not clear that there would be sufficient competition post-merger to ensure that the merged entity would have the incentive to use its diversified portfolio to offer high betting limits to customers.

- a document prepared for the Rank board states that the strength of Rank's brands will be important in driving improved performance from the Gala business.[19]

71. The evidence available to the OFT also indicates that decisions on brand positioning and customer experience are driven not only by local competitive conditions but also by national initiatives. For example:

    - Gala's recent strategy of positioning itself to attract higher-spending customers was initiated and implemented nationally and does not appear to be driven by local conditions, and

    - Rank attributes much of its recent growth to the successful development of its GCasino format. The development of GCasino was the result of a national initiative and it has been rolled out in a large number of areas. Rank submits that the GCasino innovation was not driven by competition but by its broader business strategy since it is primarily seeking to attract [ ]. Nonetheless, the OFT considers that GCasino represents an example of the importance of national strategy in improving and developing casino premises and customer experience.

72. In these circumstances, the OFT believes that it is not unrealistic to expect that a national decision by one casino operator to develop its brand positioning or customer experience, for example by improving its casinos premises would influence the national investment decisions of another operator. Therefore, the OFT considers that there may be a national dimension to competition between casinos to develop their brand and improve their customer experience and that the merger could reduce innovation and investment in developing casino brands and the customer experience.

[19] Board Discussion Materials, 8 March 2012.

Other parameters

73. There are other parameters of competition such as food and beverage offering and service levels that are at least partly determined at national level. However, in light of its findings on the above parameters of competition, in particular gambling pricing and marketing, the OFT has not found it necessary to conclude on specific impact of the merger on competition in respect of these other parameters.

2005 Act licences

74. The OFT also considered whether the merger could result in a loss of competition in bidding for new 2005 Act licences, such that new licences were less likely to be issued or the casinos developed would be of poorer quality than would otherwise be the case. However, the parties have only made a small number of bids for 2005 Act licences (each of Rank and Gala has only made one full (stage two) bid for a 2005 Act licence). Furthermore, each bidding process has included several third party bidders. Therefore, the OFT does not consider that the merger would substantially reduce competition for 2005 Act licences.

Countervailing factors

75. The OFT has considered whether third party competitive responses at a national or local level would be sufficient to prevent a deterioration of the competitive offering at a national level.

76. Genting is the only operator comparable in size to Rank and Gala. The OFT is not confident that the presence of only one other large national operator would be sufficient to prevent a substantial lessening of competition.

77. Furthermore, the evidence available to the OFT is insufficient to demonstrate that competition from smaller operators could replicate the constraint imposed on large national operators by the actions of other large operators. Even the largest the casino operator aside from Rank, Gala and Genting would compete against the merged entity in a smaller number of areas than the merging parties currently compete against each other.

78. While the casinos belonging to smaller operators (or individual independent casinos) are likely to act as constraints in a specific locality on some

parameters of competition, the OFT is not confident that such smaller operators, individually or collectively, would be able to constrain the merged entity across its estate. As outlined above, several parameters of competition may be determined wholly or partly at national level and the national decisions of large national casino operators may be influenced in particular by the actions of the other large operators against whom they compete most extensively. Therefore, it is not clear to the OFT that the actions of smaller operators (individually or collectively) on parameters such as machine pay-out ratios, loyalty scheme points, range of electronic games would constrain the merged entity to the same extent and in the same manner as the actions of Gala as a large national operator. Furthermore, the barriers to entry and expansion in the casino sector make it unlikely that any of the smaller operators could expand sufficiently to mitigate the loss of competition arising from the combination of two of three large national operators (see further paragraphs 165 to 171).

79. Therefore, the OFT cannot conclude that competitive responses from other operators at national or local level would be sufficient to replace effectively the loss of competition at national level that may arise from the merger.

Conclusion on national competition

80. The OFT considers that the degree of national consolidation arising from the combining two of the three large national operators could be expected to have a major impact on the structure of the casino sector and lead to a substantial loss of competition. Given the barriers to entry and expansion, this impact is potentially irreversible. Accordingly, the OFT believes that the merger give rises to a realistic prospect of a substantial lessening of competition at a national level.

Unilateral effects in the supply of casino services in local areas (operational casinos)

81. As outlined at paragraph 34 above, the OFT considers that, as well as competition at a national level, there is also a significant degree of local competition, with evidence that casinos, **inter alia,** flex promotional activity, service standards and premises quality based on competitor activity in the local area. Accordingly, the OFT believes that a substantial lessening of competition in a local area could result in a deterioration in several aspects of casinos' competitive offering, in addition to the reduction in competition at national level discussed above.

Analytical approach

82. As outlined above, Rank provided the OFT with overlap information using 30-, 45- and 60-minute catchment areas based on isochrones centred on each of the parties' casinos and third party casinos. The OFT's first step was to verify that this overlap analysis did not incorrectly exclude a relevant competitive interaction between the parties' casinos that are not within a 60-minute drive-time of each other (for example, because of a population centre on the edge of the isochrones that is served by both parties). This exercise did not identify any additional material competitive overlaps between the parties' casinos.

83. Rank also provided the OFT with information on the fascia reduction (that is, the reduction in the number of bricks and mortar casino operators in a local area) as a result of the merger within 30, 45 and 60 minute drive time catchment areas. Rank submitted that, **a priori,** there could be no realistic proposition of a substantial lessening of competition in an area where there would remain at least three casino operators ('4:3 or more').

84. While a useful starting point for the OFT's analysis, a simple fascia reduction count risks excluding factors relevant to closeness of competition. The OFT therefore has assessed competitive conditions in all areas of overlap in detail. The OFT has considered a variety of evidence in its assessment, including:

- survey evidence (discussed further below)
- the parties' internal documents

- third party comments
- customer distribution data and drive time analysis
- data based on natural events, such as a refurbishment or opening, which might indicate the level of diversion between casinos
- the relative geographic positioning of the casinos in the area, and
- evidence on the level of product differentiation between the parties' casinos.

85. When assessing the competition between the parties' casinos and, in particular, when interpreting evidence on likely diversion between the parties, the OFT has also had regard to the parties' variable profit margins. As outlined in the OFT/CC Merger Assessment Guidelines,[20] high variable profit margins make unilateral effects more likely because the value of sales recaptured by the merged entity will be greater. In this case the parties' gross margins are high (often around [70-80] per cent). Even taking account of additional costs which the parties submit should be treated as variable, the data available to the OFT indicate that variable profit margins of parties' casinos are generally between [30-40] and [40-50] per cent. The OFT is mindful that, in light of these margins, even relatively low levels of diversion could be sufficient to give rise to competition concerns.

Survey evidence

86. Rank submitted customer survey evidence based on a telephone survey of customers of the parties' casinos in a number of areas. As part of the survey, customers were asked what they would have done in response to the relevant casino being closed for refurbishment (the 'diversion question'). Rank submits that the results of the survey and, in particular, responses to the diversion question indicate likely levels of diversion between the parties' casinos in the relevant local areas.

87. The OFT considers that there is a risk that the survey results presented by Rank may under-estimate the likely level of diversion between the parties' casinos:

- First, it is not clear that the diversion ratios presented by Rank adequately take account of the relative value of different customers.

[20] OFT/CC Merger Assessment Guidelines, paragraph 5.4.9.

Rank weighted the survey responses by the frequency of casino visits by each customer but did not revenue-weight the responses to take account of differences in spend per visit. Rank submits that frequency of visit is a reliable proxy for the amount spent by customers. However, the OFT considers that frequency weighting may not be a reliable proxy for overall customer value given that, for example, a small number of high-rollers account for a significant proportion of the revenue at many of the parties' casinos. Furthermore, the OFT's analysis of the survey data indicated that high spending customers were [ ]. Therefore, in addition to considering the frequency-weighted diversion ratios presented by Rank, the OFT has had regard to diversion ratios that were also weighted by spend per visit. The spend weightings used were based on data from the parties' loyalty schemes on the level of spend associated with customers making the relevant number of visits per year.[21]

- Second, the OFT considers that Rank's inclusion of responses to the diversion question recorded by the interviewers as 'gone home' (which account for about [40-50] per cent of the sample once 'don't know' and other ambiguous responses are removed)[22] in the diversion ratio denominator may underestimate the true value of diversion between the parties. Rank submitted that these responses should be treated as genuine diversions away from the parties (rather than a short term response) since the responses were provided in response to question that posited the relevant casino would be closed for six months. However, it is not clear to the OFT that responses captured under this option necessarily indicate that the customer would have diverted away from both parties' casinos. In particular, given the nature of the response, for some respondents 'gone home' may simply be a short-term response to a casino closure and thus may not be a good surrogate

[21] Except where otherwise stated, this decision cites the frequency and spend-weighted diversion ratios calculated by the OFT. The difference between the Rank diversion ratios and those calculated by the OFT were not determinative of the outcome of the assessment in any area. The survey results are just one of a number of pieces of evidence that the OFT has evaluated in respect of each area. Even if the OFT proceeded on the basis of the diversion ratios as presented by Rank, this would not alter the OFT's assessment of any area, having taken account of all the relevant evidence.

[22] Based on spend and frequency weighted data.

for a longer term diversion. The OFT is mindful of this issue when considering how much value to ascribe to the survey results relative to the other evidence available. In particular, the OFT has had somewhat more regard to the relative levels of diversion between different casinos than the absolute levels of diversion, which may be biased downwards by the inclusion of 'gone home' responses.

Local area assessment

88. Based on the evidence available, the OFT excluded any realistic prospect of a substantial lessening of competition (beyond the national concerns outlined above) in respect of thirteen overlaps where there was either limited competitive interaction between the parties' casinos or where it was clear that the parties would face sufficient third party competition post-merger. The relevant overlaps are:

- Rank Luton/Gala Northampton
- Rank Coventry Gala Northampton
- Rank Coventry/Gala Leicester
- Rank Coventry/Gala Nottingham
- Rank Central Manchester and Rank Salford/Gala Stockport[23]
- Rank Sheffield/Gala Leeds
- Rank Birmingham/Gala Birmingham
- Rank Stoke/Gala Stockport
- Rank Walsall/Gala Birmingham
- Rank Newcastle/Gala Sunderland
- Rank Swansea/Gala Cardiff
- Rank Huddersfield/Gala Leeds, and
- Gala Bradford/Rank Leeds.

89. Eight additional overlap areas were subject to additional scrutiny and are discussed in more detail below. In seven of these areas there was substantial evidence that the merger would give rise to competition concerns in these areas and the OFT was unable to exclude the prospect of a substantial lessening of competition. In one further area, London, the OFT

[23] While this overlap did not in itself give rise to concerns, it is considered as part of the context to the overlap between Rank Didsbury and Gala Stockport.

did not reach conclusion on whether the merger gave rise to competition concerns.

Stockton-on-Tees

90. Rank Stockton overlaps with Gala Teeside. The merger would result in a reduction in competing facia from two to one on 30-minute isochrones around both parties' casinos (which capture more than 80 per cent of the visits to both casinos).[24]

91. Rank submits that the merger would not give rise to competition concerns in the area. It submits that the parties' casinos are differentiated (with Rank focusing on leisure customers and Gala focusing on transactional gamblers) and that new entry can be expected in the area following the recent award of a 2005 Act licence in Middlesbrough.

92. However, the OFT received evidence indicating that there is strong competition between the parties' casinos. Internal documents indicate that Gala viewed the opening of the Rank casino in September 2011 as a major competitive threat and refurbished its casino partly in response to that threat.

93. There would be no third party competitors in the area following the merger. The award of a new licence in Middlesbrough does not address the competition concerns. First, the OFT does not have evidence on when a new casino will be operational. Second, even once a new casino is operational, there would only be two competitors in the area (such that the merger would have resulted in a reduction from three to two fascia). The OFT is therefore unable to conclude that entry would be sufficient or timely to address the competition concerns.[25]

94. Accordingly, the OFT has concluded that the merger gives rise to competition concerns in respect of the Stockton area.

[24] Survey evidence was not provided in respect of Stockton-on-Tees.

[25] OFT/CC Merger Assessment Guidelines, paragraph 5.8.3.

Aberdeen

95. Rank and Gala both operate casinos in Aberdeen. The merger would result in a reduction in competing fascia from three to two on 60-minute isochrones around both parties' casinos (which would account for almost 80 per cent of visits to Rank and more than 80 per of visits to Gala). The other casino in Aberdeen is Soul (which is an independent operator).[26]

96. Rank submits that the merger would not give rise to competition concerns. It submits that the parties' casinos are differentiated (with Rank focusing on leisure customers and Gala focusing on transactional gamblers). However, the OFT received evidence indicating that there is strong competition between the parties' casinos:

- following the opening of the Rank casino in November 2008 admissions and cash drop at Gala [ ] in comparison to the previous twelve-month period, and

- internal documents indicate that Gala [ ].

97. There would be only one competitor in the area post-merger. The OFT is also mindful of the fact that the only remaining competitor would be an independent operator. A Gala internal document in respect of Aberdeen suggests that independents may [ ] on some parameters of competition.[27]

98. Accordingly, the OFT has concluded that the merger gives rise to competition concerns in respect of the Aberdeen area.

[26] Survey evidence was not provided in respect of Aberdeen.

[27] [ ].

Bristol

99. Rank and Gala both operate casinos in Bristol. The merger would result in a reduction in competing fascia from three to two on 60-minute isochrones around both parties' casinos (which would account for just over 80 per of visits to Rank and Gala). The other casino in the catchment area is a Genting. The parties' casinos are located very close to one another whereas the Genting is situated just under half a mile away. Cardiff is situated just outside the 60-minute isochrone and includes another third party competitor (Les Croupiers).

100. Rank submits that the merger would not give rise to competition concerns in the area. It submits that the parties' casinos are differentiated (with Rank focusing on leisure customers and Gala focusing on transactional gamblers) and that new entry might occur in the area once Bath City Council awards a 2005 Act licence or from the activation of a cold licence in Bristol. It also submits that [ ] presents a competitive constraint in respect of those customers living between Bristol and Cardiff.

101. However, the OFT received evidence indicating that there is strong competition between the parties' casinos:

- the customer survey suggests that the parties are closest competitors. The survey produced diversions ratios from Rank to Gala of [ ] per cent and from Gala to Rank of [ ] per cent. In comparison, diversions from the parties to Genting and Les Croupier were substantially lower than [ ] per cent in all cases, and

- the parties' internal documents suggest that [ ].

102. There will only be one competitor, Genting, in the area post-merger, with Les Croupiers situated significantly further way in Cardiff. Third party evidence suggests that Genting and Les Croupiers are relatively weak competitors. Third party evidence indicates that the Genting is considerably smaller than the parties' casinos (the parties would account for over [ ] per cent of admissions in Bristol), has shorter opening hours and is situated further away. Third party evidence also suggests that few customers of Bristol casinos are willing to travel to Cardiff.

103. The possible award of a new licence in Bath does not address the competition concerns. First, the OFT does not have evidence on when a new casino would be operational. Second, even once a new casino is operational, given that the Bath casino would be around 30 minutes away from the Bristol casinos, it is not clear to the OFT that it would impose a strong constraint on the merged entity in Bristol.

104. Similarly, the existence of a cold licence in Bristol does not address the competition concerns as the owner of the licence did not indicate any intention to develop an operational casino.

105. Accordingly, the OFT has concluded that the merger gives rise to competition concerns in respect of the Bristol area.

Cardiff

106. Rank and Gala both operate casinos in Cardiff. The merger would result in a reduction in competing fascia from three to two on 45-minute isochrones around both parties' casinos (which would account for almost 80 per cent of visits to both parties' casinos). The other casino in the catchment area is Les Croupiers (which is an independent operator).

107. Rank submits that the merger would not give rise to competition concerns. It submits that data on the effect of the refurbishment of Rank and the relocation of Les Croupiers indicate that Les Croupiers imposes a strong competitive constraint on both parties. However, the OFT placed limited evidential weight on this data:

- Rank submits that the refurbishment of Rank [ ]. However, the refurbishment did not [ ] (and therefore the refurbishment may not be a sufficiently significant event to provide a good indication of likely diversion), and

- Rank submits that the relocation of Les Croupiers [ ]. However, the [ ] compared to the level of unexplained variability in the data, making it difficult to infer that [ ].

108. The OFT also received evidence indicating that there is strong competition between the parties' casinos:

- the customer survey suggests that the parties are closest competitors. Diversion ratios from Rank to Gala were [ ] per cent, as were diversions ratios from Gala to Rank. In comparison, diversions from Rank and Gala to Les Croupier were much lower, each at [ ] per cent, and

- Gala's internal documents suggest that [ ].

109. There would only be one competitor, Les Croupiers, in the area post-merger. There is some evidence to suggest that the constraint from Les Croupiers may be limited in some respects:

- a Rank internal document [ ], and[28]

- third party evidence suggests that Les Croupiers is a relatively weak constraint on the parties' casinos. In particular, third party evidence indicated that Les Croupier is located relatively far away from the parties' casinos, is focused on high-stakes transactional gamblers and was less likely to attract the parties' leisure-oriented customers.

110. The OFT is also mindful of the fact that the only remaining competitor in Cardiff would be an independent operator. Indeed, a Rank internal document suggests that, [ ].[29]

111. Accordingly, the OFT has concluded that the merger gives rise to competition concerns in respect of the Cardiff area.

Stockport/Didsbury

112. Rank Didsbury overlaps with Gala Stockport. The merger would result in a reduction in competing fascia from three to two on a 20-minute isochrone around the Gala casino (which would account for 80 per cent of visits to Gala). The other casino in the catchment area is Casino 36, which is located in Stockport close to Gala. Rank has a broader catchment area,

[28] Bolt Due Diligence summary.

[29] Rank Cardiff capex plan.

such that an 80 per cent catchment around Rank would include two additional fascia located in central Manchester.

113. Rank submits that the merger does not give rise to competition concerns. It submits that the parties' casinos are differentiated (with Rank focusing on leisure customers and Gala focusing on transactional gamblers). It submits that Rank in particular is strongly constrained by [ ] and that Gala is strongly constrained by [ ] and that this is supported by the customer survey.

114. Rank submitted data showing that customer visits at Rank's G Casino in central Manchester [ ] following Rank Didsbury's opening, compared with the same period the previous year. However, the parties' calculations also suggested that the opening of Rank Didsbury accounted for [ ].

115. The OFT received evidence indicating that there is strong competition between the parties' casinos:

- a Rank internal document suggest that its casino would compete strongly with [ ]. Gala's internal documents suggest that [ ], including improved customer service and promotions

- the customer survey suggests that Gala is the closest competitor to Rank. The diversion ratio from Rank to Gala was [ ] per cent, with the next closest competitor being LCI on [ ] per cent. The survey suggested that [ ] was the closest competitor to Gala, with Rank second closest, and[30]

- following the opening of Rank, Gala admissions [ ], in comparison to the same four periods in the previous year. This might indicate that Rank is a substantial constraint on Gala, albeit the OFT recognises the fall in drop was significantly smaller than the fall in admissions.

116. Casino 36 is the only third party casino within the catchment area. The parties' internal documents suggest that Casino 36 is a [ ]. The central Manchester casinos lie just outside the catchment area but it is not clear to

[30] These diversions ratios are based on customer visits.

the OFT that these casinos would impose a strong constraint on the merged entity. A Rank internal document suggested that [ ].[31]

117. Accordingly, the OFT has concluded that the merger gives rise to competition concerns in respect of the Stockport/Didsbury area.

Liverpool/New Brighton

118. Rank's New Brighton casino on the Wirral peninsula overlaps with Gala in Liverpool city centre. The merger would result in a reduction in competing fascia from three to two on a 60-minute isochrone around the Rank casino (which would account for more than 80 per cent of visits to Rank). The other fascia in the catchment area is Genting, which owns one casino on the Wirral and two in Liverpool city centre.

119. Rank submits that the merger does not give rise to competition concerns. It submits that the parties are each subject to strong competitive constraints from Genting, that the parties' casinos draw most of their customers from different areas and that the customer survey supports the view that the parties are not close competitors. Rank also submits that new entry is possible in Liverpool as there are two cold licences owned by third parties.

120. The customer survey produced a diversion ratio from Rank to Gala of [ ] per cent, suggesting Gala is the closest competitor to Rank (the diversion ratio to Genting Birkenhead, the next closest, was estimated to be [ ] per cent); and from Gala to Rank of [ ] per cent. The OFT considers that diversion from Gala to Rank in this area may have been depressed by the fact that Rank only opened its New Brighton casino in May 2012. It is therefore possible that a proportion of customers may be unaware (or not be able to recall on the spot when being interviewed) that Rank had opened a casino. Even if they were aware and able to recall there may be a bias towards selecting one of the other, more familiar casinos. Accordingly, this diversion ratio may be a less reliable proxy for the competitive constraint that Rank New Brighton will exert in the medium term as it becomes more established.

[31] Rank capex plan Didsbury.

121. Futhermore, the OFT has also received non-survey evidence suggesting that the parties' may compete strongly. When Rank announced the opening of its casino, Gala prepared a [ ].[32] The document also detailed a number of competitive responses (though Gala submits that most of the responses were planned prior to the announcement of Rank opening). Rank's internal documents suggest competition [ ] (including Gala) is viewed as a key competitive threat.

122. Genting would be the only competitor in the area post-merger. Furthermore, [ ] and third party evidence suggest that the Genting on the Wirral is a relatively weak constraint on Rank, in particular given its small size and focus on traditional, transactional gamblers. The existence of two cold licences owned by third parties does not address the competition concerns as the OFT has not received evidence that the owners of these cold licence intend to develop casinos in the foreseeable future.

123. Accordingly, the OFT has concluded that the merger gives rise to competition concerns in respect of the Liverpool/New Brighton area.

Leeds

124. Rank and Gala both operate casinos in Leeds. The merger would result in a reduction in competing fascia from four to three on a 30-minute isochrone around Rank (which would account for more than 80 per cent of visits to Rank). The other casinos in the catchment area are Alea (owned by LCI) and Napoleons (owned by A&S).

125. Rank submits that the merger does not give rise to competition concerns. It submits that the parties' casinos are differentiated (with Rank focusing on leisure customers and Gala focusing on transactional gamblers) and that this is supported by data showing that the refurbishment of Rank [ ].[33] It submits that the parties are strongly constrained by [ ] and that this is supported by the customer survey. It also submits that new entry might occur in the area once Leeds City Council awards a 2005 Act licence.

[32] [ ].

[33] Rank submits that, in the four months following the refurbishment, [ ] compared to the previous four months, but were not impacted at Gala. However, compared with the four months in the preceding year, [ ]. This suggests it may be a poor candidate for a natural experiment.

126. However, the OFT has also received evidence suggesting that the parties' compete strongly. In particular, the parties' customer survey suggests that Gala is by far Rank's closest competitor, with a diversion ratio of [ ] per cent. In comparison, diversion to LCI was only [ ] per cent and to Napoleons was only [ ] per cent. The survey suggested that Napoleons was the closest competitor to Gala, with Rank second closest, with a diversion ratio from Gala to Rank of [ ] per cent.

127. There would only be two competitors in the area post-merger. The possible award of a new licence in Leeds does not address the competition concerns as the OFT does not have evidence on when any new casino would be operational.

128. Accordingly, the OFT has concluded that the merger gives rise to competition concerns in respect of the Leeds area.

London

129. Using drive-time based catchment areas the merger would result in a reduction in competing fascia from seven to six in London. However, as outlined below, the OFT considers that drive-time based catchment areas are likely to be less probative of the extent of geographic competition in the casino sector in London than in other areas. The parties each own four standard (non-high-end) casinos in London. The third party operators in London are Genting (which owns four casinos), LCI (which owns four casinos) and Aspers, A&S and Hippodrome (which each own one casino).

130. Rank submits that the merger does not give rise to competition concerns. It submits the parties' casinos are not particularly close competitors and that the presence of five competitor fascia would be sufficient to constrain the merged entity.

131. The OFT places less weight on drive-time based catchment areas as a proxy for the extent of geographic competition in the casino sector in London than in the other areas considered above. In particular, population distribution and the prevalence of public transport may mean that drive times are less indicative of customer's travel habits. For example, some third party evidence suggested that while customers may travel a relatively long distances into London from suburbs, many will be unwilling to travel

far once they arrive in central London. This suggests that geographic proximity may mean that particular casinos, or groups of casinos, within London are particularly close competitors.

132. The OFT notes that there may be a greater degree of product differentiation between casinos within London than in other areas (even once the six high-end casinos are excluded). For example, average cash drop per visit at the parties' London casinos varies between £[ ] and £[ ], and the parties' internal documents suggest a high level of product differentiation based on quality and casino ambience.

133. The OFT considers that some of the parties' casinos may be particularly close competitors and may face limited third party competition due to geographic and/or product differentiation described above. However, it is not necessary for the OFT to reach a conclusion on whether the merger gives rise to a substantial lessening of competition in London given its conclusion in respect of the loss of competition at a national level.

Conclusion

134. In light of the above considerations, the OFT believes that there is a realistic prospect that the merger would result in a substantial lessening of competition in the supply of casino services in the following areas:

- Stockton-on-Tees
- Aberdeen
- Bristol
- Cardiff
- Stockport/Didsbury
- Liverpool/New Brighton, and
- Leeds.

Unilateral effects in the supply of casino services in local areas (non-development of cold licences)

Introduction

135. In addition to considering the loss of existing competition between Rank and Gala, the OFT has considered whether the merger will prevent competition that might have emerged absent the merger.

136. A casino operator can only expand its operations by winning a new 2005 Act licence or if it owns a 1968 Act cold licence (and that licence is not currently being employed for an operational casino). Competition for 2005 Act licences is considered at paragraph 72 above. This section considers whether the merger could result in a substantial lessening of competition by preventing the addition of a new fascia that might have emerged absent the merger. In particular, the OFT has considered whether the loss of an additional fascia (vis-a-vis the counterfactual) could occur as a result of the merger causing the parties not to develop cold licences into operational casinos.[34]

OFT's concerns

137. A pre-merger Rank internal document states that Rank intends [ ].[35] Rank submitted that the merger would not [ ]. Gala submits that it has [ ]. The OFT has considered whether the merger would change the parties' incentives to develop cold licences so as to reduce the prospects of Rank opening new casinos (or further reduce the prospects of Gala opening new casinos).

138. The OFT considers that the merger is most likely to reduce the parties' incentives to develop cold licences in areas where any new casino might compete with an existing casino currently owned by the other party, such

[34] The OFT notes that, although this theory of harm has been framed in terms of the non-opening of a casino using the cold licence, the loss of competition would also occur (as compared to the counterfactual) in the event that Rank did proceed to open a casino given that the effect of the merger would be to remove competition between the existing casino and a new casino.

[35] Grosvenor Casinos 2011 Strategic Plan.

that the new casino would cannibalise the business of the existing casino. Rank's internal documents [ ].[36]

139. The OFT analysed the location of the parties' cold licences to identify areas where a cold licence could be used to develop a casino within the 80 per cent catchment area of an existing casino owned by the other party. The OFT identified several areas where (i) a cold licence owned by Rank (or Guoco) could be used to develop a casino that might compete with a Gala casino, or (ii) a cold licence owned by Gala could be used to develop a casino that might compete with a Rank casino.

140. In principle, the non-development of a cold licence may be expected to result in a lessening of competition (in comparison to the counterfactual) in any area where a new casino would substantially increase competition. The OFT considers that the reduction in competition materialises in local situations where the development of the cold licence would have introduced a new fascia in an area that currently has a limited number of competitors.

Edinburgh

141. There are currently two casino operators in Edinburgh, Genting and Gala. Genting operates three casinos in and around the city centre while the Gala casino is outside the city centre. Rank owns a cold licence in Edinburgh.

142. Rank submits that the prospect of it opening a casino in Edinburgh absent the merger is too remote to be included in the relevant counterfactual given the need, **inter alia**, to secure a site and to obtain any necessary planning permission. Rank submits that the OFT should therefore discount the prospect of a substantial lessening of competition.

143. However, the OFT considers that it is realistic to expect that Rank would, absent the merger, have opened a casino in Edinburgh in the foreseeable

[36] Rank capex plan June 2010 relating to opening Rank Didsbury and Rank capex plan April 2010 relating to opening Rank Stockton-on-Tees.

future. The OFT notes that Rank [ ].[37] Rank submitted another document assessing [ ].[38]

144. The OFT considers that owning the Gala casino could alter Rank's decision on whether to develop its cold licence. In particular, a new Rank casino could compete with the Gala casino (which would post-merger be owned by Rank). A Rank internal document suggests that the Gala casino is within [ ]. While the Gala casino is situated outside the city centre, the OFT has been unable to conclude that this would mean a new Rank casino would not compete with the Gala. First, a Rank internal document states that the [ ]. Second, the same Rank internal document states that [ ]. This might further increase the risk that a new Rank would compete with the Gala.[39]

145. Rank not developing its Edinburgh cold licence as result of the merger could result in a substantial lessening of competition in comparison to the counterfactual. As outlined above, there are currently only two fascia in Edinburgh and the addition of a third competitor may be expected to substantially increase competition in the area. Therefore, the merger could substantially reduce the competition that would have existed in the absence of the merger.

146. The OFT acknowledges that it was not certain that Rank would open a casino. It also accepts that the site of any Rank casino in Edinburgh had not been identified, and that the location of the casino would have impacted upon the precise extent to which it would have constrained the existing Gala casino (and vice versa). However, the OFT considers that, taking account of the evidence available in the round it is realistic, it considers that the prospect of a casino being opened by Rank which would substantially increase competition in the Edinburgh area is, in the round, realistic. Therefore, the OFT has found that it may be the case that the merger gives rise to a substantial lessening of competition in Edinburgh.

[37] Rank 2010 Strategic Plan.

[38] Rank commercial team assessment of Edinburgh.

[39] Rank commercial team assessment of Edinburgh.

Bradford

147. There are currently two casinos in Bradford, one operated by Gala and another operated by A&S (Napoleons). Guoco (which controls Rank) owns a cold licence in Bradford. Rank submits that competition in Bradford is 'relatively local' and that casinos in Leeds and Huddersfield impose little competitive constraint on the Bradford casinos. This is consistent with the catchment area data for Gala Bradford, which indicates that it derives 80 per cent of customer visits from within a [ ] minute drive time isochrone.

148. Rank submits that the prospect of the Guoco cold licence being developed absent the merger is too remote to be included in the relevant counterfactual. However, the OFT has not been provided with evidence on Guoco's plans for its cold licence in Bradford. Consistent with the cautious approach required of a phase one merger authority and absent evidence to the contrary, the OFT has been unable to conclude that Guoco would not use its cold licence to develop a casino in Bradford.

149. The OFT considers that indirectly owning 74 per cent of the Gala casino (via its shareholding in Rank) could alter Guoco's decision on whether to develop its cold licence. Absent the merger, if Guoco opened a new casino in Bradford this would be likely to have only a limited impact on the closest Rank casinos (in Huddersfield and Leeds). As outlined above, Rank has submitted that there is little competitive interaction between Bradford and either Huddersfield or Leeds. In contrast, post-merger, if Guoco opened a casino in Bradford it could be expected to compete with the Gala casino (which post-merger would be owned by Rank). In particular, since the Bradford market appears to be relatively self-contained, a substantial proportion of the customers attracted to a new casino would be expected to be drawn from Gala as one of the two existing Bradford casinos.

150. Guoco not developing its Bradford cold licence could result in a substantial lessening of competition in comparison to the counterfactual. As outlined above, there are currently only two fascia in Bradford and the addition of a third competitor could be expected to significantly increase competition in the area. Therefore, the merger could substantially reduce the competition that would have existed in the absence of the merger.

151. As with Edinburgh, the OFT acknowledges that it was not certain that Guoco would open a casino. It also accepts that the site of any Guoco

casino in Bradford [ ], and that the location of the casino would have impacted upon the precise extent to which it would have constrained the existing Gala casino (and vice versa). However, the OFT considers that, taking account of the evidence available, it considers that the prospect of a casino being opened by Guoco which would substantially increase competition in the Bradford area is, in the round, realistic. Therefore, the OFT has found that it may be the case that the merger gives rise to a substantial lessening of competition in Bradford.

Conclusion

152. In light of the above considerations, the OFT believes that there is a realistic prospect that the merger results in a substantial lessening of competition in the supply of casino services in Edinburgh and Bradford. The OFT has not reached a conclusion on whether changing incentives in respect of the parties' cold licences could rise to competition concerns in other areas.

Coordinated effects in the supply of casino services

Introduction

153. Post-merger, there would be only two large national casino operators remaining in the UK, Rank and Genting. Together Rank and Genting would own over 70 per cent of operational casinos and cold licences in the UK.

154. As outlined in the OFT/CC Merger Assessment Guidelines, post-merger coordination can arise where (i) firms are able to reach and monitor terms of coordination, (ii) coordination is internally sustainability and (iii) coordination is externally sustainable.[40]

155. The OFT has not received evidence of pre-merger coordination, but has considered whether the merger will alter the market structure or competitive conditions so as to increase the risk of coordination in the casino sector.

[40] OFT/CC Merger Assessment Guidelines, paragraph 5.5.9.

156. Rank submits that there is no evidence to indicate that the merger might increase the risk of coordination and that no coordination could occur at national level because casino operators do not compete nationally. However, as outlined above, the OFT has found that there may be a significant national dimension to competition.

Ability to reach and monitor terms of coordination

157. The OFT considers that there are several parameters of competition where casino operators' positions are visible to competitors and could form the focal point for coordination. For example, machine pay-out ratios are visible to competitors because regulation requires that they are published in casinos. Decisions to develop cold licences also become visible to competitors when the decision to open a new casino is announced. In principle, Rank and Genting could benefit from each reducing machine pay-out ratios or from coordinating not to use cold licences to develop casinos that would compete with the other's casinos.

158. Rank submits that neither machine pay-out ratios nor developing cold licences could form a focal point for coordination. It submits that coordination on these parameters would run counter to Rank's existing strategy: Rank's experience is that [ ]. However, if coordination is possible, there is a prospect that the merger could prompt Rank to alter its pre-merger business strategies.

159. The merger may increase the risk that it would be possible to reach terms of coordination. For example, by reducing the number of large firms in the casino sector from three to two, the merger would make it easier for Rank and Genting to reach an understanding at national level.[41]

[41] OFT/CC Merger Assessment Guidelines, paragraph 5.5.11.

Internal sustainability

160. The OFT has not reached a conclusion on whether there would be sufficient symmetry between Rank and Genting for coordination to be internally sustainable. However, there is substantial overlap between Rank and Genting at national level (see above) and the OFT estimates that of Genting's 38 casinos, at least 23 would overlap with the merged entity in a local area and, of those, 17 may not face any third party competition. Given the extent of the overlaps between Rank and Genting, the OFT considers that coordination would materially reduce the competitive constraints on Rank and Genting, such that they may both have an incentive to sustain coordination.

161. The OFT also considers that Rank and Genting may have swift and relatively low-cost punishment mechanisms available to deter cheating. For example:

- if Rank announced plans to develop a cold licence, Genting could respond by announcing plans to develop one of its own cold licences near one of Genting's casinos. This counter-announcement would not be costly but could have a significant deterrent effect. Furthermore, by concentrating the majority of cold licences in two firms, the merger could increase the prospect of an effective deterrent being available or

- if Rank increased machine pay-out ratios, Genting could respond by increasing the pay-out ratios on its machines. Since pay-out ratios can be altered relatively quickly and the alteration is reversible, this could provide each company with a credible low-cost deterrent mechanism.

162. Furthermore, by reducing the number of large chains from three to two, the merger could make punishment more straightforward, for example, by eliminating any need for non-deviating firms to agree who incurs the cost of punishing a firm deviating from the coordination.

External sustainability

163. The OFT considers that there is a significant risk external competitive constraints would be insufficient to destabilise coordination between Rank and Genting. The merger would eliminate the only large competitor to Rank and Genting. As outlined above, third party casino operators would each be significant smaller than Rank and Genting at a national level. Furthermore, as detailed below, barriers to entry and expansion in the casino sector are high, which further reduces the ability of third parties to destabilise any coordination.

Conclusion

164. In light of the above considerations, the OFT considers that the merger increases the risk of coordination in the casino sector. However, in light of the OFT's findings on the other theories of harm, it is not necessary to conclude on whether the test for reference to the Competition Commission is satisfied as regards coordinated effects.

BARRIERS TO ENTRY AND EXPANSION

165. Where the combination of merging businesses raise potential concerns about the ability to raise prices or reduce quality, the OFT also considers the responses of others. Entry by potential rivals, or expansion by existing rivals, can mitigate the effect of a merger on competition. In assessing whether entry or expansion might mitigate a finding of a substantial lessening of competition, the focus is on whether such behaviour would be timely, likely and sufficient in scope.[42]

166. The OFT has found that there are substantial barriers to entry and expansion in the casino sector.

Regulatory barriers

167. A key barrier to entry is the requirement to obtain a licence in the relevant local authority area, without which it is not possible to operate a casino.

[42] OFT/CC Joint Merger Assessment Guidelines, paragraph 5.8.3.

This requires an entrant to either own or obtain a 1968 Act cold licence or win a 2005 Act licence in a tender process.

168. There are a finite number of available licences. As regards 1968 Act licences, Rank submits that 21 cold licences will be owned by third parties. Aside from Genting, these third party cold licences are widely dispersed, with no third party owning a large number of cold licences. As regards 2005 Act licences, seven have been awarded (two to Aspers, with the remainder being awarded to separate operators) and nine are yet to be awarded.

169. In two of the local areas where the OFT has identified competition concerns (Aberdeen and Cardiff) there are no cold licences and no tender process for 2005 Act licences. Therefore, at least in these areas, regulatory barrier constitute an absolute barrier to entry. Furthermore, as regards the OFT's concerns at the national level, the finite number of available licences and their widespread distribution makes it very unlikely that any third party operator could expand sufficiently to mitigate the loss of competition arising from the combination of two of the three large national operators.

170. Finally, the regulatory regime also acts as a barrier to expansion of individual casinos. For example, licences contain limits on the maximum number of machines that can be operated in any casino. These restrictions on capacity limit the extent to which existing third party casinos could be enlarged to constrain the merged entity post-merger.

Non-regulatory barriers

171. Third parties stated that the costs involved in developing a casino are substantial:

- two operators stated that developing a small casino would cost at least £2m
- another operator stated developing a large casino would cost £7-12m
- another operator stated that developing a casino of 23,000-30,000 square feet would cost £6.5-8m.

172. While the costs of entry need to be considered in comparison to potential returns, the substantial upfront costs of opening a new casino suggest that, even in areas where licences are available, there may be significant barriers to entry.

Conclusion on Barriers to Entry/Expansion

173. In light of the evidence above, the OFT currently considers that barriers to entry and expansion are high in the casino sector. In areas where third parties hold licences the OFT has considered the prospects of entry as part of the competitive assessment of the merger in those areas. However, in no area has the OFT concluded that entry or expansion would be sufficient, timely and likely so as to resolve the competition concerns that would otherwise arise. Furthermore, the OFT considers that it cannot in general rely on entry or expansion to address its concerns as regards national competition.

THIRD PARTY VIEWS

174. Specific third party views have been discussed above where relevant. While few consumers contacted the OFT, several casino operators told the OFT that the transaction would have a negative impact on competition.

ASSESSMENT

175. The parties overlap in the supply of casino services in the UK. The merger qualifies on the basis of the turnover test. The OFT has considered the merger on the basis of a product frame of reference encompassing standard (non-high-end) bricks and mortar casinos and on the basis of national and local geographic frames of reference. The OFT considered carefully Rank's submission that there is no material national dimension to competition. However, no third party casino operator supported Rank's submission and there was evidence that significant parameters of competition are determined at least partly at national level. Several of these parameters do not exhibit any variation in response to different local conditions and may be influenced by the national actions of competitors. Accordingly, the OFT was unable to exclude the prospect that there is a significant degree of national competition.

176. The merger gives rise to a major consolidation at national level. Furthermore, the barriers to entry and expansion in the casino sector mean that a loss of competition at national level is potentially irreversible. It was not clear to the OFT that competitive responses from third party operators at national or local level would be sufficient to constrain the merged entity at a national level. Therefore, the OFT was unable to exclude the prospect that combining two of the three large national chains could result in a substantial lessening of competition. The OFT therefore found that the test for reference is met in casino services at national level.

177. The OFT also found that there is local competition and assessed the impact of the merger in local areas where there is an overlap between the parties' casinos. In each of these areas the OFT considered whether the loss of competition between the parties' casinos would be substantial in light of the constraint exerted by the remaining third party competitors. The OFT identified seven areas in which the merger may give rise to a substantial lessening of competition. These areas are Stockton-on-Tees, Aberdeen, Bristol, Cardiff, Liverpool/New Brighton, Stockport/Didsbury and Leeds; the OFT found that the test for reference is met in casino services in these seven local areas. The OFT did not reach a conclusion on whether the merger could be expected to give rise to local competition concerns in London.

178. The OFT considered whether the merger could result in a substantial lessening of competition in local areas by preventing the addition of a new fascia that might have emerged absent the merger. In particular, the OFT considered whether the merger might result in the non-development of cold licences in areas where such non-development could be result in a substantial lessening of competition in comparison to the counterfactual. The OFT found that in Edinburgh (Rank cold licence) and Bradford (Guoco cold licence), the merger could result in reduction competition (with fewer fascia vis-a-vis the counterfactual) through the non-development of licences that might have been developed absent the merger. The OFT found that the non-development of these licences could be expected to give rise to competition concerns in Edinburgh and Bradford. The OFT therefore found that the test for reference is met in the supply of casino services in these further two local areas. The OFT did not reach a conclusion on whether similar areas arise in other areas.

179. The OFT considered whether the merger could increase the prospect of coordination between Rank and Genting, but did not reach a conclusion on this issue.

180. Accordingly, the OFT believes that it is or may be the case that the merger may be expected to result in a substantial lessening of competition in the supply of casino services:

- at national level
- in the local areas of Stockton-on-Tees, Aberdeen, Bristol, Cardiff, Liverpool/New Brighton, Stockport/Didsbury and Leeds, based on current overlaps between operational casinos, and
- in the local areas of Edinburgh and Bradford, based on non-development of cold licences.

UNDERTAKINGS IN LIEU OF REFERENCE

181. Where the duty to make a reference under section 33(1) of the Act is met, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, accept from the parties concerned such undertakings as it considers appropriate for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which may result from it.

182. Rank offered to divest the following casinos by way of undertakings in lieu of reference : [ ]

183. Rank stated that the specified casinos would be [ ].

184. As outlined in the OFT's guidance, undertakings in lieu of reference will be accepted where they offer a clear-cut method of addressing the OFT's competition concerns. As outlined in the guidance, this usually requires the undertaking to restore the pre-merger position in the market where competition concerns arise.[43]

[43] OFT Exceptions to the duty to refer and undertakings in lieu of reference guidance, paragraph 5.11.

185. The OFT has considered whether the undertakings offered by Rank would provide a clear-cut resolution of the local and national concerns identified above.

186. In relation to local concerns, the undertakings may address the OFT's concerns in areas where the OFT identified a substantial lessening of competition as regards the parties' operational casinos. However, the undertakings do not address the OFT concerns as regards the non-development of cold licences in Edinburgh and Bradford.

187. In relation to national concerns, the OFT has considered carefully whether the offers of divestments in local areas would be sufficient to address the realistic prospect of a substantial lessening of competition on a national basis arising from the combination of two of the three large national casino operators in the UK. In the context of the present transaction, which involves a major change in the structure of a market with high barriers to entry/expansion, the OFT considers it important to be confident that the undertakings would be sufficient to remedy the competition lost as a result of the merger, including the preservation of three large national operators.

188. However, the casinos offered for divestment represent only a small proportion of the Gala business (they equate to [ ] per cent of Gala revenue, [ ] per cent of Gala drop and [ ] per cent of Gala admissions). Even following the divestments, the merged entity would account for [ ] per cent of casinos, [ ] per cent of drop and [ ] per cent of admissions in the UK. As such, the overall market structure would remain concentrated even following the divestments.

189. Furthermore, the undertakings in lieu would not be effective to re-create a third national chain such as to clearly address the substantial lessening of competition:

- Rank has not committed to sell all [ ] of the casinos to the same purchaser. The sale of the casinos individually to different operators clearly would not be effective to create a third national chain, and

- even if the [ ] casinos were sold as a bundle, it is not clear that there is any purchaser who would, with the addition of the divested casinos

have a national presence sufficient to mitigate the OFT's concerns. Outside the three largest chains, the next largest operators are LCI (10 casinos) and A&S (six casinos).

190. Therefore, it is not clear that the undertakings offered would be sufficient to replace the loss of competition resulting from the merger at national level.

191. Accordingly, the undertakings offered by Rank are not adequate to address the OFT's concerns in respect of the prospect of a loss of national competition in the casino sector nor the OFT's concerns in respect of cold licences in Edinburgh and Bradford.

DECISION

192. The transaction will be referred to the Competition Commission pursuant to section 33(1) of the Act.