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## Completed acquisition by Vue Entertainment Holdings (UK) Limited of A3 Cinema Limited (including its subsidiary, Ster Century (UK) Limited)

The OFT's decision on reference under section 22 given on 23 September 2005. Full text of decision published 30 September 2005.

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### PARTIES

1. **Vue Entertainment Holdings (UK) Limited (Vue)** is a cinema exhibitor with forty two cinemas across the UK. It also operates and manages five UK cinemas for the independent entity, Village Roadshow.
2. **A3 Cinema Limited (A3)** is a holding company commercially active through its wholly owned subsidiary, Ster Century (UK) Limited, which owns and operates six cinemas in the UK under the 'Ster Century' brand.<sup>1</sup> The UK turnover of A3 for its most recent audited financial year was approximately [ ]<sup>2</sup>.

### TRANSACTION

3. On 29 April 2005, Vue acquired sole control of A3. The administrative deadline expires on 23 September 2005 and the extended statutory deadline expires on 26 September 2005. Vue gave initial 'hold separate' undertakings under section 71 of the Enterprise Act 2002 (the Act) on 11 August 2005.

### JURISDICTION

4. As a result of this transaction, Vue and A3 have ceased to be distinct. The parties overlap in the supply of cinema exhibition services and the share of supply test in section 23 of the Act is met as post-merger Vue supplies more than a quarter of all cinema seats and screens in a substantial part of the UK (Edinburgh). Vue has contested jurisdiction on this basis, arguing that there must be a nexus between the reference area used for the share of supply test and the area to which a duty to refer relates. The OFT does not accept that the Act imposes such a requirement. It is clear from section 22(1) of the Act that a relevant merger situation can result in a substantial lessening of competition in 'any market or markets in the United Kingdom for goods or services'. There is no requirement that the market or markets in question should form a substantial part of the UK nor that they should be connected with the area in which the share of supply test is met. We note in passing, however, that the

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<sup>1</sup> A3's wholly owned subsidiaries are: Aurora Holdings Limited; Aurora Cinema Limited; Aurora Cinema (Ireland) Limited; and, Ster Century (UK) Limited.

<sup>2</sup> Information excised at the request of the parties for reasons of commercial confidentiality.

share of supply test is equally met on the basis of aggregating all local areas in which the merger created an overlap,<sup>3</sup> and which includes areas in which the duty to refer applies (discussed below). The OFT therefore believes that it is, or may be the case, that a relevant merger situation has been created.

## **RELEVANT MARKET**

### **Product market**

5. The parties overlap in the supply of cinema exhibition services in the UK, and in the acquisition of film exhibition rights from film distributors. Both parties also offer cinema screen advertising services. The OFT recently examined the cinema exhibition and cinema screen advertising services sectors in two merger decisions dated 7 January 2005 and 28 April 2005 (the Decisions).<sup>4</sup>
6. In respect of cinema advertising, and in line with the approach taken in the Decisions, relative to the strong buyer power of cinema screen advertising customers (Pearl & Dean and Carlton Screen Advertising), the merger changes the parties' commercial position little and a number of strong alternative suppliers remain. We received no third party comments indicating that there are competition concerns about this sector as a result of this merger. In light of these considerations we do not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition in cinema advertising and so it is not considered further.
7. As in the Decisions, the OFT has taken cinema exhibition services as the appropriate product frame of reference with which to consider the competitive effect of this merger.

### **Geographic market**

8. No evidence was received in this case to suggest that the OFT should reassess the analytical approach taken in the Decisions towards competition in the cinema exhibition sector at both the national and local level.

## **COMPETITIVE ASSESSMENT**

### **National issues**

9. According to the parties, Vue has a post-transaction share of cinema exhibition in the UK of approximately 5-10 per cent (increment less than 1 per cent) by number of sites, 15-20 per cent (increment less than 5 per cent) by number of screens and seats, and 20-25 per cent (increment less than 5 per cent) by gross box office revenues.<sup>5</sup>

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<sup>3</sup> Isochrone-based methodology is used to determine overlaps: see paragraph 12ff.

<sup>4</sup> Acquisition by Terra Firma Investments (GP) 2 Ltd of United Cinemas International (UK) Limited and Cinema International Corporation (UK) Limited and Completed acquisition by the Blackstone Group of UGC Cinemas Holdings Limited.

<sup>5</sup> Estimates provided by the parties including the five Village Roadshow cinemas operated by Vue.

10. The supply of cinema exhibition services is fairly concentrated in the UK, being dominated by four large national chains<sup>6</sup>, and will not materially change as a result of this transaction. Upstream, as noted in the Decisions, large vertically integrated Hollywood studio distributors retain strong negotiating positions vis-à-vis exhibitors based on the attractiveness to audiences of the films they supply. No third party concerns were raised regarding competition at the national level.
11. On the basis of the evidence provided, therefore, the OFT does not have reason to believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition at the national level.

### Local issues

12. In areas in the UK where cinemas of Vue (including Village Roadshow) and Ster Century<sup>7</sup> competed with each other pre-transaction, the OFT has considered whether it is or may be the case that competition has or may be expected to be substantially lessened by the merger by adopting the same local level methodology and isochrone-based analysis as described in the Decisions (which was considered appropriate for the first phase of a merger inquiry).<sup>8</sup>
13. The four primary underlying assumptions for the isochrone analysis used in this case are as described in the Decisions. First, a 20-minute drive time isochrone has been adopted around the target cinema (the primary isochrone) with a 30-minute isochrone used as a sensitivity check of the primary results. Second, cinemas with a minimum of three screens and 696 seats are considered in the analysis as effective competitors. Third, where the merger results in fewer than four fascias remaining within an isochrone (i.e. Vue and Ster Century fascias facing fewer than three other fascias) in a given area, the OFT considers that it has *prima facie* reason to believe that it is or may be the case that the merger has or may be expected to lessen competition substantially, e.g. through higher prices and/or reduced content and facility range.<sup>9</sup> Finally, where significant population centres located within the 20-minute primary isochrone do not appear to be served by sufficient cinemas other than the parties, isochrone re-centring is used as a check on the results from the application of the first three assumptions. This aims to ensure that there is a check on whether the merger might materially reduce competition for consumers served by the parties' cinemas even though such a prospect is not indicated by analysis of the primary isochrone.

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<sup>6</sup> These are Terra Firma (Odeon and UCI), Blackstone (Cineworld and UGC), Vue, and National Amusement.

<sup>7</sup> These are based in Basingstoke, Cardiff, Edinburgh, Leeds, Norwich, and Romford.

<sup>8</sup> Isochrone maps based on drive time around the parties' cinemas or population centres in areas of overlap were produced and considered in conjunction with other evidence to add to the robustness of the assessment.

<sup>9</sup> The parties submitted that a Vue price survey from 2004 showed no correlation between concentration and price. However, taking the average of the top ticket prices sampled by Vue supports our conclusions.

14. The parties have not contested any of these assumptions and no evidence has come to light causing the OFT to question their appropriateness as a guide to the possible presence of local competition issues. However, the OFT recognises that in certain areas the application of these assumptions requires further individual assessment of other factors, such as new entry, and this has been carried out where appropriate.

### **Application of the method**

15. The application of the first three assumptions indicated an overlap and a reduction to fewer than four fascias post-merger within 20 minutes of one of the six Ster Century cinemas (Basingstoke, where the merger would reduce fascias from two to one on 20- and 30-minute isochrones). The parties were unable to point to new entry in the area around this cinema which would bring in further fascias. Accordingly, the OFT believes that there is a realistic prospect of a substantial lessening of competition in this area.
16. The parties' transaction plans state that 'there is only the Basingstoke site that is impacted by competition'. However, two further target cinemas (Leeds and Romford) were examined using re-centring on significant population centres located within the 20-minute primary isochrone which do not appear to be served by sufficient alternative cinemas and in both cases fewer than four fascias remained in the re-centred isochrone post-merger. These were considered further with regard to local conditions of competition.

### **Romford**

17. The primary isochrone centred on Ster Romford includes the Vue cinemas at Dagenham and Thurrock, as well as UCI West Thurrock, Cineworld Ilford and Showcase Newham: thus suggesting a fascia reduction of five to four. However, both the parties' data and a 20-minute isochrone centred on Vue Thurrock suggest there is no overlap. While any of these isochrones passes the methodological screen we applied in the Decisions, the substantial discrepancy in results produced raises the question of whether the most accurate isochrone could fall somewhere between the two, possibly leading to an overlap with insufficient competing fascia. The position of the cinemas within the isochrone may heighten this concern. While the Ster Romford is likely to be constrained by three competing fascia close by, Vue Thurrock is less so as Vue will own two of the four cinemas closest to Thurrock: the other two competitors being the UCI West Thurrock and the Showcase, Bluewater which is south of the Thames across the Dartford toll crossing (£1 either way).
18. The parties' cinemas serve the eastern edge of London, with the town of Upminster lying between the two and accounting for approximately 20,000 of the 200,000 people living within a 20-minute drive time of this population centre. The parties' data suggests that Vue and Ster are the only alternatives within a 20-minute drive of Upminster. An OFT population re-centered isochrone also puts the UCI West Thurrock and Cineworld Ilford at the edge of a 20-minute drive time from Upminster. There is no evidence of new entry in the area.
19. Given the disparity between the parties' data and OFT isochrones, other evidence was considered. By way of sensitivity the parties asked that the OFT flex the Upminster

isochrone in line with the test applied by the Competition Commission (CC) in the Safeway Report.<sup>10</sup> Adding 10 per cent to a 20-minute drive time (the CC added/deducted one minute to/from both the 10 and 15 minute drive time isochrones in the Safeway report) would bring the UCI Basildon within the isochrone, which may become a competing fascia as it is due to be divested in line with undertakings in lieu agreed by Terra Firma<sup>11</sup>, but subtracting 10 per cent did not eliminate the overlap.

20. The nearest existing competing fascia outside the Upminster centred isochrone is the Showcase Dagenham some 24 minutes drive time from Upminster. While the Upminster-Dagenham journey is faster by train, the cinema is quite some distance from the station. The Showcase Bluewater is also 24 minutes drive time and on the other side of the toll crossing at Dartford. Although the parties argued that the toll cost of crossing and the additional time may be offset by the attraction of the Bluewater shopping centre, customers from the Upminster area would have to drive past the similar Thurrock shopping centre and the Vue and UCI cinemas on their way.
21. Accordingly our first phase fascia test is failed on population re-centring and in the absence of evidence invalidating the approach undertaken in the Decisions, the possible loss of competition from Ster Romford may be considered sufficiently substantial to allow Vue to raise price at Thurrock and there is, therefore, a realistic prospect of a substantial lessening of competition in this area.

## **Leeds**

22. The primary isochrone centred on Ster Leeds includes the Vue Leeds, Showcase Leeds, the Odeon Leeds-Bradford, and the Cineworld cinemas at Castleford and Wakefield towards the edge of the primary 20-minute isochrone. Based on the methodology described above and applied in the previous Decisions, such a fascia reduction from five to four within the primary isochrone would pass the fascia test.
23. While the fascia test is passed on the primary isochrone, the Odeon Leeds-Bradford falls just outside a 20-minute isochrone re-centred on Rothwell, a town to the south east of Leeds, suggesting a fascia reduction of four to three. With a population of around a million living within both the primary and the Rothwell centred 20-minute isochrones, however, it seems unlikely that the estimated 20,000 inhabitants of Rothwell are marginal customers constraining the price of the parties' city centre cinemas, taking into account the dense population covered by the isochrones. As such, re-centring on Rothwell does not form an alternative basis for a realistic theory of harm.
24. Finally, although Vue and Ster have the only two fascias in the centre of Leeds, a concern raised by one third party, there is no evidence to suggest that cinema prices are higher in

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<sup>10</sup> The CC report on the proposed acquisition by Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc); WM Morrison Supermarkets PLC; J Sainsbury plc; and Tesco plc – A report on the mergers in contemplation (Cmnd 5950, September 2003).

<sup>11</sup> Acquisition by Terra Firma Investments (GP) 2 Ltd of United Cinemas International (UK) Limited and Cinema International Corporation (UK) Limited.

central Leeds than in surrounding areas and that, therefore, central Leeds should be viewed as a discrete geographic frame of reference (such as Leicester Square in London). Accordingly, by adopting the approach of previous Decisions and in light of the evidence at our disposal, there are insufficient grounds for believing there is a realistic prospect of a substantial lessening of competition in Leeds

25. However, as the duty to refer exists in this case on other grounds, we also note the following. It is conceivable that an empirical study to measure diversion ratios (a survey of customers to determine to whom they would switch if one party closed its fascia) might overturn the assumptions that result in 'passing' Leeds,<sup>12</sup> and thereby suggest that there is in fact scope for non-coordinated effects in the relevant area. As the OFT does not have such evidence, this theory is at present unsupported by sufficient facts and thus speculative at this juncture. However, it is of course open to the CC to explore this issue further – as has been done in the recent Somerfield/Morrisons stores merger<sup>13</sup> where the CC was able to go beyond the isochrone analysis of the Safeway Report that partially underpins the OFT's approach in the Decisions and also this case.

### **Barriers to entry**

26. As stated in the Decisions, although there have been significant numbers of new cinemas built in recent years and several new groups have also entered the exhibition sector, barriers to entry vary by locality. The parties were unable to point to actual or potential entry in the areas around those cinemas above where concerns appear to exist.

### **Countervailing buyer and supplier power**

27. Downstream, the buyer power of individual consumers is considered to be minimal.
28. Upstream, the film distribution sector is fairly concentrated with a number of substantial international players. The OFT received no evidence in this case to suggest that the merger might adversely affect competition through an increase in bargaining power of exhibitors.

### **THIRD PARTY VIEWS**

29. Third party concerns were raised by only one third party in relation to Basingstoke and Leeds. These have been considered above.

### **ASSESSMENT**

30. Vue, which operates forty seven (including Village Roadshow) cinemas in the UK, has acquired A3, which operates six UK cinemas through its wholly owned subsidiary Ster

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<sup>12</sup> The assumption behind 'passing' an area on the primary isochrone is that three competitor fascias to the merged firm would leave insufficient incentive for the latter to raise price profitably as sufficient consumers would divert to competing fascias in response.

<sup>13</sup> The CC report on the acquisition by Somerfield plc of 115 stores from Wm Morrison Supermarkets plc (September 2005).

Century (UK) Limited. The OFT considers that cinema exhibition is the relevant frame of reference for competition assessment in this case.

31. The OFT believes competition concerns arising from the merger are local rather than national. The localities in which competition concerns arise are identified by the use of assumptions using a method based on isochrone analysis, adjusted to take account of population centres, which was also applied by the OFT in the previous Decisions. Barriers to entry do not appear to be sufficiently low generally at the local level to dispose of local competition concerns. Cinema goers do not appear to have buyer power vis-à-vis exhibitors.
32. On the basis of this analysis the OFT has identified grounds for concern about a loss of competition in relation to Ster Century cinemas at Basingstoke and Romford. In relation to Leeds, the OFT did not reach the requisite standard of belief on the available evidence that it may be the case that there may be a substantial lessening of competition in relation to Leeds because the primary isochrone raised no concerns consistent with the method described above, population re-centring does not give rise to a credible theory of competitive harm in this case, and there is little evidence available that Leeds city centre should be treated as a separate frame of reference. The CC may, however, wish to undertake further empirical scrutiny of this area based, for example, on diversion ratio analysis.
33. Consequently, 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 within a market or markets in the United Kingdom.

#### **EXCEPTIONS TO THE DUTY TO REFER**

34. The parties cited two exceptions to the duty to refer: markets of insufficient importance and undertakings in lieu. As the annual turnover of any cinema under consideration exceeds £1 million, the first exception is inapplicable.
35. In relation to the second exception, where the duty to make a reference under section 22(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 that the parties offer that the OFT considers appropriate for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it.
36. The OFT has therefore considered whether there might be undertakings in lieu of reference which would address the competition concerns outlined above. The OFT's guidance on undertakings in lieu of reference state that, 'undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut'.<sup>14</sup>

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<sup>14</sup> See *Mergers – substantive assessment guidance*, para. 8.3.

37. In lieu of reference to the CC, Vue indicated a willingness to give undertakings to make divestments only in relation to Basingstoke if 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 that area. Such a limited remedy would not address all of the competition concerns identified above, notably in the Romford area.

## **DECISION**

38. This merger will therefore **be referred** to the CC under section 22(1) of the Act.