

## Completed acquisition by the Blackstone Group of UGC Cinemas Holdings Limited

The OFT's decision on reference under section 22 given on 28 April 2005. Full text of decision published 5 May 2005

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### **PARTIES**

1. **The Blackstone Group (Blackstone)** is an international private equity investment and advisory group. On 13 October 2004, it acquired the Cine-UK (branded Cineworld) cinema chain, which operates 34 multiplex cinemas in the UK.
2. **UGC Cinemas Holdings Limited (UGC)** is a UK and Irish cinema exhibitor, with 41 multiplex cinemas across the UK. The UK turnover of UGC for the financial year ended 2003 (its last audited accounts) was £135.5 million.

### **TRANSACTION**

3. On 1 December 2004, Blackstone (through wholly owned subsidiaries) acquired sole control of UGC for [ ] million.<sup>1</sup> The extended statutory deadline expires on 28 April 2005. Blackstone gave initial undertakings under section 71 of the Enterprise Act 2002 on 4 April 2005.

### **JURISDICTION**

4. As a result of this transaction, Blackstone and UGC have ceased to be distinct. The UK turnover of UGC exceeds £70 million, so that the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is, or may be the case, that a relevant merger situation has been created.

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<sup>1</sup> Information excised at the request of the parties for reasons of commercial confidentiality.

## **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 a merger decision dated 7 January 2005 (the Decision).<sup>2</sup>
6. In respect of cinema advertising and in line with the approach taken in the Decision, 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 substantiated competition concerns about this sector in relation to this merger. In light of these considerations we do not believe that the merger may substantially lessen competition in cinema advertising and so it is not considered further.
7. As in the Decision, 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. Competition takes place predominantly at the local level because this is the relevant sphere of consumer choice, and price, content and facilities vary according to local conditions. However, certain parameters of competition for national chains (for example, negotiation with distributors for access to film content and for screen advertising fees and branding) are determined at the national level. The OFT has therefore analysed competition both nationally and locally, as in the Decision. No evidence was received in this case to suggest reassessing that position.

## **COMPETITIVE ASSESSMENT**

### **National issues**

9. As a result of the merger, Blackstone has a share of cinema exhibition of 20-25 per cent (increment around 10-15 per cent) by number of screens, seats, and gross box office revenues in the UK. It has a combined share of 10-15 per cent (increment around 5 per cent) by number of UK sites.

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

10. The supply of cinema exhibition services is moderately concentrated and, post-merger, there are four large national chains: Terra Firma (Odeon and UCI), Blackstone (Cineworld and UGC), Vue and National Amusement. As noted in the Decision, upstream cinema distribution is similarly concentrated with most of the large distributors being vertically integrated with Hollywood studios. Distributors have, and will continue to have, a strong negotiating position relative to the exhibitors depending on the attractiveness to audiences of the films that they have to offer. Furthermore distributors retain a strong incentive to distribute as many copies of a film as possible. No third party raised horizontal concerns at the national level, nor did any distributor raise a vertical concern.
11. On the basis of the evidence provided, therefore, the OFT does not have reason to believe that the merger may be expected substantially to lessen competition nationwide.

### Local issues

12. In areas where Blackstone (Cine-UK) and UGC competed with each other pre-merger the OFT has considered whether there will be sufficient post-merger constraints to ensure that no substantial lessening of competition may arise. The OFT has adopted the same conservative methodology (considered appropriate for the first phase of a merger inquiry) and isochrone based analysis<sup>3</sup> as described in the Decision to identify those areas where it is or may be the case that competition may be expected to be substantially lessened by the merger.
13. Isochrone maps based on drivetime 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 analysis.
14. The four primary underlying assumptions for the isochrone analysis used in this case are as described in the Decision (paragraphs 16-24). First, a 20 minute isochrone has been adopted (save in relation to Central London where drivetime is considered a less reliable proxy due to the unique features of the area) 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. Third, where the merger results in fewer than four fascias remaining within an isochrone (i.e. Cineworld and UGC 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 may be expected to lessen competition substantially, e.g. through higher prices and/or

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<sup>3</sup> Which is itself based broadly on the CC's Supermarkets Report (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).

reduced content and facility range. Finally, where significant population centres located between the parties' cinemas do not appear to be served by sufficient other cinemas, isochrone re-centering is used as a check on the results from the application of the first three assumptions. The parties have not contested any of these conservative 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 4 out of a total of 41 UGC cinemas<sup>4</sup> – namely those at Boldon, Harlow, Swindon, and Wigan. The parties were unable to point to new entry in the areas around these cinemas which would bring in further fascias. In view of this the OFT believes that there is a realistic prospect of a substantial lessening of competition in these areas.
16. There appeared to be areas around a further 7 target cinemas where significant population centres located between the parties' cinemas do not appear to be served by sufficient other cinemas. Application of this assumption to the areas around 3 of these – namely the areas around Bedford, Northampton and Sheffield – did not generate any overlaps between the parties in the re-centred isochrone.
17. For the other 4 target cinemas examined using population re-centering, fewer than four fascias remained in the re-centred isochrone post merger. These were considered further with regard to local conditions of competition.
  - **Birmingham Great Park:** Between UGC Birmingham Great Park and Cineworld Solihull lies a densely populated area with no other cinemas. Cinema goers in this region south of Birmingham only have cinemas in the centre of Birmingham and the Odeon Quinton on one edge of the region as an alternative to the parties' cinemas. Population re-centred isochrones within the area between the UGC and Cineworld cinemas shows a substantial population for whom the merger gives rise to a reduction in the choice of fascias from four to three as most of central Birmingham is outside the isochrone. In view of these considerations, the OFT believes that there is realistic prospect of a substantial lessening of competition in this area south of Birmingham.

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<sup>4</sup> Three of these 41 cinemas fall within central London where, as noted, the isochrones may be less reliable. These are dealt with below.

- Chester:** Cineworld Runcorn is not within 20 minutes drivetime of UGC Chester, but the parties marginally overlap in a 20 minute isochrone based on a substantial population mid-point (Ellesmere Port) between the parties' cinemas. Although the merger reduces the number of fascias in the latter isochrone to three, the population of Ellesmere Port is served by a 16-screen Vue (which the parties submit accounts for over half of total box office revenues in this area) and the customers from the Runcorn or Chester areas seeking to go to the parties' other cinema would pass Ellesmere Port en route. UGC Chester will also continue to face competition from the neighbouring Odeon Chester and the Odeon Bromborough. In view of this, the OFT does not believe that a substantial number of cinema goers within the area would choose primarily between Cineworld Runcorn and UGC Chester (as opposed to the Vue or Odeons). Accordingly, the OFT does not believe that there is a realistic prospect that the merger will substantially lessen such competition.
- Ealing/Slough:** For a very large population in the West London area the merger would give rise to a reduction in the choice of fascias from four to three (the parties, Vue and Odeon/UCI) within a number of isochrones. In addition, the parties will control a third of the cinemas in this area<sup>5</sup> and there is no immediate prospect of entry. The Himalaya Palace in Southall falls within some of the above isochrones but is not counted as a competing fascia in the analysis since it shows a high proportion of Asian language films (which the parties see as [catering for a more specialised audience such that there is no overlap in practice between this type of cinema and cinemas catering for a more mainstream audience]) on its 3 screens.<sup>6</sup> In view of these considerations, the OFT believes that there is a realistic prospect of a substantial lessening of competition in this area.

## Central London

18. The parties overlap in one part of Central London.

- Chelsea/Fulham/Hammersmith:** A 20 minute isochrone centred on Cineworld Wandsworth includes UGCs at Chelsea, Fulham and Hammersmith, with the Vue and Odeon/UCI chains also present. As noted in the Decision, however, it is difficult to apply all the same isochrone assumptions to Central London due to the unique features of the area (including public transport links). Cinemas in the West End are likely to exert some competitive constraint on the UGC cinemas. Cineworld Wandsworth and the UGCs are closer to competitors on their

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<sup>5</sup> Cinemas in this area with at least 3 screens and 696 seats are UGC Ealing, UGC Slough, Cineworld Feltham, Vue Two Rivers, Odeon Uxbridge, the two Odeons Richmond, Odeon Esher, and Odeon Kingston.

<sup>6</sup> Information amended at the request of the parties.

respective sides of the river, due to accessible transport links, than to each other. These factors together indicate that there is sufficient local competition to each of the parties. On this basis the OFT does not believe that there is a realistic prospect of a substantial lessening of competition in this area.

### **Barriers to entry**

19. As stated in the Decision, 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**

20. Downstream, the buyer power of individual consumers is considered to be minimal.
21. 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**

22. No substantiated third party concerns in relation to the merger have been raised.

### **ASSESSMENT**

23. Blackstone, which operates 34 Cine-UK cinemas in the UK, has acquired UGC which operates 41. The OFT considers that cinema exhibition is the relevant frame of reference for competition assessment in this case.
24. 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 cautious assumptions using a method based on isochrone analysis, adjusted to take account of population centres, which was also applied by the OFT in the Decision. 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.
25. On the basis of this analysis the OFT has identified grounds for concern about a loss of competition in the following 6 areas, covering 7 UGC cinemas:

- Boldon
- Harlow
- Swindon
- Wigan
- Birmingham Great Park
- Ealing/ Slough

26. 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.

### **UNDERTAKINGS IN LIEU**

27. 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 such of the parties concerned undertakings as it 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.

28. 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>7</sup>

29. In lieu of reference to the CC, Blackstone has indicated a willingness to give undertakings to make divestments in various localities where Cineworld and UGC cinema's overlap. In respect of 6 – but not all – of these areas 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.

30. In accordance with section 73 of the Act, the OFT is considering divestment undertakings in lieu of reference in relation to 6 local areas in respect of which it has a belief that it is or may be the case that a substantial lessening of competition may be expected to arise as a result of the merger. The OFT considers that these proposed undertakings are capable of clearly addressing the local competition concerns arising from the merger and identified above, subject to the particular cinema offered for divestment being sufficient to address the issue in each area of concern.

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<sup>7</sup> See *Mergers – substantive assessment guidance*, para. 8.3.

31. Accordingly, the OFT has decided to consider whether to exercise its discretion to accept undertakings in lieu of a reference under section 73(2) of the Act.

## **DECISION**

32. The OFT has therefore decided not to refer this merger to the CC because it is considering whether, instead of making a reference, to accept appropriate divestment undertakings from Blackstone to address the competition concerns arising from the merger.