COMPETITION COMMISSION

CINEWORLD/CITY SCREEN MERGER INQUIRY

Completed acquisition by Cineworld Group plc of City Screen Limited

Provisional findings report

Notified: 20 August 2013

The Competition Commission has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

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Summary

1. On 30 April 2013, the Office of Fair Trading (OFT) referred the completed acquisition by Cineworld Group plc (Cineworld) of City Screen Limited (the transaction) to the Competition Commission (CC) for investigation and report. We must publish our report by 14 October 2013.

2. With a portfolio of 79 cinemas in the UK, Cineworld is one of the largest operators of cinemas. It is listed on the London Stock Exchange. Its revenue in 2012 was £359 million. Prior to the transaction, City Screen Limited operated 21 cinemas, principally under the Picturehouse brand. Throughout this report, we refer to City Screen Limited and its subsidiaries as Picturehouse. Prior to the transaction, Picturehouse was privately owned and relied on funding from venture capital firms. In 2011, Picturehouse's turnover was £24.3 million[1]. While Cineworld operates mainly large cinemas, many of which are out of town, Picturehouse's cinemas tend to be smaller cinemas located in city centres.

3. Cineworld and Picturehouse (collectively the parties) initiated negotiations in June 2012. The shareholders of Picturehouse did not actively seek out or negotiate with any other potential buyers. On 6 December 2012 Cineworld acquired the entire share capital of City Screen Limited. In making the acquisition, Cineworld's strategy was to reach what it perceived to be a new and growing segment.

4. Together, the parties' share of supply of cinema exhibition services in the UK is just over 26 per cent. We are satisfied that a relevant merger situation has been created as a result of the transaction.

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[1] Excluding City Screen Limited's share of joint venture, the Group Turnover was £18.2 million.

5. Cinemas are of various sizes, and a distinction is generally made by the industry between multiplexes (which have more than five screens) and other cinemas. Operators of multiplexes tend to focus on showing mainstream films and to offer a largely undifferentiated service, although in recent years some have developed more tailored offerings for certain customer segments. Operators of smaller cinemas, which are generally located in town and city centres, may differentiate themselves from multiplex operators not only through the location of their cinemas and the mix of films they show (which will generally include both mainstream and specialized films), but also through the ancillary services and general ambience their cinemas offer to their customers. Three suppliers of cinema exhibition services, Odeon & UCI Cinemas Holdings Ltd, Cineworld and Vue Entertainment Holdings (UK) Limited, accounted for more than 70 per cent of box office revenues in 2012 in the UK. They operate mainly multiplexes. Picturehouse was the sixth largest UK operator, with a 1.7 per cent share of revenues.

6. The parties overlap in the supply of cinema exhibition services. We defined the relevant product market as the market for the provision of cinema exhibition services, and we saw no reason to include within the definition of the relevant product market other leisure activities and/or food and beverages. For the geographic market definition, we established the boundaries of the markets based on 20-minute isochrones[2] around the parties' cinemas, but we recognized the need to apply this rule flexibly when assessing competition in specific local areas.

7. Picturehouse also supplies film programming services to cinema exhibitors. This includes the selection of films and negotiations with film distributors. We defined the market as the market for cinema programming services in the UK.

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[2] A line joining points of equal travel time (usually drive-time) from a given point.

8. Although some decisions are made centrally by cinema exhibitors, we found that much of the competitive process takes place at the local level, and we found that generally, when setting the price of cinema tickets, exhibitors take account of the prices of all types of cinemas operating in their local area.

9. We considered what would have happened in the absence of the transaction (the counterfactual). We found that Picturehouse was a profitable business that was likely to continue to operate as a stand-alone entity, and we did not consider it likely that it would have been sold to another purchaser.

10. We identified three ways in which the transaction could have an effect on competition: first, in the areas where both parties have cinemas, the removal of one competitor could allow the parties to increase their prices or reduce the quality of their services locally; second, in the areas where either party had plans to expand prior to the transaction, the transaction may result in the loss of a competitor either because of the abandonment of the expansion plan or because of common ownership of the current cinema and the future cinema; third, to the extent that they have market power in the provision of programming services, the parties could exercise that power to distort competition in the provision of cinema exhibition services in the areas where the merger has increased their incentive to do so. We examined evidence relating to each of these three theories.

11. We first considered all local areas where both parties have cinemas. Through a filtering process that primarily involved identifying the number of cinemas under different ownership in the vicinity of the parties' cinemas, we identified nine local areas which we considered merited further investigation. Using a range of evidence and analytical tools, we studied the nature of the competitive process in each area and in particular the extent to which the parties' cinemas competed with each other

prior to the transaction and the extent to which other cinemas in these areas exerted a competitive constraint on the parties. We also considered whether any expected loss of competition could be mitigated by the timely entry of a new cinema exhibitor. We provisionally conclude that the transaction may be expected to lead to a substantial lessening of competition (SLC) in the markets for cinema exhibition services in three local areas: Aberdeen, Bury St Edmunds and Cambridge.

12. Second, we examined the expansion plans that the parties were pursuing prior to the transaction. The evidence we received suggested that plans had not been modified by the parties in order to avoid direct competition. We found that three of Picturehouse's planned cinemas and 28 of Cineworld's planned cinemas had reached the stage of development at which they were likely to be taken forward. We filtered out the areas where there was a sufficiently high number of alternative cinemas owned by other exhibitors to expect that the transaction would not lead to competition concerns, and through this process identified two planned Picturehouse cinemas (in Chiswick and Crouch End) which merited further investigation. In both cases, our investigations led us provisionally to conclude that the transaction is unlikely to result in an SLC.

13. Third, we found that Picturehouse's programming services are advisory and customers typically make the ultimate programming decisions. We also found that although customers value highly the expertise that the Picturehouse programming team provides, there are other options open to them and barriers to entry into the supply of programming services appear to be relatively low. We therefore provisionally conclude that the transaction is unlikely to lead to an SLC in the provision of programming services to cinema exhibitors in the UK.

Provisional findings

1. The reference

1.1 On 30 April 2013, the OFT referred the completed acquisition by Cineworld of City Screen Limited to the CC for investigation and report. The CC must decide:

(a) whether a relevant merger situation has been created; and

(b) if so, whether the creation of that situation has resulted, or may be expected to result, in an SLC within any market or markets in the UK for goods or services.

1.2 Our terms of reference are in Appendix A. We are required to publish our final decision by 14 October 2013.

1.3 This document, together with its appendices, constitutes our provisional findings, published and notified to Cineworld in line with the CC's Rules of Procedure.[3] Further information relevant to this inquiry, including non-confidential versions of submissions received from Cineworld and third parties, as well as summaries of evidence received in oral hearings, can be found on our website.[4]

2. The companies

Cineworld

2.1 Cineworld was founded in 1995 by its current Chief Executive. It opened its first cinema in Stevenage in 1996 and, in 2005 it acquired UGC cinemas. Prior to the transaction, Cineworld operated 80 cinemas with a total of 818 screens in the UK and the Republic of Ireland,[5] of which 77 are multiplexes (defined in the UK as cinemas with five screens or more). On average, each Cineworld cinema site has ten screens and 2,057 seats.[6] Its cinemas are commonly located in out-of-town or edge-of-town

[3] Rule 10 of the *Competition Commission Rules of Procedure, CC1*, March 2006.
[4] www.competition-commission.org.uk/our-work/directory-of-all-inquiries/cineworld-city-screen.
[5] Seventy-nine of its cinemas, accounting for a total of 799 screens, are located in the UK.
[6] Initial Submission to the Competition Commission, 22 May 2013.

leisure and retail developments with parking facilities. The locations of Cineworld's cinemas are shown in Figure 1.

FIGURE 1

Cineworld's cinemas in the UK

Source: Cineworld.

2.2 Cineworld's annual report shows that in 2012 it achieved box office revenue of £253 million out of total revenue of £359 million. Retail income represented £82.8 million and its largest other source of income was Digital Cinema Media Limited (DCM), a joint venture with Odeon & UCI Cinemas Holdings Ltd (Odeon) that sells advertising time on cinema screens to other cinema exhibitors, principally in the UK. In 2012, Cineworld generated earnings before interest, tax and depreciation and amortization (EBITDA) of £27.7 million. Detailed financials are provided in Appendix B.

2.3 Cineworld has been listed on the London Stock Exchange since May 2007.

City Screen Limited

2.4 City Screen Limited was co-founded by Lyn Goleby, who remains in the role of Managing Director. It opened its first cinema in Oxford in 1989 and now operates 21 cinemas accounting for a total of 60 screens in the UK. Nineteen of its cinemas have fewer than five screens. All but six of the company's cinemas are operated under the Picturehouse brand. On average, each Picturehouse cinema has three screens and 430 seats.[7] Picturehouse cinemas are located in city centres. The locations of Picturehouse's cinemas are shown in Figure 2.

[7] Initial submission to the Competition Commission, 22 May 2013.

FIGURE 2

Picturehouse cinemas

Source: Cineworld.

2.5 Picturehouse's turnover in 2012 was £[✂] million and its EBITDA was £[✂] million. Detailed financials are provided in Appendix B.

2.6 In addition to the supply of cinema exhibition services, Picturehouse also operates the following businesses, which account for [✂] per cent of its turnover:

(a) City Screen (Virtual) Limited (CSV), which provides film-booking services (including the selection of films and negotiation of rights with distributors) to [✂] cinemas across the UK;

(b) Picturehouse Entertainment Ltd, which aims to distribute up to six feature films every year as well as a wide variety of alternative content (eg National Theatre and RSC live transmissions) to cinemas around the UK;

(c) Newman Online Limited, which provides ticketing and event management services to venues across the UK and in Europe; and

(d) Picturehouse Bookings Limited, which provides telephone answering and ticket booking services to Picturehouse and five external clients.

2.7 Prior to the acquisition by Cineworld, significant shareholdings in Picturehouse were held by:

(a) Hoegh Capital Partners DV III Limited ([✂] per cent);

(b) Lyn Goleby ([✂] per cent); and

(c) Tony Jones[8] ([✂] per cent).

2.8 Prior to the acquisition by Cineworld, six Picturehouse cinemas had been developed through investment from a venture capital partnership, [✂][9] on a project-by-project basis. All other companies in Picturehouse, with the exception of City Screen (Bath) Limited,[10] were wholly owned by the parent company, City Screen Limited, prior to the acquisition. Following the transaction, all the cinemas are now fully owned by Cineworld.

[8] Co-founder of City Screen Limited.
[9] [✂]
[10] City Screen Limited held 75 per cent of the shareholding in City Screen (Bath) Limited, with the remaining 25 per cent held by the family that built the cinema.

3. The merger and the relevant merger situation

Outline of merger situation

3.1 The sale of Picturehouse to Cineworld followed an approach made in May 2012 by Cineworld to Picturehouse. This initial contact was followed by high-level discussions with Arts Alliance Advisors[11] in June 2012. A formal offer was made on 25 July 2012 and, following negotiations, heads of terms were agreed on 12 October 2012. On 6 December 2012, Cineworld acquired the entire issued ordinary share capital of City Screen Limited for £[✂] million. The shareholders of Picturehouse did not actively seek or negotiate with any other potential buyer.

3.2 On completion of the transaction, a Memorandum of Agreement between Lyn Goleby and Cineworld was signed. It sets out the principles for managing the Picturehouse business as a stand-alone, autonomous division within Cineworld for a period of time [✂] following the transaction. The Memorandum of Agreement included the following provisions: [✂].

The rationale for the merger

3.3 The parties told us that a [✂].

3.4 As explained in paragraphs 2.7 and 2.8, Picturehouse was primarily owned by venture capital investors. Recognizing that venture capital entities typically invest on a short- to medium-term basis, Picturehouse's management had aimed to replace these investors with a more straightforward source of future funding, which would be aligned with management ambitions for future growth.[12]

3.5 Cineworld was viewed as an attractive buyer as it was a publicly listed company with both the funds and motivation to grow the Picturehouse business.

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[11] Arts Alliance Advisors is a division of Hoegh Capital Partners DV III Limited.
[12] Initial submission to the Competition Commission, 22 May 2013.

3.6 For its part, Cineworld stated that its strategic rationale for acquiring Picturehouse was to diversify its offering and in doing so to reach a new and growing segment.[13] Cineworld had been considering how to enter the non-multiplex sector for a number of years and in 2010 entered into [✄].[14]

3.7 Arts Alliance Advisors emphasized the strategic fit and complementarity of Picturehouse and Cineworld as drivers of the transaction.[15]

Jurisdiction

3.8 Under section 35 of the Enterprise Act 2002 (the Act) and our terms of reference (see Appendix A), we are required to report on whether a relevant merger situation has been created.

3.9 Section 23 of the Act provides that a relevant merger situation is created if:

(a) two or more enterprises have ceased to be distinct within the statutory period for reference; and

(b) either the share of supply test or the turnover test specified in that section of the Act is satisfied.

3.10 The Act defines an 'enterprise' as 'the activities or part of the activities of a business'.[16] By reason of their activities in the provision of cinema exhibition services, we are satisfied that each of Cineworld and Picturehouse are enterprises for the purpose of section 23. Enterprises will 'cease to be distinct' if they are brought under common ownership or control (section 26 of the Act). As a result of the acquisition of Picturehouse by Cineworld described in paragraph 3.1, both parties

[13] Initial submission to the Competition Commission, 22 May 2013.
[14] [✄]
[15] Summary of hearing with Arts Alliance, paragraph 10.
[16] Section 129(1) of the Act.

were brought under common ownership. Consequently, we are satisfied that Cineworld and Picturehouse have ceased to be distinct enterprises.[17]

3.11 The share of supply test is satisfied if the merger creates or increases a share of at least one-quarter in the supply of goods or services of any description in the UK, or in a substantial part of the UK. The concept of goods or services of 'any description' is broad. For the purpose of the jurisdiction test in section 23 of the Act, the CC is able to apply such criterion or such combination of criteria as it considers appropriate.

3.12 For the purpose of assessing whether or not the share of supply test was met, we focused on the supply of film exhibition services in the UK, which is the activity in respect of which the merging parties overlap.[18]

3.13 According to the *British Film Institute* (BFI) *Statistics Yearbook* 2013, the parties' combined share of supply of the provision of film exhibition services in the UK in 2012, as measured as a proportion of gross box office revenue (GBOR) in the period, was 26.4 per cent, of which Cineworld represented 24.7 per cent and Picturehouse 1.7 per cent.[19] The merger therefore created a share of supply of a one-quarter of film exhibition services in the UK. Consequently, the share of supply test in section 23 of the Act was met. We did not need to consider whether the turnover test in section 23(1)(b) of the Act was met.

3.14 As indicated in paragraph 3.1, the acquisition was completed on 6 December 2012. The OFT made the reference to the CC on 30 April 2013. The reference must be made within the time limits set out in sections 24 and 25 of the Act. The period for making a reference was extended by 20 days by agreement between Cineworld and

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[17] This is not affected by the operational separation of the two businesses described in paragraph 3.2.
[18] The group of goods or services to which the jurisdictional test is applied need not amount to a relevant economic market of the type used in the substantive competitive assessment.
[19] Table 10.11 (www.bfi.org.uk/sites/bfi.org.uk/files/downloads/bfi-statistical-yearbook-2013.pdf).

the OFT to 30 April 2013 pursuant to section 25(1) of the Act. The reference was therefore made in time.

3.15 We therefore provisionally find that the acquisition by Cineworld of Picturehouse resulted in the creation of a relevant merger situation.

4. The cinema exhibition industry

History of demand

4.1 There have been public performances of films before paying audiences in Great Britain since 1896. In 1909 the first national cinema chain, Provincial Cinematograph Theatres, was founded. Cinema audiences grew and reached a peak of 1,635 million admissions in 1946. However, in the following 40 years, with the coming of television broadcasting, cinema attendance declined, reaching a low of 54 million in 1984, leading to widespread cinema closures.

4.2 The UK's first multiplex opened in Milton Keynes in 1985, and UK cinema admissions started to increase to reach 176 million in 2002. Since then admissions have remained steady and in 2012 there were 172.5 million admissions, a 0.5 per cent increase compared with 2011.

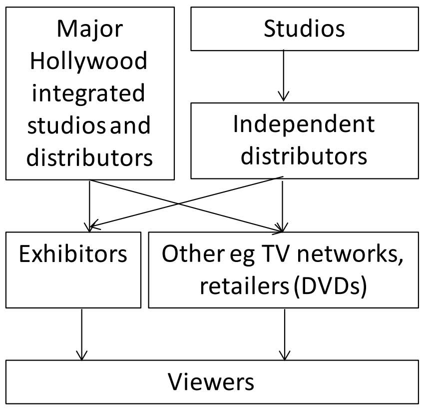
4.3 Younger people show a much higher propensity to be regular cinemagoers than the over 35s. However, older audiences are growing as a proportion of total audiences, partly driven by the ageing population. Cineworld told us that the proportion of cinema audiences aged over 55 increased from 1.13 per cent in 2002 to 1.57 per cent in 2010.

The film supply chain

4.4 Studios produce films, which are licensed by distributors for distribution in certain formats (eg cinema exhibition, DVD, pay per view/video-on-demand, subscription pay-TV services, free-to-air TV) in certain territories within a certain period. Cinemas license the right to exhibit a film from a distributor. The film supply chain is represented in Figure 3.

FIGURE 3

Film supply chain



Source: CC.

4.5 The major Hollywood studios are Columbia Pictures Industries, Inc., Warner Bros Entertainment, Inc., Disney Enterprises, Inc., Universal Studios, Inc., Twentieth Century Fox Film Corporation and Paramount Pictures Corporation. Each of these studios has a distribution arm which distributes the films it produces. Some of the major studio distributors also distribute the films of non-major studios. In addition to the major distributors that are affiliated to the six major studios, there are independent distributors, which distribute films made by non-major studios. In 2012, 750 new films were released by 127 distributors for cinema distribution in the UK. Of those, 250 films accounting for 95 per cent of box office revenue were released by 10 distributors.

4.6 Distributors are responsible for the marketing of the films they handle. Their aim is to maximize a film's profitability through promotional activity, the timing of the film's theatrical release and the subsequent exploitation of DVD and television rights. Although the number of film releases has increased rapidly in recent years, the majority of new films do not achieve widespread release. Films are generally classified as mainstream or specialized (or non-mainstream), the latter category including foreign language and subtitled films, feature documentaries, art-house productions and films aimed at niche audiences.[20] The BFI told us that the definition of specialized films included both films which were obviously specialized but also a range of films which were not inaccessible or challenging but which appealed to a specific demographic.[21] Specialized films generally account for about 8 per cent of box office revenue.[22]

Digitization of film distribution and exhibition

4.7 Digital cinema, the use of digital technology instead of 'film reels' to distribute and project motion pictures, was first demonstrated in the late 1990s. In the UK, the first significant investment in digital projection technology came as a result of a funding scheme set up by the UK Film Council in 2005 to support the distribution of specialized content.[23] From 2009, a second wave of investment was driven by the introduction of 3D films.

4.8 The Film Distributors' Association (FDA) told us that most of the costs of digitization had been borne by distributors.[24]

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[20] *BFI Statistical Yearbook*, 2012. For a full definition of specialized films, including the criteria used by the BFI to assess whether a film is specialized, see http://industry.bfi.org.uk/media/pdf/r/2/Defining_Specialsied_Film_Update_20_04_08_.pdf.
[21] Summary of the hearing with BFI, paragraph 17.
[22] Since 2003. The proportion was higher in 2009 and 2011 due to the popularity of some titles such as *Black Swan* and *The King's Speech*.
[23] www.launchingfilms.com/digital-film.
[24] Summary of hearing with the FDA*,* 24 May 2013.

4.9 It is estimated that, by the end of 2012, over 90 per cent of all screens in the UK were equipped for digital projection. The three large operators of multiplexes (Cineworld, Odeon and Vue Entertainment Holdings (UK) Limited (Vue)) became fully digitized during 2012.[25]

4.10 Cinema exhibitors told us that digital technology had delivered a number of benefits: it had given a high-quality experience to customers, enabled the growth of 3D, and made it easier to change programming and advertise with shorter lead times. Odeon commented that the full benefits of this had yet to be realized, as there was potential to programme even more flexibly.[26] In particular, Odeon anticipated that digital distribution would reduce the requirement for a fixed number of shows per week (historically a minimum of 21) and might result in any digital cinema being able to programme more varied content each week.

4.11 The availability of digital projection has made it possible for cinemas to show alternative content, such as the live screening of events happening elsewhere.[27] Alternative content includes operas, ballets, sporting events and pop music concerts. In 2012, there were 131 alternative content events, of which 52 were of operas, screened in UK cinemas, a 20 per cent increase over 2011.[28]

Cinema exhibitors

4.12 In 2012, there were 360 cinema exhibitors in the UK, 350 of which operated fewer than 20 screens each. The three largest exhibitors, Cineworld, Odeon and Vue,[29] accounted for more than 70 per cent of box office revenue and 63 per cent of

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[25] *Cinemagoing 22*, Dodona Research, March 2013.
[26] See Vue hearing summary (paragraph 4) and Odeon hearing summary (paragraph 18).
[27] See Vue hearing summary (paragraph 4), Odeon hearing summary (paragraph 18) and Showcase hearing summary (paragraph 7).
[28] *BFI Statistical Yearbook*, 2013.
[29] Excluding the Picturehouse and Apollo acquisitions.

screens, as shown in Table 1. All three primarily operate multiplexes. Both Odeon and Vue are owned by private equity firms.

TABLE 1 **GBOR share and number of sites and screens by exhibitor**

	2012 share %	*Sites (as at Jan 2013)*	*Screens (as at Jan 2013)*
Odeon	24.9	114	799
Cineworld	24.7	102	859
Vue	21.5	79	746
Showcase Cinemas	6.1	20	264
Empire Cinemas Limited	3.8	16	150
Picturehouse	1.7	21	59
Apollo Cinemas Limited	1.4	N/A	N/A
Others	15.9	417	921
	100.0	769	3,817

Source: BFI Statistical Yearbook, 2013, Picturehouse.

Notes:
1. Figures may not add to totals due to rounding.
2. The numbers for Picturehouse have been provided by the company and are inconsistent with the numbers published in the BFI Statistical Yearbook, 2013.
3. Not available: Apollo was acquired by Vue in 2012. Apollo operated 14 sites and 83 screens in 2011.
4. Others comprise 21 multi-site exhibitors and 329 independent single-venue exhibitors.

4.13 Another two companies, Showcase Cinemas Limited (Showcase) and Empire Cinemas Limited (Empire), accounted for 9.9 per cent of UK box office revenues. Both are family-owned businesses and operate primarily multiplexes. Prior to the merger, Picturehouse was the sixth largest exhibitor with a share of 1.7 per cent of the UK GBOR.

4.14 The long tail of 353 other exhibitors accounting for 16 per cent of box office revenue includes Curzon Cinemas Limited (Curzon) and Everyman Media Group Ltd (Everyman), both of which operate chains of non-multiplex cinemas.

Types of cinema

4.15 In 2012, there were 769 cinemas in the UK, of which 288 (37 per cent) were multiplexes. 75 per cent of the 3,817 screens in operation in the UK in 2012 were in multiplexes. Since 2000, the number of screens in multiplexes has increased every year and in 2012 one multiplex (nine screens) was closed and four new multiplexes (27 screens) were opened. Between 2000 and 2005, there was a steady decline in the number of screens in non-multiplex cinemas, though since 2005 the number has fluctuated with a general trend upwards. In 2012, 45 new non-multiplex cinemas opened (adding 56 screens) and there were 24 closures (loss of 24 screens). According to Dodona research, 2012 was the first year since 1994 when the number of screens in non-multiplex cinemas increased more than the number of multiplex screens.[30]

4.16 Multiplexes tend to be located in out-of-town sites with parking and close to food outlets or in shopping centres. They show predominantly mainstream films (in most cases films produced by the major studios), though with some variations to take account of local factors (eg if a cinema is close to a specific customer group, it may screen more films likely to appeal to that group).

4.17 Non-multiplex cinemas are typically located in town centres. Some of the non-multiplex cinema chains and independent cinemas[31] focus more on showing specialized films. Some of these cinemas show exclusively specialized films (and are typically referred to as 'art-house' cinemas), but the majority show a mix of mainstream and specialized films. Vue told us that in its opinion there were only a very small number of cinemas that played only specialized films, for example the Cornerhouse in Manchester, the Watershed in Bristol and the Showroom Cinema[32] in Sheffield. Odeon said that there was no longer a differentiation in the eyes of the industry between 'Hollywood films' and 'art-house' films and that the distinction between different types of cinemas had been eroded by more complex fragmentation, with cinema exhibitors trying to meet commercial targets by programming the most successful films for each cinema on a week-by-week basis. A number of parties

[30] *BFI Statistical Yearbook*, 2013. Non-multiplex figures include mixed use screens (used for film screenings only part of the time).
[31] Throughout this report, we use the term independent cinemas to refer to cinemas that are not operated by a multi-site cinema exhibitor.
[32] The trading name of the cinema owned by Sheffield Media & Exhibition Centre Ltd.

told us that they expected to see more overlap in future between film programming in multiplex and non-multiplex cinemas as digitization allowed all cinemas to be more flexible in their film programming.

4.18 According to the BFI, in 2012, 177 sites (268 screens, 7 per cent of screens) showed mostly specialized films and the majority (68 per cent) of specialized screens were found in single-screen, independent cinemas (ie not part of a chain).[33]

4.19 Some cinema exhibitors commented that Picturehouse's position in the market had changed, as the company had broadened its offering to include more commercial/ blockbuster products. They also commented that Everyman had followed a similar path.[34] Picturehouse disagreed with this view and told us that it remained committed to showing a broad range of titles including specialized and alternative content, and certain mainstream films. Picturehouse added that this was illustrated by the fact that it showed up to [✂] per cent more titles than multiplexes and that, for five cinemas it had selected,[35] between [✂] and [✂] per cent of the titles screened in 2012 were specialized and alternative content. Picturehouse also said that Everyman cinemas were programmed very differently from Picturehouse cinemas.

4.20 A small but increasing number of cinemas are now offering a premium experience at a higher price featuring enhanced levels of comfort, fewer seats and upmarket food and drink, often brought to customers' seats. Cineworld told us that premium cinemas showed mostly mainstream films. Showcase established its Cinema de Lux brand in 2008 and currently has three cinemas in Bristol, Derby and Leicester; Vue launched its Scene concept in 2010 (currently only available at Westfield London); Cineworld opened The Screening Rooms in Cheltenham in 2011 and has plans for

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[33] *BFI Statistical Yearbook*, 2013, section 10.7.
[34] Odeon hearing summary (paragraph 22) and Curzon hearing summary (paragraph 9).
[35] Bury St Edmunds, Cambridge, Aberdeen, Brighton, Southampton.

further expansion of this brand; and Odeon unveiled The Lounge concept in January 2012 at its London Whiteleys site. Market research found that tickets at premium cinemas cost between 63 and 91 per cent more than standard tickets on a weekend evening.[36]

4.21 Several other forms of specialization in cinema exhibition have been developed, eg in relation to technology (eg 3D/IMAX screens and moving chairs) and in relation to specific audiences (eg showings for parents with babies).

The economics of cinema exhibition

Revenue

4.22 The majority of a cinema exhibitor's revenue comes from box office takings, which are shared with distributors. GBOR in the UK was £1.1 billion in 2012, of which 58.3 per cent was generated by the top 20 films.[37]

4.23 Between 2001 and 2011, the box office share of the top 50 films in the UK and the Republic of Ireland fell from 84 to 74 per cent (but increased to 78 per cent in 2012), reflecting the increasing number of releases and a range of strong performances from specialized films and films produced in the UK.[38] Box office results in 2012 were significantly skewed by the performance of *Skyfall*, which was the highest grossing film of all time in the UK and grossed over £100 million (compared with the £73 million earned by the previous year's top film), almost 9 per cent of the whole year's box office.[39]

4.24 Cinema exhibitors gain revenue from two other main sources: concessions (eg food and beverages) and advertising. For multiplexes, soft drinks and popcorn remain the

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[36] [✂]
[37] *Cinemagoing 22*, Dodona Research, March 2013.
[38] *BFI Statistical Yearbooks*, 2012 & 2013.
[39] *Cinemagoing 22*, Dodona Research, March 2013, and *FDA yearbook*, 2013.

two core concession products. The average spend per head across all cinemas in the UK was £2.33 in 2011.[40]

4.25 Cinema exhibitors contract with screen advertising suppliers to provide advertisements on screen prior to a film, as well as in cinema foyers. In 2012, revenue for cinema exhibitors from screen advertising was £64.1 million in the UK, equating to 37p on each admission and approximately 4 per cent of total revenues in the UK.[41]

4.26 Cinema exhibitors have some other ancillary income streams which include the sale of 3D glasses, screen/auditorium hire fees, booking fees, income from games machines, website advertising, gift cards and sponsorships. Together these items add £40 million to industry revenues.[42]

Costs

4.27 The principal direct costs for cinema exhibitors are film rental payments to distributors (usually calculated as a percentage of box office revenues) and food and beverage wholesale costs. The percentage paid to distributors will depend on a number of factors, including the expected size of the film audience and whether the cinema is showing it on the release date (or later), as well as the location of the cinema and its penetration with audiences.[43] Cineworld told us that for most wide releases the distributor would usually insist on a minimum number of performances per day for the first week of release and that Cineworld may choose to play more but not fewer. For the second week, it would normally be in a better position to negotiate fewer screenings per day if it required.

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[40] *Cinemagoing 22*, Dodona Research, March 2013.
[41] ibid.
[42] ibid.
[43] www.cinemauk.org.uk/about-the-industry/.

4.28 The FDA told us that in the UK the amount paid to independent distributors for film rental was typically 28 to 32 per cent (after VAT), the lowest rate in Europe.[44] Cineworld told us that the amount that was paid for film rental varied from [✄] per cent of GBOR to in excess of [✄] per cent for the most successful blockbuster films, and Picturehouse told us that it paid an average of [✄] per cent of GBOR to distributors in 2012.

4.29 The main overhead costs are staff, property rental, energy, and repairs and maintenance. For the three large multiplex operators in the UK, staff costs and property lease rentals were 15.5 and 15.9 per cent of turnover respectively in 2012.[45]

5. Market definition

5.1 The purpose of market definition is to provide a framework for the CC's analysis of the competitive effects of the merger. The relevant market (or markets) is the market within which the merger may give rise to an SLC and contains the most significant competitive alternatives available to the customers of the merging companies. However, market definition is not an end in itself, and the boundaries of the market do not determine the outcome of the CC's analysis of the competitive effects of the merger in a mechanistic way. The CC may also take into account constraints outside the relevant market (or markets).[46]

5.2 As explained in paragraph 6.38, we considered three theories of harm, two of which relate to the possibility of unilateral effects in the provision of cinema exhibition

[44] Summary of hearing with the FDA, 24 May 2013.
[45] *Cinemagoing 22*, Dodona Research, March 2013. Odeon data includes results of the company's significant operations across a number of European countries. Both Cineworld (in the Republic of Ireland) and Vue (Republic of Ireland, Portugal and Taiwan) also have cinemas outside the UK but these operations are much smaller in relation to their UK circuits.
[46] *CC2*, *Merger Assessment Guidelines*, paragraphs 5.2.1 & 5.2.2.

services and one to the provision of film booking (or programming) services.[47] We sought to define the respective markets in which the services are supplied.

Cinema exhibition services

5.3 We examine in this section two dimensions of market definition:

(a) the product dimension (paragraphs 5.4 to 5.12); and

(b) the geographic dimension (paragraphs 5.13 to 5.18).

Product market

5.4 The starting point for our assessment of the relevant product market within which to assess the theories of harm based on horizontal unilateral effects is the supply of cinema exhibition services. This is for two main reasons.

5.5 First, both Cineworld and Picturehouse supply cinema exhibition services, creating an overlap in these services.

5.6 Second, a cinema exhibitor will face direct competition from other companies offering cinema exhibition services, so that the most direct demand-side competitive constraint on cinema exhibitors comes from other cinema exhibitors. We therefore considered that it was appropriate to treat all cinema exhibitors as belonging to the same product market and then assess the competition between cinemas within that product market, recognizing that cinemas are not homogeneous (as discussed in paragraphs 4.15 to 4.21), and the competitive interaction between cinemas will vary depending on the types of cinema. For example, all other things being equal, the closest competitor to a large multiplex showing predominantly Hollywood films is likely to be other large multiplexes showing similar films. Furthermore, on the supply side, digitization has increased the ability of cinema exhibitors to vary the range of films

[47] We did not seek to define markets for other services provided by the parties, as we did not identify any theory of harm for these services.

they show. Consequently, in principle they can now react more quickly to competitor successes and begin showing the same or similar films.[48] This could increase competition between cinemas, although we recognize that other factors, such as customer expectations or the nature of the contractual relationship with distributors, may limit the incentives for cinemas to change their repertoire.

5.7 The parties told us that they agreed with this approach:

> The Parties agree with the CC's statement in its Annotated Issues Statement that the competitive interactions between cinemas may vary by local area and by type of cinema, and consider that the implications of these differences are better analysed within the assessment of the competitive effects of the merger, rather than within market definition.

5.8 The parties also told us:

> the Parties consider that cinema offerings, particularly the art-house/independent product provided by Picturehouse, may be constrained by other leisure activities as well as by the increasing number of other ways of watching films. The Parties consider that the impact of these constraints on their operations should be taken into account in assessing whether the merger gives rise to an SLC.[49]

5.9 We considered whether we should widen the relevant product market to include other leisure activities. The parties told us that they competed for the 'leisure pound' in two ways: other venues (especially pubs) compete with their food and beverage offering. In addition, they monitor developments in the broader leisure context on a year to

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[48] See paragraphs 4.7–4.11 for a discussion of the impact of digitization. We discuss the extent to which this currently happens in practice in paragraphs 6.21 & 6.22 and note Odeon's comments that the full benefits of digitization had yet to be realized, as there was potential to programme even more flexibly, and that currently studios tended to secure the same exposure for their films as previously (hearing summary, paragraphs 18 & 19).
[49] Parties' initial submission, part IV, paragraph 2.2.

year basis. They told us that they did not, however, track the price of other leisure activities and did not suggest that the price of cinema tickets was constrained by other leisure activities.

5.10 We therefore do not consider it appropriate to widen the relevant market to include other leisure activities. However, to the extent that other leisure activities may exert a level of competitive constraint on the merged companies' conduct, the strength of this constraint was considered as part of our analysis of competitive effects.

5.11 We also considered whether the purchase of cinema tickets and ancillary products, such as food and drinks, should be treated as an aggregate purchase where consumers compare the prices of the aggregate package and then choose the cinema to attend. The cinema exhibitors we spoke to said that changes in the prices charged for food and drink had no substantial impact on cinema attendance levels.[50] This was consistent with our survey evidence: asked about the influence of refreshments on their choice of cinema, only a small minority of customers of either Cineworld or Picturehouse said that it influenced them a lot.[51] We therefore do not consider it appropriate to widen the relevant product market to include food and beverages.

5.12 Our product market definition is consistent with the approach taken by the CC in the Vue/A3 Cinema Limited merger case, where the CC concluded that the market was no wider than cinemas.[52]

[50] See, for example, Odeon's hearing summary (paragraph 9) and Vue's hearing summary (paragraph 3).
[51] Cineworld/City Screen Inquiry, a research report prepared for the CC, provided by GfK NOP Consumer & Retail, paragraph 50 and Figure 19.
[52] Vue Entertainment Holdings (UK) Ltd and A3 Cinema Limited*: a report on the completed acquisition of A3 Cinema Limited by Vue Entertainment Holdings (UK) Ltd*, paragraph 4.

Geographic market

5.13 The parties told us that outside London, a 20-minute drive-time broadly accorded with industry practice for multiplexes. In planning openings of new multiplexes, Cineworld often used a drive-time of 20 minutes to determine the optimal location of a site. The parties, however, argued that drive-times were referred to less in the context of art-house/independent cinemas as these were more likely to be situated in town and city centres.[53] The parties therefore did not consider a 20-minute drive-time to be an appropriate basis on which to define the geographic market for Picturehouse cinemas.

5.14 Data and documentary evidence provided to us by cinema exhibitors suggest that in general 20-minute drive-time isochrones provide appropriate geographic market boundaries:

(a) Odeon's data showed that, outside London, 75 per cent of customers travelled less than 20 minutes and 82 per cent of customers travelled less than 25 minutes. In London, 66 per cent of customers travelled less than 20 minutes, 72 per cent travelled less than 25 minutes and 77 per cent travelled less than 30 minutes.

(b) 20 minutes is the figure often used by cinema exhibitors when assessing new investments. For example, Odeon told us that 20 minutes was the drive-time it used when it was considering investing in new cinemas. In its assessment of the [✂] development, for example, Cineworld looked at the demographics of customers within a 20-minute drive-time.

(c) Cineworld told us that when advertising,

> Cineworld uses a 20 minute drive-time pattern to ensure that it does not incur wastage of effort. Cineworld will look at the main arterial routes into and out of the location of its cinema and aim to maximise

[53] Main parties' initial submission, paragraph 12.2.

its advertising spends along this corridor. More often than not Cineworld will advertise in local radio, local press or using online websites that have a broad reach.

5.15 Our own analysis suggested that in general, 20-minute isochrones provided appropriate boundaries for the assessment of competitive constraints on both Cineworld and Picturehouse cinemas:

(a) the CC survey[54] of Cineworld and Picturehouse customers showed that the average journey time to the cinema from the place where they had started their journey was just over 20 minutes, and this was true of both Cineworld and Picturehouse customers. [55] For one in five the journey time was 10 minutes or less, whilst a slightly smaller proportion took over 30 minutes to travel to the cinema. This is shown in Table 2.

(b) Price-concentration analysis (PCA)[56] indicated that outside of London Cineworld's prices are negatively associated with the number of nearby competitors within a 20-minute drive-time.

[54] Survey of Cineworld and Picturehouse customers carried out by GfK on behalf of the CC. This is described in Appendix D.
[55] Cineworld/City Screen Inquiry, a research report prepared for the CC, provided by GfK NOP Consumer & Retail, Figure 10 & paragraph 42.
[56] Using standard econometric regression techniques (ordinary least square(OLS)), we regressed average adult prices for Cineworld on variables indicating the availability of local cinema alternatives and other control variables which may influence the price customers pay. The analysis and its results are described in Appendix C.

TABLE 2 **Mode of travel, origin of journey and distance travelled for Cineworld and Picturehouse customers***

per cent

	Cineworld	*Picturehouse*	*All London cinemas*	*Non-London cinemas*
Travelled from home	88	89	86	90
Travelled from work	10	9	12	9
Other/don't know	2	2	2	1
Walked	16	32	25	26
Travelled by rail/London underground	9	8	23	2
Travelled by car	62	36	31	53
Travelled by bus	10	16	17	12
Cycled	2	7	2	7
Travelled 0–10 minutes	22	20	24	20
Travelled 10–20 minutes	39	37	37	38
Travelled 20–30 minutes	23	25	22	25
Travelled more than 30 minutes	16	18	16	17

Source: CC survey.

*Based on the 14 Cineworld and 11 Picturehouse cinemas covered by the survey. Responses weighted by number of visits.

5.16 We therefore provisionally decided that 20-minute isochrones provided appropriate geographic boundaries within which to assess the theories of harm based on horizontal unilateral effects. We noted that 20-minute isochrones were used in previous merger inquiry reports, including the OFT's report on the anticipated acquisition by Odeon Cinema Holdings Limited of assets of Reel Cinemas (UK) Limited[57] and the CC's report on the merger of Vue and A3 Cinema Limited.[58]

5.17 However, we recognized the need for flexibility in carrying out our analysis and that customers' travel times were driven by local competitive conditions. For example, we noted that travel patterns in London may differ from those outside London as customers rely more on means of transport other than the car to go to the cinema (as shown in Table 2), and therefore drive-time isochrones may be less appropriate in London than in other parts of the country. However, the CC survey suggested that 20-minute travel time isochrones remain appropriate for London (as shown in Table 2).

[57] ME/5141/11.
[58] *Vue Entertainment Holdings (UK) Ltd and A3 Cinema Limited: a report on the completed acquisition of A3 Cinema Limited by Vue Entertainment Holdings (UK) Ltd*.

5.18 The CC survey provided additional evidence on the extent to which 20-minute isochrones were appropriate in specific areas: the list of cinemas from which respondents could choose from included cinemas which were more than 20 minutes away and customers were able to identify additional cinemas if their cinema of choice was not in the list. We were therefore able to identify when 20-minute isochrones may not be appropriate and to take this into account in our assessment of the effect of the merger in local areas (paragraphs 6.56 to 6.118).

Programming services

5.19 The parties told us that Picturehouse operated the CSV Business, which provides film-booking services for [✂] cinemas. With the exception of one cinema, all are art-house/independent or premium cinemas in the UK.[59] Cineworld does not supply such services in the UK and therefore we do not consider there to be a horizontal overlap in this service.

5.20 We considered that the supply of programming services in the UK was an appropriate relevant market within which to assess the effects of the merger in this market. This is because: *(a)* these are the services offered by Picturehouse and competitors such as Reel Solutions (Film) LLP and the not-for-profit Independent Cinema Office (see paragraph 6.140); and *(b)* Picturehouse offers these services to cinema exhibitors across the UK. The parties have not expressed a view on the relevant market for programming services.

Conclusions on market definition

5.21 We provisionally concluded that the relevant markets in which to assess the competitive effects of the merger were:

[59] Initial submission, paragraph 5.7.

(a) the markets for cinema exhibition services in the catchment areas (defined by reference to 20-minute isochrones) of the parties' cinemas (including proposed cinema developments, where relevant); and

(b) the market for cinema programming services in the UK.

6. Assessment of the competitive effects of the merger

6.1 In this section, we first describe the nature of competition in the market for cinema exhibition services (paragraphs 6.2 to 6.22). We also consider what is the appropriate counterfactual situation (paragraphs 6.23 to 6.32) against which we then assess the effects of the transaction (paragraphs 6.33 to 6.149).

The nature of competition in the market

Positioning of cinemas

6.2 The parties emphasized the differences between the overall cinema offerings of Cineworld (and multiplex cinemas in general) and of Picturehouse. They told us that because of the high level of differentiation between their cinemas, they served different audiences and faced different competitors:[60]

(a) Picturehouse cinemas were programmed individually and showed a wide range of films, while Cineworld cinemas were programmed on a more formulaic basis in accordance with national programming policies dictated and measured by market share expectations.

(b) Picturehouse's cinemas provided an 'intimate ambience', a 'grown up environment' and facilities that enabled customers to socialize, while Cineworld's cinemas were not designed to encourage dwell time.

(c) Food and drink represented a higher proportion of revenue at the Picturehouse cinemas. In addition, Picturehouse's customers sought freshly cooked food and

[60] Initial submission.

alcoholic beverages, while Cineworld's customers tended to purchase soft drinks and popcorn.

6.3 By contrast, Vue and Odeon did not draw such clear distinctions between the positioning of multiplexes and independent cinemas. Odeon told us that it was constantly evolving its cinema offer and attempting to ensure that each cinema catered for the widest demographic and taste and gave examples of refurbishments and upgrades it had carried out to meet specific needs. Vue stated that 'a cinema is a cinema'. These views were echoed by Curzon: it believed that there was a large overlap between cinema types, with 60 per cent of customers willing to go both to multiplexes and independent cinemas.[61]

Monitoring of competition

6.4 We asked the parties and other cinema exhibitors to describe the activities they undertake aimed at monitoring the behaviour and actions of their competitors.

6.5 Cineworld told us that it monitored competing multiplex operators (AMC Theatres of UK Ltd, Empire, Odeon, Showcase and Vue), with a particular focus on Odeon and Vue. For these operators, [✂].

6.6 Picturehouse told us that it did not routinely monitor the activities of other cinemas, either on a national or local level. It generally monitored its share of box office revenue and that of the other main cinema groups. The only cinema for which it monitored box office revenues specifically was Cineworld Bury St Edmunds.

6.7 Odeon told us that although it perceived Vue and Cineworld as its main competitors nationally, competition took place predominantly at the local level. Any cinema

[61] Hearing summary, paragraph 11.

operating in a given catchment area was able to show the same films whether it was a large chain or an independent and regardless of the number of screens it had. Therefore Odeon considered that it would be in competition with all cinemas in the local market for each of its cinemas.[62] It monitored prices at the local level and the evidence we saw shows that it monitors all cinemas (including Picturehouse) in any given area.

6.8 Vue told us that it monitored other cinemas' programming, market share, box office revenues and both ticket prices and prices of ancillary products in all areas where it had a cinema. As a rule of thumb, Vue saw each cinema's market as covering a 20-minute drive-time around it, and viewed every cinema within that isochrone as a competitor. It did not distinguish between multiplexes or art-house cinemas in choosing which to monitor.[63]

6.9 Similarly to Odeon and Vue, Showcase told us that it viewed any and all cinemas as competitors in each local market and actively monitored what they were playing, their prices, whether they were giving more priority to 3D or 2D versions of a film, and their running times and start times.[64]

6.10 We found that in general smaller operators tend to carry out less formal monitoring of the activities of other cinema operators and some (eg The Institute of Contemporary Arts (ICA)) focus their monitoring on certain types of cinemas. Others, however, take a similar approach to that of the large operators: Filmhouse Edinburgh, for example, told us that it constantly monitored its competitiveness across the board within its local area.

[62] Hearing summary, paragraph 20.
[63] Hearing summary, paragraph 11.
[64] Hearing summary, paragraph 8.

6.11 Most operators we talked to told us that they monitored their competitors in local areas. Some operators monitored only certain types of cinemas, but many monitored all cinemas, regardless of their size or mix of programming.

Pricing and service quality

6.12 We asked the parties and other cinema exhibitors how they set their prices and the level of service quality that they provide in their cinemas.

6.13 Cineworld told us that, through its annual pricing review process, [✂].

6.14 Picturehouse told us that ticket prices were set [✂] with the result that each cinema had separate ticket pricing. Picturehouse said that [✂]. Because Picturehouse offered a premium experience, prices at other premium cinemas in an area were more relevant than prices at the local Cineworld cinemas. Picturehouse, however, explained [✂].

6.15 Odeon told us that competitive factors such as prices, content, film schedules, service delivery and the facilities (including refurbishments to improve ambience or to offer additional facilities) offered were set by cinema managers in response to local competitive conditions, in conjunction with central resources (eg film booking). The competitive offering was driven by differences in the demographic and socio-economic characteristics of the local population, the age of the cinema and competitor activity in the local areas. Opening hours were set by local management and took account of local competitor activity.

6.16 Vue told us that quality and service were set by central management through the allocation of capital expenditure and price was set at the central level, based on detailed information about the marketplace in which a cinema operated.

6.17 Most of the smaller operators we talked to[65] also told us that they took account of local competition when setting their prices (eg Rich Mix, Filmhouse Edinburgh, Bishop Grosseteste University, ICA, Regal Ipswich, Connaught Theatre Worthing, Midlands Art Centre, Rio Cinema), but some appeared not to take account of local competition (eg Peckhamplex, Newbury, Orion Cinemas) or to look at UK averages at similar venues (eg No 6 Cinema Portsmouth).

6.18 Overall the evidence shows that when setting the price of cinema tickets, exhibitors take account of the prices of all types of cinemas operating in their local area. The extent to which service quality is driven by local conditions rather than policies set by the head offices of the multi-site operators is less clear.

Customer segmentation, marketing and membership schemes

6.19 The cinema exhibition industry commonly applies different prices to different categories of customers. Odeon told us that segmentation by age group was common across the industry, although some cinema 'chains' might not offer a ticket type for teenagers. Odeon also used data gathered through its customer relationship management (CRM) systems to encourage repeat visits through targeted marketing. Cineworld analyses its customers in two ways: by lifestyle and using data on customers' behaviour that it gathers through its CRM system, and uses both to target its marketing initiatives. Vue told us that it currently segmented customers on a generic and basic level, although it was seeking to improve its understanding of its audiences using data on web-registered ticket purchasers. Picturehouse mainly segments its customers by reference to the films they watch and the clubs and groups to which they belong.

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[65] We sent a questionnaire to 22 smaller operators and received responses from 17 of them.

6.20 Many operators also operate membership schemes, which enable them to encourage repeat purchases and provide data on customer behaviour, which can in turn be used for targeted marketing campaigns:

(a) Cineworld operates two schemes: a subscription service using a membership card (the 'Unlimited Card' scheme), which provides subscribers with unlimited entrance for a set price per month; and a free membership scheme, which allows members a 10 per cent discount on tickets when booking online as well as no booking fees (the MyCineworld scheme). Cineworld uses the information gathered through the schemes to increase usage, target marketing activities and to understand trends in what people watch.

(b) Picturehouse offers a number of membership schemes aimed at specific customer groups (eg students, children, concessions), which provide customers with discounts and free tickets. Picturehouse uses the data it collects through these schemes to target marketing activities to specific segments of the audience.

(c) Odeon operates a loyalty card scheme, which it uses to encourage not only repeat purchases, but also to encourage attendance at times when attendance would otherwise not be strong and to help understand changes in local market conditions.[66]

(d) Vue told us that it did not currently operate a membership scheme, [✂].

(e) Showcase also operates a membership scheme.[67]

(f) Several of the other operators we talked to also offer memberships schemes (eg Curzon, Filmhouse, Everyman, Rich Mix, Connaught Theatre Worthing, Rio Cinema.)

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[66] Hearing summary, paragraph 10.
[67] Hearing summary, paragraph 3.

Range of titles and programming

6.21 We asked the parties and other cinema exhibitors whether they have changed their planned repertoire in reaction to, or anticipation of, the film programming of other local cinemas:

(a) Cineworld told us that its programming was done largely without consideration of the competition. The main exception was the West End, where distributors restricted access to films that were shown in the Odeon Leicester Square cinemas and the BFI IMAX.

(b) Picturehouse similarly commented that it was unlikely to change its planned repertoire in reaction to, or in anticipation of, the film programming of other local cinemas. There were, however, rare instances when it had to change its planned programming because a distributor would only supply the film to a competitor in the area.

(c) Odeon told us that programming was a central decision, but made cinema by cinema based on the forecast of film performance and factors such as the local demographics and the number of screens available. It paid attention to what its competitors were showing, and might adjust its programme accordingly, although it would be easier to adjust the number of performances of an existing film than to add a new one at short notice.[68] It had, on limited occasions, changed its film screening programme due to the film programming at local competitors' cinemas. [✂]

(d) Showcase told us that programming decisions took into account the local market around each cinema. It did not look at what its competitors were showing when making programming decisions.[69]

(e) Vue told us that decisions on what films to show were not based on what other cinemas were showing.[70]

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[68] Hearing summary, paragraphs 13 & 21.
[69] Hearing summary, paragraphs 5 & 8.

(f) Similar comments were made by smaller operators. For example, Filmhouse Edinburgh told us that that it had never changed its plans due to a film being programmed in another cinema. It chose films for its audience with little reference to where else they might play locally.

6.22 The evidence we received from cinema exhibitors suggests that programming decisions are generally not influenced by the activities of competitors, although there are some exceptions.

Counterfactual

6.23 Before we turn to the effects of the transaction, we need to assess what we expect would have been the competitive situation in the absence of the transaction. This is called the 'counterfactual'.[71] It provides a benchmark against which the expected effects of the transaction can be assessed. The CC will typically incorporate into the counterfactual only those aspects of scenarios that appear likely on the basis of the facts available to it and the extent of its ability to foresee future developments.[72]

6.24 We first examined the financial situation of Picturehouse to establish whether it was a failing or exiting firm. Based on the growth in revenue and EBITDA margin the business achieved in the period 2008 to 2012, as set out in Appendix B, Table 2, we reached the view that Picturehouse was a profitable business that could have continued to operate as a stand-alone entity absent the merger.

6.25 We considered whether, absent the merger, it was likely that Picturehouse would have been sold to another purchaser. As noted in paragraph 3.1 there was no formal sale process and the shareholders of Picturehouse did not enter into negotiations

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[70] Hearing summary, paragraph 12.
[71] *CC2*, paragraph 4.3.1.
[72] *CC2*, paragraph 4.3.6.

with any other buyer. Arts Alliance Advisors said that it did not see either of the other two major operators of multiplexes (Vue and Odeon) as likely to better Cineworld's offer price, although Arts Alliance Advisors did not approach either of these organizations, or any other possible bidders. [✂] Based on this evidence, we did not consider it likely that, absent the transaction, Picturehouse would have been sold to another purchaser.

6.26 The parties told us that, in the absence of the transaction, it was likely that Picturehouse would have remained independent. In this situation, the parties said that it was unlikely that Picturehouse's growth strategy would have been achieved as quickly or as efficiently as was expected to be the case under Cineworld's ownership.[73] Arts Alliance Advisors told us that absent the merger it was likely that Picturehouse would have considered the possibility of an Alternative Investment Market (AIM) flotation, an option it had already envisaged twice in 2009 and 2011. This would have enabled Picturehouse to achieve faster growth than if it had continued to be owned by its existing backers.[74] Picturehouse confirmed that AIM flotation was its favoured option, but it recognized that it would have been difficult to achieve. Alternatively it would have sought a new venture-capital shareholder [✂].

6.27 In order to establish the likely future growth of Picturehouse absent the merger, we first examined a plan prepared in May 2012 for the purpose of a pitch for funding made to [✂].[75] This forecast an increase in Picturehouse's turnover from £[✂] million in 2013 to £[✂] million by 2015 and assumed the opening of [✂] new cinemas by the end of 2015, supported by £[✂] million funding [✂]. However, Picturehouse told us that this was an aspirational plan and that discussions with [✂] were at an early stage. We have therefore not treated this plan as the most probable

[73] Initial submission, 22 May 2013.
[74] Summary of hearing with Arts Alliance, paragraph 12..
[75] [✂]

forecast of Picturehouse's performance in the event that the merger had not taken place.

6.28 We next sought evidence directly from the shareholders of Picturehouse. While Arts Alliance investors were supportive of Picturehouse's development plans, Arts Alliance Advisors said it was unlikely that the Arts Alliance investors would have acted as sole funders to fund the level of growth that Picturehouse was targeting. In the event that the merger had not taken place, it said it was likely that Picturehouse would have been restricted to opening a maximum of [✂] new cinemas each year.[76] In our view, it is likely that these new cinemas would have been funded [✂].

6.29 Picturehouse told us that securing the financing for new cinemas on a project-by-project basis was very time consuming. It said that although its ambition, as stated in business plans, was to open [✂] cinemas per year, in practice it would have managed to open at most [✂] per year.

6.30 We decided that absent the merger, it was likely that Picturehouse would have continued to pursue alternative sources of funding, including but not limited to an AIM listing and [✂] funding. In our view, however, the outcome of such efforts was uncertain.

6.31 We therefore provisionally conclude that absent the merger, Picturehouse would have remained independently owned and would have grown organically at a rate of [✂] or [✂] cinemas per year. Picturehouse's expansion plans in the absence of the merger are used in our assessment of the impact of the merger on potential competition (paragraphs 6.120 to 6.131).

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[76] Summary of hearing with Arts Alliance, 23 May 2013.

6.32 We also considered Cineworld's expansion plans absent the merger. Cineworld is planning [✂]. We adopted this expansion plan as our counterfactual of Cineworld's development in our consideration of the impact of the merger on potential competition (see paragraph 6.123).

Effects of the merger

6.33 In paragraph 5.21, we defined the relevant markets as:

(a) the markets for cinema exhibition services in the catchment areas (defined by reference to 20-minute isochrones) of the parties' cinemas (including proposed cinema developments, where relevant); and

(b) the market for cinema programming services in the UK.

6.34 In paragraph 6.31, we provisionally conclude that the appropriate counterfactual is that absent the merger Picturehouse would have remained independently owned and would have grown organically at a rate of one or two cinemas per year.

6.35 In paragraphs 6.2 to 6.22, we analysed the nature of competition in the relevant markets prior to the transaction.

6.36 The parties told us that because of the strategic rationale for the transaction, the transaction would not have any negative impact on the quality of the products offered by either Picturehouse or Cineworld cinemas. The parties provided an analysis of the five local areas identified in the reference to us (Aberdeen, Brighton, Bury St Edmunds, Cambridge and Southampton) and told us that they did not consider that the merger might be expected to result in an SLC in any of these five areas, because the offerings of Picturehouse and Cineworld were so different from each other.[77] The key differences they identified are summarized in paragraph 6.2.

6.37 We now consider whether the transaction has substantially lessened, or may be expected substantially to lessen, competition in these markets by reference to the counterfactual situation. In doing so, we take into account competitive constraints from within and outside the relevant markets.

Theories of harm

6.38 In our statement of issues,[78] we identified three ways in which the transaction could give rise to an SLC (the three theories of harm):

(a) *Unilateral horizontal effects at a local level.* The concern under our first theory of harm is that the removal of one competitor, in some or all of the areas where the parties both have cinemas, could allow the merging parties to increase their prices or reduce the quality of their services locally. Examples of quality reduction could include the quality and range of the films shown, the standards of the venues, associated product offerings and opening times. It was also possible that the transaction might incentivize the merged company to close one of its existing venues.

(b) *Unilateral effects at a local level due to the loss of a potential competitor.* The second theory of harm is that the transaction might lead to a loss of a potential competitor in an area.

(c) *Unilateral effects at a local level in non-overlap areas.* The concern under our third theory of harm is that following the merger, Picturehouse could use any influence it exerts on other cinema operators through, in particular, the provision

[77] Initial submission, p41.
[78] www.competition-commission.org.uk/assets/competitioncommission/docs/2013/cineworld-city-screen/issues_statement_.pdf.

of programming services to distort the competitive process between Cineworld and those cinemas in certain local markets for cinema exhibition services.

6.39 A number of operators expressed concerns about their future access to the films distributed by Picturehouse.[79] This concern was not, however, shared by others,[80] and we considered that, given the low number of films distributed by Picturehouse (see paragraph 2.6(b)), the merger was unlikely to lead to competition problems in this area.

6.40 Similarly, we received a complaint regarding the distribution of alternative content, and in particular of National Theatre Live content, by Picturehouse to other independent cinemas.[81] We noted that the comments made in the complaint were not merger specific. In addition, the evidence we received from Picturehouse, Odeon[82] and National Theatre Live suggested that the issues identified were more likely to be caused by National Theatre Live's policies of increasing access as widely as possible and avoiding adding new venues situated close to existing venues rather than by Picturehouse's alleged conduct. We also noted that Picturehouse's contract with National Theatre Live [✂]. We therefore considered that the transaction was unlikely to result in competition concerns in this area. We also considered it unlikely that the transaction would lead to competition problems in relation to the other services provided by the parties to other cinema exhibitors.

6.41 We indicated in our statement of issues that we considered it unlikely that the conditions for coordination would be significantly affected by the transaction. We did not receive any evidence that it might in response to our statement of issues and therefore did not investigate this issue further.

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[79] FDA hearing summary, paragraph 13; Vue hearing summary, paragraph 19; Odeon hearing summary, paragraph 31.
[80] Showcase hearing summary, paragraph 13.
[81] Submission received from South Hill Park.
[82] See Odeon hearing summary, paragraph 17.

6.42 As explained in Appendix C, we have provisionally concluded that if there is a commercial incentive to open a new cinema in a particular location, there are no insurmountable barriers to entry, although it may take several years from the start of the entry process. However, we consider that the likelihood of entry in specific areas may vary significantly. We therefore analyse the likelihood of entry in our detailed analysis of the unilateral effects of the transaction in the relevant overlap areas.

6.43 With regard to countervailing buyer power,[83] we note that the customers of cinema exhibitors are members of the public. We saw no evidence to suggest that they had the ability to group together to exert buyer power in order to keep prices low. This was not disputed by the parties.

Assessment of Theory of Harm 1—loss of competition in local areas

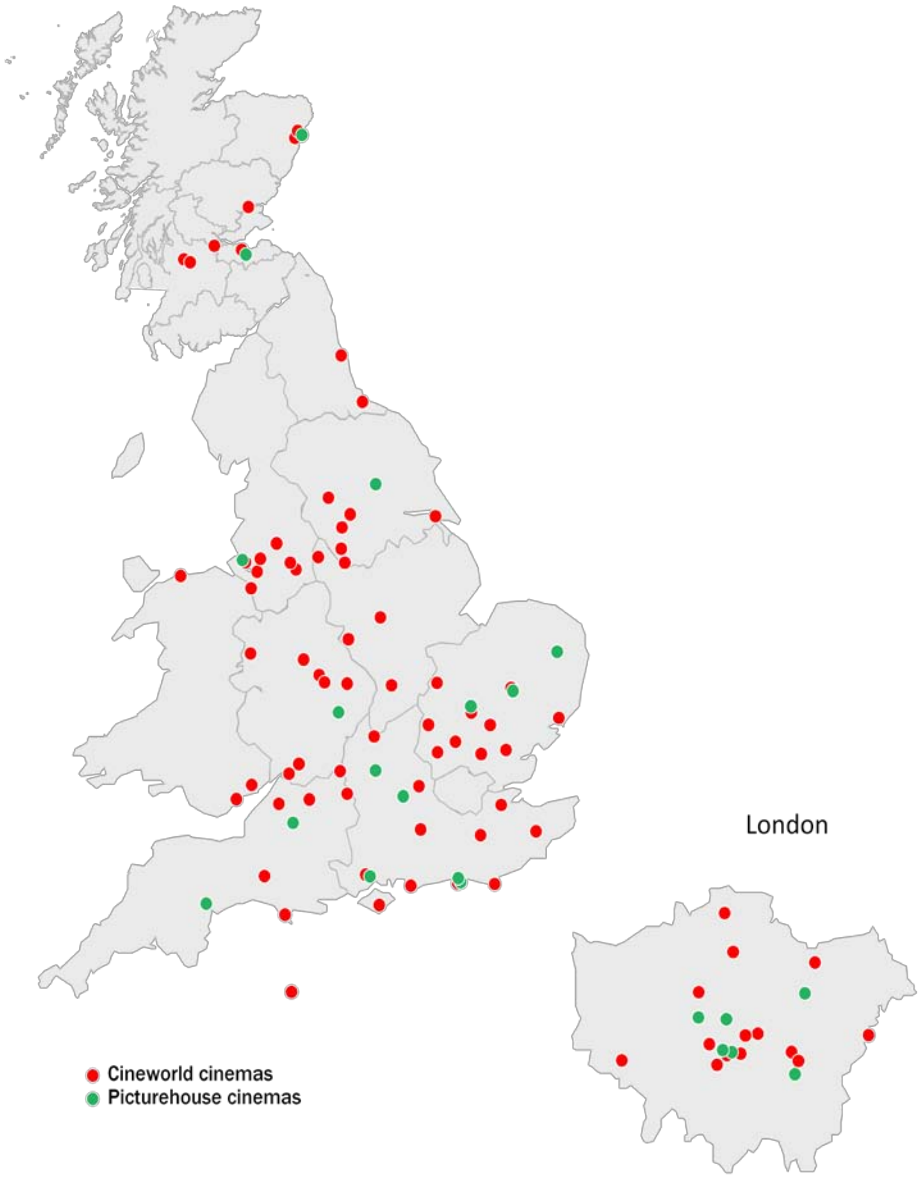
Methodology

6.44 We started our analysis with the 79 Cineworld cinemas and 21 City Screen cinemas. They are shown in Figure 4.

[83] See *CC2,* paragraphs 5.9.1–5.9.8.

FIGURE 4

Parties' cinemas in the UK



Source: Cineworld.

6.45 We carried out a two-stage process. The first stage was designed to identify the areas which may give rise to concerns based on a high-level analysis of the catchment areas of each cinema. We then carried out an in-depth analysis of the cinemas and associated areas shortlisted through the initial filtering process in order to assess whether the merger would be likely to raise competition concerns in any of those local areas. We describe below the approach and tools we used in each phase. As noted in paragraph 5.17, there may be material differences in the way customers behave in and outside of London. We took this into account in the methodology we used, as highlighted below.

- *Filtering of cinemas*

6.46 We carried out a filtering process to rule out local areas where the merger was unlikely to raise competition concerns. As a first step we identified each merging party's cinemas which were more than 30 minutes' drive-time from the nearest cinema of the other merging party. The second step involved identifying those cinemas in areas where the merger would result in a reduction in the number of fascias[84] from five to four or better, based on both a 20- and 30-minute isochrones. At this stage in the process, we excluded independent cinemas.[85]

6.47 Having carried out this analysis, we cross-checked the outcome with the list of ten areas that the OFT had investigated in more depth and noted that there were two London Picturehouse cinemas, Clapham and Stratford, which had not been shortlisted through our filtering process. Given that the OFT had based its assessment on survey data (a tool which was not used as part of our filtering process) and the fact that drive-time analysis may be less applicable in London, we considered it prudent to carry out further analysis of these two areas and therefore added them back into our shortlist of cinemas for further analysis.[86]

- *Analysis of shortlisted areas*

6.48 For each of the shortlisted areas, we sought to evaluate the strength of the competitive constraint that the merging parties exert on each other; the incentive of the

[84] One fascia includes all cinemas in a given area that are under common ownership.
[85] The fascias that are included in the analysis are cinemas owned by: Cineworld, Curzon, Empire, Hollywood, Odeon, Picturehouse, Reel, Showcase and Vue.
[86] The OFT had also investigated Stratford upon Avon in more depth, but given that the Picturehouse Stratford upon Avon cinema was outside London we were confident that the fascia analysis based on drive-times was robust.

merging parties to increase prices following the merger due to the internalization of lost profit[87] estimated quantitatively through a combination of diversion ratios and the parties' profit margins; the strength of the competitive constraint that other cinemas (including independent cinemas) exert on each of the merger parties, thus limiting their ability to increase prices; and the likelihood that timely entry in the area would counteract any competition concerns. This assessment was carried out using a series of complementary sources of evidence and analysis.

6.49 The evidence we gathered mainly consisted of:

(a) CC survey: we conducted an online and a telephone survey of customers of both Cineworld and Picturehouse in a number of areas where the two companies both operate cinemas. More details on the survey are provided in Appendix D.

(b) Parties' survey: prior to the reference being made to the CC, the parties commissioned a survey.[88] This is described in Appendix D and differences between this survey and the survey we commissioned are also described.

(c) Data provided by the main parties in response to our data request: in particular on number of screens, number of seats, profit margins, revenue, description of cinemas, opening and closing dates of cinemas, description of their monitoring activities, internal documents.

(d) Evidence provided by third parties, in particular: competitors' monitoring activities and perception of whom they compete with in the relevant local areas; relevant internal documents and research, including customer surveys; opening and closing dates of cinemas; planned openings of new cinemas.

(e) Daily box office revenue by programme for all cinemas in the relevant areas.[89]

(f) Maps of the relevant local areas.

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[87] The profit on lost sales from customers who previously switched to the products of the other merging parties following a price rise would be retained within the wider group (comprising Picturehouse and Cineworld cinemas) following the transaction.
[88] As explained in Appendix D, this was followed by a second survey, which primarily covered customers' views on various aspects of the cinema they visited. Only the first survey included diversion questions.
[89] Compiled by Rentrak.

6.50 The main analytical tools we relied on are briefly described below:

(a) *Analysis of fascia reduction within 20- and 30-minute drive-time isochrones around each of the merging parties' cinemas*. This is discussed in more depth in Appendix G.

(b) *Calculations of diversion ratios based on two survey questions,* one asking customers what they would do in response to a 5 per cent rise in the price of cinema tickets (we refer to this as the price diversion ratio), and the other one what they would do in response to the closure of the cinema for a one-year period (we refer to this as the forced diversion ratio). The two calculations provided the lower and upper bounds of our estimates. This is discussed in more depth in Appendix D, paragraphs 25 to 29.

(c) *Analysis of pricing incentives resulting from the internalization of profits that would have been lost to Cineworld and/or Picturehouse before the merger.* We used Gross Upwards Pricing Pressure Index (GUPPI) calculations[90] for this assessment. This is discussed in more depth in Appendix F.

(d) *Analysis of past events*. We analysed the effect of cinema openings, closures and ownership changes on the revenue of nearby cinemas. The analysis used control groups in an attempt to isolate any change associated with the event from more general market developments. This is discussed in more depth in Appendix G.

(e) *Analysis of the revenue overlap for the films shown*. We based this assessment on the revenue earned by competing cinemas in the relevant local areas.

(f) *Analysis of the cinemas visited in the past six months by the respondents to our survey.* We used this information to complement the responses to the hypothetical questions on customers' propensity to switch to another cinema in response

[90] This measures the change in incentives brought about by the transaction (in the absence of potential supply-side responses by competitors). The formulas for Cineworld and Picturehouse can be found in Appendix F, paragraphs 10 & 11.

to a price rise or a cinema closure. This is discussed in more depth in Appendix G.

(g) *Analysis of the location of customers, based on the postcode of respondents to our survey.* We have carried out this additional analysis for the Clapham area in order to understand this catchment area more fully.[91] This is discussed in more depth in Appendix G.

6.51 We also reviewed the analyses submitted by the parties:

(a) Analysis of the number of competing fascias based on 'customer recentering' using transaction data.[92] This is discussed in Appendix G.

(b) Diversion ratios using two sources of evidence: their survey results. This is discussed in Appendix D, and past events in Aberdeen and Bury St Edmunds. This is discussed in Appendix F, paragraphs 12 to 27.

(c) Analysis showing the percentage of overlapping GBOR, films and viewings at Cineworld and Picturehouse cinemas. This is discussed in Appendix G.

(d) Analysis comparing the elasticities implied by our survey with the parties' gross margins. This is discussed in Appendix D, paragraphs 9 to 12.

6.52 To summarize, our main views on the parties' analyses are as follows:

(a) We agreed that in principle customer recentering was one valid approach in assessing the choices that customers make, but the quality of the results depends on the accuracy of the data relating to customers. We had concerns regarding the use of transaction data for the analysis carried out by the parties. This problem is likely to be more acute in towns where there is a large student population where the billing address is not the same as the actual living address.

[91] The reasons for carrying out this additional analysis are set out in the relevant section (paragraphs 6.87–6.89).
[92] The parties submitted two technical papers.

(b) We agreed that diversion ratios based on events could provide useful information, but had concerns regarding the inferences that the parties drew from the particular entry events in Aberdeen and Bury St Edmunds.

(c) We considered that revenue overlap analysis was a better overlap measure than film overlap as revenue overlap takes into account the amounts customers spend and is therefore a better measure of the relative overlap from a commercial perspective.

(d) We considered that the CC survey results were generally robust and noted those specific occasions where there were potential issues.

6.53 In weighing this evidence and analysis, we had regard to the strengths and weaknesses of each tool in the particular context in which it was used and we made our evaluation in the round. To the extent possible, we sought to understand the source of any apparent inconsistencies between the results and conclusions that could be drawn from the various sources of evidence and analysis that we used. Our detailed analysis area by area is set out in Appendix G. We summarize the most probative information and analysis, along with our provisional conclusions on the likely competitive effects of the merger in each area, in paragraphs 6.57 to 6.118 below.

Outcome of the filtering process

6.54 Following the filtering process, we identified ten Picturehouse cinemas that required further investigation: Aberdeen, the Duke of York and Duke's @ Komedia (in Brighton), Bury St Edmunds, Cambridge, Clapham (in London), Edinburgh, Greenwich (in London), Southampton and Stratford (in London).

6.55 Following the filtering process, we also identified 13 Cineworld cinemas that required further investigation: Aberdeen—Queen's Link, Aberdeen—Union Square, Brighton, Bury St Edmunds, Bexleyheath (in London), Cambridge, Chelsea (in London), Edinburgh, Fulham Broadway (in London), The O2 (in London), Southampton, Wandsworth (in London) and West India Quay (in London). Combining the two, we identified nine areas[93] for in-depth analysis:

(a) Aberdeen, comprising the catchment areas around the Picturehouse cinema known as the Belmont and the Cineworld cinemas in Queens Link and Union Square;

(b) Brighton, comprising the catchment areas around the two Picturehouse cinemas (Duke of York and Duke’s @ Komedia) and the catchment area around the Cineworld at Brighton Marinal;

(c) Bury St Edmunds, comprising the catchment areas around the Picturehouse cinema known as the Abbeygate cinema and Cineworld Bury St Edmunds;

(d) Cambridge, comprising the catchment areas around the Picturehouse cinemas known as the Cambridge Arts and Cineworld Cambridge;

(e) Clapham, comprising the catchment areas around the Clapham Picturehouse and Cineworld Chelsea, Cineworld Fulham Road and Cineworld Wandsworth;

(f) Edinburgh, comprising the catchment areas around the Picturehouse cinema known as the Cameo and the Cineworld cinema located in Fountain Park;

(g) Greenwich, comprising the catchment areas of Cineworld’s cinemas in Bexleyheath, The O2 centre and West India Quay and the catchment areas of Picturehouse’s cinema in Greenwich;

(h) Southampton, comprising the catchment areas of Picturehouse’s Harbour Lights cinema and Cineworld’s Southampton cinema; and

(i) Stratford (London), comprising the catchment areas of Cineworld O2, Cineworld West Quay and Picturehouse Stratford (together referred to as the Stratford cinemas).

[93] For the avoidance of doubt, we do not define the cities and towns as geographic markets.

Analysis of the short-listed areas

6.56 In paragraphs 6.57 to 6.119 below we synthesize this evidence for the nine areas and set out our provisional views on the likelihood of the merger raising competition concerns in each of these areas.

- *Aberdeen*

6.57 In Aberdeen, prior to the merger, Cineworld operated two cinemas (Cineworld Aberdeen Union Square and Cineworld Aberdeen Queens Link) reachable in drive-times of 3 and 4 minutes respectively from Picturehouse Aberdeen. Vue also operates one cinema which is marginally closer (2 minutes' drive-time) to Picturehouse Aberdeen. There is no other cinema in the area and the merger would therefore result in a reduction in fascia count from three to two, with the parties owning three of the four cinemas in Aberdeen. Post-merger, the merged entity's share of screens and seats would be 74 and 77 per cent respectively. The merged entity's share of revenues would be [80–90] per cent, with the acquisition of Picturehouse contributing a 4 per cent increment. We noted that despite having a 23 per cent share of seats, Vue's share of revenue was only [10–20] per cent.

6.58 63 per cent of Picturehouse Aberdeen's revenue overlaps with Cineworld Aberdeen - Union Square (and 42 per cent with Cineworld Aberdeen—Queens Link). The opening of Cineworld Aberdeen Union Square in 2009 resulted in a 34 per cent reduction in revenue for Picturehouse Aberdeen. Picturehouse's internal documents (see Appendix G, paragraph 31) are consistent with the event analysis, suggesting a strong competitive constraint from the two Cineworld cinemas and from Cineworld Aberdeen Union Square in particular.

6.59 Our survey shows that, in response to a price rise at Picturehouse Aberdeen, of those customers who would switch,[94] [50–60] per cent would switch to Cineworld Aberdeen—Union Square, [20–30] per cent to Cineworld Aberdeen - Queens Link and [20–30] per cent to Vue Aberdeen. In response to a price rise at Cineworld's cinemas, of those customers who would switch, between 50 and 65 per cent would switch to Vue Aberdeen and 16 to 20 per cent to Picturehouse Aberdeen. Our analysis of customers' historical visits shows that [50–60] per cent of Picturehouse visits were from customers who had visited Cineworld Aberdeen—Union Square in the past six months. The equivalent overlap with Cineworld Aberdeen—Queenslink was [20–30] per cent and the overlap for Vue Aberdeen was [20–30] per cent. The biggest overlap was between the two Cineworld cinemas ([40–50] and [60–70] per cent). Taken as a whole, the survey evidence suggests that, before the merger, Cineworld Aberdeen—Union Square was the strongest constraint on Picturehouse Aberdeen.

6.60 The GUPPI result suggests that the incentive of the parties to increase prices charged at the Picturehouse cinema post-merger is particularly strong, both in absolute terms and by comparison with the GUPPIs we have calculated for other Picturehouse cinemas. The Cineworld GUPPIs suggest that the incentive to raise prices as a result of the merger appears weaker for Cineworld compared with Picturehouse's cinema. We noted that the low margins currently generated by Picturehouse Aberdeen contributed to the low GUPPI for Cineworld's cinemas in Aberdeen.

6.61 We did not see any evidence that would suggest that timely new entry is likely in Aberdeen. Consistent with this, Picturehouse Aberdeen currently receives a subsidy

[94] In this and other paragraphs where we talk about the customers who would switch, the data has been weighted by the number of visits made by each customer. For ease of reading, when we report customers' responses to this hypothetical question, we refer to what customers would do, rather than what they said they would do. We recognize, however, that what we describe is customers' intended behaviour in response to a price rise, rather than actual behaviour.

from the local council which represents around [✂]. Although the parties considered that Aberdeen could be targeted by a competitor, they did not identify any actual potential entrants. Curzon told us that the level of demand in Aberdeen would not be sufficient to support another cinema. Odeon did not believe that there was an opportunity for another cinema in the city centre, although the opening of the Aberdeen Western Peripheral Route to the north of the city in three years' time could open up opportunities in the longer term.

6.62 Overall, the evidence suggests that, following the merger, the competitive constraints on Picturehouse Aberdeen would be significantly weakened, and that there would be a strong incentive for the parties to increase prices at Picturehouse Aberdeen. This in turn would increase the incentive on Cineworld to increase prices at its two Aberdeen cinemas. Post-merger, the only competitor to the parties, Vue, would have a revenue share of [10–20] per cent, all other things equal, and we do not consider that it would be in a position to constrain the behaviour of the parties. We did not consider that entry was likely to occur in a sufficiently timely manner to constrain the merged entity. Accordingly, on balance, we concluded that the transaction could be expected to lead to an increase in prices.

6.63 We therefore provisionally conclude that the acquisition of Picturehouse by Cineworld may be expected to result in an SLC in the market for cinema exhibition services in the Aberdeen area.

- *Brighton*

6.64 Picturehouse operates two cinemas (the Duke's of York and the Duke's @ Komedia) which together account for three screens. They are both located in the city centre. Cineworld operates an eight-screen cinema that is located less than 6 minutes' drive-time away from the two Picturehouse cinemas, but in Brighton Marina Village, rather than the city centre. Together the three cinemas account for 55 per cent of all seats in the Brighton area. There is also an eight-screen Odeon cinema in the city centre and a two-screen cinema owned by an independent operator to the north of the city and within a 30-minute isochrone. The fascia reduction would be from three to two for the three cinemas based on 20-minute isochrones.

6.65 Our survey suggests that, in response to a price rise of 5 per cent, of those customers who would switch, [60–70] per cent of Cineworld's customers and [50–60] per cent of Picturehouse customers would switch to the Brighton Odeon; [20–30] per cent of Picturehouse customers would switch to Brighton Cineworld; and [10–20] per cent of Cineworld's customers would switch to one of the two Brighton Picturehouse cinemas. Our analysis of customers' past visits shows a similar picture of the strength of the competitive constraints exerted by each cinema on the others.

6.66 The opening of Picturehouse Duke's @ Komedia in 2012 had a small negative impact on the revenue of Cineworld Brighton and the revenue overlap analysis suggests that a substantial proportion of the Picturehouse cinemas' revenues comes from films shown by Cineworld Brighton and Odeon Brighton. GUPPI calculations are of an order of magnitude which would suggest that the parties would have an incentive to increase prices at Picturehouse Duke of York's.

6.67 The parties told us that Brighton was a destination city which could support additional cinemas, including an 'art-house' cinema. We found that there were plans to build a new eight-screen multiplex cinema on the site of the Hippodrome in the city centre. The developer (Alaska Development) told us that it intended to submit a planning application by mid-September 2013 and to start construction by mid-2014, with a planned opening by the middle of 2016. We were told by the developer that there was support for the development and that there would be challenges in redeveloping the site for other uses. The developer was confident that it would obtain planning permission. It said that Vue had been a catalyst for this development, [✂].[95] Brighton and Hove City Council was unable to give a definitive view on the likelihood of the Alaska cinema scheme going ahead. There clearly would be objections from the Theatre's Trust and the Regency Society. However, the view of the Assistant Chief Executive was that Alaska's proposals were the most viable option to have come forward to date, and that if these did not go ahead a possible alternative fate of the Hippodrome could be demolition.

6.68 The evidence suggests on balance that the parties would be constrained in their ability to raise prices following the merger, particularly by the closeness of Odeon's multiplex to the two Picturehouse cinemas. In addition, there are plans to develop a new cinema and although we could not reach an expectation that the specific scheme being pursued would go ahead, we considered that it indicated that this local market could attract entry.

6.69 We provisionally conclude that the acquisition of Picturehouse by Cineworld is unlikely to lead to an SLC in the market for cinema exhibition services in the Brighton area.

- *Bury St Edmunds*

6.70 The only two cinemas in Bury St Edmunds are operated by Picturehouse and Cineworld, which together have ten screens and 1,658 seats and collect GBORs of about £3 million. There are also two independent cinemas in the surrounding area: one in Stowmarket, just under 20 minutes' drive-time away and the other one in Sudbury, just under 30 minutes away. Even taking account of these two independent

[95] The parties also told us of a possible development in Hove, but acknowledged that this was still at an early stage and was 'speculative'. We did not consider that the timing and likelihood of this development were sufficiently certain to be relevant for our assessment.

cinemas, Cineworld would have a share of supply of around 90 per cent (both screens and seats) following the transaction. The parties submitted population recentering analysis which suggested that the change in fascia would be three to two, or four to three if smaller cinemas were included. These additional fascias were due to the inclusion of additional cinemas outside Bury St Edmunds. However, we noted that the data on historical visits showed only that [0–5] per cent of Picturehouse visits were from customers who had visited The Regal Stowmarket in the last six months and the equivalent figure for Cineworld Bury St Edmunds was [0–5] per cent.[96]

6.71 Our analysis shows that the reopening of what was previously a Hollywood cinema by Picturehouse in 2010 resulted in an increase in revenue at the Cineworld Bury St Edmunds. Picturehouse told us that it repositioned what had been a mainstream cinema in Bury St Edmunds to focus on quality, daytime admissions and alternative programming, and that by doing so it had grown the market. Cineworld considered that the change in the positioning of the cinema by Picturehouse was the reason for the positive effect on the number of admissions and revenue that its own cinema had experienced, although its revenues were in any event growing.

6.72 Our survey suggests that, following a price rise of 5 per cent, of those customers who would switch to another cinema, approximately 60 per cent of Cineworld Bury St Edmunds' customers would switch to Bury Picturehouse, while approximately [80–90] per cent of Picturehouse Bury St Edmunds' customers would switch to Cineworld Bury St Edmunds.[97] The overlap between the revenue of the two cinemas was among the highest for the areas we examined outside London, thus suggesting relative closeness of competition in programming terms. The CC survey results

[96] Cambridge Picturehouse (6 per cent) and Ipswich Cineworld (4 per cent) were more common responses for Bury Picturehouse customers and Cambridge Cineworld (8 per cent), Cambridge Vue (7 per cent) and Ipswich Cineworld (9 per cent) were more common responses for Bury Cineworld customers.
[97] Similar proportions of people would switch in response to the closure of those cinemas (instead of a price rise).

confirmed that an insignificant percentage of customers would switch to Stowmarket in response to a price rise.

6.73 Our GUPPI calculations suggested that both Cineworld Bury St Edmunds and Picturehouse Bury St Edmunds had an incentive to increase prices following the merger. The GUPPI calculation for the Picturehouse cinema was particularly high both in absolute terms and relative to other calculations that we have performed as part of our analysis of local competitive effects.[98]

6.74 The parties told us that Bury St Edmunds was a small centre of population and were doubtful that it could support another cinema. They told us about a possible development by Odeon in Newmarket. We spoke to Odeon, which told us that the development had recently been refused planning permission.

6.75 The evidence we reviewed suggested that the merger would lead to competition concerns in Bury St Edmunds and we did not have evidence that suggested that these concerns were likely to be mitigated by entry in the foreseeable future.

6.76 We therefore provisionally conclude that the acquisition of Picturehouse by Cineworld may be expected to result in an SLC in the market for cinema exhibition services in the Bury St Edmunds area.

- *Cambridge*

6.77 In Cambridge, Picturehouse operates a three-screen cinema. There is a nine-screen Cineworld cinema and an eight-screen Vue cinema within less than 5 minutes' drive-

[98] As discussed in Appendix F, there may be some capacity issues relating to the ability of Picturehouse Bury St Edmunds to accommodate diversion from Cineworld Bury St Edmunds if Cineworld Bury St Edmunds were to increase prices. While there may be capacity constraints on Saturdays, there are unlikely to be constraints on other days, so some marginal customers could be expected to attend the cinema on other days if there was a lack of capacity on Saturday. We therefore consider that these constraints do not make a material difference to the conclusions we draw from the GUPPI analysis.

time. The merger would result in a reduction in the number of fascias from three to two on the basis of 20- and 30-minute drive-time isochrones. 60 per cent of cinema screens and 55 per cent of seats would be supplied by the merging parties. The parties would have a [60–70] per cent share of GBOR, an increment of [10–20] per cent.

6.78 The parties' survey showed that 81 per cent of Picturehouse Cambridge customers had travelled 30 minutes or less to the cinema from their home. This is consistent with our own survey, which also gave a result of 81 per cent. For Cineworld Cambridge, our survey suggested that 87 per cent of customers had travelled 30 minutes or less.

6.79 The parties' recentering analysis was based on a drive-time of 60 minutes for Picturehouse Cambridge and 31 minutes for Cineworld Cambridge. This suggested that when isochrones were drawn around customers, rather than the cinemas, the change in fascia for 99 per cent of Picturehouse customers was five to four or better. However, we had concerns regarding the data underlying this analysis and noted that the drive-time of 60 minutes used by the parties was inconsistent with our and the parties' surveys. The parties could not supply any other information which validated the 60-minute drive-time they had adopted for Picturehouse Cambridge.

6.80 The parties provided an updated analysis based on 30-minute catchment areas. The results for this showed that for Picturehouse Cambridge the reduction in fascia was four to three for 17 per cent of customers and three to two for 83 per cent of customers. For Cineworld Cambridge, the reduction in fascia was four to three for 19 per cent of customers and three to two for 80 per cent of customers.

6.81 Our survey suggested that following a price rise at Cineworld Cambridge of those customers who would switch to another cinema, [20–30] per cent would switch to Picturehouse Cambridge and [60–70] per cent to Vue Cambridge. Following a price rise at Picturehouse Cambridge, of those customers who would switch to another cinema, [20–30] per cent would switch to Cineworld Cambridge and [50–60] per cent to Vue Cambridge.[99] The analysis of historical customer visits suggested that a substantial proportion of the customers of the cinemas of both merging parties had visited Vue Cambridge. This was consistent with [✄]. However, the overlap in historical visits between the cinemas of Picturehouse and Vue was lower than between the cinemas of Picturehouse and Cineworld.

6.82 GUPPI calculations for the Picturehouse and Cineworld cinemas were of a magnitude that suggested that the merger would create an incentive for the parties to increase prices at both cinemas, the incentive being greater at Picturehouse Cambridge. We also noted that the event analysis suggested that the opening of Cineworld Cambridge had reduced Picturehouse Cambridge's revenues substantially. Although the market structure in 2004 was similar, with Cineworld, Picturehouse and Vue, we recognized that this event took place nearly ten years ago and therefore may not fully reflect the current competitive conditions.

6.83 Commenting on the likelihood of entry in the Cambridge area, the parties told us that the site of what was formerly the Central cinema (on Hobson Street) was being marketed and could accommodate a three-screen cinema. The parties also told us that demand in Cambridge could support another multiplex.

6.84 However, we noted that the Hobson Street site had been derelict for a period of time and changed ownership on several occasions. Furthermore, Cambridge City Council

[99] If the Cambridge Picturehouse cinema was unavailable, of those who would switch, [30-40] per cent would switch to the Cambridge Cineworld and [30-40] per cent to the Vue.

told us that the site was currently being marketed as an opportunity for residential redevelopment (for which there was no reason to believe that a case could not be made) and noted that it had not been used as a cinema for over 40 years and that there was no apparent need for another cinema. We could not satisfy ourselves that the redevelopment of the site into a cinema was likely to occur in the near future. Cambridge City Council Planning Department told us that the council had just published the Cambridge Retail and Leisure Study and updated the Local Plan, neither of which mentioned any plans to develop new cinemas in Cambridge. In addition, Curzon told us that although the demographics of Cambridge were attractive, there was too much competition under the control of Cineworld and it preferred to look at areas where there were more opportunities. Odeon considered Cambridge an attractive area, but the centre of Cambridge already had three cinemas, and it was not clear that there was enough demand to support another cinema. In addition, the city centre was tight and opportunities to enter consequently limited. Odeon [✄]. It was unlikely that Odeon would be able to open a cinema in the area in the next two to three years. If an opportunity arose, likely timescales for development were the next five to ten years. We therefore considered that timely entry in the Cambridge area was unlikely. We considered that competitive constraints on the parties would be weakened following the transaction and, on balance, that other factors at play in the Cambridge area would not defeat the lessening of competition.

6.85 We provisionally conclude that the acquisition of Picturehouse by Cineworld may be expected to result in an SLC in market for cinema exhibition services in the Cambridge area.

- *Clapham*

6.86 Picturehouse operates a four-screen cinema in Clapham. There are three Cineworld cinemas jointly operating 14 screens in the surrounding area (Chelsea, Fulham and

Wandsworth). There are also cinemas operated by Curzon, Odeon and Vue and another Picturehouse cinema (in Brixton) within a 20-minute drive-time. Following the merger, there would still be six or more fascias within both 20- and 30-minute drive-times of Picturehouse Clapham. However, as noted in paragraph 5.17, people in London travel to the cinema using a variety of means of transport, and may choose between a different set of cinemas than may be suggested by drive-time analysis.

6.87 We have received mixed evidence on the propensity of customers to travel to other parts of London to go to the cinema, and the parties told us that there were difficulties in establishing which cinemas customers would switch to if their usual cinema was not available:

(a) The parties told us that it would take 20 minutes on the underground to go from Clapham to the West End, where there were many cinemas.

(b) Picturehouse also told us that London could be described as a patchwork of self-contained villages, which Picturehouse viewed as separate markets. In this respect, we noted that programming at Picturehouse's Clapham and Brixton cinemas tended to be similar, which we considered might suggest that they served different markets.

(c) Referring to customer research it had undertaken (also discussed in paragraph 5.14(a)), Odeon noted that, excluding the West End cinemas, the average travel time for 'London' was considerably shorter (for example, at Beckenham, Holloway, South Woodford and Streatham approximately 90 per cent of customers travelled less than 20 minutes).

(d) Curzon told us that customers tended to visit their local cinema and would not travel to central London unless it was to see a particular film at somewhere like the Renoir.

(e) Our analysis of past customer behaviour shows that [40–50] per cent of visits to Picturehouse Clapham were by customers who had visited Picturehouse Ritzy in

the last six months, [20–30] per cent had visited Cineworld Wandsworth and [10–20] per cent had visited BFI—South Bank. However, [20–30] per cent had visited cinemas that were not listed in our survey. For Cineworld Wandsworth, our survey suggested that [10–20] per cent of visits to Cineworld Wandsworth were by customers who had visited Picturehouse Clapham. [10–20] per cent had visited a cinema that was not on the list of the [10–20] nearest cinemas to Cineworld Wandsworth.

6.88 This tension between localism and the readiness of some customers to travel across London to go to the cinema is reflected in customers' responses to our survey question asking which cinema they would switch to in response to a price rise. Of the customers who would switch:

(a) [30–40] per cent of Picturehouse Clapham visits would switch to the Picturehouse Ritzy and [20–30] per cent to Cineworld Wandsworth. [20–30] per cent would switch to eight of the other cinemas we had listed in our survey.[100,101]

(b) [10–20] per cent of Cineworld Wandsworth visits would switch to Odeon Putney; [10–20] per cent to HMV Curzon Wimbledon; [10–20] per cent to Picturehouse Clapham; [10–20] per cent to Vue Fulham Broadway. [10–20] per cent would switch to five of the other listed cinemas.

(c) [30–40] per cent of the Wandsworth Cineworld visits and [10–20] per cent of Clapham Picturehouse visits would switch to a cinema that was not identified in the list of the nearest 12 cinemas we gave in our survey. Our analysis shows that this includes a long tail of cinemas and that cinemas which were most often listed were: Curzon cinemas (by Picturehouse customers), BFI IMAX (by Cineworld

[100] For each cinema except for those in Aberdeen, the 12 nearest alternate cinemas were listed. Hence for Picturehouse Clapham, two of the alternate cinemas listed were not chosen by any respondent.
[101] The question assumed that the price rise would be at all relevant Picturehouse cinemas. That [30–40] per cent of visits were by customers who chose another Picturehouse cinema provides some evidence on customers' perception of which cinemas are substitutable, but is not useful for the purpose of estimating diversion rates.

customers) and Odeon Wimbledon (by both Picturehouse and Cineworld customers).

6.89 Our survey and derived diversion ratios suggest that a significant proportion of Picturehouse customers would switch to Cineworld Wandsworth in response to a price rise or closure of the Picturehouse fascia. Consequently the GUPPI calculations suggested that the merger would create an incentive for the parties to increase prices at Picturehouse Clapham. However, it is possible that because of the wide choice set open to those prepared to travel outside their local area, identifying a subset of 12 cinemas from which respondents chose an alternative venue to switch to resulted in an overestimate of the diversion to the named cinemas (including Cineworld Wandsworth). The parties commented that it was a 10- to 15-minute walk from the railway station in Wandsworth to where the Cineworld cinema was located. Their view was that customers living in Clapham would be more likely to go to the Vue in Fulham than to the Cineworld in Wandsworth. The GUPPI calculations suggested that the merger would not substantially affect the incentives of the parties to increase prices at Cineworld Chelsea, Cineworld Fulham Road and Cineworld Wandsworth.

6.90 We investigated our survey results further by analysing how responses differed for customers living in different postcodes. This is set out in Appendix G, paragraphs 144 to 147. We found that a relatively large proportion of the customers of the Picturehouse Clapham and the Cineworld Wandworth who came from postcodes SW11 and SW12 had visited the other cinema in the past six months and would switch to the other cinema.

6.91 This evidence suggests that the merger would affect a large proportion of customers living in SW11 and SW12. Based on our survey, customers in those postcodes account for 28 per cent of Picturehouse Clapham's admissions and 22 per cent of

Cineworld Wandsworth's admissions. We noted, however, that these customers might also have alternatives open to them, given the nature of the transport links serving these areas.

6.92 Whether the merging parties would in practice be able to increase prices profitably would depend on whether a sufficient number of customers are able to switch to cinemas other than the merging parties' cinemas. The survey evidence suggests that the choice set of many customers is wide. This is further supported by the customer recentering analysis submitted by the parties: based on 20-minute isochrones around Picturehouse Clapham, this analysis suggests that nearly all customers would still have a choice of four or more fascias following the merger.

6.93 As a further source of evidence, we examined the impact of the opening of Cineworld Wandsworth in May 2004 on the revenues of Picturehouse Clapham and found that it had had no effect. However, the parties explained that establishing the cinema had been particularly difficult due to a poor-quality environment and that it had taken a few years to establish the cinema. Our analysis of historical revenue per seat at the Cineworld Wandsworth compared with other cinemas was consistent with this description. Given these circumstances, we did not consider that any conclusions on the current level of competition between the Wandsworth Cineworld and the Clapham Picturehouse could be derived from this analysis.

6.94 Regarding new entry, Curzon told us that it was aiming to open a five-screen cinema in central London [✄] by January 2014. Outline planning permission had been obtained and submission of the full plans was expected in the next four to six weeks. Curzon was not aware of any opposition to the cinema. When opened, this cinema could potentially pose an additional constraint on Picturehouse Clapham.

6.95 We provisionally conclude that the acquisition of Picturehouse by Cineworld is unlikely to give rise to an SLC in the market for cinema exhibition services in the catchment areas of the Cineworld Wandsworth and Picturehouse Clapham cinemas.

- *Edinburgh*

6.96 In Edinburgh, Cineworld operates one 13-screen multiplex located 2 minutes' drive-time away from the three-screen Picturehouse cinema. Within a 20-minute drive-time, there are also two 12-screen Vue cinemas, a four-screen Odeon and two independent cinemas, the Filmhouse and Dominion, which together account for seven screens and were established in 1979 and 1938, respectively. Since these two independent cinemas are large and well established, we considered it appropriate to include them in our fascia analysis. Consequently the merger would result in a reduction of fascias from seven to six. We noted that the Picturehouse, Odeon and Filmhouse cinemas were geographically close, and Filmhouse Edinburgh customer research identified Picturehouse Edinburgh as its closest competitor.

6.97 Our survey suggested that following a price rise,[102] of those who would switch to another cinema, [50–60] per cent of Picturehouse customers would switch to the Filmhouse, while [20–30] per cent would switch to Cineworld Edinburgh. Few Picturehouse customers would switch to other cinemas. For Cineworld customers, the responses suggested that the closest competitors to Cineworld Edinburgh were Vue Edinburgh Ocean Terminal and Vue Edinburgh Omni, which together would receive [30–40] per cent of Cineworld's customers. [10–20] per cent of customers would switch to Edinburgh Picturehouse.

6.98 Although the parties told us that the offer of the Filmhouse was similar to that of Picturehouse Edinburgh, we noted that Picturehouse Edinburgh's revenue overlap

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[102] Forced diversion figures are similar.

with Filmhouse was low. Picturehouse told us that distributors actively sought to avoid distributing films at Picturehouse Edinburgh and the Filmhouse at the same time, so as to focus their marketing efforts on one venue. Similarly, Filmhouse commented that quite often, distributors had refused Filmhouse access films which had been placed with competitors (and in particular Picturehouse Edinburgh and Cineworld Edinburgh). Filmhouse also told us that there was considerable crossover in repertoire between itself, Picturehouse Edinburgh and Cineworld Edinburgh.

6.99 The magnitude of our GUPPI suggests that the competitive constraints in the Edinburgh area are such that the merger would not materially change the incentives to increase prices at Cineworld Edinburgh. Although the GUPPI estimates for Picturehouse Edinburgh are slightly higher, GUPPIs do not take account of the potential supply-side responses of competitors, and the other evidence, as set out in paragraphs 6.97 and 6.98 above, suggests that the merged parties would continue to face active competition from a wide range of competitors in Edinburgh.

6.100 In addition, we understand that another cinema operator [✂] is in advanced negotiations to open another cinema, although there remains some uncertainty about the likelihood of this entry.

6.101 We provisionally conclude that the acquisition of Picturehouse by Cineworld is unlikely to result in an SLC in the market for cinema exhibition services in Edinburgh.

- *Greenwich*

6.102 Picturehouse operates a five-screen cinema in Greenwich which is within a 20-minute travel time (both by car and public transport) from Cineworld's 11-screen Greenwich—the O2 cinema and Cineworld's ten-screen cinema in West India Quay.

Closest to the Picturehouse cinema is the 18-screen Odeon Greenwich multiplex, which can be reached in 9 minutes by car and 17 minutes by bus.

6.103 Although isochrones based on drive-time may be less applicable in London (as explained in paragraph 5.17 above), the number of fascias within a 30-minute drive-time isochrones of all of the parties' three cinemas would remain above six following the merger. Using a 20-minute isochrone, this would also be the case for Cineworld Greenwich—The O2.

6.104 Our survey shows that following a price rise, a larger proportion of Picturehouse customers would switch to Odeon Greenwich than to Cineworld Greenwich—The O2 or other cinemas. In addition, our survey identified that [10–20] per cent of Picturehouse customers and [20–30] per cent of Cineworld customers said that they would switch to another, unnamed cinema.

6.105 The revenue overlaps between the Picturehouse Greenwich and the two Cineworld cinemas are similar to the overlaps Picturehouse has with other cinemas in the area. However, the Cineworld cinemas have high overlaps with Odeon Greenwich—[90–100] per cent for Cineworld Greenwich—The O2 and [90–100] per cent for Cineworld West India Quay.

6.106 The GUPPIs for Picturehouse Greenwich are of a magnitude that could give rise to concerns if supported by other evidence, while the GUPPI calculations for Cineworld Greenwich—The O2 and Cineworld West India Quay cinemas suggest that the merger would not materially change the incentives of the parties in this area. We noted that GUPPIs do not take account of the potential supply-side responses of competitors, and the other evidence, as set out in paragraphs 6.103 and 6.104

above, suggests that the merged parties would continue to face active competition from a wide range of competitors.

6.107 We considered that overall the evidence suggested that there were many alternative choices for the customers of Cineworld and Picturehouse in the Greenwich area.

6.108 We therefore provisionally conclude that, the acquisition of Picturehouse by Cineworld is unlikely to give rise to an SLC in the market for cinema exhibition services in the catchment areas of Picturehouse Greenwich, Cineworld Greenwich and Cineworld West India Quay.

- *Southampton*

6.109 There are three cinemas in the centre of Southampton. The two-screen Picturehouse and five-screen Cineworld are less than a minute's drive-time away from one another, while there is a 13-screen Odeon less than 4 minutes away. Within a 20-minute drive-time isochrone, the merger would result in a reduction in fascias from four to three, but there would still remain over six cinemas within a 30-minute drive-time.

6.110 The revenue overlap between the Southampton Picturehouse and Cineworld is one of the lowest among the areas we analysed. Our survey suggests that following a price rise of those customers who would switch, [20–30] of Southampton Picturehouse customers would switch to Southampton Cineworld, but 40 per cent to Southampton Odeon and [10–20] per cent to Eastleigh Vue. Following a price rise at the Cineworld, of those who would switch, [10–20] per cent would divert to the Southampton Picturehouse, [60–70] per cent to the Southampton Odeon and [10–20] per cent to the Eastleigh Vue.

6.111 The parties told us that Southampton was a very good cinema market but the Cineworld cinema was not well located and it faced competition from the newer and larger Odeon. In addition, the Vue in Eastleigh had taken customers from both Odeon Southampton and Cineworld Southampton when it opened. Southampton City Council was also of the view that customers living in the northern part of Southampton would find Vue Eastleigh more convenient. The parties noted that although located close to the Cineworld, Picturehouse Southampton was thriving because of its differentiated offer.

6.112 The GUPPI calculations suggest that Picturehouse Southampton would have an incentive to increase prices following the merger, while for Cineworld Southampton the incentive would be limited.

6.113 In the course of our inquiry, outline permission was awarded to Hammerson for the development of a brown-field site adjacent to the West Quay Shopping Centre. Hammerson told us that the scheme comprised plans for a ten-screen cinema, which would open by mid-2016, on the assumption that detailed planning permission was obtained within 12 months. [✂] The parties told us that there was an expectation that Odeon would close down within three or four years after the opening of the new cinema, but overall cinema capacity would still be higher than currently. We considered on the basis of the parties' evidence that the timescale and likelihood of Odeon's exit were too uncertain to take it into account in our analysis.

6.114 Given the level of probability and scale of entry that are expected in Southampton, in addition to the strong competitive constraints that appear to be exerted by existing cinemas, in particular by Odeon Southampton, we provisionally conclude that the acquisition of Picturehouse by Cineworld is unlikely to result in an SLC in the market for cinema exhibition services in the Southampton area.

- *Stratford (London)*

6.115 Picturehouse operates one cinema in Stratford. There are two Cineworld cinemas (The O2 and West India Quay) within a 10-minute drive-time. Both Cineworld cinemas can be reached by public transport in less than 25 minutes. Following the merger, there would remain at least six fascias within 20- and 30-minute drive-times of each of the three cinemas. Alternative cinemas include both non-multiplexes (such as Rich Mix and Rio Cinema) and multiplexes, in particular a 17-screen cinema operated by Vue in the Westfield centre in Stratford (Vue Stratford). As noted in paragraph 5.17, people in London are on average less likely to travel to the cinema by car than they are outside London. For this reason, there are difficulties with relying on drive-time isochrones to identify a reliable set of competing cinemas.

6.116 The diversion ratio from Picturehouse Stratford to the two Cineworld cinemas was one of the lowest among the cinemas we surveyed. By contrast, a large proportion of customers of the three Stratford cinemas that we surveyed said that they would switch to the Vue Stratford following a price rise or the closure of the relevant cinema fascia; and a large proportion of Cineworld O2 would switch to the Odeon Greenwich. A significant proportion would also switch to cinemas we did not identify in our survey, thus suggesting that the choice set for customers in the catchment areas of the parties' Stratford cinemas is wide. In addition, our GUPPI calculations are low compared with the other estimates we have calculated for other areas.

6.117 The opening of Picturehouse Hackney in October 2011 appeared to have had a significant impact on Cineworld West India Quay. However, Cineworld told us that this coincided with Cineworld taking over of the management of The O2 [✂]. We therefore did not consider the results of this particular event to be reliable in estimating competition between Cineworld and Picturehouse cinemas.

6.118 The evidence and analysis set out in paragraphs 6.116 and 6.117 suggest that the acquisition of Picturehouse by Cineworld is unlikely to result in an SLC in the market for cinema exhibition services in the catchment areas of the Cineworld Greenwich—The O2, Cineworld West India Quay and Picturehouse Stratford cinemas.

Conclusions on Theory of Harm 1—loss of competition in local areas

6.119 We provisionally conclude that the acquisition of Picturehouse by Cineworld may be expected to result in an SLC in the market for cinema exhibition services in the following local areas:

(a) Aberdeen;

(b) Bury St Edmunds; and

(c) Cambridge.

Assessment of Theory of Harm 2—loss of potential competition in local areas

Introduction

6.120 We considered two ways in which the merger might give rise to concerns because of the loss of potential competition:

(a) Either party could decide to stop a development that it would otherwise have undertaken in order to avoid competing with its merging partner.

(b) If the parties were planning to open and operate cinemas which would be competitors absent the merger, the merger could result in the loss of future competition between these cinemas compared with the counterfactual.

6.121 With regard to the first of these two concerns, it is our understanding that, as a result of the merger, development plans of both Cineworld or Picturehouse are not being modified to avoid direct competition between the two merging parties' cinemas, and that the parties are actively pursuing new development opportunities, in line with the strategic aims that had been described to us (explained in paragraphs 3.3 to 3.6).

Secondly, we found that the parties are pursuing new developments which would result in overlaps between Cineworld and Picturehouse cinemas.

6.122 Our analysis therefore concentrated on the second of these potential concerns.

6.123 We identified cinema developments that were being planned by the parties as of June 2012 and that were likely to be taken forward. There were three such proposed developments located in Chiswick, Crouch End and [✂][103] that were being pursued by Picturehouse. There were [✂] such cinema developments being pursued by Cineworld. We followed the methodology set out in paragraphs 6.48 and 6.49 in order to filter out areas where the merger was unlikely to result in an SLC. For three of these planned cinema developments (St Neots, Trowbridge and Wembley), the reduction in fascias was four to three or fewer on either a 20- or 30-minute isochrone, but our examination of the relevant local area maps suggested that these developments were unlikely to raise competition concerns.

6.124 As a result of this process, we considered that two areas, Chiswick and Crouch End, required further analysis to establish whether the merger could be expected to result in an SLC.

Analysis of shortlisted areas

- *Chiswick*

6.125 Picturehouse has obtained planning permission for a [✂]-screen cinema in Chiswick which it aims to open by [✂]. Hammersmith Cineworld (a four-screen cinema) would be the nearest competitor to this cinema when completed. There are 30 cinemas operated by other cinema exhibitors within a 20-minute drive-time, of which five are

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[103] [✂]

within a 10-minute drive-time. We therefore considered whether the merger could lead to the loss of potential competition between these two cinemas.

6.126 Cineworld told us that [✂]. A leisure property consultant, Neil Richmond & Co, told us that it was anticipated that the current cinema would be demolished in 2015 and the new cinema built in 2018, although these timescales were subject to planning permission being secured promptly. Curzon confirmed that heads of terms had been signed and that it was nearly certain that it would open a three-screen cinema in Hammersmith in 2018.

6.127 We provisionally conclude that the planned opening of Picturehouse's Chiswick cinema is not likely to lead to competition concerns.

- *Crouch End*

6.128 Picturehouse is expecting to gain planning permission by [✂] for a [✂]-screen cinema located in Crouch End. This cinema would be located close to Cineworld's cinema in Wood Green. There are 22 cinemas operated by other cinema exhibitors within a 20 minute drive-time, of which four are within a 10-minute drive-time. The parties told us that the demographics of Wood Green and Crouch End were very different and that people living in Wood Green would not travel outside their area for entertainment because car ownership was low. Crouch End had poor transport links.

6.129 Curzon told us that it was planning to franchise a two-screen cinema on a site in Crouch End, for which it would provide the programming and brand, but which would be owned and operated by a third party. One of the screens would be used entirely for films, while the other one would be used for films 60 per cent of the time. The owner was putting in place the installations and it was anticipated that the cinema would open in early October 2013.

6.130 Given the significant degree of uncertainty about the future competitive interactions between the two planned cinemas and the parties' existing Wood Green cinema, we provisionally concluded that the planned opening of Picturehouse's Crouch End cinema would not be likely to lead to competition concerns.[104]

Conclusions on Theory of Harm 2—loss of potential competition

6.131 We provisionally concluded that the acquisition of Picturehouse by Cineworld could not be expected to lead to an SLC as a result of the loss of potential competition.

Assessment of Theory of Harm 3—impact of the merger on programming services

6.132 The concern under this theory of harm was that the merger may adversely affect competition if Picturehouse's provision of upstream programming services allowed it to affect the ability of cinemas to compete with Cineworld downstream. For example, if Picturehouse provides programming services to a small cinema which competes with a local Cineworld, then following the merger, Picturehouse may have an incentive to change the film programming of this cinema to reduce competition with the local Cineworld cinema. This could be done through changing the titles shown, increasing the prices it charged for these services or reducing the quality of programming it offered. For the merger to result in an SLC, the following two conditions would need to be met: *(a)* post-merger, Picturehouse would have market power in the supply of programming services, and *(b)* as a result of the merger, Picturehouse would have an increased incentive to exploit this market power in local areas where Cineworld operates.

[104] While carrying out our investigation of Theory of Harm 2 on the Picturehouse developments, we also considered whether the additional Picturehouse cinemas would create overlaps with existing Cineworld cinemas. Cineworld's Enfield cinema was a cinema which would fail our fascia test, following the opening of Picturehouse Crouch End. The location of the two cinemas and the Curzon development in Crouch End led us to conclude that the merger would be unlikely to lead to competition concerns for customers in the Enfield area.

Analysis

6.133 The parties told us that Picturehouse's wholly-owned subsidiary, CSV, provided film programming services for [✂] cinema customers.

6.134 One way of assessing this theory of harm would be to investigate whether CSV had, in the past, been acting in a harmful way to any of its [✂] cinema customers. If it had, it may have an incentive to display such behaviour more extensively as a result of the merger, because of the increased number of overlaps. If the evidence showed that CSV had not been acting in this way in the past, this would suggest that CSV was unlikely to begin operating in this manner in the future.

6.135 However, because all of CSV's programming services are provided on an individual and bespoke basis, it would be hard to establish whether the films CSV has been recommending, or the prices it has been charging, were the result of the exercise of market power or of other factors.

6.136 We therefore asked the parties and third party cinemas for their views on this issue. We took the view that if their responses suggested that there was potentially an issue, we would investigate the theory of harm further.

Evidence from main parties

6.137 The parties told us that Picturehouse acquired the rights for all films shown at the cinemas programmed by CSV. Picturehouse could generally achieve better terms for non-mainstream films by booking films for a larger number of cinemas. CSV could also achieve better terms than individual cinemas could achieve if they kept film programming in-house. The benefits for cinema exhibitors of outsourcing programming to CSV were access to the expertise of Picturehouse's programming team and to Picturehouse's ability to enter into deals on the best possible terms.

6.138 The parties told us that all the deals to acquire film rights that CSV made were made on behalf of the individual cinemas. The individual cinemas were responsible for box office revenue and the payment of bills. [✂] In 2012, CSV earned £[✂] from fees to clients (2011: £[✂]). There were no additional direct costs to CSV but the fees [✂].

6.139 The parties told us that while individual cinemas generally engaged CSV for its programming expertise, these cinemas were free to accept the suggested programme or to request an alternative. Whether the customer accepted the suggested programme from CSV or sought a specified alternative, CSV would be able to acquire all content at the best possible rates, which enabled the customer to offer better pricing to its own customers.

6.140 The parties mentioned three ways of acquiring programming services:

(a) using the Independent Cinema Office (ICO);[105]

(b) franchising from Curzon Cinemas; and

(c) using an individual (eg filmbuyer.co.uk).

Evidence from third parties

6.141 ICA said that it selected its films with a combination of in-house programming and regular consultation with CSV. The process involved new cinema releases being recommended by CSV in a weekly consultation with ICA but with ICA's Executive Director retaining ultimate control over all programming decisions. It also said that it would be able to switch from CSV to another programmer or to in-house programming if it wished to and that this would not lead to any difficulties accessing films from its normal distributors.

[105] The ICO is the national support organization for independent exhibitors of all kinds including cinemas, film festivals and film societies. For more information, see www.independentcinemaoffice.org.uk/about/.

6.142 An independent cinema operator ([✂]) told us that it used the services of Picturehouse's programming arm to obtain films because it could get better terms from the film distributors. It met with Picturehouse every month to share programming ideas and decide on titles. Each of its cinemas had slightly different audiences. [✂] said that although there were probably alternative providers of programming services, eg Curzon, Picturehouse understood its sites and was sympathetic to its needs. The final decision on programming remained with the independent cinema operator, and Picturehouse would source its choice of films, even if it had not recommended them. [✂] had not noticed any effect from the opening of a Picturehouse cinema. Nor had the programming received from Picturehouse changed. [✂] did not expect the merger to result in any change in its positive relationship with Picturehouse. It also did not think that there would be a change in the Cineworld or Picturehouse offers. It saw the two as very distinct offers.

6.143 Everyman told us that it used Picturehouse's programming services for approximately five years and said that if it had to stop purchasing its services, it would either employ someone full time to work for it, or find an alternative supplier.

6.144 Another cinema operator [✂] told us that the CSV programmer came up with suggestions for programming, but the cinema decided what to show based on what it thought would go down well with its audience. Sometimes it asked City Screen if it could show a particular film and City Screen would try to get it from the distributor for it. The cinema did not know if the merger would affect it, but would be concerned if it meant losing the personal service it currently received.

6.145 Liverpool Philharmonic told us that it had used CSV for film booking since 1996. It had not used any other booking or ticket booking services in the last five years. If it needed to look for an alternative provider, its first option would be to do it in-house and work with film distributors directly, or if that were not viable, alternatives would be the ICO Programming and Booking Service or a service provider like Independent Film Booking.

6.146 We were also told by third parties that there were numerous alternative providers of programming services to Picturehouse, many of which were individuals. Rich Mix told us that its films were selected by its Film Officer with the support of an external established film-booking consultant. Shortwave Cinema told us that it used a freelance programmer who also programmed for Watermans Cinema and the Tricycle Cinema.

6.147 Filmbuyer.co.uk told us that it did not think the merger would affect its business.

Provisional conclusions

6.148 The evidence shows that the barriers to entry in the provision of programming services are low and that cinema operators are able to find alternative suppliers to Picturehouse. None of the cinema operators we spoke to, raised any concern over this theory of harm. The numerous programming competitors pointed out that even if Picturehouse were interested in exploiting any market power that it might have, it would not be in a position to execute it.

6.149 Given this evidence, we provisionally conclude that the acquisition of Picturehouse by Cineworld is unlikely to lead to an SLC in the market for programming services to cinema exhibitors in the UK.

Rivalry-enhancing synergies

6.150 Cineworld expects that the acquisition of Picturehouse will result in [✂] synergies of £[✂] million and [✂] of approximately £[✂] million [✂] over a 12- to 24-month period. These synergies are expected to be realized as a result of the improved negotiating position of the merged group as a result of volumes purchased.

6.151 The parties argued that the likely faster opening rate of Picturehouse cinemas following the merger compared with the counterfactual situation was a rivalry-enhancing synergy.

6.152 The CC's Merger Assessment Guidelines state that the CC is 'more likely to take cost savings into account where efficiencies reduce marginal (or short-run variable) costs as these tend to stimulate competition and are more likely to be passed on to customers in the form of lower prices'.[106] We consider that at most £[✂][107] of the cost savings identified by the parties would fall into this category. These savings amount to less than [✂] per cent of Picturehouse cinema turnover (pro-forma) and in the three areas in which we have found an SLC they would amount to less than £[✂] (allocated on the basis of 2012 turnover[108]) across the three areas. We therefore do not consider that these savings would make a material difference to the intensity of competition in those local areas.

6.153 Similarly, we consider it unlikely that the increased rate of cinema openings will take place in these three areas and therefore this claimed benefit of the transaction is not relevant to the SLC we have provisionally found.

7. Provisional conclusion on the SLC test

7.1 We have provisionally found an SLC in the market for cinema exhibition services in the local areas identified in paragraph 6.119*(a)* to *(c)*.

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[106] *CC2*, paragraph 5.7.9.
[107] We excluded the 'Advertising' and 'Other' categories. If the two categories were included, the savings would represent [✂] per cent of Picturehouse turnover.
[108] The total is calculated by adding the 2012 revenues of each Picturehouse cinema. For Duke's @ Komedia: we have annualized the numbers of the first three months of 2013, due to the opening of the cinema in late 2012.