

Completed acquisition by Cineworld plc of City Screen Limited

ME/5877/12

The OFT's decision on reference under section 22 given on 30 April 2013. Full text of decision published 5 June 2013.

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

PARTIES

1. **Cineworld plc (Cineworld):** Cineworld is listed on the London Stock Exchange and operates 79 cinemas in the UK and one in Ireland. Cineworld also operates a joint venture with Odeon Cinemas Limited, Digital Cinema Media Limited, which sells advertising time on cinema screens on behalf of its clients.
2. In 2011, Cineworld accounted for 48 million admissions in the UK and achieved a total turnover of £348 million.
3. **City Screen Limited (City Screen):** City Screen operates 21 cinemas, mostly under the Picturehouse brand.¹ City Screen was formed in 1989 with the intention of offering a broader mix of films than that commonly shown in multiplexes, and to provide cinemas that serve their communities in city centre locations.
4. City Screen operates a number of separate businesses including: The City Screen Virtual Business which provides film booking services for 44 cinemas across the UK; Picturehouse Entertainment which aims to distribute up to six feature films every year, as well as a wide variety of

¹ This includes the Duke's @ Komedia in Brighton which opened in December 2012

alternative content, to cinemas around the UK;² and Newman Online, a ticketing and event management system for use in its cinemas and in other venues across the UK and in Europe.

5. In the calendar year 2011, City Screen achieved a turnover of £[] million.

TRANSACTION

6. On 6 December 2012 Cineworld acquired the entire issued share capital in City Screen for a consideration of £[] million. As part of the Transaction the parties concluded a Memorandum of Understanding which sets out the key provisions for maintaining and developing the City Screen business model under Cineworld ownership. This includes commitments in relation to investment in the City Screen business and preserving the differentiation between City Screen and Cineworld in terms of content, product offering and audience focus.
7. The statutory and administrative deadlines for Office of Fair Trading (OFT) to make its decision are Tuesday 30 April 2013.

JURISDICTION

8. As a result of this transaction Cineworld and City Screen have ceased to be distinct.
9. The parties overlap in the supply of film exhibition services. Prior to the transaction, based on Gross Box Office Revenue (GBOR), Cineworld's share of supply in the UK was [20 – 30] per cent, City Screen's share of supply was [0 – 5] per cent, giving the parties a combined share of supply of [20 – 30] per cent.³ The OFT considers that the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met in this case.
10. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

² For example, this includes live satellite transmission of seasons from the arts organisations, such as the Bolshoi Ballet, Glyndebourne and the National Theatre.

³ Source: Rentrak

MARKET DEFINITION

Product market definition

11. The purpose of market definition is to provide a framework for the OFT's analysis of the competitive effects of the merger. The OFT will identify the market within which the merger may give rise to a substantial lessening of competition (SLC). This market contains the most significant competitive alternatives available to the customers of the merging parties. Market definition is a useful tool, but not an end in itself, and the boundaries of the market do not determine the outcome of the OFT's analysis of the competitive effects of the merger.
12. The parties overlap in the provision of film exhibition services. However, the parties argued that they do not compete on the basis that City Screen operates 'art-house' cinemas that are significantly differentiated from the 'multiplex' cinemas operated by Cineworld, based on a number of factors, including ticket pricing, the film types exhibited, the size and location of the cinema, differing audience demographics, and a different cinema going experience.

Segmentation by type of cinema

13. The parties submitted that cinemas are generally acknowledged in the industry as being of three main types: multiplex; art-house and luxury. For the purposes of this Transaction the parties submitted that the OFT should assess the impact on competition by reference to the very different types of cinemas, multiplex and art-house, operated by Cineworld and City Screen. The parties submitted that each of the three cinema types has its own distinguishing supply and demand side characteristics which give rise to different cinema-going experiences and therefore appeal to different cinema-going audiences. The parties concluded that multiplex and art-house cinema offerings are particularly stark, with the result that these cinema types do not compete with each other.

Multiplex and Art-House Cinemas

14. The parties submitted that the three types of cinema have individual characteristics that can be distinguished by reference to the following factors:

- ticket pricing
- film mix
- size and location
- audience demographics, and
- event/occasion.

The parties' arguments on each of these factors as they relate to multiplex and art-house cinemas are discussed individually below.

Ticket pricing

15. The parties submitted that art-house cinemas are on average 10 per cent more expensive than multiplexes and that this price differential demonstrates that these two types of cinemas operate in different markets.
16. The OFT notes that, although City Screen is often more expensive than Cineworld, there are areas in which they charge a similar price and also areas where City Screen is cheaper than Cineworld.⁴

Film mix

17. The parties submitted that Multiplex cinemas tend to focus on exhibiting main stream 'blockbuster' films,⁵ with art-house cinemas focusing on exhibiting specialist films,⁶ and that in past decisions, for the purposes of a local analysis, the OFT has excluded a cinema from its local assessment on

⁴ From data on the prices charged by Cineworld and City Screen submitted by the parties.

⁵ Mainstream, or Blockbuster, films are commercial films made by major entertainment studios or companies that are owned by international media conglomerates. Because of better financing, these films can afford more expensive actors and wider releases. Mainstream films are targeted for all cultures and audiences.

⁶ The British Film Institute (the BFI) provides a definition of 'Specialised films' which, the BFI recognises, is quite broad. It is more likely to consider that a film is specialised if it satisfies one or more of the following criteria: Foreign language with subtitles; Documentaries; Archive/classic films; films that do not fall within a mainstream genre; Complex and challenging subject matters; Innovative or unconventional cinematic style.

the grounds that it presents a significantly different film mix to the merging parties.⁷

18. The OFT notes that multiplexes are free to screen any type of content on their screens, subject to agreement with the film distributor. A third party competitor has noted that they will program a screen according to local demand characteristics. As such, if an art-house cinema is performing well in the area, they may increase the amount of specialist content they exhibit.
19. The OFT further notes that so-called art-house cinemas also exhibit mainstream or blockbuster films and some derive the majority of their revenue from such films.

Size and location

20. The parties submitted that City Screen cinemas tend to be significantly smaller than Cineworld's cinemas and are commonly only one or two screens. City Screen cinemas also tend to be located in city centres rather than in retail developments. The parties pointed to many examples in previous OFT cinema merger decisions where, for the purposes of a local analysis, the OFT has excluded a smaller cinema from its local assessment on the grounds that it does not present a significant competitive constraint on the merging parties.⁸

⁷ The Acquisition by Terra Firma Investments (GP)2 Ltd of United Cinemas International (UK) Limited and Cinema International Corporation(UK) Ltd 2005 (Terra Firma/UCI), paragraph 25; Cineworld/Wood Green, paragraph 36 and 37; The completed Acquisition by the Blackstone Group of UGC Holdings Limited 2005 (Blackstone/UGC), paragraph 17; Anticipated Acquisition by Cineworld Group plc [] of the cinema business operating at the Hollywood Green Leisure Park, Wood Green 2008 (Cineworld/Wood Green), paragraph 36 and 37; Completed Acquisition by Cineworld Group plc of the Cinema Business operating at the O2, London 2010 (Cineworld/O2), paragraph 42; Completed Acquisition by Vue Entertainment International Limited of Apollo Cinemas Limited 2012 (Vue/Apollo), paragraph 82, 92 and 103; Anticipated Acquisition by Odeon Cinema Holdings Limited of the AMC Cinema Birmingham 2012 (Odeon/AMC), paragraph 40 and 41. However, the OFT notes that in all these cases, there was not one overriding factor that led to a cinema being excluded from the local market assessment. Cinemas have been excluded from the analysis because a combination of factors led the OFT to conclude that they did not present a significant competitive constraint in the light of the analysis of that particular local market.

⁸ See Footnote 7.

Audience demographics

21. The parties submitted that the multiplex audience is drawn from a wide social demographic with the majority coming from the 15-34 age group; in contrast art-house screens attract an older audience.
22. The parties submitted data on the average age of Cineworld and City Screen audiences based on the recorded ages of Picturehouse members and Cineworld card holders.
23. While the information provided indicates that the average age of City Screen customers is older than that of Cineworld, the data was based on a very limited sample (only four per cent) of Picturehouse members who give their age (compared to 58 per cent of Cineworld card holders), and it is not clear if the membership base itself has representative demographic characteristics of City Screen's cinema audience.ⁱ

Event/occasion

24. The parties submitted that cinema customers tend to visit a multiplex to view a specific film, whilst those going to an art-house cinema do so as a social outing or a cultural experience. In addition, City Screen sites are typically licensed to sell alcohol, whereas Cineworld cinemas are not.

Conclusion

25. The OFT acknowledges that the merging parties appear to supply a differentiated offering and service, and may have different average customer demographics who have different reasons for visiting the cinema. Nevertheless, the evidence available to the OFT, as outlined in detail as part of the competitive assessment below, despite the differentiated offering, points to the merging parties competing and, in some cases, competing to a significant degree.
26. Further, the OFT notes, in particular, two points in relation to the factors above. First, the OFT considers that the decision of cinema operators to choose to focus their business activities on different types of films does not mean that there is no competition between them; they may still be competing to attract cinema audiences.

27. In addition, while a smaller-sized cinema may provide a weaker competitive constraint than a large-sized cinema on other large sized cinemas, other things equal, this does not preclude a smaller-sized cinema from competing with a larger cinema, or indeed to demonstrate that a large cinema does not place a strong competitive constraint on a smaller cinema.
28. Smaller size cinemas may also, to some extent, have limited ability to exert a competitive constraint on multiplex cinemas due to possible capacity constraints at peak times. However, multiplex cinemas do not suffer capacity constraints to the same degree as smaller cinemas; their size and location do not limit their ability to exert a competitive constraint on smaller sized cinemas.
29. Additionally, there is a current trend towards a more differentiated offering, with the introduction of smaller or specialist screens by multiplex operators, which may suggest that the level of competition between multiplex cinemas and smaller-sized cinemas is increasing.⁹
30. The OFT has therefore assessed the transaction on the basis of film exhibition services provided by all cinemas including multiplex and art-house cinemas.

GEOGRAPHIC MARKET

31. Previous Competition Commission (CC) and OFT cinema merger decisions have considered competition in both national and local markets on the basis that competition takes place predominantly at a local level, reflecting the fact that price, content and facilities may be set by cinema managers at a local level, partly in response to local conditions. However, certain competitive parameters may also be determined at a national level (for example, negotiations with distributors for access to film content, screen advertising fees and branding).¹⁰

⁹ The parties submitted that 'multiplex chains are seeking to make use of their large number of screens to offer a wider selection of films including independent, world cinema and art-house films as well as theatrical and operatic performances. However, this remains a minority interest and the vast majority of screening time in multiplexes is dedicated to mainstream films.'

¹⁰ Terra Firma/UCI; Blackstone/UGC; Vue/A3; Odeon/Reel; Odeon/AMC and Vue/Apollo

32. Both the parties and third party competitors indicated that they consider local catchment areas to be around 20 minutes' drivetime from the cinema.ⁱⁱ This is consistent with previous OFT cases,¹¹ where the OFT has also used a 30-minute drive time by way of sensitivity analysis. However, in certain local areas, in particular in London, the appropriate catchment area may vary, as such drive time isochrones may be less likely to reflect appropriately catchment areas or local conditions of competition, as has also been noted in previous OFT decisions.¹²

CONCLUSION

33. The OFT has analysed the effect of the merger at both a national, and a local level, using a 20-minute catchment area as starting point to consider local competition effects and considering any additional features that may be relevant from an analysis of a 30-minute catchment area. Within London, the OFT has analysed available evidence to determine the competitive constraints on the parties on a case-by-case basis.

HORIZONTAL ISSUES

National Competitive Assessment

34. The parties submitted their combined national market share would be between 12.9 per cent and [20 – 30] per cent based on various different metrics. These are shown in Table 1. The parties submitted that under the best method to use, GBOR,¹³ the parties have a combined market share of [20 – 30] per cent with an increment of [0 – five] per cent.

¹¹ Terra Firma/UCI; Blackstone/UGC; Vue/A3; Odeon/Reel; Odeon/AMC and Vue/Apollo.

¹² Cineworld/O2

¹³ **Note:** GBOR data is sourced from EDI Rentrak, who do not track either all specialised content or all independent cinemas.

Table 1: Parties' UK shares of film exhibition services in all cinemas (2011)

	Cineworld		City Screen		Combined		Total 2011	
	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total
Number of Cinemas	78	10.2	20	2.6	98	12.9	761	100
Number of Screens	794	20.8	58	1.5	852	22.3	3,824	100
Number of Admissions	[40 – 50]m	[20 – 30]	[0 – 5]m	[0 – 5]	[40 – 50]m	[20 – 30]	[170-180]m	100
Industry recorded Gross BOR	£[]m	[20 – 30]	£[]m	[0 – 5]	£[]m	[20 – 30]	£[]m	100

Sources: HIS Screen Data and EDI Rentrak data

35. Given that, post merger, there will be a minimal increment on any measurable basis, the presence of a number of strong national competitors that will remain post-merger, and the absence of any third party concerns, the OFT does not believe that national concerns will arise from this transaction.

Local Competitive Assessment

Analytical Framework

36. The OFT has investigated whether the merger may give rise to unilateral effects at the local level and, in particular, the extent to which the merger may give rise to the merging parties deteriorating the competitive offering at Cineworld and/or City Screen.
37. In its local analysis the OFT has considered and weighed a number of factors within the local area to assess the level of the potential loss of competition, including:
- **fascia reduction:** a fascia reduction of four to three or less would be prima facie indicative of a potential competition issue
 - **film overlaps:** if the extent of films shown (or more relevant, the revenue generated from such films) at both Cineworld and City Screen at the same time is higher this may point to the cinemas competing currently to a greater extent

- **diversion of City Screen customers to Cineworld:** the larger diversion of City Screen customers to Cineworld, as measured by the diversion ratio, the closer substitutes the parties' cinemas will be
 - **pricing pressure:** measuring the likelihood of unilateral effects arising
 - **competitor monitoring:** evidence that the parties are monitoring each others' prices indicate that the parties consider each other to be competitors, and
 - **other local factors:** discussed as appropriate.
38. The OFT notes that the arguments presented by the parties is focused more on the extent of the competitive constraints that City Screen imposes on Cineworld. The OFT considers that, for the reasons outlined below, any competition concerns, should they arise, are more likely to arise from the loss of competitive constraint from Cineworld on City Screen rather than visa versa. Nevertheless, the OFT considers that it is not required to show the effect of the loss of competitive constraint from both parties on each other when it is able to establish that there is a realistic prospect of a substantial lessening of competition on one of the parties in a local area as a result of the Transaction.
39. The OFT has considered and weighed the above factors in each local area and reached its conclusion based on an overview of their merits in each individual area rather than relying on any one factor having greater significance than others. Before briefly assessing each local area where competition concerns may arise, the OFT examined a number of the pieces of evidence above that apply across each of the areas and allowed for filtering of those areas that are unlikely to raise concerns.

Fascia Analysis

40. Cineworld acquired a total of 21 cinemas from City Screen. The OFT does not consider there to be any likelihood of unilateral effects where there is no overlap between the merging parties or where they will continue to face sufficient competition post-merger. The OFT considered that a fascia reduction of four to three or fewer within the 20- or 30-minute isochrone was a reasonable indication that a substantial lessening of competition may occur and warranted a more detailed analysis, where this was supported by other evidence available to the OFT in this case.

41. As a result, in the absence of any evidence pointing to potential competition concerns arising, 11 areas have been dismissed from further consideration. A more detailed analysis has been carried out on the remaining ten areas, including Edinburgh and London – Stratford as other evidence pointed to the potential for competition concerns to arise in these areas. In particular, the fascia count included a number of smaller independent cinemas, sufficient to bring the fascia reduction to four to three if these are excluded. The OFT’s analysis in these two areas sought to establish whether these smaller independent cinemas provide a competitive constraint on either of the parties.

Table 2: Fascia count in the areas containing a City Screen Cinema.

Area	20 min Fascia count	30 min fascia count	Taken Forward for Detailed local Analysis
Bury St. Edmunds	2 to 1	3 to 2	Yes
Cambridge	3 to 2	3 to 2	Yes
Aberdeen	3 to 2	3 to 2	Yes
Brighton	3 to 2	4 to 3	Yes
Southampton	3 to 2	5 to 4	Yes
Clapham	4 to 3	15 to 14	Yes
Edinburgh	6 to 5	6 to 5	Yes
Greenwich	4 to 3	10 to 9	Yes
London – Stratford	6 to 5	9 to 8	Yes
Stratford-upon-Avon	No change	4 to 3	Yes
Brixton	No change	12 to 11	No
Henley-on-Thames	No change	7 to 6	No
Oxford	No change	6 to 5	No
Liverpool	5 to 4	7 to 6	No
London - Notting Hill	10 to 9	16 to 15	No
London - Hackney	No change	9 to 8	No
York	No change	No change	No
Bath	No change	6 to 5	No
Norwich	No change	No change	No
Exeter	No change	No change	No

Film Overlap Evidence

42. The parties provided data for the film level overlap – those films shown by both Cineworld and the City Screen cinema – in each local area. To qualify

as an overlap, a film had to be exhibited on the same day in both Cineworld and City Screen, during 2012. The parties have provided the data based on a number of different metrics including revenue and number of films.

43. The parties submitted that the most relevant metric to assess the closeness of competition between the parties is the extent to which their films overlap, as this gives an indication of the actual overlap between the products that they are offering. The OFT considers that the revenue the parties earned, both from overlapping films and from films where there was no overlap, may be a more relevant metric to measure the change in the merging parties' incentives arising from the merger.
44. The revenue earned on overlapping films shows that, on average, across all cinemas, around half of City Screen's box office revenue was earned from films overlapping with those also shown at Cineworld in 2011, with one City Screen cinema,¹⁴ for example, earning as much as 85 per cent of its revenue from overlapping films. The OFT considers that this evidence suggests that there is scope for a significant degree of competition for customers between the parties in those local areas in which they are both active as City Screen is earning the majority of its revenue in the exhibition of films where customers in those local areas have the choice to see the same film at Cineworld or City Screen. Although Cineworld's revenue from the same overlapping films was significantly higher than City Screen's, it was much lower as a proportion of overall revenue.

Survey Evidence

45. The parties carried out an online survey of Picturehouse members and those who have signed up to receive emails from Picturehouse, which elicited a total of 35,000 responses.
46. Surveys can be used to gather evidence on the degree of competition in a local area. In particular, a survey can be used to produce an estimate of the proportion of a firm's business that is lost by that firm, which would divert to a specified alternative in the event that the firm raised prices or was unavailable, which is referred to as the diversion ratio. This is normally weighted by volume or value, so as to account for how revenue would move, rather than just how customers would move. The survey, conducted

¹⁴ The Clapham Picturehouse

by the parties, was used in this case to calculate an estimate of the visit weighted diversion ratio.¹⁵

47. The survey asked a three stage diversion question. Customers were first asked what they would have done if Picturehouse had been unavailable for the last six months, and were given a number of options, including: not visited the cinema; visited a different cinema less often; and visited a different cinema the same number of times. Customers who responded that they would have visited a different cinema less often were then asked how many times they would have visited this other cinema in the last six months (they had already been asked how many times they have visited Picturehouse in the last six months). Then all customers who indicated that they would have visited a different cinema were asked which ones they would have visited.
48. The survey results show that a high percentage of respondents would not divert to another cinema in the event that Picturehouse was closed. The OFT considers that this evidence appears broadly supportive of the merging parties' arguments that the cinema offerings of the two are highly differentiated and the loss of Picturehouse would result in a significant proportion of their customers, rather than diverting to another cinema, choosing not to go to the cinema at all.
49. However, the OFT has also examined the extent to which the survey design may have affected the proportion of customers who indicating they would divert outside the market (that is, not go to the cinema). In particular the OFT was concerned that a disproportionate number of non-price sensitive (infra-marginal) consumers may have indicated that they would have diverted outside of the market.¹⁶
50. The OFT has analysed the information in the City Screen survey to attempt to determine if the group of customers who would leave the market entirely

¹⁵ Weighting by visit gives a frequent cinema goer's views greater weight than an irregular cinema goer.

¹⁶ The framing of the questions in the survey was due to concern over possible variation in film overlaps over time and so the respondents not being representative of overall switching preferences. Nevertheless, such a design may introduce other difficulties – in particular, the six-month period used to estimate diversion and the sample being drawn from Picturehouse members and those who have signed up to receive emails from Picturehouse, rather than the population of Picturehouse cinema-goers – in interpreting the results.

are different to the group who would divert entirely to another cinema (those with partial diversion are excluded from this analysis). The OFT found:

- The strongest association - and possibly the main driver of switching behaviour - is the respondent's previous history of going to other cinemas.¹⁷
- Next most important appears to be the type of screenings that the respondent generally goes to see.¹⁸

51. The data suggests that those who only visit City Screen and those who mainly or only view specialist film content at City Screen are more likely to respond to the diversion question that they would leave the market. Thus, in response to a price rise (rather than a closure), it may not be the case that these customers would divert in the same proportions as the customers who have selected a diversion option.¹⁹

52. To account for this the OFT considers that including all of those customers that diverted outside the market in an estimate of the diversion ratio may lead to an underestimate of the true diversion ratio. The OFT has proceeded in its analysis using the diversion ratio estimated taking full account of those diverting outside the market as indicated in the survey as a starting point – in most local areas this makes no material difference to the competitive assessment – but notes that this may be an underestimate where relevant.

¹⁷ Those who have not been to another cinema in the previous six months show a markedly increased likelihood of leaving the market rather than diverting. Those who have been to other cinemas show a high probability of reporting 'all visits divert'.

¹⁸ Those tending to go to art-house and screen arts show an increased tendency to leave the market, those tending to go to blockbusters show an increased tendency to fully divert. Those in the middle attending to see a mix, showing a more balanced response most commonly suggesting they would go to other cinemas but less often.

¹⁹ The OFT commonly considers there to be no material difference, in the absence of evidence to the contrary, between the switching preference of marginal and inframarginal customers. However, in this case, the OFT has tested this, given the extended period in which customers responses are in reference to and the potential bias of the sample towards those customers more loyal to City Screen.

Pricing pressure analysis

53. In order to assess the extent of lost competitive rivalry likely to occur as a result of the merger, the OFT may, when available, examine the value of diverted sales that the merging parties lose to each other (in proportional terms) following a price rise. This analysis uses two primary pieces of evidence:
- the closeness of substitution between the parties' brands, as measured by the diversion ratio between them. If the parties' brands are close substitutes, unilateral effects are more likely as the parties will recapture a significant share of the sales lost in response to any price rise post-merger, making the price rise less costly, and
 - the variable profit margin on sales. If the variable profit margins of the parties' brands are high, unilateral effects are more likely because the value of sales recaptured by the parties post-merger will be greater, making any price rise less costly.
54. The greater the indicative change in incentives brought about by the merger revealed by such a calculation, the greater the level of the OFT's concern is likely to be. At the same time, this concern will be weaker if the reliability or probative value of the margin or diversion ratio evidence as a guide is in doubt, for example as discussed above in paragraphs 45 to 52.
55. The diversion ratios, in combination with the variable profit margin of a cinema, have been used to calculate a gross upward pricing pressure index (**GUPPI**). The parties provided variable profit margins for each of the Cineworld cinemas, shown in Table 3 below, ranging between [30 – 40] and [50 – 60] per cent. The OFT was provided with the line by line accounting data, in order to assess whether Cineworld have accurately portrayed their variable costs. Although the OFT note that the inclusion of some cost items is questionable, these are small and make no material difference to either the variable profit margins or the competitive assessment.
56. The GUPPI shows the value of business internalised by the merger in percentage terms. The approach of combining the variable profit margins and diversion ratios in this way provides a measure of the risk to

competition resulting from the merger in terms of incentives, rather than in terms of effects (that is, rather than an 'illustrative price rise').²⁰

57. Table 3 below summarises the pricing pressure calculations for those City Screen cinemas discussed in detail in the local analysis.

Table 3: Pricing Pressure Calculations for City Screen Cinemas

Area	Diversion to Cineworld [‡]	Margin	GUPPI
Bury St. Edmunds	[20 – 30]	[40 – 50]	13.6
Cambridge	[20 – 30]	[40 – 50]	9.5
Aberdeen	[30 – 40]	[50 – 60]	17.0
Brighton	[10 – 20]	[40 – 50]	7.0
Southampton	[10 – 20]	[30 – 40]	4.4
Clapham	[10 – 20]	[40 – 50]	4.8
Edinburgh	[10 – 20]	[40 – 50]	7.1
Greenwich	[0 – 10]	[40 – 50]	3.4
London - Stratford	[0 – 10]	[40 – 50]	3.5
Stratford-Upon Avon	[0 – 10]	[50 – 60]	3.2

Note:[‡] The stated diversion ratio includes all those diverting outside the market in the denominator and is likely to be an underestimate of the true diversion ratio, this also results in a low estimate of GUPPI.

Entry Evidence

58. Episodes of entry provide natural experiments where, if sufficient data is available, the closeness of competition between two parties can be observed. By observing the actual performance before and after entry and comparing the results to a control group, an estimate of effect of the entry of one party on the other can be obtained. The parties have identified three areas in which one of the parties has entered against the other in the last five years. Of these, only one is an episode of new entry that is has been

²⁰ A pass-through rate of 100 per cent would mean that the pricing pressure indices calculated may be interpreted as illustrative price rises. The parties and the OFT have not engaged in a discussion of pass-through in this case. This measurement does not take account a range of factors, including potential supply-side responses and the 'feedback effect', which is the accommodating price reaction from rivals, in response to a price rise from firm A, which can give the incentive for a further increase in firm A's prices.

material to the analysis of this transaction, Aberdeen. In Aberdeen, an additional Cineworld (Union Square) opened on 30th October 2009. Cineworld and City Screen were both already present in Aberdeen and Vue is also active.

59. The OFT has used data on the admissions and weekly box office revenue for each of the parties' cinemas in Aberdeen, and a group of six control cinemas.²¹ For Aberdeen, the OFT has calculated the weekly box office revenue for the 12 months pre and post entry, it has then used the growth rate of weekly box office revenue in the control group to calculate on a cautious basis, what the box office revenue could have been, if entry had not occurred. Comparing these two figures, gives an estimate of the effect on weekly box office revenue entry. The OFT has also been able to analyse the change in each Cineworld and City Screen's margin over time, but has not been able to produce an estimate of the margin if entry had not occurred.
60. Only the City Screen control group was used to calculate the expected revenue. This is due to the City Screen and Cineworld control groups having markedly different growth rates. As the expected revenue depends on the performance of the controls, the OFT recognise that the analysis is sensitive to which control group is used. The results for Aberdeen are provided below in the relevant local area analysis.

Local Areas

Bury St. Edmunds

61. The primary isochrone centred on the Abbeygate Picturehouse, Bury St Edmunds includes the Cineworld cinema at Bury St Edmunds. A third small independent cinema - the Regal Theatre, Stowmarket²² – lies outside of the 20-minute isochrone, but within the 30-minute isochrone. The merger represents a two to one reduction in fascia, based on a 20-minute isochrone.

²¹ The parties selected the control cinemas as they had not experienced entry over the time period in question. In Aberdeen the parties have also provided margin data over time for their cinemas, but they did not provided the same data for a control group.

²² The Regal Theatre has one screen and seats 234.

62. The survey information provided by the parties suggests that Cineworld imposes a strong competitive constraint on Abbeygate Picturehouse as [20 – 30] per cent of Abbeygate Picturehouse’s customers would divert to Cineworld, (see Table 4) and that as a result of the merger, prices may be expected to rise.

Table 4: Analysis of Diversion choices in Bury St Edmunds

Divert to	Number of visits	Percentage
Total number of visits not switched	3679	[60 – 70]
Cineworld	1563	[20 – 30]
Vue	95	[0 – 10]
Odeon	54	[0 – 10]
Other	90	[0 – 10]

63. The GUPPI for Bury St Edmunds has been calculated to be 13.6 per cent (see Table 3) which supports the possibility of unilateral effects in Bury St Edmunds arising as a result of the Transaction.
64. Entry analysis also suggests that Bury St Edmunds Picturehouse may be a slightly closer competitor to Cineworld than the previous owner and operator of the cinema, and the monitoring database shows that Cineworld monitors prices at Bury St Edmunds Picturehouse.
65. Therefore, the OFT considers that there is a realistic prospect of a substantial lessening of competition in Bury St Edmunds.

Aberdeen

66. The primary isochrone, centred on the Belmont Picturehouse, Aberdeen includes the Cineworld Union Square, the Cineworld Queens Link and the Vue, Aberdeen. The merger represents a three to two reduction in fascia, based on a 20-minute isochrone, or 30-minute isochrone.
67. The survey data suggests that Cineworld imposes a strong competitive constraint on Belmont Picturehouse as [30 – 40] per cent of Belmont Picturehouse’s customers would divert to Cineworld, (see Table 5) and that as a result of the merger, prices may be expected to rise.

Table 5: Analysis of Diversion choices in Aberdeen

Divert to	Number of visits	Percentage
Total number of visits not switched	2453	[50 – 60]
Cineworld	1592	[30 – 40]
Vue	675	[10 – 20]
Other	51	[0 – 10]

68. The GUPPI for Aberdeen has been calculated to be 17.0 per cent (see Table 3) supports the possibility of unilateral effects in Aberdeen arising as a result of the Transaction.
69. Entry analysis also suggests that Cineworld Union Square impose a strong competitive constraint on Belmont Picturehouse, and that its opening led to a significant decline in attendance. Cineworld Union Square opened in the area in 2009. As a result of this entry, the change in weekly box office revenue at both Cineworld Aberdeen and Belmont Picturehouse was large, which indicates that Cineworld Union Square is a close competitor for both cinemas. This may suggest that Cineworld imposes a significant competitive constraint on Belmont Picturehouse.
70. The OFT notes that there was also a [30 – 40] per cent fall in actual admissions at Belmont Picturehouse between the 12 months prior to and the 12 months post the entry by Cineworld.
71. The Cineworld competitor monitoring database show that the two Cineworld cinemas in Aberdeen monitor prices at Vue and Belmont Picturehouse, as well as each other.
72. Therefore, the OFT concludes that there is a realistic prospect of a substantial lessening of competition in Aberdeen.

Brighton (Duke of York’s Picturehouse (London Road) and Duke’s @ Komedia)

73. The primary isochrones centred on either the Duke of York’s Picturehouse, or Duke’s @ Komedia includes the Odeon Brighton and the Cineworld Brighton Marina. A fourth small cinema – the Orion, Burgess Hill²³ - lies outside of the 20-minute isochrones, but within the 30-minute isochrones.

²³ The Orion has two screens and seats 271.

The merger represents a three to two reduction in fascia, based on the primary isochrone, and a four to three based on a 30-minute isochrone.

74. The survey data suggests that Cineworld imposes a competitive constraint on the Duke of York’s Picturehouse as [10 – 20] per cent of the Duke of York’s Picturehouse’s customers would divert to Cineworld, although the Odeon represents a closer competitor to the Duke of York’s Picturehouse than Cineworld, both physically and in terms of diversion²⁴ (see Table 6) The GUPPI is estimated to be seven per cent and supports the possibility of unilateral effects arising in Brighton as a result of the Transaction.

Table 6: Analysis of Diversion choices in Brighton (Duke of York)

Divert to	Number of visits	Percentage
Total number of visits not switched	6084	[50 – 60]
Odeon	2598	[20 – 30]
Cineworld	1572	[10 – 20]
Other	457	[0 – 10]

75. The Cineworld competitor monitoring database show that Cineworld monitors the prices at Odeon and Duke of York’s Picturehouse.
76. The OFT also notes that the Duke’s @ Komedia Picturehouse opening in December 2012 provides City Screen with an additional two screens in the area. The addition of two extra screens may have allowed City Screen to programme more content which overlaps with Cineworld, with the new cinema generating the majority of its revenue from overlapping content.²⁵ⁱⁱⁱ As such, the parties may be closer competitors going forward.²⁶
77. Therefore, the OFT concludes that there is a realistic prospect of a substantial lessening of competition in Brighton.

²⁴ This does not take account of the new Picturehouse cinema

²⁵ From film overlap data provided by the parties covering January – March 2013 in Brighton.

²⁶ With the opening of Duke’s @ Komedia, Picturehouse earned 38 per cent (at the Duke of York) and 62 per cent (at Duke’s) of its revenue from overlapping films between January and March 2013.

Cambridge

78. The primary isochrone, centred on the Arts Picturehouse includes the Vue Cambridge and the Cineworld Cambridge. The merger represents a three to two reduction in fascia, based on a 20-minute isochrone or a 30-minute isochrone.
79. The survey data suggests that although there would be significant diversion outside of the market in the event of a price rise by the Arts Picturehouse, Cineworld is the closest competitor to the Arts Picturehouse with 20 per cent of customers diverting to Cineworld (see Table 7). As a result of the merger, pricing pressure models are suggesting that prices may rise at the Arts Picturehouse. The GUPPI for Cambridge has been calculated to be 9.5 per cent (see Table 3) which supports the possibility of unilateral effects in Cambridge arising as a result of the Transaction.

Table 7: Analysis of Diversion choices in Cambridge

Divert to	Number of visits	Percentage
Total number of visits not switched	9614	[60 - 70]
Cineworld	3205	[20 - 30]
Vue	2592	[10 - 20]
Other	477	[0 - 10]

80. The Cineworld competitor monitoring database show that Cineworld in this area monitors prices at Vue and the Arts Picturehouse.
81. Therefore, the OFT concludes that there is a realistic prospect of a substantial lessening of competition in this area.

Southampton

82. The primary isochrone centred on the Harbour Lights Picturehouse, Southampton includes the Cineworld Southampton and the Odeon Southampton. Outside of the primary isochrones, but within the 30-minute isochrones there are also the Vue Eastleigh, the Reel Fareham, the Everyman Winchester and the Odeon Port Solent. The merger represents a three to two reduction in fascia, based on a 20-minute isochrone, or a six to five based on a 30-minute isochrone.

83. The survey data suggest that Odeon is the closest competitor, just ahead of Cineworld, which between them account for 64 per cent of diversion to alternative cinemas.²⁷ The survey also suggests that diversion of the Harbour Lights Picturehouse’s customers to Cineworld would be 14 per cent, 30 per cent of those who would divert to another cinema. (See Table 8) The diversion ration in this area from the Harbour Lights Picturehouse to Cineworld is relatively low, 14 per cent. However, given that margins are high, this is still sufficient to give rise to pricing pressure. Taking account of the fact that GUPPI estimates are on the low side, this supports the potential for unilateral effects to arise in Southampton as a result of the Transaction.

Table 8: Analysis of Diversion choices in Southampton

Divert to	Number of visits	Percentage
Total number of visits not switched	5351	[50 – 60]
Odeon	1581	[10 – 20]
Cineworld	1402	[10 – 20]
Vue	878	[0 – 10]
Everyman	391	[0 – 10]
Other	388	[0 – 10]

84. Additionally, Cineworld monitors prices at the Harbour Lights Picturehouse, Odeon and Vue.

85. Therefore, the OFT concludes that there is a realistic prospect of a substantial lessening of competition in this area.

Greenwich and London Stratford

86. The primary isochrone includes the Odeon cinemas at Greenwich and at Surrey Quays, the Cineworld cinemas at O2 and West India Quays and the Stratford East Picturehouse. As a result of there being two City Screen cinemas in this area, we consider these together.²⁸ The merger represents

²⁷ Taking into account only those who would divert to other cinemas.

²⁸ The primary isochrone centred on the Stratford East Playhouse includes the Cineworld cinemas at O2 and West India Quay, the Vue at Stratford City and the Odeon in Stratford. It

a three to two reduction in fascia, based on a 20-minute isochrone. There are a significant number of other cinemas within a 30-minute travel isochrone including the Peckham Multiplex; the OFT considers that there exists at least a six to five fascia reduction based on a 30-minute isochrone.

29

87. The survey data suggest that Odeon is the closest competitor to City Screen, picking up around 2.5 times the diversion of Cineworld. The diversion ratio in this area from Greenwich Picturehouse to Cineworld is relatively low (five per cent). As a result of the merger, the GUPPI for Greenwich has been calculated to be 3.4 per cent (see Table 3) which does not indicate that the parties are close competitors in Greenwich

Table 9: Analysis of Diversion choices in Greenwich

Divert to	Number of visits	Percentage
Total number of visits not switched	6445	[50 – 60]
Odeon	2013	[10 – 20]
Curzon	1693	[10 – 20]
Other	747	[0 – 10]
Cineworld	630	[0 – 10]
Vue	621	[0 – 10]
Everyman	281	[0 – 10]
Empire	117	[0 – 10]
Apollo	112	[0 – 10]

88. Cineworld monitoring data shows that the O2 and West India Quay cinemas do not monitor the Greenwich Picturehouse, but Cineworld Bexleyheath does.

also includes two independents, the Genesis Mile End and the Boelyn. The merger represents a four to three reduction in fascia, based on a 20-minute isochrone, if independents are excluded.
²⁹ As Greenwich lies in central London, the OFT has looked at how Picturehouse survey respondents travel to the cinema to determine whether a drive time isochrone is an appropriate measure of geographic closeness of competition. Thirty-eight per cent of survey respondents travel to the cinema by car, 32 per cent by public transport and 27 per cent by foot. As such, it is also useful to consider public transport travel times (taken from Google maps), as well as drive times.

89. This area was previously investigated by the OFT³⁰ and the following points are pertinent to this case:
- In paragraph 52 of the decision notes that, 'the parties submitted evidence during the assessment of that transaction indicating that the main competitors to the O2 are the two Odeon cinemas and the Greenwich Picturehouse.'
 - City Screen, which has two cinemas, in Greenwich and Stratford, within 20 minutes' drive-time (and 30 minutes by public transport) also submitted that they compete with both Cineworld cinemas. City Screen show a higher proportion of independent, art-house and foreign language films than other cinema multiples but also show mainstream blockbusters and indicate that programming at the cinemas is in response to local demand.
90. In spite of the parties submissions in the previous case, the OFT considers that the evidence points to there being sufficient competitive constraints provided by cinemas in the East London area to suggest that competition will remain post merger
91. In relation to London Stratford, the parties submit that since there are two independent fascias in this area, the area should not fail the fascia based filter and as such should not be subject to further analysis. The OFT has had regard to additional evidence on closeness of competition between the parties in this area, before deciding whether or not competition issues arise.
92. The survey data suggests that Vue is the closest competitor to Stratford East Picturehouse, Vue is also the closest geographic competitor to Stratford East Picturehouse. Cineworld have two cinemas within 30 minutes' travel by public transport of Stratford East Picturehouse, but pick up less diversion from Stratford East Picturehouse than the single Odeon cinema with Cineworld only imposing a marginal competitive constraint (under 10 per cent). (See Table 10) Therefore, Cineworld are the third closest competitor to Stratford East Picturehouse. Additionally, it should be noted that neither Cineworld cinema monitors prices at Stratford East Picturehouse.

³⁰ Cineworld/O2

Table 10: Analysis of Diversion choices in London Stratford

Divert to	Number of visits	Percentage
Total number of visits not switched	1912	[50 – 60]
Vue	636	[10 – 20]
Odeon	318	[0 – 10]
Cineworld	283	[0 – 10]
Other	199	[0 – 10]
Curzon	135	[0 – 10]
Showcase	123	[0 – 10]

93. Therefore, the OFT has concluded that there is no realistic prospect of a substantial lessening of competition in this area.

Clapham

94. The primary isochrones centred on the Clapham Picturehouse includes the Cineworld cinemas in Wandsworth, Fulham Road and Chelsea, the Odeon in Streatham, the Curzon cinemas in Mayfair and Chelsea as well as the Ritzy Brixton (Picturehouse). The merger represents a four to three reduction in fascia, based on a 20-minute isochrone, a significant number of cinemas are captured under the 30-minute isochrone.³¹
95. The survey data suggests that Curzon is the closest competitor to the Clapham Picturehouse, although Odeon and Cineworld are also close competitors. As a result of the merger, the GUPPI for Clapham has been calculated to be 4.8 per cent (see Table 3) which does not indicate that the parties are close competitors in Clapham.

³¹ Picturehouse Clapham is located in a densely populated area of London, although it does lie outside of the central London congestion charge zone. In previous merger cases isochrone analysis based on drive times have not been thought to be appropriate, due to different patterns of car use in central London. In this case, the survey evidence submitted by the parties suggests that 42 per cent of respondents travel to Picturehouse by public transport and 40 per cent by foot. This suggests that public transport travel times are likely to be more important than driving times.

Table 11: Analysis of Diversion choices in Greenwich

Divert to	Number of visits	Percentage
Total number of visits not switched	2698	[40 – 50]
Curzon	872	[10 – 20]
Odeon	743	[10 – 20]
Cineworld	647	[10 – 20]
Vue	353	[0 – 10]
Other	158	[0 – 10]
Everyman	99	[0 – 10]
Empire	59	[0 – 10]

96. Clapham Picturehouse is one of four fascia who are monitored by Cineworld Wandsworth, the others being Odeon, Curzon and Premier.
97. Therefore, the OFT concludes that there is no realistic prospect of a substantial lessening of competition in this area.

Edinburgh

98. The primary isochrone includes Cameo Picturehouse, Odeon Lothian Road, Filmhouse, Cineworld Edinburgh, Dominion, and the Vue cinemas Omni and Ocean Leigh. The merger represents a four to three reduction in fascia, based on a 20- or 30-minute isochrone, only if the independent cinemas are excluded.
99. The parties submit that since there are two independent fascias in this area, the area should not fail the fascia based filter and as such should not be subject to further analysis. The OFT has had regard to additional evidence on closeness of competition between the parties in this area, before deciding whether or not competition issues arise.
100. The survey data shows a very high percentage of individuals selecting the 'other' option. The OFT has checked the raw data and the majority of the other respondents would divert to Filmhouse, with a minority indicating the Dominion. There is, therefore, significant diversion from Cameo Picturehouse to the other independents in the isochrone indicating that they do exert a competitive constraint on Cameo Picturehouse and should not be excluded from the fascia reduction count, (See Table 12.) further,

one of the independents is included in the Cineworld competitor monitoring database.

Table 12: Analysis of Diversion choices in Edinburgh

Divert to	Number of visits	Percentage
Other	3030	[30 – 40]
Total number of visits not switched	2462	[20 – 30]
Cineworld	1194	[10 – 20]
Vue	1019	[10 – 20]
Odeon	542	[10 – 20]

101. Therefore, the OFT concludes that there is no realistic prospect of a substantial lessening of competition in this area.

Stratford-upon-Avon

102. The primary isochrone centred on the Picturehouse Stratford-upon-Avon does not include any other cinemas. Cinemas within a 30-minute isochrones includes the Cineworld Solihull, the Vue cinemas in Redditch and Leamington Spa and the Royal Spa Centre Leamington Spa. The merger represents a three to two reduction in fascia, based on a 30-minute isochrone, if independents are excluded.

103. The online survey shows that there is relatively high diversion outside of the market in this area. This may reflect there being no alternative cinemas within a 20-minute drive time. As a result, there is unlikely to be a sufficient incentive to increase price to trigger unilateral effect concerns.

104. Diversion to Cineworld is low (less than 10 per cent). It should also be noted that no Cineworld cinema monitors prices at Picturehouse Stratford-upon-Avon.

Table 13: Analysis of Diversion choices in Stratford-Upon-Avon

Divert to	Number of visits	Percentage
Total number of visits not switched	2286	[50 – 60]
Apollo (now Vue)	589	[10 – 20]
Other	485	[10 – 20]
Cineworld	278	[0 – 10]
Odeon	157	[0 – 10]
Showcase	92	[0 – 10]
Vue	66	[0 – 10]

105. Therefore, the OFT concludes that there is no realistic prospect of a substantial lessening of competition in this area.

UNDERTAKINGS IN LIEU

106. Where the duty to make a reference under section 22(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned undertakings as it considers appropriate.

107. The OFT has therefore considered whether there might be undertakings in lieu of reference which would address the competition concerns outlined above. The OFT's *Mergers – Exceptions to the duty to refer and undertakings in lieu of reference* states that, 'Undertakings in lieu of reference are therefore appropriate only where the remedies proposed to address any competition concerns raised by the merger are clear cut. Furthermore, those remedies must be capable of ready implementation.' (Paragraph 5.7).

108. In lieu of a reference to the CC, Cineworld has indicated a willingness to give undertakings to make divestments in two of the localities where Cineworld and City Screen's cinemas overlap and the OFT has a belief that it is or may be the case that a substantial lessening of competition will, or may be expected to, arise as a result of the merger. Given the OFT has identified a realistic prospect of a substantial lessening of competition in five local areas, the OFT considers that the remedies offered are not

capable of clearly addressing the local competition concerns arising from the merger as identified above.³²

109. Accordingly, the OFT has decided not to exercise its discretion under section 73(2) of the Act to consider whether to accept undertakings in lieu of a reference.

ASSESSMENT

110. The OFT has analysed the transaction against a market for film exhibition services in this case. It has considered whether it is appropriate to segment this wider market by art-house and multiplex cinema. The parties failed to provide sufficient evidence in support of their arguments that the product market should be further segmented. Further, a number of pieces of evidence including: survey evidence, entry analysis, price concentration analysis and film overlap analysis indicates that there is competition between art-house and multiplex cinemas and it would not be appropriate to segment the market in this case.

111. The OFT considers that competition concerns arising from the merger are local rather than national. The localities in which competition concerns arise are identified by the use of an analysis of the local competitive pressure within a 20-minute drive time isochrones, with a 30-minute sensitivity test. Detailed analysis of the local competitive factors was carried out in those areas where the facia reduced by four to three or more, and also in Edinburgh and London Stratford where the facia count was exceeded only if smaller independent cinemas were included. Ten local areas were scrutinised in detail.

112. The OFT has carefully considered the evidence in this case, which comprises: facia count analysis; film overlap evidence; Survey evidence; pricing pressure analysis; entry analysis and an assessment of the local area conditions including competitor monitoring and other local factors. On the basis of this analysis the OFT has identified a realistic prospect of a substantial lessening of competition in the following five areas:

³² In order to accept undertakings in lieu of a reference the OFT will seek to restore pre-merger competition – Paragraphs 5.10 – 5.15 of the *Exceptions to the duty to refer and undertakings in lieu of reference guidance* on restoring competition.

- Bury St. Edmunds
- Aberdeen
- Brighton
- Cambridge
- Southampton

113. Consequently, the OFT believes that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

114. The OFT has therefore decided to refer the completed acquisition by Cineworld plc of City Screen Limited to the Competition Commission pursuant to section 22 of the Act.

ⁱ The parties have commented that they submitted additional evidence on ticket sales in order to provide further evidence on audience age. The OFT agrees that the parties submitted further analysis of ticket sales by type demonstrating, for example, that Cineworld's audience in 2012 was made up of a greater number of children (12.1 per cent) than City Screen's audience and that Cineworld sold almost twice the number of family and student tickets than City Screen sold (the City Screen breakdown shows a much larger number of tickets (12.2 per cent) sold in the OAP category). The OFT considered that this additional analysis did not materially alter its conclusion.

ⁱⁱ The OFT accepts that the parties' submissions only refer to a 20-minute catchment area as being appropriate for multiplex cinemas not in relation to art-house cinemas.

ⁱⁱⁱ The parties have highlighted that they explained in their submissions that the high overlap in this three-month period was due to the propensity for overlap in the first three months of the year as both Art-house and Multiplex cinemas will show nominated films in the run-up to the Oscars. The OFT considered that this additional analysis did not materially alter its conclusion.