

Completed acquisition by Vue Entertainment International Limited of Apollo Cinemas Limited

ME/5506/12

The OFT's decision on reference under section 73 given on 24 August 2012. Full text of decision published 3 October 2012.

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

PARTIES

1. **Vue Entertainment International Limited** (Vue) is the parent company of the business trading under the name Vue. Vue provides cinema film exhibition services. As of November 2011, Vue's UK circuit consisted of 68 cinemas, and the Vue group also operates a number of cinemas in other countries, including Ireland, Portugal and Taiwan. Vue's turnover in the financial year ended 24 November 2011 was £281.1 million, of which £259.9 million was attributable to the UK.
2. Doughty Hanson & Co Managers Limited, a Financial Services Authority authorised entity, acts as the investment manager of Doughty Hanson & Co V LP No 1 and Doughty Hanson & Co V LP No 2, the Limited Partnerships together constituting Doughty Hanson & Co V (together Doughty Hanson). Doughty Hanson, through intermediate holding companies, holds a majority of the beneficial ownership of shares in Vue.
3. **Apollo Cinemas Limited** (Apollo) is the holding company of the cinema chain trading under the name Apollo. The Apollo business is comprised of 14 operational cinemas, as well as two pipeline opportunities to open cinemas in Bicester and Brentwood. Apollo was one of the assets of the estate of the late Mrs. Anita Kim Gregg (the Estate); since her death in February 2010, Apollo has been majority owned by the Executors of the Estate (the Executors). Apollo's turnover in the financial year ended 31 March 2011 was £20.2 million, all of which was attributable to the UK.

TRANSACTION

4. On 10 May 2012 Vue acquired, indirectly via Vue's wholly owned subsidiary Treganna Bidco Limited, sole control of Apollo. This matter came to the attention of the OFT through its Mergers Intelligence Unit.
5. Vue and Doughty Hanson & Co Managers Limited gave initial 'hold separate' undertakings under section 71 of the Enterprise Act 2002 (the Act) which were accepted by the OFT on 12 June 2012.
6. The administrative deadline expires on 28 August 2012 and the extended statutory deadline expires on 7 October 2012.

JURISDICTION

7. As a result of this transaction Vue and Apollo have ceased to be distinct.
8. Since Apollo's annual UK turnover in its last financial year was below £70 million, the turnover test in Section 23(1)(b) of the Act is not met.
9. The parties overlap in the provision of cinema film exhibition services in the UK. The share of supply test in section 23 of the Act is met as post-merger Vue will have a share of supply of cinema film exhibition services in a substantial part of the UK, namely Greater London, exceeding 25 per cent – whether measured on the basis of gross box office revenue (GBOR), cinema sites, cinema screens or seats.
10. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

COUNTERFACTUAL

11. The OFT considers the merger based on the most competitive counterfactual providing always that it considers that situation to be realistic.¹ In most cases this would be the conditions prevailing before the merger, but in some cases evidence may exist such that it is appropriate for the OFT to assess the merger against an alternative counterfactual.
12. Vue submitted that the prevailing pre-merger conditions of competition are not the appropriate conditions under which to assess the merger. Vue

¹ Merger Assessment Guidelines, A joint publication of the Competition Commission (CC) and the OFT, OFT1254, September 2010, paragraphs 4.3.5-4.3.7.

stated that, in summary, there was irrefutable evidence that Apollo would have been sold within 2012. Second, the sellers of Apollo were, and either way would have been, compelled to sell Apollo as a whole in a 'package deal' instead of selling it 'site by site'. Third, given the financial state of the Apollo business, no non-trade purchaser would have been interested in acquiring Apollo. The bids that the sellers of Apollo received following their invitation to tender, confirm that the only realistic bids were coming from trade purchasers, as opposed to nontrade purchasers. Fourth, there was no realistic prospect of an alternative purchaser other than Vue and certainly none that would result in a better outcome for competition.

13. In forming a view on whether Apollo satisfied the conditions of the exiting firm scenario, the OFT considered:
 - a. whether the firm would inevitably have exited the market, in particular whether the firm was unable to meet its financial obligations in the near future and to restructure itself successfully
 - b. whether there would have been a substantially less anti-competitive alternative purchaser for the firm or its assets, and
 - c. what would have happened to the firm's sales in the event of its exit.²

a. Whether Apollo would inevitably have exited the market

14. Vue submitted that the Apollo business should be considered as an 'exiting firm'. As noted above, since 21 February 2010 Apollo has been under the control of the Executors. Vue submitted evidence suggesting that the Executors were under pressure to sell Apollo, to relieve the Estate [] of the financial burdens associated with operating Apollo.
15. In a letter to the Executors dated 3 February 2012, the managing directors of Apollo explained the requirement for a £[] cash injection to address shortfalls in Apollo's working capital and to meet current and future liabilities, including VAT payments due. The letter stated that Apollo's

² For the OFT to accept an exiting firm argument, it would need (on the basis of compelling evidence) to believe that it was inevitable that the firm would exit the market and be confident that there was no substantially less anti-competitive purchaser for the firm or its assets – that is, considerations a) and b). The OFT would then consider whether, having regard also to consideration c), the result of the exit of the firm and its assets would be a substantially less anti-competitive outcome than the merger. See Merger Assessment Guidelines, A joint publication of the CC and the OFT, OFT1254, September 2010, paragraphs 4.3.8-18.

relationships with suppliers (mainly film distributors) and certain landlords were under severe strain, and that Apollo needed 'an urgent injection of funds to redress this, otherwise there is a possibility of cessation of supply'. The letter explained the reasons why the Apollo business was under financial strain, including expenditure of millions of pounds on capital projects (such as the installation of new digital projectors), which was funded through internal resources/working capital as no new shareholder funds had been injected since February 2010, and the fact that the business had 'not performed at expected levels this year'.

16. The OFT notes that on 14 February 2012 the Executors appointed KPMG to run an 'options process' with a view to explore refinancing, investment and/or restructuring of Apollo. The early options review was delivered on 27 February 2012, and noted that Apollo's £[] overdraft facility with HSBC would be breached in the week ending 1 March 2012. KPMG looked at two alternative scenarios under which Apollo delayed certain payments due, but even in these alternative scenarios the £[] overdraft facility would still be breached, albeit by a lesser margin. Apollo approached alternative banks but these were unwilling to provide lending to Apollo. Shortly after 29 February 2012 the Apollo board agreed to follow KPMG's recommendation that Apollo freeze its liabilities and make weekly payments to cover expected VAT and PAYE, so not as to further increase liabilities to HMRC. Apollo engaged in negotiations with landlords [].³
17. The OFT has analysed data on the financial position of the Apollo business. The OFT notes that the Apollo business was making a loss before and after tax, although the Apollo business was making a short term financial contribution. The OFT also notes apparent liquidity problems in the business, evidenced by negative net current assets (that is, short term liabilities being significantly higher than current assets). As well as written comments made about financial difficulties, creditor days suggest that the Apollo business was taking over six months to pay suppliers, a significant pointer to financial strain.
18. Against this financial backdrop, the [] needs of the Estate and the [] suggest that the Estate needed to sell Apollo. Whilst minutes from Apollo board meetings in late March 2012 indicate that the Estate was willing to invest £[] in Apollo (with an additional subsequent investment of £[]), the OFT believes that this was not a permanent, long-term investment on

³ Annex 14 of Vue's submission dated 11 July 2012.

behalf of the Estate, but rather aimed at maintaining the value of the Apollo business until a sale of Apollo was completed. The OFT received evidence that the Estate ([]) 'were in no position to raise the significant monies required to fund the [Apollo] business in the long term', and that 'a buyer of the whole business had to be found'.

19. In addition, Vue submitted that the urgency with which the Sellers wished to sell Apollo was reflected in the process and the timing in relation to Vue's acquisition of Apollo. The Sellers gave Vue only two weeks to negotiate and sign a sale agreement, a timeframe which was so short that it did not allow Vue to take the necessary steps to seek financing, compelling Vue to instead finance the transaction by equity.
20. Overall, Apollo's poor financial health and the [] needs of the Estate provide good evidence to indicate that the Apollo business would not have continued to operate independently. The evidence available to the OFT suggests it is not realistic that the Estate would have continued to operate Apollo in future, whether in its current position or restructured in some form. The OFT therefore considers it likely that the first limb of the exiting firm scenario is met, but has not had to reach a definitive conclusion on this given its findings on the subsequent limbs, as set out below.
21. In addition to arguments in relation to the Apollo chain as a whole, Vue submitted that the Apollo Morecambe cinema and the Apollo Port Talbot cinema would, looked at individually, each have inevitably exited the market absent the merger given their financial performance. In respect of both cinemas, Vue provided to the OFT monthly management account data. These showed that []. However, the OFT was not provided with any evidence that Apollo intended, pre-merger, to close either cinema. Nor did Vue provide any evidence that it took steps to close either cinema in the period between completing the merger and entering into initial undertakings with the OFT.⁴ Vue has also indicated to the OFT that it has no specific

⁴ The OFT notes that it accepted initial undertakings in this case on 12 June 2012, and that under these undertakings each of Doughty Hanson and Vue will at all times during the specified period, procure that, amongst other things, the Apollo business (including, therefore, Apollo Port Talbot and Morecambe) is maintained as a going concern.

plans to close either cinema.⁵ As a result, the OFT did not consider that Apollo Port Talbot or Apollo Morecambe should be considered as inevitably exiting on an individual basis.

b. Whether there would have been a substantially less anti-competitive alternative purchaser for Apollo

22. Vue submitted that there was no realistic prospect of an alternative purchaser other than Vue and certainly none that would result in a substantially better outcome for competition.⁶
23. Vue submitted that shortly after KPMG was appointed, it was decided to proceed to a tender process for the sale of Apollo. To this end, KPMG, on 29 February 2012, drafted 'teasers' to be sent to an approved recipients' list. The minutes from the Apollo board meeting on 1 March 2012⁷ indicate that the 'teasers' agreed upon, stating that, 'the options available to... [Apollo] including refinancing and/or identifying a strategic investor.'⁸ The minutes from the Apollo board meeting of 6 March 2012 note the receipt of 13 responses to the KPMG Teaser, and the signature of non-disclosure agreements by 10 interested parties.
24. The minutes from the Apollo board meeting of 16 March 2012 notes the receipt of offers of investment from several parties []. A total of five offers of investment, made either to the company or to the shareholders directly, were noted at this stage but none was deemed to be acceptable. The OFT acknowledges that some of these offers, as well as an offer from another party [], effectively represented re-financing arrangements rather than an outright purchase. However, the OFT understands that a formal bid to acquire control of Apollo, rather than simply provide it with financing, was made by at least one party [].

⁵ Vue's responses dated 23 July 2012 to the OFT's information requested dated 17 July 2012, page 18. Vue also submitted to the OFT that, unlike many retail environments, the leases on cinema sites (including those operated by Apollo) tend to be longer-term. As a result it is not open to a cinema operator to close a cinema without incurring significant liabilities to the relevant landlord. This explains why an operator may continue to operate a cinema, in the hope of a change in financial fortunes, even where the cinema may not be profitable in the short-term.

⁶ Merger Assessment Guidelines, A joint publication of the CC and the OFT, OFT1254, September 2010, paragraphs 4.3.16-17.

⁷ Annex 16 of Vue's submission dated 11 July 2012.

⁸ Annex 15 – KPMG Teaser – of Vue's submission dated 11 July 2012.

25. On 29 March 2012 Simon Gregg sent an email to other members of the Apollo board, noting that a number of 'trade buyers' – that is to say buyers with prior experience of and current activities in the cinema sector – had been either issued with and/or signed non-disclosure agreements, []. In addition, a number of non-trade buyers [] had all expressed a continuing interest now that Apollo was 'in a non distressed situation' following the Estate's investment in Apollo described at paragraph 18 above.⁹ Additionally, on 3 April 2012, Apollo received an offer from another competitor [] to buy only one site [].¹⁰
26. Notwithstanding the above, Vue submitted to the OFT that only a 'trade buyer', could have purchased Apollo, for the reasons listed below.
- Cinema exhibition is a very specialised sector so a non-trade purchaser who might have considered such an investment would lack the expertise and know-how to be able to turn around the business.
 - The fact that Apollo was in a distressed financial situation and it was not making profits would immediately deter any non-trade purchasers.
 - Whilst a number of interested parties signed non-disclosure agreements with respect to a possible acquisition of Apollo, this is not necessarily representative of those parties intending to acquire the Apollo business, as it is common in similar situations for businesses to look around and 'check out' a target business, without this demonstrating real or even potential intention to acquire that business.
 - All offers received from non-trade buyers concerned re-financing arrangements for, rather than the acquisition of, the Apollo business and were therefore rejected by the Apollo board and the Executors.
 - Investors who specialise in distressed investments would likely make a 'derisory' offer for Apollo, which would likely not be accepted.
27. The OFT carefully considered, but did not accept, Vue's submissions on this point. In particular, the OFT notes the points listed below.
- Non-trade buyers have purchased cinema businesses before. Within the UK, Vue and Odeon are currently owned by private equity firms and

⁹ Annex 29 of Vue's submission dated 11 July 2012.

¹⁰ Annex 33 of Vue's submission dated 11 July 2012.

Cineworld was until 2009 owned by Blackstone.¹¹ Prior to the relevant investments, those private equity firms would have been considered 'non-trade purchasers' and yet made the relevant investments notwithstanding that at the time they may have lacked previous operational expertise and know-how in relation to cinemas. The OFT understands that under the terms of the relevant transactions these buyers retained at least some of the management teams in place at the relevant cinema chains. The OFT also notes that alternative purchasers may well have retained all or part of the management team in place pre-merger at Apollo; indeed, the offer made by [] for Apollo notes that at least some of the management team in place pre-merger would be kept on and incentivised.

- Notwithstanding the poor financial health of Apollo, and the apparently limited scope of marketing, non-trade purchasers did in fact express an interest in purchasing the Apollo business, as noted above.
- A number of potential non-trade buyers confirmed to the OFT that they had a real or potential interest in acquiring Apollo. Indeed, one potential non-trade buyer [] confirmed that it made an offer for Apollo and provided to the OFT a copy of the Heads of Terms sent to Apollo/KPMG in relation to that offer.
- Vue indicated that it did not have the details of offers made. By contrast, a number of potential non-trade buyers confirmed to the OFT that they intended to acquire control of, rather than simply provide financing to, Apollo.
- The OFT notes that whether the alternative purchasers are content to pay a particular asking price does not necessarily exclude a counterfactual in which there is a merger with an alternative purchaser, provided that such offers would have been for more than liquidation value.¹²

28. Moreover, the OFT has not been made aware of any conditions actually imposed during the sales process which would restrict the field of buyers

¹¹ The OFT also understands that AMC is currently owned (but being sold) by a group that includes Apollo Global Management, Bain Capital, Carlyle Group, CCMP Capital Advisors and Spectrum Equity Investors.

¹² Merger Assessment Guidelines, A joint publication of the CC and the OFT, OFT1254, September 2010, paragraph 4.3.17.

to only trade buyers. Indeed, the OFT notes that a summary of offers received as at 16 March 2012 suggests that 'any trade purchase would take several months to conclude due to competition issues'.

29. The OFT is also mindful that it was not able to contact all the parties that KPMG, coordinating the tender process for the sale of Apollo, contacted: KPMG considered that with respect to confidentiality it was unable to provide to the OFT details regarding the potential purchasers that it had spoken to in this context. The lack of transparency over potential bidders contributed to the OFT being unable to conclude that there was not an alternative non-trade purchaser for the Apollo business or its assets.
30. Based on the evidence above the OFT considers that it cannot exclude, on a realistic prospect basis, that Apollo or its assets could have been purchased by one or more non-trade buyers. As any non-trade buyer would represent a substantially less anti-competitive buyer than Vue, the OFT therefore did not consider the second limb of the exiting firm scenario to be met.¹³

c. What would have happened to Apollo's sales in the event of its exit

31. Given the OFT's conclusions above on the second limb of the exiting firm scenario, the OFT has not needed to reach a definitive conclusion as to whether the exit of the Apollo business and/or its assets may have resulted in a different outcome for competition than the merger.

Conclusion on the counterfactual

32. On the evidence currently available, the OFT does not consider that the second limb of the exiting firm scenario is satisfied. On that basis, the OFT has proceeded to examine the merger on a counterfactual of the status quo where the Apollo business (albeit potentially under different ownership) continued to operate in competition with Vue.¹⁴

¹³ The OFT notes that it considers it realistic that the entire Apollo chain could have been purchased by one or more alternative purchasers, which would include the Apollo cinemas at Port Talbot and Morecambe. This is consistent with Vue's own submission that the only transaction envisaged by the sellers of Apollo consisted of a sale of the entire Apollo circuit, rather than for only certain sites.

¹⁴ If the OFT cannot reach a sufficient level of confidence in relation to each of the limbs of the exiting firm scenario, it will use the pre-merger situation as its counterfactual to assess the

FRAME OF REFERENCE

33. The OFT's approach is first to consider the narrowest plausible candidate market in which the parties overlap and whether such a narrow candidate market may be widened in the first instance through demand-side substitution.¹⁵
34. The parties overlap in the supply of film exhibition services in the UK, the acquisition of film exhibition rights from film distributors, and cinema screen advertising services.
35. Both parties offer cinema screen advertisers the right to display advertising reels prior to the feature film on the parties' cinema screens.¹⁶ Digital Cinema Media (DCM) and Pearl & Dean (P&D) are the two major cinema screen advertising service providers in the UK. Whilst DCM supplies screen advertising services to Vue, P&D supplies screen advertising services to Apollo; the Transaction will not result in any immediate change to these arrangements. The OFT understands that Apollo is a relatively small cinema chain accounting for around 1.5 per cent of screen advertising services in the UK. A third party [] told the OFT that even if the advertising business of Apollo switched from P&D to DCM at the end of the current contract between P&D and Apollo, this would not represent any material change and P&D would be expected to continue to be active within screen advertising services. The OFT therefore does not believe that the merger will materially affect competition in this area and it is therefore not considered further.
36. Film exhibition services are considered further below.

Product scope

37. In previous Competition Commission (CC) and OFT decisions, it has been found that film exhibition was in a separate market from film distribution.¹⁷

merger. See Merger Assessment Guidelines, A joint publication of the CC and the OFT, OFT1254, September 2010, paragraphs 4.3.8-18.

¹⁵ Merger Assessment Guidelines, A joint publication of the CC and the OFT, OFT1254, September 2010, paragraphs 5.2.6 to 5.2.19.

¹⁶ Cinemas usually also sell space in foyers, ticket backs and toilets for advertising.

¹⁷ The CC's report on the completed acquisition by Vue Entertainment Holdings (UK) Limited of A3 Cinema Limited, 24 February 2006. OFT decision on the anticipated acquisition by Cineworld Group plc, through its subsidiary Cine-UK Limited, of the cinema business operating at the

It was also found that film exhibition was not part of a wider market including viewing films on television screens, either from a video cassette or DVD or from free-to-view or pay television or other types of leisure activity.

38. In this case, Vue argued that cinema exhibitors face a competitive constraint from alternative options open to consumers for viewing new films. Vue also argued that cinema-goers consider the cinema simply to be one of a variety of different means of spending leisure time.
39. Vue argued that this is supported by research from PWC.¹⁸ However, the relevant consumer survey does not relate to the OFT's primary concern, namely consumers' reactions in response to a five per cent price rise by a hypothetical monopolist within cinema exhibition. Indeed, the responses to the PWC research are entirely consistent with cinema exhibition being in a separate economic market. Moreover, the OFT appears to have been provided with only extracts from the relevant PWC research. The OFT does not therefore consider there to be sufficiently new or compelling evidence on substitution to warrant widening the product scope beyond the supply of film exhibition services.
40. The OFT therefore considers the frame of reference to be that for cinema film exhibition services.

Film Exhibition Services

Number of screens and type of films screened

41. In previous cases, the exact definition of a multiplex cinema has pointed specifically to cinemas with at least three screens and around 700 seats.¹⁹ The size of the cinema has been considered as a key determinant of its

Hollywood Green Leisure Park, Wood Green (*Cineworld/Hollywood Green Leisure Park*), 17 March 2008. OFT decision on the completed acquisition by Cineworld Group plc of the cinema business operating at the O2, London (*Cineworld/O2*), 9 November 2010. OFT decision on the anticipated acquisition by Odeon Cinema Holdings Limited of assets of Reel Cinemas (UK) Limited (*Odeon/Reel*), 6 October 2011.

¹⁸ Pages 12-15 of Vue's submission dated 11 July 2012.

¹⁹ See, for example, *Cineworld/Hollywood Green Leisure Park*, paragraph 35; OFT decision on the completed acquisition by Vue Entertainment Holdings (UK) Limited of A3 Cinema Limited (including its subsidiary, Ster Century (UK) Limited), 23 September 2005 (*Vue/Ster*), paragraph 13.

effectiveness as a competitive constraint. The closest constraint on a multiplex cinema is considered to be another multiplex cinema. A smaller cinema would provide a more limited competitive constraint on a multiplex given the limitations in number of films, show times and choice more generally.

42. In addition, the OFT has noted that not all cinemas, irrespective of the number of screens, will show the same mix of films. Cinemas will focus to varying degrees on, for example, mainstream films, foreign-language films, low budget or independent films, Bollywood films, or older classic films, which can depend, amongst other things, on the customers and target audience around the cinema.
43. In this case, Vue submitted that, as in certain previous cases, the OFT should consider only multiplex cinemas in the initial filter used for the purposes of the competitive assessment,²⁰ and then consider the competitiveness of other cinemas on a case-by-case basis, as part of the competitive assessment, irrespective of the size of and the types of show at those other cinemas.
44. Vue also submitted that the roll-out of digital projection technology in recent years has enabled smaller cinemas to have more flexible programming and to compete more closely with multiplex cinemas. However, the OFT does not consider that it has received sufficient evidence on substitution to warrant widening the scope of competitive assessment to include non-multiplex cinemas as prima facie effective competitors.
45. The OFT agreed with the approach described at paragraph 43 above, in particular because on the definition featured in previous decisions all of the relevant Vue cinemas and almost all of the Apollo cinemas would be classed as multiplex.²¹

²⁰ See, for example, *Cineworld/Hollywood Green Leisure Park*, paragraph 35; *Vue/Ster*, paragraph 13.

²¹ Each Apollo cinema has at least three screens. Only the following Apollo sites would not be classed as multiplex cinemas on this basis, due to the relevant number of seats: Apollo Morecambe (four screens, 626 seats), Apollo Piccadilly Circus (five screens, 489 seats), Apollo Rhyl (five screens, 598 seats) and Apollo Stafford (three screens, 566 seats). In addition, as noted in previous cases, multiplexes have also been conventionally defined by the industry as cinemas with five or more screens (OFT decision on the acquisition by Terra Firma Investments (GP) 2 Limited of United Cinemas International (UK) Limited and Cinema International

Exhibiting Film Format and Form of Projection

46. Films can be made available in various formats, including standard 35mm analogue film print, 2D and 3D digital hard drives,²² and IMAX proprietary 15/70mm film print and digital formats capable of being projected in both standard IMAX and in IMAX 3D format. A number of exhibitors also project standard format films onto larger screen formats.²³
47. Vue and Apollo screen films using standard 35mm and digital projection technology. [] of Vue's 675 screens in the UK have 3D capability, and [] of 83 Apollo screens have 3D capability.
48. As noted above, the OFT's approach is first to consider the narrowest plausible candidate market in which the parties overlap and whether such a narrow candidate market may be widened through demand-side substitution and then, if appropriate, to consider if substitution on the supply-side allows several products, which are not demand-side substitutes, to be aggregated into one wider market. As a result, the OFT therefore considered, in turn, the degree of substitutability between 2D and 3D formats, and whether distinct frames of reference are appropriate.²⁴

2D versus 3D film exhibition

49. In past cases, the OFT has considered a distinction between 2D and 3D film exhibition, noting factors supporting both demand- and supply- side substitution, but not considered it necessary to conclude on the precise market definition in relation to the supply of 2D and 3D film exhibition services.²⁵

Corporation (UK) Limited, 7 January 2005 (*Terra Firma/UCI*), footnote 3) and on that basis Apollo Piccadilly Circus and Apollo Rhyl would both be classified as multiplex cinemas.

²² These will generally conform to the Digital Cinemas Initiative (DCI) technical specification for digital cinema content.

²³ Examples include Vue's Xtreme and Odeon's i-Screen.

²⁴ The OFT notes that all of Apollo's screens are already digital, all Vue cinemas will have digital projection by mid-August 2012 and an industry report suggesting that, as at April 2012, 78 per cent of cinema screens in the UK were equipped with digital projectors. As such, the OFT has not considered further whether distinct frames of reference are appropriate as between analogue and digital formats.

²⁵ *Cineworld/O2*, paragraphs 24-30.

50. Vue submitted that in order to screen a 3D film, a cinema needs a digital projector and a silver screen.²⁶ Vue provided data suggesting that, as at April 2012, 78 per cent of cinema screens in the UK were equipped with digital projectors, and that the supply of 35mm prints may cease before the end of 2013, sooner than had been previously publicised. Vue also submitted that as at April 2012 just under 50 per cent of cinema screens in the UK are currently capable of showing 3D films.
51. Vue indicated that 3D ticket prices are typically higher than 2D ticket prices. A number of competitors agreed that 3D ticket prices are typically higher than 2D ticket prices, and indicated that they charge around 30 per cent more for a 3D ticket than a 2D ticket.²⁷ One competitor indicated that it considered 2D and 3D films to be substitutes from the consumer's perspective. However, another competitor and one film distributor suggested that they expected only a small percentage of customers to switch from 2D to 3D if the price of 3D were to fall relative to 2D. Film distributors have also suggested that whether 2D and 3D are considered substitutes may vary based on a film's genre, rating certificate and/or other film-specific factors.
52. The OFT was not provided with any direct information on consumers' reactions in response to a five per cent increase by a hypothetical monopolist. Supposing the OFT were to consider that all cinema tickets were part of the same market, and cost as much as a 2D ticket, and there existed a hypothetical monopolist of 3D tickets, the price differential between 2D and 3D tickets would suggest that the hypothetical monopolist would be able to profitably increase the price of 3D tickets by five per cent above that of 2D tickets. This would suggest they are in different economic markets.
53. 3D costs are likely to be higher, due to the need for a silver screen, for example, and the higher production cost of 3D films. Once any screen has a digital projector, the only investment required to show 3D films is a silver screen; the OFT understands that the cost of installing a silver screen in a cinema is relatively small, such that the investment will be quickly covered

²⁶ The silver screen is required because 3D films have lower projected light level, so need a screen which reflects more light into the auditorium.

²⁷ One competitor's 3D tickets cost £2.10 (£1.50 concession) more than a 2D ticket and another competitor's 3D tickets cost £2-£2.25 more than its standard tickets, with an additional £1 charge for reusable glasses.

by the increase in ticket prices. In particular, multiplex cinemas tend to be part of larger corporate groups, so will have sufficient capital available to install a silver screen if there is sufficient demand. There are therefore supply-side considerations suggesting that 2D and 3D cinema film exhibition services may be in the same market, at least in relation to multiplexes.

54. Vue submitted that every multiplex cinema located within a 30-minute drive-time from an Apollo cinema has at least one 3D screen. As the OFT considered only multiplex cinemas in the initial filter used for the purposes of the competitive assessment in this case, there would be no material difference in the OFT's initial competitive assessment for any relevant area whether 2D and 3D were considered separately or not. Given this consideration and also the factors noted above supporting both demand- and supply- side substitution between 2D and 3D cinema film exhibition, the OFT has not needed to distinguish between 2D and 3D film in its competitive assessment in this case separately, but considered and noted certain 2D-only cinemas on a case-by-case basis, as part of the competitive assessment, where appropriate.

Conclusion on product scope

55. The OFT considers the wider frame of reference to be cinema exhibition. The OFT did not consider it necessary to conclude on the precise market definition, but has noted as appropriate in its competitive assessment in this case where any relevant cinema did not have 3D format screening capability.

Geographic Scope

56. Previous OFT cinema merger decisions have considered competition in both national and local markets.²⁸ This is because 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).²⁹

²⁸ For example, *Odeon/Reel*.

²⁹ *Terra Firma/UCI*, paragraphs 10 to 28.

57. Vue submitted that competition principally occurs at a local level. Third parties agreed with this.
58. In relation to local issues, a 20-minute drive-time isochrone around the acquired cinema has generally formed the starting point for the competitive assessment in previous cases. This approach has been verified with sensitivity analysis using a 30-minute drive-time isochrone and considering the closeness of competition between the parties.³⁰ Sensitivity analysis has also involved re-centring on the acquirer's existing cinemas and/or on population centres.
59. Vue submitted that it agreed with the general approach taken in previous decisions, and did not provide any evidence relating to the appropriateness of any other general approach. In particular, neither Vue nor Apollo has a loyalty card scheme and as such have no data on customer catchment areas.
60. In previous cases the OFT has also noted that the prevalence of modes of transport other than driving and the more diverse nature of West End audiences make isochrones analysis a less reliable proxy in relation to Central London.³¹ Vue submitted additional data in relation to Manchester and in relation to London using drive-time isochrones other than 20 minutes or 30 minutes, but made no submissions to the effect that any other approach, or any isochrone other than 20 minutes, would be more appropriate in urban areas.
61. Based on the evidence before it, the OFT considers the 20-minute drive-time isochrone to be a good starting point for local analysis, including in urban areas, with a sensitivity check using a 30-minute drive-time isochrone and considering the closeness of competition between the parties.

³⁰ See, for example, *Cineworld/Hollywood Green Leisure Park*.

³¹ See for example: *Terra Firma/UCI*, paragraphs 27-28; *Cineworld/O2*, paragraph 36; *Cineworld/Hollywood Green Leisure Park*, paragraphs 32-33; OFT decision on the completed acquisition by the Blackstone Group of UGC Cinemas Holdings Limited (Blackstone Group of UGC), 28 April 2005, paragraph 18.

HORIZONTAL ISSUES

National level

62. At a national level, the increment in share of supply is no greater than [0-five] per cent (whether measured by reference to sites, screens, seats or GBOR), giving a post-merger UK share of supply for Vue of around [20-30] per cent (based on GBOR) or around [20-30] per cent (based on screens or seats).
63. Vue submitted that it was pre-merger, and it remains post-merger, the third largest national cinema chain in the UK, whether measured by reference to GBOR, screens or seats. Given this, and the minimal increment at a national level brought about by the merger, the OFT did not consider it necessary to analyse any further the impact of the merger at a national level and instead it focussed on local issues only.

Local level

The OFT's approach

64. The approach taken by the OFT in this case can be described as follows.
 - A 20-minute drive time isochrone was adopted around the acquired cinema (the primary isochrone) with a 30-minute isochrone used as a sensitivity check of the results from the primary isochrone.
 - In line with previous decisions, multiplex cinemas (cinemas with a minimum of three screens and 696 seats) were considered in the analysis as effective competitors. For clarity, the OFT considered that each Apollo cinema could be considered to be an effective constraint on Vue's cinemas, effectively treating each Apollo cinema as a multiplex.
 - Where the merger results in fewer than four fascias remaining within an isochrone (that is, Vue and Apollo fascias facing fewer than three other fascias) in a given area, the OFT considered that competition concerns cannot be dismissed such that the area in question should be scrutinised in further detail to determine whether there is a realistic prospect of a substantial lessening of competition (SLC) (for example, through higher prices and/or reduced content and facility range).

- Where significant population centres located within the 20-minute primary isochrone do not appear to be served by sufficient cinemas other than the parties, isochrone re-centring was used as a check on the results from the application of the first three assumptions.

65. The OFT has also conducted further analysis in a number of areas, due to third party concerns and/or the parties being each other's closest competitors geographically. In previous cases, the OFT and the CC have considered that the closer two cinemas are together, the more strongly those cinemas will likely compete.³²

66. The OFT notes that Bicester and Brentwood are sites for prospective Apollo cinemas. In certain previous decisions the OFT has on a conservative basis considered certain prospective cinemas as potential competitors for the purposes of the OFT's competitive assessment.³³ For the purposes of this transaction, the OFT adopted a conservative approach and considered the prospective Apollo cinema at Bicester as a potential competitor to Vue.³⁴ By contrast, the OFT did not consider that the prospective Apollo cinema at Brentwood to be sufficiently certain or advanced for there to be a realistic prospect of an SLC in this area; Brentwood was therefore not considered further by the OFT.³⁵

Vue's in-house customer research and independent telephone survey

67. Vue undertook in-house customer research in a number of local areas, principally at Apollo cinemas, with an overlapping Vue cinema included in the research in certain local areas. Vue also commissioned GfK NOP to undertake a telephone survey of potential customers around Bicester.

³² See OFT decision on the anticipated acquisition by Odeon Cinemas Limited and Cineworld Cinemas Limited of Carlton Screen Advertising Limited, 1 July 2008, paragraph 27; the CC's report on the completed acquisition by Vue Entertainment Holdings (UK) Limited of A3 Cinema Limited, 24 February 2006, paragraph 5.34.

³³ For example, *Odeon/Reel*, paragraphs 21-28.

³⁴ Apollo is now unconditionally committed to the prospective cinema at Bicester, following fulfilment by the developer of certain contractual obligations. Vue submitted that the external structure of the cinema would be completed by April 2013 and that the cinema would be operational in June 2013. The OFT therefore considered the prospective Apollo cinema at Bicester to be sufficiently certain and advanced for it to be taken account of in the OFT's competition assessment on a cautious basis.

³⁵ Construction in respect of the prospective cinema at Brentwood has not yet begun. []

68. The OFT considered the results of the research provided by Vue in support of its arguments.
69. The OFT did not regard the research methodology as having met its published guidance in a number of important regards, and this was communicated to Vue.³⁶ First, Vue conducted the research in cinemas over a number of days, but because individuals' cinema attendance and alternative choices will be driven by what films are being shown at that particular point in time, sampling over a short time frame is unlikely to yield a representative sample of the target cinema's population of customers. Second, the survey was undertaken by cinema staff, rather than by a third party, professionally accredited, research organisation; as such, the OFT could not be certain that the results obtained accurately reflected the opinions expressed by respondents.
70. In addition to concerns over the methodology, the OFT had concerns over the design of the interview script used, which the OFT communicated to Vue. Therefore, the OFT was unable to place much quantitative weight on Vue's research, due to the sample not being representative and the research not being conducted by an independent and accredited research organisation.
71. The OFT notes that Vue conducted a second wave of customer research, using an updated interview script, which corrected some of the problems with the previous version. However, the second wave suffered from similar methodological issues to the first wave, with the additional problem that all customers interviewed appear to have been asked which cinema they would divert to, even if they indicated that they would not have gone to an alternative cinema if their first choice cinema were temporarily unavailable.
72. Vue commissioned GfK NOP to undertake a telephone survey in the Bicester area, where an Apollo cinema is due to open in June 2013. The survey suffered from similar script design problems to the on-site research, with the additional complication of it being of potential customers, with two screening questions, to remove individuals who do not use the cinema

³⁶ Vue did not discuss the design of its initial in-house customer research or its independent telephone survey before this research was undertaken. For further information on the design of consumer surveys, see Good practice in the design and presentation of consumer survey evidence in merger inquiries, A joint publication of the Competition Commission and the OFT, OFT1230, March 2011.

or haven't visited a cinema in the last six months. This survey is discussed in more detail below in relation to the OFT's analysis in the Bicester area.

73. The OFT has taken account of the in-house customer research and GfK NOP survey results in areas in which they are present. However, the quantitative weight that the OFT has been able to place on the results in each local area has been calibrated to reflect the evidential concerns discussed above.

Areas considered in assessment of local competition

74. The OFT's assessment of local competition, as described above, indicated that there was no reduction in fascia, whether on the basis of 20-minute or 30-minute drive-time isochrones, between any Vue cinema(s) and the relevant Apollo cinema in Barrow-in-Furness, Carmarthen, Leamington Spa, Rhyl, Stroud or Torbay. After duly considering the party submissions received in relation to these areas, the OFT did not consider these six areas further.
75. There is no overlap between Vue and Apollo based on a 20-minute drive-time isochrone around Apollo Redditch. On a 30-minute drive-time isochrone, applied as a sensitivity check, whilst two Vue cinemas overlapped with Apollo Redditch (namely Vue Worcester and Vue Star City Birmingham) the OFT's investigation showed that in this area Vue and Apollo are not each other's closest competitors geographically and there remain at least four other fascia competing post-merger with Vue and Apollo.
76. In the Manchester area, Vue and Apollo overlap based on either a 20-minute or a 30-minute drive-time isochrone. However, on either basis there remain at least four other fascia competing post-merger with Vue Manchester Lowry and Apollo Altrincham, and in any case Vue and Apollo are not each other's closest competitors geographically in this area.
77. Similarly, in Central London Vue and Apollo overlap based on either a 20-minute or a 30-minute drive-time isochrone, but on either basis there remain at least four other fascia competing post-merger with the merged entity. In previous cases the OFT has noted that the prevalence of modes of transport other than driving and the more diverse nature of West End audiences make isochrones analysis a less reliable proxy in relation to

Central London.³⁷ The OFT has also previously described the West End area as including both Vue West End and Apollo Piccadilly Circus, but in this area there are at least ten other cinemas and at least five other fascia.³⁸

78. All other relevant areas are considered below.

Bicester

79. As noted above, for the purposes of this transaction on a cautious basis the OFT considered the prospective Apollo cinema at Bicester as a potential competitor to Vue. Based on a 20-minute drive-time isochrone around the prospective Apollo site in Bicester, there is no reduction in fascia.
80. On a 30-minute drive-time isochrone, there is a fascia reduction from four to three amongst multiplex cinemas. As the Apollo cinema at Bicester will have seven screens and 1,000 seats, in multiplex cinema exhibition services within the 30-minute drive-time isochrone Vue will have a combined share of [50-60] per cent (including an increment of [10-20] per cent) based on the number of screens, or around [30-40] per cent (including an increment of [10-20] per cent) based on the number of seats.
81. Vue submitted that the cinemas that are closest geographically to the prospective Apollo site in Bicester are the two Odeon cinemas in the centre of Oxford. The OFT notes that the prospective Apollo site in Bicester is located at a similar distance from Vue Oxford as it is from the two Odeon cinemas in the centre of Oxford or the Odeon cinemas in Banbury and Aylesbury. In addition, Cineworld Witney is only slightly further away from the prospective Apollo site in Bicester. Based on the evidence available, the OFT considered that these other cinemas are likely to provide a similar or greater constraint on the prospective Apollo Bicester cinema than the constraint provided by Vue Oxford. The OFT notes that Vue Oxford and the prospective Apollo Bicester cinema are not each other's closest competitor geographically, with Vue Oxford being located on the other side of Oxford to Bicester. The OFT also notes that additional Odeon and Cineworld cinemas lie on the edge of the 30-minute isochrones around Apollo Bicester, in Milton Keynes.

³⁷ See for example *Terra Firma/UCI*, paragraphs 17 and 28.

³⁸ *Cineworld/O2*, paragraph 36 and Footnote 9.

82. Vue submitted that the fascia reduction would be six to five if two non-multiplex cinemas in Oxford, the Phoenix Picturehouse and the Ultimate Picture Palace, were taken into consideration. The OFT considered carefully whether these two cinemas should be considered effective competitors to Vue Oxford and/or Apollo Bicester. The OFT notes that the Ultimate Picture Palace shows a mix of mainstream and art house films, but has only one screen (which is not, it appears, capable of showing 3D format films) and only 185 seats, and therefore has limited capacity and screenings. The OFT therefore considers that the Ultimate Picture Palace should not be considered to be an effective constraint on the parties in the Oxford area. By contrast, the Phoenix Picturehouse has two screens and a seating capacity of 310, and shows a mix of mainstream and art house films (albeit apparently not in 3D format). Moreover, GfK asked 251 customers in the Oxford area which cinema they currently use most often, and unprompted 63 customers indicated they use the Phoenix Picturehouse most often.³⁹ The OFT considers that the Phoenix Picturehouse may provide some degree of constraint on the parties in the Oxford area.
83. No third party raised any concerns regarding the merger in this local area.
84. For the above reasons, and considering also that the Phoenix Picturehouse may provide at least some constraint on the parties in the Oxford area, the OFT considers that there is no realistic prospect of a SLC in the Oxford/Bicester area.

Stafford

85. The OFT's assessment of local competition indicated that there was no reduction in fascia based on a 20-minute drive-time isochrone around either Apollo Stafford or the nearest Vue cinema, Vue Newcastle-under-Lyme. In addition, on a 30-minute drive-time isochrone around Apollo Stafford, there is a fascia reduction of five to four amongst multiplex cinemas.⁴⁰
86. However, the OFT applied as a sensitivity check a 30-minute drive-time isochrone around Vue Newcastle-under-Lyme. On this basis, there is a fascia reduction of three to two amongst multiplex cinemas, and Vue has a post-merger share of [50-60] per cent (including an increment of [five-10]

³⁹ Annex 13 to Vue's submission dated 7 August 2012.

⁴⁰ Although Apollo Stafford has three screens, it has around 100 fewer seats than a cinema meeting the definition of a multiplex cinema previously noted in OFT decisions.

per cent), based on GBOR. Similarly, there is a fascia reduction of three to two for the population within the area in which the 20-minute isochrones around Apollo Stafford and Vue Newcastle-under-Lyme overlap.

87. The OFT notes that, whilst Vue Newcastle-Under-Lyme is the closest multiplex geographically to Apollo Stafford, Apollo customers will continue post-merger to have a choice of alternative cinemas located at similar distances. Vue submitted that the drive-time from Apollo Stafford to Showcase Walsall is the same as to Vue Newcastle-under-Lyme. The OFT also notes that, to the south, Cineworld Wolverhampton, Cineworld Telford and Odeon Telford are all comparable distances from Apollo Stafford, and to the north Odeon Stoke is also within the 30-minute drive-time isochrones. Based on the evidence available, the OFT considers that these other cinemas are likely to provide a similar or greater constraint on Apollo Stafford compared to the nearest Vue cinema. The OFT also notes that Odeon Stoke is the closest multiplex to (and likely the strongest constraint on) Vue Newcastle-under-Lyme, and that Odeon Crewe is also closer than Apollo Stafford.
88. The OFT did not receive any substantiated third party concerns in relation to this local area. Indeed, four ITC respondents submitted that Apollo Stafford and Vue Newcastle-under-Lyme did not compete as they are not physical proximate to one another.
89. For the above reasons, the OFT does not consider that there is a realistic prospect of a SLC in the Stafford /Newcastle-Under-Lyme area.⁴¹

Fareham

90. The merger could be considered to result in a three to two fascia reduction within the primary 20-minute drive-time isochrone,⁴² within which Vue has

⁴¹ Vue submitted that the fascia reduction within the 30-minute isochrone centred on Vue Newcastle-Under-Lyme would be five to four if the fascia count included two non-multiplex cinemas, the Gatehouse Theatre Stafford (which lies within the 20-minute isochrone around Apollo Stafford) and the Film Theatre Stoke (which is within a 20-minute drive-time of Vue Newcastle-Under-Lyme). However, the OFT has not needed to reach a view on the level of constraints from these cinemas given its conclusion that, taking account of the other cinemas in the area, the merger does not in any event result in a realistic prospect of SLC.

⁴² Vue submitted that the primary isochrone did not strictly capture the Cineworld Southampton or Cineworld Chichester. However, Vue also submitted that these two cinemas lie on the edge of a 20-minute drive-time around Apollo Fareham. If Cineworld Southampton and Cineworld

a post-merger share of [60-70] per cent (including an increment of [20-30] per cent) based on GBOR. In addition, the merger results in a four to three fascia reduction within a 30-minute drive-time of Apollo Fareham.⁴³

91. Vue submitted that whilst Vue Eastleigh was clearly within a 20-minute drive-time of Apollo Fareham, Vue Portsmouth was outside of the primary isochrone. However, the OFT's investigation indicated that based on different driving speeds Vue Portsmouth would also be included within the primary isochrone and would therefore also overlap with Apollo Fareham.⁴⁴
92. Vue submitted that the merger would represent a fascia reduction of four to three within the 20-minute drive-time isochrone, and of five to four in the 30-minute drive-time isochrone, if the fascia counts included a non-multiplex cinema in Fareham, namely the Ashcroft Arts Centre. The OFT notes that this venue has only one screen and 150 seats, and screens only a limited amount of films as part of a wider programme of cultural events.⁴⁵ The OFT therefore did not consider that the Ashcroft Arts Centre should be considered to provide an effective constraint on the parties in the Fareham /Portsmouth area.
93. Vue submitted that Apollo Fareham and Odeon Port Solent are each other's closest geographic competitor. However, the OFT still considers that the constraint that would have existed pre-merger between, on the one hand, Apollo Fareham and, on the other hand, Vue Eastleigh and Vue Portsmouth, was of a sufficient level that the merger gives rise to competition concerns in this local area. In addition, Vue staff asked 288 customers at Vue Portsmouth which cinema they would use if the one that they were visiting were not available, and Apollo Fareham was mentioned in response by 56 customers at Vue Portsmouth. Similarly, staff at Apollo Fareham asked 324 customers which cinema they would use if Apollo Fareham were not available; 120 customers mentioned Vue Portsmouth.

Chichester were included in the primary isochrone, the OFT notes that the merger would still represent a fascia reduction of four to three, potentially resulting in competition concerns.

⁴³ The OFT received evidence that an additional cinema in Southampton, Showcase West Quays, is currently planned. However, the OFT has not included this prospective cinema in the 30-minute isochrone around Apollo Fareham, as the OFT was not provided with any evidence suggesting that the development is sufficiently certain to proceed and likely to open soon.

⁴⁴ The OFT's investigation included checking drive-time manually using Google and MapPoint.

⁴⁵ <http://peo.hants.gov.uk/peo/default.asp> .

94. One ITC respondent submitted that Vue Portsmouth and Apollo Fareham were in close physical proximity and competed with one another, and another ITC respondent noted that Vue Portsmouth and Apollo Fareham were close to Vue Eastleigh. Two competitors [] made similar submissions, suggesting that this proximity and the competition between the parties would likely mean that the merger results in a SLC in this area. A film distributor [] told the OFT that Vue Eastleigh and Apollo Fareham could be said to compete for the same end consumers locally.
95. Based on the above, the OFT considers that there is a realistic prospect of a SLC in the Fareham /Portsmouth area.

Port Talbot

96. The merger represents a three to two reduction in fascia, whether on the basis of 20-minute or 30-minute drive-time isochrones around Apollo Port Talbot. Within the primary isochrone Vue has a post-merger share of [60-70] per cent (including an increment of [10-20] per cent), based on GBOR.
97. As noted above, the OFT has previously considered that the closer two cinemas are together, the more strongly those cinemas will likely compete. The OFT notes that, whilst two other cinemas comprising one other fascia (namely Odeon Swansea and Odeon Bridgend) are present within the primary 20-minute isochrone centred on Apollo Port Talbot, Vue Swansea is the cinema which is closest geographically to Apollo Port Talbot.
98. Vue submitted that Vue Swansea and Odeon Swansea are each other's closest geographic competitor, as the OFT has previously recognised,⁴⁶ and are also equally close competitors to Apollo Port Talbot. Vue also submitted that the merged entity would be subject to an additional constraint in the near future, as Odeon plans to open shortly a new cinema in Llanelli. The OFT notes that Llanelli lies on the edge of the 30-minute drive-time isochrone around Apollo Port Talbot. However, the OFT still considers that the constraint that would have existed pre-merger between Vue Swansea and Apollo Port Talbot was of a level sufficient to give rise to competition concerns in this local area. Of the small number of customers who were asked by Apollo Port Talbot staff which cinema they would use if Apollo Port Talbot were not available, about one in three mentioned Vue Swansea.

⁴⁶ *Odeon/Reel*, paragraph 26.

99. One film distributor [] told the OFT that Vue Swansea and Apollo Port Talbot could be said to compete for the same end consumers locally. In addition, two competitors, [] also noted the geographic proximity between Vue Swansea and Apollo Port Talbot, suggesting that this proximity and the competition between the two cinemas would likely mean that the merger resulted in a SLC.
100. For the above reasons, the OFT considers that there is a realistic prospect of a SLC in this area.⁴⁷

Morecambe

101. On either a 20-minute or 30-minute drive-time isochrone around Apollo Morecambe, the merger represents a two to one reduction in fascia.
102. As noted above, the OFT has previously considered that the closer two cinemas are together, the more strongly those cinemas will likely compete. The OFT notes that Vue Lancaster is the closest multiplex cinema to Apollo Morecambe. Indeed, Vue stated that Vue Lancaster is the only multiplex cinema located within a 40-minute drive-time of Apollo Morecambe.⁴⁸
103. Vue submitted that the fascia reduction would be three to two in both the 20-minute and 30-minute drive-time isochrones if the non-multiplex cinema activities of Dukes, a combined theatre and cinema in Lancaster, were taken into consideration. The OFT's investigation indicated that this venue has only one cinema screen and 307 seats, screens only a limited amount of mainstream films and appear not to be capable of screenings films in 3D format.⁴⁹ In addition, two competitors [] submitted to the OFT that Dukes should not be considered an effective competitor to either Apollo Morecambe or Vue Lancaster. The OFT received no other evidence, and no response from Dukes as part of its market investigation, which could have otherwise facilitated an assessment of the degree of competitive constraint exerted by Dukes on Apollo Morecambe and/or Vue Lancaster. Based on

⁴⁷ Vue submitted that Apollo Port Talbot is loss-making, making an operating loss after the payment of rent (see paragraph 21 above for the OFT's assessment of the applicable counterfactual). However, whether a business is loss-making does not in itself affect the OFT's assessment of whether the merger has or may have resulted in a SLC. Based on the above, the OFT considers that the creates a realistic prospect of an SLC in the Port Talbot/Swansea area.

⁴⁸ Although Apollo Morecambe has four screens, it has 75 fewer seats than a cinema meeting the definition of a multiplex cinema previously noted in OFT decisions.

⁴⁹ www.dukes-lancaster.org/whats-on/film.

the evidence before it, the OFT did not consider that Dukes provides an effective constraint on the parties in the Morecambe/Lancaster area.

104. A number of ITC respondents submitted that Apollo Morecambe and Vue Lancaster are very close to, and in competition with, each other. A film distributor, Universal, told the OFT that Apollo Morecambe and Vue Lancaster could be said to compete for the same end consumers locally. Two competitors [] also noted the geographic proximity between Apollo Morecambe and Vue Lancaster, and suggested that this proximity and the competition between the two cinemas would likely mean that the merger results in a SLC in this area.

105. Based on the above, the OFT considers that there is a realistic prospect of a SLC in this area.⁵⁰

Burnley

106. The merger represents a two to one reduction in fascia, whether on the basis of a 20-minute or 30-minute drive-time isochrone around Apollo Burnley.

107. As noted above, the OFT has previously considered that the closer two cinemas are together, the more strongly those cinemas will likely compete. The OFT notes that the four cinemas which are geographically closest to Apollo Burnley are owned by Vue – namely Vue Accrington, Vue Blackburn, Vue (The Rock) Bury and Vue Preston. Vue was unable to identify any additional cinemas, multiplex or otherwise, in the 20-minute and 30-minute drive-time isochrones which might exert a competitive constraint on the parties post-merger.

108. One respondent to the OFT's ITC submitted that the three main cinemas in the East Lancashire area are Apollo Burnley, Vue Accrington and Vue Blackburn, emphasising the competition between those cinemas. Two competitors [] also noted the geographic proximity between these three

⁵⁰ Vue submitted that Apollo Morecambe is materially loss-making, and makes an operating loss even before payment of rent (see paragraph 21 above for the OFT's assessment of the applicable counterfactual)). However, whether a business is loss-making does not in itself affect the OFT's assessment of whether the merger has or may have resulted in a SLC. Based on the above, the OFT considers that the creates a realistic prospect of an SLC in the Morecambe/Lancaster area.

cinemas and suggested that on this basis the merger would likely result in a SLC in this area.

109. Staff at Apollo Burnley asked 630 customers which cinema they would use if no cinema were available in Burnley. In response, 355 customers mentioned a Vue cinema, with 173 customers citing Vue Blackburn.
110. Based on the above, the OFT considers that there is a realistic prospect of a SLC in this area.

Entry and expansion

111. Entry or expansion may potentially prevent or mitigate competition concerns arising through the theories of harm outlined above. The incentive of the merging parties to (for example) raise prices is diminished if such action would lead to entry or expansion by rivals.⁵¹
112. In previous cinema merger decisions, the OFT has noted certain barriers (including, for example, the planning system) which, at least in some areas, make new entry in a timely manner difficult.⁵² The OFT has received no evidence as regards any relevant changes that have occurred since the OFT previously examined this subject.
113. Vue has identified to the OFT the prospect of some third party plans to enter or expand in the cinema sector in some of the local areas mentioned above; these plans have been addressed by the OFT in its competitive assessment.
114. However, the OFT currently considers it unlikely that there would be entry or expansion sufficient to remove competition concerns in this case.

Conclusion

115. The OFT currently considers that there are no competition concerns at a national level in this case as the increment is very small and competition primarily occurs at a local level.

⁵¹ Merger Assessment Guidelines, A joint publication of the CC and the OFT, OFT1254, September 2010, Section 5.8.

⁵² OFT decision on the anticipated acquisition by Odeon Cinemas Limited and Cineworld Cinemas Limited of Carlton Screen Advertising Limited, 1 July 2008. *Vue/Ster. Terra Firma/UCI*.

116. The OFT has based its local market analysis on multiplex cinemas, taking into account the competitive constraint exerted by non-multiplex cinemas on a case by case basis.
117. In summary, based on the evidence available to it the OFT considers that the merger creates a realistic prospect of an SLC in Burnley, Fareham, Morecambe and Port Talbot.

THIRD PARTY VIEWS

118. The OFT received numerous complaints about the proposed merger – both unsolicited and in response to OFT questions – from a number of interested third parties, including the film distributors contacted by the OFT.
119. The OFT notes in particular that significant numbers of third parties expressed concerns about potential ticket price increases post-merger at Apollo and/or Vue cinemas. Other third parties expressed concern that the merger would result in a reduced quality of ‘experience’ at cinemas (and, in particular, less of a personal touch at Apollo cinemas now operated by Vue). The OFT also notes that a similar number were concerned about reductions in the choice of films offered by the parties’ combined cinema circuits and/or about cinemas closing as a result of the merger.
120. Third party comments have been taken into account where appropriate in the competitive assessment above.

ASSESSMENT

121. The parties overlap in the supply of 2D and 3D film exhibition services in the UK.
122. Given that competition takes place predominantly at a local level, and the minimal increment at a national level, the OFT did not consider it necessary to analyse in detail the impact of the merger at a national level and focussed instead on local issues only.
123. The OFT's approach on geographic market definition follows previous cinema merger cases considered by the OFT and the CC. In relation to local markets, a 20-minute drive-time isochrone around the acquired cinema has formed the basis for the competitive assessment with sensitivity analysis using a 30-minute drive-time isochrone and considering the closeness of competition between the parties.

124. Based on the above local analysis, the OFT identified that the parties do not overlap, whether on a 20-minute or a 30-minute drive-time isochrone, in Barrow-in-Furness, Carmarthen, Leamington Spa, Rhyl, Stroud or Torbay. The OFT concludes that there can be no SLC in relation to these areas as a result of the merger.
125. The OFT identified the parties overlap, based on a 20-minute drive-time isochrone and/or a 30-minute drive-time isochrone, in Redditch, Manchester and London. However, the OFT also considered that the parties were not each other's closest competitors in these local areas and a sufficient number of other competing cinemas would remain post-merger. The OFT considers that there is no realistic prospect of a SLC in these areas.
126. The parties overlap based on a 30-minute drive-time isochrone, but not a 20-minute drive-time isochrone, in Bicester and Stafford. The OFT notes that the parties were not each other's closest competitors in these local areas and that a number of other competing cinemas impose a stronger competitive constraint due to their distance from the parties' cinemas. The OFT also considered there to be a sufficient number of other competing cinemas which would remain post-merger.
127. In relation to Fareham, the merger results in a three to two fascia reduction within the primary isochrone, and a four to three fascia reduction within a 30-minute drive-time of Apollo Fareham. The OFT considered that the constraint that would have existed pre-merger between, on the one hand, Apollo Fareham and, on the other hand, Vue Eastleigh and Vue Portsmouth, was of a level which meant that the merger gives rise to competition concerns in this local area. In addition, a number of third parties expressed concerns about the merger to the OFT.
128. In Port Talbot, the merger represents a three to two reduction in fascia, whether on the basis of 20-minute or 30-minute drive-time isochrones. Vue Swansea is the closest cinema geographically to Apollo Port Talbot, and the OFT considered that the constraint that would have existed pre-merger between, on the one hand, Apollo Fareham and, on the other hand, Vue Eastleigh and Vue Portsmouth, was of a level which meant that the merger gives rise to competition concerns in this local area. In addition, the OFT received a number of comments from third parties who had merger-specific concerns relating to this local area.

129. In Morecambe, on either a 20-minute or 30-minute drive-time isochrone around Apollo Morecambe the merger represents a two to one reduction in fascia. Vue Lancaster is the only multiplex cinemas located within a 40-minute drive-time of Apollo Morecambe, and Vue appears to have no effective competitors in the local area post-merger. In addition, a number of third parties expressed concern about the local effects of the merger.
130. Similarly, in Burnley the merger represents a two to one reduction in fascia, on either a 20-minute or 30-minute drive-time isochrone. Vue owns the four cinemas which are geographically closest to Apollo Burnley, and was unable to identify any effective competitors within a 30-minute drive-time of Apollo Burnley. A number of third parties also expressed to the OFT concerns about the effects of the merger on local competition.
131. The OFT therefore considers that the merger creates a realistic prospect of an SLC within 2D and 3D film exhibition services in Fareham, Port Talbot, Morecambe and Burnley.

EXCEPTIONS TO THE DUTY TO REFER

132. The OFT's duty to refer under section 22(1) is subject to the application of certain discretionary exceptions, including the customer benefits exception under section 22(2)(b). Under section 22(2)(b) of the Act, the OFT may decide not to make a reference where it believes that any relevant customer benefits in relation to the creation of the relevant merger situation concerned outweigh the SLC concerned and any adverse effects of the SLC concerned.
133. Situations where customer benefits might be weighed against an identified loss of competition are defined in section 30 of the Act as being when the merger results in lower prices, higher quality, greater choice or greater innovation (although in this context such benefits need not be in the same market as that, or those, in which the SLC has occurred or will occur). For the OFT to exercise its discretion not to refer a merger on this basis, the claimed customer benefits must be clear, timely, and merger-specific, and the evidence in support of them must be compelling. In other words, the parties should be able to produce detailed and verifiable evidence of any anticipated price reductions or other benefits.⁵³ These will be rare cases

⁵³ Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance, OFT, OFT1122, December 2010, paragraphs 4.8-4.9.

since, ordinarily, the OFT would expect a SLC to lead to harm to customers in the form of higher prices, lower quality, reduced service and/or reduced innovation.

134. Vue identified a number of potential efficiencies and benefits which it submitted fulfil the definition of relevant customer benefit within the meaning of section 30 of the Act. Vue submitted that it had, for example, reduced ticket prices post-merger at Apollo Rhyl, increased film choice, afforded Apollo customers access to a UK-based call centre for customer service queries, improved Apollo's website functionality. Vue also submitted that it would, for example, install new automatic ticket machines at all Apollo sites, make investments in VIP seating and Vue Extreme screens, and will be better able to maintain and clean the Apollo sites under Vue's maintenance and cleaning programmes.
135. It is unclear, however, whether at least some, if not most, of the benefits claimed could not also be achieved by other means in the absence of the merger. For example, decisions to invest in a UK call centre, for example, may not be a specific result of the merger insofar as Apollo could have chosen to begin using a UK call centre, if there were sufficient demand, absent the merger.
136. In addition, the OFT did not have access to sufficient information to allow it to conclude with any certainty that such customer benefits outweigh the potential consumer detriment flowing from the merger. On the contrary, the OFT also received complaints suggesting that certain consumers are concerned about increases in admission prices, a reduction in the quality or range of films, and a degradation of the 'experience' at Apollo cinemas.
137. The asymmetry of the OFT's reference test necessarily means that the OFT requires compelling evidence in relation to these relevant customer benefit arguments to enable the OFT to find on the basis of them that there is no realistic prospect of an SLC. It is clear from the discussion above that the net impact of these arguments on local competition in this case is an empirical question, which would involve detailed analysis on a local area basis. While the OFT considers it plausible that the merger might indeed lead to some limited customer benefits, given the limited empirical evidence supporting Vue's claims in respect of relevant customer benefits, the OFT does not consider it appropriate to exercise its duty not to refer the merger to the CC because the SLC identified in the four areas is outweighed by the relevant customer benefits that may be brought about by the merger.

UNDERTAKINGS IN LIEU

138. 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 SLC 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.
139. In this respect, undertakings in lieu of reference are appropriate only where the remedies proposed to address the competition concerns are clear cut, and those remedies are capable of ready implementation.⁵⁴
140. In lieu of reference to the CC, Vue indicated a willingness to give undertakings to divest its interest in the Apollo cinemas in relation to Fareham, Port Talbot, Burnley and Morecambe if the OFT believed that it is or may be the case that the merger may be expected to result in a SLC in those areas.⁵⁵
141. Such a remedy would in principle address all of the competition concerns identified above, in a clear cut manner, insofar as it would remove any increment to Vue's local presence in all area in which the OFT concluded that the merger has or may have resulted in a SLC. The OFT has accepted undertakings in lieu involving cinema divestments in two previous cases, on a similar basis.⁵⁶
142. The OFT noted, based on information provided by Vue, that two of those cinemas, namely Apollo Port Talbot and Apollo Morecambe, were not making profits at the operating level (that is, positive earnings before interest, taxes, depreciation, amortization (EBITDA) and rent) at the time of

⁵⁴ Merger Jurisdictional and Procedural Guidance, OFT527, June 2009, paragraph 8.5.

⁵⁵ In relation to the Burnley area, Vue also offered to divest either Apollo Burnley or Vue Accrington. However, the OFT's starting point is to seek an outcome that restores competition to the level that would have prevailed absent the merger, thereby comprehensively remedying the SLC. The OFT considered that a divestment of Vue Accrington would not eliminate all of the increment to Vue's local share which results from the merger, so would not restore competition to pre-merger levels.

⁵⁶ See *Terra Firma/UCI* and *Blackstone Group/UGC*.

the merger. This is without prejudice to the fact that the rent, the service charge, and insurance must continue to be paid for many years.⁵⁷

143. The OFT considered whether such considerations might undermine the viability for a successful sale if purchasing these cinemas would not provide a buyer with a commercial incentive to continue operating a cinema business. Moreover, insofar as such divestment may take time due to questions about the commercial attractiveness of these two cinemas, these considerations give rise to doubts as to whether such divestment is a remedy that is capable of ready implementation.

144. However, Vue clarified that, to address such issues it sell any loss-making cinema only as a package together with one or more cinemas with a stronger financial performance (such as Apollo Fareham). Vue submitted that by selling loss-making sites together with profitable sites, the total consideration could potentially be lower, which should have the effect of allowing more potential purchasers, even those with limited financing capabilities, to consider offering to purchase divestment assets. On this basis, the OFT considers that there is a good prospect that Vue will be able to divest of all of the four cinema sites.

Up-front buyer

145. The OFT considered whether it is appropriate in the circumstances of this case to require that the relevant divestments are made in whole to an upfront buyer. An up-front buyer requirement means that the proposed purchaser will have committed contractually, subject to formal OFT approval of the undertakings in lieu, to acquiring the relevant divestment before the OFT accepts undertakings in lieu. This means that the OFT will accept undertakings in lieu only where a provisional sale has been agreed, thereby demonstrating that a sale to a suitable purchaser is achievable. It also means that the OFT may consult publicly on the suitability of the proposed divestment purchasers, as well as any other aspects of the draft undertakings, during the public consultation period.⁵⁸

⁵⁷ Vue subsequently stated that the financial position of one of these cinemas, Apollo Port Talbot, had materially improved since the merger, and was forecast to break into profit in the current financial year, due to the synergy benefits Vue had been able to apply to the Apollo business.

⁵⁸ Mergers - Exceptions to the duty to refer and undertakings in lieu of reference guidance, OFT1122, December 2010, paragraph 5.33

146. Vue indicated that a number of trade purchasers would be likely to be interested in purchasing the sites, based on the fact that Vue had received in recent weeks many enquiries in relation to the potential divestment sites from other cinema exhibitors. Vue also submitted that any trade purchaser(s) should have the time and financial resources to buy the sites, whether individually or as a group, suggesting that an upfront buyer requirement may not be required.
147. The OFT believes, however, there is some uncertainty in relation to both the remedy package offered and the actual number of suitable purchasers for the divestment sites. In particular, the OFT considers that the nature of the remedy, which involves the sale of discrete cinema assets, of mixed financial performance, to have a higher risk profile than some other divestment remedy and that it is appropriate to require Vue to identify purchasers for the cinemas upfront in this scenario. The OFT therefore considers that the requirement for an upfront buyer is both reasonable and proportionate in seeking to ensure that competition concerns are remedied.
148. The OFT considers that it is appropriate to suspend its duty to refer only on the basis that it will seek an upfront buyer for the divestments in this case. The OFT will therefore only accept undertakings, following consultation, when Vue has agreed to a provisional sale (or sales) with a purchaser (or multiple purchasers) with the necessary finance, expertise and business plans to acquire all of the four relevant cinemas and continue to offer cinema exhibition services in competition with Vue.

Conclusion on Undertakings in lieu

149. Vue has offered undertakings in lieu of a reference to the CC that the OFT considers are, in principle, clear-cut and capable of restoring pre-merger levels of competition. The OFT therefore considers it appropriate to suspend its duty to refer this case while it considers further whether to accept these undertakings in lieu of a reference under Section 73 of the Act.

DECISION

150. The OFT considers that it is or may be the case that the merger has resulted or may be expected to result in a SLC within a market or markets in the United Kingdom. However the OFT's duty to refer the completed acquisition by Vue of Apollo is suspended because the OFT is considering

whether to accept undertakings in lieu of reference from Vue pursuant to section 73 of the Act.