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COMMERCE COMMISSION

Decision No. 485

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

VAL MORGAN HOLDINGS PTY LIMITED

and

VAL MORGAN & CO (AUST) PTY LIMITED AND MEDIA ENTERTAINMENT GROUP LIMITED

The Commission:	MJ Belgrave PR Rebstock D Bates QC
Summary of Application:	Val Morgan Holdings Pty Limited has sought clearance to acquire Val Morgan & Co (Aust) Pty Limited and Media Entertainment Group Limited from Television and Media Services Limited
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	18 December 2002

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CONTENTS

THE PROPOSAL

1. On 15 November 2002 the Commission registered a notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act") from Val Morgan Holdings Pty Limited ("VMH") for it to acquire Val Morgan & Co (Aust) Pty Limited ("Val Morgan") and Media Entertainment Group ("MEG") from Television & Media Services Limited ("TMS").

THE PROCEDURES

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was sought by the Commission and agreed to by the applicant. Accordingly, a decision on the application was required by 20 December 2002.

3. In its application, VMH sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for a period of 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

4. The Commission's determination is based on an investigation conducted by staff.

5. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.[1]

THE PARTIES

VMH

6. VMH is an entity that is currently 100% owned by Village Cinemas Australia Pty Limited ("Village"). It is proposed that VMH will be 1/3 jointly owned by The Hoyts Corporation Pty Limited ("Hoyts"), the Greater Union Organisation Pty Limited ("Greater Union"), and Village ("Acquiring Exhibitors").
7. It is intended that VMH will be operated at arms length as a stand alone business by the Acquiring Exhibitors.

Acquiring Exhibitors

Hoyts

8. The Hoyts Group is an Australian-based cinema and film distributor with cinema businesses in Australia, New Zealand, and various other companies. It commenced distributing films in Australia and New Zealand in 2002.

9. In New Zealand, Hoyts wholly owns 47 screens at 8 locations around the country.

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[1] Commerce Commission, *Practice note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

10. Hoyts owns 33.33% of a 12 screen cinema complex in Queen Street, Auckland, with Village and Sky City Leisure Holdings Limited ("Sky City") (through related companies), being the other shareholders. Hoyts has a 20% interest in a cinema in Rotorua with other individual shareholders.

Village

11. Village Roadshow is based in Melbourne, Australia, with operations across 13 countries. Village's core businesses are cinema, movie production, film distribution, radio and theme parks.

12. Village Roadshow's assets include a film distribution business with operations in Australia, New Zealand, Singapore and Greece.

13. In New Zealand, Village, with its partners, is the country's largest exhibitor with 76 screens at 12 sites, namely:
    - 47 screens at 6 sites via a joint venture with Sky City;
    - An art-house circuit of 17 screens at 5 sites operated with Sky City and another locally based entertainment company (Rialto Entertainment);
    - an interest in the Auckland Queen Street cinema complex (12 screens) – the other partners being Sky City and Hoyts; and
    - an investment in several provincial cinemas, including Village Hastings, Downtown Cinema Napier and Toptown Cinema in New Plymouth.

Greater Union

14. Greater Union is present in New Zealand through Roadshow Distributors Pty Limited, a wholly owned subsidiary that distributes film and video in New Zealand and Australia.

TMS

15. TMS is a company listed on the Australian Stock Exchange. TMS was formerly known as Hoyts Entertainment Limited and was owned by cinema exhibitor Hoyts until its Australian Stock Exchange listing in 1987.

16. TMS is a diversified media company whose main activities include cinema screen advertising, post production, television services, studio production services and field production services.

17. TMS's principal business units are Global Television, a television services body, Val Morgan and MEG, both cinema advertisers. This application involves TMS's Val Morgan and MEG businesses. Global Television will be retained and operated by TMS.

Val Morgan

18. Val Morgan rents screentime from exhibitors. Val Morgan was purchased by the Hoyts Corporation and was sold to Hoyts Entertainment Limited (now TMS) in 1987. It commenced operations in New Zealand in 1990.

19. Within New Zealand, Val Morgan sells advertising on Hoyts cinema screens as well as independent cinemas' screens.

MEG

20. MEG was a private company operating a location television and magazine publishing business until it secured the contract to provide cinema advertising in the Village cinema circuit in Australia in 1997. On the basis of this expansion, MEG secured a public share placement and listed on the ASX. It subsequently entered into agreements to advertise in the Village/Force and Village/Rialto circuits in New Zealand through its New Zealand subsidiary Onscreen Advertising Limited. MEG was acquired by TMS in 2001, pursuant to Commerce Commission clearance in Decision 420.

OTHER RELEVANT PARTIES

Screen Vistas Limited ("Screen Vistas")

21. Screen Vistas is a locally owned business and was incorporated in 1993. Screen Vistas is based in Palmerston North and specialises in cinema advertising. It has agreements for [ ] screens at independent cinemas throughout the country (from Gore to Keri Keri), with a particular concentration in the Central North Island.

Reading Entertainment Inc ("Reading")

22. Reading is a cinema and real estate company currently operating cinemas in Australia, the United States, Puerto Rico and New Zealand. In New Zealand, Reading operate 10 screens at the Courtney Central cinema complex, and also operates 13 screens in the Auckland region under the 'Berkeley Cinemas' name. Reading also intends to open a new cinema complex in Christchurch in 2003, and in Auckland at a later date.

INDUSTRY BACKGROUND

23. Cinema advertising consists of the display of still ("slide advertisements") or moving advertisements ("film advertisements") in cinemas, generally shown immediately before motion pictures are exhibited.

24. The relationship between cinema advertising clients and cinemas is almost always mediated by cinema advertisers such as Val Morgan and Screen Vistas. Cinema advertisers generally have an exclusive relationship with a cinema or chain of cinemas allowing them to display advertisements in film sessions.

25. Val Morgan and MEG operates cinema advertising businesses in which they:

- acquire the right to exhibit cinema advertising in cinemas from cinema operators;
- sell cinema advertising time to advertisers;
- produce, or arrange for the production of, certain cinema advertising; and
- schedule the cinema advertising for exhibition at the relevant cinemas.

26. Val Morgan and MEG are the main providers of these services in both New Zealand and Australia.

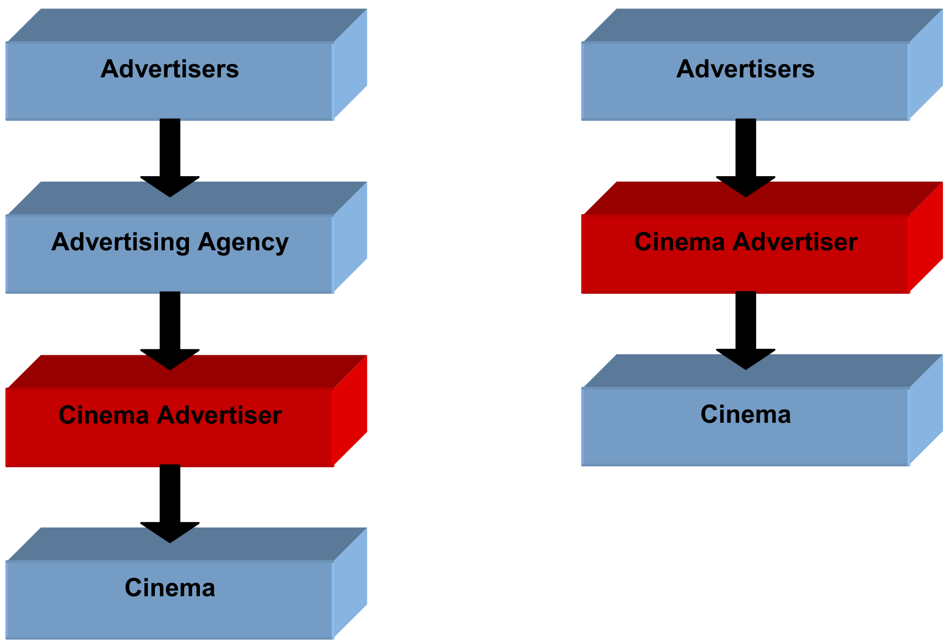
27. Cinema advertisers handle film advertising and slide advertising differently. As a rule, film advertising is sold to national or regional advertisers and slide advertising is sold to local advertisers. All film advertising is produced and placed with cinema advertisers by advertising agencies as part of an overall campaign that may encompass many media.

28. Cinema advertisers are not involved in the production of film advertisements but simply arrange for its distribution. Cinema advertisers pay a commission to advertising agencies placing film advertisements with them.

29. By contrast, advertising agencies are rarely if ever involved in the preparation of slide advertising. This preparation is generally undertaken by cinema advertisers, though advertisers may contribute some or all of the artwork involved. Cinema advertisers also have their own marketing and sales forces that attract advertisers through direct marketing.

30. The vertical structure of the cinema advertising industry is as follows[2]:

Film Advertising **Slide Advertising**



[2] Val Morgan Holdings Pty Limited Clearance Application, 15 November 2002, p16

31. Film advertising is substantially more expensive than slide advertising, and can cost between $10,000 and $250,000 for a campaign. Slide advertising can cost as little as $5,000 for a standard campaign.

32. Val Morgan sells slide advertising to advertising agencies and national clients in 15-second units on a minimum of 20 screens in eight-week blocks. Local clients can purchase advertising on a single screen, with sliding discounts for additional screens. Local clients are encouraged to book for 56 weeks, though shorter campaigns are available at a premium. Slides are shown at every session on every screen booked during the campaign period.

33. Val Morgan sells film advertising in weekly units. It operates a film scheduling system, ensuring advertising is directed towards appropriate film titles. Clients can also choose which cinemas to advertise in, or which individual movie or group of movies to follow.

MARKET DEFINITION

34. The Act defines a **market** as:

> *. . . a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.*

35. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the '*ssnip* test'). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.

36. It is substitutability at competitive market prices which is relevant in defining markets. Where the Commission considers that prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a *ssnip* imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.

37. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:

- the goods or services supplied and purchased (the product dimension);
- the level in the production or distribution chain (the functional level);
- the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
- the temporal dimension of the market, if relevant (the timeframe).

38. The Commission will seek to define relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.

39. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one. If the Commission is unable to clear the proposed acquisition on the basis of the narrower market, it will be necessary to review the arguments and evidence in relation to broader markets.

The Commission's Previous Decisions

40. The Commission has previously taken a narrow approach to market definition for advertising services in decisions concerning print media and radio stations (see Decisions 395 *Independent News Auckland Limited / Review Publishing Co Ltd* and Decision 329 *Independent Newspapers Limited / The Marlborough Express Newspaper Company Ltd*). In these decisions, the Commission stated that while there is competition at the margin, there are separate markets for each media form, and that for each medium there are two complementary product markets. One market relates to the dissemination of news, information and entertainment, and the other is for the provision of advertising services.

41. The Commission has also previously considered the provision of cinema advertising services in Decision 420, *Television and Media Services Limited and Media Entertainment Group Limited*. In this decision the Commission adopted a narrow market, defined as the market for the provision of cinema advertising services in New Zealand

The Applicant's Proposed Market Definition

42. The applicant considers that cinema advertising is directly substitutable with other forms of advertising, particularly television for national advertising, and radio, metropolitan and community newspapers, direct mail, flyers and outdoor signs for local advertising. The applicant submitted that relevant factors in defining the appropriate market are:

- The significant constraint placed upon cinema advertising by other forms of advertising;
- The relatively small size of cinema advertising as a proportion of the overall advertising spend in New Zealand; and
- The fact that for very few advertisers would there be no acceptable substitutes for cinema advertising

43. The applicant submitted that the relevant markets are:

- the market for advertising time and space, including television and radio, newspapers and magazines, outdoor and cinema advertising, direct marketing, and new media; and

- the market for advertising agency services, including full-service agencies and media buying houses.

44. Thus, the applicant considers that while Val Morgan is the principal buyer of cinema time and screens, it is just one buyer in the larger market for advertising on all media. Similarly, though advertisers usually buy cinema time and screens via Val Morgan, they do so only as one possibility within a range of alternative media.

Product Dimension

45. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers' eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.

46. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[3] The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the 'ssnip' test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

Demand-side substitution

47. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

48. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a ssnip would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market. If not, then the next most likely substitute good or service will be added to the initial market definition and the test repeated. This process continues until a combination of products is found which defines the product dimension of a relevant market, namely, the smallest combination of goods or services for which a ssnip would be profitable.

49. On the demand-side, the technical viability of one good or service as a substitute for another must be assessed. However, even where another product may technically be suitable as an alternative for the product in question, its price may be so much higher that it may be a poor substitute in an economic sense, at least for the great majority of buyers.

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[3] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1998] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: "A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive". See also *News Limited v Australian Rugby Football League Limited &Ors* (1996) ATPR at 41,687, where Burchett J stated: "Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation." Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

In judging economic substitutability between products, the Commission will have regard to relative prices, quality and performance when assessing whether they are, in fact, close substitutes in the eyes of buyers.

Supply-side substitution

50. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.

The Commissions View on the Product Dimension

51. The applicant considers that the appropriate market definition is a broad market for advertising time and space including television and radio, newspapers and magazines, outdoor and cinema advertising, direct marketing and new media. However, based on its investigation the Commission will follow the approach taken in Decision 420 and define cinema advertising as being a separate market. Cinema audiences are demographically different from most mass media and they are believed to respond differently to advertising. The current investigation has suggested a further distinction between "slide advertisements" and "film advertisements".

<u>Slide Advertising</u>

52. Slide advertisements are displayed still graphics accompanied by a voice-over. They typically advertise local retailers who might not advertise elsewhere. They display on a limited number of (usually local, and often specifically on neighbourhood cinema) screens. The effect of slide advertisements lies in repetition increasing brand awareness, in the same way as for billboards and other forms of outdoor advertising.

53. Slide advertising is sold via local salesmen, often as a result of "cold-calling". Slide advertisers then produce the slides in-house and distribute them to cinemas for display.

<u>Film Advertising</u>

54. Film advertisements consist of moving pictures, similar if not identical to television advertising. They typically advertise across a wide geographical area, though often only in metropolitan theatres. Film advertisements are used by those seeking to reach a certain demographic and seek a certain response. Film advertisements rely on responses to theatre ambiance and visual stimuli, so are used by clients advertising such products as cars, sportswear, armed services recruitment, and LTSA safety campaigns.

55. Val Morgan sells film advertising via its central office and contracts out production, though often film advertisements are adapted from television commercials. Film advertising is much more expensive than slide advertising and is usually available on more flexible terms.

Conclusion

56. The Commission therefore concludes that for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product markets are:

- The market for cinema film advertising; and
- The market for cinema slide advertising

Geographic Extent

57. The Commission will seek to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.

58. Cinema film advertising and cinema film advertising services are largely provided on a national basis. The Commission therefore considers that these markets are national in scope.

59. Conversely, cinema slide advertising and cinema slide advertising services are largely provided on a regional basis, with cinemas having a catchment area for business advertising over a radius of approximately 10km. In an interview, the applicant suggested that this market consisted of local monopolies. The Commission therefore considers that these markets are regional, but will treat them as a single market for the purpose of competition analysis.

Functional Level

60. The production, distribution and sale of a product typically occurs through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.[4] Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

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[4] *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502 The High Court (Greig J, Shaw WJ, Prof M Brunt) noted: "If we ask what functional divisions are appropriate in any market definition exercise, the answer, …, must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers. Wherever successive stages of production and distribution can be co-ordinated by market transactions, there is no difficulty: there will be a series of markets linking actual and potential buyers and sellers at each stage. And again, where pronounced efficiencies of vertical integration dictate that successive stages of production and distribution must be co-ordinated by internal managerial processes, there can be no market."

61. In Decision 420 (TMS/MEG), the Commission defined the relevant markets as "the provision of cinema advertising services in New Zealand". In this definition, there is no distinction at the functional level or at the geographic level.

62. The applicants proposed market definitions describe markets at two functional levels. In the first, advertising time and space is purchased from cinemas and other media. In this market, Val Morgan buys advertising time on a number of screens at cinemas. In the second market, Val Morgan sells its stock of time and screens to advertising agencies representing advertisers and, in the case of slide ads, often directly to advertisers.

63. The Commission considers that there are markets at two distinct functional levels which are defined by the activities carried out by cinema advertisers, namely:

- The market for cinema advertising; and
- The market for cinema advertising agency services.

Conclusion on Market Definition

64. The Commission concludes that the relevant markets are:

- the national market for cinema film advertising;
- the national market for cinema film advertising agency services;
- regional markets for cinema slide advertising; and
- regional markets for cinema slide advertising agency services.

65. The Commission considers that the first two of these markets, the national market for cinema film advertising and the national market for cinema film advertising agency services, are vertically integrated to such an extent that they can be treated as a single market when analysing the competition effects of the proposed acquisition.

66. For the same reasons, the Commission consider that the latter two of these markets, the regional market for cinema slide advertising and the regional market for cinema slide advertising agency services, may be treated as a single market for the purposes of the competition analysis. At a geographical level it is also considered that the regional slide advertising markets are similar to such an extent that it is useful to analyse them as if they were a single market.

COMPETITION ANALYSIS

Substantially Lessening Competition

67. Section 47 of the Act prohibits particular business acquisitions. It provides that:

> A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

68. Section 2(1A) provides that substantial means "real or of substance". Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.[5] What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.[6]

69. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[7]

70. While the Act defines the words "substantial" and "lessening" individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:

- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);

- the nature and extent of the contemplated lessening; and

- whether the contemplated lessening is substantial.[8]

71. In interpreting the phrase "substantially lessening competition", the Commission will take into account the explanatory memorandum to the Commerce Amendment Bill (No 2). The memorandum notes that:

> Two of the 3 key prohibitions are strengthened to bring New Zealand into line with Australian competition law, which will facilitate a more economic approach to defining anti-competitive behaviour.

and, in relation to s47:

> This proposed new threshold is the same as the threshold for these types of acquisitions in section 50 of the Trade Practices Act 1974 (Australia).

72. For the purposes of the analysis, the Commission takes the view that a lessening of competition and a strengthening of market power may be taken as being equivalent, since they are the two sides of the same coin. Hence, it uses the two terms interchangeably. Thus, in considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.

73. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years,

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5 *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).

6 *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [1993] 1 All ER 289.

7 For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.

8 See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [1987] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1998] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [1990] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

74. The Commission will continue to use a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question, and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.

75. VMH has submitted that in the absence of its acquisition of Val Morgan, TMS will be placed in administration and Val Morgan will cease trading for a "significant period" due to the severe financial difficulties TMS is currently in.

76. Screen Vision, an American cinema advertising company, recently acquired the United States operation of Val Morgan. When questioned about the sale of Val Morgan (US) to Screen Vision, Val Morgan indicated that the potential sale of the New Zealand and Australian Val Morgan and MEG businesses was not considered until it was too late in negotiations to be included as part of that acquisition. It therefore appears that a sale of Val Morgan and MEG to Screen Vision in the future is a possibility. However, no express intentions have been given.

77. Other exhibitors, in particular Reading and Berkeley, have expressed an interest in being part of a joint venture arrangement with the Acquiring Exhibitors along with a representative cross section of other independent exhibitors in order to better serve the needs of the industry.

78. If the acquisition were not to proceed, it may be that another party, such as Reading or Screen Vision, would acquire Val Morgan. However, the Commission has not been able to identify from these or any other party interest in buying Val Morgan.

79. The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios should a merger not proceed.[9] Given the uncertainty of what changes, if any, there would be in the market in the absence of the proposed merger proceeding, the Commission proposes to use the status quo as the counterfactual in order to thoroughly test the competition implications of the proposed acquisition.

[9] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.

Vertical Acquisitions

80. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of the acquisition.

81. The proposed acquisition does not involve any horizontal aggregation, as VMH will operate at a different functional level than the Val Morgan and MEG. However, the applicant accepts that the acquisition would give rise a degree of vertical integration as a result the acquiring exhibitors entering the downstream markets for cinema advertising.

82. In assessing vertical acquisitions, the Commission's main concern is where a position of substantial market power in one market is likely to be strengthened or leveraged into another market. The Commission's Practice Note 4 states that: [10]

> "in general, the vertical aspects of acquisitions leading to vertical integration are unlikely to result in a substantial lessening of competition in a market unless a situation of a substantial degree of market power exists at one of the functional levels affected by a vertical acquisition. Where such a situation is found to exist, the Commission will examine the acquisition to determine whether that position is likely to be strengthened or extended to other markets, and whether that will substantially lessen competition."

83. The Practice Note goes on to outline some of the competition concerns that may be raised by vertical acquisitions: [11]

- Vertical integration may facilitate coordination effects. For example, the efforts of a group of manufacturers to collude may be undermined by the competition between the downstream retailers. This might be prevented if each retailer were to be acquired by a manufacturer.

- Vertical integration may foreclose entry into one or other of the vertical levels affected. For example, a commodity processor that vertically integrates with upstream suppliers of the commodity may be able to foreclose others from the processing market. Likewise, a manufacturer that gains control of a downstream distribution level of the market may be able to foreclose others from the manufacturing market.

- Vertical integration may increase entry barriers. Foreclosure as just described may raise barriers to entry, by requiring an entrant at one functional level of the market to enter simultaneously at the other, foreclosed, level.

- Vertical integration may raise access concerns. A vertically integrated firm which owns an essential facility to which others need access in order to compete at a downstream level, has the ability to discriminate in favour of its own affiliated activities in the downstream market. Those affiliated activities could also benefit from information gained about rivals through those rivals requiring access at the upstream level.

84. Val Morgan and MEG prima facie appear to have a substantial degree of market power in the markets for the provision of film and slide advertising services. As there is no horizontal aggregation in this market as a result of the proposed acquisition, there is no change in this degree of market power when compared to the counterfactual. However, this leaves the question of whether this market power could be expanded into the other relevant markets and whether this would represent a substantial lessening of competition,

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[10] Practice Note 4, Page 44.
[11] ibid.

again relative to the counterfactual. The assessment of whether such leveraging is likely to take place as a result of an acquisition will depend on factors such as entry conditions and access.

85. Therefore, the implications of the proposed acquisition for the markets for film advertising and slide advertising services are now considered.

THE MARKET FOR FILM ADVERTISING

Existing Competitors

86. Currently, Val Morgan and MEG are the only competitors in the film advertising market.

State of Existing Competition

87. There are 325 cinema screens in New Zealand. Screen Vistas has the lead agreements for [ ] screens (this equates to [ ]% of all cinema screens) although it has sub-contracted the rights to provide film advertising to Val Morgan in [ ] of these screens until 2006. The remaining [ ] screens Screen Vistas has lead agreements for do not show film advertising.

88. Peter McCormick, Director of Screen Vistas, has advised the Commission that Screen Vistas' main focus is the production and placement of slide advertising for local and regional businesses. Accordingly, he currently sub-contracts the rights to provide film advertising to Val Morgan. [

].

Vertical Integration

89. A vertical integration may give rise to a substantial lessening of competition in a number of ways, as outlined in the Practice Note 4 and referred to in paragraph 84 above.

90. The first concern is that vertical integration may facilitate coordination effects. However, in the present case, this is considered unlikely due to the existence of:

- active competition from other forms of advertising;
- elastic market demand;
- no record of price fixing or other forms of collusion within the industry;
- sales of film advertising being large and infrequent; and
- limited price transparency in the tender process for the provision of cinema advertising services to cinemas.

91. These factors tend to act against collusive behaviour. Therefore, there does not appear to be any increase in the risk of collusive behaviour, compared to the counterfactual.

92. Another concern relates to market foreclosure. The ability of VMH to foreclose entry into the film advertising market will depend on the degree to which competitors (or potential competitors) require access to the Acquiring Exhibitors (i.e. whether an inability to gain access to the Acquiring Exhibitors will raise entry barriers). The ability to engage in anticompetitive practices through leveraging of upstream market power will be

influenced by entry conditions in the film advertising market, and these are considered below, along with the potential for market foreclosure.

93. The final concern relates to cinema exhibitors' access to film advertising services. The ability of VMH to discriminate in favour of the Acquiring Exhibitors will depend on the degree to which competing exhibitors require access to the services provided by Val Morgan. One party has raised the concern that VMH will be able to reduce their revenues by discriminating against them in the distribution of cinema advertising. The position of advertising agencies will be an important consideration in the analysis of this issue, as the exercise of market power in diverting business away from competing exhibitors is ultimately likely to be to the detriment of these film advertisers, as it would impact on their ability to target specific audience demographics. The countervailing power of advertising agencies is discussed below, as is the countervailing power of exhibitors.

CONSTRAINTS FROM MARKET ENTRY

Introduction

94. A business acquisition is unlikely to result in a substantial lessening of competition in a market if behaviour in that market continues to be subject to real constraints from the threat of market entry.

95. Where barriers to entry are clearly low, it will not be necessary for the Commission to identify specific firms that might enter the market. In other cases, the Commission will seek to identify likely new entrants into the market.

96. The Commission will consider the history of past market entry as an indicator of the likelihood of future entry. The Commission is also mindful that entry often occurs on a relatively small scale, at least initially, and as such may not pose much of a competitive constraint on incumbents within the relevant time frame.

Barriers to Entry

97. The likely effectiveness of the threat of new entry in constraining the conduct of market participants, following a business acquisition that might otherwise lead to a substantial lessening of competition in a market, is determined by the nature and height of barriers to entry into that market.

98. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry. In evaluating the barriers to entry into a market, the Commission will generally consider the broader 'entry conditions' that apply, and then go on to evaluate which of those constitute entry barriers.

99. It is the overall obstacle to entry posed by the aggregation of the various barriers that is relevant in determining whether entry is relatively easy or not, and therefore whether or not potential entry would prevent a substantial lessening of competition.

100. For entry to act as an antidote to a substantial lessening of competition stemming from a business acquisition, it must constrain the behaviour of the combined entity and others in the market.

101. The applicant submits that there are low barriers to entering the market for film advertising market, noting:

> "The only significant barrier to entry in the cinema advertising business is access to screens
>
> …
>
> beyond the up front costs of securing a major contract with one of the major existing exhibitors…there are no real barriers".

102. The up front costs referred to by the applicant in this quotation are the guaranteed minimum amounts and initial lump sum payment which must be bid to secure a contract with a major exhibitor, estimated to be in the range $1-$1.5 million in the first year. Independent exhibitors tend to enter into revenue sharing arrangements with cinema advertisers, where revenue is split on a 50/50 basis and there is no guaranteed minimum payment or initial lump sum payment.

103. The fundamental requirements of cinema advertising for film commercials are:

- selling of cinema advertising time to advertising agencies; and
- scheduling and distribution of advertisements for individual cinemas.

104. The key requirement for entry into the film advertising market is access to screens. Because of the existence of long-term contracts between exhibitors and cinema advertisers, new entrants have access to only a proportion of the market at any one time and thus have to overcome more than just a pure cost barrier.

105. Industry sources spoken to tend to suggest that barriers to entry in terms of replicating the services provided by cinema advertisers are low. For the sale of film advertising, the main requirement appears to be the need for a representative(s) to deal with the advertising agencies (predominantly based in Auckland and to a lesser extent Wellington) that place national film advertising. However, this leaves open the question of whether the acquisition may increase barriers to entry because of potential foreclosure into the film advertising market.

Foreclosure

106. The applicant has submitted that ownership of VMH by the Acquiring Exhibitors might be argued to be a barrier to entry, as the Acquiring Exhibitors would be unlikely to use the cinema advertising services of a competitor to their own cinema advertising company. Acquiring Exhibitors currently possess 106 (or 37.8%) cinema screens nationwide. However, the applicant has submitted that the competitive position would be essentially unchanged due to the fact that Val Morgan already has exclusive long-term contracts with Hoyts and Village anyway. Further, as 62.2% of cinema screens are not owned or operated by Hoyts or Village, these would still be available to a new entrant.

107. The Commission notes that Village has a 1/3 interest in a further 17 Rialto cinema screens, and investments in a further 13 cinema screens, bringing the total screens the Acquiring Exhibitors are involved with to 136 (or 41.8%) of cinema screens nationwide.

108. The national distribution of cinema screens by exhibitor is shown in the table below.

Table 1 : National Distribution of Cinema Screens

Location	Number of Acquiring Exhibitors' Screens	Number of Reading's / Berkeley's screens	Number of other Exhibitors' screens	Total (% of national screens)
Auckland	65 (74.7%)	13 (14.9%)	9 (10.3%)	**87 (26.8%)**
Wellington	18 (41.9%)	10 (23.3%)	15 (34.9%)	**43 (13.2%)**
Christchurch	21 (72.4%)	-	8 (27.6%)	**29 (8.9%)**
Hamilton	10 (90.9%)	-	1 (9.1%)	**11 (3.4%)**
Dunedin	9 (81.8%)	-	2 (18.2%)	**11 (3.4%)**
Others	13 (9.0%)	-	131 (91.0%)	**144 (44.3%)**
Total	**136 (41.8%)**	**23 (7.1%)**	**167 (51.4%)**	**325 (100%)**

109. The Commission considers that the acquisition of Val Morgan and MEG by VMH may potentially foreclose 41.8% of the market to new entrants. In particular, Val Morgan and MEG represent the majority of metropolitan screens – located in Auckland, Hamilton, Christchurch and Dunedin – and a substantial proportion of the screens in Wellington. This therefore represents a more significant proportion of the film advertising market than the above percentage indicates.

110. Furthermore, Val Morgan and MEG currently have the *ability* to discriminate against cinemas that compete with the Acquiring Exhibitors, although Val Morgan and MEG have no incentive to do this if it seeks to maximise profits. The acquisition may combine this ability to discriminate with the *incentive* of VMH to discriminate against their competitors in order to reduce the profits of their competitors and maximise their own profits.

<u>The View of Industry Participants</u>

111. Advertising agencies have advised that, while there are some exceptions, cinema film advertising campaigns usually depend on having simultaneous access to an effective number of screens in different central locations in the major towns of New Zealand. Thus, it is not necessarily the number of screens that a cinema advertiser represents that is important. Rather, it is their location with respect to potential 'reach' into a target market that is important.

112. Advertising agencies have also advised that the screens represented by Val Morgan and MEG, with the exception of the screens run by Reading in Wellington, are regarded as the key mainstream screens and will normally be regarded as essential when targeting a mainstream audience. Advertising agencies have suggested to the Commission that a film advertiser that did not represent these screens may be regarded as a non-essential component of an advertising campaign, and could consequently be relegated to a second supplier status. Val Morgan and MEG's share of the cinema advertising time on offer to

advertising agencies and advertisers, particularly in Auckland and Christchurch, is such that it may be impractical to mount a national campaign without using Val Morgan and MEG's services.

113. Other industry participants spoken to consider that the inability of a competitor to gain access to Hoyts and Village may raise barriers to entry, particularly given that Village is the dominant cinema chain in Auckland (with an 85% market share in central Auckland) and the dominance of the Hoyts chain in the major urban centres. However, they also considered that a contract with Reading might be sufficient for a competitor to enter the market given its prominence in Wellington, and intentions to build additional cinemas in Christchurch and later in Auckland. Furthermore, users of cinema advertising often consider some independent cinemas such as the Embassy in Wellington or the Bridgeway or Berkeley's cinemas in Auckland as key locations of an advertising campaign, depending on the campaigns target audience.

114. Peter McCormick, director of Screen Vistas (which currently competes with Val Morgan and MEG for slide advertising) was of the opinion that a cinema advertiser may be able to compete in the film advertising market if it was able to secure the Reading cinema advertising contracts.

115. Industry sources considered that the crucial requirements for a new entrant are service and representing a *range* of cinema screens. One advertising agency suggested that a cinema advertiser would not be able to compete on the same level as Val Morgan and MEG without representing either Village or Hoyts. However, all except one advertising agency interviewed advised that Reading in Wellington, plus a range of other desirable screens such as the Bridgeway in Auckland and Embassy in Wellington, would probably be sufficient for a new entrant to effectively compete in the film advertising market. As such, it may not be necessary for a new entrant to be able to secure contracts with Hoyts and Village in order to be successful as a cinema advertiser.

The Commission's View

116. Reading is a significant cinema chain and operates 14.9% of Auckland's screens and 23.3% of Wellington's screens, and also intends opening a new cinema complex in Christchurch in 2003. However, a cinema advertiser that only represents these screens may not be able to compete with Val Morgan and MEG on similarly advantageous terms for film advertising, given the comparatively small number of screens represented in Metropolitan areas.

117. While the long term contracts between Hoyts, Village and Val Morgan limit the scope of a new entrant into the market, this is more a reflection of Hoyts' and Village's importance in the cinema exhibition market than of Val Morgan and MEG's dominance in cinema advertising. Exhibitors are free to negotiate the length of contracts, in order to obtain a guaranteed level of future income (in the case of minimum guaranteed payments). Nevertheless, there remains a segment of the market in which there is some scope for competition. This segment is continuing to grow, especially with Reading building a new cinema complex in Christchurch in 2003. The extent to which entry into this segment could constrain VMH if it attempted to exercise market power is considered in the LET test below.

The "LET" Test

118. In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns that a business acquisition could lead to a substantial lessening of competition, entry of new participants in response to the exercise of market power must be likely, sufficient in extent and timely (the *let* test). If they are to act as a constraint on market participants following a business acquisition which might otherwise lead to a substantial lessening of competition in a market, entry must be relatively easy, or to put it another way, barriers to entry must be relatively low.

Likelihood of Entry

119. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power to alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

120. In general, it is the pre-merger price that is relevant for judging whether entry is likely to be profitable. That in turn depends upon the reaction of incumbents to entry in terms of their production volume, together with the output volume needed by the entrant in order to lower its unit costs to the point where it can be competitive.

121. VMH has submitted that cinema exhibitors could effectively "sponsor" new entry into the cinema advertising business, as was the case with Village's support for MEG in 1997 allowing MEG as a new entrant to the Australian market to rapidly acquire a 24% share of cinema screens. Entry of this kind would most likely come from a new entrant sponsored by Reading cinemas.

122. [

].

123. Joe Moodabe, Chief Executive Officer of Sky City, indicated to the Commission that [

].

124. The applicant has also suggested a new entrant into the New Zealand market could include international firms, such as Carlton or RMB International, in light of the current expansion strategies being implemented by these global cinema advertising companies. However, the Commission in its investigations was unable to establish any party as a de novo entrant into the film advertising market.

125. On a balance of probabilities, it appears that entry into the film advertising market may be likely by one or more parties if VMH attempted to exercise market power.

Extent of Entry

126. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. The Commission will not consider entry that might occur only at relatively low volumes, or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.

127. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that "toe-hold" position may be difficult because of the presence of mobility barriers, which may hinder firm's efforts to expand from one part of the market to another. Where mobility barriers are present in a market, they may reduce the 'extent' of entry.

128. Entry into the film advertising market is only possible into the 58.2% of the market not controlled by the Acquiring Exhibitors. Within this share, new entrants are limited in their ability to expand due to the presence of long-term contracts between Val Morgan and MEG and cinema exhibitors.

129. The experience of Screen Vistas over the last seven years in securing [ ] of the slide advertising market suggests that entry is possible to a reasonable extent. Also the experience of MEG in securing [ ] screens in 1997 suggests entry is possible to a reasonable extent, particularly with the backing of a major cinema exhibitor.

130. New entrants face no binding capacity constraints and additional exhibitors are not significantly more expensive to represent.

131. However, it is arguable whether Reading is a sufficiently important cinema exhibitor on a national scale in terms of cinema locations to support entry of the kind sponsored by Village, given the requirements of a competitive cinema advertiser to represent a sufficient range of screens with adequate reach into a target market discussed above.

132. It is also arguable whether a new entrant representing Reading and a range of other independent exhibitors would meet the requirements of a competitive cinema advertiser discussed above, and would therefore be able to sufficiently constrain VMH if it attempted to exercise market power.

133. The Commission considers that the extent to which a new entrant can enter the film advertising market is restricted by the effective foreclosure of the Hoyts and Village cinema advertising contracts, and their importance as key mainstream cinemas. As such, the Commission considers that on a balance of probabilities the market may not be able to be entered to a significant extent if VMH attempted to exercise market power.

Timeliness of Entry

134. If it is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about a substantial lessening of competition, entry must be likely to occur before customers in the relevant market are detrimentally affected to a significant extent. Entry that constrains must be feasible within a reasonably short timeframe from the point at which market power is first exercised.

135. In some markets where goods and services are supplied and purchased on a long-term contractual basis, buyers may not immediately be exposed to the detrimental effects stemming from a potential substantial lessening of competition. In such cases, the competition analysis, in a timing sense, begins with the point at which those contracts come up for renewal.

136. The Commission considers that entry may possibly occur if a new entrant were to secure the contracts of Reading. Securing contracts from other cinema exhibitors would be a more timely process, as the entrant would have to tender for new contracts as the existing contracts with Val Morgan and MEG expired. However, as this most contracts between exhibitors and Val Morgan are for the duration of one to two years this does not represent a material barrier.

Conclusion on Barriers to Entry

137. The Commission considers that the barriers to entry into the film advertising market are not necessarily high in terms of replicating the services provided by cinema advertisers. However, entry into the film advertising market may be foreclosed to some extent due to the unavailability of the Hoyts and Village contracts and their importance as film advertising locations. The Commission considers that, although this may not be sufficient to foreclose entry into the market - particularly given Reading intentions of building a new cinema complex in Christchurch - the ability of a new entrant to constrain VMH if it attempted to exercise market power is reduced by the inability of securing the Hoyts and Village cinema advertising contracts and the subsequent reduction of the extent to which a new entrant could enter the market. The Commission therefore considers that the potential for new entry into the film advertising market is at best a weak constraint in the context of this application.

OTHER COMPETITION FACTORS

Constraint from Other Media and Countervailing Power of Advertisers and Advertising Agencies

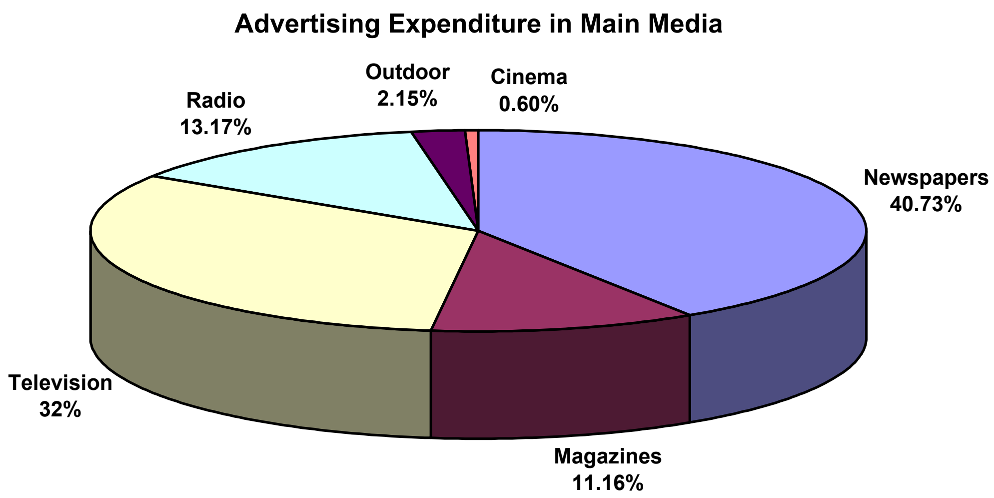
138. The potential for a firm to wield market power may be constrained by countervailing power in the hands of its customers, or alternatively, when considering buyer (oligopsony or monopsony) market power, its suppliers. In some circumstances, it is possible that this constraint may be sufficient to eliminate concerns that a business acquisition may lead to a substantial lessening of competition.

139. Where a combined entity would face a purchaser or supplier with a substantial degree of market power in a market affected by the acquisition, the Commission will consider whether that situation is such as to constrain market participants to such an extent that competition is not substantially lessened.

140. While the Commission does not in this decision place other media (including television, radio, newspapers, magazines and outdoor/billboards) within the defined market, it nonetheless accepts that other media do place an important constraint on the providers of film advertising services.

141. The Commission notes that cinema advertising represented only 0.6% of the total advertising spend in the main media in New Zealand in 2001. In dollar terms of the $1.48 billion spend on advertising in New Zealand in 2001 only $9 million went to cinema advertising. Available figures include newspapers, magazines, television, radio, outdoor advertising and cinema advertising.

142. A graphic representation of the breakdown by media type of total advertising expenditure in 2001 is shown below[12]:



143. The applicant has argued cinema advertising:

> "…rarely forms a large or essential part of a clients advertising campaign.
>
> As a result, any price increase above competitive levels by a cinema advertiser would immediately result in media buyers shifting their advertising to more cost-effective media. Even if all cinema screens were controlled by one cinema advertiser, that advertiser could not afford to raise prices without losing substantial business to other media".

144. This statement was tested in the market place. Advertising agencies expressed divergent views.

145. Some agencies disputed the validity of the applicant's assertion. They considered cinema advertising offers unique opportunities and advantages not offered by other forms of media. In particular they argued that cinema advertising could not be readily substituted with other media because it offered unique advantages including:

- high impact;
- the ability to target niche audiences – in particular young people;
- a captive audience; and
- the ability to advertise in a specific location or alongside a particular movie.

146. However, the majority of agencies endorsed the applicant's argument. They considered that they would have a degree of countervailing power given the choices of other media options available to them, and that cinema is considered to be at best a second choice medium. Cinema advertising is relatively expensive compared with other media on the basis of numbers reached per dollars spent. These agencies concurred with

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[12]Source: Advertising Standards Authority, New Zealand Advertising Industry Turnover, December 2001 Year Ended, http://www.asa.co.nz/industry_turnover/stats.htm

the applicant's assertion that there is a high degree of substitutability between cinema advertising and other forms of media. They also agreed that any increase in the price of cinema advertising relative to the other media would result in a re-allocation of advertising expenditure away from cinema advertising to other forms of media. The general consensus amongst this group of agencies is that they would have significant countervailing power to resist any attempt by VHM to exercise market power.

147. Advertising agencies did not consider that VMH would be able to restrict their access to their cinemas of choice. Advertising agencies advised that they select which cinemas they wish to place a campaign in, as determined by the nature of the campaign and their target audience. Generally this would include the major cinemas such as Village and Hoyts because of their popularity and subsequent "reach" into a target market. However, a campaign often included using cinemas outside this group, especially when targeting the more mature or affluent audiences that are generally prevalent at independent cinemas. Advertising agencies advised the Commission that they believed they had sufficient countervailing power to be able resist any attempt by VMH to favour Village and Hoyts over other cinemas in terms of scheduling of locations for cinema advertising.

148. Advertising agencies have advised the Commission that they are extremely sensitive to changes in price and would react to a price increase by diverting money used to purchase cinema advertising to other media. Cinema is regarded as a secondary advertising medium and consequently rarely forms an essential part of an advertising campaign. The overall effect of this would be to lower the effectiveness of cinema advertising and cause campaign money to be diverted to other media

149. Agencies have also said that they might be reluctant to consider launching a national advertising campaign where access to screens was restricted or available on less favourable terms.

Conclusion on Constraints from other Media and the Countervailing Power of Advertisers and Advertising Agencies

150. The Commission considers that cinema advertising can offer advertisers some advantages over other media. The particular demographics of cinema audiences and the theatre environment mean that advertisers can engage effectively with certain target consumer groups. However, the opportunities for niche marketing provided by cinema are not unique to the medium. As in Decision 420, the Commission is not satisfied that advertising on other media is sufficiently substitutable for cinema advertising to put them in the same market. However, the Commission considers that they will offer some constraint and give advertisers a degree of countervailing power against the merged entity.

Constraint from Countervailing Power of Exhibitors

151. Current competition for access to screens is limited by the fact that most screens are subject to long-term exclusive contracts. However, in the long term when screen rights become available again, the applicant has argued that exhibitors could easily remove them from the supply chain. In particular, the applicant has submitted that:

> "the supply by exhibitors of rights to advertise in their cinemas is highly price elastic, and payments from cinema advertisers are not the principal source of revenue for exhibitors. As a result, Reading and independent exhibitors provide substantial countervailing power to the

providers of cinema advertising. If Val Morgan were temporarily able to reduce the price at which advertising rights were sold, independent exhibitors would have other options:

- "selling cinema advertising direct to the advertising agencies, as is the case with a number of exhibitors in the United States and was the case in Australia when Hoyts owned Val Morgan; or
- effectively "sponsoring" new entry into the cinema advertising business, as was the case with Village's support for MEG in 1997 allowing MEG as a new entrant to the Australian market to rapidly acquire a 24% share of cinema screens. There is room for a new competitor to enter as:
  - Hoyts/Village control only 38% of screens in New Zealand
  - Screen Vistas already operates effectively without access to Hoyts/Village screens.
- going to Screen Vistas. Screen Vistas is an effective competitor even though it has subcontracted film advertising to Val Morgan until 2006. The subcontract is on terms that allow Screen Vista to compete economically."

152. The applicant suggests that since the exhibitors control access to screens, they are well placed to facilitate entry or enter themselves.

153. The majority of independent cinemas contacted have indicated that they have no objections to the proposed acquisition. All of the independent cinemas contacted have one or two year contracts with cinema advertisers. Most are comfortable that their niche market positions, which differentiate them from the multiplexes, will afford them a degree of power when negotiating their future contracts with the merged entity. Further, most independent cinemas' advertising revenue represents a lesser percentage of their total revenue than is the case for the bigger chains. In some cases this is by design, given the preferences of their patrons.

154. [ ] expressed an objection to the merger. This exhibitor expressed the concern that VMH would be less inclined to deal with the independent cinemas, and would also lower the guaranteed minimum payments to their cinema. However, other independent cinemas felt that there is a high degree of interdependence between cinema advertisers and cinema exhibitors, including independent cinemas with their niche markets. They did not see the proposed acquisition altering this fact.

155. Independent cinemas also indicated that they would be prepared to sell advertising space directly to advertising agencies themselves. However, the majority also indicated that this would likely to be a short-term solution due to the inconvenience of making the requisite arrangements, and that there was a preference for having this service catered for by a cinema advertiser. This preference was also reiterated by advertising agencies, which advised that the appeal of cinema advertising would be greatly reduced if it became necessary to deal with independent cinemas directly.

156. As discussed above, Reading may also be sufficiently large in the New Zealand market to sponsor entry into the cinema advertising market itself, much as Village did with MEG in 1997. Bridgeway cinema, a two screen independent cinema in Auckland, advised the Commission that they sponsored a new entrant into the cinema advertising market in 2001, but that the venture failed due to the lack of experience of the entrepreneur in control of the cinema advertising company.

Conclusion on the Countervailing Power of Exhibitors

157. Given the above factors, the Commission considers that exhibitors, in particular Reading, will possess a degree of countervailing power in relation to the merged entity.

CONCLUSION ON THE FILM ADVERTISING MARKET

158. VMH is likely to face constraint from other media and the countervailing power of advertising agencies and advertisers. The countervailing power of exhibitors is also likely to provide a constraint upon the behaviour of VMH.

159. Given these factors, the Commission is satisfied that the acquisition would not result, or would not be likely to result, in the substantial lessening of competition in the market for film advertising in New Zealand.

THE SLIDE ADVERTISING MARKET

Existing Competitiors

160. There are currently only two competitors in the cinema slide advertising market. The market shares of the providers are shown in Table 1 below, and are based on the number of screens represented by each participant.

Table 1: Market Share in the Cinema Advertising Market for Slide Commercials

Company	**Number of Slide Screens Represented and % Share**
Val Morgan and MEG	[ ]
Screen Vistas	[ ]
Total	325

161. To some extent these market shares may overstate the current level of competition within the cinema advertising services market. This is because the rights to sell to particular exhibitors are usually exclusive and may be for relatively long periods of time (currently [ ] years for Hoyts and [ ] years for Village/Force and Village/Rialto). Thus the competition for the acquisition of these rights may occur only infrequently. However, most independent cinemas have slide advertising contracts for a period of only one or two years.

State of Existing Competition

162. Local cinema advertising is generally slide based and consists of advertising by local businesses in their nearest local cinema. The contractual relationship between an exhibitor and a cinema advertiser is for the exclusive use of a screen by a cinema advertiser, and advertisers are generally local businesses. Cinema slide advertisers have a catchment area for business advertising, estimated by the applicant to be a 10km radius, in providing slide advertising services to advertisers.

163. The applicant faces only limited constraint from existing competition at present. Screen Vistas predominantly operates in the provincial centres of New Zealand providing

cinema advertising to regional independent exhibitors, but also represents independent cinemas in Auckland, Wellington and Christchurch. Its coverage extends from Gore to Keri Keri. Screen Vistas' core business is the production and placement of slide advertisements. Accordingly it deals almost exclusively with local advertisers. Screen Vistas has also recently extended its product range, and now produces 35mm film commercials for local advertisers as well as slide commercials.

164. Val Morgan has indicated to the Commission that it will review its slide commercial operation over the next twelve months, and may possibly exit the market if it considers the operation is not cost effective given the intensity of labour required in selling slide commercials to local businesses.

Vertical Integration

165. The discussion of the issues arising from the vertical integration of the Acquiring Exhibitors into the market for the provision of slide advertising services is as for the discussion relating to the film advertising market at paragraphs 80-84 above.

Barriers to Entry

166. The fundamental requirements of slide advertising are:

- selling of cinema advertising time to individual advertisers;
- scheduling and distribution of advertisements for individual cinemas; and
- producing slide advertisements for individual advertisers who are usually local businesses.

167. The main requirement of a slide advertiser is a sales representative to deal with potential local advertisers. The major production function currently undertaken by slide advertisers could be undertaken by the cinema or out-sourced to any graphic designer or advertising agency. The sale of slides could also be out-sourced or provided by another company.

168. The State cinema in Nelson is an exhibitor that has successfully performed the function of selling and producing its own slide commercials for a number of years. Other independent cinemas indicated that it would be easy to enter the market to sell slides should they be dissatisfied with the service of either Screen Vistas or Val Morgan. The only impediment identified by independent cinemas is the amount of effort required to secure sales to local business, given the effectiveness of competing media.

169. The Commission concludes that there are no significant barriers likely to deter expansion or new entry. Potential competition, in addition to the strength of existing competition, is likely to provide a constraint on the merged entity.

CONCLUSION ON THE SLIDE ADVERTISING MARKET

170. VMH is likely to face constraint from Screen Vistas and barriers to entry into the market are low.

171. Given these factors, the Commission is satisfied that the acquisition would not result, or would not be likely to result, in the substantial lessening of competition in the regional markets for the provision of slide advertising services.

OVERALL CONCLUSION

172. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the following markets:

- the national market for film advertising;
- the national market for film advertising agency services;
- regional markets for cinema slide advertising; and
- regional markets for cinema slide advertising agency services.

DETERMINATION ON NOTICE OF CLEARANCE

173. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for Val Morgan Holdings Pty Limited to acquire Val Morgan & Co (Aust) Pty Limited and Media Entertainment Group Limited from Television and Media Services Limited.

Dated this 18th day of December 2002

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MJ Belgrave
Chair