

Commerce Act 1986: Business Acquisition
Section 66: Notice Seeking Clearance

Date: 15 November 2002

The Registrar
Business Acquisitions and Authorisations
Commerce Commission
PO Box 2351
Wellington

Pursuant to section 66(1) of the Commerce Act 1986 notice is hereby given seeking **clearance** of a proposed business acquisition.

Part I: To be Completed by all Applicants

1. What is the business acquisition for which clearance is sought?

Clearance is sought for the acquisition of the cinema advertising businesses of Val Morgan & Co (Aust) Pty Limited (“Val Morgan”) and Media Entertainment Group Limited (“MEG”) by Val Morgan Holdings Pty Limited, an entity that will be jointly owned by The Hoyts Corporation Pty Limited (“Hoyts”), the Greater Union Organisation Pty Limited (“Greater Union”) and Village Cinemas Australia Pty Limited (“Village”) (“Acquiring Exhibitors”). Both Val Morgan and MEG are owned by Television & Media Services Limited, a company listed on the Australian Stock Exchange.

Val Morgan and MEG operate cinema advertising businesses in which they:

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

MEG and Val Morgan both provide cinema advertising services in New Zealand and Australia. In New Zealand, these services are provided through their wholly owned subsidiaries, respectively Media Entertainment Group (New Zealand) Limited and Val Morgan Cinema Advertising (NZ) Limited. MEG and Val Morgan are the main providers of these services in both New Zealand and Australia. This application focuses on the cinema advertising businesses carried on by each of MEG and Val Morgan in New Zealand.

The Person Giving Notice

2. Who is the person giving this notice?

This notice is given by Val Morgan Holdings Pty Ltd (“VMH”), an entity that will be jointly owned by the Acquiring Exhibitors. It is proposed that VMH will make the acquisition (VMH is currently 100% owned by Village). VMH requests that all correspondence and notices in respect of this application be directed in the first instance to:

KPMG Legal
Solicitors
22 Fanshawe Street
Auckland

Attention: John Land / David Moorman
Ph: (09) 379 4196
Fax: (09) 309 4276

E-mail: jland@kpmg.co.nz/dmoorman@kpmg.co.nz

Confidentiality

3. Do you wish to request a confidentiality order for:

3.1 The fact of the proposed acquisition?

No, an announcement has already been made of the proposed (in principle) acquisition to the Australian Stock Exchange.

3.2 Specific information contained in or attached to the notice?

Yes, confidentiality is sought in respect of the information in square brackets. Confidentiality is sought under section 100 of the Commerce Act 1986 and also under section 9(2)(b) of the Official Information Act 1982 on the grounds that the information is commercially sensitive and valuable and its disclosure is likely to unreasonably prejudice the commercial position of the parties. Confidentiality is sought in respect of this information for a period of two years, or until VMH advises the Commission that it may disclose this information. The foregoing request for confidentiality is made not only for this application, but for all additional information the parties may provide in respect of this matter.

Details of the Participants

4. Who are the participants (i.e. the parties involved)?

The acquirer is Val Morgan Holdings Pty Ltd, an entity that will be jointly owned by the Acquiring Exhibitors in one-third shares.

The vendor is: Television & Media Services Limited (“TMS”).

5. Who is interconnected to or associated with each participant?

Acquirer: Hoyts, Village and Greater Union each have shareholdings in a large number of companies worldwide. The material shareholdings relevant to New Zealand are as follows:

Village: Village Force Cinemas Limited, Village Rialto Cinemas Limited, Intertasman Entertainments Limited, Village Force Hoyts Cinemas Limited, Village Roadshow KP Production Limited and Vista Entertainment Solutions Limited

Hoyts: Hoyts Cinemas (NZ) Limited and Village Force Hoyts Cinemas Limited

Vendor: TMS is a company listed on the Australian Stock Exchange. TMS was formerly known as Hoyts Entertainment Limited and was owned by Hoyts until its ASX listing in 1987. TMS's largest shareholders are The Ten Group Limited ("TEN") and Publishing and Broadcasting Limited ("PBL"). TMS's New Zealand subsidiaries are Val Morgan Cinema Advertising (NZ) Limited, Media Entertainment Group (New Zealand) Limited and Television & Media Services (NZ) Limited.

6. **Does any participant, or any interconnected body corporate thereof, already have a beneficial interest in, or is it beneficially entitled to, any shares or other pecuniary interest in another participant?**

Greater Union holds an indirect interest in Village through a one-third interest in Village Roadshow Corporation Limited, which owns 47% of the voting shares in Village Roadshow Limited. Each of the Acquiring Exhibitors will shortly hold, directly or indirectly, a one-third interest in VMH. (As noted above, all shares in VMH are currently held by Village.)

7. **Identify any links, formal or informal, between any participant(s) including interconnected bodies corporate and other persons identified at paragraph 5 and its/their existing competitors in each market.**

Links between the participants that VMH is aware of in New Zealand are as follows:

- Hoyts with Village:
 - Queen Street Cinemas Joint Venture with Village/Sky (as noted in paragraph 9 below)
 - Sale of film via Hoyts Distribution to Village/Sky (as noted in paragraph 9 below)
 - Purchase of film for exhibition on Hoyts screens from Village's film distribution business
- Hoyts with Val Morgan – Contract for Val Morgan to have the right to sell advertising on Hoyts screens. (This contract is currently in negotiation insofar as it applies to renewal). This contract is due to expire in [].
- Village with MEG – contract for MEG to have the right to sell advertising on Village screens until [].
- Village and Greater Union each own 50% of Roadshow Distributors Pty Limited, which is involved in film distribution, and is understood to be the largest film distributor for cinema exhibition in New Zealand.

Other than those links noted above, there are no known formal or informal contracts, arrangements or understandings related to prices, terms and conditions of sale, territorial allocations, product or service distribution or the use of technology.

8. **Do any directors of the "acquirer" also hold directorships in any other companies which are involved in the markets in which the target company/business operates?**

There are no cross-directorships between TMS (or any of its related companies) and the acquirer.

9. **What are the business activities of each participant?**

TMS

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

TMS's principal business units are Global Television, a television services body, and Val Morgan and MEG, cinema advertisers. As noted above, this application concentrates on TMS's Val Morgan and MEG businesses (hereafter referred to as "Val Morgan business").

The Val Morgan business was founded in 1894 in Victoria and has grown into an international provider of both slide and film cinema advertising services. Val Morgan rents screentime from exhibitors, providing a unified multi-screen national offer, competing with TV and other media. Val Morgan was purchased by the Hoyts Corporation and was sold into Hoyts Entertainment Limited (now TMS) in 1987. It commenced operations in New Zealand in 1990.

Within New Zealand, Val Morgan sells advertising in the Hoyts cinema circuit as well as many independent cinemas. Outside New Zealand, Val Morgan has operations in Australia, the United States, Chile, Peru, the United Arab Emirates and Argentina and has offices in the United Kingdom.

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. As the Commission is aware, MEG was acquired by TMS in 2001.

Acquiring Exhibitors

Hoyts

The Hoyts Group is an Australian-based cinema and film distributor with cinema businesses in Australia, New Zealand, America, South America and very limited representation in England and Germany. In addition, it commenced distributing films in Australia and New Zealand in 2002.

In New Zealand, Hoyts owns 100% of 47 screens at 8 locations around the country being:

- 8 Screens at Wairau Park, Auckland
- 5 Screens at Lower Hutt, Wellington
- 5 Screens in Manners Mall and 5 Screens at Mid City – both in Central Wellington
- 8 Screens at Moorhouse Avenue in Christchurch
- 6 Screens in Northlands Mall in Christchurch
- 4 Screens on Worcester Street in Christchurch
- 6 Screens at the Octagon in Dunedin

Hoyts owns 33.33% of a 12 screen cinema complex in Queen Street, with Village and Sky City (through related companies) being the other shareholders.

Hoyts has a 20% interest in the cinema in Rotorua with other individual shareholders.

Hoyts Distribution also distributes films from some non-major film producers to all cinemas in New Zealand.

Village

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.

Village Roadshow's assets include:

- An international cinema circuit of around 1,514 screens in 174 separate sites (accounting for over half the Group's assets)
- A majority shareholding in Austereo Group Limited managing Australia's leading radio networks, Triple M and Today
- 50% stakeholding in Warner Bros Movie World, Sea World and Wet 'n' Wild Water World
- A major movie production business based in Los Angeles
- A film distribution business with operations in Australia, New Zealand, Singapore and Greece

In New Zealand, Village and its partners is the country's largest exhibitor with 76 screens at 12 sites. Village Roadshow operates 47 screens at 6 sites via a joint venture with Sky City Leisure Holdings Limited (formerly Force Corporation Limited). These six sites and the number of screens at each site include: Village Manukau (8), Village Highland Park (8), Village on Broadway (8), Village Westgate (8), Village WestCity (8) and Village Hamilton (7). An art-house circuit of 17 screens at 5 sites is operated with Sky City and another locally based entertainment company (Rialto Entertainment): Rialto Auckland (3), Rialto Hamilton (3), Rialto Wellington (3), Rialto Christchurch (3) and Rialto Dunedin (3). Village Roadshow also has an interest in the Auckland Queen Street cinema complex (12 screens) – the other partners being Sky City and Hoyts.

In addition to these joint venture interests, Village Force also has an investment in several provincial cinemas, including Village Hastings, Downtown Cinema Napier and Toptown Cinema in New Plymouth.

Greater Union

Greater Union has no specific business activities in New Zealand other than through Roadshow Distributors Pty Limited.

10. What are the reasons for the proposal and the intentions in respect of the acquired or merged business?

The key rationale for the merger is to enable the cinema advertising business of Val Morgan and MEG to survive as cinema advertising suppliers for the benefit of all exhibitors (independents and Acquiring Exhibitors) as well as national and local advertisers. A failure to sell or restructure the Val Morgan and MEG businesses will drag TMS into administration. The Val Morgan business has been making substantial losses (A\$8.7m in the year to 30 June 2002). It has current creditor commitments of over A\$10m, and ceased paying the Acquiring Exhibitors in Australia in August 2002. In New Zealand, Village has not been paid for any

period since July 2002, while Hoyts has not been paid for any period since September 2002.

TMS now has little time in which to effect a disposal or restructuring and the only realistic and credible interest TMS has been able to find is from the Acquiring Exhibitors. The Val Morgan/MEG business has been on the market for sale since March 2002. Despite extensive efforts, no interested parties have been found other than the Australian exhibitors.

The Val Morgan business in New Zealand is almost totally dependent upon the Val Morgan business and facilities in Australia. If clearance is not given, it is inevitable that the Val Morgan business in New Zealand would cease trading, as it could not continue to carry on business (at least for a significant period). This is the effective counterfactual if clearance is not granted.

TMS has experienced **severe financial difficulties** in operating the Val Morgan and MEG businesses and despite a through review, has been unable to find a buyer for these businesses apart from the Acquiring Exhibitors.

TMS has been negotiating with various interested parties regarding a proposed restructure. An in-principle agreement on the restructure is part of that negotiation. The basic elements of the proposal are as follows:

- TMS will transfer the loss-making Val Morgan and MEG Australian and New Zealand cinema advertising businesses (“Advertising Businesses”) to major creditors of the Advertising Businesses (being the Acquiring Exhibitors) in return, particularly, for the release of existing and future liabilities under cinema advertising agreements.
- TMS will be recapitalised and will focus on growing and developing its profitable TV production and outside broadcasting business through its wholly-owned subsidiary, Global Television.
- TMS will continue the review of its non-core assets, with the proceeds from any asset sales being used to reduce TMS’s bank debt.

The foregoing is subject to a number of conditions, including TMS shareholder approval, any necessary regulatory approvals and formal documentation.

Further details of the proposed restructure are as follows:

- A standstill agreement is to be entered into, pursuant to which the Acquiring Exhibitors will agree to a moratorium on outstanding cinema rentals and a reduction in the rentals for the period from 1 October 2002 until the restructure is completed or terminated. An interim standstill agreement for the period from 1 October 2002 to 15 November 2002 has been agreed.
- TMS will make a rights issue, offering (at 2.5 cents per share) 5 new shares for every 2 shares currently held. For each new share subscribed for, an option to subscribe for a TMS share exercisable during the next 3 years at 2.5 cent per share will be granted.
- The rights issue will be jointly underwritten by PBL and TEN.
- An additional placement of \$A2.5m on approximately the same pricing terms is expected to be underwritten by ANZ, which proceeds will be used as part of the Exhibitor transactions.

- Of the \$A11.4m raised under the rights issue, TMS would use \$10 million to reduce its bank debt.
- PBL and TEN will provide limited guarantees of TMS's obligations to the ANZ of up to approximately \$A13m. If the guarantees are called on during the next 3 years then the debt of TMS to PBL and TEN to the extent of the call may be capitalised at the option of PBL or TEN at 2.5 cents per TMS share.
- Each of PBL, TEN and ANZ are to be granted 50 million 4 year options to subscribe for TMS shares exercisable at 3 cents per option.

Part II: Identification of Markets Affected

Horizontal Aggregation

11. Are there any markets in which there would be an aggregation of business activities as a result of the proposed acquisition?

a. Market Definition

The Australian Competition Tribunal (comprising Lockhart J, Dr Maureen Brunt and Dr B Aldrich) made the following observations on market definition in the 1996 *Media Council* case¹:

“We identify two markets of relevance for these applications:

- *the market for advertising space and time in Australia; and*
- *the market for advertising agency services (including the creation and placement of advertising and market research services) to advertisers in Australia.*

The main participants in these markets, whether buyers or sellers, are the advertisers, the media and the advertising agencies, traditionally known as the three arms of the advertising industry. The geographic scope of these markets is largely national, but regional and local markets can be relevant.”

The Tribunal considered that the first of these markets included the traditional main media (comprising newspapers, magazines, classified directories, television, radio, outdoor advertising and cinema advertising) and also alternative means of advertising such as direct advertising by mail and letterbox drops and the new media (e.g. pay television and the Internet). It concluded:

“Accordingly we define the market for advertising space and time to include:

- *television time;*
- *radio time;*
- *newspaper and magazine space;*
- *outdoor and cinema advertising;*

¹ *Re Media Council of Australia & Ors (1996) ATPR 41-497 at page 42, 262*

- *direct marketing; and*
- *“new media” such as the Internet and pay-TV.”*

The Tribunal noted that *“While it is conventional in Australian discussions of media to refer to the industry as characterised by high market concentration and high barriers to entry, there are in fact a considerable number of alternatives available to advertisers in the present context”*. The Tribunal recorded that there were only 3 dominant TV networks and 2 dominant newspaper publishers and noted there were barriers to entry arising from Australian regulatory rules and scale economies. However, in the Tribunal’s view ***“advertisers are not restricted to free-to-air TV or to daily newspapers. There is a range of alternatives available.”***

The Tribunal also noted the diverse nature of the market for advertising services. While noting that the “full-service” advertising agency remained the most common model, it decided that:

“The market for advertising agency services includes:

- *full service agencies;*
- *creative agencies;*
- *media buying houses;*
- *advertisers’ in-house advertising services departments; and*
- *media companies’ in-house advertising services sections.”*

The Commerce Commission has in the past tended to take a somewhat narrower approach to market definition for advertising services in a number of its decisions concerning the print media and radio stations. The Commission has stated that, while there is competition at the fringes, there are separate markets for each media form (print media, television, and radio), and that for each medium there are two symbiotically linked product markets. One market relates to the dissemination of news, information and entertainment, while the other is for the provision of advertising services (see for example, paragraph 17 of Decision No. 395 (Independent News Auckland Limited / Review Publishing Co Limited) and paragraphs 19-22 of Decision No. 329 (Independent Newspapers Limited / The Marlborough Express Newspaper Company Limited)). It sees these advertising media as complementary.

While the Commission’s previous views on separate markets for print, radio and television might be argued to reflect the need for a mix of advertising that includes each of these main forms of media, that is certainly not the case with cinema advertising. 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. Advertisers could realistically choose not to use cinema advertising at all if the price were to increase relative to other media. If the price were to increase dramatically, they would be able to withdraw completely from this medium and still obtain the requisite immediacy and targeting of their advertising. The Commission in Decision 420 (Television & Media Services Limited/Media Entertainment Group Limited) specifically acknowledged that for most advertisers there is a significant degree of substitutability between cinema advertising and other forms of advertising. However, given the conclusion the Commission was able to reach in that Decision (to grant a clearance) using a narrow market definition, the Commission did not feel it necessary to reach a final view on whether cinema advertising falls within a broader market.

VMH is of the view that radio, television, newspaper and other developing media such as the internet do compete effectively with cinema advertising and this is dealt with further below. Further, VMH is of the view that the concession made by the applicants in Decision No. 321 (Look Outdoor Ltd and Asdel Street Furniture Ltd /3M New Zealand Limited) was not necessarily correct and that the advertising media noted above also do compete with outdoor advertising.

As the Commerce Commission has recognised, the relevant market can vary depending on the matter at issue (see for example Shell Exploration Company BV/Fletcher Challenge Energy Ltd, decision 408, 13 October 2000 at para 33). In *Telecom Corporation of New Zealand Limited v Commerce Commission* (1991) 4TCLR 473 (also known as the *AMPs A* case) the High Court (comprising Greig J, W J Shaw and Professor M Brunt) noted at pp499-500:

“In both the Australian and New Zealand jurisdictions it has been said, in effect, that a mechanical reliance upon substitution criteria in a contextual vacuum is not sufficient (Tru Tone at p359; Queensland Wire at p195:

‘In the case of an alleged contravention of the provisions of S 46(1), there will ordinarily be little point in attempting to define relevant markets without first identifying precisely what it is that is said to have been done in contravention of the section’.

Hence the boundaries should be drawn by reference to the conduct at issue, the terms of the relevant section or sections, and the policy of the statute. Some judgment is required, bearing in mind that ‘market’ is an instrumental concept designed to clarify the sources and potential effects of market power that may be possessed by an enterprise. In the words of Mason CJ and Wilson J in Queensland Wire at p187: ‘defining the market and evaluating the degree of power in that market are part of the same process’...”

In this case relevant factors 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. **In these circumstances the appropriate market definition, in the context of an application for clearance involving a cinema advertising business and an assessment of whether sufficient market power is acquired to amount to a substantial lessening of competition under section 47, 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.**

Thus, in VMH’s opinion, the 1996 *Media Council* case does appropriately delineate the relevant markets for advertising services, and the analysis in this case (as to whether there is a substantial lessening of competition through the combined cinema advertising and cinema exhibition activities of the parties, should the transaction be consummated) should proceed on the same basis. To summarise, the Australian Competition Tribunal in the *Media Council* case found broad markets for:

- advertising time and space, including television and radio, newspapers and magazines, outdoor and cinema advertising, direct marketing, and new media; and
- advertising agency services, including full-service agencies and media buying houses.

In the clearance application filed on behalf of TMS which led to Decision 420, a statement from expert media strategist Mr Steve Allen was annexed to the application in support of the

above proposition. VMH has no reason to believe that the views expressed in that statement have any less validity or currency.

b. **Industry Overview**

In the 1996 *Media Council* case, the Australian Competition Tribunal observed that:²

“Media advertising is overwhelmingly directed to the sale of goods and services, and it is displayed through a variety of commercial media—newspapers or magazines, television or radio, signs and billboards, cinema screens. In any instance, the advertiser’s choice in using one medium rather than another will depend on the suitability of the medium with respect to cost, the availability of time, and the size and characteristics of the wanted audience.”

A total of \$NZ1.49 billion was spent on advertising in the main media in New Zealand in 2001. Available figures include newspapers, magazines, television, radio, outdoor advertising and cinema advertising. These categories correspond largely to the Australian Competition Tribunal’s observations.

These figures relate to the cost of *placing* advertising, comprising payments to media proprietors for time or space in their media. They do not include the costs of producing advertising, such as filming, photography and design costs.

Advertising expenditure in New Zealand over the last three years was divided among the following media:

A. Advertising Expenditure by Main Media - 1999

<i>Media</i>	<i>Total Expenditure (\$NZ)</i>	<i>Share of Spend</i>
Newspapers	\$566M	39.9%
Magazines	\$159M	11.2%
TV	\$487M	34.3%
Outdoor	\$18M	1.3%
Radio	\$178M	12.5%
Cinema	\$12M	0.8%
Total	\$1420M	100.0%

Source: ASA

² *Re Media Council of Australia & Ors* (1996) ATPR ¶41-497 at page 42, 241.

B. Advertising Expenditure by Main Media – 2000

<i>Media</i>	<i>Total Expenditure (\$NZ)</i>	<i>Share of Spend</i>
Newspapers	\$596M	40.1%
Magazines	\$157M	10.6%
TV	\$501M	33.7%
Outdoor	\$28M	1.9%
Radio	\$190M	12.8%
Cinema	\$13M	0.9%
Total	\$1485M	100.0%

Source: ASA

C. Advertising Expenditure by Main Media - 2001

<i>Media</i>	<i>Total Expenditure (\$NZ)</i>	<i>Share of Spend</i>
Newspapers	\$606M	40.7%
Magazines	\$166M	11.1%
TV	\$479M	32.2%
Outdoor	\$32M	2.2%
Radio	\$196M	13.2%
Cinema	\$9M	0.6%
Total	\$1488M	100.0%

Source: ASA

The static advertising spend in New Zealand over the 2000 and 2001 years is accentuated in Australia where the downturn in the advertising market has had a negative impact in the media market, with a number of larger media companies disclosing a material drop in profits.

As will be noted, cinema advertising represented only 0.6% (NZ\$9 million) of advertising expenditure in 2001, a marked decrease from a year earlier.³ This highlights cinemas' low ranking in the advertising market and the substitutability between cinema and other forms of competitive advertising (in particular television for film advertising and other forms of local media for slide advertising) as discussed further below.

c. **Industry Participants**

The three principal “arms” of the advertising industry are the advertisers, the media and advertising agents:

ii. **Advertisers**

Advertisers comprise a very large range of international, national and local businesses providing and advertising a wide variety of products, services and information.

³ Advertising Agency Association figures.

The top advertisers by value are exclusively national or international companies placing almost entirely national advertising. However, a great proportion of advertisers *by number* are individuals and small businesses placing low-cost classified or display advertisements in the print media, on local radio, in cinemas or through direct marketing such as mail-outs and letterbox drops.

iii. **Media**

Media operators participating in the advertising industry include:

- the commercial television networks;
- the commercial radio networks;
- national, regional and local newspaper publishers;
- magazine publishers;
- cinema advertisers such as Val Morgan, MEG and Screen Vistas, who operate in cinema chains such as Hoyts and Village and independent cinemas; and
- outdoor advertisers.

They may also include the publishers of directories such as the White Pages and Yellow Pages. However, the characteristics of these directories may indicate that they arguably constitute a distinct market or sub-market, and they are not included in the calculations of advertising revenue set out in this application.

iv. **Advertising Agencies**

Many advertisers deal directly with the media to place their advertisements, particularly in the case of classified and display advertisements in the print media. However, by value, the overwhelming proportion of advertising is intermediated by advertising agency services. These services generally include one or both of:

- production of advertising material (such as creating print and television advertisements); and
- placement of advertising material with various media.

Advertising agencies may specialise in one or other of these services. However, most advertising is both created and placed by full-service advertising agencies.

v. **Summary of Advertising Industry**

In summary:

- the advertising industry consists of advertisers placing advertisements with various media, often intermediated by advertising agencies;

- the main media used are television, radio, newspapers, magazines, outdoor advertising, cinema advertising, direct marketing and “new media” such as the Internet and pay television;
- “national” and “non-national” advertising is placed in these media in different proportions, reflecting cost and the match between the medium’s audience and the advertiser’s intended audience;
- national advertisers exhibit substantial choice in their “mix” of advertising media, but tend to focus on television and to a lesser extent newspapers;
- non-national advertisers also have substantial choice in advertising media, principally newspapers, classified directories, local television and radio, direct marketing, outdoor advertising and cinema advertising; and
- agency services including the preparation and placement of advertising content are provided by a wide variety of industry participants.

d. **Cinema Advertising**

i. **Overview**

Cinema advertising consists of the display of still or moving advertisements in cinemas, generally on cinema screens immediately before motion pictures are exhibited. Advertisers in New Zealand spent \$NZ9 million on cinema advertising in 2001.

ii. **Number of Cinemas**

There are currently 325 cinema screens in New Zealand, up from 140 in 1991, approximately half of which are organised into chains of more than ten cinemas.

These chains have the following proportions of all screens (broken down by region as set out in the Appendix):

New Zealand Screens by Exhibitor Group

<i>Exhibitor</i>	<i>Number of Screens</i>	<i>Share of Screens</i>
Hoyts	47	14.5%
Village	59	18.1%
Rialto	17	5.2%
Independents	179	55.1%
Readings	23 ¹	7.1%
Total	325	100.0%

¹Readings owns solely 10 screens in Wellington and is understood to hold a 50% interest in joint ventures operating another 13 screens in three locations around Greater Auckland.

Source: Val Morgan Cinema Advertising

Cinema advertising services in New Zealand are generally charged on a per screen per week basis.

iii. **Industry Development**

The trend in the Australian and New Zealand cinema industry is towards multiplex cinemas with an increasing number of large screens, stadium seating and digital sound. These complexes are generally developed by the chains, such as Readings, Hoyts and Village in New Zealand.

Most new cinemas are opened in areas not already adequately served by existing cinemas.

vi. **Audiences**

In New Zealand, audience numbers continue to grow steadily. As is the case in all media, substantial research is undertaken into the demographics of cinema audiences in general and in relation to particular films. The typical cinema-goer is younger and more affluent than the mean, is at a higher socio-economic level and has above-average disposable income. Many people who report themselves as “light” television viewers and radio listeners frequent the cinema. Different profiles are available for mainstream and “art house” cinema audiences.

e. **Cinema Advertising Clients**

Val Morgan’s top cinema advertising clients are all essentially national advertisers and all of their campaigns involve motion film-based advertisements displayed on cinemas around New Zealand. In many cases, the same advertisements (or shorter versions of them) are also shown on television. Television is therefore a very close substitute for cinema for national advertisers. Modified versions of the same advertisement may also appear on radio and in the print media.

A significant proportion of cinema advertising clients are local businesses such as restaurants and cafes, fast food franchises, clothing and accessory stores, car dealerships and repairers, travel agents, mobile phone dealerships, professional services, colleges and other retailers. Their advertisements are almost all slide advertisements accompanied by music and a voice-over.

These businesses are predominantly located within 10 kilometres of the cinema showing the advertisement, and generally advertise in only one cinema. Other advertising by these local businesses is likely to focus on classified directories, display advertisements in regional or local newspapers, outdoor advertising, direct marketing, local radio and to some extent local television. Cinema slide advertising may use the same graphics as posters and display advertising, or the same soundtracks as local radio advertising.

Although slide advertisements are much cheaper to place than film (or “rolling stock”) advertisements, VMH estimates that around [] of Val Morgan’s New Zealand revenue comes from slide advertisements.

f. **Cinema Advertisers**

i. **Relationship with Exhibitors**

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

Advertisements are scheduled for each week in the case of film and each month in the case of slides, on the basis of session timetables provided by each cinema. The advertisements are then delivered to the cinema with instructions for the cinema's projectionist to attach film advertisements in a particular order to the feature film reel and to connect slides and soundtrack tapes to the slide projection system.

The commercial return to the exhibitor is maximised by a single cinema advertiser selling advertising across all of the exhibitor's screens, and the transaction costs to the exhibitor, cinema advertiser and client are minimised by the granting of exclusive rights preventing duplication. As a result, it is generally not practical or economic for more than one cinema advertiser to operate in each cinema. That is, the "dis-economies" associated with more than one cinema advertiser selling "space" for an exhibitor are sufficiently material for it to be uneconomic.

Cinema exhibitors tend to select cinema advertisers through competitive tender or through past relationships. As noted above, Val Morgan currently advertises in the Hoyts chain across New Zealand and has contracts with a range of independent cinemas (including Readings), while MEG (now part of TMS) has exclusive advertising arrangements with the Village Force and Village Rialto chains and a number of independent cinemas.

Arrangements between cinema advertisers and cinemas generally involve upfront payments or "key money", guaranteed minimum theatre rents and additional overage payments on a per-screen per week basis. In the case of the chains, the cinema advertiser generally has exclusive rights over all new cinemas to be opened as part of the chain during the period of the agreement.

As Val Morgan and MEG already have long-term exclusive contracts with Hoyts and Village anyway, the fact Hoyts/Village (through Val Morgan Holdings Pty Limited) will own Val Morgan/MEG makes little difference to the competitive state of the market.

New entrants would still have access to the same proportion of the market, namely the approximately 62% of cinema screens not owned or operated by Village/Hoyts. Screen Vistas already operates effectively in New Zealand on that basis.

ii. **Film and Slide Advertising**

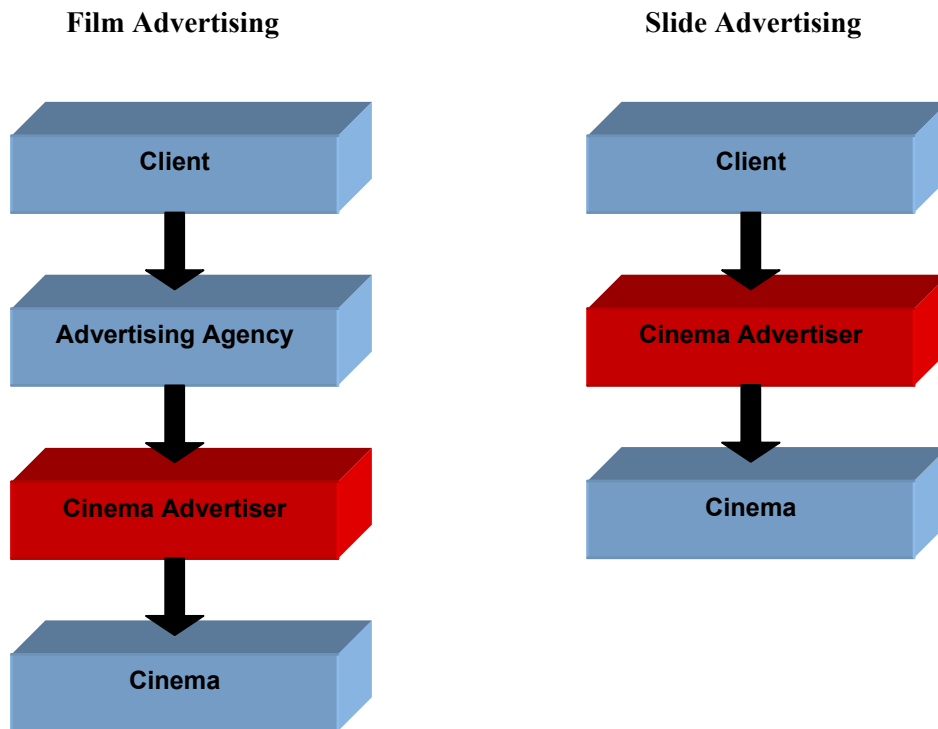
Cinema advertisers operate differently as between film advertising and slide advertising. As a rule, film advertising is sold to national or regional advertisers and slide advertising is sold to local advertisers.

All film advertising is produced and placed with cinema advertisers by advertising agencies as part of an overall campaign that may encompass many media. Cinema advertisers are not involved in the production of rolling stock advertising but simply arrange for its distribution. Cinema advertisers

pay a commission to advertising agencies placing film advertisements with them.

By contrast, advertising agencies are rarely if ever involved in the preparation of slide advertising. This preparation is generally undertaken by cinema advertisers, though clients 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.

The vertical structure of the cinema advertising industry is therefore as follows:



Film advertising is substantially more expensive than slide advertising, and can cost between \$NZ10,000 and \$NZ250,000 for a campaign. Slide advertising can cost as little as \$NZ5,000 for a standard campaign. Cinema advertisers price primarily with reference to other media, particularly television in the case of film advertising.

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.

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.

g. **Role of Cinema Advertisers**

Cinema advertisers might be seen as specialist advertising agencies, since they are involved in the production of slide advertisements and they place both film and slide advertisements in cinemas. However, clients and other advertising agencies are more likely to consider cinema advertisers as functionally equivalent to media outlets themselves, since:

- cinema advertisers have exclusive rights to exhibit advertising in each cinema;
- clients and other advertising agencies currently deal only with cinema advertisers and not with cinemas directly; and
- cinema advertisers provide a specialist service limited to cinemas, and do not place advertisements in any other medium.

As a result, cinema advertisers operate primarily in the market for advertising time and space rather than the market for advertising agency services. Val Morgan itself does not provide any creative input. Val Morgan's role is limited to the scheduling and sale of advertisements.

h. National and Local Cinema Advertising

Cinema advertisers display both slide and film advertisements, where slide advertisements are sold primarily to local advertisers and film advertisements are sold primarily to regional or national advertisers.

From a demand side, these products are in many cases distinct. There are significant discontinuities in price between slide and film-based advertising. For example, a slide advertising campaign of 56 weeks on two screens will cost between [] including production costs. This would be a typical slide campaign advertising a local business on a local duplex or multiplex cinema.

A similar film campaign would cost around [] for a "kine transfer" (preparation for a cinema display) and sound mixing *plus* film production costs, which may range from [] in the case of large international campaigns. However, due to the high fixed costs of production and transfer, film advertising is always deployed more widely. A typical film campaign might consist of 100 screens for six months at a cost of around []. Because of the high fixed costs of production, film campaigns are generally run in conjunction with television campaigns.

These cost structures dictate that local advertisers are limited to slide advertising. It is simply not practical to produce a film advertisement for a purely local business. Only national or regional businesses seeking to address a geographically diverse range of potential customers are able to justify film advertising.

These national and regional advertisers may also take out slide advertising, though they usually prefer film advertising due to its increased visual impact and the likelihood that suitable rolling stock will have been developed for television. Around [] of Val Morgan's slide advertising customers are national. Factors relevant to choosing slide rather than film advertising include entry point cost and the need to frequently update advertisements. National companies with local branches or franchises may also advertise using slides arranged at either the national or the local level.

As a result, it is clear that:

- slide advertising and film advertising are largely substitutable for national and regional advertisers; but
- film advertising is not a substitute for slide advertising for local advertisers.

Local advertisers may therefore purchase services in a sub-market distinct from the general advertising market. The division between local advertising and non-local advertising may be similar to that between national and non-national advertising proposed by the Commercial Economic Advisory Service of Australia (“CEASA”) in Australia. However, the CEASA definition of “non-national” advertising may include regional advertising which is neither national nor local in nature. The demand profiles for regional or state-based advertisers are likely to be more similar to those of national advertisers than those of local advertisers.

i. **Local Advertising Market**

VMH submits that local cinema advertising forms part of a market or sub-market for local advertising. Local cinema advertising is exclusively slide-based and consists of advertising by local businesses in their nearest local cinema. Its clear objective is to advertise directly to cinema-goers who live in or are visiting the local area of the business and are the most likely consumers of its goods and services.

As discussed above, local cinema advertising is likely to cost between [] for a 56-week campaign over two screens. This is broadly comparable with the cost of a small display advertisement in a local newspaper over the same period, though it is significantly cheaper than a larger display advertisement in local newspapers with particularly high circulations.

As with all advertising, price depends on the audience reach and likely audience recall of any advertising material. Local cinema advertising has a higher audience recall than other forms of advertising, but a narrower audience reach.

Depending on their preference for audience recall or reach and the requirements of particular campaigns, local businesses have a choice between:

- cinema slide advertising;
- classified and display advertisements in local newspapers;
- outdoor and transit advertising;
- directory advertising; and
- direct marketing including mail and letterbox drops.

Depending on the size of the business and the distribution of its potential customers, it may also be economic for a local business to advertise on local radio or, to a lesser extent, local television. Since radio and television stations generally cover the whole of a metropolitan or regional area, they may be seen as “overkill”, inefficiently extending beyond the potential customer base of smaller and more localised businesses.

In Australia, CEASA figures indicate that cinema advertising accounted for only 0.68% of all non-national advertising in 2000. Even though these figures may include regional as well as local advertising across all media, it is clear that cinema

advertising represents only a tiny fraction of local advertising. Similar figures are likely in New Zealand, where Advertising Agency Association figures indicate that cinema advertising only accounts for 0.6% of all media advertising (compared to 0.86% in Australia in 2000).

VMH submits that the geographic dimension of the local advertising market relates to the area in which advertising a local business will be effective. This will generally be the area within a certain distance from the business, and is broadly consistent with the catchment area.

Where there are multiple cinemas in a single catchment area, the relative size of each cinema and its ability to attract programming and audiences generally means that the cinemas do not effectively compete with each other to attract local advertising. Where an arthouse or independent cinema is located near a multiplex, real competition for local advertising will also be minimal, largely because the advertising appearing in each cinema will often be tailored to the demographics of the audience attending the cinema.

Val Morgan's sales staff do not consider competitive pressure from other cinemas when selling slide advertising, and do not price with reference to other cinemas. Local businesses are far more likely to consider the cost of advertising in local newspapers, outdoor advertising and direct marketing as alternatives to advertising in the nearest cinema. Val Morgan therefore prices with reference to these other outlets.

Slide advertising is sold almost exclusively through "cold calling" by sales representatives rather than approaches from potential clients. The sale of slide advertising is largely or entirely dependent on the effectiveness of this marketing. Demand for slide advertising must be actively stimulated, is highly elastic and is highly responsive to the price and quality of the service relative to other media.

The proposed transaction would therefore not result in a substantial lessening of competition in the market or markets for local advertising, since:

- there is generally only one cinema advertiser competing in each of these markets;
- cinema advertisers will continue to compete with much stronger forms of local advertising such as local newspapers, outdoor advertising, local radio and direct marketing; and
- in any event, the transfer of the cinema advertising business of TMS to VMH does not involve any aggregation of business activities as the Acquiring Exhibitors do not have any current interest in the market or markets for local advertising.

j. **Non-Local Advertising**

TMS submits that non-local cinema advertising is supplied in the broader market for national and regional advertising. This is the market for advertising space and time identified by the Australian Competition Tribunal in the 1996 *Media Council* case, which includes:

- television time;
- radio time;

- newspaper and magazine space;
- outdoor and cinema advertising;
- direct marketing; and
- “new media” such as the Internet and pay-TV.

The function of this advertising is to deliver information about an advertiser or its products to the widest suitable audience possible. All national advertising media promote their services on the basis of audience reach, typically measured in cost per 1,000 audience members. The advertisement may promote the company itself, or a particular brand, or one or more mass products or services.

As set out above, the top national advertisers all advertise across a wide range of media, though most of them focus heavily on metropolitan television. Even advertisers within the same industry may differ substantially in their choice of media.

National cinema advertising may be slide based or film based. However, most national and regional cinema advertisers use film advertising. Film or rolling stock advertising is generally produced by advertising agencies for use in cinemas and on television.

The proposed transaction will not result in any lessening of competition in the market for national and regional advertising as:

- cinema advertising has such a small share of that market; and
- in any event, the transfer of the cinema advertising business of TMS to VMH does not involve any aggregation of business activities as the Acquiring Exhibitors do not have any current interest in the market or markets for national and regional advertising.

k. Acquisition of Cinema Rights

It might be argued that cinema advertisers compete with each other to secure exclusive advertising contracts with exhibitors. As discussed above, it is a universal and long-standing practice for exhibitors to enter into exclusive commercial arrangements with a single cinema advertiser in relation to screens. These exclusive rights are granted in return for the payment of:

- a lump sum initial payment, or “key money”;
- minimum cinema rents; and/or
- a percentage of advertising revenue above these minimums.

The supply by exhibitors of rights to advertise in their cinemas is highly price elastic. Payments from cinema advertisers are not the principal source of revenue for exhibitors. As a result, Readings 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 have other options:

- selling cinema advertising directly to advertising agencies, as is the case with a number of exhibitors in the United States and was the case in Australia when Hoyts originally 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 allows Screen Vista to compete economically.

There are also incentives for Val Morgan to deal on a competitively neutral basis with independent exhibitors. Val Morgan will need to be run on an arms-length basis from the exhibitors in order to remain viable. In particular, Greater Union will ensure that this is the case. Greater Union will not allow Village/Hoyts to promote their interests as exhibitors over the viability of the joint venture.

The alternative to the transaction is for TMS to be wound up. This is the effective counterfactual if clearance is not granted. That would have a greater detrimental effect on independent exhibitors than on the Acquiring Exhibitors (as it may be more difficult for independent exhibitors to efficiently provide their own cinema advertising services than it is for the Acquiring Exhibitors).

1. **Concluding Summary**

- VMH is of the view (consistent with the Australian Competition Tribunal in the 1996 *Media Council* case) that there is a broad advertising market covering a wide range of media. However, VMH notes that local advertisers may purchase services in a sub-market distinct from the general advertising market due to their need to match media audiences with their prospective customers, and the resulting inefficiency of advertising in the wider media.
- Local advertisers may choose between slide advertising in the nearest cinema, classified display advertisements in local newspapers, outdoor and transit advertising, directory advertising and direct marketing. In Australia, cinema advertising represented only 0.68% of all non-national advertising in 2000 and similar figures are likely in New Zealand. Although this figure may include regional as well as local advertising, it is clear that cinema advertising represents only a very small proportion of local advertising.
- Non-local advertising is supplied in the broader advertising market, in which advertisers can choose from the full range of media based on a comparison of audience reach. National advertisers generally advertise across a wide range of these media, though many focus heavily on metropolitan television. Assuming a distribution of national and non-national advertising similar to that of Australia, cinema advertising would represent 0.98% of all national advertising. As a result, the

proposed transaction would not result in a substantially lessening of competition in any national advertising market.

- Television and cinema film advertising are particularly close substitutes, as reflected in Val Morgan’s marketing material and particularly in its pricing. Any price increases above competitive levels would immediately result in media buyers shifting to television advertising (or other media) unless presented with a compelling case to the contrary. Again, assuming a distribution of national and non-national advertising similar to that of Australia, cinema advertising would represent only 1.82% of national television and cinema advertising in New Zealand. The proposed transaction would therefore not result in a substantial lessening of competition on this definition of the market either.
- VMH contends that the application of the SSNIP test would at least put television advertising in the same market as cinema advertising for national campaigns, and outdoor, print and radio advertising in the same market for local campaigns. However, even if the Commission did not accept that the SSNIP test was satisfied, it is undoubtedly the case that the other advertising media constitute a substantial constraint.
- The proposed acquisition is in any event a “bare transfer” of the cinema advertising business of TMS. There is no aggregation of interests as the Acquiring Exhibitors have no existing advertising business.
- VMH does not consider that there is a substantial functional market for the purchase of rights to advertise in cinemas. If there were such a market, there would be no substantial lessening of competition by the proposed transaction due to the range of alternatives available to independent cinema exhibitors, particularly the options of selling advertising directly or sponsoring new entry into the cinema advertising business, or use of Screen Vistas. There is room for Screen Vistas to expand or for new entry, as approximately 62% of cinema screens are not owned by Village/Hoyts.
- Internationally, the trend in the cinema industry is clearly towards consolidation and globalisation combined with the digitalisation of the medium.
- The acquisition should not result in any increased concentration in any market.

12. **Please indicate whether the products in each market identified in question 11 are standardised (buyers make their purchases largely on the basis of price) or differentiated (buyers make their purchases largely on the basis of product characteristics as well as price).**

Given the nature of the service provided, it is naturally differentiated to meet the needs of advertisers. Such differentiation covers both the form of advertising (i.e. slide or film), length of advertisement and style (for which an advertiser is likely to select from a mix of different media to communicate its message).

13. **For differentiated product markets:**

13.1 **Please indicate the principal characteristics of products that cause them to be differentiated one from another.**

13.2 **To what extent does product differentiation lead firms to tailor and market their products to particular buyer groups or market niches?**

- 13.3 **Of the various product in the market, which are close substitutes for the products of the proposed combined entity? – which are more distant substitutes?**
- 13.4 **Given the level of product differentiation, to what extent do you consider that the merged entity would be constrained in its actions by the presence of other suppliers in the market(s) affected?**

Television and cinema advertising are particularly close substitutes since:

- they share a visual and sound experience (including the duplication of rolling stock between cinema and television); and
- they are both able to target particular demographic segments of the population (by screening before or within particular movies or television programmes).

Val Morgan considers that its non-local cinema advertising business competes directly with television. This opinion is reflected in Val Morgan’s marketing material. Val Morgan’s *Media Pack* provided to current and potential clients explicitly compares the value of cinema advertising with that of television advertising. It cites qualitative research demonstrating that cinema audiences have a higher recall rate and pay more attention to cinema advertising compared to television advertising.

While the allocation of advertising expenditure between television and cinema advertising may shift over time and in accordance with particular advertising campaigns, the two services are substitutable in an economic sense. The product differentiation between the two services (such as audience retention rates as opposed to immediate audience reach) does not constitute a break in the chain of product substitution. As the Federal Court of Australia decided in *Tooth & Co.*⁴

“All competition or substitution does not cease at the outer boundaries of the market: the economy as a whole is a network of substitution possibilities in consumption and production; competition is a matter of degree. Rather, at the extremities of the market there is such a break in substitution possibilities that firms within its boundaries would collectively possess substantial market power: were they to join forces in a cartel, they would be able to raise prices or offer a poorer deal without their market being substantially undermined by the incursion of rivals.”

Val Morgan does not consider itself free to raise its prices for film advertising except in the case of a corresponding rise in prices for television advertising. Val Morgan’s film advertising is placed by advertising agencies who will shift to television advertising unless presented with a compelling case. Cinema advertising is able to command a higher fee per thousand audience members because its smaller audiences demonstrate higher retention rates. However, this fee is calculated as a multiple of corresponding television rates.

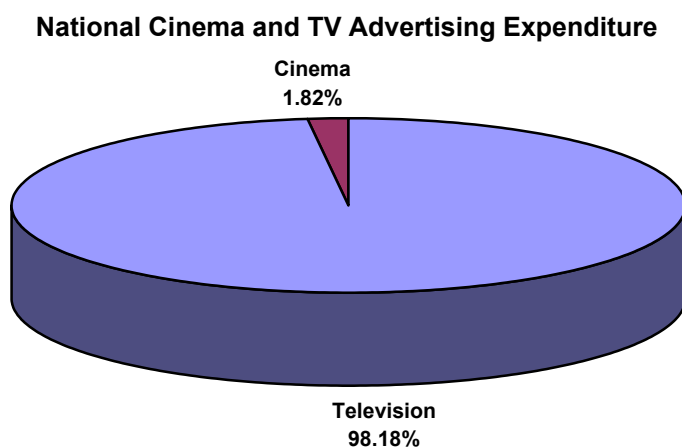
Newspapers, magazines, radio and national outdoor advertising can be distinguished from film and television advertising in several aspects, but these differences generally compensate for each other. For example, the print and outdoor media are static and may have less visual impact than the moving images of television and cinema; on the other hand, they are more permanent and are more likely to be repeatedly viewed. Radio tends to be “always on”, allowing for reinforcement, but it is more likely to be on in the background.

⁴ *In Re Tooth & Co Ltd; In Re Tooheys Ltd* (1979) ATPR 40-113.

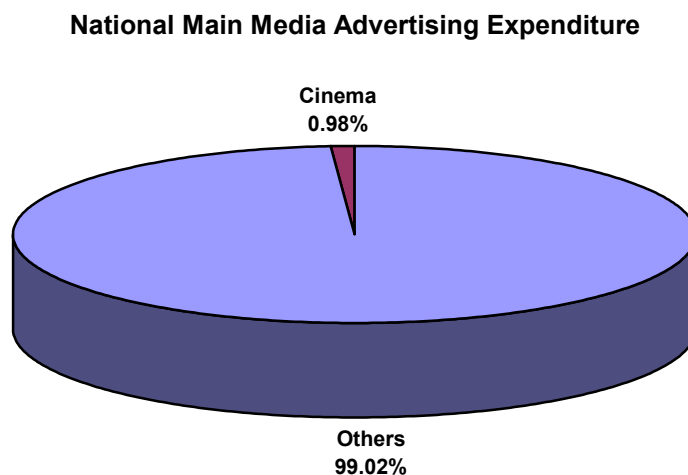
While national advertising in all media demonstrates a degree of product differentiation, it is difficult to conclude that this differentiation is sufficient to break the chain of substitution. All of these media deliver audiences to advertisers, and all are more or less suitable for advertising products. All are sold on the basis of cost per thousand audience members reached, though the particular characteristics of certain media may command a premium: for example, an on-air endorsement by a radio personality carries a premium over a straight radio placement. This premium does not indicate a separate market for the individual radio announcer's services or any other media service.

Television and film-based cinema advertising are particularly close substitutes, but the other media substitute to a considerable degree. This substitution was presumably the basis for the Tribunal's market definition in the 1996 *Media Council* case.

Assuming a distribution of national and non-national advertising similar to that of Australia, a market for national advertising time and space limited to national cinema and television advertising would comprise the following market shares based on 2000 figures (since which time cinema has declined relative to television overall):



A market for national advertising time and space that extended to all of the main media referred to in the Tribunal's 1996 Media Council Case (except direct marketing and the "new media") would comprise the following market shares:



The proposed transaction could not have a substantial effect on the market on either definition.

Vertical Integration

14. **Will the proposal result in vertical integration between firms involved at different functional levels?**

There will be a degree of vertical integration given the acquisition of the Val Morgan and MEG businesses by exhibitors. However, as the Commission notes in its Practice Note 4, the vertical aspects of an acquisition 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 integration.

If, as is firmly maintained, there is no separate market for cinema advertising, but there is a wider advertising market, any increase in market power arising out of the acquisition is de minimis. Even if the Commission was to adopt a narrow market definition:

- There is no indication that entry into one or other of the vertical levels affected will be foreclosed (independent exhibitors will still have other options as discussed at para 11(k) above).
- As will be discussed below, barriers to entry are low and the acquisition should not materially increase entry barriers. A new cinema advertiser would not be required to enter simultaneously at another level.

The reality is that there is unlikely to be any material integration in practice, as the Val Morgan business will need to be operated on an arms-length, stand-alone basis to be viable and successful (and Greater Union will no doubt be concerned to ensure that this is the case, as against any promotion by Hoyts and Village of their own interests).

Indeed, there should be no lessening of competition (and certainly no substantial lessening of competition) resulting from any perceived vertical integration as there is effectively a bare transfer from TMS to the Acquiring Exhibitors (Hoyts/Village do not currently offer cinema advertising services and the existing contracts in place between TMS and each of Hoyts and Village are functionally the same (vis-a-vis advertising clients) already. Screen Vistas will remain an effective competitor and there is room for other competitors to enter this segment of the market.

15. **In respect of each market identified in questions 11 and/or 14, identify briefly all proposed acquisitions of assets of a business or shares involving either participant (or any interconnected body corporate thereof) notified to the Commission in the last three years and, any other acquisition of assets of a business or shares which either participant (or any interconnected body corporate) has undertaken in the last three years.**

Val Morgan and MEG merged in early 2001, for which the Commission granted clearance in Decision 420.

Hoyts have been involved in 2 business arrangements in the last 3 years, both of which the Commerce Commission would be aware of:

- The proposed merger of the Hoyts/VillageForce Cinemas in 1999 which was unwound in June 2000; and
- The arrangement for the sharing of film with the Embassy Cinema in Wellington in late 2001.

Other than acquisitions of business assets in the ordinary course of business, VMH is unaware of any other acquisition of assets of a business or shares that have been undertaken by either participant in New Zealand in the last three years.

Please Answer Questions 16-26 Below In Respect Of Each Market Identified In Questions 11 and 14

Part III: Constraints on Market Power by Existing Competition

Existing Competitors

16. In the market or markets, who are the suppliers of competing products, including imports?

Screen Vistas is the principal competitor for the Val Morgan business in New Zealand for cinema advertising. Screen Vistas has a successful business providing slide advertising generally to regional independent exhibitors and has a good market share in this regard. Given the local nature of the slide advertising business the future of Screen Vistas is quite sustainable and is indeed encouraged in terms of providing an alternative service for the regional exhibition industry.

In terms of national film where critical mass and the ability to deliver national coverage is critical to compete in the broader advertising market, smaller exhibitors (due to their limited reach) find it more difficult to sell advertising services themselves because of limited interest from national advertisers. Accordingly, Val Morgan has entered into an exclusive arrangement with Screen Vistas to service their locations for film advertising. This enables Screen Vistas to benefit from the economies of scale and reach of the Val Morgan business.

Please see the chart below detailing market shares in terms of slide and film advertising.

Screen Share

<i>Contractor</i>	<i>Number of Film Screens Represented and share</i>	<i>Number of Slide Screens Represented and share</i>
Val Morgan	[]	[]
Screen Vistas	[]	[]
Total	325	297

[]

With regard to slide production, this work is able to be undertaken by any graphic designer or advertising agency. The sale of slides itself can be undertaken by any sales organisation or person.

To a large extent, exhibitors such as Readings and Village are also competitors in terms of the countervailing power in the market they are able to exercise. If they are unhappy with a cinema advertising services company, then they can deal with Screen Vistas, encourage a new entrant or deal direct with advertising agencies. In the operation of cinemas, Village has a joint venture with Sky City which has an incentive to ensure Val Morgan is providing cinema advertising services on a competitive basis. In the course of its market enquiries in relation to Decision 420 (TMS/MEG), the Commission noted that the majority of independent cinemas had no objections to the merger of Val Morgan and MEG: they were comfortable that their niche audiences gave them negotiating power. There is nothing to suggest that the proposed acquisition would change that view.

17. **What market conditions (e.g. frontier entry conditions, legislative/regulatory conditions, industrial/business conditions, other) do you consider would be likely to act as a barrier to the expansion of existing competitors, where they have the incentive to do so in response to a sustained effort by the combined entity to raise price, or to lower service or product quality?**

The only significant barrier to entry in the cinema advertising business is access to screens. The only production function currently undertaken by cinema advertisers is in slides, which could be undertaken by the cinema or outsourced to any graphic designer or advertising agency. The sale of slides could also be outsourced or provided by any other company.

In New Zealand there has been a history of smaller exhibitors handling their own ads. Taupo (Slide), Whakatane (Slide for a period of time), Queenstown (Slide for a period of time), Nelson and Oamaru (for a period of time) are examples of this. The current 2nd ranked player, Screen Vistas, commenced in the market approximately 7 years ago with just one complex and today controls []. In the Central North Island region, Screen Vistas has achieved a [] market penetration.

Screen Vistas currently subcontracts out the right to provide rolling stock advertising on most of these screens to Val Morgan and focuses primarily on selling slides. Screen Vistas is likely at some stage in the future to open their own rolling stock office in Auckland and in so doing cancel the subcontract with Val Morgan as it expires. The cost of setting up a rolling stock office in Auckland would be minimal. VMH estimates start-up costs including salaries for an Auckland rolling stock office in Year 1 at a maximum of [].

Recent history demonstrates that the barriers to entry and expansion by Screen Vistas, even in the face of two larger competitors, are low as Screen Vistas consistently achieved penetration against both Val Morgan and MEG during the seven years since its entry. Clearly this scenario could and would be repeated if there was a level of dissatisfaction with the existing players.

Another example is the quick entry and expansion in both the Australian and New Zealand markets (and also Singapore, Hong Kong and Argentina) of MEG itself. MEG became a major player in all such markets within 3-4 years. As noted above, 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. It subsequently entered into agreements to advertise in the Village/Force and Village/Rialto circuits in New Zealand, totalling [] nationally. Its expansion was equally swift in Australia, where one of the previous incumbents (having around 40% of the market) subsequently withdrew. Similarly, Val Morgan

entered into Chile (a market similar to New Zealand) with one complex approximately four years ago and now controls 52% of the market.

It is quite clear that the migration of cinema from a mechanical medium to a digital medium is occurring at a faster rate than was previously thought. In VMH's view, a penetration of up to 20% will be apparent in leading countries within a three year window. This in effect creates cinema as an alternative broadcast medium and it is inconceivable that existing broadcasters do not see this as an opportunity to expand their business. This is very much in line with the current global strategies being implemented by companies such as Carlton, a leading UK broadcaster who owns the leading screen contractor in the UK, Scottish Media Group, a broadcaster who owns Pearl & Dean in the UK and Antenna 3, a Spanish television owner who has recently expanded into cinema advertising on the Iberian peninsula.

Any argument that the big players are not interested in a small market like New Zealand is wrong:

- a. If that was the case, Val Morgan would not have entered into small markets like Chile and Peru.
- b. This is becoming a global business. Accordingly, companies must be represented globally. The threat of entry by global cinema advertising companies such as Carlton and RMB International is real.

The cinema advertising industry is volatile and apparently established structures are extremely vulnerable to change

It is acknowledged that current competition in any market for the acquisition of screen rights is limited by the fact that most screens are subject to long-term exclusive contracts. In the medium to long term when screen rights become available, the possibilities described above will prevent any lessening of competition.

Even if the Commission were to define the market as narrowly as just cinema advertising (which would not be appropriate in VMH's view), then there are clear constraints from outside the market (e.g. potential entry from overseas players), constraints from advertising agencies and competition at the fringe which are highly relevant and which prevent the exercise of market power over price and other terms and conditions. Beyond the upfront costs of securing a major contract with one of the existing exhibitors (estimated to be in the range of [] in year one), there are no real barriers to entry. There are no technical barriers to entry. Further, the upfront costs are often significantly less where growth is organic through contracts with independent cinemas. In Chile, for example, the total capital investment for TMS at the beginning was A\$150,000 from which it built a business generating approximately A\$3 million per annum in 3-4 years.

Ownership of Val Morgan/MEG by the Val Morgan Holdings Pty Limited might be argued to be a barrier for entry as Hoyts/Village would be unlikely to use cinema advertising services of a competitor of their own cinema advertising company. However, the competitive position is essentially unchanged due to the fact that Val Morgan/MEG already have long-term exclusive contracts with Hoyts/Village anyway. Further, as 62.2% of cinema screens in New Zealand are not owned or operated by Hoyts or Village, a substantial share of the market would still be available to a new entrant.

18. **Please name any business which already supplies the market – including overseas firms – which you consider could increase supply of the product concerned in the geographic market by any of the following means:**

- **diverting production into the market (e.g. from exports)**
- **increasing utilisation of existing capacity**
- **expansion of existing capacity.**

The most significant competitor which could increase supply is clearly Screen Vistas. There is also a history both in Australia, New Zealand and other areas around the world where exhibitors can enter into self supply contracts. Examples in New Zealand are both Timaru and Nelson. Independent screens in New Zealand represent 62.2% of the overall market, so there is a real potential for a competitor to start up or for the independent exhibitors to start their own service if the delivery of services to them were not sustained by Val Morgan.

In a wider context, cinema represents a small share of total advertising spend, the relationship of cinema to the overall media market and the substitutability of cinema with other media is outlined in detail above.

19. **Of the conditions of expansion listed above, which do you consider would influence the business decision in each case to increase supply?**

There are no material conditions that would influence the business decision to increase supply.

20. **How long would you expect it to take for supply to increase in each case?**

Expansion can be achieved without any reasonable delay.

21. **In your opinion, to what extent would the possible competitive response of existing suppliers constrain the merged entity?**

VMH considers that, post acquisition, the Val Morgan business will remain constrained by existing competition and the potential for new entry and expansion. Certainly in a wider advertising market, the large numbers of participants in the market support this view.

22. **Looked at overall, and bearing in mind the increase in market concentration that would be brought about by the acquisition, to what extent do you consider that the merged entity would be constrained in its actions by the conduct of existing competitors in the markets affected?**

Please refer to responses to questions 17 and 21. Further, the international trend in the cinema advertising industry is clearly towards consolidation and globalisation. For example, RMB International has expanded from its origins in Belgium into 14 countries in Europe through organic growth, acquisitions and joint ventures. European companies Mediavision (in eight countries already), Pearl & Dean (in the United Kingdom), Opus (in Italy) and Werbe Weischer (in Germany, Austria and Switzerland) have formed an alliance known as Cinennium to administer cinema advertising in their respective countries and coordinate further expansion. Film Suez operates in four South American countries including two in joint venture with Val Morgan. Pearl & Dean Asia operates in

four countries. Most cinema advertising in the United Kingdom is sold by Carlton Media Sales, which also owns 50% of leading United States cinema advertiser Screenvision.

The international trend towards consolidation is primarily driven by:

- the need to deal with increasingly global and consolidated exhibitors on an international level;
- the need to service increasingly global advertisers on an international level; and
- the need for more efficient use of resources and greater economies of scale, particularly in the context of digitalisation.

The Val Morgan business will continue to be strongly constrained by the threat of entry by global cinema advertisers such as Carlton and RMB International, as well as by the global exhibitors themselves (who may elect to take the cinema advertising function “in-house”, as has occurred in several cases in both the Australasian and international contexts).

The increased costs of digital equipment will eventually be offset by more efficient production and distribution and economies of scale.⁵ However, these economies will only be realised by advertisers with sufficient critical mass and global reach. If Australasian cinema advertisers are unable to realise these economies and invest in the digitalisation of cinema, then international cinema advertisers are certain to take their place.

Co-ordinated Market Power

23. **Identify the various characteristics of the market that, post-acquisition, you consider would either facilitate or impede co-ordination effects.**

While there is high seller concentration in cinema advertising, there are low barriers to entry as discussed above.

As noted by the Australian Competition and Consumer Commission in the *Watty/Courtaulds/Taubmans/Pinchin Johnson* application for authorisation:

“...there is not a nexus between concentration and competition ...the likelihood of co-operative behaviour depends crucially on other structural features ... (particularly) ...absence of a strong international competition and if barriers are high.”

In its decisions under the new substantial lessening of competition threshold test, the Commission has recognised that market shares are insufficient in themselves to establish

⁵ It is generally agreed in the industry that the future of cinema will be digital, driven by the need for more efficient distribution and reduced reproduction costs. Digital recording and projection of films is already being tested with high-profile trials such as *Star Wars: The Phantom Menace*.

Digital cinema slide advertising was introduced in Australia in November 2000 and should soon be available in New Zealand. A digital slide projector costs around \$A20,000 compared to \$A10,000 for an ordinary slide projector. A digital film projector is estimated to cost around \$A150,000 and would also handle slides. It is likely that cinema advertisers will need at least partial ownership of this equipment in order to maintain their business.

whether competition in a market will be lessened, and that seller concentration is only one factor that has to be assessed in determining the impact of a business acquisition on competition.⁶

There are many examples overseas of exhibitors owning screen advertising companies (e.g. AMC in the US own NCN, Regal Cinemas in the US own Regal Entertainment, Stir Kinikor in South Africa own Cinemark, Promocine Publicidade in Brazil are owned by Promocine Exhibition). The reality is that the cinema advertising companies need to operate at an arms length basis to be successful. Accordingly, the ability to deliver to the whole market is critical and in the interests of the Acquiring Exhibitors to advance the screen advertising business forward. Other relevant factors which suggest the absence of collusive behaviour (as identified in the Commission's Practice Note 4) include:

- relative ease of new entry
- active competition from other forms of advertising
- elastic market demand
- no record of price fixing or other forms of collusion.

24. **Identify the various characteristics of the market that, post-acquisition, you consider would facilitate or impede the monitoring and enforcement of co-ordinated behaviour by market participants.**

Cinema advertising is only a small proportion of the overall advertising market. The market is competitive.

Despite high seller concentration in the cinema advertising segment of the market, there are a number of disciplines that would operate against collusive behaviour (as identified in the Commission's Practice Note 4) including:

- low barriers to entry
- larger, infrequent sales
- different cost structures
- limited price transparency

25. **Indicate whether the markets identified in paragraph 9 above show any evidence of price co-ordination, price matching or price following by market participants.**

The relevant market does not show any such evidence.

26. **Please state the reasons why, in your opinion, the transaction will not increase the risk of co-ordinated behaviour in the relevant market(s).**

Refer to response in questions 24 and 25 above.

⁶ See for example the Commission's analysis in Decision 444: *Mico Wakefield Limited; Mastertrade Limited*, 6 December 2001.

Part IV and Part V

Given the answers to the questions above, it is believed that the constraints imposed by the conduct of existing competitors (in particular in a wider advertising market) will be sufficient to ensure that competition would not be substantially lessened in any market as a result of the acquisition, and therefore no further questions are answered at this stage.

THIS NOTICE is given by Peter Edwin Foo on behalf of Val Morgan Holdings Pty Limited. I am a director of Val Morgan Holdings Pty Limited and am authorised to make this application on behalf of Val Morgan Holdings Pty Limited (“Applicant”) in respect of the notice seeking clearance dated (“Application”).

I hereby confirm that:

- all information specified by the Commission has been supplied;
- all information known to the Applicant which is relevant to the consideration and determination of the Application has been supplied; and
- all information supplied is correct as at the date of the Application.

I undertake to advise the Commission immediately of any material change in circumstances relating to the Application.

Dated this day of 2002

Director/Authorised Signatory

APPENDIX
SCREEN COUNT NEW ZEALAND (325 screens)

AUCKLAND		WELLINGTON		CHRISTCHURCH		Remainder of NZ	
Village		Village		Village		Village	
Highland Park	8	No Complexes		No Complexes		Hamilton	7
Manukau City	8						
Newmarket	8						
Broadway							
Queen Street	12						
West City	8						
Westgate	8						
Total	52						7
Hoyts		Hoyts		Hoyts		Hoyts	
Wairau Park	8	Lower Hutt	5	Moorhouse Ave	8	Dunedin	6
		Manners Mall	5	Northlands	6		
		Mid City	5	Regent on Worchester	4		
Total	8		15		18		6
Berkeley/Reading		Berkeley/Reading		Berkeley/Reading		Berkeley/Reading	
Takapuna	4	Courtney Central	10	No complexes		No complexes	
Mission Bay	4						
Hibiscus Coast	5						
Total	13		9				
Rialto		Rialto		Rialto		Rialto	
Auckland	5	Wellington	3	Christchurch	3	Dunedin	3
						Hamilton	3
Total	5		3		3		6
Others	9	Others	15	Others	8	Others	147
Total	87		43		29		166