



Australian
Competition &
Consumer
Commission

9 May 2007

Statement of Issues — Video Ezy Australasia Pty Ltd - proposed acquisition of Blockbuster Australia Pty Ltd

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (ACCC) in relation to the proposed acquisition of Blockbuster Australia Pty Ltd (**Blockbuster**) by Video Ezy Australasia Pty Ltd (**Video Ezy**) (**proposed acquisition**).
2. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. In line with the ACCC's *Merger Review Process Guidelines* (available on the ACCC's website at www.accc.gov.au) the ACCC has established a secondary timeline for further consideration of the issues. The ACCC anticipates completing further market inquiries by 23 May 2007 and anticipates making a final decision on 6 June 2007. However, the anticipated timeline can change in line with the *Merger Review Process Guidelines*. To keep abreast of possible changes in relation to timing and to find relevant documents, market participants should visit the Mergers Register on the ACCC's website at www.accc.gov.au/mergersregister.
4. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

Background

5. On 12 March 2007, the ACCC commenced an informal review of the proposed acquisition pursuant to the ACCC's Merger Review Process Guidelines.

The parties

Video Ezy Australasia Pty Ltd

6. Video Ezy is an owner and franchisor of stores in Australia that primarily rent and retail DVDs and games to consumers. In Australia, stores operating under the Video Ezy brand currently comprise 492 franchisee owned stores, 6 corporate owned stores and 19 stores owned by the major shareholders of Video Ezy.

Blockbuster Australia Pty Ltd

7. Blockbuster is also an owner and franchisor of stores in Australia that primarily rent and retail DVDs and games to consumers.
8. Blockbuster is currently wholly owned by Blockbuster Inc (**Blockbuster USA**). Blockbuster USA is listed on the New York Stock Exchange and is a global provider of in-home rental and retail movie and game entertainment.
9. In Australia, stores operating under the Blockbuster brand comprise 350 franchisee owned stores and 24 corporate owned stores.

The transaction

10. Video Ezy proposes to acquire Blockbuster and the master franchise rights to the business. The ACCC understands that the proposed transaction will involve the following elements:
 - Video Ezy, or a wholly owned subsidiary of Video Ezy, will acquire 100% of the shares in Blockbuster; and
 - Video Ezy will enter into a master franchise agreement with Blockbuster USA. The master franchise agreement will run for a 10 year term with the possibility of renewal for a further 10 years.
11. The ACCC understands that post acquisition, Video Ezy intends to operate the Blockbuster brand of stores separately from the Video Ezy brand of stores.
12. The ACCC also understands that, under the master franchise agreement to be entered into with Blockbuster USA, Video Ezy will, among other things, be subject to the following obligations:
 - to maintain a minimum number of Blockbuster stores;
 - to keep all Blockbuster Divisions (which includes any departments and divisions established for the purposes of marketing and general business development) separate and distinct from the Video Ezy Divisions (which also includes any departments and divisions established for the purpose of marketing and general business development);

- to ensure that there is no information flow between any Blockbuster Division and any Video Ezy Division in connection with Blockbuster's advertising, marketing and promotional programs;
- to ensure no common ownership by franchisees of Video Ezy and Blockbuster branded stores.

Market background

Film distribution and release windows

13. In Australia, films are released for viewing by consumers in a variety of formats. Some of the forms in which a film may be available include cinema release, in DVD format through rental or retail stores, on free to air and pay television, through online rental delivery services and download services such as Video on Demand.
14. In general, film distributors release films through a series of exclusive windows. A film is released for viewing in a particular form in accordance with a series of timeframes that follow a process of accretion. The ACCC understands that in general, films are initially released exclusively at the cinema for a period of approximately 120 days, followed by DVD release in the rental and retail channels for a 90 day period, then on pay per view or video on demand for a further 90 days, followed by release to pay television and free to air television.

New releases and back catalogue

15. In general, there are two categories of DVD titles available at rental and retail stores – new releases and back catalogue. New releases refer to newly released DVD titles that generally remain in the new release category for 3 months. Box office hits (i.e. those films that gross approximately \$15 million or more at the Australian box office) comprise a small sub-set of new releases.
16. Back catalogue generally refers to those DVD titles where 3 months or more have lapsed since its release to the rental and retail channels.
17. The ACCC understands that rental businesses predominantly purchase a wide range of new release titles from wholesale suppliers, while retail businesses have a greater focus on back catalogue and box office hits.

Franchises and buying groups

18. The vast majority of rental stores in Australia are operated by either franchisees or operators who are members of a buying group. In addition to the merger parties, other rental store operators in Australia include two buying groups, a franchise, and several independents.
19. The ACCC understands that stores compete in localised markets and determine their own prices based on local market conditions.

Market inquiries

20. The ACCC has conducted market inquiries with a range of interested parties and notes that a number of market participants expressed concerns in relation to the proposed acquisition.

Statement of issues

21. The ACCC considers that the proposed acquisition may raise competition concerns and therefore further consideration is required. The ACCC now invites comment (preferably supported by examples and quantitative data) by market participants to:
 - the specific concerns identified in relation to the markets identified in this Statement of Issues; and
 - any other issue which may be relevant to the ACCC's assessment of the proposed acquisition.
22. For the purposes of this Statement of Issues, the issues in this matter are divided into three categories, 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to pose concerns'.

Issues of concern: the national market for the wholesale purchase of new release DVDs

23. The ACCC considers that there may be a national market for the wholesale purchase of new release DVDs from studios / distributors. The ACCC understands that there is limited demand and supply side substitutability between new release and back catalogue DVDs. The ACCC notes that new release DVDs occupy a specific time dimension in the market (usually 90 days). The ACCC also understands that the wholesale prices of new release DVDs are substantially higher than back catalogue wholesale prices. Also, in contrast to back catalogue titles, new releases are often the subject of extensive marketing campaigns.
24. The ACCC has formed the preliminary view that post acquisition, the merged entity may have an increased ability to secure exclusive deals and rental windows with suppliers with respect to non-box office hit new releases (which comprise the majority of new release titles). The ACCC considers that this may have a detrimental impact on the competitive viability of other rental businesses, as their network, buying group or franchisor would not be able to purchase DVDs that are the subject of an exclusive deal, or alternatively, may be required to pay a higher price than the merged entity for a DVD subject to a rental window. The ACCC also notes that customers at other rental stores would have access to a diminished range of new release titles, should the merged entity increase the quantity of its exclusive deals.

25. The ACCC invites comments from interested parties on the following issues:
- What constraints, if any, would the merged entity face in securing exclusive deals for new release DVD titles?
 - What constraints, if any, would the merged entity face in securing rental windows for new release DVD titles?
 - To what extent are suppliers able to respond to the buying power of the merged entity post acquisition? In particular, to what extent would a supplier be able to increase sales of new release (non-box office hit) titles through other rental DVD stores or retail stores that specialise in DVDs?
 - The ACCC understands that EzyDVD, a DVD retailer, will be imminently expanding its business to operate rental stores. What impact will such expansion by EzyDVD have on (i) the merged entity's ability to secure exclusive deals or windows for new release DVD titles and (ii) the ability of suppliers to respond to the merged entity's increased bargaining power, that is, in providing another outlet for suppliers?
 - Do retail DVD stores face any significant barriers to expansion into the rental DVD business? (Please provide reasons in your response).
 - What impact will the merged entity's increased buying power have on the development of download or online services?

Issues that may raise concerns: local markets for the rental supply of DVDs to consumers

26. The ACCC considers that there may be local markets for the rental supply of DVDs to consumers. The ACCC considers that in general the relevant geographic size of the market is likely to comprise an area of approximately 2-5km radius around a rental store, depending on the local area.
27. The ACCC understands that at present, the retail sale of DVDs, online rental download services, and pay television are unlikely to be effective substitutes to the rental supply of DVDs at traditional bricks and mortar rental stores for the reasons set out below:
- The ACCC understands that the retail price of a new release DVD is substantially higher than the rental price of the same new release DVD.
 - Technological barriers (download speeds etc) have meant that consumer take-up of online rental download services has not been substantial and this is unlikely to change within the next two years.
 - The exclusivity of films into the rental/retail channel prior to pay television release suggests that there may be limited competition between DVD rental and pay television. The ACCC also understands that approximately 25.5% of households in Australia subscribe to pay television. Accordingly, pay

television may not be an effective substitute for a large proportion of consumers, or pose a significant constraint on the rental supply of DVDs.

28. The ACCC notes that online rental services by postal delivery may be substitutable with the rental services provided at traditional bricks and mortar rental stores. However, the ACCC understands that at present, online rental services do not represent a significant portion of the market, and therefore any constraint posed by online rental services through postal delivery may be limited.

29. The ACCC has identified several local markets in which the level of concentration is likely to be high post acquisition due to the absence of competitors or because the competitive constraint posed by the competitor in the relevant local market has not been verified. The markets identified by the ACCC are set out below:

ACT: Weston

NSW: Lithgow, Murwillumbah, Muswellbrook, Springwood, Cessnock, Dubbo

QLD: Bribie Island, Noosa Heads/Noosaville, Redland Bay/Victoria Point

SA: Gawler, Mt Barker, Port Augusta, Port Lincoln

VIC: Mornington East, Rosebud

WA: Broome, South Lakes, Rockingham, Warnbro

30. The ACCC notes that market participants have raised concerns in relation to the increased likelihood of coordinated conduct between the merger parties and the franchisees of each of Video Ezy and Blockbuster, post acquisition. The ACCC considers that concerns relating to coordinated conduct may be relevant to those local markets identified above with no or minimal competition constraint post acquisition. The ACCC notes as follows:

- Video Ezy and Blockbuster are currently the first and second ranked national players in terms of their respective shares of bricks and mortar store DVD rental revenue.
- Market inquiries indicate that Blockbuster and Video Ezy stores are vigorous and effective competitors and are generally sensitive to each other's pricing where they are located in the same local market.
- One of the rationales for the proposed acquisition includes achieving economies of scale such as lower costs resulting from increased purchasing power with distributors. Common purchasing at the upstream level may increase the ability of Video Ezy and Blockbuster franchisees to engage in coordinated conduct due to an increased awareness of the others' key inputs and terms and conditions of supply from distributors.

31. The ACCC also notes however that post acquisition, Video Ezy would be subject to certain obligations under its international master franchise agreement to be entered into with Blockbuster USA (see paragraphs 10 - 12 above).

32. The ACCC invites comments from interested parties on the extent to which there may be concerns regarding coordinated conduct between franchisees of Video

Ezy and Blockbuster in the markets identified in paragraph 29 above and in particular –

- whether and how individual franchisees of each of Video Ezy and Blockbuster would have an increased ability and/or incentive to reduce price competition and/or non price competition, taking into account the factors outlined in paragraphs 30 and 31 above;
- what impact, if any, would the potential expansion of businesses such as EzyDVD or other existing DVD bricks and mortar rental businesses have on any attempt by Blockbuster and Video Ezy franchisees to coordinate pricing or non-price competition (eg quality of services, marketing initiative etc); and
- what impact, if any, would common purchasing costs have on price coordination between Video Ezy and Blockbuster franchisees?

Issues unlikely to pose concerns - other markets

33. The ACCC also considers that the markets outlined below are likely to be relevant to the transaction. However, for the reasons indicated, the ACCC considers that competition concerns may be unlikely to arise in relation to these markets.

The national market for the supply of franchise and/or centralised buying services

34. The ACCC understands that centralised buying groups offer services that are likely to be substitutable with the franchise services offered by the merger parties. The ACCC notes that while there is some difference in the way in which each operates, the services offered are generally similar. In particular, the ACCC understands that buying groups offer marketing services in addition to centralised buying services, similarly to franchises.

Local markets for the retail sale of DVDs

35. The ACCC considers that the existence of various competitors such as department stores, and specialist stores such as JB Hi Fi, Sanity etc are likely to pose a competitive constraint on the merger parties post acquisition.

Local markets for the rental supply and retail sale of games

36. The ACCC understands that in general the rental of games is an insignificant source of revenue for rental DVD stores. The ACCC also considers that the retail sales of games may be a substitute to the rental supply of games, as consumers may prefer to own a game given factors such as the length of time generally needed to complete a game. In this regard, the ACCC notes that there may be a number of retail competitors who would pose a competitive constraint on the merged entity post acquisition.

ACCC's future steps

37. The ACCC will finalise its view on this matter after it considers market responses invited by this Statement of Issues.
38. The ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues, and on any other issue that may be relevant to the ACCC's assessment of this matter.
39. Submissions are to be received by the ACCC no later than 23 May 2007. The ACCC will consider the submissions received from the market and the merger parties in light of the issues identified above and will, in conjunction with information and submissions already provided by the parties, come to a final view as to the appropriate course of action to take to resolve any competition concerns that remain.
40. The ACCC intends to publicly announce its final view by 6 June 2007. However the anticipated timeline may change in line with the *Merger Review Process Guidelines*. A public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement.