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UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, and STATE OF NEW YORK, by and through its Attorney General Dennis C. Vacco, and STATE OF ILLINOIS, by and through its Attorney General Jim Ryan, PLAINTIFFS, v. SONY CORPORATION OF AMERICA and LTM HOLDINGS, INC. d/b/a LOEWS THEATRES, and CINEPLEX ODEON CORPORATION, and J. E. SEAGRAM CORP. DEFENDANTS.	Civil Action No. 98-CIV 2716 COMPLAINT FOR EQUITABLE RELIEF FOR VIOLATION OF 15 U.S.C. § 18 Filed: April 16, 1998

COMPLAINT

The United States of America, acting under the direction of the Attorney General of the United States, and the States of New York and Illinois, acting by and through their Attorneys General, bring this civil antitrust action to prevent the proposed merger of Cineplex Odeon Corporation ("Cineplex") and LTM Holdings, Inc. ("Loews"), an indirect wholly-owned subsidiary of Sony Corporation of America. If the merger is permitted to proceed, it would combine the top two movie theatre operators in Manhattan and the city of Chicago and would substantially lessen competition and tend to create a monopoly in the theatrical exhibition of first-run films in both of those markets in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.

1. Loews and Cineplex both operate chains of movie theatres and earn revenue through the theatrical exhibition of films. The theatrical exhibition of films is a multi-billion dollar industry; total domestic box office revenues for 1997 exceeded $6 billion.

2. Loews and Cineplex are the two largest exhibitors of first-run films in Manhattan and the city of Chicago by revenue as well as number of screens. By combining these two companies, the proposed merger would create a theatre chain larger than all its rivals <u>combined</u> in each of these markets.

3. Loews and Cineplex currently compete against each other both in Manhattan and the city of Chicago at two levels: they compete to secure first-run films from film distributors and they

compete to attract movie-goers. The proposed merger would eliminate this competition and create a dominant exhibitor in each market; the merger is likely to substantially lessen competition in the markets for theatrical exhibition of first-run films in both Manhattan and Chicago.

4. The reduction in competition caused by the proposed merger would enhance the ability of the merged firm to raise ticket prices and reduce investment in theatre improvements and renovations in Manhattan and Chicago. The merger would also give the merged firm market power in its dealings with distributors, including the ability to depress film rental terms.

I. Jurisdiction and Venue

5. This action is filed by the United States pursuant to Section 15 of the Clayton Act, as amended, 15 U.S.C. § 25, to obtain equitable relief to prevent a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18. The State of New York and State of Illinois bring this action under Section 16 of the Clayton Act, 15 U.S.C. § 26, to prevent the defendants from violating Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18.

6. Both Loews and Cineplex operate theatres in this District. The distribution and exhibition of first-run films is

a commercial activity that substantially affects, and is in the flow of, interstate trade and commerce. The defendants purchase substantial quantities of equipment, services, and supplies from sources located outside of New York. In particular, most of the distributors from whom the defendants license films are located outside of New York. The defendants also acquire funding for their New York operations from outside of New York. The Court has jurisdiction over the subject matter of this action and jurisdiction over the parties pursuant to 15 U.S.C. §§ 22, 25, and 26, and 28 U.S.C. §§ 1331 and 1337.

7. Venue in this District is proper under 15 U.S.C. § 22 and 28 U.S.C. § 1391(c).

II. Background: The Movie Industry

8. Theatrical exhibition of feature length motion picture films ("movies") provides a major source of out-of-home entertainment in the United States. Although they vary significantly, ticket prices for movies tend to be less expensive than many other forms of out-of-home entertainment, particularly live entertainment such as sporting events and live theatre. Movies have therefore retained their appeal as mass entertainment: over one billion movie tickets were sold in the United States in 1997.

9. "Exhibitors" are companies that operate movie theatres. Some exhibitors own a single theatre, whereas others own a circuit of theatres within one or more regions of the United States. Cineplex and Loews are exhibitors and each operates one of the largest theatre circuits in North America.

10. "Distributors" are companies that engage in the business of renting, licensing, or selling movies to exhibitors. Distributors arrange for the promotion and marketing of films and contract with exhibitors to exhibit films at theatres throughout the country. Established distributors include Buena Vista, Columbia Pictures/TriStar, Metro-Goldwyn-Mayer/United Artists, Paramount, Twentieth Century Fox, Universal, and Warner Bros.

11. Distributors negotiate with exhibitors to exhibit films. Exhibitors compete to obtain films at their theatres that they believe will be successful, and distributors choose theatres to exhibit their films based on the quality, location, and grossing potential of the theatres and the particular terms offered by the exhibitors.

12. The terms of the agreements pursuant to which distributors license films to exhibitors vary and are individually negotiated. However, each agreement typically specifies a formula pursuant to which box office revenues are

divided between the exhibitor and the distributor. The agreements often provide that the exhibitor will keep a certain dollar amount from the box office revenues to compensate for "overhead," as well as a specified percentage of what remains after the overhead is deducted. It is also not uncommon for the agreements to specify a minimum guarantee (usually based on a percentage of the gross ticket revenues) that will be paid to the distributor.

13. Exhibitors set ticket prices for each theatre based on a number of factors, including the competitive situation facing each theatre.

III. Defendants and the Proposed Merger

14. Sony Corporation of America is a New York corporation with its headquarters in New York, New York.

15. LTM Holdings, Inc. is a Delaware corporation which does business under the name Loews Theatres and has its principal executive offices in New York, New York. Loews is an indirect wholly owned subsidiary of Sony Pictures Entertainment, itself an indirect wholly owned subsidiary of Sony Corporation of America, which in turn is an indirect wholly owned subsidiary of Sony Corporation, a Japanese company. Loews currently operates 139 theatres with 1,035 screens in 16 states. Its annual revenues

for the fiscal year ending February 28, 1997 were approximately $375 million.

16. Cineplex is a Canadian corporation headquartered in Toronto, Ontario. It currently operates a total of 312 theatres with 1,723 screens in the United States, Canada and Hungary. Its United States operations consist of 911 screens at 175 locations in 13 states and the District of Columbia. Cineplex had annual revenues of approximately $500 million in 1996.

17. J. E. Seagram Corp. is a Delaware corporation headquartered in New York, New York. Its subsidiary, Universal Studios, Inc., is a major shareholder of Cineplex.

18. On September 30, 1997, Sony Pictures Entertainment, Loews and Cineplex entered into a merger agreement. Pursuant to the agreement, Cineplex will become a wholly owned subsidiary of Loews and Sony Pictures Entertainment will transfer all of its U.S. theatre assets not owned by Loews to Loews or its subsidiaries. Loews will then be renamed Loews Cineplex Entertainment Corporation ("LCE"). Sony Corporation of America and Universal Studios, Inc. will control a majority of LCE's outstanding capital stock.

IV. The Relevant Markets

A. *Product Market*

19. Movies differ significantly from other forms of entertainment. The experience of viewing a movie in a theatre is an inherently different experience from a live show, a sporting event, or viewing a videotape in the home. Ticket prices for movies are generally very different than prices for other forms of entertainment: live entertainment is typically significantly more expensive than a movie ticket, whereas renting a videotape is usually significantly cheaper than viewing a first-run film in a theatre. Because going to the movies is so different an experience from other forms of entertainment and because movie prices are significantly different from other forms of entertainment, small but significant price increases for movie tickets generally do not cause a sufficient number of movie-goers to shift to other forms of entertainment to make the increase unprofitable.

20. A movie is considered to be in its "first run" during the initial weeks following its release in a given locality. If successful, a movie may be exhibited at other theatres after the first run as part of a second or subsequent run (often called a sub-run). Tickets at theatres exhibiting sub-run movies usually

cost significantly less than tickets at first-run theatres. Because the films exhibited at sub-run theatres are no longer new releases, most movie-goers do not regard sub-run films as an adequate substitute for first-run films and would not switch to sub-run films if the price of first-run films was increased by a small but significant amount.

21. From the perspective of distributors, there is no adequate substitute for first-run theatres when selecting locations to exhibit first-run films. Distributors seek to have their newly released movies exhibited widely in high-quality theatres. A small but significant reduction in the rental fees paid to distributors by exhibitors would not cause the distributors to exhibit their films in anything other than first-run theatres.

22. The relevant product market within which to assess the competitive effects of this merger is the exhibition of first-run films: from the movie-goer's perspective, the market is first-run films and from the distributors' perspective, the market is first-run theatres in which to exhibit first-run films.

B. *Geographic Markets*

23. Movie-goers typically do not want to travel far from their homes to attend a movie, particularly in urban areas.

Accordingly, geographic markets for first-run movies are predominantly local.

24. Movie-goers in Manhattan typically are reluctant to travel off the island to attend a movie. A small but significant price increase for movie tickets in Manhattan would not cause a sufficient number of movie-goers to travel out of the borough to make the increase unprofitable. Manhattan constitutes a relevant geographic market in which to assess some of the competitive effects of this merger. Cineplex and Loews are the two largest exhibitor chains in Manhattan.

25. Similarly, most movie-goers in the city of Chicago typically are reluctant to travel significant distances out of the city to attend a movie. A small but significant price increase for movie tickets in the city of Chicago would not cause a sufficient number of movie-goers to travel out of the city to make the increase unprofitable. The city of Chicago constitutes a relevant geographic market in which to assess some of the competitive effects of this merger. Cineplex and Loews are the two largest exhibitor chains in Chicago.

26. From the perspective of distributors, it is vitally important that their newly released movies be exhibited in Manhattan and Chicago. Both markets have very high population

densities. In addition, both markets are home to influential movie critics -- critics whose review of a movie can substantially affect the movie's performance nationwide. Because of the visibility and importance of both markets, theatres in other geographic areas cannot substitute for theatres in Manhattan and Chicago: a distributor cannot "pass" (i.e., not show a movie in) Manhattan and Chicago. From the distributor perspective as well as the movie-goer perspective, Manhattan and the city of Chicago constitute relevant geographic markets.

27. Distributors and exhibitors often break the Manhattan and Chicago markets into "zones" that reflect various neighborhoods--such as, in Manhattan, the Upper East Side, the East Side, the West Side, Broadway-Times Square, Chelsea, and Greenwich Village, and in Chicago, Downtown, Near North, North, Far North, West, South, and Far South. Movies typically will play at only one theatre within a zone. Because movie-goers prefer to go to movies within their respective neighborhoods, and because it is important to distributors to be able to exhibit their films in each neighborhood, there is substantial geographic-based product differentiation within each geographic market. Although some movie-goers in a zone may be willing to travel to other zones to see a movie, many are reluctant to do

so.

28. The exhibition of first-run films in Manhattan, and the exhibition of first-run films in the city of Chicago each constitutes a relevant market (i.e., a line of commerce and a section of the country) within the meaning of Section 7 of the Clayton Act, 15 U.S.C. § 18.

V. Competitive Effects

A. *Manhattan*

29. In Manhattan, the proposed merger would give the newly merged entity control of 26 first-run theatres with 84 screens and 1997 box office revenue of approximately $80.5 million. This represents a market share by revenue of 67%--more than all rivals combined. The second largest theatre circuit in Manhattan would be City Cinemas with a market share of roughly 16%. Using a measure of market concentration called the Herfindahl-Hirschman Index ("HHI"), explained in Appendix A, the merger would yield a post-merger HHI of approximately 4815, representing an increase of roughly 1911.

30. Entry into the market for first-run films in Manhattan is particularly time-consuming and difficult and is not likely to significantly reduce the market strength of the combined entity in the near future. Available sites are scarce, and real estate

and construction costs are among the highest in the nation. Identifying a site, planning the development, and constructing a theatre in Manhattan takes several years. Finally, of the four theatre sites currently in development in Manhattan, two are being developed by Loews.

B. *Chicago*

31. In the city of Chicago, the proposed merger would give the newly merged entity control of 20 first-run theatres with 108 screens and 1997 box office revenue of approximately $33.0 million. This represents a market share of 77%, more than all rivals combined. The merger would yield a post-merger HHI of roughly 6438, representing an increase of around 2874.

32. In some film zones in and near Chicago, the combined entity would be even more dominant. For instance, in the downtown Chicago zone, the combined entity would control all seven theatres. The same is true in the north (Old Orchard/Orchard Gardens), the west (Bricktown Square/Norridge) and the far south (River Run/River Oaks).

33. Entry into the market for first-run films in Chicago is particularly time-consuming and difficult and is not likely to significantly reduce the market strength of the combined entity in the near future. Available sites are scarce, real estate and

construction costs are among the highest in the nation, and acquiring the necessary permits and approvals can be difficult and time-consuming. Identifying a site, planning the development, and constructing a theatre in Chicago takes several years.

C. Consumer Effects

34. The proposed merger would make the competitive situation in Manhattan and Chicago significantly worse by further enhancing the ability of the remaining theatre circuits, particularly the Loews-Cineplex circuit, to increase prices.

(a) The largest and most influential circuit in Manhattan (Loews) and in Chicago (Cineplex) is price constrained by the prices charged by the other; in particular, they are constrained by the risk that the other will not follow an attempted price increase. If Loews or Cineplex were to increase prices and the other were not to follow, the firm that increased price might suffer financially if a substantial number of its patrons decided that the increased price was unreasonable and opted to patronize the other circuit.

(b) The proposed merger would eliminate this pricing constraint and is therefore likely to lead to higher prices for ticket buyers.

(c) These higher prices may take the form of a higher adult evening ticket price or reduced discounting for, e.g., matinees, twilight shows, seniors, students, and groups.

35. The proposed merger would also eliminate non-price competition between Loews and Cineplex and is therefore likely to lead to lower quality theatres for movie-goers.

(a) In order to attract movie-goers, and perhaps even more importantly, in order to persuade major movie studios to exhibit top films at their respective theatres, Cineplex and Loews strive to maintain high quality theatres.

(b) The proposed merger would reduce competitive pressure to maintain high quality theatres. In particular, the merger would give the merged entity such a large share of the relevant markets, and of individual zones, that it would no longer need to maintain such high quality in order to attract films.

(c) The reduction of non-price competition would reduce the incentive to maintain, upgrade and renovate theatres in Manhattan and Chicago, thus reducing the quality of the viewing experience for a movie-goer. It also may allow the merged entity to reduce the number of shows as there no longer would be competitive pressure to continue early and late shows.

D. *Distributor Effects*

36. The higher the concentration of exhibitors in a market, the worse film rental terms tend to be for distributors. In critically important markets for distributors -- such as Manhattan and Chicago--this problem is magnified since "passing" the market is not a viable option.

37. The increased concentration in both Manhattan and Chicago, as well as the elimination of the second largest competitor in both markets, would reduce competition and substantially increase the ability of the newly merged entity to dictate terms to the distributors. Distributors would lose the ability to play off Loews and Cineplex against each other. In addition, the merged entity would have such a dominant presence in both markets that a distributor would be unable to achieve adequate distribution by showing films in alternative venues. The increased market power of the merged firm would likely lead to distributors receiving less in revenue for the exhibition of their pictures, either in the form of reduced (or eliminated)

guarantees, higher overhead for the exhibitors, or a less favorable percentage of the box office receipts.

38. The reduced revenue remitted to the distributors could lead to fewer films being produced, or less money being expended on high-quality films to the ultimate detriment of movie-goers.

E. *Summary*

39. The proposed merger would therefore have the following effects, among others:

(a) competition in exhibition of first-run films in Manhattan and Chicago would be substantially lessened;

(b) actual and potential competition between Cineplex and Loews -- both to attract movie-goers and to persuade distributors to provide them with first-run films -- would be eliminated;

(c) the market share controlled by the leading exhibitor in Manhattan would increase from 46.5% to 67.0%, and in Chicago, it would increase from 46.6% to over 77%;

(d) the ability of the leading exhibitor in both Manhattan and Chicago to raise admission prices would increase, in all likelihood leading to higher ticket prices;

(e) the competitive pressure to maintain theatre quality would be reduced, thereby leading, in all likelihood, to less spending on theatre maintenance, upgrades, and renovations; and

(f) the ability of the leading exhibitor in both Manhattan and Chicago to reduce the film rentals paid to distributors would increase, thereby leading to less revenue for distributors and potentially fewer high-quality films being made.

40. The proposed merger is likely substantially to lessen competition in interstate trade and commerce, in violation of Section 7 of the Clayton Act.

VI. Requested Relief

41. The plaintiffs request: (a) adjudication that the proposed merger would violate Section 7 of the Clayton Act; (b) permanent injunctive relief to prevent the consummation of the proposed merger; (c) an award to each plaintiff of its costs in this action; and (d) such other relief as is proper.

Dated: April 16, 1998

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