



# **Alpha Flight Group Limited and LSG Lufthansa Service Holding AG**

A report on the proposed joint venture between Alpha Flight  
Group Limited and LSG Lufthansa Service Holding AG



## **Members of the Competition Commission who conducted this inquiry**

Malcolm Nicholson (*Chairman of the Group*)

Roger Davis

Ian Jones

Stephen Oram

## **Chief Executive and Secretary of the Competition Commission**

David Saunders

The Competition Commission has excluded from this published version of the final report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [X]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

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#### Glossary

## Summary

1. On 10 October 2011, the Office of Fair Trading (OFT) referred the anticipated in-flight catering services joint venture between Alpha Flight Group Limited and LSG Lufthansa Service Holding AG to the Competition Commission (CC) for investigation and report. The reference required the CC to publish its report by 25 March 2012 on whether a relevant merger situation would be created and, if so, whether the creation of that situation might be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.
2. The parties overlap in the supply of in-flight catering services within the UK. In-flight catering services comprise a mixture of conventional catering combined with other services:
  - (a) *Catering provision.* This includes the preparation and production of meals for service on the aircraft, as well as the sourcing of 'ambient' (ie unheated) and snack food.
  - (b) *Catering management and logistics services.* This includes: logistics management (including trucking of food and loading on to the aircraft), equipment and waste management (including dish washing services), managing interfaces with suppliers, sourcing retail goods available to buy on-board the aircraft (including bonded goods such as tobacco and alcohol) (BOB), and ensuring the smooth operation of the catering supply chain.
3. Traditionally, both these services have been provided by a single vertically-integrated in-flight catering services supplier, of which there are several providers in the UK including the merging parties, Gate Gourmet, DO & CO and Plane Catering. In particular, as well as managing the logistics, in-flight caterers have cooked fresh meals in kitchens at facilities located close to the airport.
4. An important (relatively recent) development in the sector has been the disintermediation of the in-flight catering services supply chain whereby different companies are able to supply different parts of the supply chain. For example, DHL (the global logistics company) entered the UK market in 2010 to supply BA's short-haul flights from Heathrow using catering provided by Northern Foods (a food manufacturer) and DO & CO (itself a vertically-integrated in-flight catering services supplier).
5. The requirement that hot food be served on long-haul flights (ie those of 5 or more hours in duration) is a key characteristic that distinguishes catering on long-haul flights from catering on short-haul flights, where the food offering tends to be much simpler. Most short-haul services now offer little in the way of catered food other than drinks and ambient snacks in their economy cabins. In addition, the catering requirements of airlines operating out of Heathrow Airport are in many respects different from the catering requirements of airlines operating out of other UK airports (we refer to airports other than Heathrow as 'Regional airports' or 'the Regions'). This reflects in part the complexity of operations at Heathrow, and the different mix of airlines using that airport (mainly long-haul), compared with airlines using Regional airports (mainly short-haul).
6. Alpha and LSG intend to combine their UK trading assets and operations into a 50:50 joint venture (JV). The parties told us that, as a result of the proposed transaction, Alpha and LSG expected to achieve synergies, mainly through consolidating under-utilized facilities at Heathrow and at Regional airports.

7. Alpha and LSG entered into a memorandum of understanding in January 2011 (amended in February 2011). We considered that, by contributing assets and operations to the JV company, the businesses being contributed to the JV would cease to be distinct. We also considered that Alpha and LSG would have the ability materially to influence the policy of the JV company. We considered that the merged entity would have a share of supply in relation to in-flight catering services of over 25 per cent in a substantial part of the UK. Accordingly, we concluded that arrangements were in progress or in contemplation, which, if carried into effect, would result in the creation of one or more relevant merger situations.
8. Alpha Flight Group Limited provides in-flight catering and non-catering services in 11 countries worldwide. In the UK, its services are provided through Alpha Flight UK Limited and its wholly-owned subsidiary Alpha-Airfayre Limited (together 'Alpha'). Alpha Flight Group Limited is a wholly-owned subsidiary of Dnata, which is a sister company of Emirates. Alpha provides a combination of logistics and traditional catering services to 28 locations from facilities at 16 UK airports.
9. LSG provides airline catering and related business activities in the UK. It is part of the LSG Lufthansa Service Holding AG group, which provides airline catering and related business activities in 50 countries worldwide under the brand name LSG Sky Chefs. LSG directly services 17 locations from 13 facilities in the UK. In addition, it services a further six airports in the UK and the Republic of Ireland through third parties.
10. In assessing the competitive effects of the merger, we considered what would happen if the merger did not take place (we call this the 'counterfactual'). For the period 2008 to 2011, both Alpha and LSG have been profitable in the UK although both companies have experienced pressure on their margins.
11. In relation to LSG, we concluded that, absent the merger, LSG would continue to operate at Heathrow given the strategic importance of this airport. In relation to the Regions, we concluded that, absent the merger, LSG would continue to operate in the Regions, and would continue to compete for new contracts at Regional airports.
12. In relation to Alpha, we concluded that, absent the merger, and in the absence of clear evidence to the contrary, Alpha would continue to operate its Heathrow operations and its Regional network (albeit that there may be some restructuring of its asset base to reduce costs). Accordingly, we concluded that Alpha would continue to compete as pre-merger for in-flight catering supply contracts.
13. We found that the supply of in-flight catering services in the UK was an appropriate relevant market within which to assess the effects of the merger. Given the different catering requirements of airlines we identified (see paragraph 5), we found that it was appropriate to consider the merger separately in respect of segments of customer demand (a) at Heathrow and Regional airports and (b) taking into account the distinction between short-haul and long-haul catering.
14. We considered whether the supply of in-flight catering services might share some of the characteristics of an 'idealized' bidding market such that competitive outcomes may be achieved even with only two bidders. We found that the supply of in-flight catering services was not a market in which competitive outcomes might be expected with only two bidders.
15. We examined the history of new entry and exit in the in-flight catering services industry. We also considered barriers to entry and expansion in the industry. We found that the most significant potential barriers to entry or expansion were: (a) the capital cost of investment; and (b) (more significantly) an airline's risk of changing

supply to a new entrant, particularly for long-haul airlines which have relatively complex requirements, and for airlines operating from Heathrow Airport.<sup>1</sup>

16. We noted that new entry had occurred at Heathrow and Regional airports in the past. We also found that expansion by existing in-flight caterers was likely at Regional airports and that any expansion would depend on the size and nature of the airline concerned. However, we did not see any evidence that established overseas in-flight caterers were about to enter the UK. Nor did we see any evidence that caterers currently active at Regional airports (but not at Heathrow) were likely to expand their operations to Heathrow Airport.
17. We examined the degree to which airlines might have a degree of buyer power pre-merger. We noted that a small number of airlines are important to the merging parties in terms of their contribution to the merging parties' revenues. To the extent that these airlines may switch or threaten to switch their business to rivals, we noted that these airlines may have a degree of buyer power, subject to there being rivals to which they may switch supply.
18. We considered a number of possible indicators of buyer power (eg the terms of the contracts between in-flight caterers and airlines) as well as levers open to airlines in their negotiations with in-flight caterers (eg whether airlines could threaten to increase the amount of catering supply nominated to external suppliers).
19. We found that some airlines have a degree of pre-merger buyer power. We found that the ability of airlines to leverage their catering requirements across a network of Regional airports was a lever which was used to improve those airlines' negotiating position. We considered that airlines could also use catering requirements at Heathrow to improve their negotiating position at Regional airports. In addition, because of the value of their business to in-flight caterers, large long-haul airlines and major low-cost carriers and charter/leisure airlines may have a significant degree of pre-merger buyer power.
20. We assessed the competitive effects of the merger in relation to segments of customer demand. At Heathrow, we considered that there were broadly four main customer segments:
  - (a) Heathrow BA, which we regarded as operating in a different competitive environment separate from other customers due to the sheer size of its operations in the UK and its willingness to enter into long-term contractual arrangements for the supply of in-flight catering services.
  - (b) Heathrow short-haul airlines (eg Aer Lingus, bmi, Lufthansa and SAS), which in the main have fairly simple catering needs, in that they often do not serve hot meals to any passengers. Most short-haul flights from outside the UK are 'back-catered' from their home hub (ie have sufficient catering loaded at the departing airport for both the outbound and inbound legs so that no catering needs to be loaded in the UK).
  - (c) Heathrow long-haul airlines with five or more daily departures from Heathrow (ie American Airlines, Air Canada, bmi, Delta, United Continental and Virgin Atlantic Airways).

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<sup>1</sup> This is because Heathrow Airport operates close to its capacity at most times of the day, and catering management and logistics services providers must be able to respond quickly and effectively to unexpected delays arising from airside congestion.



- (d) Heathrow long-haul airlines with fewer than five daily departures from Heathrow (eg Air New Zealand, Etihad, Qantas, Qatar and Singapore Airlines).
21. At Regional airports, we considered that there were broadly three main customer segments:
- (a) Regional low-cost/charter/leisure airlines, which operate from several Regional airports and require a 'network' catering solution across all of their airports. These airlines include: easyJet, Flybe, Monarch, Ryanair, Thomson and Thomas Cook which fly predominantly short-haul, but may also have some long-haul requirements. Accordingly, although high-volume customers, at least for short-haul, the catering provision tends to be low complexity as it consists of mainly ambient snacks or reheated light meals. (We refer to these airlines as 'Regional network' airlines as they require a network catering solution.)
  - (b) Regional short-haul airlines (eg Aer Lingus, bmi, Eastern Airways, Lufthansa and SAS), which operate from one or more Regional airports. As with the Regional network airlines, the catering provision tends to be low complexity. For flights originating outside the UK, these airlines nearly all back-cater.
  - (c) Regional long-haul airlines, ie long-haul carriers which operate from one or more Regional airports, as well as, in most cases, from Heathrow.
22. We assessed competition for each of these customer segments. In relation to BA at Heathrow, we found that, due to the scale of its operation at Heathrow, BA has significant catering needs, and therefore attracts a significant number of bidders in its tenders. We found that the proposed merger was unlikely to give rise to an SLC in relation to this segment as BA's existing supply arrangements at Heathrow will be unaffected and there will be a large number of credible and competitive bidders in any future contract rounds regardless of the merger.
23. In relation to short-haul airlines at Heathrow, we found that sufficient potential bidders will remain in the market post-merger to ensure an effective and competitive bidding process. This is because, inter alia, DHL has the ability and incentive to accommodate additional customers at Heathrow, and because new entry or expansion to supply airlines in this segment, particularly on a small scale, is not subject to significant barriers to entry. For these reasons, we found that the proposed merger was unlikely to give rise to an SLC in relation to this segment.
24. Whilst our conclusion in respect of this segment did not depend on the existence of any countervailing factors, we noted that some of the airlines in this segment were sizeable international airlines, which may possess a degree of buyer power.
25. In relation to smaller long-haul airlines at Heathrow, we found that, for those smaller long-haul airlines which prefer a vertically-integrated supply solution, post-merger there will be up to four possible catering suppliers (the merged entity, Gate Gourmet, Plane Catering and, for some airlines, DO & CO). We found that, for those smaller long-haul airlines which are open to a more disintermediated supply solution, post-merger there will be up to five possible catering suppliers (the merged entity, Gate Gourmet, Plane Catering, DHL and, for some airlines, DO & CO). Overall, we considered that enough caterers will remain in the market post-merger for airlines to manage an effective and competitive bidding process. As there are no capacity concerns in relation to supply to Heathrow smaller long-haul airlines, we found that the proposed merger was unlikely to give rise to an SLC in relation to this segment.

26. Whilst our conclusion in respect of this segment did not depend on the existence of any countervailing factors, we noted that while we had not identified new entry or expansion as being timely, likely and sufficient to offset any lessening of competition, both Plane Catering and DO & CO are relatively recent entrants, suggesting that small-scale new entry to serve this segment of demand might occur in appropriate circumstances. We also noted that some of the airlines in this segment were sizeable international airlines, which may possess a degree of buyer power.
27. In relation to larger long-haul airlines at Heathrow, mainly sizeable transatlantic airlines, our decision was more finely balanced. We found that, pre-merger, Gate Gourmet and DHL exert a competitive constraint on the merging parties. We found that, additionally, DO & CO may exert a competitive constraint for large long-haul airlines at Heathrow in respect of catering provision for the premium cabins.
28. In relation to DHL, we noted that:
- (a) DHL is one of the biggest and most successful global logistics companies. We identified that logistics management is a key part of providing catering management and logistics services to airlines (see paragraph 2(b)).
  - (b) DHL is present in the market and will remain so at least for the foreseeable future through its supply of all short-haul catering to BA at Heathrow.
  - (c) DHL told us that its aim was to create a significant-sized global business in 'above the wing' services. It is bidding for larger long-haul contracts.
  - (d) Several airlines view DHL as a credible catering provider.
  - (e) The evidence we saw suggests that its competitiveness is improving.
  - (f) Its business model 'goes with the grain' of disintermediation of the supply chain (as described in paragraph 4).
29. Whilst the judgement was finely balanced, overall we found that a combination of three credible suppliers (ie the merged firm, Gate Gourmet and DHL), when allied to a range of factors conferring a degree of buyer power on customers, meant that the proposed merger was unlikely to give rise to an SLC in relation to this segment.
30. We found that Regional network airlines were likely to have a choice of at least three caterers following the merger (the merged entity, Gate Gourmet and DHL), and that they may also engage with Commissaire and Newrest. This provides the airlines with switching opportunities. In addition, the Regional network airlines, which are large and sophisticated customers, may have options in terms of sponsoring or encouraging entry. Further, we found that Regional network airlines aggregate their UK airports for the purposes of in-flight catering supply arrangements. This means that the Regional network airlines' contracts are relatively valuable, and therefore attractive to in-flight caterers, which may be expected to compete actively to secure and retain them.
31. We found that following the merger there will be between three and five possible suppliers to the Regional network airlines. When account was additionally taken of the low barriers to entry and expansion, and the size and attractiveness of the business of the Regional network airlines, we found that the proposed merger was unlikely to give rise to an SLC in relation to this segment.

32. In relation to Regional long-haul airlines, we noted that there were far fewer daily departures than at Heathrow. As such, we would expect to see fewer in-flight caterers present at Regional airports than at Heathrow. We noted that most long-haul flights are made from four, principal Regional airports: Gatwick, Glasgow, Birmingham and Manchester.
33. We assessed the effects of the merger for airlines operating long-haul flights from these airports. Overall, and notably taking into account the range of options available to airlines to procure competitive outcomes, we found that the proposed merger was unlikely to give rise to an SLC in relation to this segment.
34. In relation to Regional short-haul airlines, given the low complexity of the on-board catering product required by these airlines, the availability of a number of alternative business models for caterers to meet that demand, and the ease of new entry or expansion from one airport to another in response to customer demand, we found that the proposed merger was unlikely to give rise to an SLC in relation to this segment.
35. Accordingly, for the reasons given above, we found that the proposed merger would not be expected to lead to an SLC in the market for the supply of in-flight catering services in the UK.

# Findings

## 1. The reference

- 1.1 On 10 October 2011, the Office of Fair Trading (OFT) referred to the Competition Commission (CC) for investigation and report the anticipated in-flight catering services joint venture (JV) between Alpha Flight Group Limited and LSG Lufthansa Service Holding AG. The reference required the CC to decide:
- (a) whether arrangements were in progress or in contemplation, which, if carried into effect, would result in the creation of a relevant merger situation; and
  - (b) if so, whether the creation of that situation might be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.
- 1.2 Our terms of reference are set out in Appendix A.
- 1.3 This document, together with its appendices, constitutes our final report, published and notified to Alpha Flight Group Limited and LSG Lufthansa Service Holding AG in line with the CC's Rules of Procedure. Further information relevant to this inquiry, including a non-confidential version of the main parties' initial submission, and summaries of hearing evidence, can be found on our website.

## 2. The in-flight catering services industry

### *Costs in the airline industry*

- 2.1 Whilst the proposed merger concerns in-flight catering in the UK it is important to understand the economic environment in which in-flight catering operates, including the economic circumstances of the airline industry.
- 2.2 Since the turn of the century the airline industry has experienced a number of significant challenges which have led to pressure on costs. Both the terrorist attacks of September 2001 and subsequent economic downturn later in the decade have had a significant detrimental effect on profitability. With business travel reduced and passengers downgrading their cabin class, airlines have also faced a fall in yields per passenger with collective multibillion-dollar annual losses<sup>2</sup> for the airline industry seven times over the past 11 years. A number of major US airlines have gone into Chapter 11 bankruptcy protection, most recently American Airlines. In the UK, a number of airlines including XL Airways and ZOOM have gone into administration. Other airlines have consolidated, eg BA and Iberia, and United and Continental. Faced with these challenges, many airlines have worked to reduce their operating expenditure, including the costs of in-flight catering services (one of the more controllable elements of airline costs).
- 2.3 As airlines seek to reduce costs, suppliers of in-flight catering have seen a reduction in demand for short-haul catering as:

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<sup>2</sup> [www.guardian.co.uk/business/2011/dec/22/ba-owner-iag-virgin-buy-bmi](http://www.guardian.co.uk/business/2011/dec/22/ba-owner-iag-virgin-buy-bmi).

- (a) airlines have moved away from full or, in some cases, any complimentary meal services in economy class on short-haul<sup>3</sup> flights; and
- (b) airlines flying short-haul services into the UK from European airports ‘back-cater’—ie load (‘uplift’) sufficient catering at the European airport for the return flight so that no catering uplift is required in the UK.

In addition, the rise of low-cost carriers has had implications for the in-flight catering services industry (see paragraph 2.20).

- 2.4 As explained below, the pressure on airlines and their catering partners to reduce cost goes some way to explain the emergence of new in-flight catering business models in recent years.

### ***Airlines and their different catering requirements***

- 2.5 There are a large number of airlines operating out of UK airports. Inevitably the catering requirements of airlines vary significantly depending on their individual needs and characteristics.

#### ***Short- and long-haul catering***

- 2.6 The requirement that hot food be served on long-haul flights is a key characteristic that distinguishes catering on long-haul flights from catering on short-haul flights, where the food offering tends to be much simpler. Most short-haul services now offer little in the way of catered food other than drinks and ‘ambient’ (ie unheated) snacks in their economy cabins.
- 2.7 For long-haul flights, there has been a move away from freshly-prepared food for service in the economy cabin. Many airlines have substituted food made within an in-flight caterer’s own kitchen for food sourced by external suppliers (in particular, the main meal for the economy cabin may be mass-produced by a frozen food manufacturer—see paragraph 2.33). Nevertheless, most airlines still require their in-flight catering supplier to supply freshly-prepared food for their premium (ie first and business class) cabins as a key point of difference with the economy cabin. Among airlines themselves, the quality of on-board meals is a point of competitive differentiation, with some airlines, especially some Middle Eastern and Asian airlines, using food as a key part of an airline’s brand image. The importance an individual airline may attach to the quality of its on-board meals may have implications for the range of in-flight catering suppliers it will use.
- 2.8 Further, the distinction between long- and short-haul flights has implications for the complexity of the catering service airlines require and the choices of supplier available to them. As long-haul flights require a hot meal service either the catering supplier must cook food within its own ‘in-house’ hot kitchen or work with an external catering supplier who will cook the food. Additionally, the provision of catering management and logistics services (see paragraph 2.15(b)) is more complex for long-haul airline operations where there may be more than one meal served on-board the flight and there are a large number of catering items (cutlery, crockery, sanitary items and other ancillary items) required for each meal.<sup>4</sup> In contrast,

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<sup>3</sup> In this report we have categorized any flight lasting less than 5 hours as ‘short-haul’ and any flight lasting 5 hours or more as ‘long-haul’, although we recognize that service provision may vary according to a range of factors, not just the duration of the flight, and some airlines categorize flights lasting more than 5 hours but less than 7 hours as ‘mid-haul’.

<sup>4</sup> Virgin Atlantic Airways (VAA) told us that it loaded more than 30,000 individual items on to a standard long-haul flight.

because short-haul flights are shorter and do not tend to serve hot food (except in the premium cabin), short-haul airlines may be able to work with a wider range of potential catering suppliers than long-haul airlines.

- 2.9 We consider the implications of the difference in catering requirements of airlines operating long-haul flights compared with short-haul flights in our assessment of the competitive effects of the merger (see Section 8).

### *Heathrow Airport*

- 2.10 The particular circumstances of Heathrow Airport as the UK's major hub airport have implications for the amount and type of catering required for airlines flying from Heathrow. In particular, Heathrow has a large number of airlines flying long-haul,<sup>5</sup> and a number of these airlines have high-volume long-haul catering requirements related to the number of daily departures. It also has a large short-haul catering requirement because both BA and bmi use Heathrow as their base. Finally, operational conditions for the supply of catering services both to short- and long-haul airlines flying from Heathrow are likely to be significantly more complex than at other airports. This is because Heathrow operates close to its capacity at most times of day and catering management and logistics services providers must be able to respond quickly and effectively to unexpected delays arising from airside congestion.
- 2.11 The size of the Heathrow catering requirement is reflected in the number of in-flight catering contracts which include Heathrow Airport<sup>6</sup> and the value of these contracts (around £324.3 million—around 63 per cent by value). It is also reflected in the number of catering suppliers present at Heathrow Airport (five vertically-integrated in-flight caterers and DHL) and in the fact that both main parties manage their Heathrow activity separately from the rest of their UK businesses.
- 2.12 We consider the implications of the catering requirements of airlines operating from Heathrow Airport in our assessment of the competitive effects of the merger (see Section 8).

### *The Regions*

- 2.13 Outside Heathrow the range of catering requirements of airlines is different. Demand is generated principally by low-cost airlines (principally easyJet, Ryanair and Flybe), charter or leisure airlines (such as Thomson, Thomas Cook and Monarch) and by the operations of long-haul airlines which also fly from Heathrow. The catering requirements of some regional airlines may be met by a caterer located close to the airfield or, in some circumstances, more remotely, eg by a caterer working with a local 'last mile' logistics provider located close to the relevant airport.<sup>7</sup>
- 2.14 Throughout this report, as a matter of convenience, we refer to 'the Regions' or 'Regional' to mean those UK airports other than Heathrow. We consider the implications of the catering requirements of airlines operating from Regional airports in our assessment of the competitive effects of the merger (see Section 8).

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<sup>5</sup> At Heathrow, there are more than 60 different long-haul airlines operating.

<sup>6</sup> Seventy-two contracts—62 per cent of all contracts—include Heathrow either as the sole airport catered or as part of a larger contract which includes Regional airports.

<sup>7</sup> The caterer may service the relevant airport from a facility at a neighbouring airport or from a more remote catering facility (eg LSG gave as an example how it trucked catering [✂]), or the caterer may operate a so-called 'hub-and-spoke' operation from a central facility (eg as Commissaire does).

## ***Recent trends in in-flight catering services***

- 2.15 In-flight catering services comprise a mixture of conventional catering combined with other services:
- (a) *Catering provision.* This includes the preparation and production of meals for service on the aircraft, as well as the sourcing of ambient and snack food.
  - (b) *Catering management and logistics services.* This includes: logistics management (including trucking of food and uplifting to aircraft), equipment and waste management (including dish washing services), managing interfaces with suppliers, sourcing retail goods available to buy on-board the aircraft (including bonded goods such as tobacco and alcohol) (BOB), and ensuring the smooth operation of the catering supply chain.
- 2.16 Traditionally, both catering provision and catering management and logistics services have been provided by a single vertically-integrated catering supplier, of which there are several in the UK (see paragraphs 2.22 to 2.25) including the merging parties, Gate Gourmet, DO & CO and Plane Catering. In particular, as well as managing the logistics, in-flight caterers have cooked fresh meals in kitchens at facilities located close to the airport.
- 2.17 However, an important (relatively recent) development in the sector has been the dis-intermediation of the in-flight catering services supply chain whereby different companies are able to supply different parts of the supply chain—for example, companies may hold the catering management and logistics contract but subcontract the logistics element to a separate company (a 'last mile' provider) to uplift the food to the aircraft.
- 2.18 This has facilitated the emergence of different business models for the provision of in-flight catering services, including so-called 'asset-light' catering operations, where the in-flight catering provider does not have its own kitchen but sources all food from external suppliers and assembles and presents the food according to the individual airline's requirements. Whereas the vertically-integrated suppliers have traditionally located their kitchens close to the airport, due to improvements in the integrity of chill-chains,<sup>8</sup> freshly-cooked food may be cooked at locations further away and transported by truck ('trucked') to the relevant airport.
- 2.19 In line with these developments, both airlines and vertically-integrated catering suppliers have adapted their practices. In particular, some airlines now separately source and nominate the provider of their food, while keeping their overall catering contract with the catering management and logistics services supplier—for example, many airlines nominate specialist frozen food manufacturers like Frankenberg and Marfo to provide food for economy class meals, which the catering supplier will incorporate into the catering supply it uplifts to the aircraft.
- 2.20 Another important development in the sector has been the decline of a full complimentary meal offering on-board the aircraft; principally on short-haul flights. This is in part reflective of the wider cost and competitive pressures within the airline industry and in part due to the rise and influence of low-cost carriers such as Ryanair and easyJet.<sup>9</sup> For some airlines, BOB enables the airline to generate a revenue stream to

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<sup>8</sup> 'Chill chains', ie chilling perishable food once cooked/prepared and maintaining a chilled temperature throughout the supply chain to increase the product's 'shelf-life'.

<sup>9</sup> These airlines operate a full BOB model whilst some charter/leisure airlines have also moved to BOB models, for some or all of their flights.

offset the costs associated with in-flight catering; or catering has become a profit centre in its own right.

## ***Market participants***

- 2.21 In this section we describe a number of the companies currently active across one or more parts of the in-flight catering services supply chain. We assess the competitive constraint provided by these companies in Section 8.

### *Vertically-integrated in-flight caterers*

- 2.22 There are several vertically-integrated catering suppliers in the UK including the merging parties, Gate Gourmet, DO & CO and Plane Catering. Vertically-integrated catering suppliers provide both catering management and logistics services and also the catering products themselves (see paragraph 2.16). We describe each of Gate Gourmet, DO & CO and Plane Catering in turn below. We describe the merging parties in more detail in Section 3.

#### *Gate Gourmet*

- 2.23 Gate Gourmet,<sup>10</sup> a company based in Switzerland, is a large global provider of in-flight catering services, second largest after LSG Sky Chefs. In the UK, Gate Gourmet provides in-flight catering for both short-haul and long-haul flights, at Heathrow and in the Regions. Gate Gourmet operates at the following airports: Heathrow; Gatwick; Stansted; Luton; Newcastle; Liverpool; Glasgow; Bristol International; and Belfast International.<sup>11</sup> At Heathrow it supplies long-haul catering to a number of airlines including BA and has recently been appointed by VAA. In the Regions it supplies catering to a number of airlines including easyJet. Through its Pourshins subsidiary, Gate Gourmet also offers frozen and chilled foods for airlines produced away from the immediate vicinity of the airport.

#### *DO & CO*

- 2.24 DO & CO, a company based in Austria, entered the UK market in 2003 to cater for business class on BA short-haul flights. It provides in-flight catering for both short-haul and long-haul flights at Heathrow from a hot kitchen facility in Feltham near to Heathrow Airport. From this facility it supplies catering to a number of airlines (Emirates Airlines, Etihad Airways, Jet Airways, Cyprus Airways, China Airlines and Royal Jet Airlines). Via DHL it also supplies catering to BA for its premium cabin for all short-haul flights from Heathrow. It is not currently present in the Regions. DO & CO handles the uplift for all of its customers.

#### *Plane Catering*

- 2.25 Plane Catering, a company based in Feltham, entered the market in 2006.<sup>12</sup> It provides in-flight catering at Heathrow. It supplies catering to a number of long-haul airlines (Air Astana, Arik Air, Kingfisher and Qantas) and has a contract for BA crew meals. It is not currently present in the Regions. Plane Catering produces its own

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<sup>10</sup> [www.gategourmet.com/](http://www.gategourmet.com/).

<sup>11</sup> Gate Gourmet has kitchens at Heathrow, Bristol International, Glasgow and Gatwick.

<sup>12</sup> Like DO & CO, Plane Catering started as a provider of catering before moving into the supply of catering management and logistics services as well as the provision of catering.



food in a hot kitchen as well as acting as a provider of catering products to Alpha on behalf of Qantas.

### *Non-vertically-integrated supply models*

- 2.26 As noted in paragraph 2.17 above, a relatively recent development in the sector has been the disintermediation of the in-flight catering services supply chain whereby one company (or several companies) may provide the catering whilst a different company provides the catering management and logistics services.
- 2.27 Disintermediation of the supply chain may also occur where an airline requires its provider of catering management and logistics services to source food from a nominated supplier. Often the airline will negotiate the price of food directly with the nominated supplier. (See paragraph 2.33 and paragraphs 7.39 to 7.44.)
- 2.28 We describe below a number of companies providing parts of the in-flight catering services supply chain. These companies do not produce their own catering but do provide catering management and logistics services to airlines.

#### *DHL*

- 2.29 DHL, the global logistics firm, entered the UK market in 2010 to provide short-haul catering for BA at Heathrow. Its business model may be described as 'asset-light' in that it does not have its own hot kitchen for the production of food. Rather, its business model relies on using external catering providers to supply products to DHL which in turn assembles the full airline meal and handles the catering management and logistics services, including loading the meals onto the aircraft. For the BA short-haul contract at Heathrow, DHL is supplied with chilled meals and snacks by Northern Foods for the economy cabin, and fresh meals by DO & CO for the premium cabin.

#### *Newrest/Servair*

- 2.30 Newrest entered the UK market in 2009 at London City via a joint venture between Newrest and Servair. It provides catering for short-haul flights from London City, Edinburgh and Glasgow airports, principally for BA CityFlyer.<sup>13</sup> It provides ambient snack products, and uses a 'pick and pack'<sup>14</sup> model. It does not prepare meals.

#### *Commissaire*

- 2.31 Commissaire, a company based in Birmingham, provides in-flight catering for short-haul flights for Flybe. It has a central 'pick and pack' operation from which it supplies a number of Regional airports. It told us that Derichebourg Multiservices Ltd (Derichebourg)<sup>15</sup> uplifts most of Commissaire's catering (ie Derichebourg operates as a 'last mile' provider of airside logistics services).

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<sup>13</sup> At Edinburgh and Glasgow this is via a joint venture called Newrest-ALL.

<sup>14</sup> A 'pick and pack' model involves the in-flight caterer receiving catering products and drinks from third party suppliers. The caterer then 'picks' the relevant products/drinks for each flight and 'packs' them into trollies for loading onto the aircraft.

<sup>15</sup> Derichebourg's primary business is the cleaning of aircraft rather than providing in-flight catering.

### *Other disintermediation of the in-flight catering supply chain*

- *Buy-on-board*

- 2.32 As noted in paragraph 2.20, another important development in the sector has been the growth of BOB models being applied by low-cost and charter/leisure carriers in the Regions. BOB food products consist of snack items or light meals (pizza slices etc) which are reheated on board. These airlines do not need their in-flight caterer to produce food from a hot kitchen. For example, Retail in Motion supplies Ryanair with a BOB catering solution across Europe.<sup>16</sup>

- *Frozen food manufacturers*

- 2.33 A number of long-haul airlines nominate third party food suppliers. Key suppliers include Frankenberg and Marfo, who prepare frozen food items for airlines at their facilities in Germany and Holland respectively. These items are trucked to an in-flight catering supplier in the UK, which then assembles the full aircraft meal for uplift to the aircraft. Frozen food suppliers provide catering supplies, especially in respect of the economy cabin, but do not provide catering management and logistics services.

- *Other independent kitchens in the vicinity of Heathrow Airport*

- 2.34 In addition to the vertically-integrated in-flight caterers described above, at Heathrow Airport there are a number of other food producers which produce and supply in-flight catering meals and other catering products to in-flight catering suppliers. These companies include DSI Foods (DSI) and Noon/Bombay Halwa.<sup>17</sup> These companies provide catering supplies, but do not provide catering management and logistics services.

## **3. The companies and the proposed merger**

### **LSG**

- 3.1 LSG provides airline catering and related business activities in the UK. It is part of the LSG Lufthansa Service Holding AG group, which provides airline catering and related business activities in 50 countries worldwide under the brand name LSG Sky Chefs.<sup>18</sup> LSG's ultimate parent company is Deutsche Lufthansa AG.
- 3.2 LSG directly services 17 locations from 13 facilities in the UK. In addition, it services a further six airports in the UK and the Republic of Ireland through third parties. The locations and LSG's method of operation are set out in Table 1.

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<sup>16</sup> [X]

<sup>17</sup> [www.bombayhalwa.com/bombay/aviationcatering/](http://www.bombayhalwa.com/bombay/aviationcatering/).

<sup>18</sup> [www.lsgskychefs.com/](http://www.lsgskychefs.com/). To this extent, LSG Sky Chefs is present in significantly more countries globally (50) than Alpha Flight Group Limited (11).

TABLE 1 LSG's operations

<i>Location</i>	<i>Type of operation</i>	<i>Supplied from</i>
Heathrow Gatwick Manchester	Main CSC (Customer Service Centre) (full kitchen facilities)	[REDACTED]
Birmingham Glasgow Newcastle Luton Cardiff	Mini CSC (no kitchen)	[REDACTED]
East Midlands Doncaster Stansted London City	Last mile (logistics centre)	[REDACTED] [REDACTED] [REDACTED] [REDACTED]
Teesside, Humberside, Liverpool/Blackpool, Leeds Bradford, Norwich	By road (last mile)	[REDACTED]
Belfast, Dublin, Shannon , Bristol, Exeter, Bournemouth	Third party supplier [REDACTED]	

Source: LSG.

- 3.3 In the year ended 31 December 2010 (FY10), LSG had a consolidated turnover of £[REDACTED] million (unconsolidated: £[REDACTED] million) with an operating profit (pre-exceptional items and group charges) of £[REDACTED] million. LSG Sky Chefs had worldwide turnover in FY10 of €2.2 billion and operating profit of €76 million.<sup>19</sup> In the year ended 31 December 2011 (FY11), LSG had unconsolidated revenue (unaudited) of £[REDACTED] million and an operating profit before group charges of £[REDACTED] million.
- 3.4 LSG has two principal trading entities in the UK: LSG Sky Chefs/GCC Limited<sup>20</sup> through which all Heathrow trading is reported; and LSG Sky Chefs UK Limited through which all non-Heathrow (ie Regional) trading is reported. LSG in FY11 had revenue of around £[REDACTED] million at Heathrow and £[REDACTED] million in the Regions. Both entities have historically generated operating profits (before exceptional items and group charges) as well as positive free cash flow. Details of LSG's financial performance are in Appendix B.
- 3.5 In 2011, [REDACTED]. In addition, [REDACTED]. LSG told us that this meant [REDACTED] and that consequently, [REDACTED], it would have to reconsider the shape and structure of its regional network.<sup>21</sup> We consider this and the financial performance of LSG's different operating entities in paragraphs 5.4 to 5.9.
- 3.6 LSG's principal customers include: Continental, Emirates, Qatar, Singapore Airlines, Thomson and VAA.<sup>22</sup> In Table 2 we set out LSG's principal customers in 2011.

<sup>19</sup> Lufthansa Annual Report 2010.

<sup>20</sup> LSG Sky Chefs/GCC Limited is a 50:50 joint venture between LSG and GCC Aviation Services Company Limited. [REDACTED]

<sup>21</sup> [REDACTED]

<sup>22</sup> VAA's catering contract will move to Gate Gourmet during 2012.

TABLE 2 LSG's principal customers

Customer	Area	Contract value £m	Proportion of 2011 revenue %
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: LSG.

## Alpha

- 3.7 Alpha Flight Group Limited provides in-flight catering and non-catering services in 11 countries worldwide.<sup>23</sup> In the UK, its services are provided through Alpha Flight UK Limited and its wholly-owned subsidiary Alpha-Airfayre Limited (together 'Alpha').<sup>24</sup> Alpha Flight Group Limited is a wholly-owned subsidiary of Dnata, which is a sister company of Emirates.
- 3.8 Alpha Flight Group Limited was spun out of the Forte Group in 1994. In 2007 it was acquired by Autogrill SpA. In November 2009, Alpha Flight Group Limited entered into a joint venture (through Alpha Flight UK Limited) with Air Fayre Limited (owned by Journey Group plc) to merge their respective in-flight operations at Heathrow to form Alpha-Airfayre Limited.<sup>25</sup> In November 2010, Alpha Flight Group Limited acquired the remaining shares of the JV. The JV and subsequent acquisition provided Alpha Flight UK Limited with an 'asset-light' operation at Heathrow to complement its 'traditional catering' offering.
- 3.9 In December 2010, Alpha Flight Group Limited was acquired by Dnata for [REDACTED].<sup>26</sup> Dnata's business case for investing in Alpha Flight Group included [REDACTED].
- 3.10 Alpha provides a combination of 'pure logistics' (last mile) and traditional catering services to 28 locations from facilities at 16 UK airports. The locations and method of operation are set out in Table 3.

<sup>23</sup> Alpha Flight Group operates regional networks in the UK and the Republic of Ireland, Italy and Australia as well as single locations in the USA, Netherlands, Czech Republic, Bulgaria, Romania, UAE and Jordan.

<sup>24</sup> Alpha Airfayre has two wholly-owned subsidiaries: Alpha Heathrow Limited and Airfayre Heathrow Limited. These entities provide employment services to the Alpha Group.

<sup>25</sup> Alpha held 51 per cent of the share capital in the joint venture with Journey Group holding the remaining 49 per cent.

<sup>26</sup> Dnata had acquired a 49 per cent stake in Alpha Flight Services Pty Limited (Australia) in 2007. In 2009, it commenced discussions with Autogrill SpA to acquire a 49 per cent interest in Alpha Flight Group Limited. [REDACTED], Autogrill decided to divest Alpha Flight Group Limited.

TABLE 3 Alpha's presence at UK airports and method of operation

<i>Location</i>	<i>Available facilities</i>	<i>Method of operation</i>
Heathrow	1 x full service and 1 x pure logistics	[X]
Gatwick	1 x full service (BA) and 1 x pure logistics	[X]
Manchester	Full service	[X]
Birmingham	Full service	[X]
Glasgow	Full service	[X]
Newcastle	Full service	[X]
Luton	Full service (cold food capability only—hot food third party)	[X]
Cardiff	Full service	[X]
Stansted	Full service (cold food capability only—hot food third party)	[X]
Leeds Bradford	Full service	[X]
Edinburgh	Full service	[X]
Aberdeen	Full service	[X]
Belfast	Full service	[X]
Prestwick	Bond only	[X]
Nottingham East Midlands	Full service	[X]
Bristol	Pure logistics	[X]
Durham Tees Valley	No facilities	[X]
Humberside	No facilities	[X]
Liverpool	No facilities	[X]
Bournemouth	No facilities	[X]
Exeter	No facilities	[X]

Source: Alpha.

- 3.11 In the year ended 31 December 2010 (FY10), Alpha had a turnover of £[X] million with an operating profit of £[X] million (£[X] million after group charges). This equated to [X] per cent of Alpha Flight Group Limited's worldwide turnover of £373 million and [X] per cent of worldwide operating profit of £[X] million.<sup>27</sup> In the year ended 31 December 2011 (FY11), Alpha is estimated to have had revenue of £[X] million and an operating profit of £[X] million (£[X] million [X]).<sup>28</sup> Details of Alpha's financial performance are in Appendix B.
- 3.12 Alpha operates three business units within the UK: Heathrow; the Regions; and BA Gatwick [X]. In FY10, the Regions generated [X] per cent of revenue with Heathrow [X] per cent. In FY11, the Regions revenue is forecast to be [X] per cent of total revenue [X] with Heathrow forecast to be [X] per cent [X]. In FY10 and FY11, both [X] were profitable whereas [X] was loss-making. We consider the financial performance of Alpha's different operating units in our counterfactual analysis in paragraphs 5.10 to 5.15.
- 3.13 Alpha's principal customers include: American Airlines, BA (at Gatwick), bmi, Jet2, Monarch, Pakistan Air, Qantas, Ryanair, Thomas Cook and United. In Table 4 we set out Alpha's principal customers in 2011.

<sup>27</sup> Alpha Flight Group Limited 2010 consolidated financial accounts.

<sup>28</sup> [X]

TABLE 4 Alpha's principal customers

Customer	Area	Contract value £m	Proportion of 2011 revenue %
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: Alpha.

## The proposed merger

- 3.14 The parties intend to combine their UK trading assets and operations into a 50:50 JV.<sup>29</sup> Further details of the structure of the transaction and key operative clauses are in Appendix C.

### *The rationale for the merger*

- 3.15 LSG stated that its motivation behind the JV was to strengthen its service provision in the UK. The JV would enable: significant cost reductions; a significant improvement in LSG's competitive position outside Heathrow as Alpha has a strong regional network [REDACTED]; and a significant improvement in the overall competitive business set-up. Alpha saw the JV as providing benefits in: facilities consolidation; greater purchasing power; labour and material efficiencies; and a greater ability to compete with other UK in-flight caterers and a range of suppliers of catering products to airlines.
- 3.16 The parties told us that, as a result of the proposed transaction, Alpha and LSG expected to achieve synergies which would lead to cost savings of around £[REDACTED] million a year by year three (2014).<sup>30</sup> [REDACTED].<sup>31,32</sup> The cost savings include:
- (a) addressing 'significant cost disadvantages' compared with newer entrants due to their 'heavily underutilized' legacy facilities structure. The consolidation of the excess capacity and closure of duplicate facilities is expected to yield a recurring cost saving of around £[REDACTED] (2014);
  - (b) securing better terms from suppliers, which is expected to yield a recurring cost saving of around £[REDACTED] (2013);
  - (c) reduction of overheads, general and administrative costs; this is expected to yield a recurring cost saving of £[REDACTED] (2014); and
  - (d) operational synergies from combining the existing expertise of the two parties.

<sup>29</sup> [REDACTED]

<sup>30</sup> The preliminary JV business plan was based on a completion date of 1 January 2012. As such, year one of the combined operations of LSG and Alpha was 2012.

<sup>31</sup> [REDACTED]

<sup>32</sup> [REDACTED]

- 3.17 The largest annual cost saving anticipated by the JV is in relation to facilities consolidation. The estimated annual cost saving resulting from facility consolidation is set out in Table 5.

TABLE 5 **Cost synergies from facilities consolidation**

<i>£ million</i>		
	<i>Main changes to facilities</i>	<i>Annual cost saving</i>
[REDACTED]	[REDACTED]*	[REDACTED]
[REDACTED]		
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]†	[REDACTED]	[REDACTED]
		[REDACTED]

Source: Alpha and LSG.

\*[REDACTED]  
†[REDACTED]

## 4. Jurisdiction

- 4.1 The proposed JV was referred to the CC by the OFT under section 33 of the Enterprise Act 2002 (the Act). The CC must decide, under section 36 of the Act, whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

### ***Arrangements in progress or in contemplation***

- 4.2 LSG and Alpha entered into a Memorandum of Understanding dated 25 and 27 January 2011 (subsequently amended 17 February 2011 and 18 July 2011) providing for the creation of the JV. The parties also provided us with drafts of the Contribution Agreement setting out the businesses that each will contribute to the JV and a draft JV Shareholders' Agreement setting out the ownership structure of the JV and the control rights of each of the shareholders. We found that the entering into of the Memorandum of Understanding and subsequent negotiation of the relevant contractual documentation indicated that arrangements are in progress or contemplation.

### ***Relevant merger situation***

- 4.3 We next considered whether those arrangements would, if carried into effect, give rise to a relevant merger situation. A relevant merger situation will arise under section 23 of the Act where two or more enterprises cease to be distinct and either the turnover test in section 23(1)(b) or the share of supply test in section 23(2)(b) is satisfied.

### ***Enterprises ceasing to be distinct***

- 4.4 JVCo, the legal entity to be created pursuant to the JV, is to be created as a vehicle for the transaction. We found that the businesses being contributed to the JVCo (described in Appendix C), which are businesses operating as going concerns, as well as the activities of the parties being retained outside the JVCo, all constitute enterprises within the meaning of the Act.

- 4.5 For the purposes of the Act, enterprises cease to be distinct from one another if they are brought under common ownership or common control. The structure of the transaction involves a number of separate steps. The JV will acquire outright control of each of the Alpha and the LSG contributed businesses. As a result, those contributed businesses cease to be distinct from one another and are brought under the common ownership of JVCo.
- 4.6 In addition, we have considered the jurisdictional issue by looking at the level of the JV parents. In this case, LSG/Sky Chefs Europe Holdings Limited and Alpha Flight Group Limited each acquire a 50 per cent stake in the JV, which in turn owns the contributed businesses. The JV structure is set out in the draft JV Shareholders' Agreement. The key terms of that agreement that we consider relevant to identifying the level of control held by the parties are described in Appendix C. [REDACTED] Matters relating to the scope of the JVCo are reserved to the shareholders.
- 4.7 Whilst neither of the main parties has a controlling interest in JVCo and neither appears to have independent control of the policy of JVCo, they each have the ability materially to influence the policy of JVCo through their ability to block actions of the JVCo (see Appendix C). [REDACTED]

### *Share of supply*

- 4.8 The share of supply test set out in section 23(2)(b) is satisfied where, as a result of enterprises ceasing to be distinct, at least one-quarter of goods or services of any description which are supplied in the UK, or in a substantial part of the UK, are supplied by or to one and the same person.<sup>33</sup> Information provided by the parties (see Table 6) shows that their estimated combined share of supply in in-flight catering services based on passenger numbers exceeds 25 per cent on a national basis; in the Regions (ie across non-Heathrow airports); and at Heathrow.

TABLE 6 Parties' estimates of market share

	<i>per cent</i>		
	<i>Alpha</i>	<i>LSG</i>	<i>Combined</i>
National	[20–30]	[10–20]	[40–50]
Regions (excl Heathrow)	[30–40]	[10–20]	[40–50]
Heathrow	[0–10]	[20–30]	[30–40]

Source: Parties' estimates based on CAA passenger numbers for the period January–May 2011.

- 4.9 We were satisfied that each of Heathrow and the Regional airports (ie excluding Heathrow) constitute a substantial part of the UK, and that accordingly the share of supply test was met in respect of each of the alternative bases referred to above.<sup>34</sup>

### ***Conclusion on jurisdiction***

- 4.10 As a result, we concluded that arrangements were in progress or in contemplation which, if carried into effect, would result in the creation of one or more relevant merger situations.

<sup>33</sup> Section 23(3) and (4) of the Act.

<sup>34</sup> Although not determinative for establishing jurisdiction, we also noted that the UK turnover of each of the businesses being contributed to the JVCo substantially exceeds £70 million. The UK turnover of LSG in 2010 was approximately £[REDACTED] million. The UK turnover of the Alpha business in 2010 was approximately £[REDACTED] million, of which approximately £[REDACTED] million was attributable to the [REDACTED]. Accordingly, the turnover test set out in section 28 of the Act was also satisfied.



## 5. Counterfactual

- 5.1 The application of the SLC test involves a comparison of the prospects for competition with the merger against the competitive situation without the merger: the counterfactual. In assessing the counterfactual, a number of scenarios may be possible but ultimately only the most likely scenario will be selected. In our assessment we take into account the extent to which events or circumstances and their consequences are foreseeable and typically incorporate only those aspects that appear likely on the facts available to us.<sup>35</sup>
- 5.2 In this section we set out:
- (a) the summary financial performance and arguments made by LSG (paragraphs 5.4 to 5.9);
  - (b) the summary financial performance and arguments made by Alpha (paragraphs 5.10 to 5.15); and
  - (c) our analysis and conclusions (paragraphs 5.16 to 5.18).
- 5.3 We set out a detailed analysis of the financial performance of LSG and Alpha in Appendix B.

### LSG

- 5.4 LSG made an operating profit (before exceptional items and group charges) in each of its three financial years ended 31 December 2011.<sup>36</sup>
- 5.5 LSG told us that LSG Sky Chefs was a worldwide global player. Its 'mission [is] to serve [its] customers in the biggest hubs in the world'. Consequently, Heathrow was a core business with 'global strategic significance'. LSG's operations at Heathrow were profitable in the period 2008 to 2011, [REDACTED]. LSG's Heathrow operations are budgeted to be profitable in 2012 with an operating margin of [REDACTED] per cent.
- 5.6 LSG told us that [REDACTED]. In the period 2008 to 2011, LSG's regional operations generated positive operating profits (before exceptional items and group charges). Its operating margin (before exceptional items and group charges) was [REDACTED] per cent in 2010 and 2011, [REDACTED].
- 5.7 However, LSG told us [REDACTED].<sup>37,38</sup> Consequently, [REDACTED] it would have to reconsider the shape and structure of its regional network.<sup>39</sup> [REDACTED] However, there were no other UK major multi-airport contracts due to be tendered in the near future.
- 5.8 LSG stated that it had not come to a final decision regarding the future of its UK operations but the key factors in this consideration included:
- (a) the total [REDACTED] financial impact of the developments relating to [REDACTED];

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<sup>35</sup> Merger Assessment Guidelines, CC2 (revised), September 2010 (the Guidelines), paragraph 4.3.6.

<sup>36</sup> The results for 2011 are based on actual unaudited numbers for 2011. Operating margin before exceptional items and group charges ranged between [REDACTED].

<sup>37</sup> [REDACTED]

<sup>38</sup> [REDACTED]

<sup>39</sup> Together [REDACTED] of the LSG's 2010 regional revenue. LSG estimated that the effect of the change in [REDACTED]. [REDACTED] contributed around £[REDACTED] million contribution in 2010 (the last full year of the contract).

- (b) Lufthansa Group's policy that it will not provide funding to a [REDACTED] business, without a strategic prospect of growth;
- (c) the need to maintain a presence at Heathrow to service LSG's global contracts;
- (d) [REDACTED];<sup>40</sup>
- (e) no access to the JV-related synergies; and
- (f) [REDACTED]

5.9 LSG argued that a continuation of the UK business in its current form and with current infrastructure was one possible option, but that this was by no means the most likely option. LSG considered that, were the JV not to proceed, then the most likely outcome was that it would look to [REDACTED]. However, LSG argued that it would be able to continue to compete effectively for new contracts in the Regions [REDACTED].

## Alpha

- 5.10 Overall Alpha was profitable in the period 2008 to 2011 although its operating margin (excluding group charges) declined over the period from [REDACTED] to [REDACTED].<sup>41</sup> However, Alpha was the least profitable part of Alpha Flight Group Limited. Alpha produced [REDACTED] per cent of Alpha Flight Group Limited's revenue but only [REDACTED] per cent of its operating profit.<sup>42</sup> At an individual operating segment level both Alpha's [REDACTED] and its [REDACTED] were profitable in 2010 and 2011.<sup>43</sup> However, its [REDACTED].
- 5.11 The financial position of the Heathrow operation will be affected in 2012 by the loss of bmi which has moved its contract to LSG. In addition, another of Alpha's major customers, [REDACTED], will in 2012 reduce [REDACTED] the number of flights Alpha serves. The combined annualized loss in revenue and contribution at Heathrow is £[REDACTED] and £[REDACTED] respectively. Alpha told us that it could therefore be in a position of having an overall operating loss for the UK [REDACTED].
- 5.12 Dnata stated that [REDACTED].<sup>44</sup> Alpha told us that [REDACTED].
- 5.13 Alpha stated that its facilities leases were its most significant fixed costs. Alpha has 30 UK leases. The length of the lease terms, which range from [REDACTED] to [REDACTED], was the main barrier to enabling Alpha to reduce its cost base. Of these leases, only five UK leases expire before the end of [REDACTED] and a further seven UK leases before the end of [REDACTED]. These facilities have varying levels of utilization with an average of around [REDACTED] per cent. In the Regions, Alpha told us that it had attempted to buy out the remaining term of its lease at [REDACTED] but had not been able to agree a price for doing so with the landlord.
- 5.14 Alpha told us that as a result of the loss of contracts which were primarily serviced out of its Heston facilities, one of its options was to [REDACTED].<sup>45</sup>

<sup>40</sup> LSG told us that LSG Lufthansa Service Holding AG had liquidated loss-making European operations previously in France, Italy, Spain and Scandinavia.

<sup>41</sup> Operating margin is stated before exceptional items and after group charges.

<sup>42</sup> In 2010, Alpha Group had revenue of £373 million with an operating profit of £[REDACTED] million (operating margin [REDACTED] per cent). Alpha UK had revenue of £[REDACTED] million with an operating profit (including group charges) of £[REDACTED] million.

<sup>43</sup> [REDACTED] had an operating profit of £[REDACTED] million. [REDACTED] had an operating profit of £[REDACTED] million. [REDACTED] had an operating loss of £[REDACTED] million. All figures stated after group charges.

<sup>44</sup> Dnata noted in this respect that the merger of LSG and Gate Gourmet at Paris Charles de Gaulle in 2006 had been cleared by the European Commission.

- 5.15 Alpha said that, if it could find a way out of the leases (which might include liquidation of the company), then [REDACTED]. Alternatively Alpha could exit [REDACTED] and focus on its [REDACTED]. It argued that it was less likely that Alpha's business would continue in its present form in light of recent contract losses and its steeply declining financial performance.

### **CC analysis and conclusions**

- 5.16 In-flight catering supply contracts tend to be three to five years in length. Based on our review of current contracts, we noted that the majority of contracts will be re-tendered within the next three years.<sup>46</sup> As such, we consider that the appropriate counterfactual should be over a period no longer than three years.
- 5.17 We conclude, based on the evidence set out in paragraphs 5.4 to 5.9, that having a presence at Heathrow is strategically important to LSG and that LSG's pre-merger position at Heathrow would continue absent the merger. [REDACTED] Whilst we noted that LSG Lufthansa Holdings AG has previously closed loss-making operations in Europe, [REDACTED], we do not consider it likely, given current information, that this would occur. As such, we concluded that LSG would continue to operate a regional network ([REDACTED]) which would continue to compete as pre-merger for new contracts in the Regions.
- 5.18 We conclude, based on the evidence set out in paragraphs 5.10 to 5.15, that Alpha would continue to operate its [REDACTED] and [REDACTED] so maintaining facilities at [REDACTED]. Alpha's [REDACTED] operation [REDACTED]. However, in line with our Guidelines (see paragraph 5.1), we consider that in the absence of clear evidence to the contrary Alpha would continue its [REDACTED] operations, albeit with some restructuring of its asset base to reduce costs, competing as pre-merger for new contracts.

## **6. The relevant markets**

- 6.1 The Guidelines<sup>47</sup> state that the purpose of market definition in a merger inquiry is to provide a framework for the analysis of the competitive effects of the merger. The Guidelines go on to state that the CC and OFT will identify the market or markets within which the merger may give rise to an SLC, and that this will include the most relevant constraints on behaviour of the merger firms.
- 6.2 The parties told us that the supply of in-flight catering services in the UK was an appropriate market within which to assess the effects of the merger; and that, in this context, due consideration should also be given to the competitive constraints exerted by (a) potential expansion by companies which already operate as part of the in-flight catering services supply chain or at airports (as cleaners or ground handling operators) or by (b) greenfield entry by 'international' in-flight catering services suppliers into the UK. The parties told us that we did not need to divide this market into Heathrow or regional markets; and that, in view of the supply-side substitution which exists across all customer segments, it is not meaningful to segment the market according to types of customer.
- 6.3 We found that the supply of in-flight catering services<sup>48</sup> in the UK was an appropriate relevant market within which to assess the effects of the merger. This is because,

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<sup>45</sup> This comprises [REDACTED]. In addition, Alpha would incur around £[REDACTED] million in redundancy costs. Alpha stated that if it chose to [REDACTED], it would have negative impact on the profit and loss account [REDACTED].

<sup>46</sup> For example, at least four of the six Heathrow larger long-haul airlines (excluding BA) are due to be re-tendered in the next three years (see Section 8 for description of airlines).

<sup>47</sup> Paragraph 5.2.1.

<sup>48</sup> ie the provision of catering management and logistics services and catering, as described in paragraph 2.15.

based on the available information, (a) the parties overlap in this market (both supply in-flight catering services at several airports in the UK) and (b) the most direct competition faced by one supplier of in-flight catering services comes from other suppliers of in-flight catering services either in whole or in part. This approach provides an appropriate framework for evaluating all constraints on the merged company's conduct—the constraints arising within and between product segments inside the market, as well as other relevant constraints from outside the market, including potential expansion by companies which already operate as part of the in-flight catering services supply chain or at airports (as cleaners or ground handling operators) or by greenfield entry by 'international' in-flight catering services suppliers into the UK.

6.4 We found that it was appropriate to consider the merger separately in respect of segments of customer demand (a) at Heathrow and Regional airports, and (b) taking into account the distinction between short-haul and long-haul catering. We based this view:

(a) in relation to Heathrow, on the particular characteristics of demand discussed in paragraphs 2.10 and 2.11;

(b) in relation to Regional airports, on the particular characteristics of demand discussed in paragraph 2.13;<sup>49</sup> and

(c) in relation to short-haul and long-haul catering, on the particular characteristics of demand discussed in paragraphs 2.6 to 2.8.

6.5 We have assessed the competitive effects of the merger by reference to different subsets of customer demand at Heathrow, and separately for Regional airports (see Section 8). We found that it was not necessary to identify any of these subsets of demand as a market (or markets) that would satisfy the hypothetical monopolist test as no reasonable alternative market definition would have led to a different conclusion regarding the substantive effects of the merger.

## **7. Competitive characteristics of the in-flight catering services market**

7.1 In this section we review the implications for competition of the fact that most contracts for in-flight catering services are awarded through bidding mechanisms. We then examine the available evidence on whether the post-merger conduct of the parties is likely to be constrained either by the threat of market entry and expansion or by the exercise of any buyer power by airline customers which may exist pre-merger.

### ***Bidding markets***

7.2 Most airlines use a bidding process for selecting their catering provider, inviting potential suppliers to tender before engaging in detailed negotiation with one, or more, preferred bidders. This process is often used even where the airline ultimately stays with its existing supplier, in order to improve the offering which the airline ultimately obtains.

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<sup>49</sup> We note that this is a different approach from that applied in the [BAA Airports market investigation](#). In the CC's present inquiry we were focusing on the provision of in-flight catering services. We were not considering the extent to which various airports do or do not compete with one another and the choice of distinguishing between Heathrow and other airports (which we refer to in this report as 'Regional' airports) does not indicate any view on competition between UK airports.

- 7.3 Competition in markets where price is determined through a bidding process can, if certain conditions hold, result in competitive outcomes even with only two bidders,<sup>50</sup> and under these conditions, historical data on market shares considered in isolation may not provide an accurate impression of the degree of competition in the market.
- 7.4 We found (see also Appendix D) that the market for in-flight catering services does not possess the characteristics of idealized bidding markets for a number of reasons. Most importantly:
- (a) entry of new suppliers is not easy for certain segments of the market, especially at Heathrow, which accounts for around two-thirds of total UK demand;
  - (b) there is a multiplicity of contracts, many of which are relatively low value, with only relatively few high-value contracts;
  - (c) there are incumbency advantages present in at least parts of the in-flight catering market (particularly in relation to having experience of supplying airlines with large catering requirements, and in relation to providing long-haul catering management and logistics services); and
  - (d) in-flight caterers are not homogeneous<sup>51</sup> (which also means that marginal costs are not expected to be constant across bidders—in other words, each in-flight caterer has different variable costs based on which they submit bids).
- 7.5 Therefore we did not consider that expected outcomes in idealized bidding markets—that as few as two firms can provide enough competition to ensure competitive outcomes—could be expected in the provision of in-flight catering services. Given this, we considered that any reduction in the relatively small number of potential bidders could have an adverse impact on prices and service quality available to purchasers. Nevertheless, it may be possible to reach competitive outcomes with few bidders (but more than two), especially where the set of bidders includes companies with differentiated product offerings. We consider this issue further in Section 8.

### ***Recent market entry and exit***

- 7.6 In paragraphs 7.7 and 7.8 we set out those companies which have entered or exited the UK in-flight catering services market as well as those that have expanded from operations at Heathrow into the Regions in the last ten years.
- 7.7 There have been a number of de novo entrants into in-flight catering in the UK in the past ten years: at Heathrow, DO & CO in 2003, Plane Catering in 2006 (both of which expanded from initially providing outsourced catering to providing both catering and management and logistics services direct to airlines), and DHL in 2010; and in the Regions, Newrest-Servair in 2009 (initially just at London City but more recently at Edinburgh and Glasgow). Retail in Motion and Commissaire have also entered the market supplying BOB products for Ryanair (across Europe including in the UK) and Flybe (in the UK) respectively. In addition, there have been a number of expansions by in-flight caterers into the Regions: Airfayre set up its first Regional operation at Birmingham in 2003 and Gate Gourmet is due to set up facilities in Manchester in 2012.

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<sup>50</sup> See [www.competition-commission.org.uk/our\\_role/analysis/bidding\\_markets.pdf](http://www.competition-commission.org.uk/our_role/analysis/bidding_markets.pdf).

<sup>51</sup> Even though in-flight caterers are heterogeneous, airlines are able to play them off against each other in order to obtain competitive offers.

- 7.8 Whilst there has been some entry and expansion, there have also been a number of companies which have exited or been acquired by existing in-flight caterers. These companies include: Abela Catering in 2003 and Citynet Catering in 2011, who were both acquired by LSG;<sup>52</sup> International Catering Limited (ICL) in 2006, which was acquired by Airfayre; and Airfayre, which was acquired in 2010 by Alpha after a joint venture. In addition, Gate Gourmet acquired The Caterer in Manchester in 2008. A number of smaller companies have also exited without selling either the company or its assets to another in-flight caterer.<sup>53</sup>

### **Barriers to entry and expansion**

- 7.9 In assessing whether new entry or expansion might prevent an SLC, we have to consider whether such entry or expansion would be timely, likely and sufficient.<sup>54</sup> We considered that as contracts tend to be three to five years in length, our consideration of entry or expansion should be over a period no longer than three years. In paragraphs 7.10 to 7.13 we set out the position of the main and third parties in relation to the extent of barriers to entry. In paragraphs 7.14 to 7.21 we set out our assessment in relation to the most significant barriers to entry. We look at the effect of these barriers on entry further in Section 8. We provide a more detailed summary of the evidence put to us by the main parties and third parties in Appendix E.
- 7.10 The main parties considered that barriers to entry were low,<sup>55</sup> and that barriers to expansion were lower.<sup>56</sup> They considered that the key characteristics underlying low barriers to entry were lower fixed costs for non-traditional providers (ie non-vertically-integrated suppliers) than traditional caterers; low investment costs resulting from the ability to outsource elements of the service and the use of hub-and-spoke<sup>57</sup> models; low regulatory requirements; a short set-up period; and the ease of knowledge transfer due to TUPE regulations.
- 7.11 The main parties argued that due to the dynamic nature of the in-flight catering market, there was a high likelihood that players already operating in the UK market would expand their operations to the airline segments where they were currently less active.<sup>58</sup> In addition, new entry could occur through non-traditional catering suppliers partnering with traditional caterers or in cooperation with other non-traditional suppliers.<sup>59</sup> This meant that there were a number of viable entry models a potential entrant could adopt as set out in Table 7 below. The main parties considered that the ability of an entrant to use central sourcing could provide an opportunity for an in-flight caterer to service multiple airports across the UK allowing it to bid for contracts at airports where it was not currently active, either by trucking food from one airport to another<sup>60</sup> or through a hub-and-spoke model for multi-airport contracts.<sup>61</sup>

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<sup>52</sup> LSG acquired the operational assets of Abela Catering after Abela Catering decided to close its UK operations and the shares of Citynet Catering following a joint venture.

<sup>53</sup> RIS (based at Edinburgh), Airport Logistics (based at Heathrow) and FFL (based at Gatwick).

<sup>54</sup> The Guidelines, paragraph 5.8.3.

<sup>55</sup> As demonstrated by new entrants such as DO & CO, Newrest, DHL (Northern Foods).

<sup>56</sup> As demonstrated by: [X] offering to open up a facility for [X] using premises currently held by its subsidiary [X] bidding for [X] in Birmingham and Manchester and the hub-and-spoke model used by Commissaire and Newrest (Edinburgh and Glasgow); and [X] bidding for [X].

<sup>57</sup> Trucking of catering from a central production site (the 'hub') to individual airports (the 'spokes').

<sup>58</sup> The main parties considered that the most likely to target significantly larger presences in the UK were the large global in-flight caterers: Servair, SATS, Newrest, and Chelsea Food Services, as well as Tourvest (recently commenced contracts to supply duty-free products to BA and VAA at Heathrow and Gatwick).

<sup>59</sup> The main parties considered that potential new entrants included: Logistics (Food Distribution) companies, [X]; Logistics (Last Mile) suppliers, [X]; Branded Food Suppliers, [X]; local restaurants; and contract caterers, [X].

<sup>60</sup> [X]

<sup>61</sup> Commissaire uses a single distribution centre in the Midlands for Flybe.

TABLE 7 Main parties' views of potential entry models

<i>Entry model</i>	<i>Example</i>
Network management: 100% outsourced	Actual RiM*
Outsource food and assembly: own last mile	Derichebourg†
Outsource food: own assembly and last mile	DHL‡
Own food: outsource assembly/cross-dock and last mile	Northern Foods†§
Full ownership—no outsourcing (traditional caterer)	DO & CO

Source: Main parties.

\*RiM provides network management for Ryanair (Ireland).

†Derichebourg provides last mile service for Commissaire (Flybe).

‡DHL provides assembly and last mile to Ryanair (RiM) in the Republic of Ireland and BA short-haul (Northern Foods supplies the food).

§Northern Foods supplies the food for DHL's contract with BA.

7.12 The majority of third parties considered that barriers to entry were high specifically in relation to the lead time and capital cost required to set up and the risk to the airline of changing suppliers. One party told us that there were low barriers to entry for established overseas in-flight caterers due to their market knowledge, expertise, equipment and reputation. However, it believed that new entrants may experience greater difficulties and that their success would depend upon a number of factors, including their reputation in other fields, resources and whether they entered with an already committed client base. No respondent considered that there were any barriers to exit.

7.13 A number of third parties (Gate Gourmet, BA<sup>62</sup> and bmi) considered that entry could occur from non-traditional catering suppliers. However, no third party was aware of any companies actually preparing to enter the UK market and they considered that if entry was going to occur it would not be within the next 12 months. Third parties considered that entry in the Regions was more likely to occur through expansion by a current UK in-flight provider rather than new entry. This entry was most likely to occur at Manchester as a consequence of the number of long-haul flights at the airport.

### *Conclusion as to entry and expansion*

7.14 We were told that it was highly unlikely that any entity would enter the market speculatively without either a contract or a very strong indication that it would be awarded one if it entered, and we saw no evidence that speculative entry had occurred in the past in the UK. Therefore we considered that entry would only occur as a result of the awarding of a contract.<sup>63</sup>

7.15 We considered that the extent of the barriers to entry and expansion were dependent on both the capital cost of start-up and an airline's risk of changing supply to a new entrant. We found that:

(a) Capital costs were scalable and were dependent on an entrant's chosen operating model, ie the more disintermediated the entry model the lower the capital cost.

(b) An airline's risk associated with changing supplier to a new entrant was a function of the complexity of its requirements (principally, in relation to catering

<sup>62</sup> BA told us that for short-haul, entry was possible from either logistics or supermarket companies with expertise in food supply chains. In addition, a business with existing expertise in high-volume catering and distribution (such as a large hotel chain) could potentially set up a long-haul kitchen.

<sup>63</sup> Examples include [3] and [3].



management and logistics services) and therefore the skill set required of that entrant—ie the more complex the requirement, the higher the risk and therefore the higher the barrier to entry. We set out in Section 2 that it is more complex to: supply long-haul than short-haul (see paragraphs 2.6 to 2.8); and to supply at Heathrow than in the Regions (see paragraphs 2.10 to 2.13).

### *Entry*

- 7.16 We considered that neither capital cost nor an airline's risk of changing supplier were insurmountable barriers to entry. However, we considered that of the two, it was easier for an entrant to overcome the barrier related to capital costs as a result of the different entry models available to it, than to overcome an airline's view of risk. In relation to risk, we considered that an entrant needed to demonstrate either that it had all the necessary catering and management and logistics skills in-house or that it was able, as a lead contractor, to control and coordinate all the different aspects of the in-flight catering services supply chain.
- 7.17 We considered that established overseas in-flight caterers would have the necessary skill sets to reduce an airline's risk of changing supply to them on entry. We noted that this type of entry had occurred in the UK, ie Newrest entered at London City. However, we did not see any evidence that an established overseas in-flight caterer was looking to enter the UK in the foreseeable future either at Heathrow or in the Regions. In fact, one potential entrant ([redacted]) told us that it was not going to enter the UK in the foreseeable future. Based on our analysis, we have also not seen any evidence that there are potential entrants, which are currently not in-flight caterers, which have all the necessary skill sets in-house. Therefore, we considered this type of entry to be unlikely.
- 7.18 We noted that there had been entry at Heathrow in the last ten years by companies which were either in-flight catering suppliers which moved into catering management and logistics services (DO & CO and Plane Catering); or logistics suppliers adopting a disintermediated model (DHL). We also saw evidence of de novo entry in relation to BOB (Commissaire for Flybe) in the Regions. This demonstrates that if an airline is willing to take on the additional risk, entry is possible. We consider this issue in more detail in Section 8 in relation to Heathrow and the Regions and long-haul/short-haul entry.

### *Expansion*

- 7.19 We considered that the capital cost of expansion was likely to be no higher than the cost of entry as an in-flight caterer may be able to take advantage of economies of scale. We also considered that the risk of an airline using an operator which was currently supplying the same or similar services elsewhere in the UK was lower than with a new entrant. We have noted that the risk of switching for an airline was in part dependent on the complexity of their operations. Therefore, the risk for an airline of using an in-flight caterer at Heathrow which was currently supplying similar services in the Regions will, in all likelihood, be higher than the risk for an airline using an in-flight caterer in the Regions which was currently supplying similar services at Heathrow.
- 7.20 In the Regions we saw evidence of current expansion in the form of Gate Gourmet's planned facility in Manchester as well as planned expansion which would have occurred if specific contracts had been won ([redacted]). As such, we considered that expansion was likely in the Regions. We considered that the type of expansion (trucking, hub-and-spoke or new facilities at the airline's airport of operation) would



be dependent on the size and nature of the specific contract. We discuss in more detail the likelihood and the sufficiency of such expansion in Section 8.

- 7.21 In contrast, at Heathrow we have not seen any evidence of past expansion by an in-flight caterer currently operating elsewhere in the UK; nor did we receive evidence that any such caterer was looking to enter Heathrow in the foreseeable future.

### ***Pre-merger buyer power***

- 7.22 In this section, we consider whether airlines may hold a degree of buyer power pre-merger. We consider the extent of any post-merger buyer power in Section 8.
- 7.23 Countervailing buyer power denotes the extent to which customers may directly constrain the competitive conduct of an undertaking. In particular, countervailing buyer power may give an airline the negotiating strength to limit the ability of the merged entity to raise prices or more generally mitigate the unilateral effects of the merger. As a result, the existence of countervailing buyer power to a sufficient degree may be a factor, possibly in combination with other considerations, in mitigating any SLC. However, for countervailing buyer power to mitigate any SLC, it is not sufficient that it merely exists before the merger—it must also remain effective following the merger.
- 7.24 As set out in [Section 5.9](#) of the Guidelines, countervailing buyer power is likely to be present where customers can easily switch their demand away from the supplier, or where customers can otherwise constrain the behaviour of the supplier. The most obvious means by which airlines might be able to constrain suppliers is through actual switching, or the threat of switching to a credible alternative supplier. This means that arguments relating to countervailing buyer power are closely linked to those relating to entry and expansion of existing competitors; in particular, where such entry or expansion is induced by the merger.
- 7.25 In some cases, countervailing buyer power held by some customers may be relied upon to protect all customers in the market from price increases. However, where individual negotiations are prevalent, as is the case in in-flight catering, the buyer power possessed by any one customer will not typically protect other customers from any adverse effect that might arise from the merger.
- 7.26 We consider buyer power further in relation to individual segments of customer demand in Section 8.
- 7.27 As a preliminary observation, the disintermediation of the in-flight catering supply chain (see Section 2), use of nominated supply by airlines and a shift by some airlines and caterers towards ‘open book’ costing models have allowed airlines to have greater control over, and visibility of, their catering costs. Against a general trend towards greater control over catering costs, we consider below strategies by which airlines may be able to exercise buyer power.

### ***Main parties’ views***

- 7.28 The main parties told us<sup>64</sup> that airlines exercised significant buyer power in relation to in-flight catering suppliers.<sup>65</sup> This occurred both during bidding for, and subsequent negotiation of, contracts, as well as during the contract term.

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<sup>64</sup> RBB Airline Buyer Power submission: [www.competition-commission.org.uk/our-work/alpha-flight-lsg-lufthansa/evidence/further-submissions](http://www.competition-commission.org.uk/our-work/alpha-flight-lsg-lufthansa/evidence/further-submissions).

7.29 The main parties told us that airlines had a number of strategies that were (and would continue to be) used to extract the best terms from in-flight catering services suppliers. These strategies included:

- (a) switching to other existing suppliers;
- (b) switching to 'non-traditional' suppliers;
- (c) leveraging their buyer power across multiple airports;
- (d) [REDACTED];
- (e) shifting to back-catering; and
- (f) sponsoring new entry or expansion.

### *Switching*

7.30 We note that a small number of airlines are important to the merging parties in terms of their contribution to the merging parties' revenues (see Tables 2 and 4 above which list the principal contracts of LSG and Alpha respectively). These airlines are large buyers of in-flight catering services. They are either global flag carriers such as BA or American Airlines or major low-cost carriers or charter/leisure airlines such as Thomson or Ryanair. To the extent that these airlines may switch or threaten to switch their business to rivals, these airlines may have a degree of buyer power (subject to there being rivals to which they may switch supply).<sup>66</sup>

7.31 We undertook a switching analysis by looking at switching between in-flight caterers, including the three largest vertically-integrated in-flight caterers (ie Alpha, LSG and Gate Gourmet): see Appendix F. Our analysis suggested that switching between providers was quite rare, but that it does occur. However, we noted that the frequency of actual switching was not the sole indicator of the effectiveness of switching as a competitive constraint. Tender processes which do not result in a change of supplier, or even the *threat* of undergoing a tender process, may nonetheless exercise a significant constraint.

7.32 In summary, we found that switching was possible in in-flight catering, and any switching costs present were not so high as to impede switching where this was commercially attractive.

### *Contract terms*

7.33 We found that there was some evidence from contract terms which suggested that certain airlines may possess a degree of buyer power pre-merger. The evidence can be divided into two broad groups:

- (a) a unilateral ability on the part of airlines to impose changes in service levels, product specification or product sourcing; and

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<sup>65</sup> This includes favourable contractual terms for airlines, including: [REDACTED].

<sup>66</sup> Although smaller airline customers may be less economically significant to the merging parties, smaller airlines may have a greater range of supply options than larger airlines as: (a) any supply-side capacity constraints may be smaller than for larger airlines; and (b) risks of switching supply may be less for smaller airlines than for larger airlines.

(b) open-book pricing, a requirement to share efficiency savings and/or an inability to pass through cost increases.

- 7.34 Airlines may be able to exercise a constraint on catering suppliers if they are able to change the terms of supply and/or terminate their contracts with little or no consultation with their catering supplier. Airlines may be able to use contractual provisions to resist price rises, either by threatening to terminate the contract and/or by changing the overall value proposition for the caterer by imposing changes to service levels, the product specification or product sourcing (eg using more nominated supply: see paragraphs 7.39 to 7.43).<sup>67</sup>
- 7.35 Contract data from airlines showed that some airlines in the past have instigated changes to contract terms following the signing of the contract.<sup>68</sup> We also noted that a number of contracts currently in place were costed on an 'open-book' basis,<sup>69</sup> whereby input costs were passed straight through to the airline.
- 7.36 Whilst each supply contract will be different, we found that the contractual terms of some in-flight catering supply contracts allow airlines to switch provider and may also allow airlines to change the terms of supply in such a way as to reduce the overall value proposition to the in-flight caterer.
- 7.37 In conclusion, though the evidence may be impressionistic, the contract information we reviewed tended to suggest that the balance of power rested with airlines, rather than in-flight caterers. This view was confirmed by some third party in-flight caterers, eg Gate Gourmet.<sup>70</sup>

#### *Airlines' ability to backward integrate*

- 7.38 We found that, whilst airlines may, in theory, be able to backward integrate (ie set up their own catering facilities)<sup>71</sup>, the trend in the industry has been to outsource the provision of in-flight catering services to external suppliers and we received no evidence from airlines to suggest that they would consider backward integration.

#### *Nominated supply*

- 7.39 Nominated supply is an aspect of disintermediation, as it takes value in the supply chain away from vertically-integrated in-flight caterers. The precise mechanics of nominated supply can vary (eg the airline can contract directly with the nominated supplier, or the airline can specify which products the in-flight caterers needs to procure), but each form of nominated supply gives more control to the airline.
- 7.40 [X] The parties told us that [X] per cent of their variable costs (excluding bonded sales (ie tobacco and alcohol) which were nearly always nominated) were accounted for by cost of sales (food costs and materials); and that in the context of their respective businesses, levels of nomination of food purchases by airline customers

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<sup>67</sup> As examples of airlines exercising buyer power, [X]. Alpha told us that [X] had previously used the process of considering contract extensions to attempt to extract better deals from its suppliers; and that [X] had made changes to its contract with Alpha in the form of an extension of contract term and amendment to commercial terms.

<sup>68</sup> For example, Delta instigated improvements to the terms of its contracts with [X] and [X].

<sup>69</sup> For example, the BA short-haul contract with DHL, and Plane Catering's contracts with long-haul carriers at Heathrow are currently costed on an open-book basis.

<sup>70</sup> Gate Gourmet told us that the terms of contracts were biased towards airlines, in that: some contracts factored in expected efficiency gains by Gate Gourmet but did not allow, in full or in part, for inflation; some contracts contained penalties for delays but no corresponding rewards for outperformance; some contracts contained benchmarking clauses; and some contracts factored in pass-through of efficiencies.

<sup>71</sup> The parties told us that [X] provided some of its own catering, while [X] had its own food production division [X].

had reached between [X] and [X] per cent. A large part of an airline's nominated supply may involve the use of frozen meals procured from specialist airline frozen food manufacturers such as Frankenberg or Marfo (see paragraph 2.33).

- 7.41 The main parties told us that nominated supply represented an important competitive constraint on in-flight catering service providers, and one that operated in addition to the competition for contracts between providers themselves. The parties told us that, in particular, [X]. The main parties told us that nominated suppliers effectively acted as competitors within a particular contract, [X].<sup>72</sup>
- 7.42 We spoke to a number of airlines about nominated supply arrangements. Some airlines look to avoid nominated supply.<sup>73</sup> Other airlines nominate a significant proportion of their supply.<sup>74</sup>
- 7.43 On the other hand, although a few airlines use nominated supply for the premium cabin (such as [X] (frozen meals) and [X] a restaurant [X]), it appears that airlines have a preference for their premium cabin food to be freshly prepared, whether by a vertically-integrated catering supplier's own kitchen or through outsourcing to a company with expertise in airline catering, such as DSI.
- 7.44 Overall, it appeared to us that nominated supply was an aspect of buyer power which, to a certain extent, could be used as a negotiating tool by airlines. However, the ability of airlines to use nominated supply as a negotiating tool will depend on a number of factors including (i) whether the airline has already nominated a high proportion of its in-flight catering (and so there is little scope to increase nomination), and (ii) whether the airline wishes to nominate some of its in-flight catering or prefers to leave the management of its catering provision to its in-flight catering supplier (as nominating supply is not without some cost and complexity to the airline). Further, we noted that nominated supply would not be available generally as a negotiating tool for the provision of catering management and logistics services. We therefore considered that the scope of nominated supply as a potential constraint on in-flight caterers was limited, whether or not the merger goes ahead.

### *Back-catering*

- 7.45 The main parties told us that the threat of back-catering (ie loading sufficient catering at an airport so that no catering has to be loaded for the return leg) is an expression of the airlines' buyer power, which airlines can use to drive down prices.<sup>75</sup>

### *Short-haul*

- 7.46 We were told by airlines that the decision to back-cater rested on strategic and cost saving factors, and was undertaken from the airline's home base or hub. We were told that back-catering was generally economical where the amount of catering uplifted and carried on the plane was not too large, such that the savings in handling costs which the airline made through back-catering outweighed the extra costs

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<sup>72</sup> RBB Nominated Supply submission: [www.competition-commission.org.uk/our-work/alpha-flight-lsg-lufthansa/evidence/further-submissions](http://www.competition-commission.org.uk/our-work/alpha-flight-lsg-lufthansa/evidence/further-submissions).

<sup>73</sup> For example, VAA stated that its preference was not to nominate supply, because then the airline assumed ownership of the relationship with the nominated supplier, which might include food hygiene management and commercial management of the supplier, which the airline did not wish to, [X], do.

<sup>74</sup> For example: Ryanair nominates 100 per cent of its supply, Air Canada nominates a significant proportion (around 80–90 per cent) of its economy seats, and [X].

<sup>75</sup> We note that there may be limited opportunities for back-catering available to airlines where they fly from the UK via another airport. For example, Singapore Airlines flies from Manchester via Munich, and uplifts its catering at Munich Airport. In Singapore's case, this is done mainly for operational reasons.

incurred in carrying extra weight on the plane. This tended to be the case for short-haul catering, where the food offering is simpler or BOB only, and trips and turn-around times are shorter.

#### *Long-haul*

- 7.47 In the case of long-haul catering, the CC was told that back-catering was generally uneconomical, and was only undertaken rarely.<sup>76</sup> For example, VAA told us that it only back-catered its (long-haul) flights in extreme cases, such as flights to Havana, where it struggled to find a caterer [X]. BA told us that long-haul flights were back-catered only where there were security considerations (eg Africa) or on an ad-hoc basis (eg where there were individual incidents where food safety could not be guaranteed). [X]
- 7.48 Overall, whilst we accept that the prevalence of back-catering on short-haul flights over recent years is an indicator that airlines may have countervailing power, we found that back-catering, or the threat of back-catering, was not expected to influence competitive outcomes for short-haul carriers. We found that back-catering from outside the UK was unlikely to be a credible option for long-haul airlines due to quality and safety considerations.

#### *Leveraging relationships in other markets*

- 7.49 Customers might be able to constrain any price increases in the UK (or at particular airports within the UK) if they could credibly threaten punishment in other markets, eg by reducing purchases from the merging parties in another country, or at another airport in the UK.

#### *Leveraging requirements across UK airports*

- 7.50 We were told that low-cost and charter/leisure carriers with a network of airports aggregate the UK airports in their in-flight catering contracts. For example, [X], [X], and [X]. This means that the low-cost and charter/leisure carriers' contracts are relatively valuable, and therefore important to in-flight caterers. This may give these airlines a degree of buyer power, as (a) more caterers are likely to bid for these contracts (than for smaller contracts) and (b) the caterers are likely to work hard to keep these contracts once they have been won. There is some evidence of this. For example, LSG told us that it had offered [X] conceptual, innovative solutions [X] as well as financial incentives that included [X] in return for a contract extension with [X].
- 7.51 We found that the ability of airlines to leverage their catering requirements across a network of Regional airports was a lever which was used to improve those airlines' negotiating position. We considered that airlines could also use catering requirements at Heathrow to improve their negotiating position at Regional airports.

#### *Leveraging requirements across international airports*

- 7.52 We noted that, in some cases, airlines purchase in-flight catering from the same caterer in several countries. For example, the [X] contract with LSG covers airports in [X], while [X] is supplied by LSG and Gate Gourmet at a number of locations

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<sup>76</sup> Alpha told us that [X] back-catered from [X] and that [X] and [X] back-catered on some long-haul charter flights.

worldwide. Where this is the case, the airline may be able to exert buyer power at one airport, by threatening to switch supplier at another airport, which would entail a loss of volume for the caterer. [§] Globally, this approach is more likely to be possible in relation to LSG and Gate Gourmet, which are global caterers, than with Alpha, which has scattered operations across the world.<sup>77</sup> This leveraging tool is likely to remain post-merger in relation to the merged entity and Gate Gourmet. In this regard, we also noted that certain in-flight catering contracts may contain volume clauses which are designed to encourage airlines to stay with one caterer globally.

- 7.53 In response to our provisional findings the main parties told us that the use of international leverage was an important bargaining tool in much the same way as UK-based airlines rely on leverage across UK airports to obtain more favourable outcomes. The main parties pointed to a current tender for [§] as evidence to support their point. Whilst for this airline the tender may be the beginning of a process of consolidating supply arrangements at each airport location where it is present, the evidence we saw suggested that, as a whole, most airlines, including larger international airlines, tend to negotiate contracts on an airport-by-airport basis or on a national basis, rather than internationally. As such, we found that the ability of airlines to leverage their catering requirements at overseas airports so as to improve their negotiating position in the UK was a lever open to airlines in negotiating their UK in-flight catering arrangements but that it was unlikely to be a significant lever.

### *Conclusion as to pre-merger buyer power*

- 7.54 Based on the analysis above, we concluded that some airlines have a degree of pre-merger buyer power. In addition, because of the value of their business to in-flight caterers, large long-haul airlines and major low-cost carriers and charter/leisure airlines may have a significant degree of pre-merger buyer power. We did not, however, expect any buyer power held by individual airlines to extend to protect all airlines (for the reasons given in paragraph 7.25).

## **8. Competitive assessment**

- 8.1 In our issues statement we identified a number of possible ways in which the proposed merger could give rise to an SLC, but said that we would focus our analysis on whether the proposed merger could give rise to an SLC as a result of unilateral horizontal effects—ie that the proposed merger, by eliminating Alpha and LSG as independent competitors, may give rise to higher prices and/or lower service quality in the supply of in-flight catering services. We have assessed the proposed merger in this way. Neither customers (airlines) nor competitors (in-flight caterers) have raised any substantial concerns about the merger giving rise to a possible SLC as a result of vertical<sup>78</sup> or coordinated effects, and we have not seen any evidence to show the contrary. Therefore, we do not assess vertical or coordinated effects below.
- 8.2 The parties told us that, post-merger, the merged entity would continue to face credible competition in the UK from Gate Gourmet, DHL, Commissaire, Newrest, DO & CO and Plane Catering, at the very least. It would also continue to face competitive threats from food manufacturers and logistics suppliers, which can fulfil individual components of the airlines' in-flight catering services requirements. In addition, the parties told us that, whilst their case did not rely on greenfield entry into the UK to

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<sup>77</sup> As an example, if an airline was trying to use New York as leverage in its negotiations at a UK airport, this would only be possible if the airline was negotiating with LSG or Gate Gourmet. As Alpha does not operate in New York, the airline would not be able to threaten to switch away from Alpha in New York in order to obtain a better price in the UK.

<sup>78</sup> One in-flight caterer [§].

demonstrate the absence of an SLC, post-merger there would be a credible potential threat of further expansion or entry, facilitated by the disintermediation of the in-flight catering supply chain.

- 8.3 As noted in Section 6, we found that the market for the supply of in-flight catering services was an appropriate relevant market within which to assess the effects of the merger; and that it was appropriate to consider the merger separately in respect of segments of customer demand (a) at Heathrow and Regional airports respectively and (b) taking into account the distinction between short-haul and long-haul catering. We assess the effects of the merger by considering whether the proposed merger may give rise to an SLC in relation to the supply of in-flight catering services. As described in paragraph 2.15 above, the supply of in-flight catering services comprises (a) the provision of catering; and (b) the provision of catering management and logistics services.<sup>79</sup>
- 8.4 We noted that the catering requirements of airlines vary significantly, depending, inter alia, on the airport, or range of airports, where they are present, the number of long-haul and/or short-haul flights they operate from each airport, the image and overall positioning of each airline in the downstream market for air passenger transportation as well as past experience and existing contractual relations with in-flight catering suppliers. We acknowledge that different airlines may be affected in a variety of ways or to a different degree by the proposed merger depending on their individual requirements and characteristics. It has not been possible to evaluate or to weight the competitive effects of the merger in relation to every individual customer. Accordingly, we have categorized airlines into separate segments of customer demand on the basis of common factors affecting demand or supply conditions, including the bargaining power of airlines relative to in-flight catering suppliers. We recognize that the boundaries separating each segment are not perfectly delineated and that competition for customers across the various segments may be interrelated. Thus, where appropriate we have considered how competitive conditions vis-à-vis one segment of customer demand may affect other segments.<sup>80</sup> We also note that an individual airline, such as BA, may be included in more than one segment.

### *Heathrow Airport*

- 8.5 Given the mix of airlines using Heathrow and their particular catering requirements, there appear to be broadly four main customer segments:
- (a) *Heathrow BA*, which we regarded as operating in a different competitive environment from other customers due to the sheer size of its operations in the UK and its willingness to enter into long-term contractual arrangements for the supply of in-flight catering services.
  - (b) *Heathrow short-haul airlines*, which in the main have fairly simple catering needs, in that they often do not serve hot meals to any passengers. These airlines include, for example (among other airlines): Aer Lingus, Air France/KLM, bmi, Blue1, Cyprus Airways, Finnair, Lufthansa, SAS and Turkish Airlines. Most short-haul flights from outside the UK are back-catered from their home hub, and therefore may not uplift any catering in the UK.

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<sup>79</sup> We set out below how the provision of catering may be a particular concern to some smaller long-haul airlines (see paragraph 8.81) and how the provision of catering management and logistics services may be a particular concern for long-haul airlines with a high volume of demand (see paragraph 8.26).

<sup>80</sup> For example, the success of DHL in acquiring the BA contract for supply of short-haul flights, teaming up with DO & CO and Northern Foods, informs the assessment of the competitive pressure that DHL may exert in bidding negotiations to supply other 'larger' long-haul airlines at Heathrow.

(c) *Heathrow long-haul airlines with five or more daily departures*<sup>81</sup> (see paragraph 8.6) from Heathrow. We refer to these airlines as ‘larger’ long-haul airlines at Heathrow, which are currently: Air Canada, American Airlines, bmi, Delta, United Continental and VAA.<sup>82</sup> We note that all of these airlines are sizeable international airlines which, in light of their high-volume demand, may have the ability and incentive to exert a degree of countervailing buyer power vis-à-vis the merged firm (we consider issues around possible countervailing buyer power in more detail below).

(d) *Heathrow long-haul airlines with fewer than five daily departures* from Heathrow. We refer to these airlines as ‘smaller’ long-haul airlines at Heathrow, which include (among other airlines): Air New Zealand, Arik Air, Etihad, Qantas, Qatar and Singapore Airlines. Some of the airlines within this category are also sizeable international airlines which might have a degree of countervailing buyer power vis-à-vis the merged company.

8.6 We have based the distinction between smaller and larger long-haul airlines on the following factors:

(a) For ‘smaller’ long-haul airlines from Heathrow (see paragraph 8.5(d)), there appears to be a wider range of in-flight catering suppliers (see paragraph 8.89); long-haul airlines with a higher level of demand have previously been supplied only by Alpha, LSG and Gate Gourmet<sup>83</sup> (see paragraph 8.28).

(b) Most of the ‘larger’ Heathrow airlines (see paragraph 8.5(c)) are major transatlantic airlines which use nominated supply, at least for the economy cabin.

(c) The complexity of catering management and logistics services increases with the volume of flights. This appears to be a function of a number of factors including the impact on airlines with busy flight schedules of unexpected delays, a common occurrence at major airports, especially at highly congested airports such as Heathrow.

(d) It appears to be the case that current suppliers of in-flight catering at Heathrow are likely to have sufficient capacity within their existing facilities to cater airlines with fewer than five daily departures without material new investment.

8.7 In line with the reasoning in paragraph 8.4, in making this distinction, we recognize that the split between ‘larger’ and ‘smaller’ long-haul airlines at Heathrow is not a clear-cut one, as even among long-haul airlines variations between airlines mean that the type of catering service they require can differ in ways that affect relative bargaining power in the context of bidding negotiations. For instance, Emirates, which, at Heathrow, is supplied by DO & CO had an average of just under five long-haul daily departures from Heathrow in 2011.<sup>84</sup>

8.8 In response to our provisional findings the main parties told us that Emirates is one of the largest long-haul carriers operating at Heathrow and that we should consider DO & CO as an important and effective competitor for all long-haul airlines operating from Heathrow. We discuss below how DO & CO has a different supply proposition to other suppliers at Heathrow and assess the competitive constraint DO & CO

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<sup>81</sup> Based on CAA data (2011). We have used CAA data to establish the number of daily departures of individual airlines. We noted that this data may not be directly comparable to data provided by the in-flight caterers.

<sup>82</sup> For the reasons given above, we regarded BA as operating in a different competitive environment.

<sup>83</sup> Air Canada was supplied by Airfayre prior to Alpha’s acquisition of Airfayre.

<sup>84</sup> Source: CAA.



exerts over other suppliers in the 'larger' Heathrow segment (see paragraphs 8.60 and 8.61). We considered that the distinction between smaller and larger long-haul airlines was a useful one for the purposes of our analysis as only suppliers with high capacity as well as sufficient expertise and reliability may be able to supply long-haul airlines with high-volume demand. We considered that the decision of whether or not to include Emirates within the larger long-haul airlines at Heathrow segment would not affect our substantive decision on the reference questions, and so, for the purposes of our analysis, we considered Emirates' requirements at Heathrow within the context of our analysis of the 'smaller' Heathrow segment (see paragraphs 8.76 to 8.91).

### *Regional airports*

8.9 Given the mix of airlines flying out of Regional airports and their particular catering requirements, there appear to be broadly three main customer segments:

- (a) *Regional low-cost/charter/leisure airlines*, which operate from several Regional airports and require a 'network' catering solution across all their airports. These airlines include easyJet, Flybe, Monarch, Ryanair, Thomson and Thomas Cook, which fly predominantly short-haul, but may also have some long-haul requirements. Accordingly, although high-volume customers, at least for short-haul, the catering provision tends to be low complexity as it consists of mainly ambient snacks or reheated light meals. In this report we refer to these airlines as 'Regional network' airlines as they require a network catering solution.
- (b) *Regional short-haul airlines*, which operate from one or more Regional airports, but are not Regional network airlines and so have much lower volumes of in-flight catering. As with the Regional network airlines, the catering provision tends to be low complexity. For flights originating outside the UK, these airlines nearly all back-cater. Regional short-haul airlines include (among other airlines): Aer Lingus, BA, BA CityFlyer, bmi, bmibaby, City Jet, Cyprus Turkish, Eastern Airways, Jet2, SAS, SATA, Swiss and Turkish Airlines.
- (c) *Regional long-haul airlines*. These are long-haul airlines which operate from one or more Regional airports, as well as, in most cases, from Heathrow which include (among other airlines): Air Transat, BA, Emirates, Pakistan International Airlines, Turkmenistan, United Continental and VAA—see Table 9 below). Regional long-haul airlines require hot food on their flights but at lower volumes than at Heathrow due to lower flight frequencies at the Regional airports. Some of the airlines within this category are also sizeable airlines which might have a degree of countervailing buyer power vis-à-vis the merged firm, mainly arising from the fact that they purchase in-flight catering services at Heathrow alongside Regional airports.

8.10 For each segment of customers, we assess the likely conditions of competition in the absence of the merger and evaluate whether and to what extent, relative to the counterfactual analysis, the merger has a substantial detrimental effect on the expected rivalry between in-flight caterers. Where appropriate, we also consider to what extent competing suppliers and airline customers have the ability and incentives to, respectively, modify their services and requirements, and adapt to the likely conditions of competition post-merger, thereby offsetting any possible lessening of competition resulting from the proposed merger so as to maintain pre-merger competitive outcomes.

## **Heathrow BA**

- 8.11 BA is supplied by Gate Gourmet and DHL at Heathrow. BA has [X] contracts at Heathrow,<sup>85</sup> worth around £[X] million in 2010/11. Gate Gourmet holds [X] contracts worth £[X] million covering supply to BA long-haul flights; and DHL holds [X] contracts worth £[X] million covering supply to BA short-haul flights in conjunction with catering suppliers Northern Foods (economy cabin) and DO & CO (hot meals for the premium/business class passengers). DHL won its Heathrow BA contract from Gate Gourmet, which supplied both short- and long-haul BA flights prior to 2009. (See also Appendix F, Table 3.)
- 8.12 Due to its scale of operation at Heathrow Airport, BA has a different choice of caterers from other airlines. First, BA flies both short-haul and long-haul flights from its hub at Heathrow, with around 385 flights per day. This means that it has significant catering needs, and many more companies bid for the contracts with BA than bid for contracts with other airlines. BA told us that in the most recent contract round, 14 companies (two of which have since affiliated with other bidders) bid for its contracts, of which five to six were existing Heathrow providers. Second, BA as a hub operator is able to sponsor entry, either by funding the investment in assets specific to the supply relationship or by sharing in the risks.<sup>86</sup> Third, we noted that BA has been willing to enter into long-term contractual arrangements for its in-flight catering services supply arrangements, which means that potential entrants are more likely to be attracted to bid for BA's contract than contracts of other airlines as the new entrant may be more likely to recover its entry cost during the length of the contract: ie BA acts in effect as an 'anchor client' for a new facility, and/or a new entrant.<sup>87</sup> Fourth, BA told us that it did not have any concerns with the merger between Alpha and LSG at Heathrow.

### ***Conclusion in relation to BA at Heathrow***

- 8.13 We found that the proposed merger was unlikely to give rise to an SLC in relation to this segment as (a) BA's existing supply arrangements at Heathrow will be unaffected and (b) there will be a large number of credible and competitive bidders in any future contract rounds, with the ability and incentive to bid to supply BA at Heathrow, regardless of the merger.

## **Heathrow short-haul**

- 8.14 The Heathrow short-haul (ie flights under 5 hours) segment covers [X] contracts worth over £[X] million in 2010/11. The relatively low value of the short-haul market (compared with the value of long-haul catering contracts) is a function of the low per unit value of the catering, and of the small number of short-haul flights taking on catering in the UK (due to the fact that most short-haul airlines back-cater flights from outside the UK). Of the airlines which fall into this segment, only bmi is based in the UK and therefore has higher catering requirements from Heathrow than the European airlines which predominantly back-cater from their home hubs.<sup>88</sup>

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<sup>85</sup> By 'contracts', we mean the primary relationship an airline has with its supplier of catering management and logistics services. The supplier of catering management and logistics services may, in turn, be supplied by external catering suppliers.

<sup>86</sup> [X]

<sup>87</sup> BA told us that the costs of setting up an operation large enough to serve BA would be in the region of £20–£25 million. We note that by facilitating entry, BA creates external benefits for other airlines, which may be able to benefit from the presence of the new entrant in their own tendering process.

<sup>88</sup> We noted that bmi may be sold by Lufthansa to International Airlines Group, owner of BA and Iberia. However, for the purposes of this inquiry, we have assumed that bmi will continue to be catered by LSG, its current in-flight caterer.

- 8.15 This means that nearly all short-haul catering is for either bmi, or for small aspects of an overseas airline's total catering needs, such as for a hot breakfast on early morning flights which cannot be back-catered.

#### *Pre- and post-merger rivalry*

- 8.16 The Heathrow short-haul segment is supplied by LSG, Gate Gourmet, DO & CO and Plane Catering. Of the [X] Heathrow short-haul contracts, LSG holds [X] contracts (worth £[X] million), Gate Gourmet holds [X] contracts (worth £[X] million), DO & CO holds [X] contracts ([X]) and Plane Catering holds [X] contracts (worth £[X] million). (See Appendix F, Table 3, for details of the customers supplied by each caterer.) Until recently, Alpha held short-haul contracts at Heathrow and, absent the merger, we would expect Alpha to continue bidding for contracts in this segment. Given this, we considered that at least these five companies can potentially bid for Heathrow short-haul contracts.
- 8.17 Furthermore, the data on current contracts submitted by in-flight caterers shows that there is switching of contracts in this segment, with three Heathrow short-haul contracts switching hands (worth over £[X] million): LSG won [X] current contracts from Alpha worth £[X] million, LSG won [X] current contracts from Gate Gourmet worth £[X] million, and DO & CO won [X] current contracts from Gate Gourmet ([X]). In addition, Plane Catering as a relatively new entrant has won a Heathrow short-haul contract for BA crew meals. (See Appendix F, Table 7, for details of the contracts which have switched between caterers.) As noted in paragraph 8.84, DO & CO and Plane Catering are also active in the Heathrow smaller long-haul segment, which reinforces their general credibility as suppliers. We concluded that all the caterers which bid for Heathrow short-haul contracts are credible options for the airlines, and are therefore able to exert a competitive constraint on each other during the bidding process.
- 8.18 In addition, we note that DHL is present at Heathrow, with some spare capacity. DHL's position as a long-term competitive force at Heathrow is discussed more fully in paragraphs 8.49 to 8.58. In relation to this segment, we noted that DHL told the CC that it was targeting airlines (including short-haul airlines) at Heathrow, and had capacity to take on several short-haul contracts in its existing facility. This is likely to act as a further competitive constraint in the Heathrow short-haul segment.
- 8.19 DO & CO told us that it was positioned as a high-quality caterer. Whilst several airlines we spoke to also described DO & CO as a higher-quality caterer, they regarded it as more expensive than other vertically-integrated in-flight caterers. Accordingly, whilst DO & CO will be a strong rival in the case of contracts with airlines which are seeking a higher-quality service, it may not be able to provide as strong a competitive constraint in the case of short-haul airlines at Heathrow which are seeking lower-cost solutions.

#### *Conclusion in relation to short-haul airlines at Heathrow*

- 8.20 We found that sufficient potential bidders will remain in the market post-merger to ensure an effective and competitive bidding process. This is because, inter alia, DHL has the ability and incentive to accommodate additional customers at Heathrow, and because new entry or expansion to supply airlines in this segment, particularly on a small scale, is not subject to significant barriers to entry. For these reasons, we found that the proposed merger was unlikely to give rise to an SLC in relation to this segment.

- 8.21 Our conclusion did not depend on the existence of countervailing buyer power. However, we noted that a number of the considerations discussed in paragraphs 8.70 to 8.74 below are likely to apply to a number of airlines present in this segment, some of which are sizeable international airlines.

### ***Heathrow larger long-haul***

- 8.22 The Heathrow larger long-haul (ie airlines with five flights per day or more, of duration 5 hours or more) segment covers [REDACTED] contracts worth £[REDACTED] million. Most of the airlines which fall into this segment serve freshly prepared meals to their business and first class passengers, and thus use a hot kitchen. Frozen or chilled foods prepared in locations away from the airport, with final preparation and assembly undertaken by a caterer at its airport base, may be used for the economy cabin. This is particularly the case for transatlantic flights, which form the majority of this segment.
- 8.23 We considered two potential areas of concern in relation to this segment: (a) the post-merger provision of catering (specifically, the availability of hot kitchen facilities); and (b) the post-merger provision of catering management and logistics services. We deal first with hot kitchen facilities; the provision of catering management and logistics services is considered in paragraphs 8.29 to 8.35.

### ***Catering provision***

- 8.24 In some cases, the hot kitchen facility producing fresh meals will belong to the in-flight caterer which provides the overall catering management and logistics services for these airlines. Whilst some of the smaller airlines attach significant value to using the same provider of catering as their provider of catering management and logistics services (see paragraph 8.81), the evidence we reviewed indicated that, in general, the larger airlines are prepared to consider using an alternative hot kitchen provider. In particular:
- (a) Air Canada told us that it had used a disintermediated model in the past (Airfayre). Air Canada said that both models (ie traditional catering and ‘logistics’ solution) could work.
  - (b) American Airlines told us that a disintermediated approach, such as the one offered by DHL, was acceptable to American Airlines.
  - (c) Delta said that it did not currently use the disintermediated model for any of its operations worldwide, but would not dismiss the model when it came to renewing its Heathrow contract, sometime within the next two years. Delta, however, mentioned that a bidder that did not have its own in-house kitchen would need to outsource its food provision to a good and reliable supplier and identify it at the RFP stage. In any event, Delta would have to undertake additional due diligence on the proposed third party caterer in considering such a bid.
  - (d) [REDACTED]
- 8.25 We also noted that:
- (a) DSI, an independent catering provider located close to Heathrow Airport, told us that it operated as a nominated supplier to airlines through [REDACTED]. It told us that it currently produced [REDACTED] meals per day, though, as it was running on roughly [REDACTED]

capacity, it had the potential to take on a number of new orders. We understand that DSI [REDACTED].

- (b) Plane Catering produces and supplies food to Qantas via Alpha, as well as other smaller airlines as an integrated provider of catering and catering management and logistics services.
- (c) The premium cabin of BA's short-haul flights from Heathrow is supplied by DHL using food freshly-prepared by DO & CO at its own kitchen, from which DO & CO also supplies other airlines as an integrated provider of catering and catering management and logistics services.
- (d) VAA's in-flight catering arrangements from June 2012 will utilize an asset-light model of supply. In this regard, we note that Gate Gourmet's supply to VAA will include a mix of on-site and remote provision, with the food preparation undertaken (predominately) remotely, and the logistics done at the airport.

- 8.26 Therefore, we considered that the parties' proposed consolidation of their kitchen facilities was unlikely *by itself* to lead to an expectation of an SLC in this segment, as the larger long-haul airlines will have opportunities, with some 'adaptive behaviour' on the part of airlines, to source hot food from other catering suppliers close to the airport. By 'adaptive behaviour' in this context we have in mind a willingness on the part of airlines to modify their contracting arrangements so that some or possibly all of the catering supply inputs are provided by catering suppliers distinct from the catering management and logistics services supplier, even if the latter is one of the incumbent vertically-integrated suppliers, without any deterioration in quality or pricing.
- 8.27 Accordingly, we focus below on the post-merger availability of suppliers with the necessary catering management and logistics services required to cater to the needs of larger long-haul airlines at Heathrow Airport.

#### *Pre- and post-merger rivalry*

- 8.28 The Heathrow larger long-haul segment is currently supplied by Alpha, LSG and Gate Gourmet. Of the [REDACTED] Heathrow larger long-haul contracts, Alpha holds [REDACTED] contracts (worth £[REDACTED] million), LSG holds [REDACTED] contracts (worth £[REDACTED] million) and Gate Gourmet holds [REDACTED] contracts (worth £[REDACTED] million). (See Appendix F, Table 3, for details of the customers supplied by each caterer.) Immediately after the merger, the merged entity will hold [REDACTED] of the [REDACTED] contracts, and around [80–90] per cent of the value of the segment. However, as noted in paragraph 7.3, past success is only one indicator of a supplier's competitive strength in future bidding negotiations. Moreover, a small number of credible bidders potentially may suffice to maintain the same level of rivalry post-merger as both suppliers and airlines adapt their offerings and requirements, in light of the evolving competitive environment.

#### *Switching*

- 8.29 The data on current contracts submitted by in-flight caterers shows that there is switching of contracts in this segment, with four Heathrow larger long-haul contracts switching hands in the recent past (worth around £[REDACTED] million): Alpha won [REDACTED] current contracts from LSG worth £[REDACTED] million [REDACTED], LSG won [REDACTED] current contracts from Alpha worth £[REDACTED] million [REDACTED] and more recently, Gate Gourmet won [REDACTED]

contracts from LSG worth £[§] million [§].<sup>89</sup> This indicates that larger long-haul airlines have both the ability and incentive to switch in-flight caterers and implies that switching costs are unlikely to provide an incumbent supplier with a significant advantage over other established suppliers at the time of tendering for a new contract. Notwithstanding the evidence on actual switching, we have learned during our inquiry that airlines must consider certain risks when deciding to switch to a different supplier:

- (a) First, in all cases, there is a transition risk, or ‘business continuity’ risk, which is the risk of disruption to an airline following a switch to a new caterer. This risk is present with a switch to any caterer, and is related to the possibility that the incoming caterer may make mistakes in the initial ‘bedding-in’ period. This risk applies irrespective of the identity and experience of the incoming caterer as even the vertically-integrated caterers will carry this risk.<sup>90</sup>
- (b) Second, in relation to new entrants or those suppliers without the relevant (in this case long-haul) experience (such as DHL), there is a risk associated with a lack of experience, particularly for long-haul airlines which have relatively complex requirements and for airlines operating from Heathrow Airport.<sup>91</sup>

- 8.30 These risks appear to be greater for long-haul rather than short-haul services and to increase in relation to the size of an airline’s operations. For example, Gate Gourmet said that ‘transition is more complex as the number of flights increases and therefore airlines can become conscious of disruption [ie transition] risk to their service provision’. Gate Gourmet also said that contract transfers for complex contracts were possible and did happen in practice if there was a six- to eight-month lead time to fit out the required facilities.
- 8.31 VAA told the CC that the complexity and variability of the products loaded on to the plane was higher for long-haul flights than short-haul.
- 8.32 Delta told us that it would have concerns about using a caterer with no experience of long-haul catering, even if that caterer offered a lower price (though it felt that the switching risk of a change of catering suppliers would be far less at Heathrow than at one of its major hubs.) As an example, it had made such a change at Amsterdam (a bigger airport for Delta than Heathrow) with relatively little problem following the switch, and Heathrow would be simpler than that.
- 8.33 Overall, as switching has occurred in the past (see paragraph 8.29), we considered that any transition risk present in switching in-flight catering was not so prohibitively high that larger long-haul airlines were unable to switch to an alternative supplier.
- 8.34 We considered that the risk associated with insufficient experience introduced a certain disincentive for larger long-haul airlines to be the first to switch to a new, unproven entrant. That said, we considered that this risk did not act as an absolute barrier to entry or imply that a new bidder cannot exert a competitive constraint on incumbent rivals. This was because, inter alia:

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<sup>89</sup> Though two out of the three contracts which switched have done so between Alpha and LSG, we consider that actual switching may underestimate the competitive constraint that Gate Gourmet and DHL are able to provide. The mere threat of switching (an example of which is the [§]) can be enough for an airline to obtain a better offering.

<sup>90</sup> The main parties told us that TUPE indemnification to protect against costs and the fact that airlines’ current suppliers have to provide transitional support services are one aspect that leads to low barriers to switching.

<sup>91</sup> This is because Heathrow Airport operates close to its capacity at most times of the day, and catering management and logistics services providers must be able to respond quickly and effectively to unexpected delays arising from airside congestion.

- (a) the new bidder can learn even from unsuccessful bids to modify its offer in future tenders;
  - (b) the new bidder can enhance its credibility and gain experience by successes in other neighbouring customer segments such as Regional long-haul or short-haul at Heathrow Airport, or in markets outside the UK;
  - (c) the new bidder can acquire human capital from rivals or companies in closely related markets that enhance its expertise and credibility;
  - (d) the new bidder can partner with established firms in the context of a disintermediated solution; and
  - (e) in the context of bidding negotiations, airlines can benefit from benchmarking certain components of the new bidder's offer to induce incumbents to improve their bid.
- 8.35 In addition, we noted that the risk associated with lack of experience was relevant primarily for the first airline that shifts to the new entrant. To the extent that the new entrant is successful in bidding for a first contract, it can rely on the experience it will subsequently acquire to mitigate this risk. These considerations apply generally but are relevant in particular in the case of DHL (see paragraphs 8.53 to 8.57). It follows that, to the extent that sufficient alternative credible bidders are present, and that switching is possible (taking all associated risks into consideration), the threat of switching can be used by airlines in bargaining negotiations to maintain rivalry among suppliers and obtain favourable conditions.

#### *Approach to the competitive assessment*

- 8.36 Some larger long-haul airlines expressed concerns with the merger between Alpha and LSG at Heathrow. VAA said that the merger might reduce supply options from four to three, and that it might lead to higher prices, decreased choice and/or a more belligerent supplier attitude. American Airlines said that with the reduction in caterers which were able to handle American Airlines' flights from three to two, it did not think it could extract much competition between a duopoly of just Alpha/LSG and Gate Gourmet at Heathrow Airport because there would not be excess capacity at Heathrow Airport post-merger.
- 8.37 On the other hand, United Continental said that it was not aware of any capacity issues at Heathrow, and considered Heathrow a competitive market for in-flight catering services. Another airline, Delta, said that Gate Gourmet and LSG were formidable competitors with each other in many locations globally, and as long as these two were both at Heathrow it did not see a major risk associated with the merger (even though it recognized that the merger would lead to a reduction of viable competitors post-merger). It thought the biggest risk would be if one of Gate Gourmet or LSG exited the market. Air Canada told us that it did not see it as likely or realistic that it would get to the point of receiving uncompetitive bids at Heathrow following the merger and considered that there would continue to be sufficient competition. It stated that [§<].
- 8.38 In the paragraphs below, we first evaluate the degree of competitive pressure that Alpha would exert on LSG absent the merger, and vice versa. We then assess the relative strength of the competing suppliers to the merged entity, notably Gate Gourmet and DHL. Thereafter we consider merger-induced entry or expansion and countervailing buyer power.

### *Alpha*

- 8.39 Alpha is the largest part (by turnover) of Alpha Flight Group Limited's in-flight catering and non-catering services across 11 countries worldwide. Within the UK, Alpha's Heathrow operation contributes [%] of its overall UK revenue with [%] arising from its Regional network. This is in contrast to LSG and Gate Gourmet, which are present in many more countries across the world, and which have a larger Heathrow presence.
- 8.40 Several airlines in this segment told us that they considered Alpha to be a close competitor to LSG, though perhaps not as close as Gate Gourmet. In particular, [one airline] told us that it considered Alpha to be LSG's second-closest competitor (with Gate Gourmet as LSG's closest competitor); [another airline] told us that it considered Alpha and Gate Gourmet to be LSG's closest competitors; and [an airline] told us that it considered Alpha to be LSG's second-closest competitor (with Gate Gourmet as LSG's closest competitor).
- 8.41 Alpha benefits from the backing of Dnata and the experience it has acquired in dis-intermediation from its acquisition of Airfayre. It has the experience and track record to compete and bid effectively for contracts in this segment. In the absence of the merger, Alpha and LSG are likely to remain close competitors. However, as explained in Section 5, Alpha may need to restructure its operations in the absence of the merger. This introduces a certain degree of uncertainty as regards Alpha's future cost structure relative to potentially more flexible entrants, such as DHL.

### *LSG*

- 8.42 LSG is part of LSG Sky Chefs' worldwide airline catering and related business operations. LSG Sky Chefs' 'mission [is] to serve [its] customers in the biggest hubs in the world'. Heathrow therefore is a core element of LSG Sky Chefs' operations with global strategic significance.
- 8.43 Several airlines told us that they considered LSG to be a close competitor to Alpha, alongside Gate Gourmet. In particular, [one airline] told us that it considered LSG to be Alpha's closest competitor (and Gate Gourmet to be Alpha's second-closest competitor); [another airline] told us that it considered LSG and Gate Gourmet to be Alpha's closest competitors; and [an airline] told us that it considered LSG to be Alpha's second-closest competitor (with Gate Gourmet as Alpha's closest competitor).
- 8.44 Overall, we found that both LSG and Gate Gourmet are able to exercise a strong competitive constraint on Alpha. However, as LSG and Gate Gourmet are more similar in the offering which they are able to offer to customers (in that both are global suppliers), the competitive constraint which each is able to exert on Alpha is likely to be along similar dimensions. On the other hand, other suppliers, such as DHL, may be able to exert a competitive constraint on Alpha along different dimensions, as shown by [%]. This means that, post-merger, we would expect Alpha (as part of the merged firm) to continue to face competitive constraints along several dimensions (from Gate Gourmet on the one hand, and DHL on the other).

### *Gate Gourmet*

- 8.45 Gate Gourmet is a large full-range vertically-integrated provider of in-flight catering services across the world. It recently refurbished its Heathrow West facility to secure



the BA long-haul business and invested in a new facility, Heathrow North, to service its non-BA international customers.

- 8.46 [One airline] told us that it considered Gate Gourmet to be Alpha's second-closest competitor and LSG's closest competitor; [another airline] told us that it considered LSG and Gate Gourmet to be Alpha's closest competitors, and Alpha and Gate Gourmet to be LSG's closest competitors; and [an airline] told us that it considered Gate Gourmet to be both Alpha's and LSG's closest competitor.
- 8.47 Some airlines (eg American Airlines) expressed concern that [REDACTED]. We note that, [REDACTED]. In relation to forthcoming contracts, we note that [REDACTED] contract is expected to be coming up for renewal in the near future, as is [REDACTED] contract. In relation to [REDACTED], Gate Gourmet told us that it [REDACTED].
- 8.48 More generally, Gate Gourmet told us that it would be prepared to make capital investment (ie build new facilities) if it won a larger contract at Heathrow. We would expect any such new investment to be scalable. We also noted that the evidence from a number of airlines indicated they did not have significant concerns with the merger as long as Gate Gourmet remained a competitive constraint post-merger (see paragraph 8.37). On this basis, we find that Gate Gourmet is a competitive constraint in relation to Heathrow larger long-haul airlines, and will continue to be a competitive constraint post-merger.

#### *DHL*

- 8.49 DHL is a recent entrant in the in-flight catering market in the UK. Building on its core strengths in the market for complex and high-scale logistics, it has managed to secure a contract with BA, the largest airline at Heathrow, the largest airport in the UK (and one of the largest in world). On the basis of its success in short-haul, it has signalled a strong strategic interest to expand into long-haul contracts. It has bid for [REDACTED] the VAA contract. For a number of reasons listed below, DHL can already be considered an existing bidder in this segment, and as such is able to exert a degree of competitive pressure on existing vertically-integrated catering suppliers:
- (a) *DHL is one of the biggest and most successful global logistics companies.* We identified that logistics management is a key part of providing catering management and logistics services to airlines (see paragraph 2.15(b)).
  - (b) *DHL is present in the market and will remain so at least until [REDACTED].* DHL has a short-haul contract with BA at Heathrow lasting until [REDACTED], and will remain at Heathrow at least for the length of its BA contract. In addition, DHL has shown commitment to long-haul catering by adapting its IT systems in the Heathrow facility to be able to handle the needs of long-haul airlines.
  - (c) *DHL is bidding for larger long-haul contracts.* DHL told us that its aim was to create a significant-sized global business in 'above the wing' services.<sup>92</sup> As noted in paragraph 8.50, DHL has bid for [REDACTED] larger long-haul contracts at Heathrow [REDACTED]. DHL told us that its business plan was to grow its global in-flight catering business to £250 million by the end of 2013, and Heathrow was an important part of that.
  - (d) *Several airlines view DHL as a credible catering provider.* [One airline] told us that it saw DHL as a viable supplier. [REDACTED] and told us that it would be comfortable

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<sup>92</sup> [www.dhl.com/content/dam/downloads/g0/logistics/brochures/dhl\\_airline\\_brochure\\_en.pdf](http://www.dhl.com/content/dam/downloads/g0/logistics/brochures/dhl_airline_brochure_en.pdf).

with DHL as a supplier as long as its requirements were met, and would expect to consider DHL in any bidding process. Air Canada told us that it would include all potential suppliers in its next tender process, which was expected to take place in a few years' time. Air Canada said that it liked to keep an eye on different options and their pricing, including both those which involved preparing food in-house and those where food was bought in from other suppliers. [REDACTED] Delta told us that it was familiar with the DHL model of operation and that it had held exploratory discussions with DHL. Delta also told us that though it did not currently use the DHL business model for any of its operations worldwide, when Delta came to renewing its Heathrow contract, within the next two years, it would have an open RFP process and would consider DHL, as well as any other viable caterer. American Airlines told us that it would consider using DHL when its contract is up for renewal at Heathrow, because the market can change significantly in that time.

(e) *DHL's 'asset-light' business model* 'goes with the grain' of disintermediation in the industry which we described in Section 2.

- 8.50 We noted that DHL has been unsuccessful in winning [REDACTED] recent contracts [REDACTED] VAA told us that [REDACTED]. However, VAA believed that DHL would eventually succeed in entering the long-haul market, [REDACTED].
- 8.51 In relation to these bidding processes, [REDACTED] DHL was more competitive [REDACTED] was more expensive [REDACTED].<sup>93</sup>
- 8.52 [REDACTED] Nonetheless, [REDACTED], which indicates that DHL operated as a competitive constraint during this tender process.<sup>94,95</sup>
- 8.53 [REDACTED], airlines have indicated DHL has not yet proven its ability to supply catering management and logistics services to long-haul airlines in the UK. [REDACTED] indicated that the risk of switching to DHL was somewhat higher than the risk associated with one of the large traditional caterers. [REDACTED]
- 8.54 [REDACTED] reflecting both the higher risk associated with switching to DHL (risk associated with lack of experience) and the general risks of switching a contract to a new caterer (transition risk).
- 8.55 However, DHL told the CC that it did not have problems with servicing long-haul flights in all class cabins; the current issue is that it had not been able to demonstrate its capabilities. Going forward, its experience will now include the [REDACTED] contract in Asia. DHL said that it might need to alter the commercial structure of its future bids—this included looking at the margins, and looking at the depth of services provided, [REDACTED].
- 8.56 We noted that any risk to airlines associated with DHL's lack of experience should reduce over time, as DHL gains experience of catering long-haul flights abroad, in particular as part of its new contract with [REDACTED] in Asia. VAA said that it would consider DHL again when its contract was up for renewal, because the market could change significantly in that time.
- 8.57 In addition, we noted that DHL's competitiveness is improving—[REDACTED].

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<sup>93</sup> [REDACTED]

<sup>94</sup> [REDACTED]

<sup>95</sup> [REDACTED]

- 8.58 In conclusion, despite not winning any contracts in this segment to date, we considered that DHL is a competitive constraint (based on its actual bidding for larger long-haul contracts at Heathrow Airport), and is able to constrain bids submitted by other caterers along one or more dimensions of competition.

#### *Other suppliers*

- 8.59 DO & CO said that it was always interested in airlines at Heathrow Airport. Globally, it was interested in long-haul business, across all cabins, provided that the airline was interested in DO & CO's service concept. In that regard, Heathrow larger long-haul airlines would be of interest to DO & CO if they were interested in DO & CO's service concept—ie high-quality catering through fresh food production. On this basis, we would expect that DO & CO would provide a competitive constraint in relation to any larger long-haul airline which wished to source from a 'higher-quality' catering supplier such as DO & CO.<sup>96</sup>
- 8.60 However, [X]. Therefore, DO & CO may not provide as strong a competitive constraint in respect of catering management and logistics services as other in-flight caterers in this segment. This was confirmed by [X], which said that DO & CO was at the high end of the market, [X].
- 8.61 In our view, Plane Catering, which also offers catering management and logistics services at Heathrow Airport, may not have sufficient scale to service contracts of the size required by the airlines in this segment. Plane Catering told us that it currently catered around seven long-haul flights per day, and had spare capacity of around [X] long-haul flights per day. It also told us that it was not targeting larger airlines (such as the American airlines), because these airlines were too big; the caterer would only likely have capacity for one of the airlines and would therefore be over-reliant on one customer. In response to our provisional findings the main parties told us that Plane Catering could be viewed as a credible competitive constraint on the merged company for larger long-haul airlines at Heathrow. Given the evidence from Plane Catering presented in this paragraph we considered that Plane Catering was unlikely to provide a credible competitive constraint on the merged company for larger long-haul airlines at Heathrow, at least for the foreseeable future. We consider potential new entry in paragraph 8.67.

#### *Conclusion as to pre- and post-merger rivalry*

- 8.62 For the reasons given above, we found that, as well as the merged company, Gate Gourmet and DHL are all credible options for larger long-haul airlines at Heathrow, and exert a competitive constraint on each other during bidding processes, which will continue to be the case post-merger.
- 8.63 We considered that DHL's perceived competitive disadvantage associated with its lack of experience in this segment was likely to erode (for the reasons identified in paragraphs 8.51 to 8.57). In the context of dynamic competition between in-flight caterers, both the merged entity and Gate Gourmet would likely take into consideration (or expect the other to take into consideration) the presence of DHL, even before it had succeeded in acquiring a contract to supply larger long-haul airlines at Heathrow. Furthermore, DHL's 'asset-light' in-flight catering supply model

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<sup>96</sup> For example, a larger long-haul airline could source the meals for its premium cabins from DO & CO but contract with a different supplier of catering management and logistics services (this would be similar to the model used by BA to supply its short-haul flights from Heathrow where DO & CO provides the premium cabin meals).

may help drive a more competitive outcome in bidding processes by being a point of competitive difference to a vertically-integrated in-flight catering supply model.<sup>97</sup>

- 8.64 We noted that in-flight caterers have the ability to differentiate their offerings to adapt them to the evolving requirements of airlines. We would expect Gate Gourmet and DHL to reposition and modify their future bids to take up any opportunities that may arise from the elimination of competition along any particular dimension that the merging parties exert on each other. For example, [X]. Moreover, as discussed in paragraphs 8.49 to 8.58, we expect DHL's competitive constraint in the segment to strengthen over the next three years.
- 8.65 We also noted that, whilst some airlines expressed a concern about the reduction in the number of competitors post-merger (see paragraph 8.36), all of these airlines confirmed that in future tenders they would consider DHL as a bidder.

### *Post-merger countervailing factors*

#### *Likelihood of new entry or expansion*

- 8.66 We noted in paragraph 7.17 that although there had been de novo entry at Heathrow in the past, we have seen no evidence to suggest that de novo entry is likely to occur in the foreseeable future. SATS and Newrest<sup>98</sup> specifically told us that they had no plans to bid for contracts at Heathrow. The main parties told us that our provisional findings underestimated the potential for Newrest to expand to Heathrow. Given the evidence from Newrest presented in this paragraph we considered that Newrest was unlikely to provide a credible competitive constraint on the merged company for larger long-haul airlines at Heathrow, at least for the foreseeable future.
- 8.67 As noted in paragraphs 8.59 to 8.61, Plane Catering and DO & CO do not currently supply the Heathrow larger long-haul segment [X]. We therefore concluded that expansion into the larger long-haul sector by either DO & CO or Plane Catering is unlikely. Thus, we found that new entry or expansion is unlikely to occur at Heathrow to service larger long-haul airlines, at least in the absence of direct sponsorship or support on the part of an airline (in a way comparable to BA's sponsorship of DHL's entry at Heathrow).

#### *Post-merger countervailing buyer power*

- 8.68 As noted in paragraph 7.54, large long-haul airlines may have a significant degree of pre-merger buyer power. Buyer power post-merger depends on two key factors: (a) airlines' ability post-merger to switch suppliers; and (b) other means of exercising buyer power post-merger.
- *Airlines' ability post-merger to switch suppliers*
- 8.69 Post-merger, switching or the threat of switching will only be able to constrain prices of the merged party if there are credible alternatives that airlines can switch to.
- 8.70 For larger airlines at Heathrow, post-merger there are likely to be at least three caterers (the merged entity, Gate Gourmet and DHL) exerting a competitive con-

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<sup>97</sup> We also noted that in this respect, the entry of a company such as DHL, using a different business model and hence a different cost structure from other bidders, may introduce an element of uncertainty into the bidding process which may encourage other bidders to bid closer to their 'best' price than would otherwise be the case.

<sup>98</sup> Newrest told us that this was principally due to the high concentration and domination of major caterers at this hub.

straint on prices and service quality for larger long-haul airlines. The costs of switching do not appear to be insurmountable (see paragraph 7.32). Therefore, we considered that, post-merger, airlines will have sufficient credible alternatives in order to make it possible for airlines to switch, or threaten to switch, caterers.

- *Other means of exercising buyer power post-merger*

- 8.71 We noted that, as discussed more fully in Section 2, developments over recent years have broadened the range of catering supply options open to airlines. In particular: (a) food technology developments affecting the chilled supply chain and the availability of frozen or shelf stable food products have widened choice as regards catering provision and reduced the importance of the traditional hot kitchen at or near the airport; and (b) the trend towards disintermediation has opened up opportunities for airlines to reduce the supply chain value otherwise accruing to the in-flight catering supplier, whether through full disintermediation of the catering supply chain, or through nomination of some or all catering supply. As a category, the large long-haul airlines at Heathrow (mainly transatlantic operators) have been active in exploiting these opportunities, and may be expected to continue to do so in future.
- 8.72 It was put to us that multi-market contacts between the airline and in-flight caterer at airports across the world may facilitate the exercise of buyer power, either by linking contract awards to secure improved terms at Heathrow,<sup>99</sup> or by threatening retaliation at other locations if satisfactory terms are not offered at Heathrow.<sup>100</sup> While this is a possibility, we have seen little evidence which shows that airlines have in the past sought to leverage their international position to secure improved terms at Heathrow. Therefore, although this is one lever available to be used by airline customers in the course of negotiations, we did not attach great significance to it as a stand-alone element indicative of buyer power.

*Conclusion as to countervailing factors*

- 8.73 Where, as here, the number of credible suppliers is limited to three and we have not identified any further market entry or expansion as being timely, likely or sufficient to offset any lessening of competition, we attach significance to whether or not customers have a range of negotiating options at their disposal, that will enable them to drive competitive outcomes during the course of the bidding process. We have identified above a number of negotiating options available to be deployed in the course of the bidding process by major long-haul airlines at Heathrow, which are themselves large and sophisticated purchasers. But in our view they would not of themselves be sufficient to overcome any lack of credible switching options among in-flight catering suppliers, had we not already concluded that both Gate Gourmet and DHL would be effective constraints on the merged entity.

*Conclusion in relation to larger long-haul airlines at Heathrow*

- 8.74 Whilst the judgement was finely balanced, we found that a combination of three credible suppliers, when allied to a range of factors conferring a degree of buyer power on customers, meant that the proposed merger was unlikely to give rise to an SLC in relation to this segment.

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<sup>99</sup> RBB Airline Buyer Power submission:

[www.competition-commission.org.uk/our-work/alpha-flight-lsg-lufthansa/evidence/further-submissions](http://www.competition-commission.org.uk/our-work/alpha-flight-lsg-lufthansa/evidence/further-submissions).

<sup>100</sup> For example, [38].

### ***Heathrow smaller long-haul***

- 8.75 The Heathrow smaller long-haul (ie airlines with fewer than five flights per day, of duration 5 hours or more) segment covers [X] contracts worth over £[X] million. Most of the airlines falling into this segment serve freshly prepared meals to their business and first class passengers, and thus use a hot kitchen.

### ***Pre- and post-merger rivalry***

- 8.76 The Heathrow smaller long-haul segment is supplied by Alpha, LSG, Gate Gourmet, DO & CO and Plane Catering. Of the [X] Heathrow smaller long-haul contracts, Alpha holds [X] contracts (worth £[X] million), LSG holds [X] contracts (worth £[X] million), Gate Gourmet holds [X] contracts (worth £[X] million), DO & CO holds [X] contracts (worth [X] £[X] million) and Plane Catering holds [X] contracts (worth £[X] million). (See Appendix F, Table 3, for details of the customers supplied by each caterer.) Given this, we considered that these five companies bid (and thus compete against each other) for at least some of the Heathrow smaller long-haul contracts.
- 8.77 The data on current contracts submitted by in-flight caterers shows that there is switching of contracts in this segment, with 12 current Heathrow smaller long-haul contracts switching hands (worth over £[X] million): Alpha won [X] contracts from LSG worth £[X] million, LSG won [X] contracts from Alpha worth £[X] million, LSG won [X] contracts from Gate Gourmet worth £[X] million, LSG won [X] contracts from Plane Catering worth £[X] million, Gate Gourmet won [X] contracts from DO & CO worth £[X] million, DO & CO won [X] contracts from LSG worth [X], and DO & CO won [X] contracts from Gate Gourmet worth (worth £[X] million). (See Appendix F, Table 7, for details of the contracts which have switched between caterers.) This shows that smaller long-haul airlines are able to switch in-flight caterers pre-merger (ie the switching costs do not appear to be prohibitively high), and therefore it is likely that the threat of switching can also be used as a lever.

### ***Catering provision***

- 8.78 As outlined in paragraph 2.15, in-flight catering services comprise a combination of catering management and logistics services and catering provision.
- 8.79 In relation to catering provision, we noted in paragraph 8.22 that, for long-haul flights, there has been a move away from freshly-prepared food in the economy cabin. However, most airlines still require freshly-prepared food for the premium cabins. Given this, we have considered whether any reduction in the availability of kitchen facilities for the preparation of airline meals might give rise to an SLC in relation to the Heathrow smaller long-haul segment.
- 8.80 We noted that some airlines are using a disintermediated model of supply (eg Qantas), while some others are open to considering other options for their hot meal requirements (eg Air New Zealand told us that it would not rule out using a logistics provider in combination with a hot kitchen provider). On the other hand, we noted that some airlines told us that they would not source their catering from any supplier other than their supplier of catering management and logistics services (eg Singapore Airlines told us that it would never consider caterers or contractors that did not prepare their own food, and would never appoint a logistics provider for its catering needs). Given that some smaller airlines attach value to the integrated catering solution, we consider the competitive constraint which may exist post-merger from

vertically-integrated catering suppliers as well as from non-vertically-integrated catering suppliers.

### *Catering management and logistics services*

- 8.81 We discuss below the supply of catering management and logistics services, first in respect of vertically-integrated catering suppliers and secondly in respect of disinter-mediated supply.

#### *Vertically-integrated catering suppliers*

- 8.82 As noted in paragraph 8.76, five in-flight caterers currently supply the Heathrow smaller long-haul segment. Of these, Alpha, LSG and Gate Gourmet together hold [80–90] per cent of current contracts in this segment. All three caterers also tend to bid for contracts with Heathrow smaller long-haul airlines, and there is awareness among in-flight caterers that they do so. (See Appendix F, Tables 5 and 6, for details of caterers' awareness of Alpha, LSG and Gate Gourmet's bidding by segment.)
- 8.83 In addition to the merged entity and Gate Gourmet, both DO & CO and Plane Catering will be present at Heathrow post-merger as vertically-integrated in-flight catering suppliers. DO & CO told us that it had spare capacity at its Heathrow facility of [X] long-haul flights per day and had bid for [X] in the past, as well as [X]. As noted above, DO & CO is positioned as a high-quality caterer. This means that while it will be a strong rival in the case of contracts with airlines which are seeking a higher-quality service (of which there appear to be a number present in this segment), it may not be able to provide as strong a competitive constraint on other in-flight caterers in the case of airlines which are seeking lower-cost solutions.
- 8.84 Plane Catering is able to service contracts of the size required by the airlines in this segment. Plane Catering told us that it currently catered around seven long-haul flights per day, and had spare capacity of around [X] long-haul flights per day, which could accommodate several smaller long-haul airlines. It also told us that it was in talks with several airlines, including [X] and [X]. Plane Catering told us that it could outsource some aspects of its operations (eg warehousing) if necessary to alleviate any capacity constraints.
- 8.85 We did not consider that there would be capacity concerns in relation to the supply of Heathrow smaller long-haul airlines post-merger. We noted that it was possible for caterers to reorganize their existing operations so as to free up some extra incremental capacity (either by removing bottlenecks within their facilities and/or outsourcing aspects of their operations), and that costs associated with providing incremental capacity appear scalable. These factors also enable suppliers to accommodate additional smaller short-haul customers.<sup>101</sup>

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<sup>101</sup> The main parties told us that catering assembly output could be increased simply by adding more operating shifts, utilizing existing infrastructure or adding equipment components such as mobile refrigeration or mobile kitchens. Moreover, last mile provisioning output could be increased by buying or renting high loaders, or outsourcing this service, while food supply (especially where it was [X]) could be increased by requesting the food suppliers to increase volume at their central production sites. Gate Gourmet told us that, if it were unable to take on a certain number of additional daily flights in its existing facility, it would try to maximize its capacity by looking at where the bottlenecks were and would consider things like 'pre-loading' (ie loading catering directly into trucks rather than storing within the main facility).

### *Disintermediated supply*

- 8.86 We noted in paragraph 8.81 that some airlines in this segment are using a disintermediated model of supply, whilst others would be open to considering other options for their hot meal supply.
- 8.87 We have discussed the general credibility of DHL as a competitor above, more particularly in supply to the larger long-haul segment. We noted that DHL has a facility at Heathrow (used for the BA contract), which has some spare capacity, and which can accommodate a few smaller contracts. DHL told us that it was prepared to bid for contracts with smaller long-haul airlines, and that its existing facility at Heathrow had been modified in order to be able to serve long-haul airlines. There are a number of caterers which are available to team with DHL to provide a disintermediated solution, including (in addition to Plane Catering and DO & CO—see above) DSI (see paragraph 8.25(a)) and a number of kitchens providing specialized catering. The reduced volume and complexity of requirements of smaller long-haul operators means that there would be less risk associated with switching to DHL than might be the case with larger long-haul customers.

### *Conclusion in relation to smaller long-haul airlines at Heathrow*

- 8.88 We found that, for those smaller long-haul airlines which prefer a vertically-integrated supply solution, post-merger there will be up to four possible catering suppliers (the merged entity, Gate Gourmet, Plane Catering and, for some airlines, DO & CO). We found that, for those smaller long-haul airlines which are open to a more disintermediated supply solution, post-merger there will be up to five possible catering suppliers (the merged entity, Gate Gourmet, Plane Catering, DHL, and, for some airlines, DO & CO).
- 8.89 Overall, we considered that enough caterers will remain in the market for airlines to manage post-merger an effective and competitive bidding process. As there are no capacity concerns in relation to supply to Heathrow smaller long-haul airlines, we found that the proposed merger was unlikely to give rise to an SLC in relation to this segment.
- 8.90 Our conclusion did not depend on the existence of any countervailing factors. However, we noted that while we had not identified new entry or expansion as being timely, likely and sufficient to offset any lessening of competition, both Plane Catering and DO & CO are relatively recent entrants, suggesting that small-scale new entry to serve this segment of demand might occur in appropriate circumstances. We also noted that a number of the considerations discussed in paragraphs 8.70 to 8.74 above are likely to apply to a number of airlines present in this segment, some of which are sizeable international airlines.

### ***Regional network airlines***

- 8.91 The Regional network segment covers [X] contracts worth £[X] million. The airlines falling into this segment have a wider choice of in-flight caterers, including Alpha, LSG, Gate Gourmet and potentially DHL and Commissaire (at least for non-perishable food).
- 8.92 As a preliminary observation, we noted that the industry trends described in Section 2 are particularly marked in this segment of the market. As regards catering provision, Regional network airlines no longer provide complimentary hot food (except for a limited number of long-haul flights with charter/leisure airlines). We



observed a widespread shift to BOB models for in-flight catering within this segment as well as the 'back-catering' of flights. These changes have led to a significantly reduced need for a hot kitchen to supply Regional network airlines. This in turn has reduced the requirement for a traditional 'on-site' supply structure, providing opportunities for remote, or hub-and-spoke, supply.<sup>102</sup> It has also facilitated the adoption of various forms of disintermediated supply.<sup>103</sup>

### *Pre- and post-merger rivalry*

- 8.93 The Regional network segment is supplied by Alpha, LSG, Gate Gourmet and Commissaire. Of the [X] Regional network contracts, Alpha holds [X] contracts worth £[X] million, LSG holds [X] contracts worth £[X] million, Gate Gourmet holds [X] contracts worth £[X] million and Commissaire holds [X] contracts worth £[X] million. (See Appendix F, Table 4, for details of the customers supplied by each caterer.) We noted that these contracts are awarded on a network basis, for the supply of catering to all airports from which the Regional network airline may from time to time be operating, and that the winning supplier will be expected to make such arrangements as may be necessary to ensure supply to the different airport locations.
- 8.94 The data on current contracts submitted by in-flight caterers shows that there is switching of contracts in this segment, with [X] Regional network contracts switching hands (worth over £[X] million): LSG won [X] contracts from Alpha worth £[X] million [X], and Gate Gourmet won [X] contracts from Alpha worth £[X] million [X]. (See Appendix F, Table 8, for details of the contracts which have switched between caterers.) This shows that Regional network airlines are able physically to switch in-flight caterers pre-merger (ie the switching costs do not appear to be prohibitively high), and therefore it is likely that the threat of switching can also be used as a lever.
- 8.95 Commissaire may be an option only for Regional network airlines which are looking to provide BOB offerings only. Commissaire said that it would be unlikely to bid for those Regional network contracts involving an element of perishable food supply. However, Commissaire would be able to serve Ryanair and easyJet, [X].
- 8.96 In relation to DHL we noted that [X] In addition, [X].
- 8.97 In relation to Newrest we noted that [X]. Newrest told us that it did not have any immediate plans to build a network, but that it would be prepared to build a network focused primarily on Regional airports and in conjunction with an airline.
- 8.98 Airlines differ in their views of the closeness of competition between Alpha, LSG, Gate Gourmet, DHL and other market participants, as shown in Table 8.

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<sup>102</sup> For example, as part of its contract with [X], LSG serves Teesside, Humberside, Liverpool/Blackpool, Leeds Bradford and Norwich remotely, while as part of its contract with Flybe, Commissaire uses the hub-and-spoke model.

<sup>103</sup> Examples of disintermediation in this segment include the [X], the Commissaire/Derichbourg joining for the Flybe contract and LSG sub-contracting to its competitors [X] (Belfast), [X] (Dublin, Shannon, Bristol, and Exeter) and [X] (Birmingham) at airports where it does not have facilities or the ability to serve remotely.

TABLE 8 Airlines' views of the closeness of competition

<i>Airline</i>	<i>Alpha's closest competitor nationally</i>	<i>LSG's closest competitor nationally</i>	<i>Alpha's closest competitor regionally</i>	<i>LSG's closest competitor regionally</i>
Flybe	<ul style="list-style-type: none"> <li>• <b>LSG</b> is closest competitor</li> <li>• <b>Gate Gourmet</b> is second-closest competitor</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Alpha</b> is closest competitor</li> <li>• <b>Gate Gourmet</b> is second-closest competitor</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Derichebourg</b> is closest competitor</li> <li>• <b>Gate Gourmet</b> is second-closest competitor</li> <li>• <b>LSG</b> is third-closest competitor</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Derichebourg</b> is closest competitor</li> <li>• <b>Alpha</b> is second-closest competitor</li> <li>• <b>Gate Gourmet</b> is third-closest competitor</li> </ul>
Ryanair	<ul style="list-style-type: none"> <li>• <b>DHL</b> is closest competitor</li> <li>• <b>LSG</b> is second-closest competitor</li> <li>• <b>Gate Gourmet</b> is third-closest competitor</li> </ul>	<ul style="list-style-type: none"> <li>• <b>DHL</b> is closest competitor</li> <li>• <b>Alpha</b> is second-closest competitor</li> <li>• <b>Gate Gourmet</b> is third-closest competitor</li> </ul>	<ul style="list-style-type: none"> <li>• N/A</li> </ul>	<ul style="list-style-type: none"> <li>• N/A</li> </ul>
Thomas Cook	<ul style="list-style-type: none"> <li>• <b>LSG</b> is closest competitor because of presence in similar geographical locations and it is able to offer fully outsourced in-flight retail solution</li> <li>• <b>Gate Gourmet</b> is second-closest competitor because it can provide a network service although this would be from central hub, and is able to offer fully outsourced in-flight retail solution</li> <li>• <b>Newrest</b> is third-closest competitor because it can provide a network service although this would be from central hub, and is able to offer fully outsourced in-flight retail solution</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Alpha</b> is closest competitor because of presence in similar geographical locations and it is able to offer fully outsourced in-flight retail solution</li> <li>• <b>Gate Gourmet</b> is second-closest competitor because it can provide a network service although this would be from central hub, and is able to offer fully outsourced in-flight retail solution</li> <li>• <b>Newrest</b> is third-closest competitor because it can provide a network service although this would be from central hub, and is able to offer fully outsourced in-flight retail solution</li> </ul>	<ul style="list-style-type: none"> <li>• <b>LSG</b> is closest competitor because of presence in similar geographical locations, and it is able to offer fully outsourced in-flight retail solution</li> <li>• <b>Gate Gourmet</b> is second-closest competitor because it can provide a network service although this would be from central hub, and is able to offer fully outsourced in-flight retail solution</li> <li>• <b>Newrest</b> is third-closest competitor because it can provide a network service although this would be from central hub, and is able to offer fully outsourced in-flight retail solution</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Alpha</b> is closest competitor because of presence in similar geographical locations and it is able to offer fully outsourced in-flight retail solution</li> <li>• <b>Gate Gourmet</b> is second-closest competitor because it can provide a network service although this would be from central hub, and is able to offer fully outsourced in-flight retail solution</li> <li>• <b>Newrest</b> is third-closest competitor because it can provide a network service although this would be from central hub, and is able to offer fully outsourced in-flight retail solution</li> </ul>
[X]	[X]	[X]	[X]	[X]

Source: CC.

- 8.99 Table 8 shows that Regional network airlines consider Alpha, LSG, Gate Gourmet and DHL to be close competitors, with Commissaire/Derichbourg and Newrest also providing some competitive constraint.<sup>104</sup>
- 8.100 Overall, we considered that Alpha, LSG, Gate Gourmet and DHL compete effectively against each other for Regional network contracts. In the case of DHL, we took account not only of [X], but also of its established presence in the supply of short-haul catering to BA at Heathrow, its broad logistics background and expertise, its expressed commitment to build an in-flight catering business, and the fact that its disintermediated in-flight catering business model may be well suited to meeting the requirements of Regional network airlines. We considered that Commissaire and Newrest were weaker rivals for Regional network airlines than Alpha, LSG, Gate Gourmet and DHL.

### *Countervailing factors*

- 8.101 This section considers the likelihood of new entry or expansion, and whether or not buyer power may be present for Regional network airlines post-merger.

#### *Likelihood of new entry or expansion*

- 8.102 We noted in paragraph 7.50 that Regional network contracts are attractive to in-flight caterers. In Appendix E we set out evidence in relation to entrants, entry models and barriers to entry. Both entry and expansion have occurred in the past for Regional network contracts. Entrants have bid for contracts and then put in place the necessary facilities/service arrangements to service the contract. Examples of successful entry include Gate Gourmet with easyJet, DHL/RiM for Ryanair in the Republic of Ireland and Commissaire with Flybe. We also noted that [X]. Regional network airlines' requirements tend to be relatively uncomplicated, generally being either a BOB model or ambient short-haul catering, making them easy to cater and reducing any risks associated with the airline using a de novo entrant as supplier. In addition, Regional network airlines can be serviced by a hub-and-spoke, or trucking, solution reducing capital investment requirements. For example, Commissaire operates a hub-and-spoke arrangement from one central distribution centre for Flybe. We therefore concluded that barriers to new entry or expansion by an existing in-flight caterer are low.

#### *Post-merger buyer power*

- 8.103 We considered that Regional network airlines were likely to have a choice of at least three caterers following the merger (the merged entity, Gate Gourmet and DHL), and that they may also engage with Commissaire and Newrest. This provides the airlines with switching opportunities. In addition, Regional network airlines, which are large and sophisticated customers, may have options in terms of sponsoring or encouraging entry. Further, as noted in Section 7, the Regional network airlines aggregate their UK airports for the purposes of in-flight catering supply arrangements. This means that the Regional network airlines' contracts are relatively valuable, and therefore attractive to in-flight caterers, which may be expected to compete actively to secure and retain them.

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<sup>104</sup> We note that, in responding to our questions, airlines may have looked just at in-flight caterers who are currently present at Regional airports. Given the attractiveness of this segment of demand and the low barriers to entry (see paragraph 8.102), this may *underestimate* the competitive constraints in this segment.

### *Conclusion in relation to Regional network airlines*

8.104 We found that following the merger there will be between three and five possible suppliers to the Regional network airlines. When account was additionally taken of the low barriers to entry and expansion, and the size and attractiveness of the business of the Regional network airlines, we found that the proposed merger was unlikely to give rise to an SLC in relation to this segment.

### ***Regional long-haul***

8.105 We start by providing an overview of the Regional long-haul segment and of the provision of catering supply to it. We then comment on our general approach to the analysis. Thereafter, we undertake the competitive assessment. Finally, we set out our conclusions in relation to this segment.

#### *Overview of the Regional long-haul segment*

8.106 In Table 9, we list those long-haul airlines which fly out of Regional airports. We also note whether or not the airlines aggregate their Regional activities alongside those at Heathrow under a single contract.

TABLE 9 Long-haul airlines which fly out of Regional airports: split by Regional airport

<i>Airport</i>	<i>Airline</i>	<i>Number of flights per day (2011)*</i>	<i>Does the airline sign separate contract(s) for Regions†</i>
Gatwick	BA	7.7	[X]
	VAA	5.4	[X]
	Emirates	3.0	[X]
	US Airways	1.0	[X]
	Air Transat	1.0	[X]
	Delta	0.9	[X]
	Rossiya Airlines	0.5	[X]
	Qatar	0.4	[X]
	Air Zimbabwe	0.2	[X]
	Cubana	0.1	[X]
	Air Asia	0.1	[X]
	United Airways Bangladesh	0.1	[X]
	Al-Naser Airlines	0.1	[X]
	Sunwing Airlines	0.1	[X]
	<b>Total</b>	<b>20.8</b>	
Manchester	Emirates	2.7	[X]
	VAA	1.8	[X]
	Continental	1.6	[X]
	Qatar	1.6	[X]
	American Airlines	1.6	[X]
	Delta	1.5	[X]
	Pakistan International Airlines	1.4	[X]
	Etihad	1.4	[X]
	US Airways	1.0	[X]
	Singapore Airlines	1.0	[X]
	Air Transat	0.5	[X]
	Air Blue	0.4	[X]
	<b>Total</b>	<b>16.6</b>	
Birmingham	Emirates	2.0	[X]
	Continental	0.9	[X]
	Turkmenistan	0.6	[X]
	Pakistan International Airlines	0.5	[X]
	Mahan Air	0.2	[X]
	Air Transat	0.1	[X]
	<b>Total</b>	<b>4.3</b>	
Glasgow	Emirates	1.0	[X]
	Continental	0.9	[X]
	US Airways	0.5	[X]
	Air Transat	0.4	[X]
	Pakistan International Airlines	0.3	[X]
	VAA	(Seasonal)	[X]
	<b>Total</b>	<b>3.0</b>	
Edinburgh	Continental	1.4	[X]
London City	BA	1.4	[X]
Luton	Various‡	0.6	[X]
Leeds Bradford	Pakistan International Airlines	0.3	[X]
Newcastle	Emirates	1.0	[X]
	Air Transat	0.1	[X]
	<b>Total</b>	<b>1.1</b>	
Stansted	Air Asia	0.7	[X]
	Tag Aviation	0.1	[X]
	<b>Total</b>	<b>0.8</b>	

Source: CAA (2011) and parties' responses to the CC's Market Questionnaire.

\*The totals may not add up to the sum of the individual flight numbers due to rounding. We note that the total numbers of daily departures for individual airports may have changed since 2011 and that the lists of individual airlines flying from particular airports may also have changed.

†The column shows whether the airline has a separate contract for Heathrow from that for the Regional airport in question.

‡The only airlines with 0.1 flights per day or more are Netjets Transportes Aereos (0.1 flights per day) and VISTAJET LUFTFAHRTUNTERNEHMEN (0.1 flights per day).

- 8.107 Setting on one side those contracts which also cover Heathrow, the Regional long-haul segment currently comprises [REDACTED] contracts, covering airlines which either do not operate at Heathrow or which contract separately in respect of their Regional activities. Of those, Alpha holds [REDACTED] contracts worth £[REDACTED] million,<sup>105</sup> LSG holds [REDACTED] contracts worth £[REDACTED] million and Gate Gourmet holds [REDACTED] contracts worth £[REDACTED] million. (See Appendix F, Table 4, for details of the customers supplied by each caterer.)
- 8.108 Regional airports vary significantly as regards the scale of their long-haul operations. Substantially the most important Regional long-haul airports are Gatwick (20.8 flights daily) and Manchester (16.6 flights daily). Other airports with material long-haul activity are Birmingham (4.3 flights daily) and Glasgow (3.0 flights daily). As regards the other airports listed in Table 9 (Edinburgh, London City, Luton, Leeds Bradford, Newcastle and Stansted), the scale of long-haul operation is minimal: no more than one or two long-haul flights a day often involving one or two airlines. We do, however, note that at all the airports listed, there is activity involving Regional network or other short-haul airlines, in each case with associated catering provision.
- 8.109 We noted that Regional long-haul activity tends to be concentrated on only a few airlines; namely, Emirates, BA, VAA and United Continental. Table 10 below sets out, in respect of each of those airlines, the aggregate daily number of Regional long-haul flights, the maximum number of flights from any one Regional airport and, for comparison, the number of long-haul flights each makes from Heathrow. Apart from these four airlines, no other airline has in aggregate three or more Regional long-haul flights per day, or more than one flight from any Regional airport. The scale of long-haul airlines' Regional activities is more often than not small relative to those at Heathrow (although we note that some Regional long-haul airlines may have larger catering requirements at their Regional airports than at Heathrow).

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<sup>105</sup> Includes the long-haul proportion of the [REDACTED].

TABLE 10 Long-haul airlines which fly out of Regional airports:\* ranked by aggregate number of Regional departures

<i>Airline</i>	<i>Aggregate number of Regional long-haul flights</i>	<i>Maximum number of flights from any one regional airport</i>	<i>Number of long-haul flights from Heathrow</i>
Emirates	9.7	3.0	5.0
BA	9.1	7.7	79.3
VAA	7.4	5.4	19.7
Continental†	5.7	1.6	6.8
US Airways	2.4	1.0	1.0
Delta	2.4	1.5	8.8
Pakistan International Airlines	2.2	1.4	1.5
Air Transat	2.1	1.0	0.1
Qatar	2.0	1.6	4.0
American Airlines	1.6	1.6	15.6
Etihad	1.4	1.4	3.0
Singapore Airlines	1.0	1.0	3.0
Air Asia	0.8	0.7	0
Turkmenistan	0.6	0.6	0.3
Rossiya Airlines	0.5	0.5	0
Air Blue	0.4	0.4	0
Air Zimbabwe	0.2	0.2	0
Mahan Air	0.2	0.2	0
Cubana	0.1	0.1	0
Al-Naser Airlines	0.1	0.1	0
Netjets Transportes Aereos	0.1	0.1	0
Sunwing Airlines	0.1	0.1	0
Tag Aviation	0.1	0.1	0
United Airways Bangladesh	0.1	0.1	0
Vistajet			
Luftfahrtunternehmen	0.1	0.1	0

Source: CAA data (2011).

\*Only airlines with 0.1 flights per day (rounded) or more are listed.

†Before its merger with United.

8.110 Table 11 below sets out the number and identity of catering suppliers that, post-merger, will be present at each of the four airports with significant long-haul activity. For completeness, Table 11 includes not only those caterers supplying long-haul operators, but also those currently supplying Regional network or other short-haul airlines at the airport in question.

TABLE 11 In-flight caterers who will be present at principal Regional airports post-merger

<i>Airport</i>	<i>Number of caterers present post-merger</i>	<i>Identity of caterers present post-merger</i>
Gatwick	3	Merged entity, Gate Gourmet and Commissaire
Manchester	3	Merged entity, Gate Gourmet and Commissaire
Birmingham	2	Merged entity and Commissaire
Glasgow	4	Merged entity, Gate Gourmet, Newrest and Commissaire

Source: CC.

8.111 While long-haul airlines may contract with an on-site caterer to supply an integrated service involving both catering provision from an on-site hot kitchen and catering management and logistics services, this is by no means always the case. In particular, there are a number of examples where the long-haul catering is sourced remotely rather than from an on-site facility. Thus, for example, Alpha procures catering for [X], which is then [X]; and [X]'s catering is trucked from Heathrow to Birmingham. We were also told by both [an airline] (present at Gatwick and Manchester) and [another airline] (present at Manchester) that they were open to considering options

other than the traditional vertically integrated hot meal solution for their catering requirements, including trucking in from remote locations.

- 8.112 We noted that one or both of Commissaire and Newrest are present at each of the four major Regional airports (see Table 11), providing short-haul catering services. It may be that, in appropriate circumstances, and especially where an airline has only occasional long-haul catering requirements, a disintermediated solution involving separate packing and 'last mile' uplift might be available. We are, however, aware of no case where this has occurred to date.

### *Approach to the analysis*

- 8.113 In assessing the adequacy of post-merger competition, we considered that it was right to take into account the overall scale of economic activity involved. Our principal concern was thus with those airports with a material amount of long-haul activity; namely Gatwick and Manchester and, in lesser degree, Birmingham and Glasgow. At other Regional airports, where there is only a small number of long-haul flights, perhaps involving just a single airline customer, it is not reasonable to expect that customers will have the same choice as is available at airports with a much larger scale of activity. As regards Regional long-haul generally, and those airports with limited long-haul activity in particular, two further considerations are relevant.
- 8.114 First, the competitive analysis focuses on the options available to the airline at the time that it contracts for catering supplies. Typically, an airline with operations at more than one Regional airport will contract as a minimum for supply to all its Regional airports and may also enter into a single contract for supply at Heathrow and its Regional airports. The corollary is that the choice of supplier is not limited to those suppliers with existing operations at the individual Regional airports covered. Suppliers competing for multi-airport contracts are used to putting forward solutions enabling supply to be made to airports where they are not currently active. Thus, in many cases, arrangements will be negotiated for remote supply to a particular airport. We noted, for example, that [REDACTED]; and that DO & CO (not currently active regionally) bid for a contract to supply [REDACTED] Regional long-haul operations, and would have set up new facilities for this purpose.
- 8.115 Secondly, we think that it is not unreasonable to expect that an airline will take reasonable steps to adapt its behaviour (or at a minimum threaten to adapt its behaviour<sup>106</sup>) so as to optimize the competitive choices available to it. Thus, where an airline that contracts Regionally is also active at Heathrow, we considered that it was not unreasonable to expect it to bundle its Heathrow and Regional requirements together, so as to leverage its position in the more competitive Heathrow market to the benefit of its Regional operations. Similarly, we considered that it was not unreasonable to expect that airlines will take reasonable steps to explore the possibilities of remote catering provision (as some airlines already do—see paragraph 8.112); where only very few flights are involved, and the scale of the catering activity is small and not overly complex, it may even be appropriate to explore a disintermediated solution involving 'last mile' uplift by a third party such as Derichebourg or another airside operator.

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<sup>106</sup> See also paragraph 8.26.



## *Detailed competitive assessment*

### *On-site catering suppliers at principal Regional airports post-merger*

- 8.116 As appears from Table 11 above, at Gatwick, Manchester and Glasgow, long-haul airlines will, post-merger, have a choice of at least two suppliers of long-haul catering (Gate Gourmet and the merged entity). At Birmingham, only the merged entity is present as a supplier of long-haul catering. At all four airports (including Birmingham), additional suppliers of (Regional network or short-haul) catering are already present.
- 8.117 However, as noted above, the key consideration is not the number of on-site suppliers of long-haul catering, but whether airlines have options to obtain a suitably competitive outcome. This we consider in the following paragraphs by reference to each of the long-haul airline operators listed in Table 9.

### *BA, Emirates and Continental*

- 8.118 As noted in Tables 9 and 10 above, each of these airlines has significant long-haul operations from Regional airports, and [REDACTED].
- 8.119 BA currently operates Regional long-haul flights from Gatwick and London City. Catering for the Gatwick flights is provided by Alpha from a purpose-built facility under a long-term contract entered into in 2008, while catering for the London City flights is provided by LSG. As described more fully above, BA as a national carrier enjoys a position of strength at Heathrow, and were the need to arise, we considered that its position at Heathrow could be leveraged to secure better terms at Regional airports such as Gatwick and London City. Furthermore, BA has indicated that it has no concerns over the competitive impact of the merger for its business.
- 8.120 Emirates is the largest operator of Regional long-haul flights, with a total of almost ten flights daily from Gatwick, Manchester, Birmingham, Glasgow and Newcastle. The choice of in-flight catering suppliers at the majority of Regional airports at which it operates will extend post-merger to include at least the merged company and Gate Gourmet. In addition, DO & CO told us that it would be interested in Manchester Airport given the presence of Emirates, Qatar and Etihad. [REDACTED] Emirates would also have the option of bundling its requirements Regionally and at Heathrow to take advantage of the competitive conditions prevailing at Heathrow. Moreover, Emirates has expressed no concerns about the merger. We also noted that Emirates is a sister company to Dnata which post-merger will have an interest in the merged firm (see Sections 3 and 4).
- 8.121 Continental<sup>107</sup> operates a total of around six flights daily from five Regional airports, namely Manchester, Birmingham, Glasgow, Belfast and Edinburgh. It may be that Continental's combined Regional requirements are such as will enable it to attract competitive quotes for the Regional business in future from several suppliers. In this regard, we note that [REDACTED], and that a catering supplier will typically be prepared in the context of a new contract award to arrange supplies at an airport at which it is not currently present. More pertinently, and as noted previously, Continental has recently merged with United, [REDACTED]. We have already concluded that there will be sufficient competition in the large long-haul segment at Heathrow post-merger, and we would expect that United Continental would be able to [REDACTED]. Moreover, United Continental has expressed no concerns about the merger.

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<sup>107</sup> Before its merger with United.

*Airlines which bundle both Heathrow and Regional long-haul*

- 8.122 As appears from Table 9, the following airlines currently bundle their Regional activities with those at Heathrow under a single contract: [X], [X], [X], [X], [X], [X] and [X]. We have already concluded that larger and smaller long-haul operators will continue to benefit from sufficient competition at Heathrow post-merger; and as noted in paragraph 8.110, Regional activities of these airlines tend to be small relative to their activities at Heathrow. Accordingly, we expect the competitive conditions at Heathrow to work to the benefit of the Regional operations of these airlines.

*Airlines active at Heathrow which do not bundle Regional long-haul*

- 8.123 There is a further small category of airlines which have long-haul operations at Heathrow and in the Regions, but which have hitherto chosen not to combine their requirements under a single contract. These include: [X], [X] and [X]. Among these airlines, [X] expressed some concerns about the merger (although we note that this was prior to the announcement that Gate Gourmet would be establishing facilities at Manchester), but said that it was open to trucking in catering if the quality was high enough. [X] also expressed concerns about the merger, saying that post-merger it would have only one choice of catering provider, although we note that its food is currently trucked in from [X] Heathrow and only packed and uplifted by [X].
- 8.124 The Regional long-haul activities of each of these airlines are small: [X] flies [X] daily from Manchester, [X] flies a total of [X] flights per day from [X] and Gatwick, and [X] times a week from [X]. Given the limited scale of their activities, we would expect these airlines to take reasonable adaptive steps to optimize their position. Given that we have concluded that competitive conditions will prevail post-merger at Heathrow in both the larger long-haul segment [X] and the smaller long-haul segment [X], we considered that it was a natural step for these airlines to at least threaten to bundle their requirements at Heathrow and Regionally, so as to secure competitive terms Regionally. Additionally, these airlines may be able to consider using remote supply options such as trucking.

*Remaining Regional long-haul airlines at Gatwick and Manchester*

- 8.125 There is a small residual group of airlines which currently appear to operate on an infrequent basis from Gatwick, and which include [X] and [X]. Based on the 2011 data in Table 9, they account in aggregate for less than one and a half flights per day, and following the merger they will still have a choice between the merged company and Gate Gourmet, and possibly Derichebourg, for servicing their on-airport catering needs.
- 8.126 At Manchester, there are residual airlines, including [X], with less than three flights per week, based on the 2011 data in Table 9. Post-merger, they will have a choice between the merged company and Gate Gourmet (once its new facility is on stream), and possibly Derichebourg, for servicing their on-airport needs.

*Conclusion in relation to Regional long-haul airlines*

- 8.127 For the reasons set out above, and notably taking account of the range of options available to airlines to procure competitive outcomes, we found that the proposed merger was unlikely to give rise to an SLC in relation to this segment.

## ***Regional short-haul***

- 8.128 The Regional short-haul segment covers [X] contracts worth £[X] million.<sup>108</sup> This segment includes short-haul airlines which either fly only out of Regional airports, or which have separate contracts which cover Regional airports.<sup>109</sup>
- 8.129 Of the airlines which fall into this segment, BA, BA CityFlyer, bmi and bmibaby are based in the UK and therefore have higher catering requirements from the Regional airports than the European airlines which predominantly back-cater from their home hubs.
- 8.130 The remaining airlines in this segment have low catering needs. Nonetheless, they do uplift some catering at Regional airports, and therefore need an in-flight catering solution.

## ***Pre- and post-merger rivalry***

- 8.131 Of the [X] Regional short-haul contracts, Alpha holds [X] contracts worth £[X] million, LSG holds [X] contracts worth £[X] million, Gate Gourmet holds [X] contracts worth £[X] million, Newrest holds [X] contracts worth £[X] million and Commissaire holds [X] contract worth £[X] million. (See Appendix F, Table 4, for details of the customers supplied by each caterer.)
- 8.132 These airlines currently have a choice of the three traditional vertically-integrated caterers (Alpha, LSG and Gate Gourmet), as well as Commissaire, and, at some Regional airports, Newrest.<sup>110</sup> We noted that Gate Gourmet will have an enhanced Regional presence when it begins to cater VAA's Regional flights in 2012.
- 8.133 The simplicity of the catering requirements of the airlines in this segment means that there is scope for disintermediated supply pre- and post-merger. This is already a key component of LSG's model of supply for the [X], whereby food production is centralized (and produced at [X]) and LSG uses disintermediated last mile logistics at all other airports covered by the contract.
- 8.134 In relation to UK-based airlines, BA told us that it did not have any concerns with Manchester (or other Regional airports) because of the low value of catering uplifted at the airport; whilst BA CityFlyer is supplied by Newrest. As noted above, bmi (which also owns bmibaby) may be sold by Lufthansa to International Airlines Group, owner of BA and Iberia. However, for the purposes of this inquiry, we have assumed that bmi will continue to be catered by LSG, its current in-flight caterer. Loganair is supplied by Commissaire.
- 8.135 In relation to non-UK-based airlines, we noted that UK catering requirements are relatively small, and that most non-UK-based airlines are back-catered from the home country.
- 8.136 We noted that the examples of Commissaire and Newrest/Servair show that effective new entry to serve this segment is possible.

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<sup>108</sup> Including the short-haul proportion of [X].

<sup>109</sup> We consider airlines which combine their Regional short-haul catering requirements with their Heathrow short-haul catering requirements within the relevant Heathrow segment (see paragraphs 8.14 to 8.21).

<sup>110</sup> Newrest provides short-haul catering to BA CityFlyer at London City, Edinburgh and Glasgow airports, and said that it would consider entry at other Regional airports if invited to do so by an airline.

### *Conclusion in relation to Regional short-haul airlines*

- 8.137 Given the low complexity of the on-board catering product required by Regional short-haul airlines, the availability of a number of alternative business models for caterers to meet that demand, and the ease of new entry or expansion from one airport to another in response to customer demand, we found that the proposed merger was unlikely to give rise to an SLC in relation to this segment.

## **9. Conclusions on the reference questions**

- 9.1 We found that arrangements were in progress or in contemplation which, if carried into effect, would result in the creation of one or more relevant merger situations.
- 9.2 Based on the evidence and analysis above, we found that the proposed merger would not be expected to lead to an SLC in any relevant market in the UK.