

## ALPHA FLIGHT GROUP/LSG LUFTHANSA MERGER INQUIRY

### Issues statement

#### The reference

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 between Alpha Flight Group Limited (Alpha) and LSG Lufthansa Service Holding AG (LSG).
2. The CC must decide:
  - (a) whether a relevant merger situation would be created if the joint venture was put into effect; and
  - (b) if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.

#### Purpose of the issues statement

3. This issues statement sets out our view of the analytical framework for our analysis, given our terms of reference.
4. We are publishing this issues statement in order to assist parties submitting evidence to focus on the issues we currently envisage being relevant to our inquiry and to invite parties to notify us if there are additional relevant issues which they believe we should consider.

#### Background

5. Alpha is a wholly-owned subsidiary of Dnata, which is a sister company of Emirates, the international airline.<sup>1</sup> Alpha provides in-flight catering and non-catering services to a number of international airlines.
6. LSG is a wholly-owned subsidiary of Deutsche Lufthansa AG. It provides airline catering and related business activities worldwide. In Europe, LSG owns and operates airline catering facilities under the brand LSG Sky Chefs.<sup>2</sup>
7. The parties intend to create a new joint venture (the JV), which would combine the quasi-totality of the parties' activities in in-flight catering services in the UK.

#### The markets in which the parties operate

8. Alpha and LSG overlap in the supply of in-flight catering services to airlines—ie the supply of food and/or drink and ancillary products/services to commercial airliners for consumption by passengers and crew.

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<sup>1</sup> [www.alpha-group.com/](http://www.alpha-group.com/).

<sup>2</sup> [www.lsgskychefs.com/](http://www.lsgskychefs.com/).

9. Alpha currently operates facilities at 16 airports in the UK,<sup>3</sup> whilst LSG currently operates facilities at 12 UK airports.<sup>4</sup> The parties have overlapping operations at ten airports in the UK (the ‘overlap airports’): Birmingham, Cardiff, East Midlands, Glasgow, London Gatwick, London Heathrow, London Stansted, Luton, Manchester and Newcastle. We refer to airports at which only one of the parties operates as ‘non-overlap airports’.

## Market definition

10. The purpose of market definition is to provide a framework for the CC’s analysis of the competitive effects of the JV.<sup>5</sup>
11. The CC’s initial view is that in-flight catering services should be segmented according to whether the services are being provided to short-/mid-haul flights or long-haul flights.<sup>6</sup> We will also consider whether the supply of in-flight catering services is segmented by the size of customer. This is linked to the possibility that price discrimination could arise from any differences in buyer power between airlines—see paragraph 18 below.
12. Subject to confirmation, the CC’s current view is that it is unlikely that in-flight catering services should be segmented further by other factors—eg by type of carrier (scheduled as compared with charter or low-cost carrier); by type of catering service (ambient food as compared with non-ambient food); or by the class of passenger (first/business compared with economy), although the quality of the catering service offered by in-flight caterers may be an important dimension of competition between rival firms (see theories of harm below).
13. We will analyse the geographic scope of the affected market(s) as part of the assessment of the competitive effects of the JV. Our initial view is that the JV should be considered on both a local (ie linked to the airport at which catering is loaded<sup>7</sup>) and national basis. We will consider whether the characteristics of supply differ as between London airports (especially Heathrow and/or Gatwick) and those elsewhere.

## Theories of harm

14. The CC’s initial view is that there are five possible ways in which the JV could give rise to an SLC or the expectation of an SLC (referred to as ‘theories of harm’)—however, see paragraph 23 below.
15. The CC may revise its theories of harm as its assessment of the proposed JV progresses. The identification of these theories of harm does not preclude an SLC being identified on another basis following further work by the CC and/or the receipt of additional evidence.

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<sup>3</sup> Aberdeen, Belfast International, Birmingham, Bristol, Cardiff, Edinburgh, East Midlands, Glasgow, Leeds Bradford, London Gatwick, London Heathrow, London Stansted, Luton, Manchester, Newcastle and Prestwick.

<sup>4</sup> Birmingham, Cardiff, Doncaster, East Midlands, Glasgow, London City, London Gatwick, London Heathrow, London Stansted, Luton, Manchester and Newcastle.

<sup>5</sup> See *Merger Assessment Guidelines, September 2010, CC2 Revised, Section 5.2*.

<sup>6</sup> We have categorized any flight of less than 5 hours’ duration as ‘short haul’ and any flight with a duration of 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.

<sup>7</sup> But which may include regional geographic markets, eg if aircraft are catered from facilities geographically separate from the airport at which the loading of catering occurs.

### ***Theory of harm 1: unilateral horizontal effects at the national level***

16. The first theory of harm is that the JV would remove an important competitive constraint on a national basis. Currently there are three providers of in-flight catering with national coverage: Alpha, LSG and Gate Gourmet.<sup>8</sup> Following the JV, the number of competing entities at the national level would reduce to two, which may lead to higher prices for in-flight catering and/or a lower quality of service offering.

### ***Theory of harm 2: unilateral horizontal effects at the local level***

17. The second theory of harm is that the JV would remove an important competitive constraint locally. This theory of harm may have one or more of the following elements, each of which singly, or in combination, may result in higher prices for in-flight catering and/or a lower quality of service offering:
  - (a) the JV could lead to the removal of an existing competitor at one or more of the overlap airports (see paragraph 9 above); and/or
  - (b) the JV could lead to the removal of a potential competitor at one or more of the non-overlap airports (see paragraph 9 above).
18. In respect of both the first and second theories of harm we will consider the possibility that the JV would cause (or worsen if it is already a common practice) any price discrimination between smaller and larger airlines. Price discrimination might lead to smaller airlines being charged higher prices for in-flight catering and/or receiving an inferior service offering than larger airlines.

### ***Other theories of harm***

19. We note that other theories of harm are possible, and describe three further theories of harm below.
20. *Other unilateral effects.* The JV could make Alpha/LSG's negotiating position stronger in relation to their suppliers such that suppliers may receive poorer terms. In the absence of countervailing buyer power (see paragraph 26 below), this could affect Alpha/LSG's customers if the benefits of Alpha/LSG's upstream buyer power are not shared with its customers downstream.
21. *Vertical effects.* The parent company of LSG is Deutsche Lufthansa AG, an airline company. Deutsche Lufthansa also controls a number of other airlines. Emirates, an airline company, is the sister company of Dnata, Alpha's parent company. The vertical theory of harm is that post-JV, Alpha/LSG may have the incentive and ability to foreclose access to in-flight catering services to the downstream competitors of Lufthansa (and the airlines it controls) and Emirates.
22. *Coordinated effects.* The coordinated effects theory of harm is that post-JV, the companies active in the market may be able to coordinate prices (bids offered for contracts) and/or engage in some form of market sharing.
23. The CC's initial view is that the first and second theories of harm are the most likely theories of harm which could give rise to an SLC or the expectation of an SLC. Accordingly, our analysis will focus on these unilateral effects theories of harm. As

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<sup>8</sup> [www.gategourmet.com/](http://www.gategourmet.com/).

things currently stand we are not minded to pursue the three theories of harm described in paragraphs 20 to 22 (although see paragraph 15 above).

### ***Proposed analysis—unilateral effects theories of harm***

24. In assessing the first and second theories of harm, the CC will examine:
- (a) the extent to which the parties are close competitors for customers in the absence of the JV, compared with other alternative suppliers;
  - (b) the impact of profit margins (eg whether higher variable profit margins increase the scope for unilateral effects);
  - (c) whether the JV could strengthen the merging parties' global reach which may have competition effects within the UK;
  - (d) the sensitivity of customers to price changes and/or quality changes and whether there exist any barriers and/or impediments to customers switching supplier;
  - (e) whether any spare capacity held by alternative suppliers reduces the likelihood of and scope for unilateral effects; and
  - (f) whether exogenous market developments may, irrespective of the JV, facilitate the emergence of new business models to provide in-flight catering; for example, by combining logistic and catering operations, the use of 'back catering'<sup>9</sup> and/or airlines nominating preferred suppliers.

### **Counterfactual**

25. The CC currently considers that, were the JV not to take place, the pre-existing competition between Alpha and LSG would be likely to continue unchanged. This is known as the counterfactual to the JV.

### **Countervailing factors**

26. The CC will consider whether the following countervailing factors would prevent or reduce an SLC:
- (a) *Entry*. The CC will explore whether entry would be timely, likely and sufficient to prevent any SLC that might otherwise arise. In particular the CC will assess whether the JV creates opportunities for competitors to expand or for new entrants to enter the market with alternative business models.
  - (b) *Buyer power*. The CC will assess whether the JV's customers have countervailing buyer power, whether any such buyer power possessed by some customers would be sufficient to protect all customers from the effects of an SLC and what the impact of the JV is on any existing countervailing buyer power.
  - (c) *Efficiencies*. The CC will examine any arguments made in relation to efficiencies arising from the JV, and in particular whether these are rivalry-enhancing

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<sup>9</sup> ie loading an aircraft with catering at its originating airport for consumption on the originating departing flight and subsequent departures, thus avoiding the need to re-cater each time the aircraft lands.

efficiencies that can be expected to offset the effects of any loss of competition resulting from the merger.

27. The CC is not currently aware of any other countervailing factors.

### **Possible remedies and relevant customer benefits**

28. Should the CC conclude that the JV may be expected to result in an SLC in one or more markets, it will consider whether, and if so, what, remedies might be appropriate, and will issue a further statement.
29. In any consideration of possible remedies, the CC will take into account whether any relevant customer benefits might be expected to arise as a result of the JV and, if so, what these benefits are likely to be and which customers would benefit.

### **Responses to the issues statement**

30. Any party wishing to respond to this issues statement should do so in writing, by no later than 5pm on 22 November 2011. Please email [AlphaLSG@cc.gsi.gov.uk](mailto:AlphaLSG@cc.gsi.gov.uk) or write to:

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Inquiry Manager (Alpha/LSG)  
Competition Commission  
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LONDON  
WC1B 4AD

1 November 2011