

6 Views of other parties

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Introduction

6.1. In this chapter we summarize the evidence put to us by other interested parties in written and oral submissions.

Train operating companies

Anglia Railways Train Services Ltd

6.2. Anglia said that it had a catering supply contract with RGUK until November 1999. RGUK had a distribution centre at Liverpool Street Station from which it supplied food, drink and catering equipment directly to Anglia trains at the platform. The service did not include any on-train staff, who were all Anglia employees. RGUK received a management fee to cover the cost of running the distribution centre and HQ overheads, plus the cost of all food and equipment used.

6.3. Anglia said that its original catering supply contract with OBS was inherited from British Rail. OBS subsequently became RGUK. In November 1999, due to the lack of any real competition for its new catering supply contract and the high cost of the RGUK operation, Anglia decided to set up its own catering store in Norwich and manage the food purchasing and supply to trains itself. This was the current position.

6.4. Anglia said that only RGUK tendered in November 1999 for the new contract. Anglia thought that competitive pressure existed on RGUK only because Anglia was prepared to consider taking over the supply to trains. Other rail companies that needed multiple catering stores on their routes would find this approach more difficult to implement.

6.5. Anglia said that it was not necessary to have facilities at all stations. The number of stations with facilities would depend on the length and complexity of the rail operation in question.

6.6. The level of network facilities required depended on the length of the route, the level of quality required, and the on-train storage facilities available. As far as Anglia was concerned, a facility at the point of origin was sufficient. However, as Anglia extended its operation, new sub stores were being considered.

6.7. Anglia said that companies entering the market would either have to take over facilities from RGUK or sub-lease other accommodation from either the train operator concerned or Railtrack. A TOC might be able to make this available at a peppercorn rent as part of a catering supply contract. However, accommodation on many stations was very limited.

6.8. Anglia said that access to station facilities for storage was essential. Know-how could be acquired and was mainly related to working with the logistics of the rail service. Some companies had operated low-quality trolley services. But Anglia was not aware of any company, apart from RGUK, that could provide higher-quality service.

6.9. Anglia said that it was the quality of service required, rather than the size of the contract, which defined the selection criteria.

6.10. Anglia said that it did not have international contracts. The only difference in procedures for large contracts was that the EC Utilities Directive applied.

The Chiltern Railway Company Limited

6.11. The Chiltern Railway Company Limited said that it had no objections to the merger.

Connex South Eastern Limited

6.12. Connex South Eastern Limited said that it did not wish to make any representations regarding the merger.

Eurostar Group Limited

6.13. Eurostar Group Ltd (EGL) said that its current on-board catering services contract was awarded in 1999 after a competitive tender procedure conducted in accordance with EC Utilities (Contracts) Regulations 1996. EGL had awarded the contract for an initial three years from 2000, with an optional two-year extension.

6.14. The criteria for contractor selection included risk sharing, forecasting and cost estimates, management fees, ability to deliver proposals, technical and financial capacity and management structure. Experience was needed of the catering industry, management of front-line customer service staff, supply chain logistics, railway regulations in the countries in which Eurostar operated and security procedures. Knowledge of the railway environment was also important.

6.15. Four companies had competed for the on-board services contract: Mitropa (Germany), Sodexo (France), CWL (also from France, but in partnership with RGH), and Agape (part of the Italian Grupo Cremonini, then in partnership with Granada Retail Division, now Compass). The contract was awarded to Agape because it met the selection criteria and demonstrated the partnership approach that EGL wanted. Subsequently, the contract had been taken over by Momentum, a joint venture between Cremonini and Compass.

6.16. EGL felt there was sufficient competitive pressure on the bidders during the tendering process in 1999. Naturally, the incumbent had been well placed to win the contract, but did not meet EGL's selection criteria on that occasion.

6.17. As Eurostar was an international train service operating in France, Belgium and the UK, managed by EGL, the letting of contracts has been pan-European. About 60 per cent of EGL contracts had been issued to companies within these three countries.

6.18. Companies submitting tenders to EGL for on-board service were required to establish what on-train accommodation was needed to carry out their safety responsibilities and service duties. These facilities were borne by EGL. Other accommodation requirements should be covered in the reply to tender and included in the cost estimates.

6.19. Momentum recruited, paid and trained the on-board catering service staff for Eurostar. But EGL considered it was essential that they should be seen as Eurostar staff, presenting a good image of Eurostar to passengers and reflecting Eurostar service philosophy.

6.20. EGL had a separate catering logistics contract with Rail Gourmet Waterloo International Limited, a separate division of RGUK, for servicing Eurostar trains in the UK. This company had been set up in 1991 specifically to service Eurostar UK operations. It had originally been run by SAS, but this business was acquired by RGH in 1994. Again the contract had been awarded after a pan-European tender process involving several contenders. Other contractors provide similar logistics services to Eurostar in France and Belgium.

6.21. The logistics contract ran until August 2003. It covered the purchasing, transportation to station, preparation, short-term storage and station delivery to Eurostar trains in the UK of all food and beverages required by Eurostar for its on-train services. EGL imposed detailed product specifications and strict performance criteria. The logistics contractor operated from premises controlled by Eurostar at Waterloo International station.

6.22. Eurostar first class passengers were served with high-quality meals at seat. The cost of the meal was included in the ticket price. Food and service standards were more akin to airline executive class standards than those of traditional British railway catering. This was a key element in marketing the service and maintaining the Eurostar brand image, especially as airlines were the main competitors for first class passengers.

6.23. Contrary to the usual British practice, Eurostar trains did not have traditional train galleys. Food was regenerated on board in special ovens, similar to those on airliners. Standard class carriages had a more conventional retail buffet/bar from which food and drinks were sold. Between 20 and 30 per cent of standard class passengers bought food on trains. Many others bought from station outlets before

travelling, especially passengers from France and Belgium where on-train catering was less the accepted practice than in the UK.

6.24. Momentum operated on a management fee, based partly on performance indicators. Eurostar approved the prices for all food and drink sold on its trains. Retail food and drink sold to standard class passengers had more than covered direct costs in the past two years. Eurostar catering as a whole was run as a cost centre, not a profit centre. For inclusive first class fares the balance between cost and quality was particularly critical. Catering was a vital part of the service, but expensive to run. The contractors had to meet the hygiene and safety requirements of three countries. French labour laws imposed relatively high costs on the business.

6.25. Food and beverage specifications were reviewed regularly against performance indicators and customer surveys. Customer satisfaction was a key element and Eurostar insisted on a constant effort to improve standards. Reducing costs, especially in logistics, was also vital. These reviews fed into the annual catering marketing plan, which would guide EGL's approach to the next tendering round.

6.26. The tendering process took some six to eight months. EGL policy was that effective procurement controls must be in place to protect the company's interests. This included not only ensuring compliance with the EC Procurement Directives, but also laying down strict criteria for sources of supply, especially for items or services with a critical effect on safety or business risk.

6.27. After a pre-qualification round, EGL aimed to have a shortlist of four or five qualified companies for the final round. The basic criteria would be essentially unchanged. EGL hoped to avoid running UK tender exercises too close to those in France and Belgium, which were due in 2005 and 2006 respectively. It planned to conduct separate tender exercises for the UK logistics and on-board catering services contracts. Momentum and RGUK would be welcome to bid for renewal of their existing contracts.

6.28. Good competition was expected for both contracts. Several European rail catering companies, apart from the Momentum partners, were potentially capable of providing on-board catering services to the standards required by Eurostar:

- (a) *CWL* had been in the rail catering business for over 100 years. It remained strong in France, Spain, Portugal and Italy. It had, however, lost market share in the Benelux because of open competition and new players entering the industry (for example *RGH* and *Albron*—see below). It remained a big player by having partnerships with other rail catering companies on specific networks.
- (b) *RGH* had entered the rail catering market in Scandinavia and Belgium, as well as the UK, about five years ago through mergers and acquisition. It also operated the *Thalys* service in partnership with *CWL* on other high-speed Continental European networks.
- (c) *Albron* (Netherlands) operated concessions for Netherlands Railways and some logistics bases in the Netherlands. It was a relatively new player in the rail catering industry.
- (d) *Mitropa* was a wholly-owned subsidiary of Deutsche Bahn AG. Over 90 per cent of its business was in Germany. The company was formed over 100 years ago. After the reunification of Germany it was restructured to run all bar, buffet and station concessions for Deutsche Bahn AG throughout Germany.
- (e) *Narvessen* operated in Scandinavia, where the market had recently opened up to more competition.

6.29. Among catering contractors, Sodexo was a significant potential competitor for Compass, and had shown its capacity to compete by winning the FGW contract. Airline caterers might be expected to be interested in the logistics contract, especially as their core business was still suffering from the downturn in travel following the 11 September incidents. Other logistics contractors were capable of meeting the requirements and EGL was trying to make them more aware of the opportunities than they had been in the past. EGL had also considered the possibility of taking all its catering operations in-house, but this was not a preferred option. Changes to company structure and personnel would be needed, and the learning curve might be difficult.

6.30. EGL saw a dynamic future for Eurostar with the opening of the new Channel Tunnel rail links and the St Pancras terminal, further development of additional services to Avignon, Disney World and ski resorts and possible links to new Continental European high-speed services. On the other hand, faster journey times might reduce the demand for catering on trains.

6.31. EGL thought that some UK TOCs might adopt Eurostar catering standards and models. Virgin Trains was already moving in that direction, as was Amtrak in the USA. More Continental European rail catering contractors could be expected to show an interest in the UK domestic rail catering market, as Mitropa had in the FGW contract.

6.32. The proposed merger of Compass with RGUK could bring added efficiencies to Eurostar catering logistics and on-board service operations, as well as a reducing overheads and improving lines of communication. The corporate values and philosophy of RGUK and Compass were identical, which was to be valued in a partner company. EGL did not expect the merger to reduce competition for UK rail catering service contracts significantly in the short term. But in the longer run more consolidation among service providers seemed likely and this would be bound to diminish the supplier base.

First Great Western

6.33. FGW said that it operated over 1,100 services a week in and out of Paddington. It was the leading TOC owned by First Group PLC. It offered extensive catering facilities including on-train buffets, restaurants, travelling chefs, at-seat service to first class passengers, lounge services at key stations and special trains.

6.34. Prior to 1994, British Rail provided catering on trains in-house. Then until 1997 OBS had taken over catering for FGW. During that period FGW and the other TOCs had been locked into an agreement with OBS. In 1997, FGW had broken out of this arrangement and tendered the business. RGUK had won the contract for catering supply ahead of two other companies, [38]. In 2000, the contract was again put up for tender. Sodexho had won the contract to supply from January 2001, beating three other companies—[38]—in a highly competitive tender. Sodexho's contract ran to 2004, with an option to extend to 2006.

6.35. The catering contract covered product purchasing, catering logistics, product development and marketing support. It also provided for open-book accounting and tight logistical control by FGW, with strong key performance indicators based on getting the right products to trains on time. All FGW contracts were awarded on the basis of assessing the most economically advantageous bid that met FGW's specifications. A lot of work had to be done to reconcile Sodexho's purchasing practices with the complex structured approach to purchasing needed to support the FGW catering operation properly.

6.36. There were some barriers to entry to the market, but they were not significant. It was relatively open to new entrants provided they had some expertise in logistics, purchasing and railways operations. New entrants might, however, be put off by what they perceived as an apparently 'closed' and rather bureaucratic system. It was made clear to bidders that what was required was essentially a logistics and supply operation. Purchasing power was an important consideration, but that had to be related to the railway's special requirements. FGW, like the other TOCs, saw the brand image of on-train catering services as absolutely critical and therefore insisted on using FGW staff to serve meals and snacks on all its trains.

6.37. Sodexho had proved that a new company could successfully enter the market, and had overcome the initial operating difficulties. It had brought in people with railway experience. This showed that a large contract caterer with diverse interests could successfully take over a very specialist function. It was not necessary to have an established network of facilities at stations or at the point of origin. TOCs would lease premises to new entrants. Stores facilities were necessary in close proximity to some, but not all, stations.

6.38. FGW foresaw some adverse consequences of Compass's takeover of RGUK. The contract catering market had become less competitive in recent years. Compass owned SSP, which owned most of the station food supply franchises. Purchasing RGUK potentially gave Compass a near monopoly in many railway locations in the supply of food and drink since SSP would be supplying on the station and RGUK on the train. FGW thought that Compass might try to absorb RGUK into its mainstream

on-station business and that in time the logistics of the station and on-train operations would be combined. This would have a detrimental effect on future tendering since it would make it difficult to separate them.

6.39. FGW thought there was also a danger that Compass's purchasing power might restrict choice within the market as it strove to rationalize its purchasing in order to secure efficiencies. TOCs would be encouraged to adopt Compass brands and products. This might initially seem attractive both to TOCs and passengers, but in time could have an adverse effect on choice and price. It was also possible that Compass could steer customers towards its more profitable on-station operations at the expense of on-train catering.

6.40. Looking to the future, FGW said that TOCs' contracts with food providers would necessarily reflect the length of their franchises. It was possible that the larger TOCs might consider in-sourcing. But they would always need to outsource purchasing, or possibly join a purchasing group, as their individual purchasing requirements were very small compared with those of companies like Compass and Sodexo.

6.41. FGW said that although, on balance, it was opposed to the merger, it had some positive aspects. Compass was an efficient operator and was likely to introduce more investment, better branding and wider expertise into the RGUK operation. This could result in significant improvements. There was also the danger of RGUK ceasing to operate if its parent company collapsed. That would create real problems for TOCs and, in those circumstances, Compass was likely to take over anyway. There were no other obvious potential purchasers for RGUK. Although RGH appeared to work well in Continental Europe, where there was strong public underpinning of the railways and railway catering, it had not done so well in a competitive environment.

6.42. As to possible remedies, FGW suggested that if Compass were to take over RGUK, there should be a clear division of logistics assets so that an on-train contract could be relet without prohibitive costs of entry to newcomers. TOCs should also have a right to retender existing contracts without condition with six months' notice for at least three years regardless of current contract terms.

Great North Eastern Railway Ltd

6.43. GNER said that RGUK provided services in connection with the on-train catering offered by GNER. In particular, RGUK was responsible for sourcing in part the product range, managing the distribution of the specified products to service centres along GNER's route, packaging these goods to an agreed specification and their transportation to and from GNER's trains.

6.44. RGUK's remuneration for providing its services was obtained from a product mark-up, reimbursement of distribution costs and service centre running costs (including labour costs).

6.45. GNER sourced a number (but not all) of the products within its catering range and agreed cost prices with suppliers. However, all products were subject to a mark-up by the logistics provider by way of a handling charge. Future tenders would explore the benefits of charging a flat fee for the operation rather than marking up all products. GNER had full control over both the choice of products on offer and the quality specifications, except for branded products. The contractor had to meet specific performance criteria that essentially were centred on accuracy of supply, timeliness of delivery and quality of product.

6.46. GNER's current arrangements with RGUK expired in April 2003 when GNER would be looking to either renew the arrangements with RGUK or appoint a new contractor, following a competitive retendering process. GNER said it hoped that any invitation to tender would attract interest from a wide range of catering and/or logistics companies. As part of the retendering process, GNER would be seeking to secure the most competitive commercial terms, based on the quality specification required. However, in practice it was extremely difficult for GNER to control the level of mark-up and fee applied effectively. GNER would be evaluating the cost of running an in-house operation to benchmark against tender bids, as part of the competitive retendering process. Taking the operation in-house could be an option if insufficient competitive interest was shown.

6.47. GNER said that on-train catering was very important to its business. The food was profitable, excluding the cost of labour. It was seen as a key part of the customer service offer, and as such was an integral part of GNER's marketing strategy and brand image. Given the high profile of its catering offer, GNER would not contemplate either reducing its scope or withdrawing it.

6.48. GNER said that the main constraints to change in the train catering services market were the inflexibility of train/shore base infrastructure and the limited space for expansion of service points on trains and stores facilities on station. Effectively, changes could only be incorporated to trains during major refurbishments or in new builds. It was also difficult to find space for expansion at stations.

6.49. GNER envisaged that more would be demanded of train catering in future years as customer expectations rose. This could present new opportunities in inclusive travel/meal opportunities, although these had yet to be developed. Franchising the supply of branded products was an area that had not been explored by GNER. It had always been thought that a brand other than one associated with GNER would not add to the overall marketing position. Brands such as Upper Crust, Burger King and MacDonald's often offered a narrow product range in comparison to that currently offered by GNER. Products other than food and drink had been sold on-train with limited success, and it was not thought that their inclusion in the product range of the future would make any difference to the catering services market. Ultimately, the challenge to satisfying customer needs and expectations would drive future change.

6.50. GNER was not familiar with the major players in the Continental European rail market, but anticipated that set up costs could discourage them from entering the UK market. In the past, companies such as ERC, Sodexo and Mitropa had all expressed an interest in trading with GNER. ERC and RGUK would be excluded from a potential future bid because of previous amalgamations between these companies, which meant that they would be represented by Compass.

6.51. GNER said that, although it could see benefits from the merger in terms of purchasing power, it was concerned about the removal of a main competitor from the marketplace and the extremely high market share that the merged company would then have in the on-train food market. This was further exacerbated by the fact that Compass, through its various subsidiaries, operated the majority of food outlets on the stations along GNER's route, with specific brand domination, which could be restrictive to consumer choice.

6.52. Therefore, GNER said, it would like safeguards to be introduced to protect its interests and those of other rail operators and rail passengers. It suggested that one such safeguard could be that the maximum amount RGUK could charge in respect of its product mark-up should be fixed and that RGUK would not be allowed to increase its product mark-up above this amount without first obtaining the approval of the OFT.

National Express Group PLC

6.53. National Express said that it spoke for all the TOCs within National Express: Gatwick Express Limited; Midland Mainline Ltd; Silverlink Train Services Limited; ScotRail; Central Trains Limited; Wales & West Passenger Trains Limited; Cardiff Railway Company Limited; WAGN; and c2c Rail Limited.

6.54. Only three of these companies (Gatwick Express Limited, Midland Mainline Limited and the overnight service of ScotRail) had catering service contracts with RGUK. Midland Mainline Limited and the overnight service of ScotRail were the only TOCs within the National Express to have MBT services. Not all of the other National Express TOCs had catering services on their trains, as that was not always appropriate to the route or type of train service operated. But where on-board catering was provided, National Express believed it was an important customer service and critical to the brand image of their companies.

6.55. Since privatization of the railways, some new catering supply companies had entered the rail catering supply market with varying degrees of success and some had left. National Express expected that trend to continue. Those National Express supply companies that offered on-board catering had openly retendered or renegotiated their catering supply contracts in this period.

6.56. Central Trains Limited, WAGN, Silverlink Train Services Limited and ScotRail domestic services used contractors' staff to operate trolley services on their trains. Those staff wore uniforms specified by the TOC. A wholly-owned subsidiary of Wales & West Passenger Trains Limited provided its trolley service. For the MBT services, staff employed directly by the train companies concerned prepared and served the food on board.

6.57. All catering services provided were specifically designed to meet the needs of individual train service markets and it was critically important for the TOCs to control the price, range of choice and quality of catering products on offer.

6.58. RGUK acted primarily as a logistics operator in organizing the distribution of specified products from suppliers to railway stations and distributing individually-specified orders to trains. Their catering supply contracts required stringent performance criteria, backed by a penalty/incentive regime. All transactions were subject to open-book accounting scrutiny, covering the prices paid to suppliers by RGUK and charged by them to the TOC. This gave National Express companies scope to benefit from economies of scale. RGUK was guaranteed exclusivity of procurement and distribution of all food and beverages supplied to trains. National Express companies had the right to source and supply other goods if they wished.

6.59. The National Express companies' contracts with RGUK controlled the use of any station premises by RGUK to service trains. Their use was limited to the period of the contract. RGUK could not sub-let the premises or use them to service another TOC without the approval of the National Express company concerned.

6.60. National Express companies were happy with their present contractual relationship with RGUK, but their catering supply contracts would normally be put out to a competitive retendering process when they fell due for renewal. All options that might improve customer service or deliver greater efficiencies would be examined, including the possibility of taking the whole catering operation in-house. National Express thought that Continental European rail catering operators could be credible bidders for these contracts in future, if they had the necessary logistics and support. If such operators were felt able to give a good service to the required specification, National Express companies would consider them.

6.61. Because the National Express companies using RGUK services operated in geographically-separated areas it would be difficult to combine them logistically. Their contracts with RGUK allowed them to use their combined buying power where appropriate, but did not restrict individual company control over product selection and pricing.

6.62. Compass, through its ownership of SSP, had been active in station catering but had not put itself forward in on-train catering. National Express, therefore, thought it unlikely that the merger would reduce the number of companies potentially interested in supplying UK on-train catering in the UK.

6.63. National Express took the view that, in order to preserve their ability to retender contracts effectively, TOCs' rights to station accommodation designed to support catering supplies to trains should be tied in with the contract period and remain at TOCs' discretion. It was important that this was safeguarded and that the potential use of station catering premises was not allowed to prejudice the reletting of contracts. But access to broader catering supplies on station could help to alleviate supply-chain breakdowns.

6.64. National Express companies had contracts with SSP (part of Compass) covering a variety of station-based retail operations. SSP could only be removed from these premises for breach of contract or if the National Express company concerned required the premises for operational reasons. National Express wanted to prevent RGUK, following the merger, from being able to use the greater legal protection of such Compass-leased premises to support its contracts.

6.65. Consequently, National Express suggested that Compass should be required to keep on-train and station catering contracts separate, and should not be allowed to use their dominant position to leverage one contract against another. Contracts should only overlap at the discretion of the TOC concerned.

6.66. Looking to the future, National Express expected individual TOCs to continue to develop their catering services in line with the specific needs of their markets, or perhaps as a result of franchise negotiations with the SRA. The main constraints to change were most likely to derive from technology and rolling stock design. The regulations governing the building and operation of rolling stock meant that catering operations had to use specifically-approved equipment and comply with all aspects of food hygiene regulations, within the physical constraints of trains.

ScotRail Railways Ltd

6.67. In general, ScotRail said that it supported the transfer of RGUK to Compass. It believed that Compass had superior management skills to RGUK. The market already had very little competition and the greater efficiency of Compass meant that, on price, RGUK could not compete. RGUK's market domination was largely due to the barriers to entry. The infrastructure investment required to supply full on-train catering was very high for a business that was either losing money or, at best, close to break-even. The business was dependent on a mixture of income and contract payments from the TOC, which was unattractive to most potential entrants.

6.68. ScotRail said that in its internal Scottish services it worked with CCG (now part of Compass) to introduce trolley services, prior to privatization, and they had been better than was the norm for such services.

6.69. Catering was important on longer-distance routes, as passengers tended to expect it as part of the service. While competition from other TOCs in Scotland was very limited, ScotRail suffered competition from other modes of travel, particularly the private car. Added value items like catering were an important competitive tool in this context.

6.70. ScotRail said that it also felt obliged to carry trolley services on remote rural routes in winter, even though there was very little demand. This was because several trains had become trapped in bad weather conditions and the trolley catering service provided a valuable means of maintaining passenger health in such circumstances. Most other UK TOCs had no similar need.

South West Trains Limited

6.71. South West Trains Limited (South West Trains) said that it had recently sought expressions of interest to provide on-train catering services throughout its operation, [
Details omitted. See note on page iv.
].

6.72. [
Details omitted. See note on page iv.
] It would clearly not be in the public interest were the proposed acquisition to reduce the number of suppliers willing to tender for its contracts, but it remained a matter of conjecture whether the acquisition would have that effect and it would not seem that any safeguards would be appropriate.

6.73. [
Details omitted.
See note on page iv.
].

Virgin Trains

6.74. Virgin Trains said that this was the marketing name for two separate train companies: West Coast Trains Limited (West Coast), which covered the mainline routes going north from Euston; and Cross Country Trains Limited (Cross Country) (the only national rail network which did not serve London), which had its hub in Birmingham. Virgin Trains was marketed nationally, even though the franchises for the two companies were different. Both franchises were for 15 years and were let on the basis that Virgin Trains was going to invest in complete fleets of new trains for both companies. About half of the new Cross Country trains were in service. The first of 53 new West Coast trains were just being commissioned. It would be another 18 months before all the old trains were replaced. Having invested in new trains, Virgin Trains' approach was to grow the market through added value.

6.75. The new trains would have a significant impact on the provision of food on trains. The old trains inherited from British Rail provided food and drink from a traditional single catering area in the middle of the train, serving first class on one side and standard on the other. Historically, no catering was included in the ticket price. Virgin Trains had upgraded its first class to an all-inclusive product and had designed the new trains with that in mind. The traditional catering area on board had been split into two, with a galley supporting the operation of first class and a separate retail shop in the middle of the

standard accommodation in lieu of the old cramped buffet or trolley service. This would be developed into a full-scale retail business, operating as a self-service unit.

6.76. Virgin Trains said that there was nothing in its franchise agreement or in the Railways Act or the regulatory framework that required catering to be provided on trains, or specified the quality of catering performance. But if Virgin Trains decided to withdraw on-board catering altogether, that would be likely to become an issue with the SRA. On-board catering was also benchmarked as a derogation against one of Virgin Trains' commitments in the franchise in that Virgin Trains had asked for more time for on-station investment. The quid pro quo with the SRA was that Virgin Trains guaranteed to provide certain catering services. In that context, there was a link with the franchise agreement. But Virgin Trains could not envisage any scenario where catering would become a franchise termination issue.

6.77. Virgin Trains saw catering as a key element in the commercial success of its operation. Food provision was a core part of its added-value marketing package for first class, aimed at encouraging more people to travel first class. There was a notional value in terms of the cost of catering for each customer, so that the company had control over the budget and costs, but that was just an integral part of the fare.

6.78. On routes such as London to Manchester, Virgin Trains was competing with airlines for business passengers used to airline executive class standards. Its new catering facilities would allow fresh food to be served, which the airlines were not able to do. On the West Coast line, where there was a higher proportion of first class travel than on Cross Country trains, Virgin Trains operated three and one-half first class carriages, with 145 seats, and five standard class carriages with 300 seats. Inclusive first class fares were far more profitable in yield per passenger than standard class fares. But selling food and drink to standard class passengers more than covered direct operating costs.

6.79. Virgin Trains said that RGUK was simply a logistics provider. Virgin Trains ran its own retail business, had its own brand, specified the products and served them on board. RGUK acted as Virgin Trains' agent, purchasing the food and drink, handling it at stations and delivering it to trains.

6.80. Virgin Trains would not outsource the on-train operation because of the importance of its brand image, which encompassed its whole service philosophy to the customer. It was important that the staff were Virgin Trains staff. In theory it would be possible to outsource them and, since they would be covered by TUPE regulations, the staff would not lose out. But it would be contrary to the company's philosophy.

6.81. Virgin Trains provided the interface with the customer and dealt with customer complaints. All equipment on trains was operated by Virgin Trains, which took responsibility for equipment failures. RGUK was responsible for any shortfall or poor quality of supplies.

6.82. Virgin Trains said that, on balance, it was in favour of the merger. It was seriously concerned that RGUK could well go under if it was not taken over by an organization as substantial as Compass. Sodexo might offer an alternative, or Virgin Trains might have to take over the whole catering operation themselves.

6.83. Virgin Trains was not concerned that there was one less player in the market. It was a misconception to assume that the merger would create a monopoly in the markets currently served by Compass and RGUK. Those markets were structurally different. Compass was essentially a brand-focused retailer operating on stations. The retail operation on trains was branded, controlled and all staffing provided by the TOCs themselves. RGUK was simply a provider of logistics services to a detailed specification provided by each TOC, which was the caterer and retailer with complete control over premises, product specification and pricing.

6.84. Nor was Virgin Trains concerned that Compass had a very large presence in station catering. Compass already provided a significant competitive influence on Virgin Trains's retail business, but Compass could not through RGUK have an adverse effect on Virgin Trains's retail business. This was because the logistics provisions in the contract with RGUK were very specific and the performance regime was very tough. Since Virgin Trains owned or leased the premises from which RGUK had to operate there was no opportunity for Compass to try to merge the logistics aspects of the two businesses.

6.85. Virgin Trains said that it had a 12-year contract with RGUK, but with break points, one of which had passed. The contract provided for a very strong performance regime, and any fall in

performance allowed Virgin Trains to terminate the contract at any time. The contract could also be terminated with RGUK's change of ownership. All key assets, other than labour required for the operation, were either owned or leased by Virgin Trains. RGUK only had tenancy rights, linked to the contract, to premises required for delivering the logistics service to trains. Certain equipment used in the delivery of the service, such as electric tractors, was owned by RGUK. But all reverted to Virgin Trains at the then book value on termination of the contracts. Barriers to entry to the market were therefore low and Virgin Trains remained in independent control of its product and operation at all times.

6.86. Virgin Trains said that it had complete access to RGUK's books. RGUK got a [3%] per cent mark-up on all products they supplied. Virgin Trains also paid a fixed charge each year, which covered the labour costs of operating the service centres at the stations, and for RGUK's IT network and other associated management charges. RGUK took the risk on product availability and wastage.

6.87. All product pricing for on-train supplies was externally benchmarked, and supported by a performance regime, to ensure that value for money was secured. The TOCs and Compass competed to some extent for food and drink sold to rail passengers. Virgin Trains had invested heavily in developing retail outlets on its new trains so as to compete effectively with Compass's on-station operations.

6.88. Virgin Trains had not conducted a full competitive tender when it reappointed RGUK two and a half years ago. But it had undertaken a detailed benchmarking exercise, based on comparisons with running the operation in-house. Drawing on that benchmarking exercise, it had talked to other potential service providers. These included Mitropa, the German state railways caterer, Sodexo (although it had wanted to run the whole catering operation), and SSP (part of Compass). The latter was not interested because it felt that the contract would distract it from its core business of retail catering. Virgin Trains had also spoken to airline caterers, but none had the breadth of experience required.

6.89. Virgin Trains had renewed the contract with RGUK on the understanding that performance would be significantly improved, which it had been. There were few players in this market and RGUK was the dominant one. The other players tended to be small retail catering organizations serving regional train services and they were struggling to survive. Taking the operation in-house remained a possible future option. Two areas might still be outsourced by Virgin Trains; bulk purchasing, to provide better economies of scale; and distribution (which RGUK already outsourced to Tom Granby). Supplies might also be contracted through separate micro-franchises based on key distribution points.

6.90. Virgin Trains did not accept that the nature of its contract with RGUK, with very tight conditions and low margins, effectively discouraged others from competing. To date RGUK had worked hard and made no money. But over the next ten years market growth should offer scope for profitability to RGUK through increased product volume.

6.91. The merger would not affect the auditing and benchmarking regime. Virgin Trains thought it now achieved very good prices from RGUK, due to benchmarking and vigorously challenging any attempt to change prices other than downwards. It acknowledged the difficulty of achieving complete transparency of the real purchasing costs of some commodity products sourced through a big organization like Compass. But a significant proportion of the supplies was specifically packaged or produced for Virgin Trains and Compass's greater purchasing power could turn out to be to mutual advantage.

6.92. Virgin Trains did not agree that the detailed and highly controlled regime operated by the TOCs created significant barriers to entry. It said that it would, for example, be possible to operate with a series of smaller franchises, though Virgin Trains had chosen not to do so.

Rail passengers bodies

Rail Passengers Committee, Wales

6.93. The Rail Passengers Committee Wales (RPC Wales) said that all competition was healthy. Once there was a monopoly, however well run, the TOCs did not easily have the chance to change their catering arrangements and that could only be against rail passengers' interests. The customer was effectively only interested in obtaining good quality, at value-for-money prices (and with assurance of consistently hygienic service provision at all levels and stages).

6.94. RPC Wales said that a well-managed, versatile and committed monopoly provider could be good news. However, if that monopoly provider ceased to be well managed, good news would turn to bad. At present, service provision by a multitude of suppliers was very inconsistent. The best were excellent; the worst was best left undescribed. Therefore, competition per se did not necessarily act as an effective 'quality control tool'.

6.95. RPC Wales said that a degree of regulation and quality control was needed to ensure universal maintenance of standards, whether service provision was by a monopoly supplier or by several suppliers. Universal maintenance of high standards should not lead to uniformity of style; a response to varying local tastes and needs should always be encouraged. RPC Wales suggested that this quality control or regulatory role might be designated to the Association of Train Operating Companies on an agency basis.

6.96. As far as RPC Wales was aware, RGUK provided on-board catering supplies to various TOCs, but the TOCs' own staff (rather than RGUK staff) retailed these supplies directly to passengers on trains. The TOCs determined the range of products that should be offered and the price at which they would be retailed.

6.97. If this was correct, passengers were possibly not directly affected by the proposed acquisition. TOCs might have concerns over the merger, but there was nothing to stop them establishing their own operation or inviting other companies to become suppliers.

6.98. RPC Wales therefore concluded that, unless there was information to contradict the above, it had no objection to the merger going ahead.

6.99. In summary, RPC Wales concluded that effective quality control by the industry was needed to ensure consistently high standards. From the passengers' point of view it mattered not who supplied but what and how it was supplied, and that prices should be reasonable.

Rail Passengers Council

6.100. The Rail Passengers Council (RPC) said it was the statutory body representing rail passengers' interests. RPC had sought the views of the Rail Passengers Committees (the RPC Network) in compiling its response.

6.101. Given that there was little or no competition at station level and on trains, as Railtrack or a TOC could manage any one station, the RPC Network believed that the impact of such a merger would be minimal. Whereas some members of the RPC Network believed that standardizing catering provision would ensure passengers knew what was on offer, other members had serious reservations. There was concern that the price of food at stations and on trains was already excessive, compared with the high street. Without significant competition, prices might rise even further, especially as the market was a captive one. A 90 per cent market share would put Compass in an extremely strong position should any other companies wish to enter the market. This might disadvantage the passenger, as choice would be restricted. Given this, the RPC Network concluded that the CC was best placed to advise whether this merger would have '... the objective or effect of preventing, restricting or distorting competition in the UK ...' as stated in Chapter I of the Competition Act 1998.

6.102. The RPC Network expected that, if such a merger did take place, robust conditions should be established to ensure that food quality and service delivery remained of a high and acceptable standard. The RPC Network would also recommend that, in accordance with Chapter II of the Competition Act 1998, an independent audit of customer satisfaction should be carried out annually to assess consumers' views on food quality and choice, value for money and level of service, in order to ensure that Compass did not abuse its dominant position.

Government departments and regulatory bodies

Strategic Rail Authority

6.103. The SRA said that the franchise agreement set out the terms and conditions to which franchisees needed to adhere. Bids were received on the basis of the terms set out in the franchise

agreement, and operators were in breach of their agreement with the SRA if they failed to carry out the functions required by the franchise agreement. The franchise agreement did not include a provision for on-board catering. At the time of franchising, however, operators offered passenger benefits above and beyond the franchise agreement. These benefits were included in the assessment of relative proposals and, if the proposal successfully secured the franchise, were included in the contract between the SRA and the franchisee. Some of the additional services offered by bidders included a commitment to provide on-train catering. [

Details omitted. See note on page iv.

] Conversely, other operators [*Details omitted. See note on page iv.*] did not include a commitment to provide on-train catering in their proposal, but were free to provide it if it was commercially viable.

6.104. The SRA said that certain operators were therefore committed to provide on-rail competition, and this could be specified as a buffet or trolley service. The contract did not specify, however, the range or quality of food that an operator must provide or the price the operator should charge for food or drink. Where applicable, the SRA monitored the provision of such services, but would not monitor range, quality or price. Catering provided at stations would offer a substitute for on-train catering. Many stations had some catering facilities, especially those served by intercity and commuter trains.

6.105. The SRA said that some operators now included on-train catering in the price of certain fares, such as Midland Mainline's Premier ticket, which included food and drink. Many intercity first class fares included some element of on-train catering, such as free tea, coffee and snacks. As a result, any increase in the cost of catering might be bundled into the price passengers paid for these fares. The SRA did not regulate any first class fares, or the majority of standard open fares on intercity routes.

6.106. The SRA said that its predecessor, OPRAF, had considered the case for including the provision for on-board catering within rail franchise agreements before privatization. OPRAF had taken account of the availability of substitutes, the implications for taxpayer contributions, whether it offered value for money and the likely impact on train operators' ability to deliver other key objectives of privatization. OPRAF had concluded that regulating the provision and quality of on-board catering did not represent a good use of public funds and that such provision should only be undertaken where it was commercially viable.

6.107. The SRA considered that the catering available at many railway stations offered a good substitute for on-board catering and that passengers might also buy food and drinks outside railway stations for consumption on train journeys. It pointed out that some train operators did not provide on-board catering on many train services because it was not commercially viable. The SRA thought this indicated that train operators were not price setters.

6.108. The SRA took the view that requiring TOCs to provide on-rail competition where it was not a commercial proposition would increase the contribution made by taxpayers to rail industry costs. Taxpayers' contributions could increase significantly if the SRA dictated the quality, range and price of on-board catering available. The SRA also needed to consider how to monitor the quality and price of on-board catering (for example, whether it would need to set a standard size for coffee cups) or to ensure that hygiene standards were being properly maintained. It would also need to ensure that any food quality measures it contemplated would not oblige TOCs to allocate resources away from the core function of ensuring train reliability. And it would need to consider the cost of monitoring the quality, price and range of on-board catering.

6.109. The SRA believed that allowing on-board catering companies to develop in the private sector, rather than requiring train operators to provide on-board catering themselves, should enable competition to develop, ultimately leading to lower prices, higher quality and greater choice. On the other hand, standardizing the range and quality of food to be provided might stifle innovation and increase the costs of food provision. The SRA believed it was not ideally placed to determine what rail passengers required from on-rail catering and this should be left to the market to determine.

6.110. The SRA suggested that it could consider requiring train operators to retender their contracts for on-board catering more frequently to try to encourage growth in the number of players in the market. This would require the SRA to take a view on the optimum duration of these contracts to ensure that competition for new contracts was fair while giving the incumbent contractor sufficient incentive to invest. The SRA, however, was not convinced that it was better placed than TOCs to make that decision.

Department for Transport

6.111. The Department for Transport (DfT) told us that the SRA conducted the whole of the process for letting franchises, and that the role of the DfT ministers was limited to setting the broad policy framework and giving specific approval before the SRA signed Heads of Terms and final franchise agreements. The Secretary of State's Directions and Guidance to the SRA, and his associated Franchising Policy Statement, set out the high level policy for franchising and were confined, as far as possible, to key issues. The DfT considered that the inclusion of specific references to on-board catering competition issues would probably sit uneasily with this approach.

6.112. The DfT would have no objection to the SRA taking account of on-board catering issues in reaching its decisions, assuming it was content to do so. However, this could only ever be a comparatively minor factor in the process. The key franchising evaluation drivers included service patterns, enhancement and investment options/commitments, quality, cost and value for money. The DfT said that it would expect the SRA's specifications for franchises, and its evaluation of bids, to focus on these. This was especially true where there were affordability issues around a franchise.

Catering and logistics contractors

Sodexho Alliance

6.113. Sodexho said that it was a French company listed on the first market ('premier marche') of the Paris Bourse. It was the holding company of a group of companies (Sodexho Group) active on a worldwide basis in outsourced food and management services; concession catering services (almost exclusively in leisure and sport locations); service vouchers and cards; and river and harbour cruises. Sodexho UK was one of the Sodexho Group companies. It was registered in the UK.

6.114. Sodexho Group's global business strategy was to create solutions packages that allowed clients to outsource more and more of their own 'non-core' operations. Sodexho provided a broad variety of services to a diversified client base: government agencies, corporations, public and private schools, universities, healthcare establishments and retirement homes. Outsourced food services were only part of a comprehensive range of multiple services which also included laundry, general management services, switchboard, mail, cleaning, grounds-keeping, waste recycling and disposal, custodial services, technical maintenance and security.

6.115. Sodexho said that the Group employed more than 314,000 people, at more than 24,300 sites in approximately 72 countries. For the fiscal year 2000/01, the Group's consolidated worldwide sales were €11.9 million (some 42 per cent of which was achieved in Europe and 50 per cent in North America). Sodexho's expertise was derived principally from its contract food and management service sectors.

6.116. Sodexho said that the Group was only marginally involved in on-train food service business in Europe and rail catering was not an essential part of the overall corporate strategy. Most of Sodexho's business in the UK and Ireland was in the food and management services sector. Within that sector, most of Sodexho's leisure business was concession-based. Sodexho was a market leader in corporate hospitality and leisure catering in the UK.

6.117. Sodexho UK had won the FGW catering logistic and supply contract in 2000 through a chance bid, which did not conform to normal corporate strategy (although Sodexho UK had previously held a first class food service contract with Eurostar, which had been lost when it had been retendered). Sodexho UK ran a chain of supply depots for a management fee from FGW at railway stations between Paddington and Plymouth. Food and beverages supplied to FGW trains under the contract currently had a turnover of £[redacted] million, out of a total contract turnover of £[redacted] million. The contract also covered the supply of beverages for an on-train mini-bar service for FGW trains, training of staff who were employed by FGW to serve food and drinks on trains, and purchasing, logistics and cleaning services for FGW lounges on station platforms.

6.118. Sodexho said that it supplied products to detailed FGW specifications in response to specific orders from FGW staff and delivered them to FGW trains or station lounges. The depots were owned and

maintained by FGW. They were cramped, but FGW had a phased refurbishment programme. Sodexo had inherited all the staff from RGUK on taking over the contract, although it had allocated a new Finance Manager to help operate the contract.

6.119. The contract ran until 2006, with a break point in 2004. [*Details omitted. See note on page iv.*] Discussions about possible contractual changes, including key performance indicators, were being held with FGW. Some management changes had taken place in FGW since the contract had been signed which might affect the outcome of these discussions. Sodexo could not say at this stage whether it would bid to renew the contract, nor which companies, apart from RGUK, might compete for the new contract. But in-house competition could not be ruled out.

6.120. Because of its limited business experience in on-train catering services, Sodexo had no established view or information to offer about the merger. Nor was Sodexo in a position to take an informed view of the likely future development of the market.

Compagnie des Wagons-Lits

6.121. CWL said that, as a leading European provider of on-board rail catering services, it believed that mergers and concentrations were now inevitable in the market for on-board rail catering services and that this would have positive effects for TOCs and railway passengers. The Compass/RGH merger should help to stimulate better market practices, including competitive conditions. It was likely to lead to improved quality of service, lower prices, increased levels of professionalism, greater capacity for innovation and investment, and enhanced social responsibility; all of which would be welcome to TOCs and railway passengers. CWL believed that the European Commission shared that view, which was why the merger had been allowed in all other EC markets.

6.122. CWL considered that the UK rail catering market offered interesting development potential, and it was studying the possibilities of increasing its own competitive position in that market. The merger would make no difference to those plans since it would have little or no impact on the on-board services market, which was its specific field of activity. But it should have a positive effect on station catering and logistic centres.

6.123. CWL acknowledged that the merger would improve the global value of Compass and RGH. But CWL preferred to confront a global and professional competitor with a similar economic base in almost all the markets in which they were currently engaged, rather than having to contend with a multiplicity of lower-cost and less professional smaller competitors. CWL was therefore in favour of the merger.

Tom Granby (Liverpool) Ltd

6.124. Tom Granby said that it was a logistics contractor and had been associated with rail catering for over ten years. Originally it had been contracted to Inter-city On Board Services, a division of British Rail. Following a management buyout that contract had been transferred to OBS. RGUK, a division of Swissair Group, had subsequently taken it over.

6.125. Throughout that period the service provided had changed from a fairly casual arrangement to a carefully structured and disciplined contract. The initially limited range of ambient products required had developed into a multi-temperature range which combined stock held for a period and just-in-time items. Most products were bespoke to the requirements of individual TOCs.

6.126. Tom Granby saw its role as managing the infrastructure between RGUK and its national network of service centres and a diverse range of food and beverage manufacturers. Tom Granby's single central distribution centre in the North-West of England acted as a hub to which all suppliers delivered their products. From there Tom Granby made consolidated deliveries every day to RGUK service centres as required to ensure maximum availability of supplies and operational efficiency.

6.127. Tom Granby's views on the merger were:

- (a) The financial strength of Compass should remove concerns Tom Granby had had over the past 12 months about the financial viability of RGUK. Difficulties experienced with the previous owner had placed great strain on Tom Granby's relationship with RGUK. It hoped the merger would restore the relationship to the good standing it had enjoyed when Swissair had been financially sound. No other changes were foreseen.
- (b) Rail catering's very specialized service requirements, including unpredictable menu changes and volatile volume changes, left little or no scope for developing operational synergies with the volume of existing Compass operations.
- (c) The partnership between RGUK and TOCs gave complete transparency of costs associated with managing the supply chain. Regular benchmarking and competitive tendering processes ensured operating efficiency without compromising quality standards.
- (d) Tom Granby saw no potential conflict of interest or lack of future competitiveness arising from the merger.

Xpress Catering

6.128. Xpress Catering said that it was not surprised there was little interest from companies in bidding for on-train catering service contracts. The rail industry had gone through a very bad time with a number of catering companies either going out of business or withdrawing from contracts. Very few companies were now involved in catering on trains and it was becoming increasingly difficult to make a profit in this market.

6.129. RGUK had had a monopoly of on-train catering since it came into being, following rail privatization. Xpress Catering said that, while it would be very interested in tendering for combined meals, buffet and trolley service contracts, it had never been in a position to do so due to the lack of suitable accommodation at major stations. RGUK held all the suitable sites. Xpress Catering said that when it had been given accommodation it was often too small and not suited to delivering the type of service that major operators required. Xpress Catering said that it had recently spent £80,000 on a derelict building at Nottingham to improve its own accommodation. However, at most stations suitable accommodation was just not available for smaller operators.

6.130. Compass currently had a monopoly on catering on stations throughout the country and with the acquisition of RGUK would control catering choice for the majority of passengers. Railway catering was a difficult market in which to make a profit, especially for smaller independent companies. This merger would make it even harder for such companies to compete.

Other

British Hospitality Association

6.131. The British Hospitality Association (BHA) said that it represented catering trade interests. None of its members had expressed concern about the merger nor were they expected to do so. The BHA's position was that there were no barriers to entry to the on-train catering supply business. It was seen as essentially a logistics supply business, quite separate from the retail business of on-station facilities.

6.132. The BHA noted that most catering and logistics supply companies seemed to have little or no interest in bidding for rail contracts. This was probably because it was still regarded as a specialized business where the margins were low and growth had been poor in recent years. But that could change; improvements in train service reliability and the introduction of new trains could expand the market. There was always scope for competition for on-train trolley services, where several small companies had carved a niche for themselves. MBT was a more complex, higher-risk business where the buying power and managerial ability of a big player were critical.

6.133. The BHA said that capital was not a significant issue since the facilities and some of the equipment was leased from Railtrack or the TOCs. Shore bases were so closely tied to rail operations

that it would not make sense to try to operate from alternative premises. Nor was labour a constraint: TUPE rules meant that the bulk of the workforce would be transferred to a new entrant. Skilled managerial staff could be hired.

6.134. The BHA thought that Compass had huge buying power that should enable it to improve the margins of the RGUK contracts significantly without having to increase prices. Sodexo was a serious competitor with as much buying muscle as Compass, if not more. Having gained a foot in the door with FGW, Sodexo could be expected to bid hard for major contracts like GNER and Virgin Trains when they came up.

6.135. The BHA said a more open question was whether other major players would be interested. Big logistics companies like Hays, Exel, Aramark (which mainly serviced oil rigs) and Serco (which had huge contracts with the MOD) were potential rivals that might be attracted to compete with Compass. But, unless the market looked particularly attractive, they might well leave it to Compass and concentrate on opportunities elsewhere. Airline caterers also had the expertise and the contraction in the number of airline catering operators gave extra buying power to those that remained. They might also be looking for opportunities elsewhere because of the downturn in the more valuable sectors of airline business and the squeezing of margins by low-cost airlines. But there had been no sign of this so far.

6.136. The BHA doubted whether major European rail caterers like Mitropa and CWL would be very interested in the UK rail market. They had a solid base in high-volume European business that appeared to be more profitable, and to offer more security of tenure, than the fragmented UK rail market. But, above all, apart from Sodexo they lacked a strong UK purchasing base from which to derive economies of scale. That was why Mitropa had withdrawn from the GWT bidding process.

J Sainsbury plc

6.137. J Sainsbury plc said it believed that on-train catering services were not directly in competition with its stores close to or in railway stations, except in so far as some customers might purchase sandwiches, snacks or drinks before boarding the train. J Sainsbury plc had no plans to compete more directly by offering on-train services. It did not wish to comment on the proposed merger.

D P B KINGSMILL (*Chairman*)

C R SMALLWOOD

R TURGOOSE

S R M WILKS

R FOSTER (*Secretary*)

17 June 2002