

## The supply of bulk liquefied petroleum gas for domestic use

### BP's response to the Competition Commission's Statement of Issues

#### A. Market Definition

- BP LPG UK ("BP") believes that the relevant product market is for bulk LPG supply, encompassing all competing bulk LPG suppliers, both new and existing customers, arguably both domestic and commercial customers, and may also include supply of other fuel types, in particular heating oil.
- As discussed below, there is real competition between LPG suppliers for existing customers, as well as competition for new customers.
- BP is of the view, particularly from a supply-side perspective, that the relevant market should arguably also encompass commercial customers. Any party currently supplying bulk LPG to commercial customers could switch with relative ease to supplying domestic customers.
- The costs for a domestic set-up for heating oil are sufficiently low not to deter LPG customers from switching. This is evidenced by the fact that a proportion of customers lost to heating oil each year are prepared to replace a working gas boiler in order to benefit in the medium to long run; BP calculates that after [...] **[CONFIDENTIAL]**, a customer switching from LPG to heating oil will have recouped the costs they incurred in switching and will be paying less for heating oil than they were for LPG. Out of all customers lost by BP, by far the greatest percentage is lost to heating oil. In view of this, BP believes that heating oil clearly exerts a competitive constraint on LPG suppliers and may form part of the same market as LPG.
- BP considers the relevant geographic market for the supply of domestic bulk LPG is at least Great Britain and possibly includes Northern Ireland. This is based on the following grounds: (i) there is considerable overlap between the areas that can be economically supplied by different terminals and depots, creating an unbroken chain of substitution covering the whole of Great Britain; (ii) BP's LPG domestic business is organised on a national basis; and (iii) [.....]**[CONFIDENTIAL]**

#### B. Market Structure

- As stated above, BP considers that the geographic scope of the market is national. Nonetheless, national market shares underestimate the strength of regional and local players who provide LPG on very competitive terms and many of whom have built a strong reputation in their area.

#### C. Switching

- BP considers that the number of customers who actually switch does not provide a complete indication of competition in the domestic bulk market since a much

larger number of customers do consider alternative suppliers. BP's customer surveys show a high degree of satisfaction with BP and this quality of service encourages customers to be loyal to BP.

- BP's average tank installation and uplift charges to domestic customers are low, and BP does not believe they represent a material barrier to switching. Notwithstanding the installation/uplift charges, customers have an economic incentive to switch suppliers as it is clear that customers can benefit from switching, irrespective of these costs. BP calculations show that a typical domestic customer switching to BP could save a substantial sum over the first three years of their contract.
- In addition, the link between tank ownership and supply does not give rise to any other material disincentive to switching:
  - When a domestic customer confirms that they are changing supplier, the out-going supplier and in-coming supplier then work together, in accordance with the LPG Association's Code of Practice, to ensure that the process of tank removal and installation is seamless, no break in supply occurs and the entire process takes place in the space of 24 hours. In the vast majority of cases it will take place within one working day.
  - BP aims to uplift a tank within a period of six weeks after the contract termination date and in practice it usually takes less time than this.
- Similarly, BP believes that the use of three-year fixed term contracts and three-month notice period are reasonable in the circumstances.
  - The three-year term is required so as to reduce the risk that BP is unable to recover the costs of serving a customer in the event the customer switches to a competing supplier or fuel. It also increases planning efficiencies for BP. The result is an acceptable LPG price for customers. A further benefit is that the fixed contract period enables BP to absorb product price increases and offer customers a level of price stability.
  - More generally, a longer contract length means that customers can benefit from competition for the contract by locking in good price discounts in the first three years.
  - The three-month notice period for termination is required to ensure that the uplift of BP's tank can be organised and, where the customer is switching to a competing LPG supplier, co-ordinated with the installation of the new LPG supplier's tank to ensure all the various parties involved (including contractors) are available on the same day.
  - The three-month notice period is often of benefit to the customer since this allows the tank to be run down, making the process itself less complicated and therefore safer. The three-month notice period also gives the customer time to consider any comparable lower offer put forward by the existing supplier and to use this as a negotiation tool with the potential new supplier. This competitive process allows the customer to achieve a better deal.

- BP's has structured its pricing policy to enable it to offer a lower introductory price to attract new and existing customers.

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

- The UK domestic bulk LPG market (or market segment) is mature and demand is stagnant. LPG attracts few new domestic customers, and most tradesmen and new housing developments in areas which do not have mains gas will opt for or recommend heating oil rather than LPG. BP would not therefore expect the market to attract significant new entry. Because there are few new domestic customers, competition between existing domestic suppliers for each other's existing customers is intense.
- Nonetheless, BP believes that there are few barriers to new entry or to expansion by an existing player.
- BP does not believe that switching costs create any additional barrier. In a large number of markets a new entrant will often need to undercut existing established players to attract customers. The cost-benefit analysis shows that savings are achieved by switching supplier. These can be offered by new entrants and existing suppliers alike, and there is no reason why a new entrant could not recoup tank costs in a similar manner to BP.
- Expansion by existing LPG suppliers, either from geographically contiguous areas or from bottle LPG operations, is feasible.
- A new entrant may not have national coverage, but will benefit from economies that can be achieved on a local or regional basis that, for example, allow it to reduce average delivery costs. The large number of smaller suppliers that have established a viable business with a very strong brand reputation within their local area or region demonstrates that national coverage is not required.
- BP believes that vertical integration does not confer any particular advantage in this market with different companies choosing to operate different models. In BP's case, BP plc's various businesses are expected to be profitable entities in their own right.

### **E. Pricing**

- BP sets its domestic bulk retail prices taking into account a wide range of factors including the competitive threat from other LPG suppliers and heating oil, its business costs and margin and strategy aspirations.
- The principal reason for increases by BP in its retail price is increases in the cost of product. However, in setting the retail price, BP takes into account the fact that customers value a degree of certainty.
- BP has an overall pricing framework within which its initial offer, its standard retail price and any individual customer reductions are set.
- When BP does introduce an increase to its standard retail price then typically such increase will apply to all customers with the exception of those customers within their introductory contract price period.

- In order to maintain customers, BP will often negotiate a lower price with a customer on an individual basis. The sales staff will endeavour to address price issues and in doing so will evaluate factors such as the cost of product, volume, existing margin, cost to serve, etc. However, BP operates within a pricing framework with set parameters and, to the extent that prices are set independently, this can only be done within stipulated pricing bands.
- LPG pricing is not complicated and the price offers from different competitors can be easily compared. The only components of the ongoing price of supply are the gas price and standing charge, with a one-off charge for installation at the outset and in the event of a subsequent switch, a one-off charge for uplift. Customers switching from a competing LPG supplier are familiar with the pricing structure. For new customers, comparing charges across LPG suppliers can be easier than comparing charges across natural gas or electricity suppliers. Utilities are increasingly using (i) different standing charges or (ii) price bands by reference to quantity without a standing charge, making comparisons between suppliers difficult.

**F. Profitability**

- BP plc's economic evaluation methodology ensures that all parts of the BP Group are competing for capital funds and are evaluated on a consistent basis. Accordingly, all investment decisions are evaluated at the Group Cost of Capital.
- BP believes that vertical integration does not confer any particular advantage given that: (i) BP plc's various businesses are expected to be profitable entities in their own right; and (ii) all inter-group transactions are carried out on an arms-length basis.

**G. Metered estates**

- BP does supply some metered housing estates with common LPG storage. Within the limits of existing installation and pipe work BP's customers (individual households) would only be able to switch LPG suppliers if all households agreed jointly to switch. However, BP sets up each household as an individual account and households may decide not to make use of the common LPG supply and to use an alternative fuel instead.

**H. Safety**

- BP believes that given the volatile and hazardous nature of LPG, unless the supplier of LPG to any tank also has clear responsibility for the safety of that tank throughout its lifetime, including installation, testing, maintenance and repair, there would be a marked increase in the safety risk. A single point of responsibility is necessary to ensure the integrity of safety management. It is BP's firm belief, and BP's policy, that effective safety management is not just a question of meeting legal requirements but of instilling and maintaining a culture of compliance throughout. Any compromise to that safety management system could compromise safety to the detriment of drivers, engineers, customers and their neighbours

- Any supplier making a delivery to a tank owned by a third party tank would have no guarantee that the tank, fittings and pipe work had been correctly installed, tested, maintained and repaired. Even if a complete written record of tank and pipe work history could be obtained and even if the supplier was to carry out its own tank and site audit, BP believes that the fact that the tank has been supplied by a number of different companies and maintained and tested by another third party introduces additional safety risks that would not arise were one party to be responsible for safety throughout the lifetime of the tank.
- Conversely, the tank owner would have no guarantee or means of ensuring that the LPG supplier would not incur safety risks when delivering the LPG. Whilst the LPGA Codes of Practice set out a number of minimum standards for LPG delivery, it is the supplier's safety management system, training and compliance culture that ensures safety and compliance with standards, not the mere existence of the minimum standards themselves. For instance, many of the COP requirements are broadly drafted and allow for differences in interpretation in determining the procedures that need to be put in place. The COP does not provide the tank owner with any guarantee that the third party driver would carry out a full visual inspection of the tank and site and would not fail to notice tank corrosion, fire hazards such as overgrown trees, sheds or walls. Similarly, the COP provides no guarantee that the driver will not overfill the tank due to failure to observe line of sight procedures or lack of familiarity with the tank fittings.
- In the event that an LPG leak or an unsafe tank siting was to result in a gas leak or worst still, an explosion, it is highly unlikely to be clear which party was at fault. BP does not believe that responsibility for safety could be contractually allocated solely to one party or apportioned as between tank owner and supplier.
- In BP's view any system whereby the incoming supplier purchases the tank from the outgoing supplier would present a significant number of difficulties.
  - BP would need to ensure, as it would before supplying a third party tank, that it obtained from the out-going supplier a complete record of tank and pipe work history. BP would also carry out its own site inspection (which would be the same as if installing a new tank) and, if necessary, its own tank and pipe work tests. Similarly, when passing over ownership of a tank, BP would seek mutual sign-off with the new supplier that the tank passes over in satisfactory condition.
  - If the previous supplier is unable to provide a complete record of tank history, or if BP's own tests revealed inadequate safety standards, BP would either not be prepared to purchase the tank or, provided that the tank itself met safety standards as regards to minimum thickness, no evidence of corrosion etc, would need to carry out a full refurbishment including new coatings, valves and other fittings. BP would, in addition, need to be happy that the customer site did not present any safety hazards. Out of those tanks that meet the required safety standards, there may still be a proportion of tanks that BP would not be prepared to purchase, for example, tanks for which spare parts are difficult to source, or tanks manufactured by suppliers who have been removed from BP's approved list.