



By appointment to Her Majesty the Queen
Suppliers of Liquefied Petroleum Gas
Calor Gas Limited (Warwick)



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Non-confidential version

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Dear Mr Freeman

DOMESTIC BULK LPG INQUIRY: Calor's comments on the Competition Commission's Proposed Final Report

[excised]. Set out below are our comments on the Proposed Final Report.

Procedure

1. We are very concerned about the procedure being followed by the Competition Commission in that its Remedies Working Paper has preceded its Proposed Final Report and that comments on the Remedies Working Paper were required before the Proposed Final Report was published. Moreover, this Proposed Final Report was published one week after the deadline for comments on the Remedies Working Paper – a very short timescale within which to consider the impact of the comments on the latter in the context of the proposed findings. Logically speaking, the remedies follow from the report, which introduces some significant new material Calor has not seen before. We request that our comments on the Remedies Working Paper set out in my letter of 23 March 2006 be read back into the relevant elements of the Proposed Final Report, where appropriate. We also refer to our comments in paragraphs 1-4 of my letter of 23 March which set out our views on the substantive findings which are supposed to underpin the remedies proposed.

2. In this response, we have not repeated verbatim the comments which we have previously made at various stages of this Inquiry, particularly on the Competition Commission's Provisional Findings. In some cases, these comments have been accepted by the Competition Commission. Where this is not the case, it can be taken that our previous comments still stand. For a convenient summary please see my letter of 23 March 2006.
3. Some of our specific concerns with the procedure are as follows:
 - The Competition Commission has produced, in what is supposed to be the final stages of this investigation, and without any specific attention being drawn to it, an entirely new economic analysis. This purports to show that suppliers have collectively overcharged domestic consumers [excised]. This work is also relied on in Appendix E, paragraph 2 of which states that 'prices appear to be substantially above competitive levels'. For the reasons given below, Calor considers this analysis to be flawed and unreliable. Its publication is likely to be harmful to the interests of the industry. As a matter of process, Calor believes that it and all the other suppliers should have had an opportunity to comment on the analysis and discuss it with the Competition Commission prior to its publication.
 - In relation to the proportionality of remedies, we refer to our comments in our Response to the Remedies Working Paper and to our comments below, particularly in the light of the costs to Calor of the proposed tank transfer remedy.

On certain of the specific issues raised in the Proposed Final Report or earlier, we would make the following further comments:

Terms of reference

4. For the reasons set out in paragraphs 7 to 9 of my letter of 23 September 2005, Calor firmly remains of the view that supply to commercial operators of metered estates (category (b) in the Competition Commission's table in paragraph 6 of Appendix A) falls outside the terms of reference. There is a commercial supply and the Competition Commission acknowledges, correctly, that all the suppliers treat such intermediaries as commercial customers. The domestic customer on these sites has no direct relationship with the supplier, the site owner almost invariably owns the supply network and meters, and the relationship between the supplier and the site owner is clearly business to business. As far as we are aware, the site owners themselves have not been consulted or included in the process of consideration of the issues. Moreover, we do not accept the relevance of the position taken by Ofgem in a different context and note that the Competition Commission's position as set out in paragraph 15 of Appendix A seems equivocal. More importantly, the Competition Commission has apparently not given any consideration to the impact of its proposed remedies on the commercial negotiations between bulk LPG suppliers and commercial operators of caravan and other holiday sites who in turn supply to customers. For example, the two year limit on exclusivity (albeit renewable) while acceptable in

the context of contracts with customers may raise questions of compatibility with EC Competition law in relation to business to business transactions. The OFT has itself studied the terms of supply by commercial operators of caravan and other holiday sites to their customers and this is in our view the proper basis for ensuring that such customers' interests are protected.

Features of the market

5. As a matter of law, Calor cannot see how the Competition Commission's findings that:

- “some customers are not aware of their ability to switch supplier” (paragraph 6.2(b)(i)); and
- the “limited ability of suppliers to identify and target their marketing efforts on each others' customers” (paragraph 6.2(d)),

might be regarded as a “feature of a market” as defined in section 131 of the Enterprise Act 2002. In particular, we do not see how a state of mind as reflected in the first finding above can amount either to the ‘structure of the market’ or to ‘conduct’ as defined in that section and in particular sub-sections (2) or (3). Similarly, we do not see that an ‘ability to target marketing’ amounts to a feature as defined. [excised]. For this reason, Calor requests that these findings are removed from the Final Report.

Safety

6. We maintain that the consideration of the safety issues by the Competition Commission in its Proposed Final Report is still in important respects inadequate. All Calor's previous concerns stand but we would add or reiterate the following:

7. As an initial point, I would refer to the Competition Commission's statement in paragraph 5.20 of the Report, “In principle, it would be possible for the safety regime to amount to a cloak for anti-competitive behaviour, in which case the practices outlined above would not be justified on safety grounds and might have evolved differently”. This view is carried over from the Provisional Findings Report (paragraph 5.13). As I said in my letter of 23 September 2005, there is absolutely no evidence of this, [excised]. It is unnecessary speculation and prejudice and, unless qualified or removed in its entirety from the Proposed Final Report, will be damaging to the reputation of the industry.

Safety Management procedures/systems

8. The Competition Commission does not accept that the practice of uplifting tanks is necessarily the most efficient way of safely managing the supply of domestic bulk LPG (paragraph 13 of the Summary). This finding is partly based on the counterfactual adopted by the Competition Commission, which is that “...safety management...could have evolved or been adapted to allow transfer arrangements, on reasonable terms and conditions (including the price of the transferred tank), without compromising safety.” (paragraph 5.31).

9. Calor believes that the counterfactual adopted by the Competition Commission has been incorrectly reasoned. The current system of supply ensures that LPG suppliers maintain absolute lifetime control over and legal responsibility for their tanks and associated fittings. This results in high levels of safety in an industry which directly interfaces with domestic customers and the public, and reduces the scope for disputes over product liability. In our view, it is unrealistic to consider that an alternative form of supply might have developed which would demonstrate the same clear legal and safety benefits. We refer in particular to the reasons given in Appendix 1 to my letter of 23 September 2005. The Competition Commission has accepted in Appendix D at paragraph 61 that the current model is one means of allocating responsibility. [excised], clarity in responsibility is critical in maintaining safety: that is why we view with very great concern the tank transfer proposal – which the Competition Commission accepted in its Remedies Working Paper may result in disputes between suppliers in relation to the standards or quality of transferred tanks.
10. One of the key reasons for tank transfer not being a credible counterfactual is that its development would have increased the risk of less safety conscious operators entering the market. At paragraph 18 of Appendix D the Competition Commission states that it has not been provided with any concrete evidence to support the view of suppliers operating below minimum safety standards. This misses the point that there probably is no, or little, evidence of any deliberate or systematic behaviour of this type under the current arrangements. The point made previously by Calor is that the economic incentives to behave in this way will be greater under the tank transfer regime.
11. Calor reiterates that Mott MacDonald did not examine the suppliers' safety management arrangements and procedures. Each supplier develops its own safety management system (including, but not limited to, such matters as procurement, standards, training, auditing, reviewing, communications and emergency response) to comply with the legal and safety framework in its own way. In this context, please see also our comments on for example, paragraph 10 of Appendix D in the schedule enclosed with this letter.
12. Paragraph 2.15 of the Proposed Final Report refers to full safety audits yet the Competition Commission acknowledged elsewhere that Mott MacDonald did not undertake safety audits and there is no detail on individual supplier's safety management systems. This leads amongst other things to misconceptions – for example in paragraph 36 (a) of Appendix D - as to whether the supplier's systems "are equally effective". The point is not the quality of the different systems but the fact that they are **different**. To take a safety related item (tank or fitting) out of one management system there needs to be specific acceptance of it into another. Nowhere in the Proposed Final Report is there any acknowledgement of the integration and key relationship between the **four** main safety areas – safety management, the tank, associated equipment and pipework. Other elements such as siting and use are intrinsic to certain of the above.
13. There appears to have been no risk assessment of the relative risks involved in tank uplift and tank transfer yet risk assessment is an important feature of health and safety legislation and the HSE would expect suppliers to undertake such assessments if they introduced any changes to their safety management

arrangements. Risks are set out in paragraph 5 of Appendix D but no assessment is reported, and there is no comparison of risk between the present system (tried and tested) and the proposed tank transfer system (a significant change in operating methods). Various risks allegedly associated with tank uplift are set out at paragraphs 63 and 64 of Appendix D but these are meaningless without proper risk assessment, quite apart from any balancing with an acknowledgement that the present system does operate safely, and has been thoroughly risk assessed. As discussed previously with the Competition Commission (for example[excised]; paragraph 2.2 of Appendix I to my letter of 23 September 2005[excised] any new system must be no less safe than the one it replaces (the ALARP principle). In any event, the list of risks set out in paragraph 5 of Appendix D is neither correct nor comprehensive. We therefore suggest the following changes (particularly as the items listed in paragraph a) do not in our opinion relate to design faults - they are “tank manufacturing/refurbishment defects”):

- a) Design faults: incorrect design code; location of some valve openings; some tank feet design;
- b) Tank manufacture / refurbishment defects: defective tank welds; misalignment of tank components during assembly; faulty threads/couplings; incomplete shotblasting of tank body prior to surface coating; wrong type of paint; incorrectly applied paint / zinc coating; faulty valves and capacity gauges; incorrect valves and capacity gauges; faulty or poorly installed internal tubes.
- c) Quality of Installation: as per existing paragraph b) but add: safe distance from buildings, boundaries, overhead electric cables, drains, pits and fixed sources of ignition; ventilation; ease of access;
- d) Wear and tear, resulting in the decreased effectiveness of valves (especially pressure relief valves, pressure relief valve adaptors, fixed liquid level gauges, filler valves and float gauges), degradation of emergency signage and the corrosion of the tank;
- e) Delivery issues: as per existing paragraph d) but adding: line of sight between tanker and tank obscured; fixed liquid level gauge does not shut properly;
- f) Emergency procedures: as per paragraph e) but add: quality of advice given to customers; ability of the customer to act on the advice given by the LPG supplier; and
- g) Installation and uplift of tanks: as per paragraph f) but delete “risk associated with having to lift tank over a customer’s property” – for reasons previously given this is such a rare occurrence it cannot to be considered a risk to a “normal” installation. Delete “potential appearance of a leak.....” this appears to be duplicating the point made in your paragraph b).

14. Possibly as a result of the preceding point, statements are made (for example paragraph 5.31 of the Proposed Final Report or paragraph 3 (c) of Appendix D) that key differences between tanks “are being addressed”. This is only largely true in respect of tanks and tank fittings manufactured since 2002 following the UK’s implementation of the PER and the introduction of harmonised European Standards as British Standards but only partially true in respect of installations as a whole. The Competition Commission has overstated the degree of standardisation of tanks currently in the market. The process is certainly under way but there remains a significant number of non-standard tanks and fittings. We note from Appendix D paragraph 63 that Mott MacDonald has stated that tanks in service ‘are equivalent’. This is not the case and we are surprised to see reliance on advice from that source given that its reports have been criticised by at least all of the major suppliers.

Tank examination

15. We remain of the view that with the law, the hazardous nature of LPG and the markets as they are (and quite possibly in all circumstances) a full examination of both tank and installation on tank transfer is essential. Paragraph 72 of Appendix D states that there will be increased scrutiny of LPG installations by third parties, i.e. the incoming supplier, but it is at best questionable how this will be if there is no examination as a standard procedure. The sceptical approach adopted in paragraph 76 of Appendix D contrasting the safety requirements stated to be needed with “the cursory due diligence” where competing firms are acquired completely overlooks the significance of the vastly different approach of taking an individual tank out of its safety management system and moving it to different safety management system without the ability to “ring –fence” the operation or acquire the entire business records and the employees of the acquisition target. At paragraph 75 of Appendix D the Competition Commission states that any tank transfer system needs to be flexible and allow suppliers to carry out risk assessment on a case by case basis. In Calor’s view, that assessment must include a physical examination and testing and that should be a mandatory part of any Approved Code of Practice to ensure that standards are maintained and risks kept to the minimum. The Competition Commission’s failure to mandate physical inspection lies oddly with the comment in paragraph 72 (e) of Appendix D in which the Competition Commission maintains that tank transfer “increases the level of scrutiny of LPG installation by third parties, i.e. the incoming supplier, and as such may increase the effectiveness of self regulation.” How can this be achieved without inspection? There is no acknowledgement of the point made in paragraph 77 except a (wrong) statement that a transfer of individual tanks may require *slightly* different processes (our emphasis – for example, immediate changes to data plates and emergency signage are required). Wrong assumptions have been made in the context such as that “a WSOE would provide virtually all of the information needed to ensure that a tank is safe to operate” (paragraph 76 (b) of Appendix D). This may be true in some respects for the recently installed tank but it totally ignores safety management, equipment and pipework. Furthermore, we fundamentally disagree with the Competition Commission’s statement in paragraph 76 (d) of Appendix D that “We do not believe ..that such difficulties would be significant for the vast majority of cases.” This statement is made without any supporting evidence [excised].

Codes of Practice and current legislation

16. The Competition Commission's attitude to Codes of Practice is inconsistent. Under paragraph 72 (d) of Appendix D the Competition Commission states that "the safety management framework, including the Codes of Practice would itself evolve" to deal (in that case) with rogue suppliers. Paragraph 24 of Appendix D states that the LPGA Codes of Practice "deal with all aspects of LPG supplies.....". Contrast this with paragraph 22 of the same Appendix which states that "there is no guarantee that all companies in the industry follow the LPGA's CoPs, due to their voluntary nature". At paragraph 4.24, by contrast, the importance of Code of Practice 26 is dismissed when it comes to co-ordination of tank uplift where it is stated that "the LPGA CoP is voluntary, established by a trade body to which not all suppliers belong and is not always adhered to by suppliers" and is subject to "varying interpretations". At Appendix D, paragraph 72(e), the Competition Commission states that 'the industry might have developed under a tank transfer system to ensure compliance': there is no evidence for this and it is inconsistent with the Competition Commission's own analysis of the application of and adherence to LPGA Codes of Practice identified above. A specific lacuna in respect of Codes of Practice is referred to at paragraph 43 of Annex 2 to Appendix D. It gives a strong impression that the Competition Commission dismisses the importance of Codes of Practice when it suits their argument but accepts their importance elsewhere for the same reason.
17. For the avoidance of doubt, Calor's view is that CoPs cannot be relied on as the mainstay of safety in a tank transfer scenario especially because of the lack of detailed customer knowledge about detailed safety requirements: customers would therefore be unaware whether CoP 26 had been complied with and this would be a serious gap in the enforcement mechanism. CoP26, on the other hand, if underpinned by a specific order from the Competition Commission, could easily be enforced by the OFT in the existing or Calor's proposed improved tank uplift scenario following any customer complaints.
18. We would also point out that the Competition Commission's interpretation of the Pressure Equipment Regulations 1999 is incorrect. The relevant date from which the Regulations apply is May 2002 and not "1999".

Standards of suppliers

19. In our opinion, the risk of rogue suppliers entering the market under the tank transfer arrangement is dismissed too lightly by the Competition Commission. At paragraph 18 of Appendix D the Competition Commission states that it has not been provided with any concrete evidence to support the view of suppliers operating below minimum safety standards. However, this is inconsistent with the Competition Commission's reference to Mott MacDonald's finding that there were areas for improvement in relation to installations; such finding having been made without undertaking full safety audits. Moreover, whilst there may not be any evidence of deliberate or systematic behaviour of this type currently under the present tank uplift arrangements, the point made previously by Calor is that

the economic incentives to behave in this way will be greater under the tank transfer regime, since the physical incentives to safety will be removed. Calor would also address some specific misconceptions in this area. At paragraph 72 (d) of Appendix D the HSE is quoted as saying that an unscrupulous supplier would “need to run a relatively large scale operation”. Logic – and experience in the cylinder market – suggests that this is entirely unfounded as a proposition and indeed may well be the reverse of the truth since the unscrupulous supplier will not necessarily be interested in large-scale operations, whilst the damage they can do – both physical, and to the interests of the industry and its consumers - could well be large-scale. Moreover, unless the transfer price (about which no details have yet been published by the Competition Commission) guarantees that suppliers would recover their investments, there will be a disincentive to invest in improvements in tank and fittings design and technology and safety generally.

The position of the HSE

20. The HSE is repeatedly cited as supporting the view that tank transfer is at least as safe as tank uplift (for example at paragraphs 63 and 64 of Appendix D and in paragraphs 2.13, 5.20 and 5.31 of the Proposed Final Report) yet in paragraph 63 of Appendix D the Competition Commission summarises the HSE’s evidence as ambivalent, saying ‘it is unclear whether uplift risks are higher than the risks arising from the transfer of tanks in situ’. We make two points on that. First it would follow from the HSE’s reported views that there is no safety case in favour of tank transfer. Secondly, Calor’s view (and the views of other main suppliers published on the Competition Commission’s web-site) is that there are safety risks with tank transfer as explained in our response to the Remedies Working Paper. Calor (and we presume the other suppliers) have not been given the opportunity to study the full scope and content of the discussions between the Competition Commission and the HSE. You will be aware that in January and February 2006 we suggested a meeting between ourselves, the Competition Commission and the HSE only to be finally informed (after a period of two months) that it would not be “appropriate” for the Competition Commission to take part in any such meeting – a position we find inexplicable (in the light of the importance which the Competition Commission attaches to safety issues and the transparency of its investigations). [excised].

Summary

21. Calor remains firmly of the view that if a significant change is to take place in the switching system, which in any event gives Calor safety concerns, then the safety position is going to be more complicated, and requires more consideration, greater prescription and more protective measures than the Competition Commission currently acknowledges. (Calor feels that there is a compelling argument for the Competition Commission to put this point to the HSE.) This would incidentally mean that the costs associated with tank transfer would be higher than currently acknowledged by the Competition Commission. These issues recur under the headings of “The Findings and the Tank Transfer Remedy” and “Proportionality” below.

The Findings and the Tank Transfer Remedy

22. The main thrust of the Competition Commission's argument appears to be that, relative to its proposed tank transfer regime, the present tank uplift system is:
- (i) inefficient because of the costs associated with tank uplift and installation;
 - (ii) costly for customers because of the charges imposed by suppliers for tank uplift and installation; and
 - (iii) inconvenient for customers because of the requirement to uplift and install tanks.

Much of the evidence that the Competition Commission has relied upon to arrive at these conclusions is weak and is used selectively. Furthermore, the Proposed Final Report often bundles cost and inconvenience together, causing much confusion in the arguments put forward by the Competition Commission in support of tank transfer.

Relative Costs of Tank Transfer and Tank Uplift

23. Paragraph 6 (a) of the Proposed Final Report states that tank uplift "increases the charges....". Paragraph 13 states that the Competition Commission does not accept that the practice of uplifting tanks is required or necessarily the most efficient way of safely managing the supply of domestic bulk LPG. Calor refutes this and continues to maintain that the tank uplift procedure is the best and cheapest way overall of assuring safety and clear legal responsibility. Safety cannot be left out of this equation. If the tank transfer remedy is to be pursued the costings accepted by the Competition Commission ignore certain important aspects such as the vital necessity of a tank examination (referred to under the heading "Safety" above)
24. Calor challenges directly the costings being used by the Competition Commission at paragraph 4.7 of the Proposed Final Report. Calor's analysis of the costings for tank uplift and installation has already been provided and Calor stands by the analysis which it has given. It has seen no evidence to the contrary in anywhere near the same depth as that which it has provided, and in any event Calor's proposal for a streamlined uplift system would reduce costs further and, contrary to the Competition Commission's view, would not be impracticable. The tank transfer proposal costings do not include important intangible elements, even as contingencies (to take one example, the cost of disputes referred to under the heading of "Inconvenience" below); whereas the costs of the present system are all known. Given the unknown (but, on the balance of the evidence, high) costs of tank transfer, the alleged disincentive to suppliers to pursue switching (referred to for example at paragraph 4.20 of the Proposed Final Report) will still be there (for the sake of clarity, Calor does not accept that there are disincentives in the present system but this does appear to be the view of the Competition Commission). The conclusion is then followed through to paragraph 6.2(a) (i) and (ii) of the Proposed Final Report, but there is no attempt to set against this the considerable cost of the tank transfer system even on the Competition Commission's own analysis. (This, incidentally, is one of the weaknesses of the

procedure whereby the proposed remedies had to be commented on before the Proposed Final Report was published, and separately from them).

Charges faced by customers for uplift and installation

25. At paragraph 4.9 of the Proposed Final Report, the Competition Commission reports the average standard installation and removal charges that customers face when they switch. As reported at paragraph 4.18 of the Proposed Final Report, Calor believes that the majority of its customers do not face these average charges and, in a substantial proportion of cases, pay nothing.
26. Nonetheless, to address the Competition Commission's concerns in relation to the effect of uplift charges, Calor has previously suggested that uplift charges could be capped to reflect the efficient cost of uplifting a tank to protect customers against excessive charges [excised]. This cap would mean that suppliers could recover the costs of uplift and also ensure that switching levels are efficient by ensuring that customers that do choose to switch suppliers are not subsidised by customers that do not.

Inconvenience

27. The Competition Commission refers at many points in its Proposed Final Report to the alleged inconvenience suffered by customers under the tank uplift system. Given the narrow margin of cost savings (if any) – and Calor does not believe that there are any offered by the tank transfer system - in the absence of a significant level of customer inconvenience, the Competition Commission cannot justify the introduction of a radical remedy involving in particular significant changes to the current safety regime.
28. The Competition Commission has said that "...the inconvenience involved in switching tanks can be considerable. Moreover, customer perceptions of, or uncertainty as to, the level of inconvenience may also discourage switching..." (paragraph 5 of the Summary). For the reasons set out below, Calor remains of the view that the Competition Commission has insufficient evidence to make a formal finding of inconvenience caused by tank uplift. Furthermore, the evidence that it does have is thin and has been frequently misinterpreted.

(a) What does inconvenience mean?

29. The Competition Commission has set out its own definitions, for example at paragraph 24 of Appendix G (collecting and comparing quotes, monitoring gas levels, arranging removal and replacement, uplift and replacement and length of time and degree of contact with suppliers). At paragraph 5 of the Proposed Final Report, and more particularly at paragraph 4.11, the definition is extended from actual inconvenience to customer perceptions and uncertainty about the degree of inconvenience. Calor accepts that perception and uncertainty are relevant considerations. However, for a finding of "inconvenience" to support the introduction of an obligation on a supplier to transfer its tank, such finding must focus specifically on the physical uplift and its implications since certain of the

above elements of inconvenience would apply to any switch, and/or could be dealt with by alternative remedies.

(b) The Competition Commission's evidence for "inconvenience"

ORC survey

30. The Competition Commission itself states that the evidence from the ORC Survey must be treated with caution – for example at paragraph 4.19 of the Proposed Final Report “due to the small sample size”. However, the Competition Commission uses the survey results in a very selective manner. At paragraph 4.19 of its Proposed Final Report, the Competition Commission rejects the survey evidence in preference for evidence submitted by the major suppliers. Then, in the next paragraph, the Competition Commission relies heavily upon the ORC survey results to support its argument.
31. Furthermore, insufficient significance is attached to the fact that of the respondents citing “inconvenience of tank installation and removal” as a reason not to switch, more than half did so only when prompted. [excised] That these respondents needed to be prompted before citing inconvenience as a reason for not switching is of crucial importance, as it shows that the issue of inconvenience was not a concern for most customers. (Please also see Calor’s point concerning conflation of cost and inconvenience below). The other evidence relied on consists of some customer letters (see below) and speculation. Even if the results of ‘prompted’ responses were reliable, the results still suggest that a significant proportion of respondents *did not* regard the “inconvenience of tank installation and removal” as a reason not to switch.
32. The question on “difficulty of changing suppliers” (paragraph 4.22 of the Proposed Final Report) does not solely or directly relate to tank uplift as such although the Competition Commission goes on to say a “customer’s expectations as to the level of inconvenience *may* act as a disincentive” (our emphasis). This particular interpretation of the ORC survey is then repeated in paragraph 6 and indirectly relied on in paragraph 29 of Appendix G. In terms of methodology, paragraph 69 of Appendix G refers to “consistency” of evidence in the context of the ORC survey on the basis that this promotes the finding of “inconvenience” which, for the reasons stated here, is not sustainable. This is exacerbated by selective quotation of the evidence, for example as in paragraph 7 of Annex 1 to Appendix G, stating “one in three had found the process [of switching] difficult” and omitting the fact that more than one in two found it “easy” or “very easy”. This was from people who had actually switched and therefore had experience. The Competition Commission has quoted in paragraphs 44-45 of Appendix G from a number of customer letters. These tend to support our view that it is not the uplift which is the issue so far as customers are concerned but information about the switching process, its co-ordination and, to some extent, the costs. All of these are addressed by the Competition Commission’s proposed informational remedies. Moreover the Competition Commission has not taken into account the fact that each year thousands of tanks are uplifted without complaint.

33. **The Competition Commission has also failed to take account of the fact that only 6% of the respondents to the ORC survey cited inconvenience as something they would have to think about in changing supplier. This is a very important figure which the Competition Commission has chosen to ignore.** The Competition Commission has also ignored the fact that the most frequently given unprompted response for not switching was “no reason”. Again this gives the strong impression that the Competition Commission has been selective in the use of evidence.

Customer letters

34. The Competition Commission seems to have based its finding of inconvenience, in part, on some 70 letters of complaint that the OFT and Competition Commission received from domestic customers referring to tank uplift and installation as a barrier to switching (footnote 37). These letters represent less than 0.01% of the estimated **120,000** domestic bulk customers in the UK. As the Competition Commission is treating the ORC survey with caution, given the small sample size, then it should be treating the number of letters of complaint in the same way.
35. Calor challenges the interpretation of the letters of complaint as used by the Competition Commission to suggest that the “inconvenience” of physical uplift was a major factor. Of the letters of the 76 complainants which Calor has seen only 14 referred directly or by necessary implication to the physical aspect of tank uplift and one further to the time taken for the switch. Of those, one related specifically to safety issues to do with tank siting and 3 were in relation to underground tanks, while a further one appeared to have been prompted by the content of the publicity surrounding the announcement of the Inquiry. This does not, in our opinion, amount to sufficient evidence to support any argument that the physical aspect of the tank uplift and installation acts as a barrier to switching as suggested for example by paragraph 44 of Appendix G and more tendentiously in paragraph 4.22(b) of the Proposed Final Report “(around half of the LPG customers who complained to the OFT and the Competition Commission referred to the inconvenience of switching tanks)”. We have referred to the question of costs above and we refer below to the conflation of cost with inconvenience (even where inconvenience is treated in its broadest sense).
36. Moreover, on a point of procedure, it would seem that a substantial number of customer letters in which tank uplift and installation as a barrier to switching were mentioned, have not been placed on the Competition Commission’s website (as mentioned above only 15 of the letters we have seen deal with the physical issue of tank uplift and installation). Calor believes that suppliers should have been given the opportunity to see all letters of complaint received, particularly for this reason and requests copies of them as soon as possible.

Customer Letter at paragraph 48/49 Appendix G

37. Calor has already raised its concerns with the Competition Commission over its use of this letter. It is insufficiently explained (particularly in view of the content of the first part of paragraph 49 which is unjustified) that the letter is sent to

customers anticipating switching **away from LPG** and the purpose of including this letter is therefore highly questionable. References throughout the Proposed Final Report to the customer needing to monitor the running out of the gas (for example in paragraph 4.10) are therefore equally unjustified – even if justified, they could easily be remedied by the Competition Commission ordering suppliers to comply to the letter with CoP26. (In that context see also our comments below on alternative remedies.) The statement without further comment in the first sentence of paragraph 25 of Appendix G (“the customer would usually have to monitor the level of gas...”) is also unjustified.

Difficulty of access

38. Calor challenges the last three sentences of paragraph 26 of Appendix G. The situation described is a very rare occurrence in Calor’s experience not least because of the need for safe and regular filling of the tank. The type of structures referred to would interrupt the line of sight required by the driver on filling and would be contrary to LPGA CoPs. [Excised] there seems to have been some suggestion that this is a common position, but this is untrue. [Excised]. It appears to Calor that what looks like a substantial inconvenience has been built out of very thin evidence indeed which at most applies in very rare cases (not even once in the last four years, in Calor’s experience).

(c) The conflation of cost and inconvenience

39. The idea that tank uplift is costly and that it is physically inconvenient (issues which need to be separately addressed but which, even if they were true, require separate remedies) is frequently conflated in the Proposed Final Report. This is most notable for example in the use of the ORC evidence, in the treatment of the letters of complaint referred to above, and paragraph 42 of Annex G (“...the most common reasons were cost and/or inconvenience...”) with no attempt to distinguish between the two; this follows through in paragraph 107(a) of Appendix G where customers are stated apparently to be reluctant to switch. “...in view of the cost and inconvenience of switching” as though in every case the two were combined. The evidence from the ORC Survey and the letters does not support this and customers clearly view these as two separate (if, on occasion, linked) issues in most cases.

Appropriate remedies

40. If, as they should be, costs and inconvenience are considered separately, the logic of separate remedies becomes much clearer. In respect of costs, Calor has already explained that there would be little true cost saving from tank transfer (individual costs to Calor are dealt with below) and that Calor’s alternative proposed system would result in costs no higher, at worst, than the proposed remedy. Where the alleged “inconvenience” is concerned, many of the problems that the Competition Commission seems to believe exist would be addressed by Calor’s proposed alternative remedy and proper observance of CoP26, and by the proposed informational and cost-capping remedies which the Competition Commission has proposed in the Remedies Working Paper. In respect of safety, the Competition Commission appears to place considerable confidence in the

ability of the industry to self-regulate by means of Codes of Practice, but it adopts a more critical approach to CoP26. This is the reverse of a rational approach – please see our comments at paragraphs 16 and 17 above. At paragraph 4.24 of the Proposed Final Report, for example, the Competition Commission states that it has seen no evidence in support of the claim that suppliers are disciplined into facilitating a smooth switch. This ignores the comment (and that from a customer who is making a complaint) on the website that the switch was “smooth” under the present system.

41. If the Competition Commission’s primary concern is that the charges associated with tank uplift deter customers from switching, Calor has suggested that uplift charges could be capped to reflect the efficient cost of uplifting a tank (noted above at paragraph 26). This cap would be sufficient to address the Competition Commission’s primary concern and would not require it to introduce a tank transfer regime.

(d) Customer expectations and uncertainty

42. The Competition Commission places (reasonably, in our view) significant emphasis on customer expectations where alleged “inconvenience” is concerned. Much of this can of course be addressed by informational remedies. However, the proposed tank transfer remedy would actually introduce greater uncertainty for customers than is presently the case (as outlined in paragraph 4.5 of Appendix I to my letter of 23 September 2005). Leaving aside differing policies from one supplier to another, if the tank transfer remedy is implemented Calor estimates that for every [excised] cases of switching, [excised] will still result in uplift for technical and safety reasons. Whether this will be the case will not be known for a particular customer until the process is well under way. This would not reduce customer uncertainty (as referred to for example in 4.11 of the proposed final report or in the provisional findings at paragraph 6.2 (b) (iii)) but indeed tend to increase it.
43. Most significantly, is the fact that whereas at present Calor perhaps uplifts [excised] tanks each year on change of supplier, it uplifts [excised] tanks each year for routine maintenance or (more occasionally) emergency reasons virtually without complaint – and it believes the relative figures may well be similar for other suppliers. If uplifting tanks is such an “inconvenience” as the Competition Commission suggests, this simply cannot be squared with the day to day realities of LPG bulk tank operations. Irrespective of whether switching rates increase or not, tank uplifts are an essential requirement of the LPG industry for maintenance and safety reasons, and the Competition Commission should appreciate and acknowledge this fact. This evidence appears to have been ignored by the Competition Commission but is highly relevant when considering the whole issue of alleged inconvenience.

Other areas of alleged inconvenience

44. The need for domestic customers to expend time and effort in identifying the most competitive supplier is not a ground on which to attack uplift as this is a process which has to be undertaken in any case. A prudent customer looking to switch supplier, whether under the current arrangements or under the tank transfer proposal, would spend time analysing the market and the options available to them. Indeed this would be the case in almost any consumer market. In this regard, insisting that suppliers quote prices in response to telephone enquiries would to a large extent solve any perceived problem in this area.
45. As Calor has explained on numerous occasions (for instance at page 8 of Appendix II to my letter of 23 September 2005), a cursory glance at any Yellow Pages will show a wide range of LPG suppliers advertising in the both the Bottled Gas and Gas Suppliers section. It is therefore difficult to see how the Competition Commission can maintain that finding the most competitive supplier is an actual or perceived inconvenience.
46. In any event, actual or perceived inconvenience associated with finding alternative suppliers could be dealt with by providing customers with more information on the switching process, as opposed the tank transfer remedy [excised].
47. In terms of the impact of the tank uplift system on smaller suppliers, we note that paragraph 50 of Appendix G asserts that switching costs act as a barrier to competing for other suppliers' customers and quotes the evidence from a number of smaller suppliers. In fact most of the quotations do not deal with costs. The evidence does not seem entirely consistent with the material appended to the Provisional Findings Report. In Appendix F to the Provisional Findings Report, the Competition Commission referred to the fact that there had been a 'small number of complaints concerning the conduct of incumbent suppliers' (paragraph 84) and also that the majority of smaller suppliers did not consider identifying new customers to be an important barrier (paragraph 101). But even under the tank transfer system there will be costs (especially the assessment and purchase of the tank and associated fittings) and Calor believes that these will not be significantly different from those incurred in the present tank uplift system, which will remain in place at the option of the incoming supplier.

Summary

48. It follows that even if many customers consider or perceive tank uplift to be inconvenient, which for the reasons given above Calor strongly refutes, the tank transfer proposal is a disproportionate remedy because of the risks posed to safety, the costs to suppliers, and the fact that the informational and other remedies proposed in the Remedies Working Paper would contribute to simplifying the switching process and make the process easier for customers.
49. Calor submits that a proportionate remedy to address the issue of any actual and perceived inconvenience, which again it refutes, is to provide customers with more information on the switching process. As Calor has previously stated, it is happy to work with the Competition Commission to facilitate switching between suppliers. Furthermore, as stated in our response to the Remedies Working

Paper, we are prepared to accept a shorter notice period and restrict the exclusivity periods in our customer contracts. This should offset the Competition Commission's concerns regarding inconvenience at paragraphs 4.25 to 4.30, thereby further lessening the need for a tank transfer remedy. Calor remains of the view that its proposed simplified tank uplift system would be an effective and proportionate remedy.

Findings and Remedies – Profit Levels

50. Calor welcomes the statements made by The Competition Commission in relation to profitability at paragraph 5.16 of its Proposed Final Report:

- "...none of them [the major suppliers] earned returns that were both persistently and substantially in excess [of the weighted average cost of capital.]; and so
- "...the evidence on profitability...[is] not conclusive on the point [lack of competitive pressure on the major suppliers] either."

51. - 59. [excised]

Findings and Remedies – excess Pricing

60. In Annex 3 of Appendix I of its Proposed Final Report, the Competition Commission estimates that the customer detriment arising from anti-competitive features of the domestic bulk LPG market in GB is [excised]. This estimate is based on the following three methods:

- an analysis of individual customer level data;
- a comparison of prices in Northern Ireland and Great Britain; and
- an analysis of 'excess profits'.

We would respond to each of these methods below. However, we note at the outset that none of the Competition Commission's indicators of the extent of overpricing provide a reliable estimate of the so-called detriment that is faced by domestic bulk LPG customers. The assumed "benchmark" prices in the "Customer database comparison" and "Comparison of GB and Northern Ireland" are entirely arbitrary and below the level necessary for Calor to ensure that it covers its cost of capital [excised].

Indeed, given that excessive profits are a key indicator of excessive pricing, the analysis in this section is inconsistent with the Competition Commission's finding that "none [of the major suppliers] earned returns that were both persistently and substantially in excess of [the weighted average cost of capital]" (paragraph 5.16).

Customer database comparison

61. The Competition Commission uses individual customer-level data for 2003 provided by Calor to estimate that the customer detriment for Calor's 'established' customers (i.e. customers who commenced their supply relationship before December 2001) was [excised] in 2003. This estimate is derived by:
- calculating the premium paid by each established customer as at 1 January 2004 over a benchmark price of [excised];
 - multiplying the premium paid by each established customer by the customer's consumption in 2003 to give the detriment for each customer; and
 - summing the amount of this detriment across all established Calor customers who paid more than [excised].
62. We would make the following observations on the above calculation as follows:
- First, the rationale for using [excised] as the benchmark price is weak. As the Competition Commission notes [excised], it is possible that Calor would not have found it profitable to supply all customers supplied in 2003 at a price of [excised], in which case the method would overstate the extent of 'overpricing'. The observation (in the same paragraph) that three smaller suppliers charged average prices below this level is irrelevant in the absence of evidence that these suppliers were able to supply all of their customers profitably at these lower prices. In this regard, the Competition Commission notes [excised] that the average prices charged by smaller suppliers vary over a wide range. Moreover, it appears that a majority (i.e. 6 out of the 9 who provided pricing data to the Competition Commission – [excised]) charged average prices above those of the major suppliers.
 - Second, it is unclear why the Competition Commission has excluded those customers who paid less than [excised] from the estimated detriment. On the Competition Commission's own logic, these customers have enjoyed a benefit from 'underpricing'. Clearly this should be taken into account and would reduce any estimated detriment.
63. We have similar comments on the Competition Commission's higher estimate of customer detriment which is based on a benchmark price of [excised]. A similar method was presumably also used for the other major suppliers, although no details are provided in the Proposed Final Report and so it is not possible to comment.
64. The Competition Commission also assumes that customers of smaller suppliers suffered a detriment of [excised]. This is based on the assumption that alleged overcharging by smaller suppliers accounts for a comparable proportion of their turnover as for the larger suppliers [excised]. No factual evidence is provided to support this assumption.
65. – 74 [Excised]

Switching

75. With regard to switching rates, the Competition Commission at paragraph 4.14 states that “[it considers] the [switching] figure for LPG to be low whatever the benchmark used”. The Competition Commission appears to base this on a finding by the Competition Commission in the 2002 banking inquiry (*see footnote 36*) that “an annual rate of switching of 4 to 6 percent [is] “very limited” ”. We believe that this is a false analogy: it also presupposes that there is a ‘correct’ or normal rate of switching. As Calor pointed out in paragraph 13 of Part I of its response to the Emerging Thinking Paper, the OFT’s own paper on switching costs states that the actual level of customer switching is ‘not in fact a strong indicator of the extent and importance of switching costs’ nor does the existence of switching costs necessarily imply that a market is not competitive. Moreover, the Competition Commission rejects customer satisfaction as an explanation for the apparently low rate of switching, despite the evidence given to it on this issue. Instead, the Proposed Final Report says in paragraph 6 of Appendix G that ‘a more credible explanation for the low rate of switching appears to be that barriers are potentially considerable’. We question whether this analysis can be regarded as a sufficient basis for the Competition Commission to make findings in accordance with its duties under the Enterprise Act.
76. Calor does not agree that “the fact that customers only switch after an accumulation of grievances” necessarily supports the conclusion that “customers face significant switching costs” (paragraph 4.67). In most instances, it would be unrealistic to expect customers to switch from an otherwise acceptable supply relationship following a single service failure.

Customer satisfaction

77. Calor remains of the view that customer satisfaction is the main reason for perceived low switching rates in the domestic bulk market, and welcomes the statement at paragraph 4.35, “That reported satisfaction is high is not in question.”.
78. Calor has provided substantive data through its own annual satisfaction surveys which show extremely high levels of advocacy with the overwhelming majority of Calor’s customers saying they would choose Calor if they ever had to make a similar decision in the future. In contrast, the ORC survey is critically flawed in that when asked about what discourages them to switch suppliers, respondents were not given the option of “satisfied with existing supplier”. Given our very high advocacy rates, we would expect that if this question had been put to domestic customers, a very high percentage would have answered in the affirmative.

Proportionality

79. This is a further area where, in consideration of the remedies, an analysis of the proposed final report is essential and in that context Calor would refer to the replies to the Remedies Working Paper. The elements requiring consideration are as follows:

Profits

80. As noted in paragraph 47 above, the Competition Commission states that none of the suppliers earned returns that were both persistently and substantially in excess of WACC. Accordingly, any substantial effect on competition is not borne out by levels of profit.

Pricing

81. The Competition Commission states on the basis of the matters referred to in paragraph 4.80 of the Proposed Final Report and in Appendix I that customers are paying higher prices than might have been the case in the market without the features identified as having an adverse effect on competition. This is dealt with under the heading “Excess Pricing” above and again Calor has shown that the case for intervention on the scale proposed by the Competition Commission has not been made out.

The cost of the tank transfer remedy as a whole

82. As referred to above and previously identified by Calor, the cost of the tank transfer remedy (direct costs alone) are comparable with the costs not only of the existing tank uplift system when intangible factors are taken into account, but, on a direct comparison, with Calor’s proposal for an improved tank uplift system. The running costs of the proposal would accordingly show no savings and thus not address one of the issues identified by the Competition Commission – namely, the alleged high costs involved for tank uplift. For the reasons including those set out below, the costs of setting up the system would significantly exceed those presently estimated by the Competition Commission.

The cost to Calor of establishing a tank transfer system

83. Many of the relevant figures and elements involved in the cost to Calor of setting up the necessary safety technical and administrative back up for tank transfer have already been identified to the Competition Commission particularly in my letter of 23 March 2006 and its Appendices. [excised].
84. [excised]
85. In summary, the Competition Commission has failed to make the case for reduction of costs resulting from a move from tank uplift to tank transfer; it has failed to establish that tank uplift leads to any significant inconvenience. Yet it is proposing to introduce a new untried and untested system with significant safety implications, at a disproportionate cost to the industry and to Calor in particular. Many if not most of its alternative remedies would deal with identified problems (and indeed Calor supports many of them as indicated in its response to the Remedies Working Paper) without such extreme intervention, and Calor’s proposed improved tank uplift remedy would result in the minimum change to existing practice with the maximum benefit to consumers at lower cost. Calor accordingly regards the tank transfer proposal as a disproportionate remedy.

Northern Ireland

86. References to Calor Gas Northern Ireland Limited are inconsistent throughout the Proposed Final Report. It is referred to variously as “Calor” (e.g. in paragraph 4 of the Summary), “Calor NI” (e.g. in paragraph 2.3) or “CGNI” (as in Appendix H). On occasion this leads to inaccuracies of some significance – for example, in paragraph 4 of the Summary it states that “Calor” is a supplier in Northern Ireland. In the context of the document as a whole where “Calor” means in effect “Calor Gas Limited” this is incorrect. The correct explanation of the position appears at paragraph 23 of Appendix E, although correction of the name alone will not correct paragraph 4 of the Summary. We believe that the reference should be to “Calor NI” or “CGNI” through the entire document with the necessary explanation, and a change to the Glossary accordingly.

Summary of key issues

In summary:

- In Calor’s submission, the evidence for a finding of inconvenience, which underpins much of the Proposed Final Report including the proposed tank transfer remedy, is thin. It is partially based on the ORC survey – notwithstanding the Competition Commission’s own reservations about it and the suppliers’ comments on it – and partially on selected customer letters and speculation. No new evidence has emerged since the publication of the Provisional Findings Report. We do not consider that this provides a sufficient degree of certainty of the factual basis on which the Competition Commission would be able to base a finding within the meaning of the Enterprise Act.
- Calor does not accept that a state of knowledge on the part of customers or smaller suppliers can amount to a feature of a market as defined in the Enterprise Act.
- The extension of the scope of the Inquiry to commercially operated caravan and holiday parks appears inconsistent with EC competition law.
- The Competition Commission’s concern about the low rate of switching is misplaced. It is well accepted by economists that the rate of switching per se is meaningless. In so far as the levels of switching are influenced by uncertainty on the part of customers and costs, these are addressed by the proposed informational remedies and proposed caps on uplift costs.
- The Competition Commission’s analysis of alleged excessive pricing is flawed and unreliable. The benchmark selected is arbitrary and the findings are inconsistent with the Competition Commission’s own findings on profitability.
- The tank transfer remedy does not satisfy the tests set out in CC3. Moreover, it introduces potentially significant safety risks. If the remedy is to be introduced, Calor believes that the conditions set out in Appendix 1 to its letter of 23 March 2006 must be introduced.

- In developing the tank transfer remedy the Competition Commission has unjustifiably placed too much reliance on the evidence submitted by officials of the HSE [excised]. Calor urges the Competition Commission to consult further with the HSE before adopting, and then requiring the implementation of, the tank transfer remedy.

Inaccuracies and omissions in the Proposed Final Report

87. Finally, I enclose a schedule of some of the factual or legal inaccuracies that we have found in the Competition Commission's proposed Final Report, some of which we have highlighted more than once before. There may well be more but we have had insufficient time to be as comprehensive as we would like to be on this.

Yours sincerely

Howard Kerr
Managing Director