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Mr P Freeman
Chairman
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

Dear Mr Freeman

DOMESTIC BULK LPG INQUIRY

I refer to Mr Simon's letter of 2 March 2006 and the accompanying Working Paper on Remedies ("Working Paper"). Our comments are set out below.

- 1 Calor believes that the evidence (in so far as this has been disclosed to Calor) on which the Competition Commission has based its assertion that competition is not working as effectively as it could and, in particular, to support the implementation of a tank transfer remedy is insubstantial. For the reasons given in our response to the Provisional Findings Report, the economic case – which is substantially based on alleged inconvenience – is thin. We do not believe that the case has been made out that uplifting tanks causes inconvenience to domestic customers such as to deter them from switching (see paragraphs 11 – 26 of my letter of 23 September 2005).
- 2 There is no evidence to suggest that (i) the costs associated with switching under the integrated supply model significantly deter switching or that (ii) the costs associated with switching will significantly fall under the tank transfer regime. The Competition Commission has acknowledged implicitly in paragraph 166 of the Working Paper that levels of switching under the tank transfer regime may not be greater.
- 3 We note that the Working Paper is premised on the conclusions set out in the Provisional Findings Report and does not take into account any changes that might be made to those conclusions following comments submitted by the suppliers and other third parties.
- 4 The Working Paper contains a number of factual and legal errors. These are set out in the attachments together with our detailed comments on the Working Paper. This letter deals with points of principle and in particular identifies measures which we

believe must be taken as part of an implementing order to minimise any compromise of safety if the tank transfer remedy is to be adopted.

THE TANK TRANSFER REMEDY / PROPORTIONALITY

5 In our submission, critical to the assessment of the appropriateness and proportionality of the tank transfer remedy are: the extent to which it may affect safety risks; the costs to suppliers and customers; and the impact on distribution. We acknowledge that the proposal for two-year exclusive contracts (subject to our comments below on duration) will largely address our concerns about distributional efficiencies. We comment on safety and costs below.

Safety

6 In relation to safety, we note that at least three of the four major suppliers and some others have raised safety as an issue in relation to the tank transfer proposal. In many instances, the Competition Commission has responded to those views by preferring the evidence given by the HSE. [Excised].

7 [Excised] the HSE does not monitor the domestic bulk supply market which is largely self-regulated. It does mean however that the Competition Commission should be more circumspect in preferring the HSE's evidence to that of those who have day-to-day experience in the industry and are concerned to ensure that their practices conform to the ALARP principle. Indeed some of the views expressed by the HSE appear to be contradictory: see [Excised].

8 Significantly, the Competition Commission relies on the HSE's evidence that *'the risks associated with tank transfer will be significantly less than the risks associated with tank uplift and installation'* (para 183). There is no evidence to support this assertion. [Excised] there is no evidence that tank uplift introduces greater risks than the transfer of the tank in situ. On the contrary, there is a good deal of evidence to demonstrate that tank uplift has been performed safely as a matter of routine [Excised].

9 The apparent dislike of uplift, or preference for it to be avoided, appears to be based on intuition rather than evidence and on a simple preference to avoid uplifting wherever possible [Excised].

10 That tank uplift can be managed with minimal risk is demonstrated by the Competition Commission's acceptance that the tank transfer remedy would not be mandated and that reasons for a supplier to prefer to uplift and replace would include minimising the range of tank types within that supplier's population (see paragraph 169).

11 In relation to the question of examination by the incoming supplier, the Competition Commission has again relied heavily on the views of the HSE. According to paragraph 124 of the Working Paper *'the HSE said clearly that it did not consider that an incoming supplier would necessarily need to undertake an examination of a tank in order to satisfy itself that the tank was fit for the purpose before supplying into it'*.

12 [Excised], we do not see how the Competition Commission can conclude that the HSE's view was *'clear'*.

- 13 [Excised].
- 14 The Competition Commission notes in paragraph 124 of the Working Paper that an examination would only be necessary where *‘something in the documentation or in the initial visual inspection of the tank gave particular cause for concern’*. Nothing is said about how an incoming supplier is supposed to satisfy itself that the position on paper accurately reflects the true position on the ground and that the tank is ‘fit for purpose’.
- 15 We do not consider the HSE’s evidence to be a sound basis for the Competition Commission to require the adoption of the tank transfer remedy or to disregard the views of the main suppliers on safety and the protective measures which would be required. We have proposed to the Competition Commission that we meet with them and the HSE to discuss their views but the Competition Commission has unfortunately declined to pursue our suggestion. This is regrettable.
- 16 In a number of cases, the responses made by the Competition Commission to the concerns raised by suppliers are not supported by evidence and in some cases are based on intuition or fairly thin arguments. For example, in paragraph 182 of the Working Paper, the Competition Commission asserts that it does not believe that the remedy will *‘increase non-compliance with the safety regime’*¹. There is no evidence for this and it is contradicted implicitly by paragraph 165 which acknowledges that there will be claims relating to tank quality and by paragraph 178 which states that the suppliers can work with the HSE if they feel that greater codification of standards is necessary. In paragraph 169 the Competition Commission has responded to concerns about the diverse nature of tank populations by saying that it *‘believes’* that corporate acquisitions made in the past *‘suggests that suppliers could reasonably be expected to manage such an increase’*. There is no examination here of the factors which would be involved in managing one-off differentiated tanks as distinct from acquiring entire systems.
- 17 The Competition Commission has implicitly accepted the contribution of the integrated supply model to current safety standards and the certainty which it brings in terms of responsibility. Yet in response to concerns expressed, the Competition Commission says in paragraph 163 of the Working Paper that *‘it does not accept that the tank transfer remedy will necessarily result in a loss of clarity over the allocation of responsibility for tank safety’* (emphasis added) and that the tank transfer remedy will *‘to a large extent retain the integrity of the integrated supplier model ...’*. These are, to our view, equivocal statements and not a sound basis on which to premise a remedy.
- 18 In some instances, the Competition Commission has implicitly recognised an issue but then not proposed a remedy, leaving it to the suppliers (or some of them) to sort out. For example, in paragraph 165 of the Working Paper the Competition Commission appears to acknowledge that suppliers might be tempted to take a short term view and reduce their incentive to invest in tanks but rejects the argument that the remedy will lead to falling standards by saying that the incoming supplier can make a claim against the outgoing supplier (without any consideration of the difficulties of litigating such claims).

¹ There is a typo in this paragraph of the working paper: the text above is based on what we assume was meant.

- 19 Calor adopted the cradle to grave management system for tanks as the most effective means to ensure optimum levels of safety for customers, employees and the public at large. The majority of the main suppliers have said that the current integrated supply model of the tank by a single supplier is the most effective means of achieving this. For the reasons set out in our response to the Provisional Findings Report [excised] and in the attachments to this letter we believe that the tank transfer proposal is inconsistent with the ALARP principle and will, given the potential number of parties having control over a tank during its life, increase safety risks.[excised]

Costs

- 20 Calor believes that the Competition Commission has underestimated the costs associated with operating the tank transfer regime because it has not factored in a number of relevant costs. These include costs associated with (i) errors associated in the valuation of tank assets; (ii) negotiations between suppliers before transfer and later in relation to any dispute; (iii) the inclusion of metered estates; (iv) insurance costs; [excised]
- 21 Unless the Competition Commission produces valuation figures for each category of tank we cannot comment on the cost of the remedies package (including the impact of the tank transfer remedy on the capital value of the business) and therefore on its proportionality.
- 22 As we have previously said, the proper valuation is critical for ensuring that suppliers recover their investment; undervaluation would disincentivise suppliers from further development and investment in safety. For instance, there would be no incentive to develop or invest in new valves and fittings as these items cannot be changed in the field and no credit would be given for them in the tank valuation process which is proposed to be based on an average of current prices.
- 23 The proposed 60-year depreciation for tanks does not reflect current industry practice.
- 24 For the reasons given in more detail in Appendix 2, we believe that the proposals as drafted will result in significant negotiation costs for suppliers, and the Competition Commission has recognised the scope for claims between suppliers arising from the condition of tanks and their fittings post transfer. We had sought to avoid negotiation disputes in our proposed pricing methodology which has been rejected.
- 25 We note the Competition Commission proposes to include metered estates within the tank transfer remedy. Many of these installations fall outside the standard domestic sizes and configurations making them unsuitable for the valuation approach adopted by the Competition Commission. Moreover there are considerable practicable and commercial difficulties in extending the remedies proposed to metered estates for the reasons set out in paragraphs 7-9 of my letter of 23 September 2005.
- 26 In relation to insurance, we have sought to obtain information about the likely impact of the tank transfer model on our insurance premiums. We have been unable to obtain any reliable information, nor – it seems – has the Competition Commission been more successful. But this is an important issue which has been left in an unsatisfactory state by the Competition Commission.

- 27 [excised]
- 28 With regard to paragraph 361 of the Working Paper, the Competition Commission has not provided any evidence as to why it believes Calor's estimates provide "the upper bound" of the costs faced by individual suppliers in implementing the remedies including tank transfer.
- 29 For the reasons given above, we believe that the tank transfer remedy does not meet the tests set out in the Competition Commission's Guidance on Market Investigations in terms of appropriateness, costs, proportionality and effectiveness.

CONDITIONS NECESSARY FOR TANK TRANSFER

- 30 If a tank transfer remedy is to be imposed, Calor believes that the following additional measures must be adopted in order to make the system work effectively and to minimise any compromise of safety:
- (a) Pre-transfer tank examination must be mandated as part of an HSE Approved Code of Practice or as a condition in the Competition Commission order.
 - (b) Emergency cover responsibility must be transferred concurrently with the title to the tank.
 - (c) Valuation methodology should result in tank prices that accurately reflect their true replacement cost.
 - (d) All current relevant voluntary industry standards and practice must be codified within HSE Approved Codes of Practice.
- 31 We deal with each of these in more detail in Appendix 1.

OTHER REMEDIES

- 32 [excised] we had indicated that it was desirable to make the process of switching simpler for the benefit of customers and we put forward a number of proposals many of which are now reflected in the Working Paper. For our comments on all of the proposed remedies, we refer the Competition Commission to Appendix 2 of this letter. However there are two aspects on which I wish to comment in this letter.

Wake-up letter

- 33 The proposal to send a "wake-up letter" to each customer within one month of the expiry of their fixed term contract is disproportionate. Customers will have, in accordance with the Competition Commission's remedies (and in many cases their own practices) documents with their contracts setting out the switching process. Customers will be able readily to find out the names and prices of other suppliers. The costs to us of the wake up letter are estimated to be of the order of [excised] per year. This is an unreasonable cost burden and not required of any other energy or utility sector in the UK.

Uplift charges

- 34 As Calor noted [excised] it does accept that uplift charges should be capped but we do not accept that they should be capped at zero. Suppliers should be able to levy reasonable charges to deter frequent serial switching and to recover the costs from a customer leaving the LPG market, which would raise industry costs to the detriment of those who switch less frequently.

CALOR'S ALTERNATIVE REMEDIES PACKAGE

- 35 Calor notes the comments which the Competition Commission has made on its alternative package of remedies. Calor believes that each of those comments can be addressed satisfactorily and does so in Appendix 2.
- 36 In particular we regret that the Competition Commission has not given Calor any earlier opportunity to discuss refinements to its proposed package before the Competition Commission dismissed the package in the Working Paper.

TRANSITIONAL PERIOD AND IMPLEMENTATION

- 37 Calor would need around 12 months to make the necessary changes to its business model to make it suitable for the tank transfer remedy. [excised]
- 38 The Competition Commission must appreciate that it is in the interests of everyone concerned to ensure that sufficient time is allowed to bed-in any new supply arrangements and avoid any supply disruptions for domestic customers.
- 39 The Competition Commission will be aware that one element of disparity among tanks has been removed by the Pressure Equipment Regulations 1999 which came into effect from 29 May 2002 for new equipment. Since that time there has been an increasing degree of standardisation of tanks and the associated fittings. We therefore suggest that the tank transfer remedy should only apply to tanks placed on the market since 29 May 2002.
- 40 Finally, the introduction of a tank transfer remedy will represent a significant change in the way in which the industry has hitherto operated. Calor therefore requests an opportunity to discuss its comments in this letter and the attachment with the Competition Commission.

Yours sincerely

Howard Kerr
Managing Director
Calor Gas Limited