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DOMESTIC BULK LPG INQUIRY

**CALOR GAS LIMITED**  
**CALOR GAS NORTHERN IRELAND LIMITED**

**RESPONSE TO THE COMPETITION COMMISSION'S  
EMERGING THINKING PAPER IN THE MARKET INQUIRY  
INTO SUPPLY OF BULK LPG FOR DOMESTIC USE**

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**PART I**

**KEY ISSUES**

**A. INTRODUCTION**

1. This paper responds to the Emerging Thinking Paper ('ETP') published by the Competition Commission on 1 April 2005, and its Annexes B to E published on 15 April 2005. Annex F (Profitability) and the two working papers on WACC and ROCE arrived during the course of preparation of this paper (the last paper arrived on 26 April) and we have not had an opportunity to comment on the issue of profitability in this response and will do so separately.
2. The focus of this market investigation appears to be the integrated supply model under which LPG suppliers in virtually all cases own the tanks installed on domestic premises and into which they supply bulk LPG. The Competition Commission's current thinking appears to be that this supply model inhibits switching; that the level of switching is low; that there is limited competition among LPG suppliers; and that increased competition would lead to lower prices.
3. Calor has not sought to promote integrated supply on safety grounds alone, nor has it claimed that this is the only conceivable model, although it is common ground that LPG is a hazardous product and that safety is of critical importance. Calor believes that integrated supply has prevailed in the domestic LPG sector because it is attractive to customers and because a combination of safety and efficiency factors make integrated supply the most cost effective supply model for this product, and that this brings significant benefits for the customer. In Calor's view, the integrated supply model does not inhibit competition.
4. In the Executive Summary of its Main Submission *excised* Calor outlined the key benefits of the integrated supply model: the Response to the Issues Statement also considered whether those benefits would be achieved under the counterfactual scenarios put forward by the Competition Commission. Those views are summarized in Section H of Part I. The other Sections of Part I address issues raised in the ETP including market definition, market structure, switching, barriers to entry and

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expansion, pricing and profitability, and metered estates, with, as appropriate, comments on competition in Northern Ireland.

5. In Parts II and III, Calor sets out its detailed comments on the ETP and separately on Annexes B to E of the ETP, including specific points of difference (such as interpretation of survey results) and inconsistencies.

**B. THE MARKET**

6. The Competition Commission has taken domestic bulk LPG as the relevant market for discussing competition issues in the context of this market inquiry. In Calor's submission, the Competition Commission has not accorded the appropriate degree of significance to competition between LPG and other fuels, particularly heating oil. In particular, the absence of short-term LPG price changes in contrast to the prices of other fuels does not justify the conclusion that those fuels do not place a substantial constraint on the price of LPG.
7. Calor *excised* customers per year, and also *excised* customers per year. Those customers have to be persuaded to choose Calor in place of heating oil (frequently in the case of a new installation) or a rival LPG supplier. Customers also have to be persuaded to remain with LPG at the time of boiler replacement. As stated in *excised* of customer losses (where the new supplier was known) were to heating oil. *Excised*. While customers will pay some premium for the greater convenience of LPG, that premium is not unlimited. If the price of LPG, compared to that of heating oil, were to rise permanently by *excised*, it is clear that the rate of customer loss would accelerate and customer gains dwindle. While it cannot be said with certainty that such a trend would drive Calor out of business in a sufficiently short timescale to satisfy the SSNIP test, that would clearly be the eventual result.
8. The integrated supply model – which avoids for the customer the capital cost of acquiring the tank and fittings, as well as assuming responsibility for maintenance and safety – is among other things a means by which the LPG sector competes against heating oil. So are introductory prices.

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9. The information that Calor has given to the Competition Commission about its price monitoring shows that Calor pays considerable attention to the price of heating oil in its LPG pricing decisions. *Excised*, but the relative price of heating oil is (based on the evidence submitted to Competition Commission) a strong constraint on LPG pricing *excised*.
10. Calor agrees that Great Britain is a relevant geographic market for the purposes of the inquiry, and that Northern Ireland is a separate geographic market.

**C. MARKET STRUCTURE**

11. Calor does not agree with the suggestion that the current structure of the market is the result of any anti-competitive features of the market. The market contains suppliers of a range of sizes and has seen normal levels of exit and entry. The theory that the market inhibits competition by smaller against larger suppliers is not borne out in reality.
12. Calor notes that the Competition Commission is still considering whether concentration could facilitate non-coordinated action or coordinated effects; Calor does not believe this is the case and will comment on any further papers should the Competition Commission pursue this line of thinking.

**D. SWITCHING**

13. It is clearly a central plank in the Competition Commission's emerging thinking that the rate of switching is 'low' or 'very low'. This pre-supposes that there is a 'correct' or 'normal' rate of switching which is higher and somehow more desirable; this supposition is poorly founded. The OFT (2003) paper "Switching Costs" clearly explains that "Whilst switching costs affect how competition operates in a market, they do not necessarily make markets less competitive". The paper continues to describe why the actual level of customer switching is "...not in fact a strong indicator of the extent and importance of switching costs" (see paragraphs 1.10 and 6.3 respectively).

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14. The Competition Commission's working paper on switching makes the point that introductory prices can be pro-competitive in a market with switching costs. That is plainly what is happening here. The offer of lower introductory prices – together in some cases with the waiving or reduction of certain charges and offers of free LPG – are a prime means by which suppliers seek to attract customers to switch. *Excised.*

*Rate of switching*

15. The Competition Commission is concerned that the requirement to change tank may be the main reason for the observed low level of switching, and that this may impede effective competition.<sup>1</sup> Whilst the requirement to uplift and install tanks is an intrinsic feature of the integrated supply model, Calor does not believe that this is a substantial barrier to switching for the majority of customers.
16. In Calor's view, the observed level of switching reflects a combination of factors, the most important of which are:
- the direct financial cost of tank uplift and installation;
  - the cost savings that are available to customers who switch supplier;
  - the patterns of annual LPG consumption by bulk domestic customers; and
  - the preference among customers for a particular supplier.
17. The Competition Commission estimates that on average customers face an up-front cost of £300 in relation to uplift and installation charges, whilst the available savings from switching are around 5 ppl over two years.<sup>2</sup> These figures imply that, on average, the available savings from switching will exceed the cost of switching for customers whose consumption exceeds 3,000 litres per annum.

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<sup>1</sup> See ETP, para. 7.

<sup>2</sup> See ETP para. 7(a)(ii), *excised.*

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18. The table below shows that *excised* of Calor's customers consume more than *excised* litres per annum, *excised*. Calor submits that there are a number of reasons why these customers appear not to switch, including:

- the net financial benefit is relatively modest for customers whose volume is not substantially above *excised* litres. *Excised*. For these customers, *excised*;
- high levels of satisfaction with the current supplier. As a consequence, customers are loyal to their current supplier and will not switch for purely financial reasons. *Excised*; and
- suppliers take actions to retain customers, for example by offering discounts to customers who are considering switching supplier. The Competition Commission suggests that this may discourage suppliers from trying to win each other's customers. Whilst Calor acknowledges that this is theoretically possible, in practice this is not the case in the intensely competitive domestic bulk LPG market.

<i>Excised</i>	<i>Excised<sup>3</sup></i>	<i>Excised</i>	<i>Excised</i>
<i>Excised</i>	<i>Excised</i>		
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<i>Table 1: Excised</i>			

19. The Competition Commission has also identified a number of other factors that may “deter” customers from switching supplier, including: “inconvenience”, “customer

<sup>3</sup> *Excised*.

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inertia”, uncertainty on charges and contractual terms, lack of customer awareness of suppliers’ offers, inadequate marketing by suppliers, the impact of 3 or 5 year contracts and the impact of 3 month termination periods. Calor does not agree that these factors have a material impact on switching, for reasons that are set out in detail in *excised*.

20. Customers do not regard the requirement to change tank as an inconvenience, as evidenced by the Competition Commission’s own ORC survey. In this regard, it should be noted that in most cases tanks can be uplifted and replaced using a crane, or more usually a small trolley, and without the need for vehicles to be driven over a user’s property, as stated in the ETP.<sup>4</sup>

*Differential between standard and entry price*

21. Calor agrees with the Competition Commission that the ability of suppliers to offer different prices to new and existing customers can lead to more intense rivalry as suppliers compete to attract each other’s customers. However, Calor does not agree that the fact that a large proportion of customers do not switch to avail themselves of lower prices reflects the impact of switching costs associated with the requirement to change tank.<sup>5</sup> As discussed above, Calor believes that the level of switching reflects *excised*.

22. Nor does Calor agree with the Competition Commission’s suggestion that the ability of suppliers to maintain higher prices to existing customers than to new customers is in itself an indicator of weak competition.<sup>6</sup> This is apparently based on the theoretical proposition that if suppliers can price discriminate in a market with switching costs, then all customers would pay a similar price in the competitive outcome. Unfortunately, the Competition Commission does not provide any analysis in support of this observation.

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<sup>4</sup> ETP, para. 7(a)(vi).

<sup>5</sup> ETP, para 7(c)(ii).

<sup>6</sup> ETP, footnote 6.

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23. In summary, Calor's submission is that introductory prices are having the pro-competitive effect of increasing competition between LPG suppliers - as well as between LPG and heating oil - and that the threat of switching constrains existing suppliers' standard prices.
24. The evidence shown above indicates that the relationship between standard and introductory prices is such that for a customer with average consumption, the cost and benefits of switching may cancel each other out.
25. That in itself goes a long way towards showing that the observed level of switching is attributable to a constraint on standard prices and therefore should not be regarded as 'low' in the area implied in the ETP, or 'lower than should be expected'.
26. It is also to be expected that customers will not make a decision to switch on purely financial grounds. The ORC survey evidence is that customers overall are highly satisfied with their supplier (77% satisfaction), *excised*.
27. The Competition Commission's concern that low rates of switching may be explained by difficulty of switching is not borne out by the ORC evidence. Of respondents with actual experience of switching, only 36% were charged for tank removal and only 16% for installation of a new tank; 26% received compensation from their new supplier and 23% received a credit for LPG left in the old tank. 61% of switchers said that changing supplier cost less than £10. Of those who had not yet switched, a high proportion would expect such compensation or refund. According to the ORC Survey, 66% did not find switching difficult.
28. Further, the evidence on customers' attitudes to pricing does not, taken in context, indicate a frustrated wish to change supplier. This is borne out by the ORC findings that a very high percentage of respondents were either satisfied or very satisfied with their current supplier. Clearly, some expressions of dissatisfaction are to be expected from a survey into the price of domestic bulk LPG (as the ORC International survey was stated to be), but such expressions do not necessarily equate to a feeling by customers that their LPG suppliers are overcharging them. In fact, customers

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correctly perceive LPG prices as being largely dictated by wholesale price increases which are outside the control of the LPG suppliers.

29. This partly explains the low rate of awareness of rival offers. It is important to understand, however, that this rate does not mean that customers are not able to identify alternative LPG suppliers easily if they wish to make price comparisons.
30. The low rate of switching in Northern Ireland is largely explained by social factors peculiar to the Province.
31. Prices are lower in Northern Ireland despite the lower rate of switching owing to the different features of that geographic market. One significant feature is that mains gas traditionally had a smaller reach in the Province than in Great Britain and in Northern Ireland there is a much stronger oil culture, particularly in rural areas. Availability of natural gas has only recently started to expand with two new pipelines extending to rural areas. Heating oil moreover has a denser distribution network than LPG, which has depots only in Belfast.

**E. BARRIERS TO ENTRY AND EXPANSION**

32. Calor does not accept any suggestion that small suppliers face barriers to expansion; that the ability of the larger suppliers to price discriminate deters entry or expansion; that modest growth in the market deters entry or expansion or that smaller suppliers are unable to enjoy the economies of scale enjoyed by larger players. This is borne out by the history of entry and expansion in the market since the early 1980s: some 19 operators have entered in the last 10 years, all of which provide price and non-price competition.

**F. PRICING AND PROFITABILITY**

33. Calor rejects any suggestion that there may be limited price competition in the market *excised*.
34. In relation to profitability, *excised*. Calor does not accept the validity of key elements of the analysis, *excised*.

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35. Calor has, as it has informed the Competition Commission, *excised*. This efficiency drive is continuing.

36. The ETP asserts that the prices to domestic bulk customers are higher than those to other categories, such as commercial. The fundamental reason for this is the cost of supply. Agricultural and commercial customers tend to purchase much larger volumes of LPG and with less seasonality.

**G. METERED ESTATES**

37. The Competition Commission has questioned whether there may be additional barriers to switching for customers on metered estates and whether prices to these customers reflect the costs of delivery. Customers on Calor operated metered estates may switch to an alternative LPG supplier (by installation of a bulk tank or cylinders on their own property) or switch to oil with just as much ease. *Excised*.

38. In terms of pricing, *excised*.

**H. SAFETY AND COUNTER-FACTUALS**

39. *Excised* Calor provided a full analysis of why it views the current system of domestic bulk LPG supply, whereby suppliers own the tanks that they supply, as being critical to the maintenance of safety standards and procedures, as well as providing economic efficiencies. In *excised*, Calor analysed the impact on economic and safety issues of the two counterfactuals addressed by the Issues Statement and repeated in paragraphs 19-20 of the ETP. In relation to the economic and safety implications of the counterfactuals, Calor draws the Competition Commission's attention to *excised* on the Competition Commission's Legal Review - the latter having identified uncertainties and possible confusion which might exist in a non-integrated supply model. *Excised*.

40. *Excised*.

41. This response deals with one issue raised at the Hearing on 3 February. At that hearing, the Competition Commission asked why the incentives to maintain safety

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would have been any lower under either of the two key counterfactuals (tank transfer, or tank ownership by the customer or a TankCo).

42. In the case of tank transfer, there would be a strong incentive to do the minimum necessary in terms of tank maintenance (particularly in the case of older tanks) given that the owner for the time being would not know when the tank might be transferred again. If the agreed transfer value for the tank were not sufficient to compensate suppliers for investment in safety features and technological improvements, the incentives to invest further would significantly diminish, and the process now naturally occurring of monitoring, replacing, renewing and refurbishing would deteriorate. There would also be, as shown in *excised*, less efficiency in the structure of supply and potential confusion in or duplication of responsibilities.
43. With regard to customer-owned tanks, few customers seem willing or interested to take on board the responsibilities for the maintenance and ownership of a tank. Moreover, customers are not the subject of any regulation (except the duty to report and if possible to prevent gas leaks) and approaches to safety among customers would vary considerably. Customers would have to bear the upfront costs of tank ownership and continuing maintenance.
44. A TankCo's incentive to invest in and maintain tanks would substantially depend on the transfer value at which the tanks were acquired from the existing suppliers. There may be an incentive to maximise return from rental by minimising costs. This would most likely lead to the company doing the minimum necessary in terms of maintenance of the tank. It is also questionable whether a TankCo would have any incentive to invest in technological advances *excised*. Moreover, as noted in *excised*, Calor believes that *excised* [it] is highly unrealistic *excised* that a company would wish to operate solely as a TankCo. Further, a key question is the extent to which there would be competition between TankCo's; in the absence of more than one, the sole provider would have to be regulated.

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**PART II**

**CALOR'S DETAILED COMMENTS ON THE COMPETITION COMMISSION'S EMERGING THINKING PAPER**

*Summary*

1. In sub-paragraph (a) it is said that the market is partly characterised by a concentrated structure. While this may be the case, it is Calor's view that this does not affect the level of intense competition between LPG suppliers. Furthermore, the presence of, and competitive pressure exerted by smaller players cannot be underestimated. Many have built strong reputations in their area and compete aggressively to win customers from the main national players.
2. In sub-paragraph (b) the need to change tank is cited as a barrier to switching. Calor has explained in *excised*, its Main Submission, *excised* that Calor's tank installation and uplift charges to domestic customers are low and that they do not represent a material barrier to switching. *Excised* a typical customer switching to Calor can save a substantial sum in a relatively short period of time. On the other hand, using the Competition Commission's own figures in the working paper on Switching costs, there is a significant percentage of customers for whom there would be no financial incentive to switch and this may explain, as set out in paragraphs 15 to 20 of Part 1 of this Response, of the apparently low level of switching. In practice, some customers prefer not to switch and Calor believes that this is a consequence of very high satisfaction rates *excised* amongst its customers.
3. It is also stated in sub-paragraph (b) that there are monetary and non-monetary costs of switching that flow from the need to change tank. The ORC's findings suggest otherwise: while slide 31 of the ORC's presentation shows that customers who have not switched think the costs of switching are higher than they actually are, the effect of this expectation is cancelled out by the high level of expectation of receiving compensation from the new supplier.

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4. Sub-paragraph (b) recognises that there may also be an element of customer reluctance to change supplier. Calor believes that this is very much the case, and that it reflects the very high satisfaction rates *excised* of our domestic customers.
5. We remain concerned that the Competition Commission may believe that Calor, and perhaps other LPG suppliers also, make profits from a “metal business”. As we have explained *excised*, this is simply not the case. We do not have a metals business.
6. In the third paragraph on page 2 of the ETP, the Competition Commission says that the “above [features of the market] suggests to us that competition in supply of LPG in GB is not fully effective, and prices for customers may be higher than they would be in a market with fully effective competition.”. Our prices are constrained by customers’ ability to switch and our competitors’ prices.

***The emerging thinking***

7. Calor welcomes the Competition Commission’s recognition of the constraint of heating oil on the prices charged to domestic bulk LPG customers. However, we are disappointed that the evidence supplied by Calor (and also now published from other LPG suppliers on the Competition Commission’s website) seems to have been discounted. In *excised* we said the market was “... *at least as wide as the supply of bulk LPG for domestic uses*”. Subsequently we have provided a great deal of evidence about the intense competition between LPG and heating oil. We are sending further evidence of this competition under separate cover.
8. In paragraph 1(a) the conclusion does not recognise the evidence supplied by Calor. Including “don’t knows” we have seen *excised*. This is a serious loss and requires great efforts to replace these lost customers.
9. The retail price of heating oil is indeed an important factor taken into account by Calor in setting its price of LPG, particularly in respect of any introductory prices to its customers. *Excised*. According to the Competition Commission’s own evidence (see paragraph 2 of Annex B) “*around one third*” of customers who switched, switched to heating oil from LPG.

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10. Whilst the Competition Commission may argue in paragraph 2 that supply side substitution from other fuels may be somewhat limited (although we disagree – see above regarding heating oil which we see as a competitor), we do not accept that a commercial bulk LPG supplier cannot readily respond to opportunities in the domestic bulk LPG market. It should be noted that all LPG suppliers with only one exception operate in both the domestic and commercial sectors. In fact, *excised*, this is how most LPG suppliers in the domestic bulk market have started. (Please see *excised*.)

***Features in the domestic bulk LPG markets***

*A. Market structure*

11. In relation to paragraph 3 please refer to Part I of this Response.
12. As to the possibility of coordinated effects, paragraph 19 of Annex E shows that this is not feasible in relation to pricing.
13. Paragraph 1(a) of Annex A asserts that there is limited non-price competition. Calor strongly disagrees with this statement which contradicts the mass of evidence supplied and listed by the Competition Commission in paragraphs 4, 6 and 7 of Annex D. In particular the Competition Commission appear to have ignored the evidence of the *excised*. Moreover, in paragraphs 6 and 7 of Annex D, the Competition Commission summarises the information which has been given about non-price competition but then says that no supplier presented the Competition Commission with data that showed the impact of any non-price initiatives and that only one supplier quantified the gains of such work. In terms of the example, the Annex omits some of the non-price initiatives undertaken *excised*.
14. *Excised*.
15. This paragraph also tries to show there are coordinated effects among suppliers by stating that “*the carrying out of similar practices with regard to minimum contract periods*”. In response, please refer to our comments in paragraph 12 of Part I.

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*B. Switching*

16. Paragraph 5 provides that fewer users are satisfied than dissatisfied with the value for money they get from their LPG supplier. As explained in our letter to the Competition Commission of 7 April, this might not be surprising in the context of a survey presented as being into pricing. Whether this is an unduly high level in the context of a pricing inquiry can only be assessed by comparison with other appropriate industries.
17. In respect of customer satisfaction as referred to in paragraph 5, please see paragraph 17 and following our comments on Annex C to the ETP.
18. We do not agree that the proportion of customers who successfully negotiate a price reduction is low (paragraph 6). As shown in slide 26 of the ORC's presentation, 29% of all respondents tried to negotiate a price reduction, of whom 65% were successful. This is hardly an insignificant proportion of bulk LPG customers.
19. In paragraph 6, it is said that LPG suppliers are able to price discriminate between customers, meaning they can respond to competitive threats at a lower cost, by reducing prices only to those customers who appear likely to switch. Calor is of the view that individual pricing in response to a threat of switching reflects the vigorous operation of the competitive process in a competitive market. In any event, it is Calor's belief that customer satisfaction is, by far, the most significant factor that prevents customers from switching. *Excised.*
20. In paragraph 7, the Competition Commission remains concerned that the main reason for the low rate of switching is the cost to the customer of installing and removing tanks. However, this is not supported by the actual customer experience which shows actual switching costs to typically be at a very low level – less than £10 in the vast majority of cases as borne out by the Commission's own survey of customers. In any event the need to install and uplift tanks is the necessary result of the safety management procedures adopted by Calor and throughout the rest of the LPG industry and generally throughout the world where safety is an issue. *Excised, Calor*

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seeks to reduce any obstacles to switching that result from the need to exchange tanks. For instance, its tank installation and uplift charges are maintained at a low level.

21. Also in paragraph 7, Calor cannot accept that it has a limited incentive to market to existing or potential new customers, *excised*.
22. It is noted that the Competition Commission states in paragraph 7(a) that suppliers seldom, if ever, allow customers to receive domestic bulk LPG from another supplier into their tanks. As has been explained in Calor's Main Submission, *excised*, the link between ownership and maintenance of the supply of LPG to a domestic tank is essential to avoid compromising safety and placing the customer at risk.. It is also an effective economic approach.
23. In paragraph 7 (a) (iii) the Competition Commission states that the uncertainty of whether or not a customer will be charged for removal of a tank or early termination of a contract is likely to deter customers from switching. However, there is no evidence to support this assertion. In fact the Competition Commission's own research showed that the vast majority expected to be incentivised to switch by the new LPG supplier and only a minority thought there would be any charges involved with switching. Only 27% of customers thought they would be charged for tank uplift and only 32% believed there would be a charge for the installation of the new tank.
24. Paragraph 7(a) (vi) suggests that there is inconvenience associated with having to change a tank, for example from the need for heavy vehicles to be driven over a customer's property. This also bears no relation to the reality which is that tanks are delivered and removed either by using small crane vehicles which have to stay on proper hardstanding or (for the smaller tank sizes) through the use of a small trolley. Practical inconveniences of switching supplier tanks are limited through the strict adherence by Calor and other LPG suppliers to the LPGA's Code of Practice 26 and the fact that customers do not have to be present at tank switchover, reducing further any perceived inconvenience. In any event, minibulkers would still need to be used to make LPG deliveries even if an alternative form of supply were adopted. It is also not

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clear where the CC came up with the prejudicial phrase “heavy vehicles”. The vehicles are smaller than the delivery tankers and generally the domestic tank is taken from the garden in a trolley or the crane vehicle is outside the customers premises.

25. In paragraph 7(b) the Competition Commission is concerned that the use of 3-year initial contracts and three-month notice periods for termination are longer than necessary and enable LPG suppliers to retain customers that signify an intention to switch. This was also covered *excised* where Calor made it clear that the 3 month notice period had absolutely nothing to do with giving Calor a chance to retain customers expressing a desire to change suppliers. *Excised*. With regard to notice periods, some period is necessary to allow a safe transition from one supplier to another and increase planning efficiencies for Calor. Timing is usually as a result of the customer wishing to use up the LPG they have already paid for or, for example, of difficult ground conditions. *Excised*.
26. The Competition Commission is also concerned in paragraph 7(b) that there is a lack of clarity in some contracts regarding costs and uncertainty as to whether particular terms in contracts will be enforced. Calor considers that the contract clauses in its new Domestic Gas Order (DGO) are clear and fair and customers accept these conditions in return for our investment in the installation. This view is also supported by the OFT's CRU which approved the contracts less than two years ago.
27. We do not understand how the Competition Commission can reach the view that the ability to price discriminate may discourage competitors from trying to win other LPG suppliers' customers (paragraph 7(c) (i)). *Excised*.
28. With regard to paragraph 7(c) (ii), Calor does not understand the reasoning that the Competition Commission has used to arrive at the view that “*price discrimination has not had a competitive outcome*”, particularly in light of the Competition Commission's comment that “*in principle price discrimination may also enable suppliers to price more aggressively to each other's customers*”. Calor is of the view that it does price aggressively to its competitors customers and that our overall price level is competitive. [The main reason that those of Calor's customers who have not switched supplier to avail

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themselves of lower prices did not do so either because they did not consider the savings worthwhile or because they are by and large very happy with the service standards which they receive from Calor.]

29. Calor has already stated in its comments on the ORC slide presentation, that the figure of 9% is highly unreliable. *Excised*, it is highly unlikely that only 9% of all domestic bulk LPG customers have been targeted by suppliers other than its own. With a market of only approximately 120,000 dispersed customers it is simply not cost effective to knock on doors, *excised*. In addition, a recent quantitative survey by Future Foundations entitled 'The Consumer experience of direct marketing' states that half of respondents under-estimate the actual volume of communication they receive via different channels.

*C. Barriers to entry and expansion*

30. With regard to paragraph 9, both Great Britain and Northern Ireland domestic bulk LPG markets have seen a history of significant change as suppliers have entered or exited the market. *Excised*, there are opportunities for new suppliers to enter the market by acquiring customers from existing suppliers. In particular, *excised*, is a good example of a supplier that has aggressively grown its business over a period of 20 years both by acquisition and by targeting its competitors.
31. In this paragraph the Competition Commission expresses concern over the fact that few small suppliers have been able to grow. In Annex D the Competition Commission showed the results of a sample survey into the reasons for small suppliers not expanding. The key finding from this admittedly unstructured survey, was that lack of capital and set up costs restrained small suppliers. The wording in the paragraph that "few small suppliers have been able to grow" is misleading as most are unwilling to grow and a more structured survey may have exposed these facts. This survey also showed the smaller suppliers as having "no huge barriers to entry". This evidence has not been used by the Competition Commission. There has also been examples of well funded new entrants who have gained significant market shares in a short period of time. ie. Flogas, British Gas, Altagas, Supergas. Calor's position is that

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expansion within the LPG sector is possible and the Competition Commission's own information in Annex C provides evidence of this.

32. Calor does not believe that smaller suppliers are placed at a significant scale disadvantage to larger suppliers. Both large and small suppliers deliver LPG from local depots and are in a position to exploit any local customer density advantages that may exist.
33. The Competition Commission should note that although Calor is classified as a large supplier, Calor is not vertically integrated. We therefore question the extent to which the opportunity for vertical integration represents a material barrier to entry and expansion. In recent years the increased volatility of LPG pricing has meant that storage and many forward purchases have become a liability. This is likely to be a feature of the LPG market in the coming years. The only hedge against this happening is for the LPG supplier to be vertically integrated.
34. The final sentence of this paragraph ignores the Competition Commission's own evidence in Annex D of the 19 new entrants to the domestic bulk LPG sector in the last 10 years which has had the impact of keeping competition fierce in this market.  
*Excised.*

*D. Pricing*

35. With reference to the Competition Commission's view in paragraph 11 (c) that there is "*a lack of price transparency*", we would reiterate that Calor has a policy of providing an indicative price to a customer before providing a full quotation. Furthermore, the Competition Commission fails to recognise the fact that Calor provides indicative running costs *excised*, or with reference to the comment "*..the inability of most suppliers fully to commit to future prices*", that it is only possible to secure derivatives for 6 to 12 months periods. The experience of the last 18 months demonstrates the extreme volatility of oil and LPG prices.
36. In terms of the level of Calor's pricing, by far the single largest element in the retail price charged to domestic customers for bulk LPG is the cost of the gas supplied to

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the customer. As previously explained by Calor, this cost is highly volatile and a non-vertically integrated supplier such as Calor has a limited ability to mitigate the risk of such cost fluctuations. We note that the Competition Commission is continuing to investigate whether prices tend to adjust more rapidly to increases than to decreases in those prices. *Excised.*

37. On the basis that it earns a return on capital employed of *excised*, which is a reasonable rate of return for the risk taken on the investment it has made, Calor submits that none of its customers are charged an excessive price.
38. As noted in *excised* and the charging of different prices to different customers the 2-tier pricing structure has evolved in a pro-competitive manner to compete against heating oil as well as other LPG suppliers. *Excised.* This structure does not mean discrimination but is a reaction to competitive pressure in the sector from other LPG suppliers and heating oil. *Excised.* This linkage is not noted in the Annex or in the ETP.
39. Furthermore the last 4 years have seen great volatility in the price of oil, as well as the input cost of LPG to suppliers like Calor. This reality makes pricing even more challenging for all LPG suppliers – *excised.* Suppliers price independently for their own commercial reasons. Although the higher retail price gap between LPG and the lower oil retail price has reduced in recent years, if this were to be a long-term structural change it would take several years for large numbers of customers to move to LPG from oil. Historically, LPG was around 2 times the price of oil. The ETP does not recognise these interplays (and denies any linkage).
40. Paragraph (b) sets out a theory of what could happen in a non competitive market. This is not the reality for the supply of bulk LPG to domestic customers. As already shown in Calor's various submissions our profits are at a reasonable level and our costs are not high.
41. Paragraph (c) has not taken account of the evidence supplied to the Competition Commission over the period of this Inquiry. Customers are able to telephone and ask

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for the prices currently available for new customers, the standard prices being charged and how they will reach these prices.

42. In Calor's experience, when customers decide upon a heating system supplier (LPG or fuel oil), they take into account both the upfront cost of installation and the on-going running costs. When competing for new business, Calor explains to customers what the costs associated with tank supply and maintenance are and the Competition Commission has not made this clear.
43. The concluding paragraph yet again asserts the Competition Commission's belief that they have seen little evidence of non-price competition. Calor completely refutes this position as it is not borne out by the facts. *Excised* outlined at length to the Competition Commission on several occasions.

**Other relevant factors**

*Profitability*

44. Calor only received Annex F on 26 April, so it is difficult for us to comment on the specifics of the Competition Commission's analysis at this stage. As a consequence, we would ask the Competition Commission to recognise that our comments on profitability are of a general nature and that we would like an amplified discussion to take place.
45. In paragraph 13(a) it is stated that "*accounting profit margins in GB currently appear to give rise to returns possibly above and certainly not below the cost of capital.*" Whilst it is noted that this is stated not necessarily to be consistently the case for all companies in all years, we consider that this generalised statement does not reflect the information *excised* cannot be considered an excessive return.
46. At the end of paragraph 13 it is stated "*if competition is not fully effective, it might also be expected that the level of costs may be higher than in a fully competitive market.*" Calor has explained at several points, *excised*.

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47. It is stated in paragraph 14 that *“the level of profitability in Northern Ireland may be less than in GB.”* If this is the case, it should be pointed out that the market circumstances are very different because the market in Northern Ireland is shrinking steadily.

*Metered Estates*

48. Calor notes that the Competition Commission states that it has *“received a number of complaints from residents of Metered Estates.”* It is however noted that it is not specified to what extent these complaints arise from supplier operated (as opposed to owner operated) Metered Estates, a distinction which the Competition Commission draws in its explanatory wording; and what these complaints consist of. Reading through the individual complaints it is clear that the majority are from customers on owner operated estates. This is not made clear in the ETP. We note that at this point this paper does not appear to advance the arguments on Metered Estates in any significant way beyond what has already been set out in the Issues Statement.
49. In relation to paragraph 15(a), which questions whether the customers on Metered Estates face additional barriers to switching to other LPG Suppliers, Calor would draw attention to its *excised* which explains in detail why apparent barriers to switching on Metered Estates where the Estate is operated by the LPG Supplier are not in fact significant in practice. In particular, not only do the customers have the option of switching to direct bulk supply for their individual property but, in the event that the supply to the estate as a whole changes hands from one LPG Supplier to another, there is no direct cost (such as uplift or installation charges) applicable to the individual customer. The costs of uplifting and replacing the tanks in the tank compound are for the respective supply companies who will also be responsible for arranging transfer of ownership of the relevant pipework and meters. Whilst it is true that it will be necessary for all the occupiers to agree on a change of supplier in this way, there remains (as mentioned above) the option for the individual customer to change to an alternative supplier by installing a bulk tank or cylinders on their own property and discarding the piped supply from the central storage. The individual

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customer is also able to (and does) move to another fuel either before taking residence or during the life of the contract.

50. In relation to paragraph 15(b), which questions whether there may be particular barriers to entry or expansion by smaller suppliers supplying metered estates, Calor would reiterate *excised* that smaller suppliers can indeed supply metered estates although there may be extra capital costs, and there will be engineering expertise required together with more complex management. These are not absolute barriers to a smaller supplier as such but, as already shown in the Competition Commission's own survey, small suppliers have issues on the cost of capital and metered estates often require significant investment.
51. In relation to paragraph 15(c) Calor is unclear what is meant by the suggestion as to the prices to the customers on metered estates "*failing to reflect the cost of supplying those estates.*" *Excised.*

*Safety*

52. *Excised.* However, it would like to make a number of points here.
53. It would seem that the Competition Commission's emerging thinking on safety issues is largely based on the report produced by the appointed technical consultants, Mott MacDonald. They saw only saw 7 domestic bulk tanks out of a market of approximately 120,000 tanks currently at or available for use at domestic customers' premises in Great Britain. Accounting for approximately 0.005% of the total GB domestic tank population, this is a statistically poor sample from which few, if any, meaningful conclusions can be drawn. In particular, paragraph 17 of the ETP is not at all borne out by the evidence.
54. However, from this very small sample, Mott MacDonald made a number of sweeping and, in our view, inaccurate generalisations about the industry. Based on well-established engineering statistical techniques, the sample size should be in excess of 300 to give 95% confidence in the results.

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55. Calor remains firmly of the view that the current integrated system of supply, whereby suppliers of bulk LPG own the tanks to which they supply, is vital to the maintenance of safety standards and procedures. This is because it ensures clarity of responsibility and the continued safety of the product, its delivery and its means of containment.
56. Calor notes the statement in paragraph 16 of the ETP that the Competition Commission has noted *“that there are some suppliers who do supply some customer’s tanks”*, Calor would reiterate at this point that, so far as Calor is concerned, *excised*, most of which were the result of acquisitions of other businesses, but that such tanks are treated as part of Calor’s estate for the purposes of checking maintenance, emergency service and so on. Most importantly, a proper examination of the tank was required before supply could commence. Calor can accept this burden because the numbers are very small in the overall tank population, but if they were to increase to any significant extent the cost and administration difficulties in handling matters in this way would become a major burden and quite possibly insuperable within the present legal framework. Referring to the comment *“some suppliers supply tanks acquired as part of the business of other suppliers”*, it should be clearly noted that, from Calor’s point of view, this has only been the case where the business has been acquired as a whole, the costs of acquisition have been built into the purchase, and a proper survey of the tanks could be undertaken as soon as possible after acquisition *excised* any belief that tanks could be bought in from another supplier with their business and that these could be assumed to be entirely safe was negated by these experiences.
57. In relation to the final sentence of paragraph 16 of the ETP, Calor considers it to be a serious omission that the necessity of compliance with legal requirements excludes the whole issue of tank and fitting manufacture and emergency provision which are also essential parts of the safety provision which are dealt with naturally and efficiently within the current integrated supply arrangements.
58. In paragraph 17 of the ETP there is a statement that there are *“no technical reasons.....for suppliers not to supply domestic bulk LPG to tanks owned by other parties.”* If the intention here is to say that there is no “theoretical” technical reason then the statement might

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be acceptable. However, Calor has given plentiful evidence *excised* where there were very real technical incompatibility issues with pressure relief valves, filler valves and liquid withdrawal valves to name but three. So whilst it may have been theoretically possible to supply the tanks, a number of tanks had to be re-sited as they were in unsafe location and the incompatibility issues would have adversely affected their future maintenance and inspection as well as in the provision of an effective emergency service. Extensive rectification programmes, *excised*, had to be put in place. The technical specification for Calor valves and regulators differs from that of many of its competitors. There are technical issues relating to customer, contractor and employee safety, as well as operational efficiency. Accordingly, the statement that *“there are no technical reasons....”* is misleading at best if it omits the word “theoretical.”

59. At the start of paragraph 18 of the ETP, the current arrangements are stated to be *“one means to ensure clarity and responsibility for safety of tanks”* Calor would wish to make the following points:
  
60. Whilst it is self evident that any arrangement is only “one means” to ensure various things, Calor has made it quite clear that in its view the current system is also the best means of ensuring this. The Competition Commission should not ignore the fact that Health & Safety Law in its many aspects requires suppliers to reduce risks as low as reasonably practicable. If it is suggested that there are other means of ensuring clarity in responsibility then it will have to be shown that these are at least as safe as the present system. This must be clearly explained and set out in the Competition Commission’s considerations, as otherwise the implication may be given that it would be acceptable for some other standard of safety to be pursued and this would result in the operators within the LPG Industry placing themselves in breach of current Health & Safety Law. To date, we have seen no evidence that this aspect of the matter has been properly and fully considered. Quite apart from anything else, the current system is also, from the cost of benefit point of view, the most efficient and effective way of ensuring compliance with the LPG Industry’s statutory duties. Again, that aspect of the matter does not appear to have been addressed.

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61. At the end of paragraph 18 of the ETP there is a statement “*we also remain concerned that the switching of tanks may increase safety risks to LPG suppliers, consumers and the public.*” No evidence of any such risks has been produced. Indeed, the evidence already supplied to the Competition Commission by Calor is that there are no incidents recorded where uplift has posed any safety risk. The Health & Safety Executive themselves in their own evidence to the Competition Commission stated that whilst there were risks these could be controlled. The entire LPG Industry is built around the control of recognised risks. Tank uplift is an everyday event in the LPG industry and is a very tightly controlled operation. Over the past 10 years Calor has carried out over 50,000 such uplifts without significant incident. Calor is deeply concerned that whereas in paragraph 17 of the ETP the possibility of suppliers supplying to tanks which they do not own appears to be accepted without any reference to potential safety issues (which are considerable and real) an unsubstantiated safety issue is raised in relation to tank switching. For the sake of balance, safety issues should be mentioned specifically in relation to filling (where there is a history of recorded incidents) at least equivalent to the reference in the case of the switching of tanks. On the basis of the evidence provided already, indeed, filling of third party tanks should be of greater concern than the uplifting of tanks. Calor believes that safety risks would increase if tanks were not installed and uplifted, as this process (whether carried out pursuant to switching suppliers or to carry out a mandatory inspection) ensures that the integrity of the tank population in Great Britain and Northern Ireland is maintained.

*Alternative Arrangements*

62. In paragraph 19 of the ETP, the phrase “*an acceptable level of safety*” is used in the introduction and in sub-paragraph (a). *Excised*, Calor is required not to place a product on the market unless that product is a “safe product” as defined. Under the 1974 Act, Calor is obliged to ensure “so far as reasonably practicable” the safety of its employees and other persons. We do not therefore believe that “an acceptable level of safety” is an appropriate measure in the context of analysing each of the counterfactuals. Each of them could only have come about if it would have allowed the suppliers to meet those obligations. What is quite clear is that, as referred to in

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paragraph 19(a) "*an acceptable level of safety*" must be at least as high as the present level. There can be no room for error or experimentation in any future arrangements if this cannot be guaranteed. Customers, employees, contractors and members of the public cannot be exposed to a lower level of safety. This is not only a moral or practical argument, bearing in mind the future of the LPG industry, but also in our opinion a legal requirement.

63. Calor has already commented on the final phrase in paragraph 19(b) of the ETP, namely that "*customers may be less conscious of safety requirements.*" The key point here is customer knowledge. In Calor's experience, customers are fully aware of the need for safety and when asked rate this as a significant consideration. However, they do not have the necessary knowledge to ensure safety and rely on others to provide this. Evidence shows that customers do not wish to have that responsibility. Any arrangement which required customers to ensure compliance with safety standards can only result in a system less safe than the present one to the extent that it only requires an inattentive or indeed reckless customer to combine with a cavalier supplier for safety considerations to be overridden altogether. This is particularly a problem where the economic factors may militate in favour of such an outcome. Where there is economic advantage to the customer in short circuiting safety arrangements, history unfortunately teaches that sooner or later one or more customers will go down this road with possibly disastrous consequences. Where there is no clear responsibility between the LPG supplier, the tank supplier, anyone maintaining the tank and maybe an emergency provider, the idea that the situation will be monitored and controlled by any of these professional bodies in any way as effectively as under the current integrated supply system flies in the face of experience. With multiple interfaces, safety will inevitably be compromised and the previous references by the Competition Commission to controlling the situation by contract has been shown to be an ineffective method of maintaining safety standards. Again, risks cannot be taken with customers' safety. They cannot be exposed to a lower level of safety. Quite apart from this, under current legislation the customer has no legal responsibility in many of the

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areas for which a supplier does have such responsibility and carries out their duties in the light of that. Customers would be placed in a legislative twilight zone.

64. Paragraph 20 of the ETP suggests that it might be possible to maintain safety under alternative arrangements by the use of contractual terms. Generally speaking, criminal law liabilities cannot be properly enforced by contracts. Neither can they be laid off by contracts. However, with multiple parties involved and interfaces it becomes much more difficult to assess, under both criminal and civil law, which party may be liable. This is a recipe for danger because any party knowing that it has clear criminal and civil liabilities has every incentive to maintain safety. Under each of the alternative possible arrangements interfaces are increased, liabilities are unclear (for example the liabilities of a domestic customer under the criminal aspect of Health & Safety Law) and the possibilities of failure in the chain of liability or communication are multiplied.
65. Calor notes with general approval the final sentence of paragraph 20 of the ETP raising consideration of whether customers and possibly some potential suppliers fully understand their obligations. However, Calor considers that this may be missing the principal issue which is that, even if certain suppliers are aware of their responsibilities (and this would be far from clear with the multiplicity of parties involved), they may be incapable of ensuring that those responsibilities are properly carried out other than by drastic means such as, for example, an LPG supplier simply refusing to supply LPG into a tank. This is a problem above and beyond simple lack of knowledge which, if accepted, may itself be a problem. The net result, however, is a potential “race to the bottom” in standards where, for example a responsible LPG supplier refusing supply into a tank may result in an irresponsible supplier being contacted by a customer and the tank being filled regardless of potential safety problems. Under the present integrated supply system this issue does not arise and the LPG supplier has every incentive to ensure the safety of the tank and the supply to it – and indeed every responsibility to the customer to ensure that.

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**PART III**

**CALOR'S COMMENTS ON ANNEXES B TO E TO THE COMPETITION COMMISSION'S EMERGING THINKING PAPER**

**ANNEX B: MARKET DEFINITION**

*Summary*

1. The Competition Commission has not given appropriate weight to the impact of heating oil on LPG prices. Please see further our comments on Part 1 of the Response on the ETP. In *excised* we said the market was "... *at least as wide as the supply of bulk LPG for domestic uses*". Subsequently we have provided a great deal of evidence about the intense competition between LPG and heating oil. We can also supply further evidence of this competition. We expected the Competition Commission to take more account not only of our evidence but also the now published evidence of other LPG suppliers about the level of competition. Calor has to take account of the prices of heating oil to ensure the competitiveness of its offering especially to new customers and those considering replacing their boilers or appliances. *Excised*.

*The product market – demand side substitution*

2. In terms of the product market, we note that paragraph 4 recognises that prices for LPG would "at *some level*" be constrained by heating oil. The retail price of heating oil is indeed an important factor taken into account by Calor in setting its price of LPG, *excised*. According to the Competition Commission's own evidence (see paragraph 2 of Annex B) "*around one third*" of customers who switched, switched to heating oil from LPG.

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3. Moreover, we disagree with the last sentence of paragraph 4 which states, "However, the price level at which such a constraint would bind the monopolist may be more than 5 per cent above the competitive level." There is no evidence that prices are not at the competitive level *excised*. The simple fact that heating oil is cheaper than LPG means that it is difficult for LPG prices to rise to the uncompetitive level.

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4. We note that in paragraph 15 of Annex C (Switching costs) the Competition Commission explains the gap between the introductory price and standard price “*as evidence of high switching costs, and discriminatory pricing*”. We fundamentally disagree. The lower introductory price offered by Calor is pro competitive and enables it to compete not only with other LPG suppliers but also with heating oil, (which has a much larger customer base), and in our view (as we assume to be the case with other LPG suppliers) heating oil is also a direct competitor product of LPG. The two-tier pricing structure makes LPG more attractive to heating oil users, or potential users and reflects a highly competitive market between LPG suppliers and with heating oil. In the last two years the price of heating oil has risen well above Calor’s entry price. *Excised.* This argument should have been included in this Annex and the Emerging Thinking paper itself, and its omission demonstrates a misunderstanding of the domestic LPG bulk market by the Competition Commission.
5. In relation to paragraph 5 which states that “suppliers have generally argued that in the long-term, heating oil and to a lesser extent other fuels place some constraint on the price of domestic bulk LPG, but not necessarily that they are close enough substitutes to be considered in the same market”, *excised.* Please also refer to paragraph 1 above.) In our opinion, the above comment fails to recognise *excised.*
6. The Competition Commission should note that Calor initiated the bulk domestic sector in order to compete with heating oil and offer an alternative to heating oil. This remains an important service to rural households, and one benefit not noted by the Competition Commission is that the provision of LPG in such communities is a valuable important alternative to heating oil. The two-tier price structure ensures that the two sectors are linked and remain competitive. Calor requests the Competition Commission to deal with this argument in its analysis.
7. With reference to Footnote 2 to paragraph 4, CGNI does not believe that switching is slow in Northern Ireland, nor does it believe that heating oil and natural gas are separate markets. *Excised.*

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8. We note that the Competition Commission has decided against treating each supplier, and each customer, as a separate market but has noted in paragraph 7 “*the limited price constraint LPG firms place on each other*”. We agree with the Competition Commission that there are not individual supplier markets: we believe that there is intense price competition between LPG suppliers to win new customers and retain existing ones. In particular, we have provided information that highlights this:

*Excised.*

*Excised.*

*Excised.*

This evidence should not be ignored and should not have been omitted from Annex B.

9. In Calor’s opinion, customers in rural areas (without mains gas supply) are continuously able to make the choice of using LPG, oil or other fuels. This is a large potential customer base. This happens for example when they move house or renovate their property, or are contacted by other suppliers to move to alternative LPG suppliers or fuel types. Although in paragraph 13 of Annex C (Switching costs), the Competition Commission states that LPG suppliers on average lose around 3% of customers annually, *excised*. These are extremely important matters which should be taken into account by the Competition Commission. These matters should in our opinion be referred to in this Annex.
10. We cannot comment on paragraph 6 because it is so ill-defined in its present form. For example, what is meant by “*significant price differences*” and “*.in some cases*” in the third line, and “*sustained average price levels of more than 5% above others*” in the fourth line? Would the Competition Commission please clarify this paragraph? As it stands, in our opinion, it contains very vague, unsubstantiated statements and premature speculation. Certainly, Calor does not accept that switching itself is low or that its

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pricing policy treats its existing customer base unfairly if that is the implication of this paragraph.

***Supply – side substitution***

11. In terms of supply-side substitution, Calor's answer to *excised* did not concede that a commercial bulk LPG supplier could not readily respond to opportunities in the domestic bulk LPG market. We do not accept that a commercial bulk LPG supplier cannot readily respond to opportunities in the domestic bulk LPG market. As is recognised in the Competition Commission's Market Definition Annex, many commercial suppliers already supply domestic customers. In fact, as stated in *excised*, this is how most LPG suppliers in the domestic bulk market have started. *Excised*.
12. A commercial LPG supplier would have the significant advantage of not having to invest in additional storage facilities or (possibly) tankers.
13. We have said in *excised* that there are no separate retail markets for bulk tanks for use by domestic bulk customers and maintenance separate from the supply of LPG.

Calor accepts that the term 'bundling' is a well known term in competition law and economics. Calor notes that the standard definition of bundling (or tying) set out in EC and UK competition law is '*making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which by their nature or according to commercial usage have no connection with the subject of such contracts*'. Whether there is tying in any case is always a question of fact. In this case, it cannot be said that the tanks and LPG do not have any connection with each other: commercial usage (and customer preference) is that the product supplied to the domestic consumer is LPG in a contained form (whether in cylinders or tanks). Calor therefore considers the term 'bundling' to be inappropriate in this inquiry. The situation is one of integrated supply: not only is the provision of the tanks an intrinsic element of the supply of LPG to the customer but also the management of safety and operations is part of the same service.

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**ANNEX C: SWITCHING COSTS**

*Summary*

1. In relation to the substance of Annex C, Calor does not recognise how the Competition Commission has come to its stated summary conclusions.
2. We note that paragraph 1 refers in the context of switching costs to “*inconvenience*”. There is no evidence in this Annex of this so-called inconvenience. It merely refers in paragraph 6 to the requirement to cooperate under the LPGA’s Code of Practice 26 but gives no evidence at all of any practical difficulties encountered. Our evidence is that there is no inconvenience to the customer and the ORC International Survey found that among those customers who have switched, switching was easy. Over half of those changing supplier (54%) said that it was easy to change supplier. Among all respondents, when asked what would be the main reason to discourage switching, 26% gave “no reason”. “Inconvenience” was only given by 17%. When prompted, inconvenience, not surprisingly, scored more highly. But that is not borne out by the actual evidence and, as we said in *excised*, we would be prepared to work with the industry through the LPGA to improve information about switching. Calor does not understand what “inconvenience” is being referred to in this paragraph.

In paragraph 1, we also note the use of the language “*these costs appear to be substantial...*” We have already given evidence (and discuss further below) that the costs are not in practice “*substantial*” compared with the savings available. Indeed, customers do think through the benefits when they make these decisions. Our evidence is supported by the findings of the Competition Commission’s own survey through ORC which found that 75% (62 out of 83) of those who had switched paid less than £10. Of the balance, the majority did not know how much they had paid.

3. Regarding paragraph 2, and the words “*Switching Costs generally impede competition*” and “*while there are exceptions.....it is not clear....*” again we are concerned by the lack of clarity. Could the Competition Commission please state urgently:-

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**ANNEX C: SWITCHING COSTS**

- a) what the exceptions which they have considered are; and
- b) why they do not arise in this case.

***Installation and removal costs***

4. Paragraph 3 says “*in some cases, switchers may receive some recompense for the removal cost as an inducement to switch*”. Again, this misstates the results of the ORC survey. 26% stated that they had received compensation by the new supplier and 23% received a refund for gas left in the old tank. The correct interpretation based on these figures is that a substantial number of customers receive recompense. *Excised*. Accordingly, “some” would be more fairly expressed as “many”.
5. In the third line of paragraph 3, we do not understand the statement that upfront standard charges are “*typically between £250 and £350*” and we would ask the Competition Commission to specify precisely what this first sentence is intending to say. For example:
  - are the prices quoted averages of quoted prices?
  - or the average paid per customer?
  - or the sum actually paid by the largest number of customers (with some customers perhaps paying more and some less)?
  - otherwise, what can the word “*typically*” mean?

In this context also the words “*upfront standard charge*” must be explained. *Excised*. Clearly, we need to know how the Competition Commission reaches its stated figures and the assumptions. All this is lacking so far. As the stated information does not reconcile with Calor’s understanding of reality, our only explanation must be that the Competition Commission is working on much higher average prices elsewhere. Clearly there is confusion, but we see the statement as currently drafted as misleading. Worse, it can lead to erroneous conclusions. It certainly bears no relation

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to the figures quoted by the majority in the ORC survey. Also, the Competition Commission's distinction between typical and average costs is not clear. Can the Competition Commission clarify how it has defined "typical" and "average" in this paragraph?

6. The final sentence of paragraph 3, stating that "*smaller suppliers typically do not charge for tank installation or removal*" is contrary to our own information and we question the source on which the Competition Commission is relying for this statement
7. There is a point in paragraph 4 which may require clarification. Certainly in the case of Calor, any under-recovered installation costs are not recovered specifically (by way of higher price or other recovery) from the customer in question *excised*, but if the Competition Commission still maintains that there is direct recovery from the particular customer of the particular costs, especially from current revenue streams it should say so; especially, as, by the Competition Commission's own reckoning, *excised*, the situation does not apply to Calor and any suggestion that the situation is therefore "*typical*" would be incorrect.
8. Referring to paragraph 5, the costs of underground tanks are indeed [much] higher than for above-ground tanks. However, it should be recognised that at the time of installation the customer has the choice of whether to take the cheaper or more expensive option. *Excised*. The issue of contract duration was covered at some length during our discussions with the OFT's Contract Regulation Unit details of which the Competition Commission is fully aware. *Excised*.

***The switching process***

9. We consider that the option to pump over the LPG from the old to the new tank which is referred to in passing as item 8 in table 1 should be included in the text of paragraph 6. It should be emphasised that the customer does not lose; the process is not a problem; and if there is any LPG in the tank at the time of removal, it can be handled safely.

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10. Regarding the steps in table 1, of paragraph 6, it is not unusual for the switch to take place before the expiry of the notice period if this is more convenient for the customer. Further, the words “*not normally cause an interruption of LPG supply*” should read “*very rarely cause an interruption*”. The four major suppliers and many of the minor suppliers, work in accordance with the LPGA Codes of Practice and this covers 90% plus of customers.
11. In paragraph 7 (c), it is stated that the policies of some suppliers include “*delaying removal of the tank until gas is used up*”. This gives the impression of deliberate obstruction. Delay would only take place with the agreement of the customer because it may suit them to have a delay. In our opinion, such activity would be extremely rare in comparison with normal LPG industry practice. It is certainly not Calor’s policy, and the small scale of this perceived problem should be noted by the Competition Commission.
12. In paragraph 8, the paper notes that one of the larger suppliers has said that the long notice period gave them an opportunity to retain the customer. It is very unfortunate that the paper does not report the view expressed by Calor *excised*.

***Contract terms***

13. In the third line of paragraph 9, it is stated “*that a small proportion*” of customers may have had previous experience of switching LPG supplier. *Excised*. These facts contradict the individual comments made to the Competition Commission by certain small suppliers. Moreover, this is something that should in our opinion have been referred to in the ETP.) Accordingly, we consider that the statement that “*a small proportion of customers may have had previous experience of switching LPG Supplier*” is misleading. In any event the Competition Commission’s own research shows that perceptions on switching costs do vary between “switchers” and “non-switchers” with the vast majority of “switchers” reporting switching costs at less than £10 and a

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similar majority of non-switchers saying that they did not know what costs would be involved in switching.

*Excised.*

14. We are concerned to note the statement “*some smaller firms do not use contracts*”. Such a practice leads to the danger that liabilities (including insurance), obligations and safety requirements are not clearly recorded, particularly important in view of the nature of LPG and its storage. Calor will be interested to see how the Competition Commission interprets this evidence, and whether this is a practice the Competition Commission will want to see become widespread. As previously stated, LPG is a potentially hazardous fuel, that needs safe transportation to customers, and storage at their premises until used – it is not the equivalent of petrol stored at filling stations, to which drivers can simply come and refill their small tanks without special precautions – one of which is clearly having written contracts.
15. In addition, in paragraph 11 we consider that insufficient weight has been placed on the phrase “*efficiencies to suppliers*.” The Competition Commission will be aware that the ability to predict the length of time for which a customer can reasonably be expected to remain taking their supply from Calor is very important *excised* without which Calor’s logistics would be very significantly more expensive and less efficient.

Calor’s cost base and efficiency of operations are critical to its success and competitiveness, and are kept under constant review because of input costs such as inflation, fluctuating distribution costs (including fuel prices) and national insurance. It would be a mistake for the Competition Commission to think that Calor’s scale allows it to carry high levels of overhead or unnecessary costs. We have previously submitted evidence to the Competition Commission of Calor’s actions to reduce costs. *Excised.*

*Excised.*

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16. In the case of the final sentence of paragraph 12, where the Competition Commission suggests there is low risk of cost under-recovery on contracts of short length, we would suggest that this displays circular logic. The Competition Commission has expressed concern that switching rates are too low, but that this rate includes those who are beyond their initial contract period, suggesting that it is not the contract which is contributing to “*low*” switching rates. The Competition Commission is however stating that “*this risk*” (i.e. the risk of under-recovery for the supplier) “*is small*”. This would not be the case if the switching rate were higher, and this evident conclusion needs to be stated. Interestingly, we find the Competition Commission is relying on a perceived low switching level to justify its conclusion that the risk of cost under-recovery is low. How then can it suggest that low switching levels are a problem? The Competition Commission’s argument seems to confirm that low switching levels reduce this risk of under-recovery, and therefore are pro-competitive in the LPG sector. Please can the Commission clarify its thinking on this important subject?

***Switching rates***

17. Paragraph 14 has presented us with many problems in understanding the Competition Commission’s thinking. The following are just a few of the problems we have had to address.
18. In response to the third sentence of paragraph 14, we would emphasise, *excised*.
19. Moreover, paragraph 14 also misquoted the results of the ORC survey: this states that “*most [customers] do not believe that the service from other suppliers would be any less satisfactory*”. According to the quantitative report 72% said that they did not know how the quality compared, with 21% saying that the service would be about the same or no different. (Please refer to paragraph 5.2 on pages 9-10 of the quantitative report). If customers do not know how to compare quality, how can the Competition Commission conclude they would assume similar service from moving? Please can

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the Competition Commission clarify its thinking on this point? We do note that this has been clarified in the version of this Annex published on the Competition Commission's website but not in the ETP.

20. In the fourth line of paragraph 14 the Competition Commission say in brackets "*perhaps predictably*". We note this is not repeated in the ETP.
21. In the last sentence of paragraph 14, the Competition Commission states that contractual "*lock-in*" (a term with which we disagree) is a barrier to switching with the potential to impede competition. We refer to the view expressed above that this is not the case, based on the Competition Commission's own logic. (Please see paragraph 13 above relating to the under-recovery of costs from short-term contracts). Accordingly, should not the Competition Commission be withdrawing its assertion in the paragraph regarding the LPG sector? If increased switching or reduced contractual length were to occur, the risk would fall squarely on LPG suppliers. Calor assumes that the Competition Commission is carrying out a cost/benefit analysis to show its thinking is actually pro-competitive. Calor would like to share the Competition Commission's cost benefit analysis showing its thinking.
22. We note from Footnote 2 that there is considerable discussion at this point on negotiation regarding price which should be in the main text and the main argument. There is no analysis of the significance of this footnote. For example, Flogas UK has said that a significant proportion of its customers get discount and paragraph 4.10 of its response to the Issue Statement says:

*"In practice there is no category of Flogas customer who is disadvantaged by an inability to seek a price reduction, or if they were to seek a price reduction, are less likely to obtain one than a similarly situated customer with similar consumption. Flogas price policy does not distinguish between new and existing customers or between other categories of customer. A substantial proportion of Flogas customers are able to use their negotiating power (including through the threat of switching) to obtain price reductions. In these circumstances, the*

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*competitive process operates effectively to the benefit of consumers, through suppliers pre-emptively reducing prices to avoid switching.”*

We see nothing to even note this argument in any of the Annexes! Were the argument to be noted, the Competition Commission would need to show their counter-arguments. As currently assessed by the Competition Commission, Calor and Flogas account for a large proportion of the sector, so we cannot understand why the Competition Commission has omitted our respective views.

In Calor's view, it is clear that switching and threats to switch constrain our standard prices.

***Indicators of Switching Costs***

23. Please refer to paragraphs 16 – 19 of Part I of this Response.
24. In paragraph 15 of Annex C the Competition Commission refers to the 2003 OFT Discussion Paper on Switching costs. The text quoted is selective compared with the full text of paragraph 1.9. We note the partial quotation from the NERA study for the OFT on Switching Costs. In response, we would comment:
  - the NERA study also found that switching costs do not necessarily make markets less competitive
  - switching costs are modes in this sector
  - levels of switching are not insignificant in the context of the supply of domestic bulk LPG and Calor's customer base
  - Calor seeks to retain a balance between entry prices and prices to existing customers, as already explained.

We do not understand why the Competition Commission has not fully recognised the information it was quoting from – indeed the paragraph starts by noting that the level

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of switching (i.e. rates of switching which the Competition Commission repeatedly suggests as low) is not necessarily a good indication of the presence or importance of switching costs, etc. Please can the Competition Commission clarify its thinking on this important subject and provide full arguments.

The Competition Commission is well aware of Calor's position that the difference between the introductory prices to LPG customers in this sector, and the higher standard prices is a very specific market reaction to competition from heating oil and other LPG suppliers. This two-tier pricing structure is a reflection of an intensely competitive sector and if there was a single price structure, it is Calor's view that the LPG sector would suffer further decline, and worse, customers may face less choice of fuel. LPG customers might also face higher charges. The Competition Commission is also aware that Calor extends its customer base by competing for heating oil customers, and vice versa. Calor also competes against LPG suppliers. *Excised*, shows the effort made by Calor to win business in this intensely competitive sector.

25. In the above context, the comments in paragraph 17 have not been quantified in any way. Indeed, the reverse appears to us to be the case. We cannot possibly reply to this paragraph without the full argument being set out in detail. Is it being suggested that paragraph 17 is an intensification of paragraph 16 (i.e. things are "worse" than actually set out in paragraph 16) or that it is an alternative and things are not as "bad" as set out in paragraph 16? Moreover:

- What does the statement "*substantial, if not prohibitive*" actually mean? Is it to be interpreted in the usual way to say that they may be regarded as prohibitive but might in some cases simply be substantial? Or is it intended to be interpreted in the opposite way, to say that they are substantial or in some cases prohibitive? We cannot comment until there is clarity. Please let us see the workings in relation to Calor.

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- In this paragraph we also note the use of the words “*and deterred*” in the penultimate line i.e. the Competition Commission’s assertion that “*switching [levels] remains low indicates that customers are deterred in some way from availing themselves of these savings [from switching].*” The Competition Commission has not supplied any evidence as to what kind of “*deterrent*” it believes may be taking place. Given that the Competition Commission already has evidence from ORC and from its various other enquiries, we can see no such evidence of additional “*deterrents*”. Without the evidence, Calor considers that the use of this strong word cannot be justified. In Calor’s view the key “*deterrent*” is the high level of customer satisfaction.

We note that the statement that “*potential (in some cases large) savings*” may be made appears to contradict the “*substantial, if not prohibitive costs*” reference above. Again, please can the Competition Commission clarify its thinking in Annex C?

***Effect on competition and entry***

26. As Calor noted *excised*, the Competition Commission's theoretical model illustrating the impact of switching costs on prices is inappropriate since it considers a situation in which suppliers charge all customers the same price. Paragraph 19 refers to this inappropriate model. Given this, Calor cannot see why this should be included in the Switching costs Annex, at least not without a caveat pointing out its limited relevance.

In any case, the conclusion that all suppliers will charge the monopoly price, irrespective of the size of the switching cost, is incorrect as a matter of economic theory. In general, the monopoly outcome can only be maintained if the switching cost is large enough to ensure that no supplier has an incentive to unilaterally undercut the monopoly price in order to win more customers.

27. We consider that the first and indeed subsequent sentences of paragraph 23 show a fundamental misconception (as is accepted in effect, elsewhere by the Competition

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Commission, for example, in commenting on switching rates in Annex B). The LPG suppliers have to fight aggressively for new customers against heating oil, not just other LPG suppliers. More detail is given in Annex D (and in our comments thereon) but what is quite clear is that, regardless of the comments made in paragraph 5 of Annex B (Market Definition) the price of LPG to domestic customers is generally most heavily influenced by the input cost of the raw material, which is the main determinant of standard prices, together with heating oil, overall prices and competitor pressure. *Excised.*

Entry prices, which are pro-competitive in principle, have to be set at a level where customers will be attracted not just (or even mainly) from other LPG suppliers but in particular from heating oil. This is of course dependent on the fairness requirement of the customer being aware of the relationship between the entry price and the standard price, and the way in which one moves to the other *excised.*

There is an assumption at the start of paragraph 23 that in fixing the entry price our calculation is simply against other LPG suppliers. This is quite incorrect and this should be reflected in this paragraph, as it is at a point like this that Competition Commission's theoretical reasoning breaks down.

In addition, in paragraph 23 there is no reference to the possibility of customer satisfaction (a rather different feature from "*customer inertia*" as mentioned) as being a feature which may hold back customers from switching. The evidence from the ORC Survey suggested that there is certainly a high level of customer satisfaction in general, and even the evidence on satisfaction with pricing (which, as the Competition Commission admits, is difficult to interpret) does not clearly suggest an overall dissatisfaction level.

28. We disagree with the reference to "*high switching costs*" at the start of paragraph 25, and have provided evidence that the costs are not "high". This paragraph also makes a number of assertions which seem to require clear evidence. For example, the last

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sentence stating that under circumstances where LPG suppliers usually respond with lower price offers when a customer threatens to switch, *“switching costs can be a barrier to smaller companies winning new customers, as even if they undercut the incumbent’s price, it may be more attractive for the customer to stay with their existing supplier and avoid switching costs.”*

There is nothing shown in Annex C which supports this assertion about smaller suppliers. See also our comments on paragraphs 24 to 27 of Annex D. Calor’s evidence shows that it loses customers to other LPG suppliers (large or small). Please can the Competition Commission provide its evidence to make this assertion.

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**ANNEX D: NON-PRICE COMPETITION AND ENTRY**

*Summary*

1. Paragraph 1(a) of this Annex asserts that there is limited non-price competition. Calor disagrees, and this statement contradicts the mass of evidence supplied and listed by the Competition Commission in paragraphs 4, 6 and 7 of this Annex D. Moreover:

- In paragraphs 6 and 7, the Competition Commission summarises the information which has been given about non-price competition but then says that no supplier presented the Competition Commission with data that showed the impact of any non-price initiatives and that only one supplier quantified the gains of such work. In terms of the example, the Annex omits some of the non-price initiatives undertaken by Calor *excised*.
- *Excised*.

*Excised*.

2. Paragraph 1(b) fails to mention that Calor created this market to compete against oil central heating. Also if the Competition Commission is implying that a high concentration of 4 suppliers with 90% of the LPG sector is of necessity anti-competitive, there is still no evidence to support this view. The experience of NI shows that an even more concentrated market is in decline due to the inroads of mains gas and heating oil and therefore that concentration is no indication of market power per se. The paragraph as written is misleading.

3. In paragraph 1(c) the Competition Commission makes a clear statement that “*There are barriers to entry and expansion*”. Taking into account the Competition Commission’s supporting statements on paragraph 14, Table 1 of Annex D, this is an apparent conclusion which Calor simply cannot understand. In Table 1 it shows there is a large number of smaller suppliers who have entered the LPG bulk sector in the last 10 years. There are also significantly more smaller suppliers operating in the LPG bulk

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sector as described in *excised*. The presence of these smaller suppliers in addition to the four major suppliers clearly constitute a competitive environment across the whole of GB. The Competition Commission's summary is therefore misleading. We note that in the published version of Annex D the words used are "there may be barriers to entry and expansion" although in paragraph 9 of the published version of the ETP it says "we therefore remain particularly concerned there are barriers to expansion by smaller suppliers in the market and about their effect." We refer to the statement in paragraph 23 of Annex D that there are no huge barriers to entry.

***Strategies of suppliers***

4. With reference to paragraph 2, Calor has explained the reality behind strategy documents and this seems to be missing from this paragraph. *Excised*.

*Excised.*

***Non-price competition***

5. With reference to paragraph 6, in addition to the list of non price initiatives at the start of this *excised*. However it is not possible to make the same actuarial assessment of individual non-price initiatives.
6. Paragraph 9 seems to ignore the evidence listed in preceding paragraphs and the evidence given by Calor. *Excised*. The range of non price initiatives is noted by the Competition Commission in paragraphs 4, 6 and 7 of Annex D and Calor has to spend these large sums of money to both win and retain customers. We find it strange that this is not reflected in the ETP itself. Calor cannot understand why the Competition Commission would disagree with this.

***Market Structure***

7. With reference to paragraph 11, in the final sentence it should be noted that Calor initiated the bulk domestic market in the early 1980s *excised*. In addition, there is no

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recognition of the reality that entry has been possible, businesses have been taken over, and there has been vibrancy in the sector over the 2 decades of its existence. We note Mr Freeman's comment *excised*: i.e. "*Obviously there is a limited value in looking at concentration measures as a measure of competition. We think they have an importance but they are NOT going to be the whole answer, but they are part of the picture. As you said, you invented this market, now you are down to excised...*" Calor's view is that market shares in the LPG sector do not signify market power. We would invite the Competition Commission to take these points on board.

8. With reference to paragraph 12, what is Calor meant to interpret from a large supplier being "aggressive". If there is any significance to this statement, can the Competition Commission please clarify what it means?
9. With reference to paragraph 13, it may be useful to note that the experience of LPG in Northern Ireland again suggests that consideration of market shares in the LPG sector is meaningless – they do not indicate market power. CGNI continues to lose customers to heating oil.

***Entry***

10. The statement in paragraph 15 as set out may have been as a result of a comment from a supplier but paragraph 17 goes on to list a range of entry and expansion strategies that do not necessarily require acquisition. "*Critical mass*" is also a vague statement as we can see that there are a substantial number of smaller suppliers who are very strong competitors in their own area, perhaps they have the "*critical mass*" in their area of operation. Can the Competition Commission please define critical mass to allow us to consider this statement? Table 1 indicates 19 entrants in the last ten years, covering most parts of GB – clearly the opportunities for entry have existed.
11. Paragraph 16 refers to limited expansion by smaller suppliers. Although the Competition Commission states there could be many reasons for this, it is important to note that if the Competition Commission wishes to draw inferences regarding anti-

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competitive effects, Calor needs to see a more detailed explanation of the reasons. The reasons given for businesses choosing to remain small are all relevant to a competitive market structure. Calor's position is that expansion within the LPG sector is possible and the Competition Commission's own information (relegated, we see, to Footnote 1) provides evidence of this. *Excised*.

### ***Entry and Expansion Strategies***

12. The sentence in paragraph 18(b) gives a misleading impression of the costs of buying a tanker. A standard tanker is around £ *excised* and a 12tonne tanker is around £ *excised*. Both examples are for new tankers. Occasionally second-hand tankers become available for around £ *excised, excised*. Could the Competition Commission please emphasise that a small player could enter the sector for an investment of some £ *excised* in the purchase of a second hand tanker, excluding other start up costs.

### ***Exit***

13. Paragraph 20 fails to comment on the fact that if the sector was uncompetitive and profitable (i.e. showing excess profits) then there would be a strong incentive to stay in such market. *Excised* we are surprised that the Competition Commission has not made the point that Shell have put their LPG business up for sale. The businesses shown in Table 2 that have exited were in some cases, divisions of larger groups which were divested so that the parent could pursue other interests. Of the 7 examples given, only 1 firm (Altagas) exited due to insolvency, and it was acquired by Flogas. All this reinforces the conclusion that the LPG sector is intensely competitive. More companies have entered than exited this market over the past 10 years which is a sign of a vibrant market with low barriers to entry.

### ***Possible barriers***

14. Paragraph 21 again refers to "*inconvenience*" in changing tanks in switching and, as noted before, without providing any evidential support for this.

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15. Paragraph 22 requires more clarity to allow us to comment properly. There is no weighting of the answers, no detail of number or weight of the respondents, no weighting on the effect of the alleged barriers. Paragraph 24 then goes on to examine the behaviour of large incumbents. If this was considered such an important barrier to entry and expansion (as described in Annex D) then why was it not important enough to be included in the survey? Table 3 gives many mixed messages.
16. We are puzzled by what appears to be a throw away line at the end of paragraph 23, "We were also told that there were no huge barriers to entry: any restrictions to entry were probably related to technical knowledge..". We are struggling over the use of the word "huge" and would ask the Competition Commission to clarify this. We consider that there are no barriers (and that "technical knowledge" is not itself one.)

***Behaviour of large incumbents***

17. Paragraphs 24-27 suggest that the behaviour of large suppliers deters entry. Again, there is no evidence of this: in fact the evidence is to the contrary, namely the entry of a number of new suppliers over recent years. How can the Competition Commission come to this view on the basis of the evidence? The comments as they stand are by implication prejudicial to us.
18. Paragraph 25 implies that a supplier of Calor's size would have to spread overheads over a larger customer base. If Calor fails to achieve this, then it will incur losses. Our calculations (and also the Competition Commission's own calculations) show we do not make excessive returns. There is no recognition in the Competition Commission's conclusions about any of this. In any case, we see no logical basis for singling out the "major suppliers" as defending their investment. This is a natural response by any business in any competitive market. The assertions that if the ownership of tanks were released there would be significant opportunity for the smaller player to grow shows a superficial understanding of the issues for the following reasons:

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- There would be no certainty as to the length of time for which a small company would retain the tank before it was transferred to another supplier;
- Secondly, under the tank transfer proposal there would be a significant loss of logistical efficiency.

These factors are likely to increase costs for the smaller supplier.

19. Paragraph 26 is a jumble of comments from various sources with no attempt to weight or give a time dimension. As suggested generally at our paragraph 15 above, can the Competition Commission please give details so that we can comment sensibly on this paragraph.
20. *Excised*, the paragraph reports a total misrepresentation of the facts, and in particular ignores or distorts the evidence presented to the Competition Commission and published with the statement of Issues. One historical event or circumstance does not constitute an ongoing situation. Small suppliers have good opportunities to exploit the market, for example through spot purchasing LPG and even longer term supply contracts with, for example, oil refineries.

Of course Calor itself is not a vertically integrated LPG supplier and yet has been successful i.e. vertical integration is not a pre-requisite for success.

### ***Stagnant Market***

21. The statement in paragraph 30 is correct but fails to mention why Northern Ireland was steadily declining. We are surprised that the Competition Commission failed to mention the important reasons for the decline – i.e. customer sensitivity to price and switching to mains gas and heating oil. This has serious implications for the definition of the competitive market in Northern Ireland as it can be seen that both of these competing fuels can have a substantial effect on the LPG sector.

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*Economies of scale, scope and density*

22. Paragraph 31 asserts that large companies (Calor disputes the word “large” *excised*) which also sell to agricultural customers may have peak agricultural demand in the summer to compensate for low domestic demand. That is, again, a significant generalisation as smaller suppliers also supply to the agricultural sector. Calor also explained *excised* that agricultural demand for LPG does not necessarily peak in the summer.

*Identifying new customers*

23. In paragraph 35 the Competition Commission appears to be making a large issue from the comment of one supplier. Can the Competition Commission please give proper weight to the comments received about the ability to find new customers. What proportion of the smaller suppliers said it was a problem? Paragraph 36 even states this is not a barrier to small suppliers. Calor would like to understand why the focus on this statement when the majority of the evidence (as opposed to unweighted comments) shows the opposite. Customer lists are a competitive tool and therefore are never made publicly available in any market that we are aware of. This is every bit as much the case where competition from heating oil is concerned. Any suggestion that LPG customers should be “public” but oil customers should not would be enormously damaging to the LPG industry and its ability to compete.
24. We agree with the majority view expressed in paragraph 36.
25. Paragraph 37 presents the views of one party about the difficulties of acquiring a customer from another supplier and refers to practices such as filling up the tank to retain the customer for a few more months. The Competition Commission has given no indication of the number of occasions on which this practice might have occurred: the reader is left with the impression that it might be widespread. As the Competition Commission already knows it is Calor’s policy to suspend automatic deliveries as soon

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as a customer has indicated their desire to switch suppliers. As such Calor's view is that this is not the case, but that this assertion is mere prejudice.

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**ANNEX E: PRICING**

*Summary*

1. We must take issue with the Competition Commission over its comment “*The proportion of customers who negotiate prices appear small as is the proportion who are aware that they can do so*”. The Competition Commission has received evidence from Flogas and its own ORC survey to the effect that this is not the case. (The ORC findings show that almost a third (29%) tried to negotiate a decrease and of those 65% had been successful). Please refer to paragraph 13 below.
2. The 2-tier pricing structure has evolved in a pro-competitive manner to compete against heating oil as well as other LPG suppliers. *Excised*. This structure does not mean discrimination but is a reaction to competitive pressure in the sector from other LPG suppliers and heating oil.
3. The last 4 years have seen great volatility in the price of oil, as well as the input cost of LPG to suppliers like Calor. This reality makes pricing even more challenging for all LPG suppliers – *excised*. Suppliers price independently for their own commercial reasons. Although the higher retail price gap between LPG and the lower oil retail price has reduced in recent years, if this were to be a long-term structural change it would take several years for large numbers of customers to move to LPG from oil. Historically, LPG was around 2 times the price of oil. The Emerging Thinking paper does not recognise these interplays (and denies any linkage).

*Headline prices*

4. In paragraph 1 is the Competition Commission comparing entry to “existing” customer prices? If so there is a clear and transparent reason for these price variations which, in our experience, are common across the industry. The Competition Commission asserts that “*UK LPG suppliers differ substantially in their pricing policies ... and in the prices they charge*”. This is not borne out either by our experience or our analysis of competitor pricing behaviour. In particular, the statement is completely inconsistent

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with paragraph 5 which describes a large number of features which it describes as “*broadly typical*” of the pricing policies of the major suppliers – accounting for over 90% of customers.

5. The summaries in paragraphs 2-4 are misleading to the extent that while they contrast the lowest price with the highest price of any given supplier, there is no indication of frequency. We cannot see how any meaningful conclusions can be drawn from what is drafted. The only conclusion that can be drawn is that there is price variability – **that is the effect of a competitive market.** *Excised.*
6. In paragraph 3, the figures are presented with no explanation which renders the information meaningless and/or misleading.

***Pricing Policies***

7. In paragraph 5(c), the statement is correct about fixed prices being offered for a short period. Calor believes this is not anti competitive.
8. In paragraph 5(e), the Competition Commission should take into account *excised.*

***Pricing by Smaller Suppliers***

9. In paragraph 6 the statement that prices vary widely is surely more proof of a competitive market. The conclusions drawn about prices charged to new and established customers is extracted from a sample of only 9 smaller suppliers. We would ask where the rest are. The last sentence says “*average prices charged by seven smaller suppliers in 2003 ranged from 4 ppl below that of the cheapest of the major suppliers to more than 1ppl above that of the most costly of the main parties.*” Such dispersion suggests vibrancy and competition across the LPG sector.

***Comparison by Sector***

10. With reference to paragraph 7, the Competition Commission has accepted that the domestic bulk and commercial bulk market are different.

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There is no attempt to compare like with like as many commercial bulk customers are large consumers. In fact, on average commercial bulk customers are generally purchasers of far larger volumes of LPG than domestic bulk customers. Many commercial customers have a steady demand for LPG and buy disproportionately more during the off-peak season. *Excised.*

This statement is dangerously superficial without proper explanation for the differences in prices. The phrase “typically up to 50 per cent” is highly prejudicial, drawing a sensational conclusion from unspecified statistics. It should therefore be removed or properly explained.

***Determinants of Price***

11. Paragraph 9 fails to note that LPG competes against heating oil and that is the reason for the introductory price level. This should be seen as a positive competitive tactic by the LPG industry in fighting against the dominance of oil. Any weakening of the LPG position against oil will result in a rapid decline for domestic bulk LPG. This is particularly important *excised.*

***Price sensitivity***

12. In relation to paragraph 13, it should be noted that the service element is an important aspect of the supply relationship, and cannot be divorced from any examination of customer behaviour when considering pricing.

***Information on Pricing***

13. In relation to paragraph 15, the evidence published by the Competition Commission (as submitted by Flogas) shows that a substantial number of their customers are on a discount. Also the ORC survey showed that 29% of customers had attempted to negotiate prices. This contradicts the first sentence. It was explained to the Competition Commission that there are local discussions between customers about prices but this is extremely difficult to quantify. The fact that it is difficult to quantify

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should not be taken by the Competition Commission to mean it does not happen as the last sentence implies.

14. We do not understand the point being made in paragraph 16. Could the Competition Commission please clarify? The first sentence "*Fluctuations in price due to variation in the cost of propane may increase the difficulty of comparing prices between suppliers.*", makes an assertion with no proof. The final sentence, "*We note that this does not amount to an understanding of how competing LPG price offers in the retail market will change over time*" is meaningless in the context of the real world – how can anyone predict price changes "*over time*"? particularly in an internationally traded commodity.

***Price negotiations***

15. In relation to price negotiations, and paragraph 17, the ORC survey says that of those who try to negotiate a price decrease, 65% had been successful. We note elsewhere that a figure of this magnitude is described as a "substantial majority" and we suggest that that description be used here as well.
16. Regarding paragraph 18, it is not clear why the Competition Commission should expect termination rates to increase necessarily with LPG price increases – as input propane prices change, they create the need for LPG retail prices to change – if customers notice oil and fuel prices are going up at a particular time together, they are not necessarily going to terminate abruptly. *Excised.* There is a clear relationship that is reasonable and fair.

*Excised.*

*Excised.*

17. The text of paragraph 19 demonstrates that tacit collusion on pricing (see paragraph 3 of the ETP) is not feasible.