## Response by Shell Gas Limited (SGL) to emerging thinking document: Summary

### 1. **Market Definition**

1.1 SGL encourages the Commission to examine the operation of competition against a number of different models of supply which, in turn, might suggest a number of possible market definitions. The model most usually found in Great Britain today involves the supply of the bulk LPG system and of LPG itself under a single arrangement and for a single price. As the terms of reference make no mention of the supply or maintenance of tanks for the storage of LPG, the Commission will need to take a view on market definition before reaching any conclusions in relation to particular features of relevant markets.

1.2 Other fuels such as LPG cylinders, electricity, natural gas and heating oil are close substitutes for bulk LPG and do act as substantial competitive restraints on prices without necessarily forming part of the same market. There is, for example, evidence of partial switching between LPG and electricity and between LPG and solid fuels in response to changes in the price of LPG. The Commission's own research (figure 6.3 of the ORC report) shows that 12% of those customers who took action in response to an increase in the price of LPG increased their electricity usage.

1.3 The Commission has overstated the supply-side issues faced by a supplier of commercial bulk LPG seeking to enter the domestic sector.

1.4 SGL agrees with the Commission that:

(A) Defining each supplier or each account as a separate market is inappropriate; and

(B) This is a national rather than a local market.

### 2. **Market Structure**

2.1 SGL refutes any suggestion that it engages in non-co-ordinated action. In general terms, SGL considers that it faces significant competitive constraints on its commercial behaviour and that there is nothing about the structure of the market which confers any element of market power on SGL.

2.2 SGL refutes any suggestion of co-ordinated effects in this market. Firstly, there is no evidence of such effects and secondly, the conditions as detailed in the Commission's Market Investigation References guidelines (CC3) such as high degree of homogeneity between firms, high degree of transparency etc. do not exist in this market.

## 3. **Switching**

3.1 Limited actual switching from one supplier to another cannot be regarded as conclusive evidence of a lack of competition in the market. Other explanations include:

(A) Customer satisfaction;

(B) Customer inertia; and

(C) Customers may engage in partial switching (see paragraph 1.2 above) and this is not captured in switching figures.

3.2 Contractual lock-in is a "milder" barrier to switching compared to barriers to switching arising from unavoidable switching costs, for example, it is time limited and fully transparent at the time at which the consumer enters into the contract.

3.3 Whilst SGL considers the switching rates in domestic bulk LPG to be consistent with a competitive market, SGL acknowledges that comprehensive details on the switching process may not always be given to all customers and that there is scope for making more information about the transfer process available to customers.

## 4. **Barriers to entry and expansion and non-price competition**

***Non-price competition***

4.1 Customers place significant emphasis on non-price factors - the ORC quantitative survey reports that 19% of those users who had changed supplier were dissatisfied with the previous supplier's service and that this had prompted them to switch. If LPG suppliers did not keep up-to date with innovations in the market, they would lose customers to their competitors.

4.2 There is a significant level of non-price competition which exists throughout the market as suppliers strive to innovate, not least for the purposes of reducing costs and retaining their existing customer base.

4.3 SGL is constantly investing in improving its service to customers and delivering operational excellence internally in order to ensure safety, quality, consistency of supply, and reliable invoicing, amongst other things.

4.4 In a mature market a focus on the defence of an existing customer base may well be an economically rational course in the face of competition. Nevertheless, in addition to keeping its existing customers happy, SGL engages in activities to attract new to market customers.

***Barriers to entry***

4.5 SGL does not agree with the suggestion that "*there has been very little expansion by the smaller suppliers*" (paragraph 16 of Annex D). Regional suppliers achieve, on average, a higher growth rate (in absolute and in percentage terms) in the regions they operate in than the growth rate achieved by larger suppliers in those regions.

4.6 SGL does not agree with the view in paragraph 28 of Annex D that "*growth in this market has to be through acquiring customers from other suppliers*." This fails to consider the strong competition which exists between suppliers to supply new build properties, for example.

4.7 The number of new entrants listed in paragraph 14 of Annex D and the level of merger activity in the LPG sector does not support the proposition in paragraph 24 of Annex D that the presence and size of the larger suppliers in the market may deter entry.

## 5. **Pricing**

5.1 LPG suppliers make significant investments in infrastructure and this investment must be reflected in prices accordingly. In many cases, this investment is never fully recouped.

5.2 SGL regularly reviews and challenges its cost base with a view to driving out inefficiencies and making structural cost reductions in order to increase its competitive advantage.

5.3 The possibility to renegotiate prices on an individual basis is a feature of the LPG market which differentiates it from other market models, notably natural gas and electricity.

5.4 The presence of fixed introductory prices is consistent with the presence of ex ante competition for new customers of the kind which can characterise competition in markets with switching costs.

5.5 Any comparison with other sectors should take into account the fact that price differences are affected by cost factors and any true comparison should take proper account of the different services provided to different customers in terms of the size of tank and the volume of gas supplied. Volume alone does have a small impact on the prices charged to domestic customers. However, a larger effect can be observed by considering the drop size per visit as prices are driven by delivery efficiency which is in turn driven, amongst other things, by drop size.

5.6 In paragraph 13 of Annex E, the Commission appears to imply that the view of a supplier that "*customer gains rarely reflect movements in (short term) prices*" is not consistent with competition. SGL considers that losing customers as a result of an accumulation of grievances, rather than immediate switching due to dissatisfaction with a single price change, is consistent with competition and it is unrealistic to expect consumers to switch an otherwise acceptable supply relationship due to a single pricing incident.

5.7 SGL's own research concludes that customers do express an awareness of prices paid by other LPG consumers. This is not reflected in paragraph 14 of Annex E. Furthermore, the paragraph does not reflect the fact that, just because some consumers are willing to pay a premium for the comfort and convenience of LPG, does not mean that LPG does not compete with other fuels. Competition can occur between differentiating products.

## 6. **Profitability**

6.1 SGL's main concerns with the Commission's approach to profitability are as follows:

(A) SGL questions why the Commission is using Return on capital employed (ROCE) as a key measure of profitability rather than, for example, a return on sales; and

(B) SGL is of the view that because assets are regularly refurbished, net book value (NBV) underestimates their true value and therefore the appropriate method for valuing the asset base is to use the current replacement value.

## 7. **Safety and alternative arrangements**

7.1 The provision of a bulk LPG system, i.e. the provision of the tank (etc.) and LPG, by a single supplier is the safest operating model and one which provides most clarity on roles and responsibilities under the current legislative and regulatory regime for the following reasons:

(A) The overriding duties of the gas suppliers and employees under the Health and Safety at Work etc. Act 1974 ("HSWA 1974") can best be met through the provision of a bulk LPG system; and

(B) Given the timeframes involved, a supplier to a tank nearing the end of its life would have difficulties in discharging its duties under the HSWA 1974 if the tank had been under the control of a number of different parties.

7.2 Safety is a key commercial issue to LPG suppliers and any attempt to divorce commercial and safety issues in the analysis of this market is erroneous. There are a number of incentives for LPG suppliers to operate safely and these include:

(A) To ensure the safety of customers, employees and premises – this is and will remain SGL's top priority;

(B) To comply with the law – a breach of the law gives rise to a criminal offence and the possibility of an action for damages by anyone suffering harm as a result. The existence of criminal sanctions in a legal framework which is, in places, ambiguous creates a strong incentive to err significantly on the side of over compliance;

(C) To protect the reputation of the business and of the brand; and

(D) To ensure a clear allocation of legal responsibility and liability.

7.3 It is SGL's view that it is not possible to consider alternative arrangements, in the nature of a counterfactual against which to compare the current market, without having regard to the overriding safety obligations which the HSWA 1974 imposes on suppliers and employees as detailed above and which are subject to criminal sanctions for breach. Any change to the current operating model would require detailed clarification of the roles and responsibilities of all parties.