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NON-CONFIDENTIAL VERSION

Dear Mr Simon

Domestic Bulk LPG Inquiry - Flogas' Response to the Competition Commission's Remedies Working Paper

I refer to your letter of 2 March 2006 enclosing the Competition Commission's Remedies Working Paper (the "Working Paper") and inviting further comments on this Paper. Flogas has previously commented in detail (on 28 September 2005 and 13 December 2005) on the Provisional Findings Report and the Notice of Possible Remedies. Although Flogas has a limited number of comments on the Working Paper, it has significant concerns in relation to certain aspects of the proposed remedies, in particular the tank valuation methodology, to which it wishes to alert the CC.

A. TANK VALUATION METHODOLOGY

The success of the tank transfer remedy crucially hinges upon the workability of the tank valuation methodology and, in particular, striking the correct balance to ensure that investment decisions by LPG suppliers are not distorted by undervaluations either of the tank over its full lifetime or by the non-inclusion of the installation costs. Flogas' concerns in relation to these aspects of the proposed tank valuation methodology are set out below.

1. Installation costs

The Working Paper proposes, both as regards those customers switching to LPG from alternative fuels and in the event of the installation of a replacement tank on a customer's switching, to exclude from the tank valuation methodology the costs of installation, both as to initial installation costs (including the costs of installing the pipework and connecting the customer's heating and/or cooking appliances to LPG) and as to replacement installation costs.

Whilst it is understood that, going forward, once the tank transfer remedy is in place, the costs to an incoming supplier of installing a tank may be avoidable, this will only be the case if the customer does not elect to have a replacement tank installed. It is

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extremely important that the remedy should not undervalue the investments made in the past and to date by suppliers. The exclusion of the costs of installation would prejudice those LPG suppliers like Flogas who, in order to encourage customers to switch (including switching to LPG from alternative fuels), do not impose installation charges on customers.

By undervaluing the transferred assets, the proposed exclusion of installation costs from the tank valuation methodology could facilitate opportunistic entry, as such entry is more likely to occur where the transfer price does not fully reflect the real value of the installation. An incoming supplier would be obtaining a windfall gain since the transfer price would not reflect the real value of the installation. A further consequence is that suppliers generally are less likely to focus on expanding the market by developing new customers for LPG as there will be easier gains to be made from acquiring customers and tanks from other LPG suppliers, who have made the necessary investment.

Flogas on the other hand would be penalised if incoming suppliers were to obtain its tanks without paying for the installation costs. [CONFIDENTIAL]

Flogas is extremely concerned that the tank valuation methodology should therefore include installation costs, to the extent that the supplier has not recovered these costs through installation charges. In this context, Flogas would be prepared to accept that installation costs and termination costs be capped at zero to ensure that the cost of installation cannot be recovered from both the customer and the incoming supplier on tank transfer. Flogas would suggest that the installation costs be depreciated over a 10-year period.

As a final point, it should be noted that the position taken at paragraph 92 of the Working Paper is contradicted by paragraph 94(b), which states that the valuation methodology involves "*base prices for each category and class of tank based on average replacement cost of tank plus fittings and initial installation*" (emphasis added).

2. Depreciation Profiles

In the worked example contained at Appendix 2 (Depreciation Profiles) of the Working Paper, £650 is given as the current replacement cost, the cost of a 20 year refurbishment test is given as £400, and the cost of a 10 year refurbishment test is given as £70. It is assumed that the £650 figure does not include the cost of fitting alongside the cost of the tank and fittings. Therefore, these calculations would need to be revisited in the context of Flogas' concern about the non-inclusion of installation costs.

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3. Metered estates

It is stated at paragraph 23 of the Working Paper that there is “*no reason why the tank transfer remedy should not apply equally to above-ground tanks, underground tanks, and those metered estates that fall within the terms of reference*”.

Installations at metered estates are far from being homogenous, and the costs of installations at metered estates can vary between [CONFIDENTIAL]. Given this diversity, the high level of investment that LPG suppliers have to commit to such projects (including the cost of the metered estates pipework), and the different ongoing maintenance costs, it would be wholly inappropriate for the tank transfer remedy and tank valuation methodology proposed to apply to metered estates in the same way as individual customer above-ground or underground tanks.

Flogas therefore submits that the transfer value of installations at metered estates (which very importantly include the pipework) should be negotiated on a case by case basis, rather than by recourse to the tank transfer methodology proposed, to reflect the widely varying nature of such installations and the investments entered into by installing suppliers.

B. SWITCHING PROCESS

The switching process, and in particular the tank transfer process, must operate smoothly if the proposed remedies are to be effective. Flogas' concerns as regards aspects of the switching process as currently envisaged are set out below:

1. Prompt notification of outgoing supplier

Flogas welcomes the fact that the Working Paper at paragraph 107 recognises that allowing an incoming supplier to delay notifying an outgoing supplier of a customer's termination of a contract would limit the ability of outgoing suppliers to take steps to retain that customer and could therefore deny the customer some benefit. The CC recommends an obligation on the incoming supplier to forward notification of termination “as soon as reasonably practicable”. Indeed, the flowchart at Figure 6 at page 40 of the Working Paper envisages that the outgoing supplier receives notification of termination of the contract on Day 1. Flogas believes that it is important that the CC specify the actual period (and that this should not exceed 2 working days) and that the notice should be sent to the supplier's head office (or the address specified by the outgoing supplier in its contract with the customer).

2. Contract renewal

At paragraph 302, the Working Paper states that “Should an LPG customer choose to remain with his or her supplier after the [2 year] exclusivity period has expired, he or

she will be free to do so". Flogas understands that, if the customer whose exclusive period had expired were to elect to enter into a new contract (as opposed to rolling over the previous contract), such a new contract could have a further 2 year exclusivity period e.g. in recognition of a reduced price or other service consideration. If this is not in fact the case, an existing supplier would face a disadvantage that its competitors would not face, since if the prevailing model were tank transfer and no tank installation costs would therefore arise, each supplier, including the incumbent supplier, should be able to compete for the new contract.

Also, it is a practice among suppliers to "pre-sign" a customer of another supplier so that, when that customer's contract expires, the incumbent supplier is precluded from re-signing the customer. The operation of the cap on the exclusivity period could operate to disadvantage the incumbent supplier if it were to operate in such a way that the incumbent supplier, unlike its competitors, could not pre-sign its existing customer for a further contractual exclusivity period. Flogas would be grateful to receive clarification from the CC on these issues.

3. Warranties

Flogas notes that, where title to a tank is transferred, the fact that the Working Paper at paragraph 120 envisages that outgoing suppliers should not be obliged to provide warranties as to the condition of the tank (but should be required to provide warranties as to title to the tank) means that, rightly in its view, the transfer will be made on a "buyer beware" basis.

Flogas further submits that, in order to ensure a smooth transfer and minimise the possibilities for disputes between the incoming and outgoing supplier, title to the tank should only be transferred to the incoming supplier once the outgoing supplier has received payment in full.

4. Debt recovery

The Working Paper, at paragraphs 249 to 251, proposes that LPG suppliers should be unable to prevent a customer from switching to another supplier where the customer has an outstanding debt with that supplier. The Working Paper suggests that suppliers should instead rely on "debt recovery tools".

However, the use of such tools would increase the cost of debt recovery to individual suppliers and the industry as a whole, which would inevitably have to be passed on to customers through higher prices. Equally, the inability of suppliers to prevent a customer from switching where that customer has an outstanding debt would allow unscrupulous customers to deliberately terminate contracts and switch suppliers, thereby leaving large outstanding debts with the outgoing supplier. This would again add to the costs to the industry and to other customers.

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Flogas therefore submits that suppliers should be allowed to prevent a customer from switching to another supplier where that customer has a significant outstanding debt at above a certain level, for example, £800.

5. Scrap value

In assessing the scrap value of a tank, the OFT will need to take into account the cost of making the tank inert and the cost of uplifting it.

6. Dataplate removal

At paragraph 136, the Working Paper states that the incoming supplier should be obliged to change the dataplate and the signage on the tank as soon as possible after title has transferred and in any event within two weeks of transfer. The CC is asked to note that in fact the dataplate is welded onto the tank and cannot be removed.

Please do not hesitate to contact me if you would like to discuss any of the above issues further.

Kind regards.

Yours sincerely

Suyong Kim