

FLOGAS' COMMENTS ON THE DRAFT SAFETY WORKING PAPER

NOTES:

1. In accordance with the CC's letter of 4 February 2005, this commentary highlights those instances where, in Flogas' view, the Working Paper contains inaccuracies or is incomplete. As the CC intends to publish the Working Paper as a "staff working paper", Flogas has also taken this opportunity to highlight instances where it believes that the assumptions on which statements in the Working Paper are based are incorrect. Nevertheless, the fact that Flogas has not expressly addressed a particular view presented in the Working Paper should not be understood to indicate Flogas' agreement with that view.
2. Flogas' views on the issues raised in the Working Paper are contained in further detail in its response to the Economic Questionnaire, and in its response to the Statement of Issues. References to those responses are given where appropriate.
3. Definitions and abbreviations used in this document follow those used in the Working Paper, unless the context otherwise requires.
4. Representations on confidentiality are contained in a separate submission.

PARAGRAPH(S)

- 8(b)** The Working Paper reports that a party's statistics appear to suggest that *"LPG tanks present an extremely low risk compared with everyday risks of fatality"*. Flogas would note that the fact that there have been few recent fatalities (or indeed other serious incidents) associated with the use of bulk LPG is a direct result of the stringent safety maintenance and procedures adopted by reputable suppliers (see Flogas' comments below on paragraph 27 of the Working Paper).

- 10 The Working Paper states that duties under the HSWA “*are not particular to the LPG industry and will not be described in this paper*”. Accordingly, these duties are not assessed in the Working Paper which risks significantly understating the practical relevance of this legislation as regards the activities of bulk LPG suppliers. The HSWA, and associated secondary legislation, imposes an overreaching requirement on businesses to protect the health and safety of employees and others insofar as is reasonably practicable: given the nature of LPG, this requirement imposes a significant statutory duty on LPG suppliers which cannot be ignored.

In particular, the Management of Health and Safety at Work Regulations 1999 require an employer to make a suitable and sufficient assessment of the health and safety risks to employees and others to which its activities give rise, in order to put in place appropriate control measures. Compliance with the statutory obligations referred to in the Working Paper as being “*of most direct relevance to bulk domestic LPG*” does not necessarily mean that this general duty has been fulfilled (see Flogas’ comments below on paragraph 17 of the Working Paper).

- 13 Flogas notes the ambiguity surrounding the application of the PSSR to domestic bulk LPG. Flogas would further add that LPGA Code of Practice 1, part 3 states that: “*[w]hilst vessels for domestic suppliers are not currently within the scope of the PSSR it is recommended that similar examination should take place*”. This reflects the then view of HSE, which was fully involved in the preparation of Code of Practice 1. Although HSE (in their submission to the CC) appear now to have reversed their previous view, Flogas believes that this demonstrates the continuing ambiguity in this area. Whilst members of the LPGA may take the cautious approach recommended in the Code of Practice, this ambiguity could be exploited by less scrupulous suppliers.

Flogas notes that in the case of a tank owned by a domestic customer, HSE are consistent in stating that the PSSR does not apply.

14 and 15 The Working Paper recognises that LPGA Codes of Practice are voluntary in nature, and that there is therefore no guarantee that all LPG suppliers will follow them in full. Flogas further notes that suppliers who are not members of the LPGA (and, of course, individuals) are not required to follow the LPGA Codes of Practice.

Flogas is also concerned that the CC should recognise that, although it may be sufficient for LPG suppliers to follow the LPGA Codes of Practice in order to comply with health and safety law (including the HSWA), that will not always be the case (as accepted by Nick Starling, Chairman of the HSC, in the statement referred to in paragraph 15 of the Working Paper). In this context, Flogas further refers the CC to the HSC foreword to LPGA Code of Practice 1 part 1, which makes it clear that the Codes of Practice relate to compliance “*with health and safety law in respect of those specific issues on which the Code gives advice*” (emphasis added). Also, as paragraph 1.3.1 of Code of Practice 1 part 1 states:

“The guidance is given without prejudice to the general requirements under the Health and Safety at Work, etc. Act 1974 that risks should be reduced to as low as is reasonably practicable.”

The practical implications of the overreaching nature of the HSWA, and the fact that compliance with the LPGA Codes of Practice is not always sufficient to discharge the duties which arise under that Act, are illustrated by Flogas’ experience following the acquisition of the [*] LPG business. The filling of LPG tanks which require the running of the delivery hose

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through a garage or similar structure is not specifically disallowed by Code of Practice 1 part 1. However, following a detailed risk assessment in performance of its duties under the HSWA, Flogas took the view that such deliveries posed an unacceptable risk to its employees and others. As a result, when Flogas acquired the [*] LPG business, each of the [*] customer sites where the filling of the LPG tank required the running of the delivery hose through a garage or similar structure was visited by a Flogas representative, and one of the following solutions adopted: (1) improvements were made to the access route at Flogas' cost; (2) the tank was re-sited to a more accessible position (again, at Flogas' cost); (3) the customer was provided with a cylinder supply on the same terms as their bulk contract; or (4) the customer switched to an alternative fuel supply.

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Although the Working Paper recognises that some suppliers have developed their own policies which may go beyond legal requirements, and which clarify areas where the LPGA Codes of Practice are subject to interpretation, Flogas is concerned that the Working Paper appears to accept Mott Macdonald's view that the basis of comparison of suppliers' compliance with safety requirements should be the regulatory framework (i.e. the Regulations, as identified at paragraph 10 of the Working Paper, but not including the HSWA or associated secondary legislation) complemented by the LPGA Codes of Practice.

In any event, it is not clear that such a basis for comparison is appropriate, particularly if due account is given to the duties imposed on LPG suppliers by the HSWA and associated legislation. Indeed, the approach suggested by Mott Macdonald would penalise suppliers that operate more stringent safety policies and procedures, which are an essential element of the integrated service provided by reputable LPG suppliers. Such suppliers would be unable to take over installations installed by competitors (or owned by customers) that operate to the 'bare minimum' standards

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without further significant investment: by contrast, their own installations would be open to attack from less safety conscious competitors. This may have the effect of lowering safety standards across the industry to the lowest possible standards commensurate with (or possibly below) the minimum levels necessary for compliance with the law.

On reviewing the Mott Macdonald report provided, Flogas notes that the views of Mott Macdonald are based on an inadequate sample of domestic tanks (see Flogas' comments below on paragraphs 41 and 42 of the Working Paper) and that, of the limited number of installations inspected, not all met the standards required by the Codes of Practice.¹

19-23 Flogas does not agree with the HSE's view that there are no loopholes in the legislative framework as regards domestic customer owned LPG tanks: in particular, it is recognised that domestic customers owning their own tanks are not subject to the requirements of the PSSR.

Flogas would agree with the HSE that one concern in this context is the fact that duty holders may not be aware of their statutory duties. However, Flogas is also concerned that, even if duty holders are aware of their duties, it cannot be assumed that they will always carry them out. As the HSE admit in their submission at the CC hearing "*the more duty holders that were required to comply, perhaps the more difficult it was for the HSE to reach them; also perhaps that the introduction of people who were less familiar with the business and less familiar with the legal requirements might lead to a requirement for some training and some action*".

¹ Flogas also notes that the Working Paper refers to Mott Macdonald's view as regards the adherence of bulk LPG suppliers to safety standards, as summarised in Appendix 3 of Mott Macdonald's report: however Appendix 3 of the report has not been made available for comment.

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The Working Paper does not reflect the fact that this potential lack of compliance, combined with a lack of proactive inspection by HSE², could result in a situation where a lack of compliance will only come to light following an incident. This is compounded by the fact that, as recognised in the Working Paper (at paragraph 23), there is no pre-qualification or registration system in place for LPG suppliers, and so it is possible that some operators may operate below even the minimum safety standards without detection. In the event of a forced transfer of tanks between LPG suppliers (i.e. a “must buy, must sell” obligation), this may lead to a distortion of the market whereby companies with higher standards unwilling to take on sub-standard installations will be vulnerable to less safety-conscious competitors (see Flogas’ comments above on paragraph 17 of the Working Paper).

As stated, in the case of ownership of domestic LPG tanks by customers, it is Flogas’ view that the law at present does not impose duties on domestic customers to properly maintain bulk LPG tanks. As a result, the only sanction available to an LPG supplier if it is concerned about the standard of an installation is to refuse to supply the customer (unless the customer is willing to invest in the necessary modifications), although it is possible that a less scrupulous supplier may then do so.

25 Flogas will comment on the issues raised in this paragraph when responding to the “Competition and Entry” and “Switching Costs” working papers in due course.

27 The Working Paper raises two questions:

² The HSE stated that “*the only instance when a check was made was if the HSE were investigating a particular event*”.

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Are current market practices such as the uplift of tanks still appropriate in a more standardised and consolidated industry?

It is not clear on what basis the supply of bulk LPG could be described as more consolidated or standardised, or what impact any such developments would be expected to have on the appropriateness of current market practices.

Although there has been significant consolidation in recent years, there have been several new entrants over the past few years (including K G Smith, LPG Direct (Northern), Extra Gas, Bulk Gas UK Ltd and Premier Gas). In addition, the supply of bulk LPG is considerably less consolidated than it was in the early 1980s when the market was dominated by Calor, which had an estimated share of the supply of bulk LPG over 75 per cent. In this context, Flogas notes the opinion expressed by Mott Macdonald that “[t]he voluntary and self-regulating nature of the safety aspects of the business is better suited to an earlier era when there were a few large competitors. Today, the increasing number of participants, and the expanding nature of their roles, requires more formal governance”³.

Notwithstanding the above, the uplifting of tanks remains appropriate for the reasons set out in detail at paragraph 9.6 *et seq* of Flogas’ response to the Statement of Issues. Flogas further notes here the acknowledgement contained in the Working Paper that the separation of tank ownership and LPG supply would give rise to “a number of issues concerning insurance, liability and the LPG suppliers’ ability to ensure the safety of its employees and compliance with its safety duties”.

³ See page 31 of Mott Macdonald’s report of 22 December 2004.

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Is the good safety record of the industry a product of companies' policies or is it linked to the relatively low age of the tanks installed?

As stated above, the good safety record associated with the use of bulk LPG is a direct result of the stringent safety maintenance and procedures adopted by reputable suppliers, and the heavy investment in safety and maintenance undertaken by such suppliers.

In any event, the age of installed LPG tanks is not a relevant issue, provided that the tanks are maintained in an appropriate way. For example, as part of the acquisition of the [*] LPG business, Flogas acquired tanks which are over [*] years old, but which have been refurbished and so are in "as new" condition. However, ageing installations do require maintenance: it is Flogas' firm view that the integration of tank ownership and LPG supply ensures that all necessary investment is made throughout the life of the tank.

29 [*]

31 Flogas is concerned that the counterarguments put forward by the Working Paper do not fully reflect the practical impact of the situations described.

The Working Paper suggests that problems arising from the fact that domestic customers are not obliged to comply with either the PSSR or HSWA, and in any event are unlikely to have the requisite knowledge, could be resolved if:

- LPG suppliers were provided with a test certificate before delivering LPG to a particular customer. However, in practice, the provision of a tank test certificate does not, in isolation, guarantee

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that an installation is safe to fill. For example, the pipework, regulators, tank siting, access requirements and so on (which would not be covered by a test certificate) may also pose safety risks to employees or the public.

- The Working Paper further suggests that these problems could be overcome by way of a contractual arrangement for tank maintenance with the relevant LPG supplier. However, this assumes that the customer is prepared to enter into such a contract with the relevant supplier, and pay for the necessary services directly, which will not always be the case. Such arrangements could only be effective if made compulsory: i.e. if the supply of bulk LPG were to be conditional upon agreement for the provision of such services (and even then customers may be unwilling to pay for such services in addition to the cost of the LPG, and may instead choose a supplier who does not insist upon this).

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The implications of customer or third party owned tanks as regards the insurance of LPG tanks were outlined in Flogas' response to Q119 of the Economist's Questionnaire, and paragraph 9.14 of Flogas' response to the Statement of Issues.

Flogas does not believe that conditions in the industry have changed such that integrated tank ownership and LPG supply is no longer "*the most logical approach*" (see in particular Flogas' comments above on the statement, at paragraph 27 of the Working Paper, that the industry has become more consolidated).

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Flogas appreciates that some of the issues raised may be contractual in nature, or relate to the efficient supply of bulk LPG, rather than strictly to the safety of supply. However, such issues are nevertheless extremely important and have not been addressed in the working papers provided.

33 The figures included in Table 4 are inaccurate: [*] of Flogas' [*] domestic customers who own their own tanks do not have exclusive supply contracts with Flogas (i.e. [*] per cent of Flogas' domestic customers).

34 For the reasons set out in the response to Q107 of the Economist's Questionnaire, Flogas is of the view that a joint arrangement between all LPG suppliers to provide emergency services regardless of tank ownership would be impracticable. One further practical issue is the availability of relevant information. The effectiveness of emergency responses requires ready access to all relevant (and potentially confidential) information – such customer specific information would not be readily available to other suppliers of bulk LPG.

The Working Paper raises the question of whether the safety concerns associated with non-exclusive delivery to domestic customers could be resolved if tanks were independently certified or if there was mutual recognition of assessment. Flogas' view is that neither of these would adequately address the safety concerns:

- As stated, in practice, the provision of a tank test certificate does not, in isolation, guarantee that an installation is safe to fill. For example, the pipework, regulators, tank siting, access requirements and so on (which would not be covered by a test certificate) may also pose safety risks to employees or the public.

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- The mutual recognition of assessment would be difficult to achieve in practice. As stated, the HSWA, and associated secondary legislation, imposes an overreaching requirement on businesses to protect the health and safety of employees and others insofar as is reasonably practicable: risk assessments may legitimately differ between suppliers. Additionally, it cannot be assumed that all suppliers will follow the LPGA Codes of Practice and legal requirements in full, particularly given the lack of an *ex ante* mechanism to ensure that safety requirements are observed (see Flogas' comments above on paragraphs 19-23 of the Working Paper), and the fact that there is no pre-qualification or registration system in place for LPG suppliers.

36 [*]

38 When undertaking tank transfers following its recent acquisitions, although Flogas has not identified compatibility problems relating to the tanks themselves, it has identified problems associated with differing standards relating to other aspects of the installation, as outlined in Flogas' response to Q101, Q109 and Q121 of the Economist's Questionnaire.

Flogas also asks the CC to note that, following the acquisition of the [*] bulk LPG business in 1993, Flogas had to replace approximately [*] per cent of the tanks acquired and upgrade [*] other installations because of their substandard nature.

[*]

39 Flogas has not suggested that customers with older tanks may struggle to get low price gas offers. However, Flogas submits that potential incoming suppliers may be less willing to take ownership of tanks where either the

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tank records are incomplete or where the physical condition of the tank (or other elements of the installation) are below that supplier's safety standards. This would have the perverse effect of making it more difficult for the customers of suppliers with poor safety records and standards to switch supplier, in effect rewarding suppliers with lower standards by making it less likely that their customers would be able to switch.

Flogas is strongly of the view that "must buy, must sell" agreements should not be imposed in an industry where there are significant health and safety issues concerning supply. An incoming supplier which has genuine health and safety concerns relating to a particular installation should not be forced to purchase (or supply bulk LPG to) tanks which fall below its own safety standards, irrespective of whether those safety standards go beyond the minimum legislative requirements.

The Working Paper makes the assumption that full documentation would always be in place for tanks in compliance with PER and PSSR. However, full compliance with these regulations cannot be assumed due to the lack of effective enforcement, as outlined in Flogas' comments above on paragraphs 19-23 of the Working Paper (see above). In any event, as stated above, the tank test certificate does not guarantee that other aspects of the safety of installation are up to the standards of the incoming supplier. Although the cost of inspections alone would be lower than tank replacement, in some cases the cost of any necessary remedial work may exceed this.

Flogas notes that, at paragraph 39 of the Working Paper, it is stated that the LPGA Codes of Practice provide a "baseline" for standards of inspection, risk assessment and tank installation: such a view is unsustainable for the reasons set out above in Flogas' comments on paragraph 17 of the Working Paper.

40 Flogas notes that it has raised practical issues regarding the transfer of tanks. In particular, depending on the mechanism for determining the value of the tank upon transfer, Flogas believes that some new entrants may be attracted by the possibility of acquiring tanks at rates reduced to take account of the assumption that future testing costs will be incurred. By failing to carry out these tests, or exiting the market before they are due, they may be able to undercut the prices of other suppliers. Flogas' views on the requirements for any transfer of tank ownership between suppliers are set out in its response to the Statement of Issues at paragraph 9.9. This concern is real, particularly given the lack of an *ex ante* mechanism to ensure that safety requirements are observed. Disreputable suppliers operate in this sector ([*]): requiring the transfer of tanks when customers switch between suppliers would provide a further opportunity for disreputable suppliers to exploit.

41 and 42 There are few activities that are completely without risk. However, the uplift of tanks does not impose unjustifiable risks: the controlled risks are far outweighed by the safety implications of separating tank ownership and the supply of LPG. Flogas notes the view expressed by the HSE that exchanging tanks is "*not a complicated process*", and the fact that the Working Paper fails to identify the specific risks associated with the uplifting of tanks in the diagram entitled "Safety and Operational Concerns associated with Bulk Tanks" at paragraph 7 of the Working Paper. The HSE further noted that "*the risks associated with changing a tank were not that great, and could be controlled, as long as the extra checks were made*". HSE also expressed the view that "*there would... be no problem if the control over the tank could be passed without changing the tank itself, subject to proper observance of standards*" (emphasis added). However, in practice, as there is no *ex ante* mechanism to ensure that such standards are observed by private individuals or even LPG

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suppliers, compliance depends on self-regulation which, as discussed above, cannot always be assumed.

In any event, the risks associated with the uplift of tanks are controlled and last for a very limited period of time. In contrast, the risks of separating tank ownership and the supply of LPG would be unknown and ongoing.

Flogas also notes that the views of Mott Macdonald on this issue appear to have been based on extremely limited evidence. In particular, their assertion that *"tanks in service are equivalent"* is based on site visits to only seven domestic LPG tank installations, which were self-selected by LPG suppliers from a total population of over 100,000 vessels. Although there may be no appreciable problem with the compatibility of the vessels themselves, the overall safety standard of the installation as a whole (including pipework, regulators and tank siting) could not be assumed to be equivalent based on such an extremely limited sample. Furthermore, by their own admission, *"MML visits were not HSE / Safety audits"*, and as such cannot be regarded as being comprehensive in establishing safety standards.

43 [*]

Flogas further believes that there are valid safety, liability, customer service and economic reasons for the practice of exchanging vessels in the event of a customer switching for the reasons given at paragraphs 9.6-9.11 of Flogas' response to the Statement of Issues.

44 [*]

50 Flogas notes that the advice given by Mott Macdonald to the CC, that *"as most domestic customers are on a "top-up" arrangement, the supplier*

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should have a good understanding of their run down rate for a more accurate notice period... In addition, the seasonality in consumption should be taken into account when setting the notice period”, would be impossible to implement in practice. It is important that notice periods are clearly established at the outset as regards contracts with consumers: this would not be possible if notice periods were subject to the factors identified by Mott Macdonald, as it is not possible to predict at the time the contract is originally signed when, or in what circumstances, a customer may choose to end their contract.

51 [*] In the case of a customer switching to oil or another alternative fuel source, there is a good reason for the customer to use up the gas remaining in their tank, as the option of transfer into the new tank is not available, and it is not permissible to transport the LPG vessel if it contains more than a very limited quantity of product. It is obviously not possible to predict the reason for a customer ultimately choosing to end their contract at the time it is originally signed.

52 and 53 Flogas confirms its strongly held view, based on considerable experience in the bulk LPG sector, that the ownership and maintenance of LPG tanks by suppliers of bulk LPG enhances safety and efficiency. The separation of tank ownership and the supply of bulk LPG would seriously compromise the safety and efficiency of the supply of bulk LPG. Flogas’ view is that the risks associated with the separation of tank ownership and the supply of bulk LPG are neither identified nor adequately dealt with in the Working Paper.

Flogas agrees with the statement in the Working Paper that the responsibility for installation and maintenance of the tank by the LPG supplier makes sense for liability and practical reasons. However, Flogas

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is opposed to an artificial distortion of the market to encourage the widespread ownership of LPG tanks by customers. [*]

[*]

Flogas notes that the conclusion that the integrated approach “*brings significant barriers to entry*” is not supported by arguments contained in, or referred to elsewhere in, the Working Paper. Flogas further notes that the fact that that comprehensive safety statistics are unavailable does not mean that the good safety record of the industry results from anything other than the investment in safety and maintenance procedures made by bulk LPG suppliers, which has been possible because of the integration of LPG supply and tank ownership.