

# Shell Gas Limited

Initial Submission - 29 July 2004

Competition Commission inquiry into  
domestic bulk LPG

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1. **Introduction**

- 1.1 In response to the Competition Commission's letter of 7 July 2004 inviting an initial submission, Shell Gas Limited ("Shell") would like to make the following initial comments in respect of the Competition Commission inquiry into the supply of LPG to domestic customers, with particular regard to the Office of Fair Trading's reasons for making the reference.
- 1.2 In Shell's view, there is effective competition in the supply of LPG to domestic customers. Suppliers of LPG compete to provide a number of services – LPG tank installation, tank leasing, tank checks/maintenance, 24/7 emergency coverage and LPG supply as efficiently and as safely as possible. Shell's view is that the most effective operational model to meet these two parameters (efficiency and safety) is provided under a single contract for the *bulk LPG system*. A preliminary overview of the factors underlying the currently prevalent operational model, how this fits with the current regulatory framework, and how in Shell's view the market currently operates to best deliver LPG to domestic customers safely and efficiently are set out in this submission.
- 1.3 Following a short description of Shell's LPG business in the UK, this submission is divided as follows:
- 1.4 In section 3 the physical aspects of LPG and its distribution to the level of the domestic consumer are set out. It will be shown where the risk lies and why safety is so important to Shell/Shell group, the industry as a whole, and the consumer.
- 1.5 There are then set out in section 4 some initial thoughts on the potential market definitions. It is suggested that there are a number of potential product/service markets, which can helpfully be considered together as a *bulk LPG system*, including tank installation, rental, maintenance, emergency cover and supply of the complementary product LPG itself under a single contract.
- 1.6 Next, section 5 gives a broad overview of the current system of legislation, Codes of Practice and Shell/Shell group's own safeguards. It is suggested that the logic to the current scheme of regulation lies in the nature of the product and the safety issues. The intention is not to prematurely anticipate the nature of any issues that the Competition Commission might in due course consider arise, or indeed to suggest that any remedy might be required. However, the OFT's reasons for making a reference rely heavily on the existence of switching costs, and further preliminary conclusions that issues arising out of and related to these costs (such as length of contracts) may not exist if there were not

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unity of tank supply and the supply of LPG. It is helpful, in order to address those preliminary conclusions, to have regard - in broad terms only at this stage – to what kinds of issues, in particular safety issues, arise when one considers other hypothetical operational models. It will be pointed out that the current legislation was not drafted with separation of tank supply and LPG supply in mind, and although such an operational model would not be illegal, it would in Shell's view be insufficiently safe on the basis of the current legislation. To make such a model safe would require extensive further regulation.

- 1.7 In section 6 some comments are made on how LPG suppliers compete for customers, and it is suggested that the market is currently effective in delivering an efficient and safe service to consumers.
  
- 1.8 Finally, some concluding remarks are made in section 7.

2. **Shell/Shell group**

- 2.1 The Royal Dutch/Shell group of companies is engaged worldwide in the exploration, production and sale of oil and Natural Gas, the production and sale of chemicals and oil products, power generation and the production of energy from renewable resources.
- 2.2 The Competition Commission has been provided with an organogram working “bottom up” from the relevant UK company for the purposes of this investigation – Shell Gas Limited (Off-the-shelf materials I – Document 5). This UK business is subject to lines of management operating on a global basis in respect of the Shell group’s LPG businesses worldwide. One particular line of global management relates to compliance and safety issues *[excised]*. “Compliance” in this instance encompasses applicable local laws as well as Shell/Shell group’s own international safety rules and procedures.
- 2.3 In respect of the UK, Shell’s LPG business is vertically integrated from production to retail. At Appendix 1 is a diagram of the production/distribution chain for LPG<sup>1</sup> which is explained further in Section 3 below, along with a description of Shell’s activities in the supply chain.
- 2.4 Shell operates on the basis of the Shell group’s Business Principles, adherence to which is mandatory. These Principles include important elements relating to health and safety, which are carried through to the operational level in the form of more precise guidance to individual Shell group operating units by the mandatory “Group HSE – Management System” (see Appendix 2). *[excised]*

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<sup>1</sup> Copied from “Guidelines for Good Business Practices in the LP Gas Industry” produced by the World LP Gas Association.

3. **Description of the Physical Product, the Production/Distribution Chain and Safety Risks**

3.1 **LPG production and distribution**

3.1.1 LPG that is supplied in bulk to domestic customers is a standardised<sup>2</sup> product consisting of commercial propane for Domestic and Commercial/Industrial bulk application in the UK (specifications according to BS 4250). At Appendix 1 is a diagram of the production/distribution chain for LPG from which it can be seen that it may be produced from Natural Gas or refining of oil. The LPG that is sold in the UK comes from Natural Gas from UK off-shore gas fields, from oil refineries in the UK and is also imported into the UK (having come from gas fields/refineries outside the UK). LPG from UK sources accounts for about half of the LPG that is consumed within the UK.

3.1.2 Shell produces LPG by both methods of production for the UK market. Shell also buys LPG from other suppliers. Shell acts as a wholesaler (see Market Study (Off-the-shelf materials I - Document 7D) and Appendix 1 for an overview of the supply chain), selling direct to customers from the production facilities (terminals) as well as delivering product to third party depots (LPG Cylinder filling plant or bulk sub-depot). Finally, Shell supplies to large industrial users directly from the terminal. *[excised]*. Its retail business is supplied through sub-depots.

3.2 **LPG - a hazardous substance**

3.2.1 LPG is a hazardous substance requiring careful handling. The training of personnel reflects this, as training additional to the Natural Gas training is required before a person may be certified to handle and check LPG equipment & installations. For engineers this is regulated via Corgi, for drivers via the ADR certification. *[excised]*

3.2.2 To put this in context, LPG - unlike Natural Gas - is heavier than air and as such less likely to dissipate in the event of leakage. It is stored at high pressure in domestic tanks, which exacerbates the risk (and distinguishes it further from Natural Gas). The ultimate risk arising out of LPG distribution and storage on domestic premises in a bulk tank is the risk of explosion. Amongst the other risks are asphyxiation, cold burns and fire. LPG becomes explosive in air at lower percentages than Natural Gas and will explode with greater force. At Appendix 4 to this submission is an outline of the characteristics and

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<sup>2</sup> **Subject to European standardisation of composition, one metric tonne is 1975-8 litres (Shell standards use 1975 litres/tonne).**

effects of an explosion of a tank of the size commonly used in domestic premises. The destructive force of an explosion would be immense, with a high risk of fatalities and serious injuries within a wide radius of the tank.

- 3.2.3 Naturally, Shell cannot countenance taking any material risks in its LPG supply business (whether those risks concern its own staff or the consumer) and it is described below in Sections 3.3 and 5 how Shell minimises the risk as far as possible as a matter of internal policy which it applies globally.
- 3.2.4 Shell would strongly urge the Competition Commission to bear the safety risks in mind going forward, and to have regard to the fact that domestic consumers cannot generally be expected to appreciate the nature of level of risk associated with LPG, or the steps needed to address such risk. In the absence of a level playing field (ie. where there are loopholes in the legislation in the domestic context, which potentially allow companies with lower safety standards to supply at higher risk to the consumer) the lack of consumer perception of safety risks may lead to a level of risk to the consumer which is not consistent with good public policy.

### **3.3 Practical measures to treat LPG safely**

- 3.3.1 The risk of explosion will be increased whenever there is a potential compromise of the integrity of the tank, the pipework, the tank's valve system, or the distribution truck and associated facilities. This risk will further increase if the emergency response is non-effective (e.g. because of inadequate responsive reaction by a driver at the scene or inadequate action taken by a Competent Person who is called to the scene). Any compromised integrity of the system may lead to a leak, which may be due to a break in the physical fabric of the tank/pipes/valves, or caused by incorrect use (for example the failure to close a valve correctly). Damage may arise for example through misuse, elements in the local environment (e.g. exposure to excessive levels of humidity or temperature extremes) or simple wear and tear. Where there is a leak, ignition of the gas may occur from an electrical source (e.g. a light switch), cigarettes etc., or a friction/electrostatic spark.
- 3.3.2 Shell follows its own internal procedures in order to minimise these risks.
- 3.3.3 Health and safety form part of Shell/Shell group's "total process thinking" (see Off-the-shelf materials I - Document 4C). *[excised]*

### 3.4 **Compatibility of systems**

3.4.1 As LPG is a standard product, there will be no difficulty mixing product from different suppliers in one tank. While tanks and fittings are not entirely homogenous, in principle there should be no technical reason preventing a tank being filled by a number of suppliers, through use of adaptors where necessary. However, this will not always result in best practice, and indeed the industry has a Code of Practice (1 part 1 paragraph 3.1.16.4) promulgated by the LPGA which limits the number of types of fill connectors to “maintain an industry standard and minimise the use of adaptors”. Most vessels will presumably therefore be 1¾ in ACME<sup>3</sup>.

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<sup>3</sup> **This is one example of use of industry-promulgated Codes of Practice to supplement the legislation, as described further below.**

**4. Possible Relevant Economic Markets**

**4.1 Product Market(s)**

4.1.1 We found the OFT's analysis of the product markets in its reasons statement to be somewhat cursory. In particular, the suggestion that a low level of switching in and of itself demonstrates either that customers are captive and/or (the further conclusion) that a product market defined on the basis of the SSNIP test would mean that each individual supplier would comprise a distinct market is not sustainable<sup>4</sup>. Indeed, even if all customers were fully captive (i.e. if customers never switched after signing a contract with a supplier), this would not represent sufficient evidence to conclude that each supplier comprises a distinct market. This is due to the fact that, at any point in time, suppliers compete against each other for new customers and hence they effectively constrain each others' prices. We therefore support the conclusion (though not the analysis behind that conclusion) that the market for supply of LPG is in fact wider than each individual supplier, as discussed further below.

4.1.2 We also note that at a very late stage the OFT widened the definition of "domestic" customers to include business customers whose consumption is similar to that of households (notably without consulting Shell in accordance with its duties under the Enterprise Act 2002). This is not a category that Shell uses to identify types of customer, and indeed is so imprecise (and otherwise unworkable as a definition) as to be likely to pose problems with the inquiry going forwards. The reference to "consumption of LPG by volume" is ambiguous - both tank size and use of LPG vary between domestic customers, and as between domestic and business users.

4.1.3 In terms of how the terms of the reference relate to market definition, as outlined further below there are significant differences in the regulation of domestic and business users as regards roles and responsibilities, and that regulation fundamentally affects the nature of the market(s) concerned. This suggests that many businesses with low consumption will not be in the same market as households, but are rather in a separate business market. Again, there is no apparent logic to the definition employed in the reference; including small users in the business sector will cover a vast range of supply scenarios, from an

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<sup>4</sup> **One obvious fault with the analysis is that, having suggested that a demand-side analysis and application of the SSNIP test suggested a narrow market, the OFT resiled from this conclusion, purportedly due to supply side reasons. It is of course axiomatic that a correct application of the SSNIP test will reflect both demand and supply-side responses.**

independent corner shop for example, to a large PLC which uses a small amount of LPG to heat the offices of a manufacturing facility.

4.1.4 Our preliminary comment on the issue of product markets is that there are a number of possible ways of looking at this sector, but that there are likely to be a number of related markets. In practice, a number of these are provided as a *bulk LPG system* to the domestic user of bulk LPG.

**(A) An overall bulk LPG System**

The prevalent operational model for domestic bulk LPG involves a single contract governing provision of tank rental, installation, safety checks, maintenance and emergency cover along with the supply of LPG. While these complementary products and services are likely to be viewed as separate markets, it may be helpful to think of these markets in terms of the *bulk LPG system* provided to the customer.

**(B) A market for the purchase of LPG tanks**

The sale of LPG tanks (or perhaps *small LPG tanks* suitable for domestic use) might be considered as a distinct product market, or more than one market in a vertical distribution chain (e.g. wholesale and retail markets).

There are currently a number of manufacturers of tanks that supply the UK market (Schneider Industries (main supplier), Cookson, Zinn), selling directly to the LPG supply companies and to Corgi-registered dealers which then sell and install tanks (under contract to LPG suppliers or LPG customers in the business or domestic sector), and in at least one instance to an LPG supply company which encourages domestic consumers to purchase their own tanks<sup>5</sup>. As the lifetime of an LPG tank typically runs to a number of decades and the customer base is relatively stable, this is a market with a very low turnover.

Downstream, the Corgi-registered installers and LPG supply companies may install tanks on behalf of the consumer. This is not the most common operational model, however, as in both the business and domestic contexts tank leasing (generally as part of a system – see below) is prevalent.

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<sup>5</sup> This was noted by the OFT in giving its reasons for the reference.

**(C) LPG tank leasing**

There may be a potential separate market for the lease of LPG tanks to (domestic) consumers. The market would be for the provision of the tank for use by the consumer, with ownership retained by the supplier.

**(D) LPG tank installation, removal and maintenance**

There may be one or more markets for the ancillary services of tank installation, removal, inspection, maintenance and refurbishment to (domestic) consumers. These services are of course complementary to tank use (be it through ownership or lease). Corgi-qualified technicians provide these services, either on an independent basis, or in-house for a tank/LPG supplier.

**(E) Emergency cover**

Emergency cover has a main purpose to make the LPG installation safe after a gas leak (or other dangerous situation arising). Corgi-qualified engineers can provide these services, either on an independent basis, or in-house for a tank/LPG supplier.

**(F) The supply of bulk LPG to domestic customers**

The supply of bulk LPG to domestic customers may be a separate product market (largely existing only where there is no Natural Gas transmission/distribution network). It is significantly different in terms of the regulatory framework to the supply of bulk LPG to business customers, as noted above. However, we would make the following comments:

- Natural Gas is a very close substitute (and where available it might be said to be the in the same product market); where the Natural Gas infrastructure allows delivery to a household, the take-up rate in order to replace bulk LPG is at or nearly at 100%<sup>6</sup>.
- Heating oil is a close substitute (and may be in the same product market). It is able to provide energy for heating (though not a flame/coal effect gas fire) and heating water, but is unsuitable for other applications such as cooking. It

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<sup>6</sup> **It is generally a cheaper source of energy, is more convenient in terms of delivery (ie. there is no need to monitor levels and arrange deliveries), and has other practical/presentational advantages arising out of the absence of the need to have a tank on-site.**

may be combined in a household with electricity use for other applications. It is readily available<sup>7</sup>.

- Finally, electricity is a potential substitute, able on its own to fulfil all household energy requirements.

It may be helpful to distinguish consumer behaviour in off-the-mains (ie. no Natural Gas supply possible) scenarios depending upon whether the consumer (i) has already chosen its energy source (and thus already invested in durable products – heating systems, ovens etc. of a type which may depend upon the original choice of energy source) or (ii) is either choosing energy source for the first time, or otherwise considering replacing the durable products. In the second scenario, the consumer will likely more readily consider all energy sources as substitutable; the one-off investment in the durable products will likely be of broadly similar cost.<sup>8</sup>

There are likely to be separate production and wholesaling markets upstream from the retail sector.

## 4.2 Geographic scope

4.2.1 In Shell's view, the geographic scope of the market(s) is likely to be national in scope, arising (at the LPG retail level) through chains of substitution. Shell is not present in the supply of bulk LPG in Northern Ireland.

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<sup>7</sup> **The common operational model for heating oil supply is for the homeowner to own the tank; thus investment in the durable product is generally required to switch. The fact that this model is common reflects the fact that heating oil is intrinsically a much safer product, not kept under pressure.**

<sup>8</sup> ***[Excised]***

5. **Legislation, Codes of Practice, and Shell/Shell group's internal safety policy**

5.1 **Overview**

5.1.1 The HSE has said that the Gas (including LPG) sector is the second most highly regulated sector in terms of health and safety regulation after nuclear power, which reflects the hazardous nature of the product. The structure of regulation and other safety measures in respect of LPG supply is outlined below. A noteworthy characteristic of the regulation in this industry is that there is a large degree of responsibility taken by the industry itself for ensuring safe practice (in particular through the LPGA Codes of Practice – see below).

5.1.2 First, there is secondary legislation (as detailed in the Annex) made under the Health and Safety at Work Act 1974 which places strict obligations on an employer to ensure the health, safety and welfare of his employees and others. This legislation has been drafted with a particular focus on business premises and in certain circumstances the rules (specifically the PSSR 2000) do not apply to domestic premises at all. If Shell could no longer ensure the unity of supply of both tank and LPG to its domestic customers, the current legislative framework would in its view be insufficient to enable it to fulfil its health and safety duties.

5.1.3 This legislation is supplemented in the UK by Codes of Practice promulgated by the LPG Association (the LPGA), itself an industry body open to all members of the industry to address areas of concern such as technical and safety issues. The Technical Committee of the LPGA is primarily responsible for drafting the Codes, which are then reviewed by and eventually endorsed by HSE following any necessary amendment. These Codes of Practice indicate best practice, but do not themselves have legal force.

5.1.4 ***[Excised]***

5.2 **The Legislation**

5.2.1 Reference is made to the Annex to this submission which sets out the relevant legislation in this sector. Shell would draw attention in particular to the following points here:

- Even though unity of supply of tank and LPG is not required by the legislation, the legislation was not drafted with separation in mind, and indeed problems arise with doing this in practice (notably increased safety risks).
- For example, safeguards included in the business sector (where on average appreciation of safety risks, training of staff and so on is *higher* than the domestic

sector) will not apply in the domestic context. Presumably the HSE would agree that these safeguards should be the very minimum necessary to ensure safety in the (potentially more risky<sup>9</sup>) domestic environment. There is currently for example no obligation to keep a schedule of maintenance/written scheme of examination *[excised]* – or indeed make any regular checks of the tank/system.

5.2.2 Not only is the domestic consumer likely to be unaware of the risks, but the safety incentive which applies to a single commercial supplier/tank owner may not arise as a matter of fact where a number of suppliers supply the tank (which may legally be owned by the consumer). This may be especially true in cases where either upgrading the tank or the distribution infrastructure can enhance safety or where liability for improvements can be “shown” to lie with the tank owner, which leads to non-action by the LPG suppliers.

### 5.3 **Shell’s approach in the domestic sector**

5.3.1 Given the hazardous nature of the product outlined in Section 3, Shell cannot countenance taking any material risks in its LPG supply business (whether those risks concern its own staff or the consumer).

5.3.2 As detailed in the Annex, the current legislation in relation to the domestic supply of LPG does not enable Shell to be sufficiently certain of the integrity and safety of the system unless it takes responsibility for both the tank and supply of LPG. Shell/Shell group has internal rules and procedures – which apply internationally, even where the degree of actual regulation is low – to reflect what it believes is best practice. Only when the LPG tanks are company owned/company filled is Shell in a position to properly ensure compliance with all health and safety duties by maintaining control over (and regularly auditing the safety of) its own tanks.

5.3.3 Even then, given the dangers associated with LPG, Shell adopts additional internal procedures to mitigate the risks associated in the domestic sector *[excised]*

5.3.4 Shell’s approach is consistent with (indeed, arguably required by) the obligations of an employer generally (i) under UK health and safety legislation, (ii) as set out in EC Directive 99/92/EC *on minimum requirements for improving the safety and health protection of*

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<sup>9</sup> **A number of different scenarios can arise in the business sector, though it is certainly the case that appreciation of safety risks is on average higher. In larger companies – which may nonetheless be small users of LPG – specific HSE training will likely be given to staff, and there will be a clear allocation of responsibilities for all elements of site safety.**

*workers potentially at risk from explosive atmospheres*<sup>10</sup> and (iii) as set out in EC Directive 98/24/EC *on the protection of the health and safety of workers from the risks related to chemical agents at work*<sup>11</sup>.

- 5.3.5 Shell would strongly urge the Competition Commission to bear the safety risks in mind going forward, and to have regard to the fact that domestic consumers cannot generally be expected to appreciate the nature or level of risk associated with LPG, or the steps needed to address such risk. In the absence of a level playing field (ie. where there are loopholes in the legislation in the domestic context, which allow companies with lower safety standards to supply at higher risk to the consumer) the lack of consumer perception of safety risks may lead to a level of risk to the consumer which is not consistent with good public policy.

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<sup>10</sup> See in particular Article 3, which refers to the employer taking technical and/or organisational measures appropriate to the nature of the operation and in accordance with the principle of prevention of the formation of explosive atmospheres/avoidance of ignition of such atmospheres. See also Article 8 relating to documentation, and minimum requirement 2.5 (Annex II) relating to maintenance and operation of equipment.

<sup>11</sup> See in particular Article 6(1) which requires that the employer ensure that any risk is eliminated or reduced to a minimum.

**6. Competition in the sector**

**6.1 General comments**

6.1.1 The supply of LPG is a competitive market, with 4 larger players – Calor, Flogas, Shell and BP competing with a large number of smaller suppliers *[excised]*.

6.1.2 In Shell's view profits/returns on capital are reasonable and not excessive *[excised]*.

**6.2 The Interaction Between Safety Concerns and Competition**

6.2.1 Shell believes it has an efficient business in this sector, and will continue to be competitive so long as it can compete on a level playing field (that takes the highest safety standards as a minimum). To the extent that there are currently loopholes in the (legislative) regulation of domestic supply, this could give a competitive advantage to supply companies which maintain lower safety standards (based on the lack of consumer perception of risk) and risks jeopardising consumer confidence in the industry as a whole. Shell would therefore welcome a result of the investigation which included the HSE addressing the current loopholes in the regulation of domestic supply.

6.2.2 Shell strongly urges the Competition Commission to have regard to the fact that domestic consumers cannot generally be expected to appreciate the nature or level of risk associated with LPG, or the steps needed to address such risk. This may have the practical result that consumer responses do not reflect an informed choice, and indeed their choices will not accord with good public policy - the level to which safety risks are addressed by individual suppliers (which of course affects the supply costs of such suppliers) - will not be taken into account, and there may be a tendency towards less safe supply if left to the market without proper regulation.

**6.3 The OFT's concern about switching costs**

6.3.1 The OFT's tentative conclusion is that:

*"the high switching costs [principally the charges to the customer for removal of the current supplier's tank and for installation of the new supplier's tank] may form a barrier to entry, so that competition is restricted and many customers face higher prices overall than they would in a similar market without switching costs".*

6.3.2 It is undeniable that the need to install and remove a tank amount to a switching cost in the market for an LPG system, or indeed in the tank rental market alone. However, Shell

submits that existence of switching costs does not in itself suggest that there is a failure of competition in this sector. Indeed, in a dynamic setting the contest to win the right to supply locked-in customers can be all the more intense because of the benefits that those switching costs confer on suppliers. It would therefore be simplistic to adopt a general prediction that markets in which customers face switching costs are less competitive.<sup>12</sup> Such instances of aggressive competition in the face of switching costs are not unusual. They show that competition in the presence of switching costs is often different to, but is not necessarily any less effective, than in markets where no such costs arise.

- 6.3.3 As is common in markets with switching costs, the domestic LPG sector is characterised by competition *ex ante* – ie. the major suppliers compete for business by (i) subsidising tank installation costs and/or (ii) offering special introductory rates<sup>13</sup>. The cost of the consumer durable in this sector – ie. the tank itself – is not commonly paid for by the consumer up-front by means of purchasing a tank, but must be recouped (along with any below-cost installation/introductory offers) over the life of the contract. This is a common feature of markets with a system of both a consumer durable (the primary key product) and its complements (the secondary market products) and does not in any sense evidence market failure. Indeed, if a supplier knows that once a consumer has been induced to make a particular primary market purchase it will be possible to set prices for its secondary market products at levels that will allow it to recoup the initial losses, then one would expect suppliers to be prepared to compete extremely aggressively to win those customers in the first place. Indeed, there are numerous examples, of expensive durable products, such as mobile phones, games consoles, satellite TV reception units and printers, given away or sold at prices substantially below the costs of production, precisely because of the secondary market profits that the suppliers believe will flow from those sales. Indeed, in this case, it is possible (although not common) for consumers to buy a unit capable of handling the LPG of different suppliers. In many of the markets referred to above, it is simply not possible to purchase a generic piece of original equipment capable of being used with consumables from a range of suppliers (e.g. one cannot buy a generic games console that can run Playstation, Nintendo and X-Box games – even if one is prepared to pay the true cost of such consoles and forego the subsidy currently provided for the specific consoles of a particular manufacturer).

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**For example, as a low-cost airline with a fleet comprised entirely of Boeing aircraft, easyjet faced substantial switching costs when it came to contemplate buying Airbus aircraft. Yet in 2002 Airbus won a major new order from easyjet at prices reported to concede a very substantial reduction from the list price, and Airbus also undertook to cover the switching costs associated with training engineers to maintain the new aircraft.**

6.3.4 Shell also disputes the OFT's inference that relatively low levels of switching evidence competition concerns. Levels of switching are in and of themselves neutral in this regard. Indeed, low levels of switching might just as well reflect consumer satisfaction as any other aspect of the market<sup>14</sup>. Moreover, even if the percentage of price sensitive customers (i.e. those that do switch) is relatively small, their presence together with that of new customers likely may well have the effect of protecting the larger number of domestic users who consider themselves completely locked in or captive to their existing LPG supplier. This is due to the fact that in choosing their LPG supplier, customers will consider both the initial cost of installing the tank and the LPG price that they will be charged during the subsequent years of use. This implies that if a supplier has a reputation of offering low installation charges to its new customers followed by high LPG prices after an initial period, that supplier would unlikely be able to attract a large number of new customers. This reputation effect, which is undisputedly very important to win new business, has the effect of protecting less price sensitive customers.

6.3.5 The OFT (at page 10 of its reasons document) said that no figures were provided to support the argument that switchers frequently were not charged for tank installation, or were undercharged for tank removals. This is in our view misleading, as there is clear evidence which has been provided to them of consumers being undercharged for both installation and removal. In fact, relevant information was specifically requested by the OFT in its questionnaire to Shell (which presumably reflects the questionnaire sent to other companies). *[excised]*

6.3.6 In summary of the above, an important point is that while the form of competition may be affected by unity of tank and LPG supply (along with all ancillary services) – with ex ante competition perhaps being more important than otherwise – this does not itself mean that competition in the market is ineffective or insufficient. A number of distinct points may also be made arising from the fact that the provision of an LPG system under one contract provides *advantages* in terms of efficiency and safety, and is more convenient for the consumer:

- It is not clear to Shell that an alternative model would in fact suit consumer preferences. As described above, it is not in fact prohibited by the legislation for a

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<sup>13</sup> This is referred to by the OFT. *[excised]*

<sup>14</sup> Indeed, the Competition Commission will have seen Shell's consumer survey which reveals a high level of customer satisfaction. Off-the-shelf-materials I document 7B.

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consumer to buy a tank and a supplier to supply it<sup>15</sup>. As the OFT points out (at page 9 of its reasons document) there is in fact one small company that explicitly encourages customers to own their own tanks – it offers to sell them to customers and the majority of its customers do own their own tanks. If consumers did generally prefer to own their own tanks (which of course involves them covering the capital cost of the tank directly, but conversely ought to permit spot purchasing of LPG as there is no need to recoup tank and installation costs through longer term agreements for LPG supply) then one might expect this company to grow its market share rapidly and other entry to occur on this basis.<sup>16</sup>

- The supply of a *bulk LPG system* (tank installation, maintenance, checking and LPG supply) maintains the economic rationale to invest in ongoing safety improvements. *[excised]* is one example of a measure that makes sense not only in terms of safety but also economically where there is a single supplier of tank and LPG<sup>17</sup>. *[excised]* The World LP Gas Association promotes responsible investment and states that a company should have the right to stipulate that the equipment only be used for the sale of the company's own gas thereby providing the company with an incentive to ensure that the equipment is maintained in a safe condition.
- The supply of a system is generally less burdensome to the consumer in administrative and economic terms. The consumer buying a system – as distinct from buying its own tank - will not have to arrange safety checks and maintenance through third party contractors (these are of course necessary, even if not currently required under the legislation in the domestic context), which would tend to be more expensive if not provided “in-house”.
- The current legislation does not adequately meet safety concerns in the domestic context. While other operational models can be envisaged, Shell will only continue to operate so long as the safety issues are adequately addressed. In Shell's view there is a real logic (and efficiency) to its current mode of operation – namely supply

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<sup>15</sup> **Though Shell believes much tighter regulation would need to be in place in order to properly address safety concerns.**

<sup>16</sup> **Taking the OFT's worst-case scenario - which will not reflect the market reality - in which purportedly customers are or believe they are “captive” for 3-5 years under a contract with a combined tank and LPG supplier, on average 20-33% of the market would be contestable each year. Again, however, a comparison with the business market might be instructive – tank ownership by the customer is marginally more common, and is in fact better accommodated by the regulations, but is nonetheless not a particularly popular option.**

<sup>17</sup> ***[Excised]***

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of a system - deriving from safety concerns and consumer preferences. In its view, given the nature of LPG, a very high degree of regulation is required as a minimum and it is not commonly considered appropriate to place extensive regulatory duties on the consumer. A division of responsibilities amongst a number of market players is of course theoretically possible, though very likely this would require overly burdensome regulation of the market.

## 7. Concluding remarks

- 7.1.1 In summary, Shell does not perceive competition issues with the domestic bulk LPG that require to be addressed. The supply of a *bulk LPG system* is the most effective and efficient means of providing a safe product, with additional advantages for the consumer. Customers are protected by ex ante competition (witnessed by subsidies of installation for example) and, to a certain extent, possibilities for other supply models (consumers buying own tanks) to flourish if preferred<sup>18</sup>.
- 7.1.2 In light of this, Shell also believes that there would be likely to be great difficulties in changing the fundamentals of the market while addressing safety concerns. Nonetheless, it looks forward to exploring the issues fully with the Competition Commission and it would welcome a result in which safety issues are fully addressed in line with good public policy.

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<sup>18</sup> **Shell however would however point out that it is contrary to both its own risk-management approach, and public policy for these to become prevalent without proper (and further) regulation.**

## Annex – outline of relevant legislation

### Health & Safety legislation

#### 1.1 Health & Safety at Work Act 1974 (HSAW)

- 1.1.1 This statute places a duty on each employer to ensure the health, safety and welfare at work of all his employees (Section 2(1) HSAW).
- 1.1.2 In addition, the employer has a duty to ensure that he conducts his undertaking in such a way that the health and safety of those other than his employees is ensured (Section 3(1) HSAW).
- 1.1.3 Shell therefore has an overriding duty to protect its employees at work on domestic premises and, pursuant to Section 3(1) HSAW, Shell must ensure that the health and safety of other persons present at that site, eg customers, is not at material risk.
- 1.1.4 Currently, Shell is able to fulfil this overriding duty because it is responsible for both the tank and the supply of LPG to it. If Shell were to supply LPG to a domestic customer without having supplied the tank, under the current legislation (in particular the PSSR), Shell would not have, and could not be expected to have, knowledge about that tank and whether or not it is safe to be filled<sup>19</sup>. As a result, it would be impossible for Shell to fulfil its duties under the HSAW and many of the regulations made under it.

#### 1.2 Pressure Systems Safety Regulations 2000 (PSSR)

- 1.2.1 The PSSR apply to or in relation to pressure systems which are used or intended to be used at work (Regulation 3(2) PSSR). As the OFT points out in its reasons, it is the opinion of HSE that PSSR do not apply to bulk LPG installations used in the home (which includes a large proportion of the installations considered for the purposes of this reference) because the pressure system is not used or intended to be used at work. In other words, there is a lacuna in the treatment of domestic users (which are probably those most in need of protection).
- 1.2.2 Under the PSSR, the user of an installed system must not operate the system or allow it to be operated unless he has established the safe operating limits of the system (Regulation 7(1) PSSR).

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<sup>19</sup> **Shell would have to have a competent person inspect before delivery. This would give evidence of the condition of the tank, although it would not be apparent whether maintenance had been carried out to Shell's standards.**

- 1.2.3 Further, the user of an installed system must ensure that he has a written scheme for the periodic examination of the system before he operates it or allows it to be operated. All protective devices, pressure vessels, pipelines, and parts of the pipework, which would give rise to danger if a defect existed, must also be identified in the scheme (Regulation 8(1) PSSR). Again, this safeguard in the legislation will not apply to domestic customers.
- 1.2.4 This duty to maintain a written scheme of examination and records would not apply to a domestic user. This has been acknowledged by the HSE (See paragraph 5 of Annex B of the OFT's reasons for making a reference).
- 1.2.5 If Shell were to supply LPG to a domestic customer without having supplied the tank, under the current PSSR, Shell would not have, and could not be expected to have, knowledge about that tank in the absence of such a written scheme. Although the industry, through its Codes of Practice, currently requires an application of the PSSR to domestic tanks, legislation does not. It is therefore Shell's contention that the current legislative framework for the domestic environment does not adequately support the separation of tank and supply of LPG.

### 1.3 **Gas Safety Installation And Use Regulations 1998 (GSIUR)**

- 1.3.1 As set out below, the GSIUR place duties on both the installer of an LPG tank (and related pipework) and on the supplier of LPG. Currently, Shell acts as both, and is therefore responsible for all obligations under the GSIUR. If Shell were to supply LPG to a domestic customer without having supplied the tank, under the current legislation (in particular the PSSR), Shell would not have, and could not be expected to have, knowledge about that tank. It would therefore not be feasible to expect the LPG supplier to fulfil his duties under the GSIUR. It is for this reason that the LPGA has sought the inclusion of a revised "supplier" definition in the proposed revision of the GSIUR. This would make the tank owner the gas supplier in all situations.

#### (A) **Installer of tank**

The installer of a gas storage vessel must not install the vessel unless the site where it is to be installed is such as to ensure that the gas storage vessel can be used, sold or refilled without causing a danger to any person (Regulation 6(7) GSIUR).

#### (B) **Installer of service pipe work**

If an emergency control is installed which is not adjacent to a primary meter, the tank installer must prominently display on or near the means of operating the emergency

control, a notice indicating the procedure to be followed in the event of an escape of gas (Regulation 9(3) GSIUR).

**(C) Gas supplier**

- (1) The first supplier of gas to premises where an emergency control is installed must ensure that the notice required by Regulation 9(3) GSIUR remains suitably worded or shall, if necessary, amend or replace that notice so as to give the effect of provisions of Regulation 9(3) GSIUR (Regulation 9(4) GSIUR).
- (2) The first supplier of gas through a primary meter must ensure that a suitably worded notice in permanent form is prominently displayed on or near the meter indicating the procedure to be followed in the event of an escape of gas (Regulation 15(1) GSIUR).
- (3) A gas supplier must not supply gas through an installation consisting of one or more refillable cylinders unless the gas supply passes through a regulator which controls the normal operating pressure of gas (Regulation 14(3) GSIUR). Para 2(d) of Annexe B of the OFT's reasons states that the identity of the person responsible for meeting this requirement may vary. This would specifically become an issue if there is more than one supplier into a tank.
- (4) Without prejudice to Regulation 9(3) GSIUR, a gas supplier must not supply gas through an installation consisting of four or more re-fillable cylinders connected to an automatic change-over device unless there is an adequate alternative means for preventing the installation pipework and any gas fitting, downstream of the regulator, from being subjected to a greater pressure than that for which it was designed should the regulator fail (Regulation 14(4) GSIUR).
- (5) There is an obligation on the supplier of gas to prevent the escape of gas within 12 hours of being informed of the escape (whether by cutting off the supply of gas to the premises or otherwise) (Regulation 37 GSIUR). This would specifically become an issue if there is more than one supplier into a tank, both in terms of deciding actual responsibility, and in terms of ensuring the customer has the correct contact details to hand (on the tank and in promotional and other literature).

- (6) Regulation 37 assumes a single supplier for each tank. This regulation in its current form could only apply in the event of the separation of tank and supply if there is a reasonably long term supply contract in place, otherwise the obligation would be unattainable.

#### 1.4 **Dangerous Substances and Explosive Atmospheres Regulations 2002 (DSEAR) and Management of Health and Safety at Work Regulations 1999 (MHSAW)**

1.4.1 The DSEAR implement Council Directive 98/24/EC<sup>20</sup> *on the protection of the health and safety of workers from the risks related to chemical agents at work* and Council Directive 99/92/EC<sup>21</sup> *on minimum requirements for improving the safety and health protection of workers potentially at risk from explosive atmospheres*.

1.4.2 Under DSEAR and MHSAW, an employer must do the following:

- (1) carry out, and document, a risk assessment of any work activities involving dangerous substances and document this assessment (Regulations 5(1) DSEAR and 3(1) MHSAW ).
- (2) provide measures to eliminate or reduce risks as far as reasonably practicable (Regulations 6(1) DSEAR and 3(1)(b) MHSAW).
- (3) provide equipment and procedures to deal with accidents and emergencies (Regulations 8 DSEAR and 8(1) MHSAW).
- (4) provide information and training to employees.(Regulations 9 DSEAR and 10(1) and 13(2) MHSAW).
- (5) classify places where explosive atmospheres may occur into zones and mark the zones where necessary (Regulation 7(1) DSEAR).
- (6) co-operate with other employers active in the same workplace to ensure an appropriate division of responsibilities (Regulations 11 DSEAR and 11(1)(a) MHSAW).

1.4.3 If Shell were to supply LPG to a domestic customer without having supplied the tank, under the current legislation (in particular the PSSR) Shell would not have, and could not

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<sup>20</sup> **OJ 1998 L131/11.**

<sup>21</sup> **OJ 2000 L23/57.**

be expected to have, knowledge about that tank. As a result, it would be impossible for Shell to fulfil its duties under DSEAR and MHSWA (at least without very significant further compliance costs).

## **1.5 Carriage of Dangerous Goods and Use of Transportable Pressure Equipment Regulations 2004 (CDGUTPE)**

1.5.1 Regulation 23 CDGUTPE places a requirement on drivers to comply with Annexes A and B of the *European Agreement Concerning the International Carriage of Dangerous Goods by Road* (1 January 2003) and Annexes A and B of Council Directive 94/55/EC, as amended, (21 November 1994) *on the approximation of the laws of the member states with regard to the transport of dangerous goods by road*.

1.5.2 Essentially, drivers must not unload if deficiencies exist which might affect the safety of unloading. As the OFT points out at Annex B (paragraph 4) to its reasons, the driver must be convinced that the tank is safe to receive the load. It follows from these regulations and DSEAR that those persons supplying LPG to a domestic bulk LPG installation should first ensure that the tank is safe to be filled. This is key – currently, the filler has responsibilities regardless of who owns the tank. It is not reasonable to expect a tanker driver, on his own, to accept these responsibilities when he has no expertise or knowledge relating to the tank. Whilst the comment is made in terms of the CDGUTPE and DSEAR the whole raft of health and safety legislation will apply to the driver, and his employer in first ensuring that the tank is safe to be filled.