
Advice on Liquefied Petroleum Gas Supply Arrangement for 15 Public Rental Housing Estates

Background

1. The supply of Piped Liquefied Petroleum Gas (Piped LPG) affects the daily lives of around 156,000 residents in 15 public rental housing estates in Hong Kong. There have been concerns over the perceived lack of competition in respect of the current Piped LPG supply arrangement to these housing estates. In light of this, the Competition Commission (Commission) has approached the Hong Kong Housing Authority (HKHA) which manages these housing estates, and reviewed the relevant information provided as well as other information in the public domain.

Existing Practice

- 2.1 While the HKHA's policy is to provide Towngas to public housing estates wherever available, 15 public housing estates have to rely on Piped LPG due to the lack of coverage of Towngas at the time these estates were constructed. Residents of these estates have the option of choosing cylinder LPG.
- 2.2 The duration of the original contracts to supply Piped LPG in these estates was set at 15 years and they were awarded by way of open tenders. The LPG suppliers were responsible for constructing the facilities to provide Piped LPG, managing and maintaining such facilities, and supplying LPG to the residents of the estates.
- 2.3 To be granted the exclusive concession to supply and distribute Piped LPG in the estates, and the licence to use the designated land in the estate for the LPG compounds, LPG suppliers were asked to bid on a premium to be paid to the HKHA, and the award of tender was based on the amount of premium proposed.
- 2.4 Upon the expiry of 15 years, the award of subsequent contracts will not involve

re-tendering or other means that will involve competition. An incumbent supplier's contract will be renewed for 10 years upon the HKHA being satisfied with the supplier's performance in various aspects. The HKHA will also factor in residents' views on a supplier's services for the past years. Another premium is payable by the supplier to the HKHA upon renewal of the contract.

Commission's views

- 3.1 The existing way in which the continuous supply of Piped LPG to 15 public rental housing estates is being secured may be improved from a competition perspective.
- 3.2 The current practice of renewing incumbent suppliers' supply contracts instead of conducting a competitive process favours such incumbents and reduces the possibility of obtaining better terms and services for the residents concerned. There is no cogent reason for an incumbent supplier to offer better terms if there is effectively no prospect of losing a contract to another supplier.
- 3.3 The practice of treating premium payable to the HKHA as the key criterion for awarding subsequent contracts, but the benefits of which cannot be shared with the residents, is not desirable from a competition standpoint.

Recommendations

- 4.1 The HKHA should consider introducing a competitive process to determine the award of subsequent contracts with a view to obtaining better terms and services for residents.
- 4.2 There are different ways to introduce competition to the process. The HKHA could invite tenders from all qualified suppliers or it could seek to engage qualified suppliers through negotiations while making this arrangement known to the incumbent.
- 4.3 The HKHA should consider forgoing the practice of treating premium as the key criterion for awarding subsequent contracts and in its place, use LPG prices to be charged to residents to determine the award. A proposal by a prospective supplier

could include an initial price at the start of the contract and a pricing formula that allows for periodic price adjustments during the contract period. In allowing for such adjustments, it is important that they should benchmark against objective indicators, such as international LPG prices, as prevailing market price may not be the best benchmark for the LPG market which is a highly concentrated one in Hong Kong. The Commission advocates that whichever supplier proposes the lowest initial LPG price shall win the contract to supply LPG to the estate concerned.

4.4 The HKHA can consider “bundling” estates for tender or negotiation with suppliers to provide more incentive for both incumbent and non-incumbent suppliers to bid for “packages” of estates. It also addresses the concern that some sites may not be regarded as attractive on their own due to their locations or other factors.

4.5 The HKHA could build upon the current system of seeking residents’ views before expiry of the existing contract. In addition to asking residents about the performance of the incumbent supplier and whether they support a supply contract renewal, it can also be posed to the residents whether they would like the HKHA to seek out other potential suppliers. The pros and cons of each option can be presented to the residents thus enabling them to make an informed decision.

Concerns and Response

The HKHA’s concerns

5.1 There are concerns that bringing in new suppliers may cause possible disruption of service and inconvenience to residents. Residents would need to enter into new service agreements and replace gas meters at their own cost should there be a new supplier.

5.2 There are also concerns about the feasibility of introducing effective competition at the renewal stage. As potential new suppliers would be at a disadvantage vis-à-vis the incumbent, particularly when they need to take on the risks of assuming responsibility for infrastructure installed and maintained by the incumbent, new suppliers may be hesitant to bid. There is also a worry that the

incumbent supplier may choose not to compete if a competitive process is introduced and decide to withdraw from an estate.

Commission's response

5.3 While the Commission believes that these concerns have some validity, it has reservations as to whether they are sufficient grounds for ruling out competition in awarding subsequent contracts. The Commission based its views mainly on the following:

5.3.1 In 2010, Chevron withdrew from the domestic LPG supply market and this had a direct impact on a number of estates. It turned out that there was no significant disruption and transition to the new supplier was seamless. While the Commission does not underestimate the efforts made by the HKHA in facilitating the transition, this should in some way alleviate concerns about the effect of withdrawal of incumbents and the entry of new suppliers. Furthermore, it should be possible for the HKHA to take measures, such as specifying a hand-over protocol, to help minimise potential difficulty that may arise during the transition.

5.3.2 If better terms and services could be offered by another supplier, there will be every incentive for residents to enter into new service agreements. As the replacement cost of gas meters would not likely be significant, if a competitive process were to be adopted, interested suppliers can be asked to absorb such limited costs.

5.3.3 The HKHA could consider “bundling” estates for tender or negotiation with suppliers to provide incentive for both incumbent and non-incumbent suppliers to bid for “packages” of estates.

Conclusion

6.1 The Commission appreciates that the current renewal arrangement in securing continuous Piped LPG supply to the public housing estates is a long-established practice and it does not make light of the HKHA's concerns in introducing changes to the practice. However, the exclusion of competition in the process of

awarding subsequent contracts effectively deprives residents of a genuine choice and the possibility of enjoying better terms and services that a competitive process may bring. This is something that needs to be addressed.

- 6.2 The Commission has outlined the possible directions for change from a competition perspective and the possible ways to implement such changes. The HKHA is in the best position to review the feasibility and appropriateness of the proposed changes taking into account considerations such as technical issues, the circumstances of individual estates and the timing of introducing changes. The Commission strongly urges the HKHA to consider introducing competition to the process of securing the continuous supply of Piped LPG to the housing estates concerned and hope that its recommendations will assist them to that end.