



John Bradley
UNC Panel Secretary
31 Homer Road
Solihull
West Midlands
B91 3LT

8 May 2009

Dear John

Modification Proposals No. 246, 246A and 246B: Quarterly NTS Entry Capacity User Commitment

Gazprom Marketing and Trading Limited ("Gazprom") welcomes the opportunity to comment upon the three alternative UNC modification proposals, raised to introduce the principle of Shippers' securitising against their long term entry capacity holdings. Gazprom does *not* support Modification Proposal 246. Gazprom supports Proposal 246B.

As echoed within Gazprom's response to Review Group 221 on the 20 February 2009, we are not adverse to developing proposals that improve the existing capacity security arrangements. However, the rationale behind the original modification 246 merely involves bolstering security to levels which cannot be justified. During Review Group 221 National Grid's proposals contained an aggregate level of security of £65m, whilst modification 246 leads to a security sum of £119.5m, without an explanation of why this is the appropriate level for the UK gas industry to securitise against. Gazprom requests that the issue of securitisation is taken back to first principles and a quantification of the risks is undertaken before these modification proposals are progressed any further.

We believe it is inevitable that any additional securitisation costs incurred by Shippers will eventually have to be paid for by consumers. It is essential that the additional costs incurred are proportionate to the risks faced by the industry. The draft modification report for modification 246 has not addressed this issue.

As a consequence of the UK gas industry being at risk of over-securitisation through the original 246 proposal, a whole new set of challenges arise. Gazprom believe over-securitisation will encourage a number of existing and new Shippers to restrict their participation in the UK gas market to the periphery i.e. delivery to the beach only. This strategy is likely to be undertaken by the smaller Shippers, significantly reducing liquidity at the NBP market. In respect of Standard Special Condition A11.1 (d), the securing of effective competition, is likely to be in jeopardy. Secondly, over-securitisation increases the probability of forcing a party into liquidation due to the introduction of security arrangements that attempt to capture the perceived risks rather than actual investment costs incurred. Over-securitisation is a worse situation for the community than the status quo. Shippers may use the opportunity provided by the implementation of modification 246 to withdraw from their current capacity commitments. Finally, over-securitisation also leads to other areas of the regime being affected. A perverse incentive arising is Shippers' taking into

consideration the credit requirement of their potential bids which influences their bidding strategy. The types of entry capacity being held by Shippers' may also fundamentally change. Shippers' are more likely to own short-term capacity, whilst avoiding the burdensome long-term entry holdings which includes security liabilities. As a result of this change NGG will no longer receive the much valued long term signals provided by Shippers, impacting its performance in relation to Standard Special Condition A11.1(c), the efficient discharge of the licensee's obligations under this licence.

Gazprom appreciates the industry's efforts in raising alternative modifications, proposing amendments that seek to reduce the destructive, adverse impacts of the original proposal. We support proposals 246A and 246B which both maintain the use of the existing tools i.e. Parent Company Guarantees (PGCs) as a means of providing credit, rather than the restrictive tools of proposal 246. The original proposal only permits cash and Letter of Credit (LoC). It is appropriate for the requirements of securitisation to take into consideration the credit rating of the company in order to reflect the risk of failure. It is highly inefficient tying up funds in providing additional credit where the risks of failure are nominal.

In the current climate, the imposition of a costly, retrospective proposal like modification 246 can be destructive to the UK gas market through participants perceive increased prevalence of regulatory risk. The industry will be reluctant to make long term commitments within the gas market i.e. undertaking investment projects knowing the Regulator is supportive of imposing burdensome regulatory changes retrospectively. If Users had known about the potential increase in cost created through the implementation of modification 246, this would have lead to changes in the amount of long term capacity they were willing to purchase in previous QSEC auctions. We do not support the retrospective nature of modification 246 due to increases in regulatory risk it creates. Gazprom supports the alternative proposal 246B which captures the risk of the shipping community from cost socialisation posed by all future QSEC bids only.

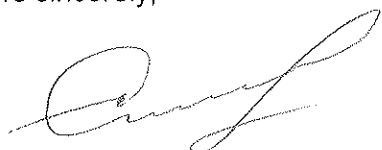
Gazprom would like the following issues being addressed with Ofgem's Impact Assessment (IA):

- What sense check has been undertaken to ensure that the User Security Value (USV) calculation within the draft proposal achieves the correct balance between the additional costs incurred by Users and the industry's exposure through the smearing of costs?
- How has the current level of securitisation proposed been derived? For example, why is Years Y2 to Y16 multiplied by [0.1] appropriate? How has this calculation been determined as the most appropriate level for securitisation?
- The magnitude of the rise in customer bills as a consequence of Shippers facing higher costs due to the imposition of over-securitisation.
- The impact upon existing and new Shipper as a consequence of modification 246, in particular the creation of barriers to entry of physically participating on the NTS.
- The risks of Shippers returning their long term holding back to NGG as a consequence of over-securitisation.
- Will modification 246 prove to be a significant additional disincentive to Shippers in the future booking of long-term entry capacity, and how will this impact upon NGG's investment decisions, and the efficiency of such decisions?

Finally we also believe additional action could be taken in the form of licence changes to reduce the industry's exposure. In the event of a shipper defaulting, an automatic trigger of the reopening of the licence parameters could be implemented, if no investments were undertaken. This key licence change minimises the industry's ongoing liability, permitting a reduction in the amount securitised by individual Shippers.

To conclude, we believe further work is required to ensure the correct balance is achieved between Users' security requirements and the industry's potential risk. Modification proposal 246, unfortunately has not managed this equilibrium. Gazprom therefore cannot support proposal 246, but would support the introduction of a less onerous USV that manages to preserve and encourage the appropriate behaviour, unlike the perverse effects of over-securitisation. The additional features contained in modification 246B i.e. use of additional credit tools like PCGs and the removal of retrospection is supported by Gazprom. We also believe it is extremely important to pursue the suggested licence change to complement the credit regime, even under the existing regime.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Alexey Selikhov', written in a cursive style.

Alexey Selikhov

Director of Finance, Mid & Back Offices