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Dear Tim

**SUBJECT: Gazprom Marketing and Trading –Retail consultation response to
Modification 0228**

Gazprom Marketing and Trading-Retail does not support the implementation of modification 0228. Gazprom Marketing and Trading-Retail believes that modification proposal 0229 represents a far more effective and equitable solution to the problem and so should also be considered by the Ofgem RIA that will consider this important industry change.

1. The Modification Proposal

This modification looks to allocate a proportion of unidentified gas to the Large Supply Point (LSP sector). At present all unidentified gas is allocated to Smaller Supply Points (SSPs) through the RbD process, a feature that was accepted by SSP suppliers when the RbD process was examined by Ofgem in 2006. Despite this view, Gazprom Marketing and Trading - Retail believes that this is unfair and that the portion of gas that is due to the LSP market should be allocated to that sector.

It is critical that any allocation process is proportionate and fit for purpose. The values and methodology that are determined by any process must be accurate to eliminate as far as possible any cross-subsidy of market sectors. Modification 0228 proposes to allocate a percentage of RbD to the LSP market sector. This is inappropriate for several reasons.

Firstly, as the size of RbD varies daily, this link will create the counterintuitive effect of the unallocated gas error varying with RbD. There is no link between the size of the RbD "pot" and the volumes which should be applied to the individual error categories. For example it seems incorrect that as the RbD volume varies the amount of gas stolen by industrial and commercial customers also varies in direct proportion of the correction of initial allocation, and could in theory become negative.

Secondly, the variance of unallocated gas will make it impossible for Shippers to efficiently procure the necessary gas. Having to contract for, potentially, large amounts of gas that fluctuates on a daily basis will add significant costs (£75m pa assuming a 25% share of RbD) and undermine competition in the LSP market.

Thirdly, the values that have been suggested by British Gas Trading do not appear to be robust. The values that are determined by any process must be accurate to eliminate as far as possible any cross-subsidy of market sectors. It is also critical that any values determined must be supported by a coherent and transparent methodology. The methodology used by British Gas Trading has not been provided in a coherent fashion. From our estimation of their process, it seems that the BGT modification is attempting to allocate 20% of all of RbD to LSP sites, with little justification. It is our view that such a large value is excessive and includes a significant proportion of SSP consumption. This proposed approach merely reverses, not solves, the current allocation problems.

Lastly, there does not seem to be any mechanism for altering these values as proposed, save by raising a further modification proposal. This seems to be an inefficient mechanism for varying the amount of unidentified gas allocated to the LSP sector, and furthermore the modification does not provide any supporting process to undertake such necessary reviews.

It is more appropriate that any unallocated gas to be applied to the LSP market are as the result of a robust and independent assessment that calculates the values on an annual basis. We would suggest that owing to the potential materiality of any allocation mechanism, it is too contentious for Shippers to determine. We are mindful that an additional modification, namely Modification 0229 directly addresses this important issue in a satisfactory manner.

It therefore seems premature to consider these modifications 0228/0228a in isolation, considering the materiality of the change. Any decision that is made must be in light of the Ofgem RIA.

2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Standard Special Condition A 11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates;

Modification 0228 leads to arbitrary cost allocation to the LSP sector, leading to potential cross-subsidies of the SSP market. It will therefore not incentivise good practice and will not reduce theft. It does not further this objective.

Standard Special Condition A 11.1 (b): so far as is consistent with sub-paragraph (a), the coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;

We do not believe that implementation of this Proposal will better facilitate this relevant objective

Standard Special Condition A 11.1 (c): so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

We do not believe that implementation of this Proposal will better facilitate this relevant objective

Standard Special Condition A 11.1 (d): so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;

Modification 0228 will allocate a large and varying level of gas to the LSP market. All Shippers with LSP portfolios will incur significant costs managing this uncertain risk. This will discourage new entrants (as start up costs will be much higher) and make smaller Shippers less competitive.

Also the values that are proposed have not been robustly developed and therefore this proposal will cause an inappropriate allocation of SSP consumption to LSP sites.

This modification is therefore detrimental to this relevant objective.

Standard Special Condition A11.1 (e): so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers;

Implementation of this proposal would not be expected to better facilitate this relevant objective.

Standard Special Condition A11. 1 (f): so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

Implementation of this proposal would not be expected to better facilitate this relevant objective.

3. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) Implications for operation of the system

We do not believe that implementation of these Proposals will present such implications

b) Development and capital cost and operating cost implications

We do not believe that implementation of these Proposals will present such implications

c) Whether it is appropriate to recover all or any of the costs

No cost recovery would be necessary

d) Analysis of the consequences (if any) this proposal would have on price regulation

We do not believe there would be any consequences on price regulation from the implementation of this Proposal.

5. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposals.

No such consequence is anticipated.

6. The development implications and other implications for the UK Link System of the Transporter, related computer systems of each Transporter and related computer systems of Users

Modification 0228 will require the extension of RbD processes to the LSP market. We expect there to be significant costs in adjusting settlement and billing systems for both Transporters and Users.

7 The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk:

a) Administrative and operational implications (including impact upon manual processes and procedures)

No such implications have been identified.

b) Development and capital cost and operating cost implications

No such costs have been identified.

c) Consequence for the level of contractual risk

The contractual risk for Shippers with LSP sites will increase to an uncertain and varying degree owing to exposure to RbD.

8 The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

Modification 0228 will assign large and unpredictable costs to LSP Shippers. A significant proportion of those costs will be due to SSP consumption.

9 Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

To take account of the varying gas levels that Modification 0228 will allocate to LSP Sites, all LSP site contracts will need allocate this daily varying level of gas. This will add additional costs onto LSP customers.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

a) Advantages

Modification 0228

None identified

b) Disadvantages

Modification 0228

- The unidentified gas volume will vary on a daily basis, with no relation to gas consumption.
- The unpredictable and counter-intuitive variation in unidentified gas will create significant costs to Shippers in contracting for such gas.
- The vales proposed are not robust, have no coherent supporting information and do not give any confidence that they are appropriate.
- This modification will result in a cross-subsidy between markets being created.
- There is no attempt to provide a future verification process that is needed to take into future market development.

I trust these comments are helpful. If you have any queries regarding this response please do not hesitate to contact me directly on 0161 838 9533.

Yours sincerely



Glenn Nixon
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GM&T Retail