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John McNamara
Ofgem
9 Millbank
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23 November 2007

Dear John

Re: DNPC03 - LDZ System Charges Capacity Commodity Split and Interruptible Discounts - Draft Impact Assessment

Gazprom Marketing & Trading Retail ("GM&T-Retail") welcomes this opportunity to respond to the Draft Impact Assessment consultation.

GM&T-Retail welcomes changes to the charging methodology which will foster stability and predictability. As a supplier to customers we are keen not to see a repeat of the recent price hikes in distribution charges which caused unwarranted disruption to the functioning of the gas supply market. Such price changes undermine the reputation of the UK Gas Market and cause unnecessary upheaval for suppliers and customers alike. The DNPC03 proposal will promote stability in distribution charges and therefore, in a broad sense, GM&T-Retail would welcome its implementation.

We are not convinced, however, that the proposed implementation is desirable or practical. Although we understand the need to introduce price stability with some haste, a premature implementation will only serve to undermine competition and the overall benefits to the industry and customers. In order for the market to adjust to this significant change in pricing levels, borne out by the analysis performed by Ofgem, participants needed to be afforded time to develop products and contracts which will best serve the customer. We do not believe that an October 2008 target date is practical and will only serve to reinforce the market position of the large portfolio players with a mix of customers, in terms of size and location. It is our belief that implementation should be targeted for October 2009 as this will ensure that all shippers/suppliers are able to engage with customers and develop products which best meet their needs.

In the remainder of this response GM&T-Retail will address the questions posed in Appendix 1 of the document.

CHAPTER 2: Key Issues

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Question 1: What are respondent's views on our assessment of the proposal against the objectives of the distribution charging methodology?

In terms of cost reflectivity we would agree that the proposal would better facilitate this objective when compared with the current charging structure. We are concerned, however, that the data provided by the DN's is fairly scant and it cannot be concluded with any conviction that 95:5 is cost reflective. GM&T-Retail does understand that in this case it is probably appropriate to accommodate the variation within the current charge structure as it is likely that a more targeted approach will only generate additional implementation costs.

In terms of developments in the Transportation Business we understand that the removal of the volume driver will increase the divergence between allowed and actual revenues if charges remain strongly influenced by commodity considerations. For this reason it appears reasonable to align charges with Price Control developments.

Finally, competition between suppliers and shippers will be better facilitated in the medium to longer term as a result of greater price stability. However, in accordance with the views expressed in the previous section of this response we are convinced that competition will be undermined if the implementation date is targeted for October 2008.

Question 2: What are respondents views on which elements of Use of System costs are related to system capacity, system throughput or neither? and

Question 3: What are respondents views on how best to recover costs that are neither related to system capacity or system throughput?

GM&T-Retail has addressed these issues in the answer to question 1.

CHAPTER 3: Distributional Impacts

Question 1: What are respondents views on the methodology used to determine the distributional impacts of this proposal?

GM&T-Retail is comfortable with the methodology used. We note, however, that Ofgem has used the default WAR in its analysis and therefore it is clear that the outputs should be considered as representing only a proportion of total customers. On this basis we find it rather puzzling that Ofgem has decided to base its conclusions on this limited sample. To claim that "the absolute sums involved are small and the effect on business costs will be marginal" is at best ill-informed and at worst misleading.

In Table 3.8 Ofgem does consider the impact of variable WARs and GM&T-Retail and it is clear from this analysis that the impacts are significant for certain classes of customers. In our opinion this adds further credence to our assertion that implementation should be deferred until October 2009 allowing the industry time to evaluate impacts and where possible mitigate risks for both customers and suppliers.

Question 2: Can respondents identify any additional impacts that have not been included in our analysis?

Please refer to the points raised in our answer to Question 1 above.

Question 3: How do respondents view the proposal as it relates to interruptible supply points?

GM&T-Retail is comfortable with the proposal to accommodate interruptible supply points. On this issue we understand that Ofgem was keen to introduce changes after Interruptible Reform had been finalised, but given actual operation of the new regime is not due to commence until 2011 we see no need to make the change in 2008. In our opinion, an implementation date of October 2009 would not have any impact on Interruptible Reform.

CHAPTER 4: Other Impacts

Question 1: What are respondent's views on our analysis of the impacts that might result from implementation of the proposal?

In general we are satisfied with the analysis performed with a few exceptions. As highlighted in our answers provided above the general statements made about impacts on small businesses are misleading and should recognize that the analysis is based on a limited "sample". In terms of Security of Supply we are slightly confused over Ofgem's assertions. On the one hand Ofgem claims that the changes are insignificant when considered in conjunction with the total delivered price, but in this area it claims that consumers will be able to better respond to economic signals derived from more accurate cost targeting. Both of these statements cannot be true!

In terms of the environment the same arguments apply. If Ofgem believes that customers will respond to the economic signals in terms of use of the System, then surely they will respond in terms of consumption behaviour and therefore such a change in charges would be detrimental to environmental objectives.

Question 2: Do respondents have any additional information with regard to possible environmental impacts?

Please refer to the answer provided above. We do not believe that the Proposal will have a positive impact on consumption behaviour, but the overall impact is likely to be minimal.

CHAPTER 5: Unintended Consequences

Question 1: Can respondents identify additional significant unintended consequences?

GM&T-Retail has made its position very clear on the impact on competition and the market. We strongly agree with the Ofgem claim *that "that strong competition is the most effective means of protecting the interest of consumers"* however, we are concerned that hasty implementation of this proposal will limit effective competition.

Question 2: What analysis would respondents like to see with regard to bi-annual adjustments to charges?

GM&T-Retail believes that the analysis already performed by DN's through the DCMF process to promote this proposal is sufficient to render bi-annual adjustments as

unnecessary and totally detrimental to the effective operation of the competitive market. Under no circumstances, assuming that this proposal is implemented should DNs be able to make within year adjustments to protect their revenue streams. This proposal effectively passes the entire commodity risk onto shippers/suppliers and any within year adjustments will only serve to exacerbate this risk further. Gazprom would welcome a Modification Proposal which prohibits such activities.

CHAPTER 6: Cost Benefit Analysis

Question 1: Do respondents agree that we have identified all relevant costs and benefits?

GM&T-Retail believes that for reasons already explained Ofgem has misrepresented the impact on customers and has not adequately factored in the impact on supply competition. It has failed to recognize contractual impacts and not evaluated the costs/benefits of altering the implementation date.

Question 2: Do respondents believe that our quantification of costs and benefits is correct? Interested parties are requested to provide information about any costs and benefits they can identify, which in turn will inform our final IA?

Please see the answer provided above. We are unable to provide additional information on the costs we have identified as they will be at the market rather than individual company level.

We trust that you find this response helpful and if you have any further questions then please get in touch.

Yours sincerely



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GM&T-Retail