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Mark Feather  
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27<sup>th</sup> February 2009

Dear Mark,

**SUBJECT: Gazprom Marketing and Trading –Retail consultation response to Code Governance Review (Major Policy Reviews and Self-Governance)**

Gazprom Marketing & Trading Retail Limited (GMTR) supplies gas to wholesale and small and medium sized Industrial and Commercial customers within the UK. We are not presently active within the electricity market, or the domestic gas market, and so have limited our answers and views to our experience of operating within the framework of the UNC as an I&C Shipper/Supplier.

#### **CHAPTER: Two - Key issues and objectives**

*Question 1: Do you agree with our assessment of the deficiencies of the codes governance arrangements and do you agree that there is a case for reform? Are the proposed reforms a proportionate response to the problems with the status quo that we have identified?*

It is vital that any regulatory framework can be adapted to effectively meet the changing needs of the gas industry and it is clear from this consultation that Ofgem considers that the current regime is deficient in several key respects:

- *multiple proposals being raised on key policy issues*

In a complex and evolving environment such as the gas supply market, it is impossible to ensure that any proposed significant change is an optimum solution. It is expected that different market players will draw upon their own experience in developing the most suitable solution, and that these views will differ. Far from being a defect, it is a key benefit of the current UNC regime that multiples proposals can be put forward (with the cost borne by the proposer), to ensure that the industry, and ultimately the authority, have the widest possible number of scenarios to

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evaluate; a centrally managed process will close out potentially profitable lines of enquiry. The recent experience of the current exit reform process has demonstrated the value of a multi-track approach.

- *duplication of assessment processes, with assessments being performed by Ofgem, code panels and industry participants*

It is not our experience that the UNC suffers from such issues. The joint office does not provide independent assessment of change proposals, so this concern is not applicable. In order to understand the impact to customers and business operations, Industry participants as well as Ofgem are likely to perform the same level of analysis for Major Policy Review, as for the current regime. Any modification of the change process in this regard will not result in cost reductions.

- *piecemeal development of proposals, with proposals often being raised on similar issues several months apart*

We fail to understand this concern. The time taken to develop significant changes (usually in the order of several months), means that initial views on appropriate solutions may not be valid at the end of the process, and the process itself will give rise to issues and solutions that were not apparent at the start. It seems appropriate therefore that the industry can propose solutions at any time. To minimize the impact this natural process has, the UNC Panel has historically ensured that, where possible, modifications are considered jointly and industry participants have attempted, where possible, to raise changes to allow them to be considered with similar proposals. Any form of blocking mechanism to prevent solutions being proposed mid-way through, or after, the development process will limit development and may prevent optimum solutions being progressed.

- *cross-code and code/licence/charging methodology coordination issues*

Significant industry change does sometimes require co-ordination between industry codes and methodologies, possibly with associated licence changes. It is not our experience however that under current arrangements such co-ordination issues for such changes as interruption and exit reform have presented a significant hurdle to industry development; related licence and methodology changes have been implemented with minimal inefficiency. This does not seem to be a significant issue.

- *divergences in the commercial interests of different players, some of whom may be opposed to reform.*

It is a sign of a healthy and functioning market that different players will have a different view on changes, and naturally some may oppose change if they are detrimental to their core customer segment, or their business function. Such differing views should be welcomed, not seen as an impediment to customer interests, as it allows a full examination of the issues presented, and provides the Authority with the widest possible views on which to base a decision. To disregard any views will limit debate and increase the possibility of subsequent challenge.

*Summary*

From our analysis of the concerns put forward by Ofgem, we do not agree that there is a case for wholesale reform. We cannot comment on the change process in the electricity industry, but the gas industry has a proven track-record in successfully progressing involved and contentious change in challenging conditions. Where the process has been less successful, such as interruption reform, this is due to insufficient time given to examine the possible solutions.

It is therefore our view that the reforms are not proportionate or warranted, and furthermore do not attempt to differentiate between the various industries codes, which by necessity reflect the differing needs of the activities they govern. Reform, if warranted, must be specifically targeted at each code to ensure that any change is suitable for that industry framework. We would welcome suggestions by Ofgem on what changes it feels are necessary for the gas industry, in particular the UNC.

*Question 2: Would the Major Policy Review process enable key strategic issues (e.g. electricity cash-out or transmission access reform) to be progressed more effectively and efficiently with consequent consumer benefits?*

At present the gas Industry is successfully progressing change to the funding of UNC modifications (User Pays), and the AMR metering framework for I&C customers, with minimal Authority involvement. The resources committed to these initiatives by industry participants to development are subject to natural commercial incentives to limit costs, whilst ensuring an adequate solution is devised. The Authority is able to follow the development the industry proposals with minimal cost, and can objectively decide on the range of solutions it is provided with. In summary the process is both effective and efficient. We cannot comment on the requirements of the electricity industry, but do not see the need for reform in the gas industry.

With a Major policy review process, it is likely that the costs to Ofgem would increase substantially as they initially classify and then internally attempt to replicate the processes undertaken by the entire industry when developing change. As alluded to above, the Industry would still undertake the same level of internal assessment, and would still commit resources to any external workgroups, hence not reducing its costs. A Major Policy Review process would therefore result in additional costs through duplication of effort. More significantly there will be a loss of transparency, compared to the current development process, to parties external to Ofgem who will not see the development of change proposals as they do now in industry workstreams. Furthermore, by developing the policy proposals themselves, Ofgem and the Authority will no longer be perceived as objective within the change process with the consequent increased likelihood of an appeal to the competition commission being lodged.

The major policy review process that Ofgem proposes would result in increased costs and duplication, and so would not be as efficient or effective as the current regime operated within the gas industry.

*Question 3: Would a Self Governance route be suitable for a significant proportion of modification proposals?*

GMTR is not opposed to minor modifications being examined and decided upon by the relevant industry panel, with the Authority acting as an arbiter in the event of any dispute. However any such process that is designed must ensure that the market can never be dominated by an individual party, or group of industry players, as this will be detrimental to an effective market, and ultimately consumer interests. Please see our response in Chapter 3 for a further examination of this option.

*Question 4: If both the Major Policy Review and Self Governance routes were implemented, is there a case for retaining an Improved Status Quo path?*

As we have stated above, the Major Policy Review proposal does not seem to be warranted, though the option of Self-governance should be explored. In any event, the current process for the UNC should be retained as the primary route by which all changes should be progressed. In our view it forms a pragmatic and efficient framework allowing all industry participants to have a voice in industry change if they wish, with the Panel ensuring that changes are sufficiently developed for the Authority to make a decision.

*Question 5: If this package of reforms is implemented, should it apply to all codes? If not all, which? Should the introduction be phased?*

We cannot comment on the appropriateness of reform in the electricity market or to codes which we do not participate in, though it is significant that the examples Ofgem cite are purely within the electricity industry. Nevertheless, it is our view that each code should be examined individually, and where appropriate, the minimum necessary change should be progressed.

As shown above, the UNC does not seem to warrant any modification to its processes. The other gas industry framework, the SPAA is being examined by industry participants to reform its governance arrangements, and any reforms should await the outcome of this process.

#### **CHAPTER: Three - Filtering criteria**

*Question 1: Once a modification has been raised, should the filtering decision be taken by Ofgem (with a panel recommendation) or by the relevant panel with an Ofgem veto?*

If any form of Self-governance process is introduced within the UNC, then how changes are classified will be vital to their development. If a Self-governance process were introduced, we would prefer for the Panel to be responsible for classifying any change as it places the primary onus on the industry to determine how changes to its contract are handled. This also places a higher test on any intervention by the regulator who will be able to do from an objective stand point, effectively as a route of appeal. If Ofgem is making the ultimate decision then not only will Ofgem be called to judge every modification which will use time and resources (even when the classification is clear), it will remove any effective appeals process.

*Question 2: What criteria should be applied to assessing whether a modification falls into Path 1 or Path 2?*

As we do not feel that a Major Review Process should be implemented for the gas industry, we are not able to comment on the appropriateness of the criteria to differentiate between paths 1 or 2.

For Self-governance, the criteria that are proposed for paths 1 and 2 are useful in setting out the broad parameters for any future guidelines. Any criteria that is used by the Panel for determining any Self-governance path however should be positive, i.e a modification should follow the self-governance path if it fits a specific criteria, not that it does not meet criteria to follow the Status Quo. This will ensure that any modification where there is doubt on which it should follow will default to the current regime, minimizing any controversy.

Before we can give detailed comments on the proposed criteria however, we would prefer to see specific criteria developed under which a UNC change would follow the Self-governance process.

We agree that the criteria should be applied to all modifications, including alternates as the impacts may be different.

*Question 3: How should we treat modifications that fall within the scope of an existing Major Policy Review?*

As stated previously, we do not believe that a Major Policy Review process is warranted in the gas industry. In any event, were such a process to be implemented, it is vital that no one party should be able to close down any avenues of discussion. This could prevent potentially profitable solutions from being examined, to the detriment of customers and industry participants. Any modification that is raised should therefore be progressed normally, irrespective of other industry developments.

#### **CHAPTER: Four - Proposed "Major Policy review" process**

*Question 1: What process should be adopted for Major Policy Reviews?*

*Question 2: What are your views on the Options for determining the outcome of a Major Policy Review?*

*Question 3: How ought the outcomes of a Major Policy Review to be implemented? Question*

*4: What safeguards and appeal mechanisms should be in place?*

*Question 5: Should there be a moratorium on subsequent code modifications following the completion of a Major Policy Review?*

As we have stated above, we do not believe that, for the gas industry, a Major Policy Review process will bring tangible benefits and it will in fact harm industry development by limiting change and adding additional costs. We therefore do not feel it is appropriate to comment on this area.

#### **CHAPTER: Five - Proposed "Self Governance" process**

*Question 1: If current Panel / voting arrangements for any code are to be changed, which model is optimal (Independent Panel, Representative Panel, signatory voting)?*

At present we only have experience of the Representative Panel approach as operated under the UNC. We agree with Ofgems assessment that this approach has sizable advantages over an independent panel approach (which is difficult in practice to achieve), or a signatory voting process (which will result in some groups or parties being marginalized and is overly complex). We would therefore prefer to see the current voting arrangements to substantially continue. The current composition of the UNC Panel however may make it inappropriate for it to vote on all changes. It does not seem appropriate that Transporters should have votes on Shipper-only issues and vica-versa. An expanded Panel could be

used for these self-governance issues, preferably with each affected Licence holder (or company group of licence holders) given a position on the Panel.

*Question 2: Should it be mandatory for panels to have a consumer and a small market participant representative?*

We welcome Ofgem's desire to ensure that industry governance regimes take account of the needs of the consumer and smaller market players. We note that within the UNC, consumer representatives may raise modification proposals, and have done so in the past. The number of modifications that have directly affect consumers, as opposed to affecting their supply companies, is historically low. Also, the addition of a consumer representative with voting powers will alter the current equal levels of influence in the UNC between Shippers and transporters, which was a key requirement of Ofgem's during the DN Sales process. We therefore do not feel that formal representation is needed on the Panel.

With regard to smaller market player, historically 2-3 of Shipper representatives on the UNC Panel have come from outside the "big six". We do not believe this will alter in the future. We would assert therefore that, for the UNC, the current Panel arrangements are adequate for representing the views of consumers and smaller players.

*Question 3: What voting procedures should apply governing code decisions?*

Any voting mechanism that is used to approve modifications must ensure that an individual party, or group of parties, cannot impose change against the wishes of a sizable minority of industry participants. This brings benefits by reducing appeals to the Authority or other body, and ensures that maximum effort is expended in reaching a mutually acceptable solution. We would assert that the current voting arrangement within the UNC Panel strikes an appropriate balance between all Shippers, and that this principle should be maintained, with an expanded Panel for Shipper-only issues and an appeals mechanism to escalate disputes.

*Question 4: What appeal mechanisms should be in place? Should defined appeal arrangements be set out or should Ofgem have discretion over whether or not to hear an appeal?*

We agree that all decisions should have an appeals mechanism to safeguard against abuse of whatever self-governance regime is instituted, and that Ofgem forms a natural escalation body. For self-governance decisions there should be clear grounds for appeal, but disagree that this should be linked to a percentage of suppliers or a pre-set challenge lodged before voting. Any decision that impacts a party should be appealable to the Authority; the requirement to fund costs (though we feel that some element of discretion should be built into this requirement to not deter smaller suppliers unduly) will deter groundless appeals and help minimize costs. We note this automatic appeal approach is currently used within the SPAA.

*Question 5: Should a consumer and small participant representative have an automatic right of appeal?*

It is our belief that embedding the automatic right to appeal for all changes into the party agreements would cover this requirement.

## **CHAPTER: Six - Impact assessment**

*Question 1: Do you agree with our assessment of the package of reforms against the Review Objectives?*

### *Major Policy Reviews*

Unlike the electricity industry, the gas industry is governed by only 2 major codes (SPAA and the UNC), which have little overlap. Significant changes, such as the DN sales process, have been achieved under the current framework. Ofgem has acted as an observer and the industry have progressed the code changes required, with consequent methodology and licence issues being developed simultaneously. The process is both time and resource efficient, and smaller players have been able to provide valuable input. The results of this process have been of a high standard and have provided Ofgem with a range of solutions from which to objectively evaluate.

We do not agree that the Major Policy Review process will be able to achieve higher levels of efficiency, flexibility and inclusivity over the current UNC regime, and that there is a possibility the Major Policy review process will generate additional costs and complexity, whilst excluding smaller players from effectively participating. Ofgem will certainly no longer be perceived to be objective if this process is implemented, with the greater risk of appeals being raised as a result.

### *Self-Governance*

On the face of it, the Self Governance processes should provide for cost savings and efficiencies in the change process by reducing the role of Ofgem in modifications. We would like to see more detail on how Self-governance processes will operate within the UNC before giving a firmer commitment.

*Question 2: Do you agree with our quantitative assessment of the potential cost savings of reform?*

We are not active within the electricity market and so do not feel we comment on the case study that is presented. Without further information it is similarly difficult to comment on the costs that are stated by Ofgem with regard to Self-governance.

*Question 3: Do you agree with our assessments of the potential impact of reform on consumers, competition and sustainable development?*

It has been our experience that consumer representatives have a high level of interaction in the UNC process, either directly (through the gas customer forum and by attending relevant meetings such as regarding interruption reform or charging methodology debates), or through their shippers/suppliers. Smaller suppliers (such as Corona, Shell Gas Direct and GDF Suez) also have a track record in proposing and supporting change, such as expanding Daily Metering using AMR technology. We feel that Major Policy Reviews will at best be neutral to this current situation, and may well reduce the ability of smaller shippers to propose change. Self-governance processes will likewise not increase smaller player participation, but if properly implemented, will have neutral impact in this regard.

We cannot comment on the impact these changes will have on renewable generators, though we note that the gas industry is successfully progressing the implementation of AMR metering to I&C customers, which is expected to bring significant energy savings.

*Question 4: Do you agree with our assessment of the potential unintended risks and consequences?*

*Major Policy Review*

We agree with Ofgems assertion that this process will not be as effective as the regulator believes. As we have stated before, this process will result in loss of transparency, additional cost through duplication of effort, delays in solution development and restriction of debate, as well as a greatly increased risk of appeals being raised to the Competition Commission. We believe this risk has a very high likelihood of coming into being.

*Self Governance*

It is difficult to predict the number of modifications that will go through the Self- Governance process, though we would expect there to be a steady trickle of minor changes. We agree that detailed criteria for what constitutes a minor change in the UNC would need to be developed to ensure appropriate levels of change go through this route. The use of the process for inappropriate change does also exist, but proportionate guidelines and the ability of the regulator to intervene will manage this process, though this should a light touch, and Ofgem should be involved as a last resort.

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



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