

Gazprom Marketing & Trading Retail Ltd
Bauhaus
5th Floor
27 Quay Street
Manchester
M3 3GY
England

Tel: +44 (0)161 838 9533
Fax: +44 (0)161 838 9538

e: billingretail@gazprom-mt.com
w: www.gazpromretail.co.uk

Ofgem
9 Millbank
London
SW1P 3GE

29th January 2010

Dear Sirs

SUBJECT: Gazprom Marketing and Trading Retail Ltd response to Ofgem Impact Assessment on Identification and Apportionment of Costs of Unidentified Gas (Mods 0194/0194A, 0228/0228A, 0229)

Gazprom Marketing and Trading Retail Retail Ltd wishes to provide comments on Ofgem's Impact Assessment regarding the Apportionment of Costs of Unidentified Gas.

CHAPTER: Three

Question 1: Do you agree with Ofgem's assessment that the likely impact of the Modification Proposals on charges made to consumers?

The costs for LSP customers (I&C and Domestic) that are proposed by Modification 0228 & 0228A are significant, but are not supported by any underlying information. It is important that any methodology that reallocates energy between market segments is subject to rigorous analysis to ensure costs are appropriately targeted. Otherwise a cross-subsidy will be created.

TPA

As Ofgem has indicated in its Impact Assessment, it is unclear how the proposers have determined the values proposed. In light of this deficiency, the I&C Shippers and Suppliers group (ICoSS) commissioned TPA solutions to analyse the underlying assumptions of Modification 0228 and 0228A. The information used in compiling this report is that provided by xoserve to Ofgem as part of the impact assessment.

Modifications 0228/0228A both attempt to ascertain the contribution to RbD from genuine reconciliation and Unidentified Gas.

Sources of RbD volumes

Source of RbD volumes	Percentage of RbD volumes arising from various sources	
	%	Rationale
"Genuine reconciliation" (read submission issues)	15.0	Differences in AQ accuracy in LSP and SSP sectors can lead to "genuine" reconciliation quantities. Addressed by accounting for rate of movement in AQ share between sectors
Late and Unregistered sites	2.9	Failure of shippers to register sites in a timely manner. Percentage inferred from xoserve analysis
IGT issues	5.7	Deficiencies in CSEP creation process. Percentage inferred from xoserve analysis
Shrinkage	0.0004	Difference between initial and final shrinkage allocations – xoserve data
LDZ Metering	0	Primary assumption is that overall there is not an over or under registration of gas entering the system
End Supply Metering	0	Assumption is that supply point metering does not contribute to NDM error.
LSP Temp & Press	0	No rationale provided
LSP Temp & Press	0	No rationale provided
Other	0	No rationale provided
Theft	76.4	Theft is regarded as the "balancing factor" i.e. remaining RbD volumes that cannot be attributed to other causes or issues
Totals	100	

Source: TPA Solutions

Analysis of Modification 0228/0228A assumptions

- It can be seen that the modifications assume that genuine reconciliation is 15% of total of RbD, with the rest being Unidentified Gas. It is unclear what the rationale for this percentage is. Looking at the information provided by xoserve, Genuine Reconciliation is variable, but is consistently much higher percentage than the 15% estimated.

2006/7 Genuine Reconciliation		2007/8 Genuine Reconciliation		2008/9 Genuine Reconciliation	
GWh	%RQ	GWh	%RQ	GWh	%RQ
5659	48.47%	1968	17.59%	2407	19.88%

- The two modifications use different mechanisms to derive their final volumes, with Modification 0228 looking to apply the percentage splits to the whole RbD volume and Modification
- 0228A only applying percentage splits of Unidentified Gas to the RbD volumes. There does not seem to be any reason for this difference in calculation.
- No attempt is made to ascertain the error caused by imperfections in the algorithms that are used to allocate demand on a daily basis to Small and Large Supply Points. In theory if all AQs are accurate, then the AQs for a particular gas year should equal the sum of the daily allocations. Analysis suggests that there is a 10-17TWh, annual overstatement of LSP AQ and a general overstatement of -2 to 13 TWh for SSP AQ. In comparison Modification 0228A is looking to allocate 3 TWh to the LSP sector in entirety.

Though the effect of this transitory as AQs are adjusted over time, this variance in allocation values should be considered significant. These errors therefore must be taken into account in any calculations of RbD to be allocated to LSPs.

- It is assumed that Theft is around 76% (Mod 0228) or 9 TWh (Mod 0228a) in size. In comparison the total theft levels detected by the industry is 169 GWh. Even accounting for the fact that some Theft will be undetected in any given year, Modification 0228/0228A significantly overestimates the impact on the industry.
- The percentages proposed for iGTs and late/unregistered sites are not supported by any of the data provided by xoserve.

Conclusions

The analysis undertaken by TPA solutions indicates that there is no basis for the values or percentage proposed by modification 0228/0228A. They should therefore be seen to be spurious and that, if implemented, further work will need to be undertaken to correct them.

Question 2: Do you consider that the proposed governance arrangements under UNC229 offer adequate protection to the interests of consumers in their present form?

We have complete confidences that the Panel and the UNCC, being composed of industry representatives, will ensure that any AUGÉ that is appointed will undertake their work with care and diligence. If this is achieved, then each customer segment will be allocated the correct amount of Unidentified Gas, which is in the interests of customers. If any deficiencies in the process are identified, then the guidelines allow the Committee to suggest solutions with either the tender process, or the values derived by the AUGÉ. In the event that such issues cannot be resolved, then Code Parties may raise a modification. The UNC framework is adequate for protecting consumer interests.

Question 3: Do you anticipate any further impact upon consumers in addition to those considered in this chapter?

The work done by the AUGÉ will ensure that a large body of evidence on the causes and reasons for Unidentified Gas will be collated. This will allow progress to be made in reducing the materiality of Unidentified Gas. Modification 0229 has additional benefits over the other modifications.

CHAPTER: Four

Question 1: Do you agree with our assessment that any of these Modification Proposals will have an effect upon incentives for shippers to reduce the quantity of Unidentified Gas offtaken at LDZs?

These modifications are looking to correctly allocate Unidentified Gas to customers. Shippers will only have a natural incentive to identify and reduce the scale of Unidentified Gas if they have confidence that their efforts will result in a reduction in the amount of Gas allocated to their customers. Only Modification 0229, by proposing an annual exercise to determine the size of Unidentified Gas, will allow these activities to be taken into account and so incentivise Unidentified Gas reduction.

On a wider note, the industry is currently examining how to reduce Unidentified Gas through a National Agency (Modification 0274). Whilst this is not the subject of this Impact Assessment, it should be noted that Modification 0229 would aid the activities of a National Agency by creating a body of information it could draw upon.

Question 2: Do you agree with our assessment of the likely distributional impact of the Modification Proposals?

The values provided by Ofgem seem to reflect the work we have commissioned through TPA solutions. (See Chapter 3 response).

Question 3: Do you believe that the potential benefits of the Modification Proposals justify the additional costs which may be imposed on customers?

Any change to the UNC is likely to incur costs. As long as those costs do not outweigh the benefits then those changes will benefit the Industry. There is currently little benefit to customers from Modifications 0194, 0228 and 0228A. All they do is attempt to subsidise SSP customers by allocating an arbitrary amount of gas to the LSP sector. As shown by TPA solutions, the numbers proposed have no basis in reality and will be repeatedly adjusted through modifications proposals. This will add cost and complexity to customer as charges vary over time.

In addition to assessing the scale of the issue, Modification 0229 will result in a large body of information on Unidentified Gas being compiled, helping the industry to form measures to tackle the causes. Only Modification 0229 outweighs the benefits.

Question 4: Do you agree that applying a variable RbD charge upon LSP shippers would potentially entail a negative impact upon competition? Do you feel that this potential impact justifies the imposition of a fixed rather than variable charge on LSP shippers?

RbD does not achieve the aim of allocating LSP Unidentified Gas to that sector for several reasons. RbD varies daily according to LSP reconciliation, not gas consumption. Unidentified Gas consumption does not vary in line with this activity – any variation would be either due to seasonality effects (Gas Theft) or be constant (Shrinkage errors). The use of RbD will mean that either some, none, or all of the LSP Unidentified Gas for that day will be allocated to the LSP sector. Indeed it may mean that more gas than is warranted is allocated, if RbD is particularly large on any given day.

In addition the size of RbD, being the sum of reconciliation of LSP meter points undertaken on any set day, is inherently unpredictable. This means that Shippers (particularly those with a large LSP portfolio) will undertake inefficient gas procurement to cover their needs. This will increase the

activities undertaken by the Transporters in managing overall system operation and result in higher costs for consumers generally. Finally, there has been little attempt to ascertain that the proposed percentages of RbD to be applied are appropriate. As we have shown above, there is a

strong case to argue they are incorrect. In summary both Modifications 0194 and 0228 will damage competition and result in cross-subsidies between market sectors.

These issues are avoided by using a fixed charge. A predictable target is more appropriate for most aspects of Unidentified Gas. It also allows efficient procurement of gas long-term, so lowering costs for customers. On this basis, Shrinkage volumes are now set as a fixed volume, not a percentage of throughput. Both Modifications 0228A and 0229 propose a fixed charge, but Modification 0228A does not provide any supporting analysis and there is no mechanism to alter the fixed charge over time. Modification 0229 creates greater certainty that the volumes derived are accurate as they are the result of expert analysis of the underlying causes. They can also be updated annually. On this basis Modification 0229 provides significant benefits over Modification 0228A.

We do acknowledge Ofgem's issue with a lack of seasonality explicitly mentioned in any of the modifications. We would suggest that Modification 0229 (only) will be able to provide a varying allocation to take into account seasonal consumption patterns.

Question 5: Should any third party authority created under the terms of UNC229 be tasked to review incentives for investigating theft upon individual shippers?

Modification 0229 will highlight the scale and natures of the cause of Unidentified Gas to the industry. We would then expect Shippers to propose modifications that would address these causes on the basis of this information. It should be noted that two modifications (namely Modifications 0274 and 0277) are currently being progressed by Shippers to address the causes of Unidentified Gas.

CHAPTER: Five

Question 1: Do you agree with Ofgem's assessment that any impact on sustainable development as a result of these Modification Proposals is likely to be marginal?

These modifications will have a marginal impact on sustainable development as they do not attempt to reduce overall gas consumption.

Question 2: Do you agree with Ofgem's assessment of the relative impact on sustainable development of each of the Modification Proposals?

Ofgem's assessment that Modification 0229, by identifying the causes of Unidentified Gas, is likely to have the greatest impact on sustainable development is correct.

Question 3: Do you consider that there are any further impacts on sustainable development that are likely to result from the Modification Proposals?

We do not anticipate any further impacts.

CHAPTER: Six

Question 1: Do you anticipate any impact on health and safety as a result of these Modification Proposals? If so, what?

We agree with Ofgem's assessment that the modifications will have limited health and safety benefits. Modification 0229 by identifying the underlying causes of Unidentified Gas, in particular Theft of Gas, will aid to a limited degree safe operation of the networks.

CHAPTER: Seven

Question 1: Do you agree that implementation of UNC229 would leave parties with adequate recourse to query decisions made by the AUGE?

The AUGE will be subject to the oversight of either the UNCC or the Panel directly, and/or through a UNC sub-committee. Though this means that the AUGE process will not be directly subject to authority oversight, the Major Policy Review process will allow Ofgem to propose changes if it is felt necessary. This should provide sufficient oversight of AUGE activities. Consumer representatives do not currently have a vote, but the self-governance discussions occurring under the auspices of Modification 0276 may result in greater consumer representation and we would prefer to see this work conclude before suggesting changes to the UNC regime.

Question 2: If not, how should any additional governance be implemented?

As stated above we do not feel that any additional governance is needed, but feel that the AUGE process should be included in the discussion currently being undertaken in Modification 0276.

Question 3: Are there any additional risks which may be placed upon industry parties by implementation of the Modification Proposals within scope of this Impact Assessment which we have not identified in this document?

All have been identified.

Question 4: How could the Governance Arrangements for appointment of an AUGE be structured to minimise impact upon shipper parties? Should GTs be indemnified from any risks from holding this contract, and if so how might this be implemented in practice?

The GT concerns are based on an incorrect premise. The modification for appointing the AUGE clearly states that Shippers will be able to commence legal proceedings for the activities undertaken by the AUGE in compiling the AUGS only if the AUGE activities are found to be fraudulent or clearly erroneous¹. In addition the AUGE must limit its legal proceedings to the recovery of any fees from the Transporter.² It should be noted that the modification has not had legal text prepared; it is incorrect to suppose that the proposed, non-legal, wording of the Modification should be taken as its final form. We are confident that the Transporters will be able to draft appropriate wording to give effect to the modification's intentions.

If we assume that the Transporters are able to discharge their responsibilities in this manner, the Transporters will only have limited liability for managing the contract they will have with the AUGE. This contract can draw on the precedence of appointing such third parties as the RbD auditor and the Meter Error Expert. There seems to be no issue with these contracts, though they obligate the Transporters to have contracts with agencies who are subject to Shipper

¹ Final Modification 0229 Report Appendix 1, Section 5: Generic Terms of Reference for Appointed AUGE

² *ibid*

oversight. It is also clear that under the proposed process the GT have no compulsion to contract with the appointed AUGE, only to offer the contract to the favoured AUGE. Modification 0229 places the GT in a very strong position to enter into a favourable contract.

There is no need to create additional securities to indemnify the GTs. If this was done, then the GTs may not undertake their contracting activities with the care expected of a commercial entity.

CHAPTER: Eight

Question 1: Do you agree with Ofgem's assessment that the benefits of appointing an independent third party to assess Unidentified Gas would accrue to the industry?

As this post will be tendered for annually, the AUGE will be incentivised to make a robust case of the values proposed. We therefore agree with Ofgem that any third party that is appointed will undertake analysis on the underlying causes of Unidentified Gas to ascertain its impact. In addition this analysis will be objective as they are not impacted by the values derived. They will also be able to adjust the Unidentified Gas values over time in light of industry developments. None of the other modifications generates these benefits.

CHAPTER: Nine

Question 1: Do you believe that a post-implementation review will be necessary for the Modification Proposals which Ofgem is minded to implement?

If Modification 0228 or 0228A were implemented then the arbitrary values suggested would require repeated revisions to take into account industry changes and so a post-implementation review would be needed on a rolling basis.

Modification 0229 avoids these issues. The timeline proposed in Modification 0229 includes a period to allow the UNCC (or whatever committee oversees the AUGE) to examine the tendering process and to suggest improvements. There is also a query process that all Parties may use if any issues with the values are identified. This seems to provide adequate opportunity for the process to be reviewed and a separate Ofgem process seems unnecessary.

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
Head of Retail Capability and Integration
GM&T Retail