Making a positive difference
for energy consumers

Gas Transporters, Centrica,
Xoserve, and other interested
parties

Email: industrycodes@ofgem.gov.uk
Date: 4 September 2026

Dear Colleague,

Decision on the appeal by Centrica against the Central Data Service Provider Annual Budget of 2022/23.

1. On 28 February 2022, Ofgem[1] received a notice of appeal[2] from Centrica ('the appellant') against the Central Data Service Provider (CDSP) Annual Budget of 2022-23 ("**CDSP Budget**").[3] Having considered the arguments and evidence submitted by the appellant and the CDSP, we have decided to:

- partially allow the appeal in relation to Ground 1 that Xoserve have failed to demonstrate the efficiency of the Maintain the Business Costs;
- partially allow the appeal in relation to Ground 2 that the treatment of Intellectual Property Rights for the Contract Management System does not comply with the Data Services Contract and Xoserve have failed to objectively identify the delivery model that represents the greatest value for Customers; and
- partially allow the appeal in relation to Ground 3 that the Xoserve BP22 effectively changes the risk profile to which Customers are exposed that was set by a regulatory decision.

[1] References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.
[2] See para.8, Gas Transporter Licence, Standard Special Condition A15 (Central Data Service Provider)
[3] The appeal was made pursuant to Paragraph 4(d) of Standard Special Condition A15 of the Gas Transporter Licence. Standard Special Condition - PART A Consolidated - Current.pdf (ofgem.gov.uk).

2. We acknowledge the passage of time since this appeal was first raised. A number of factors have contributed to this, including the necessary prioritisation of resources during our response to both the COVID-19 pandemic[4] and the energy crisis, as well as this being the first decision of its kind to be taken by Ofgem and therefore we have had to consider and develop the appropriate processes and approach in coming to a decision.

3. This letter sets out the reasoning for our decision.

[4] Ofgem information for energy licensees on coronavirus (COVID-19) response - 30 June update | Ofgem

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Background

4. Relevant Gas Transporters (RGTs) are required under Standard Special Condition (SSC) A15 of the Gas Transporter Licence to have in place a "central data service provider" ("CDSP") with effect from 1 April 2017.[5]

5. Paragraph 2 of SSC A15 sets out that "the licensee must, together with Relevant Gas Transporters, ensure that there is in post at all times a person appointed as the CDSP to provide CDSP Services and systems (together referred to as "CDSP Services" in compliance with the minimum requirements set out in [Part A of this condition])".

6. Xoserve Limited ("Xoserve")[6] are the entity appointed by Gas Transporters as the CDSP and provides a range of services to support the GB gas industry. Xoserve took on its role as the gas industry's CDSP on 1 April 2017. It is jointly owned by National Gas Transmission Plc and the four Gas Transporter licensees with distribution networks.[7]

7. SSC A15 mandates the creation of a 'CDSP Service Agreement',[8] which includes obligations on Xoserve to provide, or otherwise procure, the CDSP Services.[9] This Service Agreement takes the form of the Data Services Contract (DSC).[10] The licence requires that the CDSP Service Agreement includes an obligation on the CDSP to produce, in consultation with Relevant Users of CDSP Services, and publish, an Annual Budget in respect of the delivery of CDSP Services.[11]

8. For 2022-23, Xoserve undertook an iterative process to develop its Business Plan and Annual Budget, as follows:

- **June 2021**: Published its draft principles and approach behind the development of its 2022-23 Business Plan.[12]

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[5] Standard Special Licence Conditions apply to Gas Transporters with GDNs (ie DNOs), other gas transporters and National Grid Gas Plc.
[6] https://www.xoserve.com/about-us/ Xoserve are the CDSP for the gas industry.
[7] Cadent Gas Ltd; Northern Gas Networks; SGN; Wales & West Ltd.
[8] Paragraph 4(a) of SSC A15.
[9] Paragraph 6(a) of SSC A15.
[10] Documents relating to the Data Services Contract are available on the Joint Office of Gas Transporters' website: https://www.gasgovernance.co.uk/DSC-Documents.
[11] Paragraph 6(c) of SSC A15.
[12] xoserve-bp22-principles-and-approach-draft-single.pdf

- **July 2021**: Published its final principles and approach to developing the 2022-23 Business Plan.[13]
- **September 2021**: Published its response to the feedback and responses received to the final principles and approach (July 2021).[14]
- **September 2021**: Published its first draft of the 2022-23 Business Plan and Annual Budget.[15]
- **November 2021**: Published the feedback received to the first draft of the Business Plan and Annual Budget, along with Xoserve's responses to that feedback.[16] In November 2021, Xoserve also published its second draft of the 2022-23 Business Plan and Annual Budget.[17]
- **December 2021**: Published the feedback received to its second draft of the Business Plan and Annual Budget, along with Xoserve's responses to that feedback.[18]
- **January 2022**: Published its final 2022-2023 Business Plan and Annual Budget.[19]

9. Paragraph 4(d) of SSC A15 requires Gas Transporters to ensure that the Uniform Network Code (UNC) includes a process enabling a Relevant User of CDSP Services to appeal the CDSP Annual Budget by issuing a notice to the Authority in writing. This appeal process is set out in the Budget and Charging Methodology (BCM), which is one of the CDSP Service Documents within the DSC.

10. In accordance with Paragraph 4(d) of SSC A15, the circumstances under which such a notice of appeal can be issued to the Authority are limited to where the appellant considers the CDSP Annual Budget to not be fit for purpose for the CDSP to be able to fulfil its obligation specified in paragraph 5(b) of SSC A15 (see below for more detail). The minimum obligations of the CDSP include that it is a company the purpose of which is to provide CDSP Services.[20]

11. Where the Authority receives a notification of appeal in accordance with paragraph 4(d) it will decide whether there are grounds for appeal.[21] If, having made its assessment, the Authority decides that the appeal should be allowed, it will issue a

[13] xoserve-bp22-final-principles-and-approach_singles.pdf
[14] 2022-business-plan-principles-and-approach-feedback-and-responses.pdf (xoserve.com)
[15] xoserve.com/media/42567/xoserve-bp22-first-draft-singles.pdf
[16] xoserve.com/media/42742/2022-business-plan-feedback-and-responses-on-first-draft.pdf
[17] xoserve-bp22-second-draft_singles-final.pdf
[18] business-plan-2022-feedback-and-responses-on-second-draft.pdf (xoserve.com)
[19] xoserve.com/media/42991/xoserve-bp22-final-version_singles.pdf
[20] Paragraph 5(b) of SSC A15.
[21] Paragraph 8 of SSC A15.

direction (the "Direction") to every licensee in whose licence this condition has effect, requiring the licensee to require the CDSP to make changes to the CDSP Annual Budget as set out in its direction.[22]

12. If, following assessment, the Authority allows the appeal, the Authority must consider the value of the amended CDSP Annual Budget that is to apply.

13. The Authority will state such a value, along with the years in respect of which the amended CDSP Annual Budget applies and any other conditions relating to the CDSP Annual Budget that the Authority deems appropriate to impose on the relevant licensees, in a direction to every relevant licensee.[23] Any amendment to the CDSP Annual Budget would be only to the extent necessary to make it fit for purpose for the CDSP to be able to fulfil its obligation specified in paragraph 5(b) of SSC A15.

Appeal to the Authority

14. On 28 February 2022, the appellant issued a notice of appeal to the Authority appealing the CDSP Annual Budget of 2022-23 on the basis that the CDSP Annual Budget of 2022-23 is not fit for purpose.

15. In addition, letters of support were received from OVO Energy,[24] E.ON Energy,[25] and GTC Infrastructure.[26] While we have considered the arguments raised in these letters of support, we note that the letters did not contain any substantive, new or additional information, focusing instead on selected elements of Centrica's appeal. We have therefore made our decision primarily based on evidence provided in the appeal notice submitted by the appellant and the CDSP.

Our assessment framework

16. In our 2016 decision to modify the CDSP funding and governance arrangements set out in SSC A15, we stated our expectation that "appeals will be by exception as the governance arrangements, including the newly reformed Xoserve board, should ensure decisions with regard to budgets are made with full involvement of relevant parties, and the decision made is ultimately in the interest of consumers".[27]

[22] Paragraph 10 of SSC A15.
[23] Paragraph 10 and 11 of SSC A15.
[24] Letter 11th March 2022.
[25] Letter 14th March 2022.
[26] Letter 14th March 2022.
[27] https://www.ofgem.gov.uk/publications/decision-new-standard-special-condition-a15a-central-data-service-provider-modification-ssc-a15-agency-and-other-consequential-modifications-gas-transporter-licence.

17. We have considered this intention and the current situation when arriving at our approach to decision-making for CSDP Budget Appeals set out below. We have also had regard to our principal objective and statutory duties.

Process steps

18. The following are the steps that we will use to consider the 2022-23 Budget Appeal (the "appeal"). Ofgem provided the parties with this process prior to making this decision. We considered representations made by the parties in relation to the process and decided that no changes were required, as the process already contains flexibility, as well as consideration of the broader CDSP background and regulatory context. We note for clarity that the scope of appeal discussed in this process provides non-exhaustive examples and that wider circumstances can lead to a CDSP Budget not being fit for purpose, provided these wider circumstances are connected to the purpose of providing CDSP Services. Following consultation on a draft decision, we made some clarifications relating to the scope and standard of the decision below and have detailed these in Appendix 1.

Step 1	We will check if the appellant has followed the correct procedure for making the appeal (see paragraph 4(d) of SSC A15 and section 4.8 of the CDSP Budget and BCM).
Step 2	We will assess, on the face of the appeal, whether the grounds of appeal go to the question of whether the Budget is fit for purpose (see paragraph 4(d) and 8 of SSC A15). This assessment will take into account the background of the nature of the CDSP as prescribed by the broader regulatory regime set down by SSC A15.

Step 3	We will conduct our substantive assessment of whether the appellant has shown that the Budget is not fit for purpose for the CDSP to fulfil its obligation to provide CDSP Services (see paragraph 4(d) and 5(b) of SSC A15). In particular, we will consider whether the Budget is fit for the purpose of: • the CDSP being a body in relation to which there must be an opportunity for non-RGT users to participate in both certain decision-making processes, and in the Business Plan and Budget (see paragraphs 3(b) and 3(c) of SSC A15); • the licensees jointly controlling and governing the CDSP on an economic and efficient basis (see paragraph 4(c)(i) of SSC A15). Further information regarding the grounds of the appeal is provided below.
Step 4	We will either: • make a preliminary decision on whether any grounds of appeal should be allowed, or • disallow the appeal (see paragraphs 10, 11, and 12 of SSC A15).
Step 5	If proposing to allow the appeal, we will consider what direction to make under paragraph 11 of SSC A15.
Step 6	If proposing to allow the appeal, we will consult on the direction as provided for in paragraph 12 of SSC A15.
Step 7	We will make a final decision and publish any direction (see paragraph 10 of SSC A15).

Scope of an appeal under SSC A15

19. As explained above, an appeal lies only where the appellant considers the CDSP Annual Budget to not be fit for purpose for the CDSP to be able to fulfil its obligation to provide CDSP services. This is the first appeal of its kind and we have had to reflect on both the scope of an appeal under the Condition and the standard of review which we should apply when considering grounds which are within the scope of an appeal.

20. In relation to the **scope** of an appeal, we consider that the Budget may not be fit for purpose if the CDSP were unable to fulfil its obligation of being a company the purpose of which is to provide CDSP Services.[28] We consider that to properly understand and interpret that purpose, one should look at the obligations that apply in this context, which include:

- that the CDSP produced the Budget following consultation with Relevant Users of CDSP Services,[29] and
- that the CDSP is a body in relation to which there must be an opportunity for non-RGT users to participate in certain decision-making processes[30] and the Business Plan and Budget,[31] and
- that Relevant Users of CDSP Services are able to jointly control and govern the CDSP on an economic and efficient basis.[32]

21. In our decision, and below, we refer to some of these bullets as “grounds” of appeal. By this we mean that these are matters which properly fall within the scope of an appeal of this nature. We discuss some of these grounds in more detail below. It is important to be clear that although these are examples of matters which properly fall within the scope of an appeal of this nature, this is a non-exhaustive list. Grounds of appeal which do not directly engage these points may be within the scope of an appeal of this nature, having regard to the test in the Condition and the regulatory background. In any future appeals we will assess the grounds as presented to us, against the language of the Condition and the regulatory background, in order to reach a view as to whether the grounds raised do fall within the scope of an appeal of this nature.

Examples of matters within the scope of appeal

The CDSP is a body in relation to which there must be an opportunity for non-RGT users to participate in certain decision-making processes and the Business Plan and Budget

22. Paragraphs 3(b) and 3(c) of SSC A15 impose obligations on a licensee, together with the RGTs, to ensure that the CDSP is a body in relation to which there must be an

[28] Paragraph 5(b) of SSC A15.
[29] Paragraph 6(c) of SSC A15.
[30] Paragraph 3(b) of SSC A15.
[31] Paragraph 3(c) of SSC A15.
[32] Paragraph 4(c)(i) of SSC A15.

opportunity for non-RGT users to participate in certain decision-making processes and the Business Plan and Budget.

23. The budget may be not fit for purpose in this regard where it will have an effect on the ongoing operation of the CDSP. Non-exhaustive examples of where we may consider this likely to be the case are where:

- no provision (or insufficient provision) was made in the Budget for stakeholder engagement for non-RGT users to have a say on decision-making and the Business Plan and Budget, or
- no provision (or insufficient provision) was made for a mechanism (e.g. consultation) through which to engage stakeholders on decision-making and the Business Plan and Budget.

Jointly control and govern the CDSP on an economic and efficient basis.

24. Paragraph 4(c)(i) of SSC A15 imposes an obligation on a licensee, together with the RGTs, to ensure that the UNC sets obligations on the licensee and certain other users of CDSP Services to jointly control and govern the CDSP on an economic and efficient basis. We consider this obligation to the extent to which it affects whether the CDSP Annual Budget is fit for purpose, as specified in paragraph 5(b) of SSC A15.

25. We consider that the Budget may not be fit for purpose if it is too low for the CDSP to be able to fulfil its obligation of being a company the purpose of which is to provide CDSP Services. An example of where we may consider this to be the case is where a CDSP Service is not budgeted for.

26. Alternatively, the Budget may be not fit for purpose in relation to paragraph 4(c)(i) of SSC A15 where it is found to be too high. Some (non-exhaustive) examples of where we consider this likely are where:

- the Budget contains one or more item(s) that are not legitimate items of expenditure for the CDSP, or
- the Budget contains one or more item(s) that are manifestly inappropriate provisions for the activity in question, and there are insufficient safeguards in place to ensure that the actual costs incurred will be efficient, or

- the Budget contains one or more item(s) that will, or are likely to, prejudice unfairly the interests of one or more Parties, or cause them to be in breach of UNC, the Energy Licences and/or Law.

It is important to be clear about the reason why we have included the language "manifestly inappropriate" in the second example above because this phrase has caused some concern and confusion amongst stakeholders. In particular, see further paragraph 2-9 of Appendix 1 below. The obligation is to govern the CDSP on an economic and efficient basis and that is indeed the test which we are applying. However, when it comes to the assessment of particular budgetary items, it would not be within the correct standard of an appeal for Ofgem to step in to take those decisions as a full merits review. The reason why we added the language of "manifestly inappropriate" was to reflect the appropriate **standard** of review which we will apply when we address an appeal which is within scope. As we explain further below, in light of the intention of the regulatory regime that there would be relatively few appeals, it is clear to us that an appeal of this nature is not one in which Ofgem is to consider the appropriateness of a Budget afresh as if it were taking the decision itself. An appeal of this nature is not a full merits review of the budgetary decisions. The language of "manifestly inappropriate" was intended to reflect this standard of review in the second bullet point above. We note, for the avoidance of doubt, that our position that the standard of review is not "full merits" applies across the various examples which we consider fall within the scope of an appeal of this nature, and is not limited only to the example in the second bullet point outlined above. Accordingly, even though the other examples do not include the language of "manifestly inappropriate" we will not be applying a "full merits" standard of review in respect of such examples.

Our decision

27. We have considered the issues raised by the appellant and letters of support received. In accordance with Paragraph 8 of SSC A15, when reaching our determination, we have considered whether there are grounds for appeal in this specific instance. In coming to our final decision, we consulted on a draft decision and considered all submissions made in relation to that draft.[33] We address the specific points made in those submissions in turn in Appendix 1 to the decision below. We have also had

[33] We consulted on our draft decision in accordance with SSC A15.12 on 26 September 2025. We received three submissions that we considered in coming to our decision. More detail on these submissions and how we considered them is set out in Appendix 1.

regard to our principal objective and statutory duties.[34] In summary, we consider that it is in the interests of existing and future consumers for the CDSP to be jointly controlled and governed on an economic and efficient basis. This includes ensuring Relevant Users have enough information to meaningfully scrutinise and respond to budgets during the budget-setting process and that the CDSP is taking appropriate action to ensure their costs are efficient.

28. Ofgem's principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. [35]

29. Under the Uniform Network Code (UNC), parties are required to exercise their rights and powers under the DSC so as to jointly control and govern the CDSP on an economic and efficient basis, and to ensure that the CDSP incurs costs efficiently and economically.[36] CDSP costs should therefore be scrutinised and challenged by licensees and other users, and the CDSP should facilitate this through, among other things, transparent reporting of costs and forecast expenditure.

30. We consider that promoting efficiency and economy in the electricity and gas networks is in the interests of existing and future consumers, and therefore consider that it is the interests of existing and future consumers for the CDSP to be jointly controlled and governed on an economic and efficient basis. This includes ensuring that Relevant Users have sufficient information to meaningfully scrutinise and respond to budgets during the budget-setting process, and that the CDSP takes appropriate action to ensure costs are efficient.

31. We have also had regard to our growth duty, which requires Ofgem to have regard to the desirability of promoting sustainable economic growth.[37,38] We consider that the CDSP being controlled on an economic and efficient basis, supported by transparent budgeting, ensures that market participants face predictable and efficient costs, which in turn serves to reduce barriers to entry and enables market participants to allocate resources effectively. More broadly, we consider that the effective operation of the CDSP facilitates an operationally stable gas network, which supports growth in the

[34] The Authority's statutory duties are mainly detailed in the Gas Act 1986 as amended.
[35] The Authority's statutory duties are mainly detailed in the Gas Act 1986 as amended.
[36] Uniform Network Code – General Terms Section D paragraph 1.4.4
[37] The Deregulation Act 2015 Section 108
[38] Growth duty - GOV.UK

sector. We consider that our decision on the appeal represents a proportionate regulatory response that does not, itself, have a negative impact on economic growth.

32. We do not consider that our decision has an impact on any person or class or person, including those with protected characteristics,[39] in terms of the equality duty.[40]

33. In relation to consumers' annual energy bills, we recognise that the CDSP budget does ultimately feed through to consumer bills. However, we do not expect our decision to have any direct impact on these bills as we have not directed a change to the budget (other than a nominal £1.00 change).

34. We consider that each of the grounds of appeal which Centrica has raised go to the question of whether the Budget is fit for purpose (interpreted in light of the wider regulatory regime; as discussed in paragraphs 19 to 21 above) and thus fall within the proper scope of an appeal of this nature. This is discussed further in relation to each ground below.

35. Our conclusion is that the grounds for appeal have been partially satisfied in relation to Grounds 1 [41], 2 [42], and 3 [43], and we are therefore proposing to issue the directions described at the end of our discussion on each ground below and attached to this decision.

The rationale for these decisions is set out below.

Reasons for our decision

Procedure of appeal

36. The first draft of the CDSP Budget was published on 10 September 2021.[44] The appellant notified the CDSP and the Committee of its objection to the CDSP Budget by 15 October 2021,[45] within 20 Business Days after the draft CDSP Budget was sent. This feedback and Xoserve's response were then published on their website.[46] On 28

[39] See section 149(7) of the Equality Act 2010.
[40] See section 149 of the Equality Act 2010.
[41] That Xoserve failed to demonstrate the efficiency of the MTB costs.
[42] That treatment of Intellectual Property Rights for the Contract Management System did not comply with the Data Services Contract and Xoserve failed to objectively identify the delivery model that represented the greatest value for Customers.
[43] That Xoserve's BP22 effectively changed the risk profile to which Customers are expose that was set by a regulatory decision.
[44] xoserve-bp22-first-draft-singles.pdf
[45] business-plan-2022-first-draft-response-centrica.pdf
[46] Business plan

February 2022, the appellant issued a notice of appeal to the Authority appealing the CDSP Annual Budget of 2022-23, within 20 Business Days after the final CDSP Budget was sent to Customers on 31 January 2022.[47] The appellant sets out in their notice of appeal the basis on which they consider the grounds of appeal are met, and the amendment to the CDSP Budget, which they consider necessary.[48]

37. We are satisfied that the appellant has followed the appeal process as set out in the BCM.[49] We have therefore proceeded to fully assess whether the appellant has demonstrated that the Budget is not fit for purpose of the CDSP being able to fulfil its obligations under para 5(b) of SSC 15A.

Grounds of appeal

38. We note that, while the appellant has raised concerns regarding the transparency of the budget-setting process, as well as other concerns relating to the process, it has specifically stated that this was not a ground of appeal. We have not considered these concerns in our assessment of the budget appeal, except to the extent that they further arguments to the grounds presented (for example, if a lack of transparency meant that a budget item unfairly prejudiced the interests of one or more parties). We welcome the efforts that have been made by the appellant and other CDSP Customers in working with Xoserve to develop process improvements since this appeal was lodged.

39. We have assessed the appeal against the "not fit for purpose" appeal criteria set out in Paragraph 4(d) of SSC A15. We have considered whether the Budget is fit for purpose for the CDSP to be able to fulfil its obligation of being a company the purpose of which is to provide CDSP Services (a concept which we interpret in light of the obligations which apply in this context).

40. We consider the non-exhaustive list of scenarios set out above (see paragraph 26) assist us in assessing whether the Budget was fit for purpose within the meaning of SSC A15.

[47] xoserve.com/media/42991/xoserve-bp22-final-version_singles.pdf
[48] Paragraph 4.8.5 CDSP Service Document - Budget and Charging Methodology
[49] Paragraphs 4.8.2 to 4.8.5 CDSP Service Document - Budget and Charging Methodology, Paragraph 4.8.5 CDSP Service Document - Budget and Charging Methodology

41. As to the standard of review, we have not conducted a full merits assessment. By this we mean that we do not consider it appropriate for us to assess whether or not the CDSP made the absolute best value decisions possible in each situation. We consider this to be consistent with our Funding Governance & Ownership (FGO) decision that appeals to Ofgem would be limited to occasions where a party appealed the final Budget on the ground that the Budget would not allow the CDSP to deliver its obligations. Further, that this would be used "in extremis and not as a matter of course", with the majority of concerns to be addressed through the consultation process.[50]

42. For example, our assessment might include whether items in the Budget are manifestly inappropriate (rather than if there were any scope for improved value in that Budget item). We have gone into more detail regarding our standard of review in relation to Ground 1 below.

43. The appellant's grounds of appeal are that the Budget is not fit for purpose because, in its view:

    (i) Xoserve has failed to demonstrate the efficiency of the Maintain the Business Costs;
    (ii) the treatment of Intellectual Property Rights for the Contract Management System does not comply with the Data Services Contract and Xoserve has failed to objectively identify the delivery model that represents the greatest value for Customers;
    (iii) the Xoserve BP22 effectively changes the risk profile to which Customers are exposed that was set by a regulatory decision.[51]

44. In addition, we consider the submissions supporting the appeal that were received from OVO Energy[52], E.ON Energy[53], and GTC Infrastructure.[54]

45. Xoserve contend that the appeal is not valid. They argue that the appellant's grounds of appeal cover a wide range of topics that extend beyond the scope of the Budget and do not satisfy the requirements of an appeal that is based on whether BP22-23 is fit for purpose.

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[50] Completion of the Xoserve funding, governance and ownership (FGO) implementation phase | Ofgem
[51] Decision on our review of gas transporter agency (Xoserve) costs in RIIO GD1 and T1 | Ofgem
[52] Letter 11th March 2022.
[53] Letter 14th March 2022.
[54] Letter 14th March 2022.

46. Below, we consider whether, in relation to each of its three grounds of appeal, the appellant has demonstrated that the Budget is not fit for purpose for the CDSP to be able to fulfil its obligation of being a company the purpose of which is to provide CDSP Services.

Ground 1 - Xoserve have failed to demonstrate the efficiency of the Maintain the Business Costs.

Context

47. The appellant argues that Xoserve did not provide adequate evidence or explanation to demonstrate the efficiency of the Maintain the Business (MTB) costs included in the 2022-23 Budget. The appellant proposes the following remedies:

- the 2022-23 CDSP Annual Budget be reduced by an amount equivalent to the application of an annual ongoing efficiency rate to the MTB costs in the CDSP Annual Budget in BP20 and, subsequently, to the MTB costs in the 2021-22 CDSP Annual Budget in BP21;
- that the annual ongoing efficiency rate should be set by default to 1.2% or at a value deemed appropriate by the Authority; and
- that a direction be issued that requires Xoserve to robustly evidence that the budgets it proposes in future business plans are economic and efficient.

48. The appeal is raised against the CDSP Service Budget item of MTB. MTB costs are the costs for Xoserve's day-to-day CDSP activities under the Data Services Contract (DSC) that represent the cost of delivering the CDSP Services.[55] In other words, it funds the costs of the people, systems, and support costs for Xoserve and its service providers to meet the requirements of the CDSP Services. The MTB costs for BP22 are £52.1m, comprising 66% of Xoserve's total expenditure (TOTEX).

Does the appeal ground go to the question of whether the Budget is fit for purpose?

49. Xoserve contend that the appeal is not valid as, in their view, the appeal does not go to the question of whether the Budget is fit for purpose. However, we consider this

[55] Business Plan 2022, xoserve-bp22-final-version_singles.pdf.

ground of appeal to be a question as to whether the Budget is fit for purpose in relation to the obligation, set out in Para 4(c)(i) of SSC A15, on the licensee, together with the RGTs, to ensure that the UNC sets obligations on the licensee and certain other users of CDSP Services to jointly control and govern the CDSP on an economic and efficient basis.

50. This is because Relevant Users need to be able to properly assess costs and whether they are efficient in order to "jointly control and govern the CDSP on an economic and efficient basis".

Centrica's position

51. Centrica contend that Xoserve have not evidenced the efficiency of the MTB costs, including in the drafts or the final versions of BP22, in other documents published as part of the BP22 planning cycle, or at Contract Management Committee (CoMC) meetings held during the BP22 planning cycle. Centrica provides that:

- Xoserve setting MTB costs in BP22 at the same level as forecast in BP20 and BP21 does not demonstrate efficiency as the costs forecast in those budgets did not show evidence of efficiency;
- 'locking in' MTB cost forecasts from previous planning cycles prevented any efficiency gains that could have been made during the latest planning cycle;
- the Xoserve Cost Efficiency Review for 2019-20 Budget does not endorse the MTB costs as efficient because the review identified opportunity for efficiency savings that warrant further investigation and analysis of the cost group.[56] Even if it did, it could not be used to assume forecasts for 2022-23 in BP20 as it would not account for efficiencies realised since BP20 was finalised in January 2020;[57]
- Xoserve failed to demonstrate that third-party costs were efficient – which was particularly relevant as Xoserve's direct cost base materially reduced as a result of the sale of Correla;
- testing the market, given the extent to which a sole third party (Correla) were engaged to deliver CDSP Services, would have helped to demonstrate the efficiency of the MTB costs allocated to third-parties;

[56] Paragraph 124 of the appeal notice.
[57] Paragraph 123 of the appeal notice.

- contractual commitments to not disclose third parties' costs should not prevent Xoserve from disclosing its own 'internal' expenditure at a sufficiently granular level;
- it is unclear whether the purpose of the rebate given to Customers resulting from Xoserve's sale of Correla was solely that of the net proceeds of the sale or whether it was possible for it to include a value for forecast efficiency gains and, if the latter, it is unclear what these efficiencies are or how they're realised;[58]
- Xoserve appear to 'double-count' some efficiencies arising from investment that has already been funded in previous business plans.[59] This would be the case if the efficiencies were part of the valuation of Correla, then they cannot also be considered as efficiencies in BP22.

Xoserve's position

52. Xoserve's overall position is that the appeal is not valid because it does not go to the question of whether the Budget is fit for purpose (which we have addressed above). In response to Centrica's first appeal ground on efficiency of the MTB costs, Xoserve argues that Centrica's proposed remedy of a 1.2% reduction to MTB is arbitrary and that such a reduction would mean that the MTB costs no longer reflected the cost of delivering the service.

53. In their response to the appeal, Xoserve acknowledge that the direct costs to shippers have increased due to changes in the scope of the services. However, they state that the overall costs of CDSP Services on a like-for-like basis have decreased. In information provided to us, they describe the evolution of Xoserve's total costs since 2017-18, including inflation uplifts since this year, and Shipper Charges by year since 2017-18 and the proportion of the General Charges funded by Shippers.[60]

54. This aligns with BP22 itself, where the MTB chapter provides an explanation of year-on-year movements from March 2022 to March 2025. This explains that there has been an overall increase in costs from year-to-year but that this increase has been driven by scope changes to the service. In a like-for-like comparison of the scope, Xoserve argue there have been savings.

[58] Paragraphs 127 – 135 of the appeal notice.
[59] Paragraphs 127 – 138 of the appeal notice.
[60] Xoserve's response to notice of appeal received 14 March 2022.

55. Further, Xoserve argue that savings have been achieved in specific projects. They explain that, despite the overall increase due to scope changes, within the baseline MTB charges (where the scope is the same) there is a "reduction of £2.7m over the first two years" from £53.8m to £51.8m in the baseline MTB.[61,62] Xoserve retain an assumption in BP22 from BP20 and BP21 where it was forecast that baseline MTB costs would reduce in 2022-23 and 2023-24, on a like-for-like basis, for those years.

56. Additionally, the following paragraphs describe the responses Xoserve made to questions raised throughout the consultation process on the efficiency of MTB costs, the benefits of these costs, the controls that they have in place in the budget-setting process, and relating to independent review of costs.

57. In response to Centrica's feedback on the second draft of BP22, Xoserve state that the key benefit to consumers in MTB "is in the centralisation of data services on a mutualised basis across the gas industry."[63] Xoserve argue that benefits of investments made since the cost efficiency review they conducted in 2018 have been set out and published in BP22 as a MTB waterfall diagram illustrating BP20, BP21, and BP22.[64] These include, "Maintaining and Improving our Services cost reductions (2020-21 -£2.4m, 2021-22 -£2.0m and 2022-23 -£1.0m a total of -£5.5m over 3 years)" and savings related to two of five BP22 priorities and investment focus areas, UK Link (2023-24 -£0.7m) and Exceptional Customer Experience (2022-23 -£1.0m).[65] Further, Xoserve argue that an efficiency benefit in MTB, relating to the sale of Correla, of £3.8m was identified and communicated to Customers as part of BP21, and "has and will be delivered over a period of three years".

58. In response to Centrica's feedback on the second draft of BP22, suggesting that Xoserve should detail their processes on its assurance of third-party costs, Xoserve explain that their assurance processes applied to third-party costs "can be broadly separated into two key phases: Pre and Post Business Plan approval".[66] According to Xoserve, the pre-business plan approval includes review of investment proposals, needs assessment, assessment of cost appropriateness, review of each business case ensuring that they clearly articulate customer benefit, why the investment represents value for money, and how success will be measured. The post-business plan approval

[61] Figure 04 - year-on-year MTB movements in costs (in £m) from April 2022 through to March 2025, xoserve-bp22-final-version_singles.pdf
[62] business-plan-2022-feedback-and-responses-on-second-draft.pdf (xoserve.com)
[63] business-plan-2022-feedback-and-responses-on-second-draft.pdf
[64] Business plan (xoserve.com)
[65] business-plan-2022-feedback-and-responses-on-second-draft.pdf (xoserve.com)
[66] business-plan-2022-feedback-and-responses-on-second-draft.pdf

process is an assurance process for the delivery of each project against stated aims of the investment and benefits.[67]

59. Regarding the ongoing "run" services funded by MTB, and in part a response to providing further breakdown to MTB costs, Xoserve state that they have "verified that (i) the baseline MTB (same scope) reflects what was approved in BP21; (ii) that the changes proposed to the previously approved baseline MTB Budget appropriately reflect changes in the "run" scope; and (iii) that no costs have been added arising of the creation and sale of Correla".[68]

60. In response[69] to an Ofgem letter relating to an Appeal of the CDSP Annual Budget 2020-21 raised by Centrica (which was later withdrawn)[70], Xoserve committed to ensure that in accordance with the Principles and Approach document for Business Plan 2022 (BP22),[71] they would ensure that BP22 clearly articulates the basis on which they have assessed each investment to be either a CDSP Service or is required to manifestly facilitate the efficient delivery of CDSP Services in each document published, and that they would highlight the addition of this information through their engagement with the DSC Contract Management Committee.

61. Further, following the Ofgem recommendation, they committed to implementing a dedicated Board assurance statement in BP22. BP22 includes a 'Board Assurance Statement' which confirms the activities Xoserve have undertaken to scrutinise and assess BP22, and the considerations they have taken into account when doing so, to provide assurance to Customers that the cost of the CDSP Services provided by Xoserve under DSC is appropriate. This includes a Board assurance that the MTB costs in BP22, "reflects maintain the business (MTB) costs that include the savings identified in the BP21 Business Plan, have not been increased as a result of the creation and sale of Correla in March 2021 and are provided to an appropriate level of detail".[72]

62. In response to feedback through the 2022 Business Planning process, including from the appellant, Xoserve acknowledged customer desire for enhanced external

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[67] business-plan-2022-feedback-and-responses-on-second-draft.pdf, page 11.
[68] business-plan-2022-feedback-and-ronses-on-second-draft.pdf
[69] https://www.xoserve.com/media/42723/xoserve-reply-to-ofgem-april-2021.pdf
[70] Ofgem Letter from Cathryn Scott, 'Appeal of the CDSP Annual Budget 2020/2021', dated 6 April 2021 ofgem-letter-to-xoserve-april-2021.pdf.
[71] xoserve-bp22-final-principles-and-approach_singles.pdf
[72] xoserve-bp22-final-version_spreads.pdf p40

challenge on the CDSP Budget and proposed a third-party efficiency review that could be included in the BP23 costs.[73]

63. Xoserve appointed a management consultancy to conduct this review of their expenditure for the financial year 2022-23 (the Report). We consider the findings are therefore relevant to BP22 budget appeal. Xoserve published a summary of this review in September 2023.[74] A full copy of the Report was also shared with the Authority by Xoserve. Xoserve state that the objective of the review was to redefine their services and costs "in such a manner as to increase their comparability with external benchmarks".[75]

64. The review covers 80% of Xoserve's expenditure, which includes 60% of their cost to operate expenditure. It assesses Xoserve performance against comparators and benchmarks, which included other bodies within code governance arrangements. The review found that across 20 metrics Xoserve roughly fell in line with peers. The summary of the consultancy's findings states that Xoserve's 'cost to operate' generally performed well against benchmarks, "with half at upper performance, a quarter at median and quarter at lower quartile', with exceptions in reporting and assurance. Whilst 'precisely sizing the efficiency opportunity is difficult, as the volume and nature of change can vary and visibility into how change is delivered could be improved', in other typical assessments 5 to 15% savings can be achieved. By comparison, based on the review of the costs in scope, the consultancy found an efficiency opportunity of the CDSP Budget of between 2 to 8%.

65. Of the specific areas identified for improvement as lower quartile in cost to operate, 'Gas vs. electricity enquiry services' (GES) accounts for £2.7m (11%) and 'Reg. & reporting proportion of total cost' 3.7m (16%) of assessed 23.6m spend. The report provides some contextual commentary, such as "Regulatory and reporting costs ranks higher than the typical spend in the industry, potentially due to the single governance code in the gas industry" but recommends further investigation by Xoserve as to whether reporting costs can be further optimised. Of the areas identified as median performance, namely invoicing, the Report finds that Xoserve performed 'in-line with utility comparators' and 'is competitive when considering the complex invoicing process'.

[73] https://www.xoserve.com/media/43490/bp23-draft-pa-response-to-centrica-final.pdf
[74] Efficiency-Review-Summary-September-2023.pdf
[75] Efficiency-Review-Summary-September-2023.pdf p2

Sufficient opportunity to scrutinise the MTB costs

66. We note that in Appendix 2 of their appeal notice, Centrica have set out their concerns with the process Xoserve have undertaken. As above, Centrica have provided that these do not form a part of their grounds of appeal. As a result, we have only considered aspects of these transparency issues as they relate to the grounds of appeal in the notice of appeal.

67. Here, we consider that the question of whether users were provided sufficient opportunity to scrutinise the Budget goes to whether the Budget is fit for purpose in relation to the obligation to ensure that the licensee and other users of CDSP Services jointly control and govern the CDSP.

68. Xoserve explain that in response to feedback for more transparency through the business planning and consultation process, their draft and final versions of BP22 included an expanded explanation of MTB.[76] The final version of BP22 then breaks these services down into service areas. Investments are categorised by five core focus areas, that represent the CDSP Service priorities for the upcoming business plan period, as well as three focus areas driven by market changes, irrespective of how this is split between Xoserve's costs and third-party costs. A breakdown of MTB costs across the Service Areas set out in DSC is also provided. The final draft of BP22 contains a breakdown of the charges. The 15 'general services' account for approximately 92% of the MTB costs in BP22, split into 13 service areas and two further service areas covering Gemini activities and the Data Discovery Platform (DDP).

Standard of review

69. As described above, we consider the question of whether Xoserve have failed to demonstrate the efficiency of the MTB costs is an aspect of considering whether the Budget is fit for purpose in allowing users of CDSP Services to jointly control and govern the CDSP on an economic and efficient basis. As this is a question of whether the Budget is set at too high a level, we consider that the Budget will likely not be fit for purpose in allowing users to jointly control and govern the CDSP on an economic and efficient basis where:

[76] xoserve-bp22-final-version_spreads.pdf p3

69.1 the Budget contains one or more items that are not legitimate items of expenditure for a CDSP, or

69.2 the Budget contains one or more items that are manifestly inappropriate provisions for the activity in question, and there are insufficient safeguards in place to ensure that the actual costs incurred will be efficient; or

69.3 the Budget contains one or more item(s) that will, or are likely to, prejudice unfairly the interests of one or more Parties, or cause them to be in breach of UNC, the Energy Licences and/or Law.

70. In making this assessment, we do not consider it appropriate for the Authority to step into the shoes of the CDSP and, line by line, consider whether or not the CDSP made the absolute best value decisions possible in each situation. It is clear to us from the regulatory framework[77] that industry scrutiny, rather than Ofgem's scrutiny, was deemed most appropriate for this role of line-by-line scrutiny. As a result, we consider our role in assessing whether a budget is fit for purpose with regard to users being able to jointly control and govern the CDSP on an economic and efficient basis to be an assessment of where the budget, or budget item(s), is clearly inappropriate for the provision of the service in question – rather than taking a full merits approach.

71. Therefore, in assessing the question of efficiency of the MTB costs we have referred to the standard of whether the Budget contains one or more item(s) that are manifestly inappropriate provisions for the activity in question, and that there are insufficient safeguards in place to ensure that the actual costs incurred will be efficient to allow us to understand whether the Budget is fit for purpose with regard to users jointly controlling and governing the CDSP on an economic and efficient basis.

72. We also note that the appellant has specifically provided that procedural points relating to transparency do not form grounds for their appeal.[78] However, as discussed below, where issues of process and transparency go to the ground in question (here whether users of CDSP Services were able to jointly control and govern the CDSP on an economic and efficient basis) we have considered them as a part of that question.

73. In this way, as set out below, we have considered whether the processes used by, and manner in which, Xoserve engaged with Relevant Users on the setting of MTB

[77] Decision on our review of gas transporter agency (Xoserve) costs in RIIO GD1 and T1 | Ofgem
[78] Notice of Appeal, paragraph 5.

costs (and particularly relating to the demonstration of the efficiencies of those costs) prevented those users from jointly controlling and governing the CDSP on an economic and efficient basis and therefore whether the Budget was fit for purpose in this manner.

Our view on whether sufficient opportunity was given to scrutinise the MTB costs

74. We consider that, at least, the provision of information to Relevant Users through the budget-setting process was lacking. We acknowledge that Xoserve made changes following feedback on the second draft of BP22 to include an expanded explanation of MTB costs, including a breakdown of costs across 15 service areas accounting for approximately 92% of the MTB costs. However, this would have been beneficial to users far earlier in the process to allow them to properly scrutinise costs and provide feedback in a manner that would allow them to influence the final version of the Budget, and thereby jointly govern and control the CDSP to ensure the MTB costs were economic and efficient. In our view, the lack of this information throughout the decision-making process, and particularly in time to make representations in the consultation period, hampered users’ (including the appellant's) ability to do so.

75. This said, even had this information been provided at an earlier stage in the process, we consider the CDSP should have done more to facilitate users’ (including the appellant’s) ability to scrutinise the MTB costs.

76. An example of the kind of information we would expect to be provided during the process to increase transparency includes:

- more detailed information regarding the cost reductions and efficiencies that are described in the business plan;
- further breakdown of costs, for example into direct and outsourced categories;
- inclusion of more detailed evidence in the Board Assurance Statement;
- further information on areas of uncertainty that Xoserve will be monitoring;
- a summary of what is amended through the process as a result of stakeholder feedback;
- additional information on rebates and forecasts for rebates in the BP, including a table with the total amount that will be published the Annual Charging Statement, the budget element such as Service and Operate, rationale for why the rebate is due and how they are split across years, for example Y-1 and Y-2; and

- a breakdown of charges, rebates and additions from prior years, which includes how the rebates or additions are split across users, the budget element such as Service and Operate and how they are split across years, for example Y-1 and Y-2.[79]

77. We understand it would not be possible for the CDSP to provide a breakdown of third-party costs to users as part of the budget-setting process, as this would divulge information that is confidential owing to contracts for services with those third parties. However, we do not consider that should prevent the CDSP from breaking down their own costs in the manner detailed above.

78. We note that we consider the timing for, and format of, providing this information should be considered in how to ensure users are able to properly scrutinise those costs. In our view, there was an over-reliance on iterative updates to the BP22 through the consultation process and information and materials presented at CoMC meetings. This made it difficult for users to fully engage from the outset with material that was shared and, as discussed above, other information was provided too late in the process.

79. As a result, we do not consider that the appellant was provided with an appropriate ability to scrutinise the MTB costs in the process for setting BP22 and thereby jointly govern and control the CDSP on an economic and efficient basis.

80. We note that our findings in this section relate to the processes used by Xoserve to engage with Relevant Users on the setting of MTB costs and not to whether the MTB costs themselves were efficient or otherwise. We discuss the substance of the MTB costs in more detail below.

Our view on the efficiency of the MTB costs

81. Below we discuss each of the arguments raised by Centrica individually, and then discuss the overall question of the efficiency of the MTB costs.

82. Retaining 2020-21 cost profiles overlooked efficiencies - locking in efficiency forecasts prevents realising efficiency gains made since the forecasts / 2018 efficiency report:

[79] CDSP Annual Charging Statement 2024_25.pdf

82.1 We agree that the presentation of information in BP20 and BP21 was in a similar style to that presented in the BP22 process discussed above. As a result, it is hard to see from those budgets (without additional information) whether the forecasts were efficient or inefficient.

82.2 Likewise, we agree that it is possible that certain efficiencies may have arisen between when those efficiency forecasts were made in 2020-2021 and the making of BP22. Any such efficiencies could necessarily not have been included in the forecasts. That said, we do note that rebates have been issued owing to efficiencies found later (see BP25 table 4a), so a safeguard does exist to allow the inclusion of efficiencies found after the forecasts were made.

83. <u>Third party costs / not testing the market</u>:

83.1 Two of the levers available to Xoserve in the DSC+ contract with Correla (that cover most of the MTB costs) are market testing (conducted by Xoserve with support from Correla) and market monitoring (conducted by Correla to ensure Xoserve receive competitive rates for essential delivery items).

83.2 The 2023 efficiency report reviews the use of all levers under the contract. As at the time of the review, market testing had yet to be conducted and market monitoring had been used occasionally with work underway to use it more pro-actively. The Report suggests utilising these levers more frequently as a key step in finding the efficiency opportunities within the C2O area – particularly given the fixed cost structure of the contract.

83.3 Given the relatively early stage in the contract (at the time of BP22) we do not see this (particularly in the case of market testing) to be so egregious as to mean the MTB costs are manifestly inappropriate provisions for the activities in question and that there are insufficient safeguards in place to ensure the actual costs incurred will be efficient. In fact, it is not necessarily determinative of whether the costs are efficient or not.

83.4 However, it is a key tool in helping to understand whether or not costs are efficient (and then if they are not, to help in adjusting accordingly). As the contract progresses, we would expect to see these types of levers utilised to ensure (a) Xoserve and users are able to appropriately scrutinise the MTB costs, and (b) the MTB costs are efficient.

84. <u>Disclosure of internal expenditure at sufficiently granular level</u>:

84.1 We have dealt with this in relation whether a sufficient opportunity was provided to the appellant to scrutinise the MTB costs (paragraphs 74 – 80 above). We note that a breakdown of the costs was provided in the final version of BP22.

85. Purpose of the Correla rebate / double counting:

85.1 Following the sale of Correla to Northedge, Xoserve provided a rebate to Customers in the form of a credit note that was paid directly to Customers in March and August 2021.[80,81] When setting the principles and approach for BP22 in July 2021,[82] and when notifying Customers by letter of the credit note,[83] the reason given for this was that this was the net proceeds of the sale of Correla, and passed back to Customers by way of a credit note rebate against the general charges payable under Business Plan 2020-21.[84] At this stage, no specific mention was made of the rebate including forecast efficiency savings valued by Northedge in the purchase price (this was not mentioned until November 2021 in relation to the Feedback and Responses – BP22 First Draft).[85] Here, and since, Xoserve have provided that the potential efficiencies identified in the sale by Northedge were reflected in the sale price and paid upfront to Customers in the credit note rebate.[86]

[82] "MTB for BP22 will reflect the savings promised in BP21. Additional savings from future digitalisation and automation activity were forecast and included in the sales and valuation process which led to the formation and divestment of Correla by Xoserve. The benefits from this divestment have already been passed back to Customers by way of a rebate against the general charges payable under BP20 "xoserve-bp22-final-principles-and-approach_singles.pdf, page 15.
[83] Appeal notice, paragraph 129.
[84] The CDSP will be run as a not-for-profit organisation with funding coming from all users. Xoserve - decision in relation to new funding, governance and ownership arrangements for the gas transporters' central agent | Ofgem.
[85] 2022-business-plan-feedback-and-responses-on-first-draft.pdf, page 7
[86] "At the point of the sale of Correla, all known efficiency improvements for the year ahead (2021-22) and the subsequent two years were already identified and communicated to Customers as part of BP21" and "The valuation of future efficiencies arrived at by the highest bidder in the sale process was reflected in the sales price and ultimately the rebate to Customers. This amount is in addition to the £3.8m identified already as part of BP21. The extent of competition throughout the sale process is what gives us confident we achieved best value for money as a result of the restructure." xoserve-bp22-second-draft_singles-final.pdf. Further, "The sale of Correla to Northedge was based on Northedge's assessment of the future performance of Correla. As with most business valuations, this included an assessment of potential future efficiency savings which might be able to be derived from the on-time and on-budget completion of current in-flight investments, alongside any potential further internal investments that Northedge were prepared to fund. Since the sales proceeds reflected Northedge's view of potential savings, the rebate of those sales proceeds to Customers did too, meaning that Customers received the benefit of those potential savings through the reduction in 2020-21 charges that the rebate of sales proceeds created. Any further risk associated with achieving these future efficiency savings now sits with Correla and Northedge, rather than with Customers, meaning that any future benefit has been "liquidated" up front." 2022-business-plan-feedback-and-responses-on-first-draft.pdf, page 7.

85.2 However, we do not consider these to be exclusive or necessarily evidence of "double-counting". It is clear that the sale of Correla resulted in Xoserve issuing the credit notes for Customers against general charges payable under Business Plan 2020-21 as a result of the sale (because Xoserve are not for profit and the proceeds of the sale would have otherwise given them a profit). At the time of issuing the rebate, it was not stated what factors went into the valuation of Correla by Northedge. In our view, it is reasonable that one of the factors in doing so is the potential of the asset – including its potential gains in efficiency. If that potential increased the valuation in a manner that led to profit, any resulting rebate would represent that profit made as a result of the potential efficiencies.

85.3 In our view, it is reasonable to assume the sale included value for forecast efficiencies. However, having not found, or been provided with, evidence detailing a breakdown of these values it is impossible for us to provide a view on the extent to which the credit note rebate related to efficiencies of the MTB costs.

85.4 The appellant argues that Xoserve's explanation as to the purpose of the rebate in FY2020-21 is not clear. In their view the reason for the rebate in FY2020-21 was proceeds of the sale and that BP22 could not claim an additional rebate for efficiencies on MTB, if this was restating the rebate for proceeds of the sale. For this reason, Centrica claim that rebates were "double counted" as proceeds of the sale and efficiencies in the delivery of MTB.

85.5 In our view, Xoserve's explanation as to the reason for the credit note rebate is insufficiently clear as to the breakdown of the cost of sale, including elements that related to efficiencies of the MTB costs. We note that Table 4a of the 2024-25 Annual Charging Statement does provide a rebate against "Service and Operate" (which is the new name for MTB) for the 2022-23 year. However, it is not clear if, or to what extent, these costs reflect efficiency savings as opposed to general underspend (eg for vacant roles). Whilst this lack of clarity is consistent with our view that Xoserve did not ensure licensees could jointly govern and control the CDSP (i.e. in terms of process), it does not necessarily amount to double counting of efficiency costs or the Budget being one that was inefficient to the extent that it was manifestly inappropriate and therefore unfit for purpose. We discuss our view on the MTB cost efficiency below.

86. <u>Overall view on MTB cost efficiency:</u>

86.1 A key resource in understanding the efficiency of the MTB costs in BP22 that only became available later is the 2023 Efficiency Report conducted by an independent assessor.[87]

86.2 This Report assessed 80% of Xoserve's cost base (£64.6m out of a total £82.8m). Within this, roughly 60% of the MTB costs (labelled "Cost to Operate" or "C2O" in the Report) were tested for efficiency (the roughly 40% of these costs not directly assessed was due to a lack of applicable benchmarks). As a result, the Report cannot provide a complete view of efficiency for the MTB costs in BP22. However, in our view it does provide the best insight we have into the efficiency of those costs.

86.3 Of the costs assessed, the Report concludes that Xoserve have an efficiency opportunity in the range of 2-8% and provides that, "…in other typical assessments we have seen 5-15% savings achievable with good confidence". This 2-8% opportunity is an assessment across all costs – with the report providing that Costs to Change (C2C) represents the largest opportunity area with C2O (i.e. the equivalent of MTB costs and what we're considering here) yielding a lower opportunity – in part due to the structure of the contract with Correla being a fixed charge setup.[88] The Report provides that Xoserve generally benchmark well including against other similar utilities bodies.[89]

86.4 We consider that savings of 2-8% are by no means trivial, and we encourage Xoserve to use the Report's findings to seek these efficiencies. However, 2-8% being within (and indeed toward the lower end of) the range of efficiency opportunities typically seen in these types of reviews presents a view that this level of opportunity does not go as far as to make the Budget manifestly inappropriate in the manner it provides for MTB costs.

86.5 In our view, there is a gap between having a relatively low opportunity to realise efficiencies within the business and the costs in place being manifestly inappropriate for a CDSP. The Report provides a similar analysis, "A good performance against assessment does not mean that there is not further opportunity for efficiency, as we recognise that other energy industry bodies are also not likely at the efficiency frontier given structural reasons that drive higher cost for the industry (eg low risk tolerance, complex industry flows)."[90]

[87] Xoserve Efficiency (Value for Money) Review, Final Report, 13 September 2023. Xoserve Efficiency Review Summary Report, September 2023, Efficiency-Review-Summary-September-2023.pdf
[88] Page 29 of Efficiency report
[89] Page 19 of the Efficiency Report.
[90] Page 15 of the Efficiency Report.

86.6 Whilst we note that the Report does not cover the entire MTB cost base, the Report does provide a view on the efficiency of the majority of those costs (those costs that were not assessed being those with no readily available benchmarks to compare to). We have also not seen evidence that the remainder of those costs are inefficient. Noting, as described above, that we consider the CDSP's process and transparency has not be sufficient/adequate to allow an appropriate level of scrutiny across the MTB costs by Customers.

86.7 We note that, now that the CDSP has identified these efficiency opportunities, it may not always be the case that it is reasonable to have that same opportunity persist in the future – although any future consideration would necessarily need to assess the circumstances as they stood at the time. In particular, due to the lack of available benchmarks for the ≈40%, we would expect the CDSP to be testing the market to ensure that, where services represented by the costs within the ≈40% are provided by Correla, they are efficient and represent market value.

86.8 With this said, we note BP25 includes provision for the Efficiency Review Implementation in Xoserve (ERIX) Programme that looks to improve the value of CDSP Services by making them more economic, efficient, or effective.[91] This work is being conducted in collaboration with Customers. Xoserve set out the initiative, progress, impact to date and in-flight ERIX initiatives, that include recommendations from the 2023 efficiency report such as market testing and market monitoring. Xoserve committed to reducing Service and Operate (previously MTB) costs by 9% compared with the 22-23 baseline (noting that this was a higher amount than that identified as potential opportunity by the assessor). This appears to us to reinforce our position that the level of efficiency opportunity to be found in the Budget is not manifestly inappropriate.

86.9 Additionally, when setting their approach for setting BP24, Xoserve committed as a principle to articulate Value for Money (VfM).[92] For example, Xoserve set out that the efficiency initiative would seek to further reduce S&O costs Customers would pay per meter. Xoserve set out that per meter costs had reduced from £2.40 per-meter-point in 22-23, to £2.29 in 23-24 and that the initiative in BP24 would seek further reductions to £2.19 per meter by 26-27. Xoserve also stated that there had been per-meter costs reductions in S&O and that further reductions were being committed to in BP24 is confirmed in

[91] bp25-business-plan-final-version-spreads.pdf, pages 39-41
[92] xoserve-annual-review-2023_24.pdf

the Board Assurance Statement that 'the Company has already delivered ongoing real-terms reductions in core service and operate costs since 2020'.[93]

86.10 As we have not seen evidence / a breakdown of the rebate following the sale of Correla, we cannot comment on how it may impact on the efficiency of MTB costs charged to users. We note that rebates have been provided to users where efficiencies have been found (including in relation to MTB costs). For example, Table 4a in the 2024-25 Annual Charging Statement provides a rebate against "Service and Operate" (the new term for MTB costs) in the amount of £968,000 (although this does not relate to costs incurred from Correla). It is not yet clear that similar rebates provided in the 2024-25 Annual Charging Statement relate to costs and services attributed to Correla.

86.11 As part of a budget-setting process, it is reasonable to expect that there will be some discrepancies between forecast costs and how they crystalise in reality (as budgets are attempting to predict the future). Here it appears that where costs have been found to be less than predicted, rebates have been provided. This appears to us to show that safeguards are in place to return to Customers funds where additional efficiency savings can be found following the making of a budget.

86.12 As a result, we do not believe that the MTB costs provided for in BP22 were manifestly inappropriate provisions for the activities in question with insufficient safeguards in place to ensure that the actual costs incurred will be efficient. Therefore, we consider that the level at which the MTB costs were actually set at did not mean the Budget was not fit for purpose because users were prevented from setting the MTB costs on an economic and efficient basis. Although, as above, we do find that the process for setting BP22 did not do enough to allow the appellant to properly scrutinise the costs and therefore, in terms of transparency, they were prevented from jointly controlling and governing the CDSP on an economic and efficient basis.

Remedies

87. Therefore, we do not consider that it would be appropriate for Ofgem to direct that the Budget is changed as a result of these findings, other than a nominal value of £1 to meet the requirements of paragraph 11(a) of SSC A15. Instead, in the attached direction, we direct that, in future budget-setting processes:

[93] business-plan-bp24-final-version-spreads.pdf

- Xoserve share with Customers sufficiently granular information to allow Customers to meaningfully scrutinise and respond to budgets during the budget setting process, thereby allow Customers to jointly control and govern the CDSP on an economic and efficient basis;
- where appropriate, Xoserve look to testing the market in relation to MTB costs provided by Correla to ensure that users are able to assess the efficiency of the costs of services provided by Correla;
- Xoserve ensure that Board Assurance Statements are accompanied by evidence of why the Board is comfortable with the content of the statement as well as, where appropriate, an explanation of how the Board reached that conclusion;
- Xoserve collaborate with Centrica, and with other Relevant Users, to consider any additional steps which could be taken as a result of Ofgem's decision on Ground 1.

Ground 2 - The treatment of Intellectual Property Rights for the Contract Management System does not comply with the Data Services Contract (DSC) and Xoserve have failed to objectively identify the delivery model that represents the greatest value for Customers.

Context

88. In March 2021, Xoserve completed the sale of Correla Ltd to NorthEdge Capital LLP. Xoserve separated into two companies – Xoserve and Correla. Correla have since been sold to a private investor but continue to deliver CDSP Services to industry on behalf of Xoserve via a DSC+ contract.

89. As a part of this arrangement, Xoserve initiated a project to put in place a new contract management system (CMS). CMS is a workflow management system designed to manage all customer interactions that orchestrate key industry processes. This works on a 'subscription model' where Customers pay a subscription fee for delivery of the CMS, which is owned and provided by Correla.

Does the appeal ground go to the question of whether the Budget is fit for purpose?

90. This ground of appeal relates, in part, to an argument that Xoserve have not complied with their obligations under the DSC. The appellant argues that Xoserve's treatment of the CMS IPR does not comply with the DSC and that the option Xoserve have opted for in this regard allows a third party to own and benefit from the IPR (while an option

that involved Xoserve retaining ownership of the IPR was discounted). The appellant argues that the third-party ownership of the IPR is an integral part of the option and cannot be separated from the investment. The question then becomes one of whether provision for this investment in the Budget is illegitimate because of this. We consider that where a budget provides for expenditure that is illegitimate for the CDSP, that Budget may not be fit for purpose in relation to the obligation on licensees to jointly control and govern the CDSP on an economic and efficient basis. We therefore consider that this question does go to the question of whether the Budget is fit for purpose.

91. Additionally, under this ground, the appellant argues that Xoserve have not objectively demonstrated that the delivery model for the CMS offers the best value to consumers. In Centrica's view Xoserve have not provided sufficient clarity on the costs and benefits of each approach by which the CMS investment could be funded and does not fully justify that the subscription-based option delivers better value for consumers.[94] Additionally, they allege the CDSP did not provide Relevant Users with the relevant information that would have allowed them to assess and compare the options more fully.

92. We note that Xoserve contend that the appeal is not valid as, in their view, the appeal does not go to the question of whether the Budget is for purpose. However, we consider this ground of appeal to be a question as to whether the Budget is fit for purpose in the context of the obligation to jointly control and govern the CDSP on an economic and efficient basis.

Centrica contend that Xoserve: (a) have treated IPR in a manner that breaches the DSC, (b) have not presented a full cost-benefit analysis of the CMS options it considered, (c) have not demonstrated that the subscription-based funding model for the CMS represents the greatest value for Customers, and (d) excluded alternative approaches to the CMS that should have been considered

93. Centrica contend that Xoserve's treatment of intellectual property rights (IPR) in the contract management system (CMS) breaches the provisions of the Data Services Contract (DSC). Therefore, as treatment of the IPR cannot be separated from investment in the CMS itself, provision for the CMS in the Budget is illegitimate.

[94] business-plan-2022-feedback-and-responses-on-second-draft.pdf (xoserve.com)

94. Centrica also contend that Xoserve have not identified the delivery model that represents the greatest value for Customers. Centrica set out Xoserve's engagement at a series of meetings, when the model was first introduced and subsequently during the BP22 consultation process, where they and other Customers requested additional information and information in writing. They argued that, in each instance, insufficient information was provided for Customers to objectively determine their preferred model, or to support a direct comparison of the options.

- First, they argue that Xoserve did not disclose the costs of delivering and operating the CMS via both delivery models, thereby preventing them from being compared on a like-for-like basis.
- Second, they were not able to assess whether the difference between the total of the annual subscription fees to be charged to Customers and the total of the costs of delivering and operating the CMS via the 'subscription model' delivers better value for money for Customers.
- Third, Centrica argue that Xoserve have not disclosed the costs of the mitigation measures that address the key risks associated with the 'subscription model' that could materialise if the DSC+ contract is terminated or not renewed.
- Fourth, Centrica contend that Xoserve have not disclosed the benefit of the chosen delivery model (for example, in comparison to owning and leveraging the IP in the CMS).
- Fifth, Centrica conclude that taken together, Xoserve have not demonstrated the 'subscription model' delivers better value for money for Customers and, by consequence, consumers (including by showing a robust cost benefit analysis).
- Sixth, Centrica proffer that Xoserve have not shown more than two options, which would have allowed further assessment of whether it was possible to seek further value for Customers and consumers.

95. Centrica have suggested the following remedies:

- a direction requiring Xoserve to retain ownership of the intellectual property rights associated with the CMS, so as not to contravene the DSC;
- a direction requiring Xoserve to conduct a robust cost-benefit analysis to identify the CMS that represents best value for money for Customers (which would be consulted on before identifying delivery model);

- a direction requiring Xoserve to seek Ofgem's approval before settling on a CMS investment option.

Xoserve's position

96. In response to Centrica's appeal that the treatment of Intellectual Property Rights for the CMS does not comply with the DSC, Xoserve state that the proposed model for CMS is consistent with the DSC. In their view, this is because under the subscription model the CMS would act like a third-party product. They argue that the relevant clause 7 of the DSC does not set an obligation on Xoserve to retain all IPR. Instead Xoserve are required to ensure DSC Services, UK Link (which includes CMS) and any UK Link enhancements, are provided to UK Link Users. This can be done, they argue, with third party products where Xoserve may not own the IPR.

97. Xoserve's position throughout the process has been that the costs and benefit of each funding option was presented at DSC Contract Management Committee (CoMC) on 17th November 2021 and December 2021. Xoserve conducted customer engagement throughout 2021 with over 50 workshops to understand customer requirements for the CMS when considering options.[95] However, Xoserve also acknowledged at that time that the BP22 process would need further detail on the CMS rebuild options.[96] During BP22 two options were shared by Xoserve and discussed with Customers. The two options were a 'subscription' model and CMS rebuild model with a standard DSC initiated Xoserve project. [97,98] This included sharing an additional presentation to Contract Managers showing a 16-year comparison, which resulted in the committee choosing the subscription model on 21 December 2021.[99] The analysis showed a cumulative saving over the 16-year period of £4.5m for the 'subscription' model compared to the CMS rebuild option with a standard DSC initiated Xoserve project. Xoserve felt this supported their assessment that the subscription model offered benefits to Customers, including removal of investment peaks, removing service risk, and offering longevity of solution.[100]

98. Xoserve have stated that the overall cost of the subscription charge option is lower than the operation cost option because the subscription charge option includes

[95] 2.1 CMS options.pptx
[96] business-plan-2022-feedback-and-responses-on-second-draft.pdf
[97] Option 1 – Platform (Software) as a Service
[98] Option 2 – DSC Project.
[99] UNC DSC Contract Management Committee Minutes 21 December 2021
[100] CMS Rebuild - Options Analysis

funding of the initial investment and any future re-platforming, and that Customers do not need to bear the upfront costs for the initial investment or on-going change.[101]

99. Xoserve stated that should the DSC+ contract be terminated or not renewed that Correla would be required to deliver the DSC Services as long as the contract is in place and there are provisions for 18 months' notice of termination of CMS.[102]

100. Xoserve have also provided that BP22 includes planned costs to re-platform the CMS, and an explanation that costs are based on the costs and funding profile of the subscription model, as opposed to an alternative model of DSC funding. They set out their rationale for why they think the subscription model offers better value for consumers. This rationale includes their view that the:

- overall cost for Customers is less than if it was funded through the traditional DSC investment process;
- subscription charge includes funding of the initial investment and any future re-platforming; and
- Customers do not need to bear the upfront costs for the initial investment or on-going change.

101. We note that Xoserve introduced an additional safeguard of the 'Board Assurance Statement'. This sets out the activities Xoserve have undertaken to scrutinise and assess BP22, along with the considerations they took into account when doing so. For BP22, this included:

- that the Budget reflects the business cases for investments, and
- that where investments have not been fully defined appropriate controls are in place.

102. Following these assessments, the Board were assured that "the plan is a true and accurate reflection of our view of what is required to deliver the CDSP Services and meet customer requirements in the period 2022-25, including industry developments and the obligations in the Data Services Contract, and that the associated investments and costs represent value for money to achieve the benefits described in

[101] business-plan-2022-feedback-and-responses-on-second-draft.pdf
[102] CMS Rebuild - Options Analysis

BP22."[103] This statement is intended to provide assurance to Customers that the cost of the CDSP Services provided by Xoserve under DSC is appropriate.

Our view on the treatment of IPR

103. We consider that where a budget provides for expenditure that is illegitimate for the CDSP, that budget may not be fit for purpose in relation to the obligation on licensees to jointly control and govern the CDSP on an economic and efficient basis. We also consider that if budget expenditure is in breach of the CDSPs legal obligations it is likely to be illegitimate.

104. In this case, the relevant alleged breach of obligation is Xoserve's contractual obligations in the DSC. However, we do not consider we are the appropriate body to be considering and making a finding of breach of contract here. The appropriate body would be the relevant court or body appointed via dispute resolution mechanisms in the DSC. To go further, we consider it would be inappropriate for Ofgem to make a finding of breach of contract here as the legal framework does not position us to do so.

105. As such, in lieu of such a finding having been made by the relevant court or other appropriate body as set out in the DSC (and we are not aware of any such finding), we cannot find in this appeal that the expenditure in question was illegitimate on the basis of contractual breach. We have found no other reason to consider this expenditure to be illegitimate and so, as a result, do not consider the Budget to be unfit for purpose in this regard.

Our view on whether Xoserve have failed to objectively identify the delivery model that represents the greatest value for Customers

106. In deciding upon this appeal, we do not consider it appropriate to step into the shoes of the CDSP and, line by line, consider whether or not the CDSP made the absolute best value decisions possible in each situation. Instead, we need to consider whether the Budget was fit for purpose – in particular noting that the "purpose" here includes jointly controlling and governing the CDSP on an economic and efficient basis (which includes us being satisfied that the Budget does not include item(s) that are

[103] xoserve-bp22-final-version_spreads.pdf p.41

manifestly inappropriate *and* do not have sufficient safeguards in place to ensure that the actual costs incurred will be efficient).

107. This said, we agree with the appellant that the process taken to decide upon the subscription model for the CMS (which was run in parallel to, and directly impacted upon, the process to put in place BP22) was not optimal and could have been improved:

- to allow for Customers to be informed earlier on in the process, as well as to provide a greater understanding of the options available, so that they could better assess and feed-back on the question of whether the Budget was fit for purpose;
- so that the format of information provided to Customers better ensures that those Customers are properly able to analyse and scrutinise available data, with the aim of providing feedback and producing the best possible outcome for consumers;
- by comparing available options to help ensure Customers were properly informed when inputting on decisions relating to the Budget.

108. The result of this was that Customers were not able to properly assess and scrutinise the costs and benefits of the different CMS options available in order to input into the decision-making process in a meaningful way, instead needing to rely on Xoserve's assertions. In turn, we consider this means that BP22 did not provide Relevant Users with the ability to jointly control and govern the CDSP in the development of the CMS project and therefore was not fit for purpose in this regard. It is not sufficient in terms of paragraphs 3(b) and 3(c) of SSC A15 that a consultation took place for the Budget to be deemed fit for purpose. That consultation must be meaningful, and, in our view, it was not sufficiently so here.

109. We note that, despite finding that the consultation process here was flawed, this does not necessarily mean that an inefficient model was selected. Ofgem has not made any findings as to the efficiency or otherwise of the subscription model chosen.

110. We recognise that the appellant has not sought a remedy for Ofgem to direct the Budget be amended. We agree that this would not be appropriate here, beyond a nominal value to meet the requirements of paragraph 11(a) of SSC A15. We also recognise that the CDSP Budget for BP22 is now at a stage where it has been spent

and the subscription model CMS has been developed, implemented, and is being used. The result of this is that we do not consider it to be appropriate (nor would we consider it to be in the best interests of existing and future consumers) to direct that Xoserve begin a process to consider changing, or unwinding the investment in, that system now. We also consider it an inefficient use of time and resources to direct Xoserve to undertake analysis into the extent to which the subscription model option chosen was more or less efficient than potential alternative,

111. Instead, in the attached direction, we direct that:

- in future budget-setting processes Xoserve consider, compare, and share with Customers sufficient options and cost-benefit analysis, and provide them sufficient time to meaningfully engage with such information, when making decisions on material investments to properly allow Relevant Users to jointly control and govern the CDSP on an economic and efficient basis;
- Xoserve collaborate with Centrica, and with other Relevant Users, to consider any additional steps which could be taken as a result of Ofgem's decision on Ground 2.

112. In making these directions, we also recognise the improvements made by Xoserve, alongside Relevant Users, in the budget-setting and consultation processes since the BP22 process. For example, the development of UNC modification UNC0841 'Introduction of Cost Efficiency and Transparency Requirements for the CDSP Budget', which was approved in May 2024.[104]

Ground 3 - The Xoserve BP22 effectively changes the risk profile to which Customers are exposed that was set by a regulatory decision.

Context

113. The appellant argues that the sale of Correla and introduction of the DSC+ contract resulted in changes to the risk profile for CDSP Customers to a 'downside only' risk profile without 'upside risk' of MTB in BP22 and the CMS investment.[105] This, the appellant argues, is contrary to the regulator's intention for a two-sided risk profile of

[104] UNC 0841: Introduction of Cost Efficiency and Transparency Requirements for the CDSP Budget – decision, https://www.ofgem.gov.uk/decision/unc-0841-introduction-cost-efficiency-and-transparency-requirements-cdsp-budget-decision.
[105] We note that in one of the letters of support, a similar concern regarding the outsourcing arrangement was raised.

co-operative governance. In particular Centrica say that the Funding Governance & Ownership (FGO) reforms resulted in Xoserve being structured as a not-for-profit company. This means Customers would be exposed to both downside risks (eg additional funding requirements) and upside risks (reduced charges due to efficiency gains being realised).

114. In October 2013, we published a decision to change Xoserve's funding and governance arrangements,[106] and on 31 March 2017 we announced completion of the Xoserve funding, governance and ownership (FGO) implementation phase.[107] FGO implemented a fully cooperative model, under which decisions about the future provision of data services supporting the supplier market will rest with the users of the services, and the costs of those services being recovered from them directly, meaning users would control costs since they would be involved in the decision making, annual budget setting, and governance of Xoserve.[108] Additionally, FGO arrangements had the intention that "shippers and GTs [gas transporters] to collectively share corporate control of the central service provider, and in doing so, assume the performance risk of the company".[109] The co-operative model and the scheme of industry participation was the means of controlling costs, along with safeguards in an efficiency obligation on participants and a limited appeal right.

115. The regulatory framework provides for a robust annual budget process that will be managed by the CDSP board, in consultation with users, and then the final budget decided on by the board. Users can scrutinise the budget and appeal if they consider the budget is not appropriate for the CDSP, and those who control the CDSP, to deliver their obligations. The FGO arrangements allow an appeal against the Annual CDSP Budget where it is not fit for purpose. Ofgem would then assess the appeal, then have the power if the appeal is upheld to require changes to the budget. Our decision also makes clear that "to achieve the transparency users desire the quality of the information provided between parties will be key".[110]

[106] Decision on our review of gas transporter agency (Xoserve) costs in RIIO GD1 and T1 | Ofgem
[107] Completion of the Xoserve funding, governance and ownership (FGO) implementation phase | Ofgem
[108] The Uniform Network Code (UNC) was modified to establish that the CDSP and Customers would be jointly responsible for controlling and governing the CDSP on an economic and efficient basis.
[109] Consultation on implementing new funding, governance and ownership arrangements for Xoserve, the gas transporter central agent
[110] Xoserve - decision in relation to new funding, governance and ownership arrangements for the gas transporters' central agent | Ofgem

Does the appeal ground go to the question of whether the Budget is fit for purpose?

116. We note that Xoserve contend that the appeal is not valid as, in their view, the appeal does not go to the question of whether the Budget is fit for purpose. However, we consider this ground of appeal to be a question as to whether the CMS investment and associated arrangements, so far as it is relevant to the budget and affect the risk profile Centrica are exposed to, are fit for purpose for the obligation to jointly control and govern the CDSP on an economic and efficient basis. The budget may be unfit, for example, if it was demonstrated that the CMS investment and associated arrangements regarding risk profile amounted to unfairly prejudicing the interests of one or more Parties, or caused them to be in breach of the UNC, the Energy Licences and/or Law.

117. In order for this ground of appeal to apply, we consider that it would need to be demonstrated that the treatment of risk allocation of MTB costs or the CMS investment, so far as it is relevant to the Budget, was such that the relevant licensees and certain other users of CDSP Services were unable to jointly control and govern the CDSP on an economic and efficient basis.

Centrica's position

118. Centrica contend that (a) the governance arrangements relating to CDSP Service provide for a two-sided risk profile for Customers, and (b) that Xoserve's BP22 changes this risk profile to downside only as a result of the handling of MTB costs and the CMS investment.

119. Centrica provide that the FGO programme resulted in changes to Xoserve's corporate governance from April 2017, the intention of which was for the CDSP to be cooperatively governed by industry as a not-for-profit organisation funded by its Customers. They provide that the result of this was a two-sided risk profile where underspend (for example, as a result of efficiency gains) would result in lower charges for Customers and overspend (for example, where additional funding is required for the provision of services after the budget is set) would result in higher charges for Customers.[111]

[111] Centrica notice of appeal – paragraphs 161 and 162.

120. Centrica contend that BP22 changes this from a two-sided risk profile to a downside only risk profile in two ways:

- firstly, that, in relation to MTB costs, Customers will still be required to provide further funding if needed (for example, in relation to a fine or penalty incurred by Xoserve, or where additional funding is required for services after the setting of the budget) but that, in Xoserve's words, "any further risk associated with achieving these future efficiency savings now sits with Correla and Northedge, rather than with Customers.";[112,113]
- secondly, that, in relation to the CMS investment, Customers will be required to provide additional funding if needed (for example, to enable small enhancements to be delivered or to support industry wide changes requiring integration) but that there is no mechanism to allow for a rebate of fees (paid via an annual subscription fee) to Customers where investment is less than initially anticipated.[114]

121. Centrica provide that sub-contracting arrangements can be utilised effectively here but to do so the CDSP must take actions to control costs as commercial confidentiality reduced its ability to be fully transparent (and therefore for Customers to control costs on an economic and efficient basis). Centrica suggest, following the third party efficiency review findings, that the CDSP had limited visibility and control over costs in service to operate category (formerly MTB costs) as they were managed by Correla, that the CDSP had not utilised the market testing lever at the time of BP22, and the fixed price nature of the contractual arrangements meant that there was limited opportunity to drive reduction in the service to operate category.

122. In addition, Centrica argue that in BP22, the CDSP frustrated meaningful scrutiny of proposed costs, for example by not sharing MTB costs with meaningful granularity beyond the total value, or the supporting detail that underpinned the costs or evidence of its efficiency.

123. Centrica have suggested the following remedies:

- that the 2022-23 Charging Statement is modified so that:

[112] 2022-business-plan-feedback-and-responses-on-first-draft.pdf
[113] Centrica notice of appeal – paragraphs 164 and 165.
[114] Centrica notice of appeal – paragraphs 166 and 167.

  - the “Prior Year Charges (Rebates)/Additions” in Table 4 should be disaggregated to explicitly state the Forecast Over/Under Amount for Year Y-1 (2020-21);
  - explanatory notes should be added to Table 4 that describe the source(s) of Forecast Over-Under Amount for Year Y-1 and the Outturn Over-Under Amount for Year Y-2.
- that it should be confirmed that forecast under-spend against the MTB costs allowed for in the 2021-22 CDSP Annual Budget in BP21, regardless of whether that under-spend is expected to be realised by Xoserve or by Correla, will be included in the Forecast Over-Under Amount for Year Y-1 in Table 4 of the 2022-23 Charging Statement;
- that it should be confirmed that actual under-spend against the MTB costs allowed for in the 2021-22 CDSP Annual Budget in BP21, regardless of whether that under-spend is realised by Xoserve or by Correla, will be included in the Outturn Over-Under Amount for Year Y-2 in the 2023-24 Charing Statement;
- that underspend, regardless of whether that under-spend is realised by Xoserve or by Correla, must be returned to Customers as applicable in each charging year and, specifically, that under-spend against the MTB costs allowed for in the 2022-23 CDSP Annual Budget in BP22, regardless of whether that under-spend is realised by Xoserve or by Correla, to be returned to Customers, as set out in Section 3.4 of the Budget and Charging Methodology.

Xoserve’s position

124. Xoserve’s position is that this is not a valid ground of appeal relating to the BP22 and whether it is fit for purpose. In their view the ground relates to previous regulatory decisions, and that the appeal attempts to re-open these decisions. In Xoserve’s opinion, this ground of appeal is not about BP22, but rather is a complaint about the restructure of Xoserve in spring 2021 and the decision at that time to create Correla as a separate commercial entity and sell it to a private investor. In its view, Xoserve do not consider this to be a valid ground of appeal relating to BP22.

125. Regarding the appellant’s view that the treatment of MTB in BP22 changes the risk profile to a ‘downside only’ risk profile, Xoserve’s view is that rather than removing the opportunity for Customers to benefit from ‘upside risk’ while retaining ‘downside risks’, it had the opposite effect, protecting Customers from downside risk. In Xoserve’s view, the protection of Customers from downside risk is achieved in the

following ways: protection from unexpected costs, with costs to deliver services and projects being fixed (for fixed scope); the introduction of contractual levers to incentivise performance, including a service credit regime; as well as step in or termination rights.

126. Xoserve state that Customers benefited from a rebate against the general charges payable under Business Plan 2020-21 through the sharing of sales proceeds relating to the sale of Correla, which was issued directly to Customers as credit notes in March and August 2021.[115, 116] Xoserve argue that future efficiencies arrived at by the highest bidder in the sale process was reflected in the sales price, which they claim forms a rebate to Customers. They argue that as the sales proceeds reflected potential savings and that those potential savings were applied as a reduction in 2020-2021 charges that this forms a rebate to Customers. Therefore, Xoserve argue that Customers did then benefit from 'upside risks', including receiving a share of the proceeds of the sale of Correla and a reduction in charges.

127. Xoserve argue that they explained this to Customers, both by issuing a letter at the point of crediting the sales proceeds rebate and during the consultation period. For example, in response to Centrica's BP22 second draft feedback, they explained that the efficiency of £3.8m achieved at the point of sale for BP21 and the subsequent two years was realised by what that contract enabled, namely focus on clearing the backlog of defects and moving infrastructure away from existing hosting arrangements. Further, "the valuation of future efficiencies arrived at by the highest bidder in the sale process was reflected in the sales price and ultimately the rebate to Customers. This amount is in addition to the £3.8m identified already as part of BP21. The extent of competition throughout the sale process is what gives us confidence we achieved best value for money as a result of the restructure."[117] Xoserve argue that all efficiency savings identified over a five-year period (through the fixed prices for that period) was paid or "liquidated" upfront as part of BP21.[118]

128. Regarding Centrica's view the fixed price nature of the contractual arrangements meant that there was limited opportunity to drive reduction in the service to operate category, Xoserve argue that there were additional contractual levers that meant additional efficiencies could be realised within the term of the contract. Further, that

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115 2022-business-plan-feedback-and-responses-on-first-draft.pdf p.6
116 business-plan-2022-feedback-and-responses-on-second-draft.pdf p.6
117 business-plan-2022-feedback-and-responses-on-second-draft.pdf
118 https://www.xoserve.com/media/42742/2022-business-plan-feedback-and-responses-on-first-draft.pdf

where cost reductions are identified relating to Correla these would be forecasted in the business plan, communicated to Customers in the business plan via waterfall diagrams and in those circumstances would not therefore require additional rebates.[119]

Our view

129. As discussed above, in setting up the FGO arrangements, we stated the intention that "shippers and GTs to collectively share corporate control of the central service provider, and in doing so, assume the performance risk of the company".[120] This means that by assuming the performance risk of the company that the result of this was a two-sided risk profile for Customers of upside and downside risk.

130. The question, therefore, is (a) whether Xoserve's BP22 changes this risk profile to downside only as a result of the handling of MTB costs and the CMS investment, and (b) if it does, whether that change in risk profile, so far as it relates to the Budget, means that the relevant licensees and certain other users of CDSP Services were unable to jointly control and govern the CDSP on and economic and efficient basis.

131. Sub-contracting arrangements for MTB costs and CMS investment: Xoserve entered the contract with Correla during BP21 which means that a large part of efficiencies that would usually be realised year-on-year were instead applied upfront (for BP21) as lower fixed-fee elements of the contract (NB: this refers to the contract for services between Xoserve and Correla rather than the agreement to sell Correla to Northedge).[121] We note that, as discussed in Grounds 1 and 2, the process engaged by Xoserve to demonstrate to Relevant Users the extent and detail relating to the efficiencies was insufficient to allow them to jointly control and govern the CDSP on an economic and efficient basis. The third-party efficiency report provides that, due to the nature of a fix-price contract (lesser visibility and control over those costs once the contract is entered into), the levers available in the contract for ensuring efficiency would be important.

132. We agree with this, particularly as the contract proceeds through its term the use of levers such as market testing and market monitoring will become increasingly

[119] For example, Figure 04 on page 13 of BP22, xoserve-bp22-final-version_singles.pdf
[120] Consultation on implementing new funding, governance and ownership arrangements for Xoserve, the gas transporter central agent
[121] The comparatively lower fees of £3.8m were applied upfront in BP21, representing reduced investment costs and 'upside risk'.

important to ensure the prices negotiated at the outset of the contract remain appropriately efficient (and ensure there are not gains in efficiency that have been made on the supplier side which are not being realised by the CDSP). We have discussed a similar point in Ground 1 and would expect to see the market testing level in particular used more as the contract proceeds. Although, despite this (and as discussed in ground 1), the efficiency report does provide a useful indicator that the CDSP's costs as assessed in 2023 did not allow so much of an efficiency opportunity to be, in our view, manifestly inappropriate.

133. We would also note and agree with Xoserve's position that the nature of the contract does protect Customers from a large portion (but not all) of downside risk that might otherwise arise. Again, this is due to the same nature of a fixed-price model and must, at least to some degree, be balanced against potential upside risk. However, this does not, in our view, remove the need for Xoserve to engage with market testing (as well the other contractual levers available to it) as the contract progresses through its lifecycle.

134. Additionally, in relation to the CMS investment, it appears that rebates have been issued where certain functionality of the re-built CMS system was not required. This evidences that, at least where it becomes clear that certain services are not required, rebates are available to be passed back to Customers. We note that this is not the same as efficiencies realised within services that continue to be provided at a fixed fee.

135. <u>The sale of Correla:</u> In BP24, Xoserve reiterate that the 2021 creation and sale of Correla "Shared proceeds from company sale (as rebate to charges in FY 2020-21)".[122]

136. In Ground 1, we discuss Centrica's argument that it is unclear whether the purpose of the rebate given to Customers resulting from Xoserve's sale of Correla was solely that of the net proceeds of the sale or whether it was possible for it to include a value for forecast efficiency gains and, if the latter, it is unclear what these efficiencies are or how they're realised. We agree this is unclear, and therefore we cannot comment on the extent that this may have further frontloaded "upside risk" through efficiency gains realised in the rebate. This is because, in our view, Xoserve's explanation as to the reason for the credit note rebate is insufficiently clear as to the breakdown of the

[122] business-plan-bp24-final-version-spreads.pdf

cost of sale element and related to efficiencies of the MTB costs. Further, it is insufficiently clear how additional efficiencies in MTB (particularly those relating to services provided by Correla) through the contract levers would be achieved and the value communicated to Customers. For example, whether these would be negotiated upfront and communicated as a reduction in the forecast of charges or whether they would result in rebates against previous charging years.

137. We would expect that from the outset of the consultation process, rebates and additions are broken down to categories and/or service areas, and financial years. These service areas should include detailing where the rebate or addition are associated with MTB (now termed Service and Operate), given that it is a significant proportion of the budget. This, we feel, would provide more transparency for the allocation of rebates and additions, as opposed to the investment focus areas in BP22.

138. An example of this is the level of information would be to provide:

138.1 additional information in the BP regarding rebate forecasts, which includes the total amount that will be published the Annual Charging Statement, the budget element (as opposed to investment focus areas in BP22) such as Service and Operate (previously named MTB), rationale for why the rebate is due, and how they are split across financial years Y-1 and Y-2; [123] and

138.2 in annual charging statements, a breakdown of Prior Year Charges (Rebates) / Additions, which includes how the rebates or additions are split across users, the budget element such as Service and Operate and includes a breakdown by financial year Y-1 and Y-2.[124]

139. Proposed remedies: We note that since Centrica's appeal, Xoserve have sought to address some of the requested remedies. For example, the CDSP Annual Charging Statement 2022-23[125] was updated in version 2 published 15 November 2022 to include Table 4a, Breakdown of Prior Year Charges (Rebates) / Additions, which is an addition to Table 4 Grand Total of DSC Charges.[126] Table 4a includes which BP year the rebate or addition applies to, a description of which area of the budget, and a breakdown by user type.

[123] business-plan-bp24-final-version-spreads.pdf
[124] CDSP Annual Charging Statement 2024_25.pdf
[125] CDSP Annual Charging Statement 2022-2023.pdf
[126] CDSP Annual Charging Statement 2022-23 v2 (15 November 2022).pdf

140. Scrutiny of costs: As discussed in relation to Ground 1, we agree that further transparency in the budget setting process is required to allow Customers to jointly control and govern the CDSP. We have not repeated that discussion here. The result of this is that it hampers Customers' ability to assess whether or not upside risk is retained.

141. Conclusion: Therefore, we partially allow the appeal on Ground 3 as the process relating to transparency and the provision of information here were flawed as they obstructed users' ability to assess the risk involved, and therefore jointly control and govern the CDSP on an economic and efficient basis;

142. We also note the use of levers in the contract with Correla, particularly as the contract proceeds further in its lifecycle away from its initial negotiation, is crucial to ensuring that upside risk is not lost out.

143. However, we do not find on the substantive point that it has been demonstrated that the arrangements resulted in a 'downside' only risk profile. Here we consider that if the contract levers are used appropriately over the lifecycle of the contract that upside risk can be retained. Following, if these levers can be used appropriately, then this would not mean that the relevant licensees and certain other users of CDSP services were unable to jointly control and govern the CDSP on an economic and efficient basis in relation to the Budget.

Remedies

144. In the attached direction, we direct that, in future budget setting processes:

- Xoserve share with Customers sufficiently granular information to allow Customers to meaningfully scrutinise and respond to budgets during the budget setting process, thereby allow Customers to jointly control and govern the CDSP on an economic and efficient basis;
- where appropriate, Xoserve look to testing the market in relation to MTB costs provided by Correla to ensure that users are able to assess the efficiency of the costs of services provided by Correla;
- Xoserve collaborate with Centrica, and with other Relevant Users, to consider any additional steps which could be taken as a result of Ofgem's decision on Ground 3.

Additional remarks

145. We note the appellant raised concerns about the transparency of the budget setting process, but that the appellant has specifically provided that this was not a ground of appeal (noting that we have considered these points where they go to Centrica's three grounds of appeal). In light of this, we set out the following expectations and acknowledgements, which sit apart from our consideration of the grounds of appeal discussed in this decision.

146. Paragraph 6(c) of SSC A15 requires the licensee and Relevant Users to agree that the CDSP produce an annual budget in consultation with the RGTs. For the CDSP to fulfil its obligation in this regard, it would not be sufficient simply to publish a consultation. Instead, the budget would need to be developed through meaningful consultation and engagement with Relevant Users, allowing a real opportunity, and sufficient time, for those users to not only see and understand the budget proposals but to also feed into the development process with any comments and inputs legitimately considered and, as appropriate, addressed by the CDSP.

147. On 6 April 2021 we issued a letter to Xoserve setting out possible steps that it, alongside industry, should consider to ensure that the CDSP Budget setting process is robust and ultimately operates in the interests of consumers.[127]

148. We recognise the efforts that have been made by Xoserve, Centrica, and other CDSP Customers in working to develop improvements in the budget setting and consultation processes (both during and following the BP22 process). Particularly, we acknowledge the development of UNC modification UNC0841 'Introduction of Cost Efficiency and Transparency Requirements for the CDSP Budget', which was approved in May 2024.[128]

149. We encourage Xoserve to continue to work with Relevant Users in exploring opportunities to improve its engagement on its annual strategy and budget, to ensure

[127] ofgem-letter-to-xoserve-april-2021.pdf, Appeal of the CDSP Annual Budget 2020-2021, 6th April 2021.
[128] UNC 0841: Introduction of Cost Efficiency and Transparency Requirements for the CDSP Budget – decision, https://www.ofgem.gov.uk/decision/unc-0841-introduction-cost-efficiency-and-transparency-requirements-cdsp-budget-decision.

that CDSP Parties are able to effectively scrutinise the costs included, and to appropriately consider and address comments / concerns where they are raised.

Decision notice

150. In accordance with Paragraph 10 of SSC A15, the Authority has decided to:

- partially allow the appeal in relation to Ground 1 that Xoserve have failed to demonstrate the efficiency of the Maintain the Business Costs;
- partially allow the appeal in relation to Ground 2 that the treatment of Intellectual Property Rights for the Contract Management System does not comply with the Data Services Contract and Xoserve have failed to objectively identify the delivery model that represents the greatest value for Customers; and
- partially allow the appeal in relation to Ground 3 that the Xoserve BP22 effectively changes the risk profile to which Customers are exposed that was set by a regulatory decision.

Carmel Golden
Deputy Director, Industry Rules
Signed on behalf of the Authority and authorised for that purpose.

Appendix 1: Responses to submissions on the draft decision

Background

1. As provided for in the Condition (SSC A15.12), on 26 September 2025, we consulted all relevant licensees and other users of CDSP Services on our draft decision and proposed direction. In this Appendix, we summarise the submissions we received, how we considered those submissions, and describe any changes we made before issuing our final decision.

Submissions in relation to the scope of the appeal and standard of review

Summary of responses

2. One matter raised in responses provided that the standard of review should be "economic and efficient" rather than "manifestly inappropriate" as the previous wording appears in the licence and was consulted on as part of the FGO arrangements, with Ofgem having used that wording, including in the draft decision. It was also provided that it would be irrational to impose legal obligations on Users to ensure that the CDSP's costs are economic and efficient and then assess an appeal about whether the CDSP prevented Users fulfilling that obligation on a difference basis.
3. Another submission sought clarity regarding the obligation in SSC A15.4(c)(i) (to ensure the provisions of the UNC require the joint control and governance of the CDSP on an economic and efficient basis) – namely that the specific reference is to Paragraph 4(c)(i), which does not relate to the Appeal process, but rather, to an obligation on the licensees to ensure provisions are within the UNC that require the joint control and governance of the CDSP on an economic and efficient basis. They seek clarity on whether the requirement set out in the Licence is so that the UNC effectively determines the manner of how the CDSP is controlled and governed.

Considerations

4. As to the first matter (discussing the appropriateness of the wording "manifestly inappropriate" in comparison with "economic an efficient"), the language of "manifestly inappropriate" is not a replacement of the "economic and efficient" test, but rather an explanation of how we apply that test.
5. The following provides where the terms we've used come from.

5.1 In relation to the scope of an appeal, the licence provides for an appeal to be lodged where the CDSP Annual Budget is not fit for purpose for the CDSP to be able to fulfil its obligation to be a company the purpose of which is to provide CDSP Services and which shall set out within its articles of association a prohibition on the distribution of profits and declaration of dividends.

5.2 The licence does not explicitly provide for what is required to make a budget fit for purpose for the CDSP to be a company the purpose of which is to provide CDSP services. We consider that to properly understand and interpret that purpose, one should look at the obligations that apply in this context, which include:

i. the CDSP produces the budget following consultation with Relevant Users;
ii. the CDSP is a body in relation to which there must be an opportunity for non-RTG users to participate in certain decision-making processes and the Business Plan and Budget; and
iii. that Relevant Users of CDSP Services are able to jointly control and govern the CDSP on an economic and efficient basis.

5.3 In our decision, we set out our view on how the CDSP could fail to meet those obligations. In relation to the obligation that Relevant Users are able to jointly control and govern the CDSP on an economic and efficient basis, we look at where the budget is found to be too high and provide some non-exhaustive examples of where we consider that likely, including:

i. the budget contains one or more item(s) that are not legitimate items of expenditure for the CDSP;
ii. the budget contains one or more item(s) that are manifestly inappropriate provisions for the activity in question, and there are insufficient safeguards in place to ensure that the actual costs incurred will be efficient, and
iii. the budget contains one or more item(s) that will, or are likely to, prejudice unfairly the interests of one or more parties, or cause them to be in breach of the UNC, the Energy Licences and/or law.

5.4 These are ways in which we can see whether the Relevant Users were able to jointly control and govern the CDSP on an economic and efficient basis.

6. We use the standard of "the budget contains one or more item(s) that are manifestly inappropriate provisions for the activity in question, and there are insufficient

safeguards in place to ensure that the actual costs incurred will be efficient" as one of the ways in which users may have been prevented from controlling and governing the budget on an *economic and efficient basis*, therefore making the budget not fit for purpose. In our view, manifestly inappropriate spend without sufficient safeguards to ensure efficiency is one of the ways in which the budget may not be fit for purpose in allowing users to jointly control and govern the CDSP on an economic and efficient basis and therefore making the budget not fit for purpose. "Manifestly inappropriate" is not an alternative to "economic and efficient", which remains a requirement on *the CDSP and users* (i.e. in order to jointly control and govern the CDSP on an economic and efficient basis).

7. We use this as we consider that the regulatory regime has been designed to avoid Ofgem retaking budgetary decisions on a full merits basis. The obligation is to govern the CDSP on an economic and efficient basis and that is indeed the test which we are applying. However, when it comes to the assessment of particular budgetary items, it would not be within the correct standard of an appeal for Ofgem to step in to take those decisions as a full merits review. The reason why we added the language of "manifestly inappropriate" was to reflect the appropriate **standard** of review which we will apply when we address an appeal which is within scope. In light of the intention of the regulatory regime that there would be relatively few appeals, it is clear to us that an appeal of this nature is not one in which Ofgem is to consider the appropriateness of a Budget afresh as if it were taking the decision itself. An appeal of this nature is not a full merits review of the budgetary decisions. The language of "manifestly inappropriate" was intended to reflect this standard of review.
8. As to the second matter (that paragraph 4(c)(i) does not relate to the appeal process, but rather, to an obligation to ensure provisions are within the UNC that require the joint control and governance of the CDSP on an economic and efficient basis and that the requirement set out in the Licence is so that the UNC effectively determines the manner of how the CDSP is controlled and governed), we consider that paragraph 4(c)(i) has multiple purposes:

   8.1 the first is referenced so that the UNC effectively describes how the CDSP is controlled and governed, and

   8.2 the second is to require *how* the UNC does this (i.e. by ensuring that an obligation exists that Relevant Users do control and govern the CDSP in an economic and efficient manner).

9. The licence provides that an appeal can be brought where the appellant considers the Budget not to be fit for purpose. It does not set out the scope of the appeal or the standard of review that should apply. We have therefore considered obligations in the licence that relate to the Budget so we can understand what would cause a Budget to no longer be fit for purpose. One of these obligations (paragraph 4(c)(i)) provides a clear intention that where the budget does not allow licensees / Relevant Users of CDSP Services to adequately fulfil their obligations under paragraph 4(c)(i) (i.e. to jointly control and govern the CDSP on an economic and efficient basis) it is not fit for purpose. We consider this to be the case despite the actual requirement to do so being contained in the UNC as the licence effectively requires that it is an obligation and creates a clear intent.

Submissions in relation to Ground 1 of the appeal

Summary of responses

10. One submission raised that safeguards not being present is not enough (as provided for in the second part of the "manifestly inappropriate" standard – i.e. the Budget contains one or more item(s) that are manifestly inappropriate provisions for the activity in question, and there are insufficient safeguards in place to ensure that the actual costs incurred will be efficient") and instead those safeguards need to be utilised to prevent detriment. It also provided that Xoserve failed to sufficiently use the safeguards that were designed to promote efficiency and, in any event, Xoserve's actions led to insufficient safeguards being in place to ensure actual costs incurred would be efficient.
11. The submission also provided that Xoserve put in place insufficient safeguards to ensure actual costs incurred were efficient. The submission asserted that Xoserve did this by entering contractual arrangements with the third party that is subcontracted to deliver the majority of CDSP services but with limited visibility and control over costs in the MTB/S&O category.

Considerations

12. Our draft decision discussed whether or not safeguards were present and whether or not they were utilised. As a matter of principle, we agree that the use of safeguards is as important as the existence of safeguards. Our draft decision discussed the existence of safeguards and the appropriate use of those safeguards. We provided that there were safeguards (also referred to as contractual levers) available to Xoserve, such as that of

market testing and market monitoring. We considered that, at the time of the third-party efficiency review, Xoserve had yet to engage in market testing and market monitoring had been used occasionally with work underway to use it more pro-actively. The review suggested that utilising these levers more frequently would be a key step in finding the efficiencies opportunities identified in the C2O area.

13. However, at the stage in the contract at which the appeal was made, we did not see this as manifestly inappropriate. This is because the contract was in a relatively early stage (having started in 2021 and the appeal was made in February 2022). Some safeguards had been used (market monitoring) and others were available but given the relative proximity to the start of the contract it was considered not to be manifestly inappropriate to have not engaged them yet. We provided that the so far un-utilised market testing lever was a key tool in helping understand whether costs were efficient, particularly as the contract progresses – and that we would expect to see these types of levers used going forward.
14. We agree that the use of safeguards is an important consideration in our decision-making for whether or not the MTB costs were manifestly inappropriate provisions for the activities in question and that there were sufficient safeguards in place to ensure the actual costs incurred would be efficient. In this situation, we consider that the use of safeguards in the manner applied by Xoserve was not inappropriate. We have clarified this in the language of our decision – see paragraph 83.
15. To the question of whether the contractual levers were "sufficient safeguards", we consider they were. Value for money is necessarily assessed in the negotiation of a contract. In our view, the levers in place (market monitoring and market testing) were intended to ensure that, as the contract progressed and markets change and evolve so that the initial assessment of value made during negotiations may be less accurate, Xoserve would be able to safeguard the limiting of visibility and control over costs that arise when services are contracted out. We consider that those safeguards were sufficient for this type of contract.

Submissions in relation to Ground 2 of the appeal

Summary of responses

16. One submission discussed Xoserve's treatment of the IPR for the CMS. The appeal provides that the treatment of IPR for the CMS does not comply with the DSC and that the option Xoserve have opted for in this regard allows the third party to own and benefit from the IPR (while an option that involved Xoserve retaining ownership of the IPR was discounted). The submission describes that third party ownership of the IPR is

an integral part of the option and that it cannot be separated from the investment. The question of whether Xoserve's preferred option here is legitimate becomes relevant as ownership of the IPR is inherent to the expenditure.

17. The submission provides that it is therefore not a matter of whether the "right" level of funding is provided in the Budget (i.e. it is not a matter of whether Relevant Users can jointly control and govern the CDSP on an economic and efficient basis) but whether Xoserve had the vires to include any level of funding in the Budget that does not comply with the provisions of the DSC (i.e. it is a question of whether the Budget contains one or more item(s) that are not legitimate items of expenditure). Therefore, Ofgem needs to first assess whether Xoserve had the vires to do so (and that Ofgem is wrong to limit its assessment to whether the Budget provided the "right" level of funding for the CMS).

Considerations

18. We have considered this in light of our decision-making framework and the scope of an appeal (as we've described in paragraphs 19-26). As described in paragraphs 26 and 90, we consider that the scope of the appeal does encompass issues of the legitimacy of an item of expenditure and that the standard of our review is not a full merits review. We are also clear that Ofgem is not the party charged with determining disputes in relation to the DSC (i.e. the relevant court or dispute resolution mechanisms in the DSC) and the appeal process under SSCA15 is not one designed to determine contractual disputes.

19. On this basis, we consider that it is appropriate that we engage with the issue of legitimacy. As a result, we have updated our decision to reflect this and have shown our consideration at paragraphs 103-105. In summary:

    19.1 it is clear that Ofgem is not the party charged with determining disputes in relation to a breach of the DSC, that the appeal process here is not designed to determine contractual disputes, and we are not aware that any relevant court or appropriate body has made a finding of breach of the DSC on this point;

    19.2 in lieu of such a finding, we have found no other reason to consider this illegitimate spend; and

    19.3 we consider that we therefore cannot find that the Budget was not fit for purpose on the basis that this spend was illegitimate.

Submissions in relation to Ground 3 of the appeal

Summary of responses

20. One submission provided, in relation to the third ground of appeal, that:
    (a) there is no evidence of the proceeds of the sale to Correla including forecast efficiencies, that the burden of proof must lie with Xoserve to substantiate claims that transaction values may sometimes take account of future efficiencies, and that Ofgem's statement that efficiencies "…*that would usually be realised year-on-year were instead applied upfront (for BP21) as lower fixed-fee elements of the contract…*" is factually incorrect;
    (b) that as Xoserve failed to fully utilise contract levers designed to promote efficiency, Relevant Users were not fully exposed to upside risk; and
    (c) that the use of future levers is irrelevant because the appeal is considering the Budget for 22-23.

Considerations

21. On consideration of the first point, that there is no evidence that the proceeds of the sale of Correla included forecast efficiencies, the burden of proof should be on Xoserve to demonstrate that if there was, and Ofgem's draft decision may have included a factually incorrect statement, we have considered the paragraph in question. We understand the point made that Ofgem cannot consider a value of forecast efficiencies where it has not been provided with evidence that this was the case – and we agree with that (see paragraph 136).
22. However, the wording in paragraph 131 of the draft decision that, "*…that would usually be realised year-on-year were instead applied upfront (for BP21) as low fixed-fee elements of the contract…*" does not relate to the contract for the sale of Correla and instead relates to the contract with Correla to provide services (and the point in question is that when a price for services is agreed in a contract, that price will necessarily include the value assigned to those services over the period of time (including what parties estimate possible efficiency gains to be)).
23. We see the contract for the sale of the company as distinct from the contract for specific services in this regard and have added wording in our decision to help clarify this (see paragraph 131).
24. Regarding the point that Xoserve failed to fully utilise contract levers designed to promote efficiency, Relevant Users were not fully exposed to upside risk – we set out in the draft decision that contracting on a fixed price basis limits both upside and downside risk (i.e. it locks in a price). So, while upside risk has been reduced, so too has

downside risk (noting that this has not been eliminated as there are still the possibilities in some situations for extra fees to be paid).

25. There is also possibility of upside risk in some situations. For example, we discuss (a) that rebates have been issued where certain functionality of the re-built CMS system was not required (noting that this is not the same as efficiencies realised within services that continue to be provided at a fixed fee), and (b) that there are contractual levers available (such as market monitoring and market testing), some of which have been used occasionally and all of which could be used going forward to help ensure costs are efficient (we discuss that it is not necessarily required to have used such a lever so early in the contract life but that we would expect to see it moving forward).
26. Specifically on the point of not fully utilising contractual levers we refer to our discussion on these levers in paragraphs 12-15 of this Appendix regarding the appropriateness of using or not using those levers. Additionally, we do not consider the question of maintaining upside risk to necessitate that upside risk be found during this budget period, but instead that the ability for upside risk to be found has not been taken away – and for the reasons given above do not think it has been. This also reflects our consideration on the third point in this submission as to why we consider the ability to use the levers in the future to be a relevant consideration.

Submissions in relation to the direction

Summary of responses

27. One submission provided that the direction should be amended so that:

    27.1 the date by which each direction must be delivered is specified;

    27.2 the Criteria that Ofgem will use to assess whether each direction has been fully delivered should be specified;

    27.3 a requirement for the licensees to submit a report to Ofgem on their assessment of the applicability of the directions and their completion, and for Ofgem to publish its assessment and approval of this report;

    27.4 in relation to Grounds 1 and 3, the direction that requires licensees to direct the CDSP to look to test the market in relation to MTB (now "S&O") costs provided by Correla to ensure that users are able to assess the efficiency should be expanded to include all types of costs and all third parties;

27.5 in relation to Ground 2, the word "material" should be removed from the direction that requires licensees to direct the CDSP to consider, compare, and share with Customers sufficient options and cost-benefit analysis.

28. Another submission provided that the direction should be amended so that:

28.1 it is clear that the term "Maintain the Business" means the area of the Budget named this in 2022-23 and any subsequent label applied to the same area of the budget in subsequent years (i.e. "S&O");

28.2 a caveat be inserted that "Correla" means the organisation named Correla, or any subsequent organisation that may replace it, that provides the Data Services Contract plus service under contract with the CDSP; and

28.3 it refers to "all Relevant Users" rather than "Centrica and all other Relevant Users" as the direction itself (as opposed to the letter) should not refer to a named party as this will not take into consideration should they cease trading under that name for any reason.

Considerations

29. We have considered these submissions as discussed in the table below.

	Submission summary	Consideration
1	Include the date by which each direction must be delivered.	The directions in question either are of an ongoing nature or apply "where appropriate", as a result we do not consider we can impose a date by which they should be completed.
2	Include criteria to assess if a direction has been delivered.	As above, the nature of the directions means they will not be completed, with the requirements being ongoing.
3	Include a requirement to submit a report on applicability/completion, and for Ofgem to publish.	As above
4	Expand directions requiring CDSP to look	Given the scope of the appeal relates to MTB costs and particularly those services provided by Correla (including a

	to test the market to include all types of costs and all third parties.	discussion of the type of contract entered into and the levers available under that contract), we consider it would be inappropriate to expand the direction beyond that scope. Expand this direction in a blanket manner to other costs and to all third parties would not consider the circumstances relating to those costs or the type and scale of the third parties and contracts involved.
5	Remove the word "material" in relation to Ground 2 direction.	We consider the word "material" here may create too high a bar. That said, removing the word "material" may risk unintentionally making the budget-setting process overly burdensome if such requirements are applied to minor or insignificant costs in a blanket fashion. We have therefore clarified our intention that this relate to all investments that are more than minor.
6	Clarify that MTB includes any subsequent label applied to the same area of the budget (i.e. "S&O").	We have updated the direction to reflect this so that it is clear the direction refers to the costs described (regardless of the term used to name the budget item).
7	Clarify that "Correla" includes any subsequent organisation provides the Data Services Contract plus.	We have updated the direction to reflect this so that it is clear the direction applies to the provider of CDSP services under the DSC+ regardless of whether that is Correla or a subsequent organisation.
8	Refer to "all Relevant Users" rather than "Centrica and all other Relevant Users".	We have updated the direction as we consider it more appropriate and consistent with the licence condition (see in particular SSC A15.11) to refer to all Relevant Users than specifying any one in particular (including because any Relevant Users may cease trading under a particular name).

Submissions in relation to the appeal mechanism in the licence condition

Summary of responses

30. One submission suggested that amendments could be made to the appeal mechanism set out in standard special licence condition A15 to make it more consistent with the

approach taken in relation to other not-for-profit regulated entities, of which there is an increasing number. Such amendments could look to ensure a simpler, more pragmatic and light touch approach.

Considerations

31. While it sits outside the scope of the current appeal, we agree that there are improvements that could be made to improve clarity in the appeal mechanism set out in the standard licence conditions. We will look to consider these points in our continued regulation of the energy sector – including in our stewardship of the licences.

Appendix 2: Glossary of commonly used terms and abbreviations

Term	Definition
BCM	Budget and Charging Methodology, which is one of the CDSP service documents within the Data Services Contract (DSC)
Budget	Central Data Service Provider Annual Budget of 2022-23
BP22	The CDSP's Business Plan for 2022
CDSP	Central Data Service Provider
CDSP Services	Services for the gas industry – see UNC Section D, paragraph 1.3
CMS	Contract Management System – a workflow management system designed to manage all customer interactions that orchestrate key industry processes
DSC	Data Services Contract
DSC+	Contract between Xoserve and Correla for the provision of CDSP services
FGO	Ofgem's Funding, Governance and Ownership decision
Ground 1	Xoserve have failed to demonstrate the efficiency of the Maintain Business Costs
Ground 2	The treatment of Intellectual Property Rights for the Contract Management System does not comply with the Data Services Contract and Xoserve have failed to objectively identify the delivery model that represents the greatest value for Customers.
Ground 3	The Xoserve BP22 effectively changes the risk profile to which Customers are exposed that was set by regulatory decision
IPR	Intellectual Property Rights
MTB	Maintain the Business Costs
Relevant Gas Transporter (RGT)	A gas transporter who is a DN operator or an NTS operator
Relevant Users	Gas Transporter licensees and other users of CDSP services, to the extent such other users of CDSP services are required to be party to the CDSP Service Agreement (see SSC A15 4(c))
The Report	Review of Xoserve expenditure for financial year 2022-23
SSC A15 / the Condition	Standard Special Condition A15 of the Gas Transporter Licence
UNC	Uniform Network Code

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