
CONSULTATION ON STRATEGY FOR THE NEXT GAS DISTRIBUTION PRICE CONTROL

XOSERVE RESPONSE

1. Introduction

- 1.1 This document is xoserve's detailed response to Ofgem's consultation on strategy for the next Gas Distribution Price Control Review ("RIIO-GD1").
- 1.2 Our comments are concerned with the questions raised in Chapter 4 of the "Outputs and Incentives" Supplementary Annex. We have set out below in Section 2 our summary responses to each of these questions, and have supplemented these responses with more detailed observations on the drivers for potential change to the scope and nature of xoserve's services (Section 3), and the aims of Ofgem's proposed review (Section 4). We have also noted a small number of other relevant matters in Section 5.
- 1.3 Background information on the xoserve business, our performance and service, and observations on the operation of User Pays arrangements are included as appendices.

2. Summary Responses

Question 1: Do you agree with the scope and the timing of the review?
--

- 2.1 We welcome this review as an opportunity to determine the optimum arrangements for the xoserve business for the next ten years.
- 2.2 We agree that the timing of the review is appropriate, not only because of its alignment with the review of the GTs' regulatory arrangements and price control allowed revenues, but also because of the significant industry changes currently in progress and its potential to influence the scope and nature of xoserve's services and how they are funded.
- 2.3 The uncertainties associated with the significant industry changes, taken together with Ofgem's proposed review of governance and funding arrangements, present a significant challenge in planning the longer term future for the industry and for xoserve. We would welcome the review concluding in a timely manner, arriving at conclusions that provide certainty for stakeholders and enable xoserve to prepare an informed RIIO Business Plan submission.
- 2.4 To the extent that the proposed review brings forward options for change to prevailing governance and funding arrangements, we consider that it is essential that Ofgem sets out with absolute clarity the particular issues that it is seeking to address and presents for consultation an objective evaluation of the extent to which each option would deliver measurable customer benefits.
- 2.5 We would ask Ofgem to note that the xoserve common Agent function includes in its scope services delivered on behalf of both Gas Distribution Networks ("GDNs") and National Grid

Gas Transmission (“NGGT”). A review of xoserve arrangements may therefore have parallel implications for the outcomes of both RIIO-GD1 and the next transmission price control review (“RIIO-T1”).

Question 2: Are there any issues with xoserve that we have not considered that you think are relevant to a review?

- 2.6 The consultation document sets out the majority of the considerations associated with xoserve and the services that we provide. In addition, we believe that the governance of industry change is a key consideration.
- 2.7 The review should consider the efficiency and effectiveness of the governance of industry change. It may be that potential shortcomings in this area are manifesting themselves as apparent problems with the quality of xoserve’s service delivery.
- 2.8 We consider that a robust industry governance framework is essential to ensuring the fulfilment of users’ requirements. A good governance framework should require change proposals to be subject to industry level prioritisation and initial cost benefit analysis at an early stage. This approach should build consensus and confidence amongst industry participants to subsequently invest resources in delivering agreed change priorities through a managed release programme to realise defined industry benefits. We would be happy to support discussions with Ofgem and the industry on how changes to the industry governance framework might further the delivery of these objectives.
- 2.9 We have noted Ofgem’s intentions to make provisional recommendations in respect of its review of xoserve in summer 2011 and to make firm recommendations in autumn 2011. During at least the early part of this timeframe, it is expected that the GTs will be progressing their RIIO stakeholder engagement programmes, including, in conjunction with xoserve, consultation on matters related to the future role of xoserve. It is likely that both the GTs’ consultation and Ofgem’s review will consider similar issues, and we would welcome a further dialogue on the potential for sharing thoughts and feedback as these two initiatives are moved forward.

Question 3: Do you think xoserve will be able to deliver the requirements for the Smart Metering Programme and Project Nexus?

- 2.10 We have a delivery record that clearly demonstrates the core strengths of our business as a provider of reliable, quality and efficient services, and of timely and robust industry change solutions, underpinned by the capabilities of our employees and service providers and the resilience of our systems.
- 2.11 We have a strong track record of successful change delivery. The time and effort that we have invested in defining and analysing users’ requirements, in assessing the wider process impacts of these requirements, and in extensive acceptance testing has ensured that related

services have continued to be provided without error or interruption. The essential value to the industry of this approach to managing change must not be underestimated.

- 2.12 The powerful combination of both functional and infrastructure change experience demonstrates a vital knowledge and capability base for planning and delivering the significant system changes that are likely to be required during the next price control period (and indeed in the remainder of the current period).
- 2.13 Obtaining clarity of future requirements and funding arrangements is essential to scoping and planning our investment. Subject to this clarity, we are confident that we are ideally positioned not only to be fully responsive to meeting users' needs, but to facilitate and expedite necessary change.

Sections 3-5 contain further supporting information and comments.

3. Scope and Nature of Services – Potential Change Drivers

- 3.1 The consultation document rightly identifies a range of industry change programmes that have potential implications for the scope and nature of xoserve's services. This section provides xoserve's thoughts on key change programmes in so far as they are relevant to the determination of RIIO-GD1 and RIIO-T1 outcomes.

GT Implications of Smart Metering

- 3.2 The role of xoserve in the Smart Metering market and the means by which funding is provided to enable both the rollout of Smart Meters and subsequent operation of the market are key uncertainties for our Business Plan, and we welcome Ofgem's recognition of the need for clarity.
- 3.3 The options for the scope and role of the Central Data and Communications Provider ("DCC") being considered by the Smart Metering Implementation Programme ("the SMIP"), including the potential for future transition in DCC arrangements as the Smart Metering market evolves, and the outcomes of the ongoing UNC discussions and potential Significant Code Review in respect of the possible use of Smart Metering data in industry processes such as switching and settlement, are significant uncertainties that have the potential to impact both the scope and nature of xoserve's services during the next price control period.
- 3.4 We are continuing to engage with the SMIP to understand our role in the 'smart framework' to inform the scope, nature, timing and funding of investment in xoserve systems that will be required, but set in the context of parallel investment demands on other industry participants. We will be looking to undertake investment that avoids the risk of future asset stranding, ensures the delivery of GT obligated services, and provides the capability for future development as the Smart Metering market evolves. We are hopeful that the conclusions from the SMIP will provide clarity regarding the future scope of our services and how they are funded, and that industry discussions on the evolution of UNC rules reach timely and clear conclusions, if necessary marshalled through the Significant Code Review.

- 3.5 Our response to Ofgem's DCC Scope Options Information Request in October 2010 indicated that, under any of the defined options, the majority of the prevailing scope of xoserve's GT Agent services would remain in place in order to discharge the suite of GTs' UNC and licence obligations.

Project Nexus

- 3.6 We are continuing to engage the industry through our Project Nexus Advisory Group and the Project Nexus UNC Workgroup meetings to understand industry requirements for xoserve services in support of the GTs' UNC that will be considered alongside technology and other drivers to inform our systems investment plans.

Services to National Grid Gas Transmission

- 3.7 Any review of the future scope and nature of services should also take into account the implications for the range of operational and change delivery services undertaken by xoserve on behalf of NGGT, currently funded using NGGT price control allowed revenues.
- 3.8 Assuming that this arrangement will continue to be applied into the next price control period, we would encourage Ofgem to consider carefully the implications of the proposed review of xoserve on RIIO-T1 outcomes.

Independent Gas Transporters

- 3.9 We have noted the comments in the consultation about the feasibility of certain obligations on independent Gas Transporters ("iGTs") being delivered by xoserve using common UNC standards. The original scoping of our Project Nexus service requirement gathering activities envisaged the establishment of an iGT services work stream. Subsequent discussions with the industry recognised that it would be necessary initially for requirements gathering to take place under iGT UNC governance arrangements.
- 3.10 We have previously presented proposals to the industry for the xoserve provision of iGT services. However, discussions with stakeholders concluded that the current regulatory and contractual arrangements do not provide appropriate stakeholder incentives.
- 3.11 We are keen to participate in industry discussions to explore this matter further. In the light of our previous experiences, we would encourage the early determination of changes to the regulatory and contractual framework, and a high level scoping of iGTs' and Shippers' service requirements. Taken together, these might provide the industry with sufficient confidence to invest resources in the development and implementation of new arrangements.
- 3.12 In the meantime, we are promoting, where appropriate, approaches that would introduce commonality of GT and iGT arrangements. For example, we have put proposals to SMIP in which xoserve would act as a conduit for DCC agents' access to both GT and iGT data for the purposes of authentication of meter access requests.

4. Proposed Review of xserve

4.1 This section discusses the aims of the proposed review of xserve.

xserve Governance and Funding

4.2 Whilst there are uncertainties about the evolution of the scope and nature of xserve services and therefore of GTs' revenue requirements during the RIIO-GD1 period and RIIO-T1 period, we consider that the prevailing framework of largely GT funded and centrally delivered systems and services that discharge GT obligations, including a common interface between multiple GTs and Shippers, offers all relevant stakeholders an inherent level of economic efficiency and regulatory simplicity for the delivery of these GT obligations that should remain a core feature of any future arrangements.

4.3 To the extent that the proposed review brings forward options for change to prevailing governance and funding arrangements, we consider that it is essential that Ofgem sets out with absolute clarity the particular issues that it is seeking to address and presents for consultation an objective evaluation of the extent to which each option would deliver measurable customer benefits.

User Pays Arrangements

4.4 Our discussions with customers since the publication of the open letter responses indicate that the comments about the quality of services were made with particular reference to the effectiveness and suitability of the User Pays for Change framework for the introduction of new services.

4.5 We have shared previously with Ofgem our observations on the extent to which the User Pays framework is achieving its objectives. We expressed the view that, whilst the arrangements have delivered some benefits, a number of aspects have not worked so well, and that our previous and continuing ability to deliver services under bilateral arrangements outside of the User Pays framework may offer an equally effective means of responding to customers' requests. We have reproduced and updated the detailed comments in Appendix 3, and would encourage Ofgem to take these observations into account in its review.

Delivering Industry Change

4.6 We have a strong track record of successful change delivery. In recent years, we have successfully delivered complex and significant systems and process change to support Network Sales, Exit Reform and a large volume of smaller changes. The time and effort that we have invested in defining and analysing users' requirements, in assessing the wider process impacts of these requirements, and in extensive acceptance testing has ensured that related services have continued to be provided without error or interruption. The essential value to the industry of this approach to managing change must not be underestimated.

-
- 4.7 We also understand the importance of investing to ensure that our services are sustainable, that our systems meet the exacting demands of very high levels of availability, and that system users do not experience degradation in performance. We have delivered infrastructure projects, most notably the UK LINK Technology Refresh, with only minimal planned and actual interruption to services. Where projects have encountered difficulties and delays, we have openly communicated these to our stakeholders, and have modified our approach to delivery whilst sustaining services and managing the risk to users.
- 4.8 The powerful combination of both functional and infrastructure change experience demonstrates a vital knowledge and capability base for planning and delivering the significant system changes that are likely to be required during the next price control period (and indeed in the remainder of the current period).
- 4.9 We are working hard with the industry through our GT funded Project Nexus engagement activities to understand the requirement for future change to the scope and nature of services that discharge prevailing GT obligations.
- 4.10 We are also contributing fully to SMIP discussions to understand the GT Agent implications of the rollout of Smart Meters and the establishment of the DCC. Funding of change activity in response to SMIP requirements both prior to and during the next price control period has yet to be determined.
- 4.11 Obtaining clarity of future requirements and funding arrangements is essential to scoping and planning our investment. Subject to this clarity, we are confident that we are ideally positioned not only to be fully responsive to meeting users' needs, but to facilitate and expedite necessary change.
- 4.12 We consider that a robust industry governance framework is essential to ensuring the fulfilment of users' requirements. A good governance framework should require change proposals to be subject to industry level prioritisation and initial cost benefit analysis at an early stage. This approach should build consensus and confidence amongst industry participants to subsequently invest resources in delivering agreed change priorities through a managed release programme to realise defined industry benefits. We would be happy to support discussions with Ofgem and the industry on how changes to the industry governance framework might further the delivery of these objectives.

UNC Review Group 334

- 4.13 We have noted Ofgem's support for the scope and timing of the work being undertaken by UNC Review Group 334 "Post Implementation Review of Central Systems Funding and Governance Arrangements" ("RG334"), and the expectation that the outputs from RG334 will inform the proposed review.
- 4.14 We are supportive of the work that is being done by RG334 members to consider the extent to which refinements to operational processes might address the concerns that have been

expressed about the User Pays for Change framework. We have received positive feedback from the industry about the process improvement ideas that xoserve has contributed to the RG334 discussions.

5. Other Relevant Matters

- 5.1 We have noted Ofgem's intentions to make provisional recommendations in respect of its review of xoserve in summer 2011 and to make firm recommendations in autumn 2011. During at least the early part of this timeframe, it is expected that the GTs will be progressing their RIIO stakeholder engagement programmes, including, in conjunction with xoserve, consultation on matters related to the future role of xoserve. It is likely that both the GTs' consultation and Ofgem's review will consider similar issues, and we would welcome a further dialogue on the potential for sharing thoughts and feedback as these two initiatives are moved forward.
- 5.2 We would welcome clarity from Ofgem on the implications of the proposed review for the timescales for submission of an xoserve Business Plan to Ofgem as part of the RIIO process, and how xoserve costs should be handled by GDNs and NGGT in their July 2011 Business Plan submissions.
- 5.3 We would also welcome greater clarity regarding the thinking behind the statement on the "potential of more contracting out",

Appendix 1 - The xserve Business

Great Britain's principal Gas Transporters ("GTs") have a licence obligation to appoint an agency ("the GT Agent") for the common provision of certain services and systems. This obligation was satisfied through the appointment of xserve as the GT Agent following completion of Network Sales in June 2005.

The range of centralised gas transportation services provided by the GT Agent is defined in the GTs' Uniform Network Code ("UNC") and licence, and includes maintenance of the GTs' Supply Point Register, Supply Point transfers, gas transportation invoicing and energy balancing invoicing.

For the period immediately following the appointment of xserve as the GT Agent, all regulated services were funded by the GTs using price control allowed revenues.

The previous Gas Distribution Price Control Review ("GDPCR1") largely affirmed these arrangements for both GDNs and NGGT, whilst introducing a differentiation between "Core Services" that are funded by the GTs using price control allowed revenues (where Users' charges are based primarily on their supply point portfolio) and "User Pays Services" that are funded through charges to the users of the services and that vary with their usage of each service. GDPCR1 also established the principle of "User Pays for Change", and arrangements have subsequently been put into effect through modification to the UNC.

Appendix 2 - Performance and Service

The GT Agent arrangements that were established at the time of Network Sales provide the industry with a service delivery model that offers a common user experience and is more cost effective and lower risk than the alternative of multiple and locally diverse provisions.

We have a delivery record that clearly demonstrates the core strengths of our business as a provider of reliable, quality and efficient services, and of timely and robust industry change solutions, underpinned by the capabilities of our employees and service providers and the resilience of our systems. Our Key Performance Indicators that are determined principally by reference to that are determined by reference to industry agreed targets within GTs' licence and UNC obligations show that we consistently meet operational performance targets, and our customer satisfaction surveys that we conduct with Shippers provide very positive feedback on the quality of our service.

Customer satisfaction levels dropped somewhat immediately following implementation of the User Pays arrangements. However, they have subsequently recovered, are continuing to show sustained improvement, and are now at their highest level since xoserve was founded. We place great importance on customer satisfaction, and continue to work with our stakeholders to explore opportunities for improvement and to actively address concerns that our customers may have about service quality or performance.

Appendix 3 - Observations on User Pays Arrangements

Considering the objectives of User Pays set out in the GDP CR1 Final Proposals:

- a) We believe that there is some evidence that the arrangements have acted as an effective incentive to manage the costs that industry participants impose on xserve because they pay for the additional services that they use;
- b) There is no evidence to suggest that GTs have been incentivised to provide additional services to generate additional revenue, although aligning beneficiaries and those bearing the costs has delivered benefits;
- c) Outside of the User Pays arrangements xserve has continued to respond to customer requests for additional services, providing these on a bilateral basis; and
- d) The principle of giving incremental capacity on new systems to those who value it most has yet to be tested.

Industry benefits

We believe that the arrangements have caused customers to give greater consideration to which services are of value to them, resulting in a rebalancing of the level of demand for some services and a more rational use of other services. Examples of this behaviour have included a significant reduction in the utilisation of the Must Read service, in the number of requests for reports and increased Shipper resolution of USRVs. Following a significant rationalisation of IAD accounts around the time that the arrangements were implemented, there has been a subsequent increase in demand for the IAD service.

Early experience suggests that the greater alignment between the identity of service beneficiaries and the parties that fund the costs of changing services has influenced industry participants' approach to UNC Modification Proposals. Notable applications of the User Pays for Change framework to date have been the introduction of the DM Elective service (UNC Modification 229) and the containing of avoidable expenditure on Partial Assignment of Exit Capacity (UNC Modification 276). Although the principles of User Pays for Change have been applied to incremental change, they have yet to be tested for a significant or complex investment.

What has not worked so well

Feedback from Shippers has indicated a level of dissatisfaction with the manner of implementation of the User Pays arrangements, attributable to both the limited timescales and lack of supporting detail. This has given rise to a general perception that the arrangements have required the industry to expend a level of effort that is disproportionate to the costs of providing User Pays services.

Whilst our customers are generally supportive and comfortable with the governance arrangements for Code services, particular concern has been expressed about those for non-Code services. Indeed, three Shipper organisations are of the opinion that this additional layer of governance is

unnecessary given the Licence framework that preceded the introduction of User Pays arrangements and which remains in place. These organisations have declined to sign contracts for the provision of non-Code services, although they are continuing to order and pay for services.

A number of parties have raised with us the possibility of bringing non-Code services into the scope of UNC as a way of simplifying the governance arrangements and removing perceived inefficiencies in the management of the User Pays arrangements. We are aware of concerns that this approach might preclude non-Code signatories from being able to take current non-Code User Pays services, and would be happy to support a review of the relevant provisions of the UNC in order to facilitate the inclusion of non-Code signatories.