



18<sup>th</sup> November 2011

James Grayburn  
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Head of RIIO-GD1  
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Dear James

### **Open Letter Consultation: Review of Xoserve**

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Gemserv welcomes the opportunity to respond to the above consultation and supports the Ofgem initiative to undertake a review of Xoserve's funding, ownership and governance arrangements.

Gemserv has a demonstrable background in developing and evolving processes and procedures to ensure markets work efficiently for all stakeholders. We have been at the forefront of evolutionary change in the energy, water and environmental sectors, working effectively both with and for participants and customers to develop best practice governance solutions. In our role at the centre of the energy sector and as an organisation set up specifically to facilitate a successful liberalised market, Gemserv has acquired extensive experience in the provision of robust and practical solutions utilising governance, process and market architecture expertise. These areas of competency are clearly at the centre of the debate on which this consultation seeks views. Indeed, our central role over the last decade in governing the electricity switching and supplier registration arrangements under the Master Registration Agreement (MRA), means we have an unparalleled understanding of the governance, processes and systems that underpin successful and enduring market arrangements. Moreover, we hold the contract for, and provide the single point of contact for all matters related to, the Electricity Central Online Enquiry Service (ECOES). We are also heavily involved in the Gas sector providing a support function for the independent Gas Transporters Uniform Network Code (iGT UNC) together with the provision of the independent chair for the iGT UNC Panel.

Whilst Gemserv has no direct operational contact with Xoserve other than very occasional communications through its role as the iGT UNC representative and as the provider of the governance services for the MRA, we do believe we can add valuable input into your consideration of governance and ownership arrangements (Question 2), options for change (Question 3) and critical issues (Question 4). We focus our response, particularly when answering Question 3, on how effectively each option adheres to Ofgem's and DECC's general principles of good governance. We formulate this assessment on our practical experience in managing successful governance regimes.

Whilst we are unable to comment on matters pertaining to the performance of Xoserve, due to our limited direct operational contact with them, our position working at a market level, serving the needs of the collective, and understanding their issues means we are aware of the issues contained in the consultation document. Indeed, in our role as the provider of secretariat services

for the Gas Forum and various metering groups, we have very regular contact with a wide range of industry sectors which allows us to recognise general issues such as User Pays under the Uniform Network Code (UNC) and the responsiveness of Xoserve to industry change. We are aware that there is an industry perception of a lack of transparency as to the role of Xoserve in industry discussion versus the role of Xoserve's owners, the large transporters.

Moreover, looking beyond Xoserve's role simply as the provider of services to the gas industry, it is not perhaps surprising that there is the perception that Xoserve's prime responsibility is to the transporters who own it rather than the shippers who are contractually reliant on its services. The negotiation of proper Service Level Agreements has always been a challenging area, particularly in terms of the main contract – the UNC which is between shippers and transporters, not shippers and Xoserve.

We hope you find our input, particularly our cross-referencing of the options for change against the principles of good governance and the timing for that change, useful. We note that Ofgem were intending to hold a workshop within the consultation period. Should you hold further workshops or have additional questions, please do not hesitate to contact me on 0207 090 1058 or at [steve.ladle@gemserv.com](mailto:steve.ladle@gemserv.com). I would be very keen to meet you to talk through our response, including sharing our experience of managing the Master Registration Agreement (MRA).

Yours sincerely



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**Question 2: Current Arrangements: What concerns, if any, do you have with the current funding, governance and ownership arrangements? Do you agree or disagree with CEPA's assessment of the limitations of the current arrangements for Xoserve (pp.29-32)? Please provide reasons.**

It is clear that the ownership of the entity that provides the required services between transporters and shippers, as set out under the UNC by National Grid prior to the sale of four of the distribution networks, was successful in introducing and developing a competitive GB gas market. However the sale of the distribution networks and the change in the ownership of Xoserve, together with the introduction of User Pays, was a fundamental change to the structure of the industry.

The vast majority of the current funding for Xoserve is recovered via transportation charges and therefore Xoserve is not directly reimbursed for its services from shippers. This can mean that the charges Xoserve levies (to its transporter owners and subsequently collected from shippers) are not transparent. However the fact that all shippers pay for them via transportation charges does mean that they can, in general, be passed through to consumers.

User Pays was introduced at the time of the Distribution Network sale to try and introduce a way in which non transporter users could influence the work done by Xoserve and allow them to provide services which did not have a direct transporter benefit, or which did not strictly meet the transporter licence objectives, which historically have been the drivers for industry/ Xoserve change.

Conceptually User Pays is workable although its application through the current governance arrangements can be cumbersome because of the way in which the modification process is designed. Our understanding is that whilst Xoserve will at some stage in the process produce a costing for any charges associated with the potential introduction of a User Pays proposal, this is often done via a "Rough Order of Magnitude", which together with alternative proposals for cost recovery, can create significant risk for users. Further, whilst parties can comment on the proposed charging, Ofgem in approving whether to implement a proposal does not have an ability to amend the charges if these are considered to be inappropriate. When User Pays was restricted to purely Non-Code services with core services continuing to be funded through the transportation price control, this may not have been such a significant problem but increasingly User Pays appears to be considered for a far wider range of modification proposals to the UNC.

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**Question 3: Options for change: What are your views on the costs and benefits of the three options for change (Chs. 7)? Do you agree or disagree with CEPA's assessment of the options (Ch 8)? Are there any other options not identified by CEPA that we should consider?**

Our response to this question consists of observations on each of the individual Options followed by a table in which we have assessed each option against the Ofgem and DECC general principles of good governance as an alternative to the criteria used by CEPA in their report. We believe this allows for easier comparison against the other industry arrangements and goes wider than the provision of good quality services. We have also added an additional assessment criterion - "Specific and proportionate to the market need". This criterion gives a good basis to assess whether

the changes that are proposed for the market are of such significance and impact for the various industry parties such that the level of change associated with each option can be justified.

### Option A

This may have advantages in terms of a less significant change proposal but if fundamental change is required then it may not address a number of the key issues.

One significant flaw may be that it will not change the overall perception that Xoserve's prime responsibility is to provide services to the transporters rather than to the shippers. Whilst the concept of a User Planning Group can work well in circumstances whereby a software provider provides services to a number of customers via a common offering, its success may also be linked to the operation of fully contractual Service Level Agreements together with the ultimate sanction that the customer can move to an alternative provider if it is not satisfied with the service. However shippers do not have this option as under the UNC they will continue to be bound to use Xoserve for the defined services and to manage the relationship with the transporters.

CEPA have also proposed complementary changes to the current funding mechanisms. In particular, they consider that user requirements could be explicitly linked to funding through an extended User Pays model, and/or a negotiated settlement model. This could potentially address the problem highlighted above but could also be extremely complex, taking into account the large number of parties each with their distinct needs and views of the services they believe to be key.

Parties may also be concerned about the relative "power" they would have to get the services they need when in practice they would be competing against their competitors for the provision of User Pays services. Whilst the current User Pays concept is very limited and supposedly restricted to non-core services, the extension of User Pays could make it very difficult for the industry to agree the outputs for the services to be delivered and could therefore result in numerous applications to Ofgem for their intervention.

Further, the proposal for a single non-executive board member to sit on the Xoserve's board in order to represent network users' interests would seem to be very difficult to achieve in practice, taking into account the wide diversity of interests across the users.

### Option B

Establishing Xoserve as a separate licensed entity clearly allows it to operate under its own objectives rather than the large transporter objectives. Whilst the latter includes the requirement to secure effective competition between relevant shippers and between relevant suppliers, the main focus for the large transporters is the efficient and economic operation of their pipeline. Though initially Xoserve's focus was on running transporter systems to deliver the requirements under the UNC, it is clear that there are increasing pressures to widen its role, particularly regarding the provision of services that may be more focused on shipper and supplier needs than those of the large transporter.

Similarly the setting of different objectives under the licence may help in removing any concerns that arise from the continued ownership by the large transporters, although there is also a risk that these concerns remain.

CEPA also recognise that this option has considerable risks and it could therefore be argued that it might be unwise to introduce an untested model into an area which is so crucial to the operation of the GB gas market, particularly at a time of potentially significant change.

### Option C

It is our experience in developments such as the MRA and Supply Point Administration Agreement (SPAA) that moving to a model that has a wider ownership than just the large transporters (as is the case for Xoserve) may help in promoting industry confidence and support an expansion of the Xoserve services that the industry may need to develop to maximise the benefits from developments such as Smart Metering.

The not for profit model supported by transparent and easily understood arrangements has worked well and has been successful in driving down industry costs while being highly adaptive to change. In 1998, when the MRA commenced, it cost approximately £10m p.a. (at today's prices) to run. For 2011/12, the annual MRA budget is £3.4m (excluding the operation of ECOES) with an increased scope since 2006. For this reason it would seem advisable to continue with a model of this type rather than move to one that is theoretical and untested.

However it must be acknowledged that this will take considerable industry commitment at a time when it is already stretched on a range of industry developments such as Smart Metering, Green Deal, Renewable Heat, Nexus, Recalculating Annual Quantities, Single Service Provision and Theft of Gas.

<b>Assessment of the three Options against the Ofgem and DECC principles of good governance</b>			
<b>Principle</b>	<b>Option A</b>	<b>Option B</b>	<b>Option C</b>
Promote inclusive, accessible and effective consultation	This is generally handled under the UNC which may be improved through the introduction of the industry planning group.	Would require either the development of a new Xoserve code or extensive revisions and extensions to the Agency Services Agreement in addition to the UNC.	Would require either the development of a new Xoserve code or extensive revisions and extensions to the Agency Services Agreement in addition to the UNC.
Be governed by processes that are transparent and easily understood	Currently a perceived weakness of the transporter ownership of Xoserve. Adding a non-executive board member may provide limited improvement.	Proposals unclear. However, continued ownership by the large transporters needs to be balanced by very transparent governance arrangements which could lead to conflicts.	Both the MRA and BSC models are well developed and understood by the industry.
Be administered in an independent/ objective manner	Currently a perceived weakness of the transporter ownership of Xoserve. Non large transporters have little direct influence over activities.	The continuation of large transporter ownership could impact the ability to make independent and objective decisions.	Removal of transporter ownership should further encourage Xoserve to operate directly for the benefit of the industry.
Provide rigorous, high quality analysis of any case for change	The extent of any analysis carried out is agreed by the large transporters although the UNC arrangements may have a limited influence.	The improvement in accountability to different industry groups should ensure that the necessary analysis can be delivered.	The improvement in accountability to different industry groups should ensure that the necessary analysis can be delivered.
Be cost effective	Currently the ability for non large transporter parties to assess cost effectiveness is limited. Ofgem have suggested that they find it difficult to fully assess the Xoserve costs. Negotiated settlement may contribute to an improvement and, in theory, greater use of User Pays should assist. To date parties have not been very satisfied that User Pays costs are transparent.	Under this option there should be more transparency of costs and more potential for changing the way services are provided – i.e. the industry may have more say in whether or not Xoserve continues to be used for certain services. However, as the report identifies, cost allocation may still be contentious and difficult to achieve to the satisfaction of all.	Under this option there should be more transparency of costs and more potential for changing the way services are provided – i.e. the industry may have more say in whether or not Xoserve continues to be used for certain services. Accurate cost allocation will continue to be difficult to achieve but the ownership structure should ensure that there are no particular conflict of interest issues.
Contain rules and processes that are sufficiently flexible to allow for efficient change management	This is currently handled under the UNC and may be improved through the introduction of the industry planning group.	This may require the introduction of a further level of complexity to manage change in addition to the UNC. However the licence should ensure that all parties can participate.	This may require the introduction of a further level of complexity to manage change in addition to the UNC. However all parties should be familiar with the change process.
Be delivered in a manner that results in a proportionate regulatory burden	Generally parties seem satisfied with the level of regulatory burden but this may change if the proportion of services provided under User Pays increases significantly.	As highlighted Ofgem may continue to be called upon to arbitrate on issues that parties cannot agree on thus adding additional regulatory overhead.	Experience to date, particularly with MRA, suggests that the industry is comfortable with this type of governance arrangement.
Specific and proportionate to the market need (Gemserv addition)	Historically this was the case but it is unlikely that this will continue to be the case as the market continues to evolve. The industry planning group could be beneficial in this area as they could negotiate a settlement.	The overall concern is what this solution would add in terms of motivating Xoserve to meet the needs of the whole market other than its licence obligation. The move to an untried model introduces significant risk to address an area that to date has worked reasonably well.	The move to this type of arrangement would take significant industry focus and time and it is questionable whether, particularly with everything else that is currently in hand, that the industry would believe the change is proportionate to the market need.

**Question 4: Critical Issues: What are your views on the critical issues identified by CEPA for determining the preferred option (p.73)? Are there any other critical issues we should take into account before making the decision?**

Our view is that the two key points that should influence how this issue progresses are:

- What appetite is there amongst industry participants outside the Gas Transporters to assume a greater role, responsibility, and therefore accountability for Xoserve and its activities; and
- Whether the systems and services provided by Xoserve are of such criticality to the industry during a period of already significant change in the energy sector, that fundamental change to Xoserve funding, governance and ownership raises too great a risk?

Whilst we do not consider we can or should attempt to answer these on the basis that we are not a principal user of Xoserve services, we do note that there are a number of key activities that overlap with many of the areas currently managed by Xoserve. Amongst these would be the re-write of many of the systems administered by Xoserve under the Nexus project together with the associated change to a number of the key industry processes (RbD, Rolling AQs), the responsibility for the DCC to operate a single registration system and the proposal (yet to be agreed) for Xoserve to operate service provision for the iGTs.

Having said this we also believe that some of the above issues will only be resolved by the industry rather than regulatory imposition. Our main reason for expressing this view is that most of the major issues relate to the changing supplier role in the market rather than to transporter motivated industry developments. Whether the timing is right to make such change now needs to be determined by the industry.