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Dear James,

Re: Open letter consultation: Review of Xoserve

Thank you for the opportunity to respond to your open letter consultation on the review of Xoserve. It is in our capacity as a Gas Transporter that this response is made.

We believe that the current governance and funding arrangements for Xoserve, as a delivery agent of GT obligations, are fully aligned and appropriate given the current structure of licence obligations within the sector. We do not believe that changing these arrangements will deliver any significant benefits to customers. Nor do we detect that other industry parties are willing and able to take over responsibilities from the GTs.

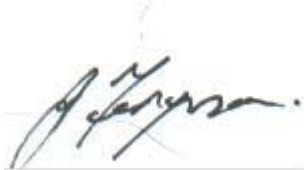
Xoserve was created as the common services agent of the GT's at the point of network sale in 2005 as a result of industry concerns relating to the possible fragmenting of processes GT's were obliged to perform and the likelihood of increased costs if the Gas Distribution Networks (GDNs) were each to undertake their own UNC and invoicing activities. The common agent approach has successfully delivered a single point of contact for all Shippers to the GT activities that are obligated under the Uniform Network Code (UNC). NGN is of the view that the fundamental model is sound and does not require structural change.

We believe that none of the options noted in the CEPA consultation are suitable in their entirety and that any changes need to be proportionate to the actual issues. An incremental approach to improvement has already begun and this should be allowed to complete its course. The change process operated by Xoserve is largely in response to UNC driven modification and it is this element that may benefit from improved processes and transparency. The ability of Xoserve to respond to change depends on Shippers taking appropriate action to articulate problems, rather than just solutions and this element of the communication process is being considered as part of the Review Group 0334 conclusions.

More clarity on funding of general industry change would be welcomed, particularly for areas where User Pays may not be appropriate and for changes that are driven by legislative change rather than commercial drivers. A cost through process that aligns itself to the UNC governance has been suggested in the past by GDNs and this should be further considered as part of an incremental improvement programme.

I hope you find these comments useful and please contact me should you require further information.

Yours sincerely,



Joanna Ferguson
Network Code Manager

Questions

Question 1: *What, if any, concerns do you have with regard to the performance of Xoserve? Do you agree or disagree with CEPA's articulation of network users' concerns about the responsiveness of Xoserve to industry change, and lack of transparency (pp28-29)?*

Xoserve has an extremely strong record of performance with the range of Key Performance Indicators monitored and reported to GT customers. The day-to-day performance on both Shipper and GT facing services goes largely unnoticed due to the strong achievement and this is reflected in the very positive Shipper satisfaction survey results. The comments contained within the CEPA report note poor responsiveness and lack of transparency as concerns raised by Shippers but these are not commonly reflected when Xoserve undertakes regular Shipper surveys and visits with stakeholders.

As the GT's IT systems manager with responsibility to the GTs for a large IT system which has been the subject of continued change in requirements since 1995, Xoserve operates a robust analysis and change process when Shippers or GTs request change through the UNC Modification process. As a result of UNC Review Group 0334 Xoserve has taken a closer role in attending UNC workgroups and uses this opportunity to raise early issues about the system implications of proposed contractual changes. This closer relationship with the shipping community has also led to Shippers being more inclined to contact Xoserve in advance of raising UNC changes so that significant system implications can be considered at an early stage. NGN would encourage Shippers to continue to use this route fully and to clearly articulate the issues they are seeking to resolve as this enables Xoserve to provide a range of options, where possible, for facilitating changes. This increased interaction naturally leads to more efficient processes as complex system solutions may not need to be analysed if they can be ruled out at an early stage in the UNC Modification process.

Changes that are directed from UNC Modifications are carried out by Xoserve as part of their change management programme. These changes need to be carried out in an efficient manner and this may result in changes being combined at the point of technical resolution to reduce risks posed when system changes are made. An overview of the change programme and the implementation plan are discussed with the UNC UK Link Committee which Shippers are party to. NGN believe that the visibility of change through this forum remains a key interaction with Shippers.

Transparency has been raised in the context of User Pays and UNC Modifications. At the point in the modification process that business rules are sufficiently well defined Xoserve produces Rough Orders of Magnitude (ROMs) for inclusion in the Modification Report. The increased use of the ROM process as part of the User Pays UNC Modifications has led to recent standardisation of ROM templates to ensure that the level of content is consistent across different changes. Costs in this context relate to the bought in services that Xoserve will need to incur to carry out a particular change. The level of charges associated with User Pays is around 5% of the overall annual costs of Xoserve.

Question 2: *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 (pp29-32)?*

The current funding, governance and ownership of Xoserve reflects the role of Xoserve as the GT's centralised agent and service provider for certain UNC functions. GTs are obligated through their licence and the UNC to undertake many activities that are Shipper facing, and in order to achieve a consistent and efficient approach, together with delivering value for money for

customers, Xoserve was created to deliver these obligations. GTs are further obligated through their licence to implement provisions for the common provision of UNC services and systems.

Xoserve currently receives its income and investment funding by a combination of charges to GTs through the formal agency contract (ASA) and User Pays charges from Shippers. The ASA charges account for around 95% of the overall annual costs and this proportion of their charges is reflective of the fact that the vast majority of services that Xoserve provide is to discharge GT obligations.

Given the particular nature and responsibility for delivery of the range of services and processes under the UNC, including that of invoice production, it is important that the GTs are able to exercise a proportionate amount of control over the agent. The ASA is a largely risk free contract for Xoserve in light of the way in which it is funded and to ensure that the GTs are suitably protected from risks associated with outsourcing of business critical activity it is appropriate that in addition to contract management activity, GTs are further able to monitor Xoserve through their role as shareholders and non-executive directors.

NGN agrees that the use of pre-agreed allowed revenue is not necessarily appropriate for funding an area of constant unknown change however given uncertainties over industry change and the lack of short term pass through mechanisms to address such funding requirements it may be the best approach currently available. The run-the-business costs of Xoserve are relatively stable and predictable, however the change process would benefit from a more flexible approach to funding of changes that have industry wide benefits and impacts such as a shorter term pass through mechanism.

Question 3: *What are your views on the costs and benefits of the three options for change (Ch 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?*

NGN does not agree that any of the options presented are necessarily required unless there is a rebalancing of roles and responsibilities for the delivery of the outputs xoserve currently manages for GTs. However, that aside, we would have the following comments on the various options presented:

Option 1: This option will result in the least disruption to industry and largely enables incremental improvements to continue. The inclusion of a Shipper as a non-executive board member is disproportionate to the issues that have been raised. A role as an observer or non-voting board member at the xoserve Board may be more appropriate which would have the advantage of not placing unnecessary Companies Acts duties on such an individual. The creation of a broader industry change board would however, seem to better address the areas of concern that Shippers have raised in relation to responsiveness to change. The existing UK Link Committee is of a largely technical nature and either a change to the terms of reference of this group or the creation of a new change board could be achieved without significant upheaval. The current UNC workgroup process already provides user requirements group, and a new group considering change will need to be mindful of the large number of UNC Modifications that may impact on a future change landscape.

The nature of the negotiated settlement area of this option appears to present extended User Pays services. Certainty of funding for GT obligations that are discharged through Xoserve should continue to be funded as part of the GT price control. These services currently account for around 95% of Xoserve's activity and GTs have no option in carrying out these functions. Extended engagement in the funding of future change from Shippers would on the face of it appear to ensure that change is considered to deliver clear benefits to Shippers, but since the

inception of User Pays Shippers have preferred to raise changes as GT obligations rather than using a User Pays or bi-lateral route to obtaining additional services. It is not clear to NGN how negotiated settlement would operate in practice.

NGN noted that at the Ofgem workshop on 24 October option1 lite appeared to be the preferred option of most parties with a clear preference for incremental improvement before considering the risks posed by more disruptive changes. The lack of clarity on using a negotiated settlement process was also discussed at this workshop and with this in mind, NGN believes that incremental changes which encompass the spirit of this option would be the most suitable route forward at this time.

Option 2: NGN does not believe that the creation of a new licensed organisation to deliver central services, while leaving ownership with the GTs offers clarity or efficiency. The UNC is a bilateral arrangement between GTs and Shippers, albeit operating in a multilateral manner. Under this model it would be appropriate to transfer the GT obligations to the new licensed entity. This would be a considerable task with a requirement for extensive changes to the existing contractual arrangements to establish the separate role and obligations of such an entity throughout the UNC and related instruments. Such a process would be time consuming and costly for all concerned and would not appear to deliver any actual benefits. NGN noted that at the Ofgem workshop held on 24 October there was no support for this option and would consider that this should effectively remove this option as having no industry appetite at unknown costs and benefits.

Option 3: A key feature of the current model is that there is alignment of the obligations under UNC on GTs with the ownership of the means of delivery through the use of agency principles. This option effectively severs that link but does not shift responsibility for delivery which adds risk back into the process for all concerned but no added reward, this is not appropriate. By disassociating the obligations from ownership considerable additional risk to GTs is created, in particular for activities such as invoice production which arguably should remain under the control of the GTs. In the context of minimising such income risks GTs might well look to take their invoice production processes back within their own core activities (as Shippers do!) which would have the effect of undermining what was a key concern of Shippers expressed at the time of network sales, namely the non proliferation of system interfaces with GTs.

In a practical business sense issues such as funding, cashflow and liabilities, would cause practical problems as the organisation became more standalone and subject to normal commercial requirements and costs associated with dealing with such issues.

The differing interests and business drivers of parties in different sectors is currently one of the highest change drivers in the UNC. The diversity in activity and organisation size in the gas industry makes it difficult to establish a co-operative arrangement that is considered to be fair and proportionate to all parties. The desire for inclusion of Industrial & Commercial (I&C) Shippers into the Supply Point Administration Agreement (SPAA) has resulted in a series of proposed changes to the SPAA Ltd voting arrangements, none of which have succeeded to date. This shows that creating a co-operative model poses high risks to Shippers who may feel disenfranchised as well as the risk to GTs of lack of control of invoice production and other licensed obligations.

This model would require significant industry upheaval and costs to create the co-operative governance and changes to the existing obligations within the UNC would need to be re-aligned if there is to be any alignment of obligation and risk.

Question 4: *What are your views on the critical issues identified by CEPA for determining the preferred option (p73)? Are there any other critical issues we should take into account before making our decision?*

There is a wide ranging change landscape for the considerable future with the Government desire for roll-out of smart metering to all domestic premises and the creation of another industry code to manage this (Smart Energy Code). This process will need to consider consequential changes to both the UNC and SPAA for gas and further radical change on top of this would introduce significant risk to gas industry participants. Separation of Xoserve services to facilitate radical change will further put at risk the developments that the industry appears to desire from Project Nexus.

Question 5: *Should we change the current arrangements? If so, what is your preferred option?*

NGN believes that the current arrangements remain appropriate in aligning obligations and accountability, and continuity to deliver the best solution to the industry for the most efficient level of cost. There is room for improvement in the UNC change processes which Xoserve helps deliver and these are being addressed through a programme of incremental change. This route offers a low risk way forward and remains the most appropriate.