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Dear James

Open letter consultation : Review of Xoserve

Thank you for providing SSE and SGN with the opportunity to respond to the above open letter consultation on the Review of Xoserve funding, ownership and governance following the publication of Cambridge Economic Associates (CEPA) report.

SGN as joint shareholders and customers of Xoserve, alongside the other gas distribution networks and National Grid Transmission, places great importance on the smooth and efficient running of Xoserve and the services it provides to ensure licence and code obligations placed upon us are delivered successfully. We rely on the services and data managed and collated by Xoserve for many critical network activities including asset management, emergency service provision and ultimately for the timely and accurate billing of 99% of our income.

SSE as a gas Shipper and Supplier also places great reliance upon Xoserve to ensure many industry activities are discharged on time and to a high degree of accuracy, particularly energy balancing and transportation charging activities.

Since the commencement of the first gas distribution price control (GDPCR1) the core activities Xoserve undertake on behalf of the gas transporters (GTs) and the industry as a whole have been funded through a regulated ex ante funding mechanism with the Agency Services Agreement (ASA) providing the contractual link between the GTs and Xoserve as a service provider. Early in GDPCR1 Ofgem also introduced the User Pays mechanism in an attempt to encourage the GTs (through Xoserve) to provide additional services to the gas industry. The cost of these additional services are funded through a separate User Pays mechanism to ensure the cost of incremental change is targeted at Users who request and benefit from such change.

We believe the core day to day activities undertaken by Xoserve, which provide a critical foundation to the operation of the gas industry, are carried out successfully. The ex-ante funding mechanism also provides a sensible framework for the funding of these services as they largely relate to licence and code obligations and are predictable across a price control period.



However we recognise issues and concerns exist. We believe they largely focus on Xoserve's ability to react to incremental change prompted by individual industry participants and the transparency afforded in relation to funding and timing of such incremental change. We believe current arrangements could be fine tuned to address these important concerns. We do not believe significant reform of funding, governance or ownership arrangements is required at this point in time.

We believe concerns could be addressed through an enhanced Option A. We are concerned the scale and nature of change proposed under Options B and C is disproportionate and high risk. We believe costs could outweigh any potential benefit. In particular, the scale and nature of change required under Option B and C could detract from the services provided by Xoserve at a crucial point in the gas industry's development where Xoserve support will be integral to the successful introduction of smart metering, bio gas growth, interfaces with iGT systems and processes and European directed change.

Our responses to the specific consultation questions are detailed below in the attached appendix. In essence we believe the existing regulated ex-ante funding mechanism remains robust for the core business activities which Xoserve provides. Where incremental change is required as a result of participant led initiatives we believe a more flexible and inclusive approach could be developed which would permit greater industry control and transparency while retaining strong efficiency drivers for cost control.

Should you have any further questions relating to this response please do not hesitate to contact me at the above address or Joel Martin on 0131 4691813.

Yours sincerely

Malcolm Burns
Senior Regulation Manager

Appendix: Response to consultation questions

1. Xoserve's performance: 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 user's concerns about the responsiveness of Xoserve to industry change, and lack of transparency (pp. 28-29)? Please provide reasons.

We believe the day to day performance of Xoserve in the provision of core services has been reliable and thoroughly professional. We believe this view is supported by the majority of responses Xoserve has received to the annual Shipper satisfaction surveys and is also reflected in CEPA's own report following discussions with industry stakeholders. Xoserve consistently provide ASA based services to SGN and ultimately the industry as a whole on an efficient basis with little or no disruption to activities. We also believe the wealth of experience Xoserve has built up and retained within the organisation since their inception is fundamental to the continued successful provision of crucial core services.

We believe the majority of industry concerns expressed in relation to Xoserve relate to industry led incremental change and the ability of Xoserve (through funding and governance arrangements) to react to the requirements of individual participants and the industry as a whole in a timely manner.

The Uniform Network Code (UNC) & the Change Process.

Historically the vast amount of industry led change to be delivered by Xoserve has been the result of proposed modifications to the UNC. As the UNC governs both the way individual participants work and how they interact with each other, code modifications which impact on systems tend to be more complex than participants envisage. Robust governance procedures support change and protect industry arrangements, all industry participants and their individual systems. Unfortunately, these robust arrangements are often seen as delaying change and adding to cost.

It is our experience that modification proposals often require substantial analysis, development and detailed specification to finalise system requirements, determine cost and allow proposals to proceed through the UNC governance process. This can easily take 12 months to complete as Xoserve has to ensure it fully understands the proposer's requirements and as the detail starts to emerge, there are often differing and sometimes conflicting industry views which can result in alternative proposals being raised or the original proposal being modified. This in turn requires further analysis which creates more delay and uncertainty. While this may be frustrating for the proposer we believe it is a robust governance arrangement that is essential to protect the integrity of the market and all participants.

Since the inception of the User Pays regime a further layer of complexity and delay has been added to allow cost / benefit analysis to take place and to determine how costs should be recovered where they are to be targeted at a specific group of Users. Again, while we believe this is necessary and robust, it is often seen as causing delay and adds to concerns about participants' abilities to instigate and deliver industry led change.

Xoserve's ability to deliver industry led change in an efficient and timely manner has been an ongoing criticism throughout GDPCR1. In our view some of this criticism is unfair. We believe it is crucial that Xoserve ensures proposals are well defined and fully understood in order that it can ensure existing systems are able to cope with new requirements without compromising the overall delivery of critical industry processes and to ensure costs are fully understood.

It must be remembered that Xoserve's systems interact with multiple organisations' systems, not just a single organisation's own internal structure. As a result extended testing and development schedules are sometimes necessary, particularly when dealing with systems which are now over ten years old. We do not believe it is always appropriate to compare the service or a response from Xoserve to that of another IT service provider to a single entity's requirements. That said we believe there is scope for improvement in some areas.

The UNC Modification Proposal 334 (Post Implementation Review of Central Systems Funding and Governance Arrangements) looked to address several issues raised in the CEPA report and following the publication of the completed workgroup report Xoserve is now in the process of implementing a number of changes which we believe will help address concerns. One enhancement we believe will help deliver significant improvements is the introduction of a specific Xoserve point of contact. This will allow industry participants to engage with Xoserve earlier in the change process to understand system constraints, ensure proposals and requirements are clearly defined and to assess all alternatives. This will not only improve transparency and industry understanding of Xoserve systems and constraints, it will also help reduce cost, protracted implementation timescales and ensure the most effective solution is developed and implemented. It could also help ensure greater coordination between projects.

In addition to the measure set out above, we believe greater transparency is still required in relation to Xoserve activities. Excessive cost is an issue that is often raised by industry participants and has resulted in a number of change proposals being cited as uneconomic. As set out above, we believe costs are often higher than participants originally anticipate because of the way proposals are developed; other less costly alternatives may exist. Through greater Xoserve involvement at an earlier stage this could be avoided, but we also believe cost must be judged in relation to the aging and inflexible systems. It also needs to be considered against all participants' willingness to pay, not just against the wishes of the proposer. We believe increased transparency around cost is required to improve industry understanding and confidence and to provide certainty when judging whether change is beneficial or not.

We do not believe changes proposed to the structure, funding or governance of Xoserve are necessary or will address the concerns listed above. Investment in overall system flexibility, such as that being considered by Project Nexus, will help tackle the root cause but greater transparency and earlier Xoserve involvement in the change process can also be delivered under current arrangements.

In summary, we believe the issue of industry change and the ability of Xoserve to react to required industry led change is an area which should be considered and analysed separately from the day to day services Xoserve provide. Also, any changes which may be considered appropriate to remedy any weaknesses in the industry change process should be judged in relation to the overall impact they may have on the critical day to day services and should not jeopardise or undermine the provision of these services. We believe the conclusions drawn from the MOD 334 industry work group and the subsequent changes Xoserve is enacting should be allowed to develop prior to any further radical change being considered. In the meantime incremental improvements in transparency and budget control should be progressed.

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.

We believe the current funding, governance and ownership arrangement of Xoserve has successfully delivered the day to day business requirements. However we recognise a number of organisations within the gas industry have raised concerns regarding Xoserve's ability to react to industry led change and operate within the current funding framework. Both the User Pays' regime, because of its complexity; and the transporter (ex ante) funding mechanism, due

to its innate driver to reduce cost have not provided the flexibility some participants expected.

We believe it is important to recognise both regimes have robust governance arrangements to protect all participants. All UNC modification proposals must better facilitate the relevant licence objectives. Xoserve is often criticised where proposals fail when in reality the proposal fails to meet this crucial industry test. Similarly, User Pays proposals often fail as agreement can't be reached amongst participants in relation to cost / benefit or willingness to pay. We believe the principals behind these processes remain valid and should be retained but we suggest they could be further refined through industry engagement to provide efficiency checks, more flexibility and control over change budgets for Shippers. We believe this could be delivered under the current governance model or an enhanced Option A.

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 (Ch 8)? Are there any other options not identified by CEPA that we should consider?

Of the three options defined within the CEPA report we consider an enhanced Option A to be the most preferable. This will provide a firm platform for the continued provision of crucial industry requirements while providing a more flexible funding regime to address future industry requirements associated with such areas as smart metering. We believe Options B & C, which would introduce fundamental changes to the way Xoserve is governed and funded, would pose too great a risk at this point in time. We also believe the genuine issues raised by industry participants relating to the current change process can be effectively tackled by enhanced features under Option A, including but not limited to:

- (a) increased industry involvement around the change process e.g. direct involvement in a change oversight committee;
- (b) increased knowledge of Xoserve board activities e.g. a regular Shipper nominated observer to attend Xoserve board meetings; and
- (c) a change budget to be controlled by Shippers (this would be linked to the GT ex ante funding mechanism).

We believe Option B poses too great a risk. Xoserve would be established as a single licensed entity breaking the link between the GTs and the licence requirements. It would then require a high degree of industry support to establish the subsequent commercial contracts required to support vital services provided by Xoserve and essential to the smooth operation of the current industry arrangements. We would strongly recommend Ofgem do not consider Option B at this stage.

Option C, which would create a jointly governed Xoserve entity, similar to the Elexon model, would also pose the same risks to the industry as under option B and potentially could result in increased delays in the change process due to multi party agreement being required to set and agree Xoserve priorities and budgets. The current activities provided on behalf of the GTs and National Grid Transmission would be required to be separated out from the general industry facing change activity which would cause potential disruption to day to day activities and cause a splintering effect to Xoserve expertise across the industry, with the risk that may pose.

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 our decision?

We have drawn from the CEPA report the critical issues to be the following:

- (a). *Are the systems and processes carried out by Xoserve separable from the GT businesses?*

As we have previously stated the systems and process Xoserve performs on behalf GTs are integral to the day to day running and operational activities we perform. Separating out these functions from the requirements of other industry organisations would be difficult and require significant resource capability and commitment from all industry bodies. Although not impossible, given the involvement required from Xoserve to facilitate the smart metering roll out and other key industry change requirements (Nexus etc.) this would be too great a risk to the industry as a whole at this point in time.

(b). Are the activities performed by Xoserve cooperative in nature?

The systems and processes performed by Xoserve are cooperative in nature in that they provide the foundations for a multitude of organisations' requirements. However the model established at network sales, of a GT owned and managed central agency, remains as valid today as it did then. GT licence requirements ensure industry services are maintained without the potential distraction of individual (commercial) drivers of different organisations that may impact on the efficient running of these crucial core services. Individual Shipper requirements could and are provided for through the User Pays process where Xoserve interface directly with these organisations to provide such services.

(c). Is there an appetite amongst industry participants to take on a greater role, responsibility and accountability for Xoserve?

We are not aware of a significant driver from other industry organisations to take on the responsibility and accountability for all Xoserve services, particularly core services. We believe the requests for increased transparency of Xoserve costs and grater influence over the incremental industry led change process may have been interpreted as desire to directly control the organisation itself.

(d). Is there too great a risk of separating Xoserve systems and modifying Xoserve's funding, governance and ownership at this stage in the industries development to justify an option B or C approach?

As we have previously stated, the risk at this particular time of adopting an Option B or C approach to Xoserve governance would be too great. We also do not believe they are necessary or proportionate to the concerns that we believe exist. We believe industry concerns could easily be addressed through an enhanced Option A that provided for increased Shipper involvement in the change process and separate more flexible funding arrangements for Shipper led change e.g. through a separate GT ex-ante funding mechanism.

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

Considering the three options detailed within the CEPA report we consider an enhanced Option "A" would be the most appropriate template to apply to the future funding, ownership and governance of Xoserve and the associated activities. A modified Option A would provide the opportunity to address the specific concerns raised as part of the UNC Modification 0334 process and the wider industry dissatisfaction with the change process. Specifically we would suggest a modified Option A should incorporate the following features:

1. A continuum of the current ex ante funding mechanism for core Xoserve service provision.
2. A flexible funding regime which while providing for cross industry agreed change also takes into account the principals established in the User Pays regime, i.e. targeted costs and assurance of cost against benefits. Whether this was established via a directly funded Shipper change 'pot' or via incremental Xoserve cost requests should be developed further by the industry as a whole.



3. Increased representation of industry organisations in an observer capacity at Xoserve board meetings and change managements / steering groups.
4. A rolled out programme of UNC MOD 334 conclusions including increased Xoserve interaction with gas Shipper customers to more efficiently align change requests with outcomes and expectations.