



James Grayburn  
Head of RIIO-GD1  
Ofgem  
9 Millbank  
London  
SW1P 3GE

Wales & West House  
Spooner Close  
Celtic Springs  
Coedkernew  
Newport NP10 8FZ  
T. 029 2027 8500  
F. 0870 1450076  
www.wwutilities.co.uk

Tŷ Wales & West  
Spooner Close  
Celtic Springs  
Coedcernyw  
Casnewydd NP10 8FZ

22<sup>nd</sup> November 2011

## Wales & West Utilities response to Ofgem's open letter consultation: Review of Xoserve

Dear James,

Wales & West Utilities Limited ("WWU") is a licensed Gas Distribution Network ("GDN") providing gas transportation services for all major shippers in the UK. We cover 1/6th of Great Britain and transport gas to 2.5 million supply points. WWU is the only licensed operator that focuses solely on gas distribution in Great Britain.

WWU is currently in the process of writing its business plan for submission by 30<sup>th</sup> November 2011 for the next price control period 2013-2021 ("RIIO-GD1").

Firstly, we would like to thank you for the opportunity to respond to your open letter consultation on the future of Xoserve governance and funding. As a GDN, we are a licensed entity and our licence contains Standard Special Condition ("SSC") A15 ("Agency"), the requirement to use a centralised agency for common transporter services and we are a signatory to the Agency Service Agreement ("ASA"). The ASA charging methodology is based upon the services that we receive from Xoserve and the determined usage of such services.

Based upon our current network customer numbers and types we account for approximately 11% of Xoserve GDN funding. The 11% accounts for approximately 1% of WWU's annual allowed revenue and less than 0.1% relates to industry change and development. Whilst we appreciate the issues that have been identified are significant to Xoserve stakeholders and customers, any solution must be proportionate.

We have provided below a brief summary of our thoughts on the Xoserve review and have also provided answers to the specific questions contained in your open letter consultation.

### Summary

WWU believe that the arrangements put in place by way of SSC A15 were appropriate at the time of network sales and, for the vast majority of Xoserve activities, this remains the case. We agree with the industry concern over the change process and understand why shippers may feel that cost allocation, cost of change and reasons for 'lengthy' timescales are not as transparent as they could be. We also agree with the CEPA report and industry representations that the day-to-day activities that Xoserve carry out, which are fundamental to the operation of the gas industry, are performed to a high degree of competence with a high degree, and continually increasing, level of customer satisfaction.

24 hour gas escape number  
Rhif 24 awr os bydd nwy yn gollwng

**0800 111 999\***

\*calls will be recorded and may be monitored  
caiff galwadau eu recordio a gellir eu monitro

Wales & West Utilities Limited  
Registered Office:  
Wales & West House, Spooner Close, Coedkernew, Newport NP10 8FZ  
Registered in England and Wales: No. 5046791

The three options outlined in the CEPA report and in the Ofgem open letter present fairly significant changes albeit to differing degrees. We are generally supportive of initiatives contained within Option A as we believe they will deliver the most appropriate and proportional solutions. This is aligned with the general feedback given by stakeholders at the recent Ofgem round table discussion.

Option B is impracticable in terms of the effort required to establish a licence for Xoserve to operate under. CEPA have used the Data Communications Company (“DCC”) that is required for smart metering roll out as an example of where this has happened elsewhere. In order for DCC to become a licensed entity there has been the requirement to change primary legislation to create prohibited activities in the Gas Act (and the Electricity Act). This would seem a totally disproportionate solution to the issues identified.

Option C would use other existing industry arrangements as a model for a revised ownership structure. Even though a number of services provided by Xoserve are not to the direct benefit of transporters, the services are obligations within the Uniform Network Code (“UNC”). Having a UNC in place is one of our licence requirements (SSC A11 “Network Code and Uniform Network Code”) and therefore delivery of UNC services that facilitate the relevant objectives are effectively transporter licence requirements. WWU is not supportive of any arrangements that would lessen the control they currently have on delivery of such obligations. An alternative to Option C, and potentially a more suitable arrangement, would be for shippers/suppliers to take on shipper/supplier facing obligations and be responsible for full delivery of them under other industry supplier led arrangements (e.g. under the Supply Point Administration Agreement (“SPAA”) or through the new Smart Energy Code (“SEC”) and the DCC).

**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 on network user’s concerns about the responsiveness of Xoserve to industry change, and lack of transparency (pp.28-29)? Please provide reasons.**

It is apparent from the CEPA report, from network user’s comments at the recent Ofgem round table session and from Xoserve’s customer satisfaction surveys that the industry is predominately happy with the level of service that Xoserve provide. The areas of concern relate mainly to the change process, transparency of costs and cost allocation.

As a direct customer and signatory to the ASA, WWU are satisfied with the level of service that they provide to us. Whilst we appreciate the concerns identified regarding the responsiveness of Xoserve, we must remember that the over arching governance and control of industry change sits within the modification rules of the UNC. Over recent times there have been an increased number of UNC modification proposals raised that require systems and cost analysis to be carried out by Xoserve. This process has often been burdensome due to unclear requirements and modification proposals containing solutions rather than clearly identifying the issues. There have been occasions where modification proposals appear to have fallen at the last hurdle, and often after months of discussions, due the output from Xoserve analysis. Such frustrations partly led to a UNC review group being formed to look at the change process, funding and governance of Xoserve. The review proposal is known more commonly as Mod 0334<sup>1</sup> and has led to a number of recommendations for the industry to take forward.

Since the conclusion of the Mod 0334 review group Xoserve have been leading on a programme of work to take forward the recommendations, relevant to them, from the review group report. We have already seen many benefits of this work with notable changes such as:

---

<sup>1</sup> [www.gasgovernance.co.uk/0334](http://www.gasgovernance.co.uk/0334) (“Post Implementation Review of Central Systems Funding and Governance Arrangements”)

- a) A process of early engagement for shippers that may be considering raising a UNC modification proposal allowing them to discuss the issues, potential solutions and the key drivers behind likely costs and implementation timescales. This not only leads to a reduction in the time taken for proposals to develop in industry meetings but also helps a modification proposer to tailor the proposed solution to meet their needs and the general needs of the industry.
- b) A Post Implementation Review process allowing industry participants to take previous UNC modification proposals and establish lessons learnt with the aim to continue improvements in the modification and change process.
- c) Increased work group and modification panel attendance. Xoserve have established new roles for representatives involved in the change process ensuring that they can attend the key industry meetings as informed service providers and support the modification process.
- d) Changes to the cost estimate process. Xoserve can now provide an indication of likely costs and development/implementation timescales at various levels throughout the modification process. This has helped to better inform the industry in the early stages of a modification to give an idea of the likely timescales and cost with more detail being available as a proposal develops and clear business rules are defined.

**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 agree with the issues that CEPA have identified; the general day-to-day (run the business) elements of Xoserve activities do fit with the ex-ante price control approach. However, it does not seem appropriate or sustainable to apply this funding mechanism to ongoing industry change that Xoserve is dealing with (e.g. UNC modifications, DCC enablement, Project Nexus (UK Link replacement)). The User Pays regime has also been a cause of industry frustration during the current price control period. As with the change process, this is not entirely in Xoserve's control and we would suggest that, although we are supportive of User Pays, the regime would benefit from some changes (detailed below).

As mentioned above, the day-to-day run the business elements of Xoserve provide a high level of service and satisfaction to the industry. The use of ex-ante allowances via the transporters continues to be appropriate as it has proven to deliver cost effective and efficient services year on year.

We agree with CEPA that a more flexible funding mechanism is required for industry changes that are out of the control of Xoserve and the transporters. Having a set allowance for unknown projects over an 8 year period could create the perverse incentive on transporters to drive down costs and prevent industry required development and changes. We believe that these elements of Xoserve should be treated in a similar way to other uncertainties in our RIIO submission that would allow for the appropriate funding to be available only when costs are incurred. This would remove the risk element from the transporters and give additional transparency to the process. An alternative to a fully flexible funding regime for incremental and industry change would be to allow for an estimate of change costs to be included in the transporter allowance with a suitable annual true-up mechanism.

We have previously suggested to Ofgem that Standard Special Condition E3 of our licence could be used as a suitable mechanism for flexible funding. By adding an additional term in our licence to cover industry or regulatory changes, coupled with links in to the UNC modification rules for improved governance, would allow for industry agreed costs to be recovered through transportation charges. This would effectively remove the need for transporters to be funded up front for changes that are uncertain, or in most cases

unknown, in the run up to a price control period giving the shipping community the transparency that they require.

This is the same model that DECC have proposed should be used for the DCC's<sup>2</sup> allowed revenue. The DCC will also be in the position that they will not be in control of changes that they are required to make which have come from the SEC modification process or mandated regulatory changes (including European Directives). As with current SSC E3 terms, for costs to qualify for treatment under E3 they would either need to meet the criteria specified in the licence or would need to be approved by Ofgem (or through some other governance framework). This mechanism could also bring benefits to the User Pays regime; we have described this in more detail below.

User Pays was introduced as part of the existing price control period and originally focused on taking existing price control funded services and making them User Pays. Following significant industry consultation it was agreed that a small number of services (approximately £3m per annum in cost) would become User Pays. These arrangements have been largely a success with shippers targeting those services that are valuable to them which has resulted in changes in demand and a clear focus from Xoserve in delivering cost effective services.

At the time, the concept of User Pays applying to industry change and the UNC modification process had not been developed. UNC modifications were raised to create the User Pays regime within the modification process and this has continued to develop over the last few years. Overall we are supportive of the User Pays regime as it clearly focuses the industry on the real value of modification proposals and, on occasions, has been the determining factor in organisations' support or opposition for change. However, there are a number of issues with the User Pays regime that need to be addressed and would reduce the frustration experienced by industry participants:

a) Dual governance

The approval process, or veto process, for the Agency Charging Statement ("ACS") comes under the governance of the transporter licence (SSC A15). When a UNC modification proposal is subject to User Pays the proposer should follow the UNC guidelines on how to apportion costs between transporters and shippers of development/implementation and, where applicable, ongoing service costs. Once a modification proposal is in the final stages, Xoserve, on behalf of the transporters, issues a draft ACS amendment to Ofgem and they have a period of 28 days to veto the changes if they determine it necessary to do so. There has always been a general principle that Ofgem would not approve a UNC modification proposal in isolation and the industry could expect to get consistency with decisions (i.e. approval or rejection of both the modification proposal and the ACS submission). This issue materialised with UNC modification proposal 0276<sup>3</sup> where Ofgem approved the UNC modification proposal but rejected the ACS submission. This has left the transporters in a position where they are unable to act upon the Ofgem direction and implement the proposal as a suitable funding mechanism has not been agreed.

In light of this issue, and as an output and recommendation from the Mod 0334 review group, WWU now intend to raise a UNC modification proposal to put the governance of the ACS into the UNC. The

---

<sup>2</sup> The proposed arrangements are currently subject to a DECC consultation (<http://www.decc.gov.uk/assets/decc/11/consultation/smart-metering-imp-prog/2883-cons-detailed-policy-design-of-dcc.pdf>)

<sup>3</sup> [www.gasgovernance.co.uk/0276](http://www.gasgovernance.co.uk/0276) ("Alternative User Pays approach to - UNC Modification Proposal 0263 - Enabling the Assignment of a Partial Quantity of Registered NTS Exit (Flat) Capacity")

intent of such a proposal is to tie the decisions on UNC changes and ACS amendments together and remove this dual governance. Ofgem engagement on this proposal will be required as in order for this to be taken forward changes will be required to SSC A15.

b) Significant industry changes

Where a fairly significant change to the UNC is proposed, such as the recent modification relating to the EU requirement for 3 week switching proposed by EON<sup>4</sup>, which has a broadly equal impact on shippers, it does not seem appropriate for it to be subject to User Pays charges. Shippers cannot opt out of the 3 week switching requirement, and the service is not targeted at a certain market sector, so the only justifiable use of User Pays is that it acts a convenient way to recover costs from the industry. If such changes were known about prior to a price control period, it is likely that the costs would form part of the Xoserve element of the transporters' submissions and would be funded via transportation charges. The mechanism describe above utilising SSC E3 of our licence would be a suitable way of funding such changes and would remove the need to create User Pays charges for industry change that would otherwise be centrally funded.

c) Minor changes

The issues around minor changes, with relatively small or insignificant costs<sup>5</sup>, are similar to that with significant industry change; the User Pays regime appears to create more cost and frustration for changes that could simply be funded via the transporters. The transporters, or Xoserve, could be given a change fund each year to manage minor change with the costs still being under the scrutiny of the UNC modification process. However, this still could lead to the same concerns that ex-ante allowances create. Utilising the SSC E3 mechanism described above would again be a suitable mechanism for dealing with such costs.

An alternative flexible funding mechanism would be to retain the ex-ante approach for day-to-day activities but allow any ongoing incremental Xoserve costs to be recovered directly from Users. This would effectively remove the transporters from the funding and invoicing arrangements, remove the need for multiple transporter invoices for single changes, and deliver greater transparency of the cost of change and transparency on how those costs are apportioned. Currently Xoserve are unable to bill shippers directly for services that are provided on behalf of the transporters, however, some simple governance changes (mainly within the UNC) could allow for this change to take place.

However, a slightly simpler mechanism that would give the same transparency, albeit not the benefits of costs being invoiced by a single entity, would be for transporters to create separate charge items for Xoserve costs (e.g. a new charge type or invoice type) that would clearly identify the Xoserve element of allowed revenue (up front funding) as well as any additional incremental costs that had been incurred for incremental change (potentially via revised arrangements within SSC E3).

---

<sup>4</sup> [www.gasgovernance.co.uk/0396](http://www.gasgovernance.co.uk/0396) ("EU Third package: Three week switching")

<sup>5</sup> UNC Modification Proposal 0395 [www.gasgovernance.co.uk/0395](http://www.gasgovernance.co.uk/0395) ("Limitation on Retrospective Invoicing and Invoice Correction") is an example of where minor costs have been identified. Development and implementation costs will be less than £15k and will need to be recovered via a User Pays Service and User Pays Charges from over 40 shippers.

**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 views on the costs and benefits of each of the CEPA options are:

**Option A (“Enhanced/Improved as-is”):** We believe that Option A, or elements of it, will deliver the most appropriate and proportional solutions to the issues identified. The gas industry is currently undergoing a period of significant change and the industry appetite for significant reform of Xoserve is not apparent or evident. This is consistent with the discussions that took place at the Ofgem round table session where the general view from stakeholders was:

- a) The issues identified are limited to a small part of the Xoserve function/role;
- b) Options B & C present significant industry upheaval without necessarily resolving the issues;
- c) Options B & C appear wholly disproportionate; and
- d) The Xoserve day-to-day role is working well, Xoserve services are vital to transporter and shipper organisations and this should not be put at risk during a period with such significant industry change.

Xoserve are currently involved in several major pieces of industry change, we believe that Option A is the only solution that would not put these at risk, which include the following:

- i) The establishment of transporter/Xoserve services to the DCC and iGTs to allow DCC to perform “Access Control” and to allow critical smart metering information to pass between suppliers at change of supplier (required by 2014);
- ii) Project Nexus (UK Link replacement requirements gathering) is coming to an end and Xoserve and the industry are about to move into the next phase of the project. This will scope, design and deliver the changes required for UK Link systems to support gas industry arrangements over the next 10 years (all subject to UNC modification proposals);
- iii) Establishment of a single service provider for all gas transporters (GDNs and iGTs). This is a topic that has been about for a number of years and is now being looked at under the auspices of iGT UNC modification proposal 039. Shippers, iGTs, GDNs, Xoserve and Ofgem are all working to take forward what is seen as one of the top priorities of shippers/suppliers.

We believe that continual incremental improvements to the modification process and the Xoserve change process are already delivering the desired outcomes and resolving some of the issues identified. Xoserve, transporters and shippers will continue to work to implement the recommendations from the Mod 0334 review group and, as mentioned above, WWU are committed to playing a key role in such developments.

The other area that would bring significant benefits would be the change in funding arrangements allowing a more flexible and transparent approach. We have outlined above our thoughts on how a flexible funding model could operate. We would welcome further discussions with Ofgem and stakeholders to develop these models further.

The costs of Option A are fairly limited as it only involves changes to process and governance. Option A would also be the most expedient way of delivering solutions to the issues identified. It would seem wholly sensible to opt for an Option A model at least as a first step with a further review being carried out later during the RIIO-GD1 period or prior to RIIO-GD2.

**Option B (“Xoserve as a licensed entity”):** We believe that Option B is impracticable in terms of the work required to establish a licence for Xoserve to operate under. CEPA use the DCC, which is required for smart metering roll out, as an example of where this has happened elsewhere. However, In order for DCC to become a licensed entity there has been the requirement to change primary legislation to create prohibited activities in the Gas Act (and the Electricity Act). This would seem a totally disproportionate and extremely costly option.

Establishing Xoserve as a separate licensed entity would not necessarily resolve the main issues that CEPA have identified. The UNC modification process would remain the same and Xoserve’s interaction with it would remain the same (without implementing parts of Option A and the output from the Mod 0334 review group). We would also be concerned that functions that are core to the operation of our business (i.e. not shipper facing services) were being taken out of control and increasing the risk to our business.

In summary, we are not supportive of Option B as it would create unnecessary industry upheaval, would take significant time and effort to implement (if indeed possible), may not resolve the issues identified, would increase the risk to our business and is wholly disproportionate.

**Option C (“Cooperative body”):** Option C would use other existing industry arrangements as a model for a revised ownership structure. Even though a number of services provided by Xoserve are not to the direct benefit of transporters, they are obligations within the UNC. Having a UNC in place is one of our licence requirements (SSC A11) and therefore delivery of UNC services that facilitate the relevant objectives are effectively transporter licence obligations. For services to be within the UNC, or to be amended or added to the UNC, they must facilitate the transporters relevant objectives. One of the key relevant objectives is to facilitate competition, the transporters have the obligations under the UNC to deliver the majority of services within the UNC and, in our view, this arrangement has been the industry preference due to the impartial role that the transporters fulfil and helps to facilitate competition in the market.

The services that Xoserve provide to transporters, and the obligations that they satisfy, are critical to the operation of their businesses. WWU is not supportive of any arrangements that would lessen the control they currently have on delivery of such obligations.

An alternative to Option C, and potentially a more suitable arrangement, would be for shippers/suppliers to take on shipper/supplier obligations and be responsible for full delivery of them under other industry supplier led arrangements (e.g. under the SPAA or through the new Smart Energy Code and the DCC). The ability to move services, roles and responsibilities from the UNC to other codes sits with industry participants (transporters, shippers, suppliers etc.), we believe that the appropriate governance exists between these codes and therefore, if a change in responsibility and ownership of obligations is indeed desirable, the industry should be allowed to manage such a transition.

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

***Are the activities managed by Xoserve separable from GT businesses?***

Yes although this would not be a simple task. However, with the inception of the DCC and with changes on the horizon being delivered through the Project Nexus / UK Link replacement project; this could present an opportunity for this. The key to separating activities has to be driven by a change in obligations.

***Are the activities performed by Xoserve “co-operative” in nature?***

UNC administration and Xoserve services (under the ASA) are already separate and carried out by different organisations. Some of the services that Xoserve carry out could be considered to be ‘co-operative’; however, the majority of services are where Xoserve are carrying out obligations that rest with the transporters through either the UNC or licence. Some services will be directly for transporters whilst others facilitate market functions (e.g. change of supplier) are entirely shipper facing. For shipper facing activities, the transporters (or Xoserve) carry out a purely facilitating role and, in our view, this is beneficial to the shipper/supplier market and facilitates the transporters relevant objective of promoting effective competition.

***What is appetite for shippers to be accountable for Xoserve?***

There appears to be a mixed level of appetite from shippers to be accountable for, or in control of, Xoserve, however, we have seen little or no evidence of appetite to take on obligations or the risks involved with delivery of such obligations.

***Are the systems and services provided by Xoserve of such criticality to the industry during a period of significant change in the energy sector, that fundamental change to Xoserve raises too great a risk?***

Yes. As described above, the industry is currently undergoing significant change and we believe that the upheaval, time and cost associated with Option B & C would put such change programmes at risk.

We do hope that the comments provided are helpful to Ofgem in completing this review of Xoserve governance and funding. We would welcome a further opportunity to discuss the options above with Ofgem and stakeholders, following the review of responses, in order to further develop any of the options identified by CEPA or any alternatives that have been suggested.

If you have any questions relating to this response then please contact myself or Simon Trivella ([simon.trivella@wwutilities.co.uk](mailto:simon.trivella@wwutilities.co.uk)).

Yours faithfully



Steve Edwards  
Head of Regulation and Commercial  
Wales & West Utilities