Gas Transporters, Shippers,
Suppliers and other interested
parties

Promoting choice and value for
all gas and electricity customers

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Date: 16 January 2012

Dear Colleagues,

Open letter: Review of Xoserve – Ofgem's conclusions

In our March Strategy Decision document for the gas distribution price control review (RIIO-GD1), we set out our intention to undertake a review of Xoserve's funding, governance and ownership arrangements.[1] The purpose of the review was to examine whether the current arrangements facilitate the provision of an efficient and high quality service, and one that is responsive to network users' needs, and wider industry change. Xoserve provides a range of centralised data services to support the operation of the GB gas industry.[2]

The level of satisfaction with Xoserve's current service provision is high. We undertook the review in response to shippers' concerns about whether the current arrangements would provide the required responsiveness and flexibility in funding in the context of future industry changes, notably the roll-out of smart metering.

In July 2011, we commissioned Cambridge Economic Policy Associates (CEPA) to undertake a review of the current arrangements.[3] In September 2011 we issued an open letter consultation which set out the potential options for change based on CEPA's review, and in October 2011 we held an industry round table discussion to consider the potential options.[4] This letter sets out our conclusions on the optimal set of arrangements following consideration of the responses that we have received to our open letter.[5]

Our conclusions

We have concluded that option C ("co-operative model") represents the optimal set of arrangements. Under this option decisions about the future provision of data services supporting the supplier market will rest with the users of those services (ie shippers/suppliers), and the costs of such services will be recovered from them directly. Option C reflects existing arrangements governing other energy sector data service providers, such as Elexon and the Master Registration Agreement Service Company (MRASCo) in electricity. Our proposed model contrasts with the current arrangements

[1] See: Ofgem (March 2011) Decision on strategy for the next gas distribution price control – RIIO-GD1 Outputs and incentives. Link: http://www.ofgem.gov.uk/Networks/GasDistr/RIIO-GD1/ConRes/Documents1/GD1decisionoutput.pdf
[2] See: http://www.xoserve.com/
[3] CEPA (August 2011) Review of Xoserve Funding, Governance and Ownership, Final Report
[4] See Ofgem (19 September 2011) Open letter consultation: Review of Xoserve. http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=324&refer=Networks/GasDistr/RIIO-GD1/ConRes
[5] We have published the non-confidential responses along with this decision letter. We received one confidential response which we have not published.

where control over data services rests with the Gas Transporters (GTs), and costs are recovered through GTs' regulated network charges. We consider that option C will best address the concerns expressed by the industry about their influence over decision-making, transparency and flexible funding, and will enable the industry to effectively respond to future challenges for data service provision arising from the roll-out of smart meters.

Respondents have proposed a range of different models within the scope of option C. For example, some respondents have suggested the separation of GT facing services from supplier services within the new arrangements. We have not reached a decision on the details of the new arrangements such as the degree of separation of GT and supplier services. Instead, we will initiate an implementation project to determine the precise funding, governance and ownership arrangements within the ambit of option C (ie where the governance of the supplier facing services rests with the industry).

In annex 1, we set out in more detail the reasons for our conclusions. In annex 2, we set out next steps, including key issues we will need to address in putting in place the new arrangements, and how we will fund Xoserve in the transitional period. In annex 3, we summarise responses to the questions we set out in our open letter consultation.

If you have any questions in relation to this letter please contact me by e-mail (james.grayburn@ofgem.gov.uk) or on 020 7901 7483.

Yours sincerely,

James Grayburn
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Annex 1: Reasons for our conclusions

We first set out respondents' and our views on the limitations of the current model. We then set out respondents' views on the options for change, and our conclusions.

Limitations of the current model

CEPA's report identified two potential flaws in the current institutional arrangements which could hinder the development of future data services to meet the requirements associated with the roll-out of smart meters. First, CEPA considered that the current contractual arrangements – where Xoserve is effectively an outsourced data service provider to the GTs – mean that Xoserve is focussed on serving the GTs rather than focussed on providing services to the wider industry. Second, CEPA considered that funding Xoserve through network charges – based on an 8 year ex-ante fixed allowance – fails to provide the flexibility or transparency required to respond to changes to data services required to support the gas market.

Respondents' views

Most respondents believed that the current price control arrangements had provided strong incentives to minimise costs, and the arrangements worked well where the outputs/policy environment was stable. However, most respondents, including Xoserve, GTs and shippers, considered that more flexible funding arrangements (as opposed to a fixed 8-year ex-ante allowance) would be required for the next price control to accommodate uncertainty in relation to data services supporting the supplier market.

Most respondents also considered that the current arrangements did not provide sufficient transparency with regard to the costs associated with delivering change. The reasons cited include the small proportion of revenues accounted for by Xoserve as a total of GT price regulated revenues (less than 1%)[6], and the lack of clarity of the funding and associated outputs agreed at the price control. Respondents also expressed concern about the User Pays model, including the weak incentives on GTs/Xoserve to develop User Pays services, a complex cost allocation process, and cumbersome recharging arrangements.

With regard to the contractual arrangements, Xoserve and most GTs did not consider that the current corporate ownership and governance arrangements led to the prioritisation of GTs' interests. Xoserve noted that they acted in accordance with the relevant code and licence governance arrangements regardless of whether the change is GT or shipper driven.[7] ICOSS stated that their primary concern was in relation to funding rather than governance and ownership, and considered that improvements could be achieved without fundamental changes to the current governance/ownership rules.[8]

By contrast, other shippers considered that the limitations of the current governance arrangements – which confer day-to-day control to GTs – required more fundamental reform to ensure network users have sufficient control over the strategic decisions facing the gas sector and data service provision.

Our view

We consider there is strong case for changing the current institutional arrangements. As widely acknowledged Xoserve's day-to-day performance is good and improving. However, shippers have expressed dissatisfaction with the current institutional arrangements and the management of change. Consistent with most respondents, we have concerns about the

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6 See Ofgem (December 2010) Consultation on strategy for the next gas distribution price control - RIIO-GD1 Outputs and incentives, para 4.23 http://www.ofgem.gov.uk/NETWORKS/GASDISTR/RIIO-GD1/CONRES/Documents1/GD1%20outputs%20and%20incent.pdf

7 Xoserve (18 November 2011) op. cit., para 3.4

8 ICOSS (18 November 2011) op. cit., p. 1

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inflexibility of funding arrangements associated with funding Xoserve through GT revenues, as well as the ownership and governance which rests solely with the GTs.

As we have explained above, most respondents to our open letter agreed that the current institutional arrangement required change. However, there is disagreement among the respondents as to whether incremental or fundamental change is required to address the limitations of the current model. We discuss the potential options for change and respondents' views below.

Options for change: Respondents' views

In our open letter, we set out three options for change. We summarise these as follows:

- *Option A (optimising current arrangements)*: Option A retains the current governance (i.e. ASA) and ownership (i.e. owned by the GTs) arrangements but proposes a number of potential changes to provide wider industry participation in the determination of services provided by Xoserve, and more flexible funding. For example, CEPA proposed to formalise the industry involvement in determining the services provided by Xoserve through a "User Requirement Planning Group"[9] comprising Xoserve and shippers.[10]

  CEPA also proposed to extend the User Pays model, and/or introduce a negotiated settlement model to provide more flexibility in funding relative to the current ex-ante price cap mechanism. CEPA also proposed a non-executive board member to sit on the Xoserve's board.

- *Option B (licensed entity)*: This option establishes Xoserve as a separate licensed activity. The GTs would continue to own Xoserve, and certain service obligations which are critical to the operation of the GTs' businesses (e.g. invoicing shippers) might be retained within the GT licences, and managed through a contract between the GTs and Xoserve (as per current arrangements). However, the obligation to provide all other market services would lie with Xoserve as the licensed entity. The objective of this model would be to create a more empowered central agent and one that is directly responsible to shippers.

  CEPA also envisaged changing the funding arrangements in order to recover the costs of the central agent directly from industry users instead of through network charges. CEPA also envisaged the adoption of a negotiated settlement process to define the services and funding levels (as with option A).

- *Option C (co-operative model)*: Under this option, CEPA proposed a co-operative not-for-profit agent, similar to the current arrangements in the electricity sector, eg MRASCo and Elexon. The key characteristic is that responsibility for the provision of supplier-facing services would rest with the wider industry.

Respondents' views on the options

Respondents broadly divided into two groups. Of the 18 respondents[11], seven respondents including Xoserve, most of the GTs, plus ICOSS and SSE considered that only incremental change to the current arrangements was required, i.e. along the lines of option A. By contrast, seven of the respondents, including most shippers supported option C. One shipper supported option B or C. NPower was the only respondent that supported option B outright. NGGT did not support any of the options, and the Gas Forum did not express a preference.

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[9] See CEPA (August 2011) op. cit., page 40 for a description of the User Requirements Planning Group.

[10] Option A incorporates the elements of UNC 334 modification workgroup which reviewed central system funding and governance arrangements (UNC Review 334). See CEPA (August 2011) op. cit., Chapter 6. For UNC 334 report, see: http://gasgovernance.co.uk/0334

[11] We received 18 responses counting the joint response from SGN and SSE as two separate responses.

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Supporting A

Respondents supporting option A suggested a number of variations to the proposed option described by CEPA. For example, most of the respondents supporting option A did not support the adoption of negotiated settlement as conceived by CEPA but instead proposed alternative mechanisms to ensure flexible funding. For example, WWU suggested that we extend existing pass-through mechanisms to recover "*industry agreed costs*" (eg costs arising from UNC modifications and other regulatory changes).[12] NGGD proposed a "*not-for-profit element of incremental funding*" to provide funding for services to the industry.[13] ICOSS also considered that flexible funding could be achieved through a pass-through item for change management costs where the costs are agreed by the wider industry.[14]

Those supporting option A also considered that improvements to the transparency and responsiveness of change management could be achieved through incremental changes. For example, Xoserve noted that the changes set out by UNC Review 334 could deliver improved transparency and responsiveness to network users without any need for fundamental ownership or governance changes. Xoserve set out their intention to introduce shipper representation on the Board; a change oversight committee to establish user requirements; and, the development of an industry priority plan (as well as proposals for flexible funding).[15] ICOSS considered that improvements to transparency such as an oversight committee and non-exec Board member can be progressed without changes to the current governance/ownership rules.[16]

Most of the respondents supporting option A considered that options B and C would be a disproportionate response to shippers' concerns, be costly and carry a high risk in relation to the successful delivery of current projects delivering change (eg Project Nexus, iGT harmonisation). SGN/SSE noted that the potential separation of the GT activities from the market facing activities under option C would cause potential disruption to day-to-day activities. The GTs also noted concern about lessening control over GT critical operations which might require them to take such operations (eg shipper invoicing) in-house. Xoserve were concerned that option C would leave the arrangements without an "*independent arbiter*" (ie Ofgem). [17]

Supporting C

By contrast, a majority of the shipper respondents (with the exceptions of ICOSS and SSE) considered that option A would not address their concerns with regard to the lack of industry influence over the prioritisation, progression and delivery of change. Most shippers considered that option A would leave the GTs to determine the priorities for changes to services supporting the gas market rather than the users of such services.

Some respondents also noted that Project Nexus working groups – which would provide a model for enhanced shipper engagement under option A – was at an early stage and the real test of how well the process worked was yet to come. In relation to the specific proposal to appoint a non-Executive Director, BG cited the CEPA report that non-execs are generally appointed to prevent activities and outcomes as opposed to driving strategy and decision-making.[18]

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[12] WWU recommended treating such costs as pass-through costs under Standard Special Condition E3 (or the equivalent revised condition). Source: WWU (22nd November 2011) Wales and West Utilities response to Ofgem's open letter consultation: Review of Xoserve, p.3

[13] NGG (18 November 2011) op. cit., p.3.

[14] ICOSS (18 November 2011) op. cit., p.2

[15] Xoserve (18 November 2011) op. cit, p.5

[16] ICOSS (18 November 2011) op. cit., p.1

[17] Xoserve (18 November 2011) op. cit. p. 4.

[18] British Gas (18 November 2011) op. cit., p.8, para. 3.8

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Some shippers also considered that a wait-and-see approach to see if the incremental changes under option A improved performance was high risk. If option A failed then the industry would have to undergo more fundamental change in a few years time, and at a much more critical time for the industry (eg closer to the transfer of functions to the DCC).[19] They considered that it was necessary to put in place the optimal arrangements now and in advance of addressing the critical issues facing the industry.

BG supported the development of a model akin to the MRASCo rather than Elexon as they considered MRASCo is more inclusive of industry parties in terms of representation and voting.[20] Scottish Power noted the potential to draw on lessons from the Supply Point Administration Agreement (SPAA) as well as Distribution Connection and Use of System Agreement (DCUSA).[21] More generally, shippers noted that the governance arrangements under option C would need to ensure that the arrangements did not confer undue control to any single industry interest group.

BG noted that it is important the industry eventually moves towards an overarching governance structure under the Smart Energy Code (SEC) that provides harmonised retail governance with the ultimate migration of SPAA, Master Registration Agreement (MRA), and relevant sections of the UNC to enable cross-fuel switching processes.

Supporting B

Most respondents did not support option B for a number of reasons including: cost and complexity of establishing a new licence; the risk that negotiated settlement will default to arbitration by Ofgem; and, because the option leaves ownership and control with GTs with the risk that shippers' concerns about control over decision-making remain unresolved. The only exception was NPower who considered that option B "*balances relatively simple changes that overcome the constraints of the [existing] funding model*".[22]

Other

Finally, NGGT expressed concern with all the models. For option A, they were concerned that is does not take into account the differences between the distribution and transmission activities which face different drivers of change. Under option B, NGGT were concerned about the transfer of de jure obligations placed on GTs to a separate licensed entity. Under option C, they considered that it was difficult to state whether the arrangements were appropriate depending on the obligations that passed to the new body.

Options for change: Our conclusions

We consider that option C represents the optimal set of arrangements. This is the only option that assigns control for the delivery of the data services supporting the supplier market to those that will principally rely on such services, i.e. shippers and suppliers. Option C will also provide more flexible funding arrangements for new services by recharging the cost of such services to market participants (as opposed to fixing allowed revenues on an ex-ante basis). We also consider there is significant merit in removing Ofgem from the process of periodically determining outputs and associated funding levels. Under option C, our role will be minimised.

We consider that such arrangements provide a better framework for delivery of data services than option A. With regard to control over the services delivered, the proposed extension of the current Project Nexus arrangements as proposed under option A is untested as a model for user engagement, and would leave the final decision with GTs over

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[19] The DCC is the data communications company (DCC). The DCC will manage data and communications from smart meters in the domestic sector for both the gas and electricity sectors. See http://www.decc.gov.uk/en/content/cms/tackling/smart_meters/dccg/dccg.aspx

[20] British Gas (18 November 2011) op. cit., p.10

[21] Scottish Power (18 November 2011) op. cit., p3.

[22] Npower (18 November 2011) op. cit., p.4

the provision of market-facing services. We also consider that the flexible funding arrangements envisaged under option A are inferior to option C. Proponents of option A proposed changes to provide flexible funding, such as cost pass-through arrangements or the extension of User Pays. But such provisions in the price control will inevitably involve us assessing whether the proposed costs are efficient unless the industry can attest to this (which we envisage will be difficult to achieve, as demonstrated by User Pays). As a consequence, under option A there is a risk we would be required to determine additional revenues on a periodic basis with the attendant cost and delay that referral to us would imply.

We also have concerns about extending User Pays to all (or most) market-facing services or relying on negotiated settlement under option A, as CEPA envisaged. Most respondents (including GTs) consider that User Pays has not worked well to date because of, inter alia, the informational advantage that Xoserve/GTs enjoy over shippers, the weak incentives on GTs/Xoserve to develop such services, cost allocation issues etc. We consider that extending User Pays will accentuate such problems, and that its extension to a wider set of shipper services is impractical.[23] With regard to negotiated settlement, we note that such arrangements are untested in a UK regulatory environment, and there is a high risk that the industry fails to agree to outputs and costs (again, as witnessed under User Pays) and the arrangements collapse back to a periodic price review by us.

We do not support option B as we consider that establishing a new licensed entity would involve significant cost but would still leave control with the GTs over data service provision. As with option A, we also consider that the extension of User Pays arrangements or negotiated settlement as envisaged by CEPA under option B will not provide practicable solutions to the requirement for flexible funding. We also note that only one respondent to our consultation supported option B.

We therefore consider that option C represents the optimal set of arrangements relative to either options A or B.

Critical issues

In our open letter, we also set out critical issues that we would need to consider before making our final decision. The responses to our consultation have reassured us that such critical issues do not present obstacles to the adoption of option C.

We stated that we needed to be clear that there was shipper appetite to be involved in setting-up the reformed central agency if we were to implement fundamental reform (eg option C). Most shipper respondents expressed support for fundamental change to the current arrangements, and to be involved in the development of the new arrangements.

We also asked whether respondents considered that the potential risk to the provision of Xoserve's services from fundamental change – and distraction from delivering change – provided a reason not to adopt option C. We consider that the industry should put in place the optimal arrangements prior to the major industry changes, eg DCC implementation, finalisation of Project Nexus. These challenges provide the reason for putting in place the optimal arrangements now as opposed to a strategy of wait-and-see (as proposed by some respondents supporting option A). We consider that there is a greater risk from adopting option A and delaying more fundamental change to a later more critical date for the industry, as expressed by a number of respondents.

We also agree with those respondents who considered that the short-term risks to current service delivery can be mitigated by a clearly defined industry delivery plan.

[23] For example, if User Pays is extended to cover major capex as opposed to incremental funding, this raises questions of who provides the initial funding, and who bears demand and cost risk. The process will accentuate the cost allocation issues (as the costs will be larger), and concerns about transparency and timing of service specification and cost. For a discussion of the problems associated with extending User Pays to cover a broader set of market services, see: CEPA (August 2011) op. cit., p. 56

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We also consider that the risks of failure of the new arrangements are mitigated by the existence of comparable models such as Elexon and MRASCo, as set out in our consultation, as well as SPAA and DCUSA governance arrangements as noted by respondents to our consultation.

We are therefore satisfied that there is a general shipper support for the implementation of reform, and the implementation risks are manageable.

We also asked whether the GT and market-facing services were separable such that we can identify the costs of provision and assign these costs to the relevant parties. We also asked whether the separation of UNC governance from Xoserve presents any obstacles to a co-operative model. We are satisfied that these issues do not provide material obstacles to option C, and should be addressed at the design stage. We return to the issue of the separation of GT and supplier facing services in discussing the key issues to address in Annex 2.

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Annex 2: Next steps

We intend to initiate an implementation project to define the precise funding, governance and ownership arrangements for central services within the broad ambit of option C, ie where governance lies with the wider industry. We will run this project in close collaboration with the industry.

Overview of the implementation project

We will appoint a project manager to manage the implementation project. The project manager will identify the issues that need to be resolved to put in place the new arrangements, and resolve these issues through collaboration with the industry. In order to ensure industry input, we envisage establishing an industry working group, and we will appoint the chair of the working group. We intend to provide financial support for the costs of the implementation project through price controlled revenues.

In terms of the timetable for introducing the new arrangements, we anticipate this will take around 12 months from this decision based on responses to our consultation, i.e. early-to-mid 2013. We will establish detailed interim milestones and a proposed date for implementation of the new arrangements.

We will be in contact with the key stakeholders shortly setting out the arrangements and inviting stakeholders to an industry working group.

Issues to address

One of the issues that we along with the industry will need to address is whether the GT-facing and market-facing services should be separated, eg functionally-separated (ie within the new co-operative entity), legally (ie delivered by separate legal entities) or by ownership.

A number of the respondents considered that they could be provided by separate legal entities or separate owners. For example, WWU noted that a potential suitable arrangement would be for shippers/suppliers to take on their obligations and be responsible for meeting them under other industry supplier led arrangements (e.g. under the SPAA or SEC).[24] NGGD also proposed that GT services could be retained by Xoserve, with market-facing services assigned to a new co-operative entity. NGGD also suggest the potential for SPAA to take on the "UNC company" role.[25] First Utility also proposed restricting the provision of Xoserve services to GT Agent services, and creating a new licensed company to provide market facing services.[26] NGGT noted that attention needs to be given to the location of Gemini, including incorporating Gemini within NTS.[27]

However, some network respondents considered that the separation would require significant re-engineering. This potentially points to retaining GT and market-facing services within the same entity. A number of respondents noted that UK Link replacement project might offer one opportunity to separate GT from market facing systems.

We have not reached a decision on the functional, legal or ownership separation of GT and market facing services in this letter. Instead, we will need to consider this issue as part of the implementation project.

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[24] WWU (18 November 2011) op. cit., p.2. WWU state that: "*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 led arrangements (eg under the "Supply Point Administration Agreement ("SPAA") or through the new Smart Energy Code ("SEC") and the DCC*".

[25] NGGD (18 November 2011) op. cit., p. 3

[26] First Utility (18 November 2011) op. cit., p.2

[27] NGGT (18 November 2011) op. cit., p.7

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As noted by a number of respondents, we will also need to consider the constitution of the future independent Board(s) to ensure that it is not dominated by Executive Directors, or non Executive Directors that represent any one particular interest.

We will also need to consider the implications for the harmonisation of iGTs within central service provision. Respondents to the consultation considered that option C would facilitate their incorporation. We expect iGTs to be represented on the industry working group.

Once we have determined the precise arrangements, we will need to identify the changes required to licences and codes including the residual licence conditions resting with the GTs; changes to UNC and iGT UNC; and, shipper licences etc.

Funding Xoserve in the transitional period

Finally, we note that the proposed changes have implications for how we set allowed revenues for the GTs in respect of Xoserve services at RIIO-GD1 and RIIO-T1 which will commence 1 April 2013. Under our proposed arrangements, we will need to allow GTs to recover the costs of their revised set of obligations through price controlled revenues. However, we also need to address the risk that the GTs revised set of obligations and associated funding requirements will not be known in time for setting final price limits for RIIO-GD1/T1. We therefore need to consider how to fund GT/Xoserve through the transitional period. One potential option is to roll-forward current funding arrangements for Xoserve for RIIO-GD1 and RIIO-T1, and introduce a mechanism to allow us to re-set the required revenues within the price control period once GT obligations and funding requirements are known. We propose to discuss the transitional funding arrangements with the implementation working group.

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Annex 3: Summary of Responses

This annex summarises respondents' views on the five questions that we set out in our open letter consultation

Question 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 users' concerns about the responsiveness of Xoserve to industry change and lack of transparency (pp.28-29)? Please provide reasons.

Most respondents, including both GTs and network users, agreed with CEPA's view that Xoserve provided a high level of service with regard to its day-to-day performance.

However, many respondents also expressed concerns with the responsiveness, transparency and management of industry change, and considered that the concerns were related to the current funding and governance arrangements.

Many network users considered that there was a lack of responsiveness to requests arising from shippers/suppliers; by contrast, Xoserve seemed able to implement a GT driven change more quickly. A number of shipper respondents also noted that the projected costs given by Xoserve for the realisation of system changes were often higher than expected, without a clear explanation of the reasons for being so.

Xoserve and most GTs considered that the perceived lack of transparency and responsiveness derives from the governance arrangements around the Uniform Network Code ("UNC"). Such respondents noted that the majority of changes delivered by Xoserve related to UNC modifications. Xoserve and most GTs noted that the UNC governance procedures were cumbersome and can often delay change and result in additional costs.

Most respondents (GTs and shippers included) considered that the User Pays funding process had often caused delays to implementing change. A number of GTs also noted that Xoserve's systems are aging and interact with different organisations' systems; therefore a prolonged period of testing solutions was required to minimise the risk of system failure.

Some respondents noted that, as a result of UNC Review 334, Xoserve has taken a more active role in engaging with shippers. Some respondents commended Xoserve on the management of Project Nexus to date. However, they also considered that it was uncertain if such a forum would work well as Project Nexus proceeded through to more complex phases.

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.

Most respondents, including both GTs and shippers, agreed with CEPA's report that the funding arrangements – where Xoserve is funded through GT price controlled revenues – were not flexible enough to respond to industry change. The respondents considered that the funding arrangements create stronger incentives for GTs to minimise costs rather than incentivising Xoserve to respond effectively to industry change.

Many respondents, including both GTs and shippers, highlighted concerns over the User Pays mechanism. They considered that the process has often led to delays in the change process as parties have been involved in lengthy discussions about cost allocations ("Who pays Users Pays?"), instead of discussing the substance of a modification proposal.

One respondent noted that many of the delays associated with the Users Pays process are outside of its control (eg cost allocation issues).

One GT was supportive overall of the User Pays process as it ensures that the industry considers the cost implications of any service changes. However, this respondent also considered that User Pays requires reform in order to address shippers' concerns. A number of GTs also suggested potential ways to introduce more flexibility into the funding arrangements through the extension of existing pass-through mechanisms in the price control formulae, eg through a revision to GTs Standard Special Condition E3. The pass-through items could include costs in relation to UNC modifications etc but would exclude GT facing services which would continue to be funded on an ex-ante basis.

Another GT considered that for User Pays to work efficiently there needs to be more clarity on what has been paid for through ex-ante allowances and what can be reasonably recharged to shippers. They also considered that the process for invoicing shippers needed to be simplified.

Another GT believed that the principles behind User Pays remained valid but suggested that the process should be refined to provide more efficiency checks, flexibility and control over change budgets.

Most shippers stated that the current ownership arrangements mean that Xoserve's primary responsibility is to its owners, the GTs, rather than its customers, the network users. In particular, one respondent stated that the current ownership arrangements mean that the transporters become involved in modification proposals that have no impact on them, relegating the shippers' role in the change process. Another shipper believed that fundamental reform of Xoserve's ownership would be beneficial to all industry parties including Xoserve, as it would provide them with greater freedom to engage pro-actively with the industry.

On the other hand, other respondents, including both GTs and shippers, did not consider that Xoserve's governance and ownership arrangements were an issue, as long as the funding arrangements were reformed. In particular, one respondent noted that, although there may be a perception that the ownership structure leads to a bias in decision-making in favour of the GTs, the actual decisions regarding changes to services are made by the relevant Code and Licence governance bodies. Another GT believed that it was important that the GTs were able to exercise a proportionate amount of control over the central agent (Xoserve).

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?

Option A - Changes within the current ownership and governance framework

Some respondents (including both GTs and shippers) considered that Option A, or a modified version of this option, constituted the most proportionate and effective way to resolve the problems with the current arrangements. These respondents also noted that most of the incremental changes, such as those set out by the UNC Review 334, could be implemented by Xoserve and by the industry without the need for licence or UNC changes. These same respondents believed that Option B and C would be disruptive and would pose too great a risk to the industry.

One network respondent did not support option A and was critical of a number of elements. In particular, they were concerned that the negotiated settlement and "Change Oversight Committee" (as proposed by UNC334/CEPA) could mean that insufficient priority is given to transmission related changes. They also believed that it would be premature to extend the User pays mechanism.

By contrast, some other respondents, mainly shippers or other non-network respondents believed that Option A would not resolve the fundamental problems highlighted by the CEPA report. In particular, they considered that option A would leave control over the decisions affecting the supplier market with the GTs.

Some of these respondents did not agree with the introduction of a negotiated settlement process in order to provide flexible funding. They considered that it would be complex to put in place and, given the conflicting interests in the industry, would inevitably result in arbitration by Ofgem.

One respondent did not believe that the proposal for a single non-executive member for Xoserve's board would work in practice, as it would be difficult to have one person representing the wider industry. Another respondent agreed with CEPA's view on the limited role of non-executives, that is, they are generally appointed to prevent activities rather than to drive strategy and decision making.

Option B - Separate licence, customer facing GT subsidiary

Almost all respondents were critical of option B. Most of these considered that the creation of a licensed entity would require considerable changes to the regulatory framework and would be costly to implement. They also noted that the negotiated settlement aspects of this option were untested.

A number of respondents also considered that the negotiated settlement process would imply a substantive role for Ofgem as arbiter.

Some respondents also believed that this option would not solve some of the fundamental issues with the current arrangements. In particular, under this model the GTs would still retain control over decisions affecting supplier processes.

On the other hand, one shipper expressed a preference for Option B as they considered that it balances relatively simple changes that overcome the constraints of the existing funding model, as well as preserving the integrity of critical functions, increasing transparency, and improving responsiveness.

Option C - Cooperative body

Many respondents (primarily shippers and other non-network respondents), expressed support for option C. These respondents considered that, under this option, Xoserve would be a more empowered entity, independent from the GTs and more responsive to change. They also believed that this option would promote the efficient provision of services.

Some of these respondents also suggested that SPAA as well as DCUSA might constitute useful governance models for the reformed Xoserve, in addition to the Elexon and MRASCo models cited in the open letter consultation. One of the respondents suggested the MRASCo model was preferable to the Elexon model, as they considered that the Elexon model failed to provide parties with an appropriate level of influence over the change process.

Some respondents also considered that option C would provide a solution to potential harmonisation of iGT services within central data services.

By contrast, some other respondents, included GTs and shippers, considered that option C would lead to significant industry upheaval and would pose too great a risk at this point in time. Some of these respondents also noted that changes to the existing obligations on GTs would need to be introduced to reflect a narrower set of obligations.

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Some respondents also noted that the diversity of interests of the parties to the UNC would make it very difficult to establish a co-operative arrangement in which all of the parties are fairly represented.

Other options identified by respondents

One shipper proposed an alternative solution: restrict Xoserve to the provision of GT Agent services which could not be reasonably separated from the GT's business, and create a new licensed company to provide additional "User Pays" services. The respondent also suggested that Ofgem could promote competition in the provision of data services by allowing other companies to provide Xoserve's services.

Another shipper proposed that Xoserve contract management (the majority of its services) could be moved to a third party such us Elexon, which would bring synergies and economies of scale.

Two GTs (not supporting option C) considered this option could be feasible if shippers/suppliers were to assume obligations for shipper/supplier services and be responsible for full delivery of them under other supplier led industry arrangements, such as SPAA or the SEC (Smart Energy Code).

Another respondent considered that one option would be to restructure the gas industry to mirror the electricity industry, in particular the MRA, BSC (Balancing and Settlement Code) and DCUSA models.

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 our decision?

4. a) Are the activities and systems managed by Xoserve separable from gas transportation business?

Most respondents, including both GTs and shippers, considered that Xoserve's activities and systems were separable from the GTs businesses. However, a number of respondents considered that it would be costly to separate Xoserve's GT services from the GTs businesses. These respondents were also concerned that any restructuring would pose too great a risk to the industry.

One respondent considered that it would be unrealistic to separate Xoserve's services from the GT businesses, as many of the systems that Xoserve manages are core to the delivery of GTs obligations. One GT also noted that elements of the Gemini systems are integral to the operation of the NTS and were therefore concerned about separating Xoserve systems into a new separate entity.

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

Most respondents considered that Xoserve's functions were co-operative by nature. One shipper noted that similar services in the electricity industry were provided on a co-operative basis which implied that Xoserve's services could also be provided in the same way.

4.c) What is the appetite for shippers to be accountable for Xoserve?

A number of shippers stated that they were prepared to assume a greater role and responsibility for the provision of data services. In particular one shipper stated that they were willing to assist in the development of the new model. One other shipper believed that there was a strong appetite to assume a greater role in governance and funding but noted

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that consideration needs to be given to the governance arrangements to ensure fair representation of all parties.

4.d) 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?

Almost all respondents recognised that the gas industry was about to undergo a period of significant change. However, there were opposing views on whether reforming Xoserve now or later would pose the greater risk.

Most GTs were concerned that seeking to introduce fundamental change now would place a strain on industry's resources and could cause delays in implementing industry changes (eg Project Nexus).

By contrast, other respondents mainly shippers, considered that the risk posed by delaying reform was greater than the potential risk posed by reforming Xoserve.

4.e) Other critical issues

A number of respondents highlighted that reforming Xoserve offered an opportunity to harmonise iGTs within central data services.

One respondent expressed concern that Ofgem's consultation had focused on the gas distribution related services and that insufficient consideration had been given to the transmission related services within the options for change.

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

The following Table summarises the respondents preferred option(s). As indicated by an asterisk (*), many respondents provided material modifications to the high-level options described in our open letter.

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Name	Preferred Option(s)
Xoserve	A*
Shippers/suppliers	
BG	C
Eon	C
Npower	B
First Utility	B or C
EdF	C
Scottish Power	C
ICoSS	A*
SSE (with SGN)	A*
Transporters	
NGGD	A*
NGGT	No support for any of the options
NGN	A*
WWU	A*
SGN (with SSE)	A*
Others	
Gemserv	C
AEP	C
Confidential respondent	C
Gas Forum	No preference

**=* *means that the respondent proposed modifications to the high-level option set out in our open letter consultation*

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