

**Consultation on implementing new funding, governance and ownership arrangements for Xoserve, the gas transporter central agent**

**Service delivery**

*1. Do you agree that there are benefits in retaining the central service provider as one delivery body for all systems and services, including Gemini systems? Do you consider there to be an alternative structure with greater benefits? Please provide evidence of these additional benefits.*

We concur with the views of CEPA and with Ofgem's preliminary recommendation. Given that the central service provider's systems are highly integrated and that all three of the recognised user groups have some degree of reliance upon the majority of systems and services provided, we agree that the most pragmatic approach is to retain the central provider as a single delivery body.

We do not consider there to be any other plausible, alternative structure which would achieve any further benefit to the industry.

It should be noted that as users of the Gemini System, it is important that shippers also have the opportunity to voice opinion and have influence upon any future changes to the system.

**Budget setting, cost allocation and charging**

*2. Do you agree with our preliminary recommendation for how future budgeting, charge setting and invoicing arrangements should work? Do you consider there to be greater benefits in establishing other arrangements? Please state your reasons why.*

We agree in principle with the aims of cost reflective charging, however given the high level of system integration highlighted by CEPA we are not convinced that cost reflectivity in charging, applied in a micro style to individual service lines, is either possible or efficient

The important element that the new arrangements will deliver will be the transparency of the annual budget and an overview of how this is broken down, at high level, into constituent parts. This step is enough to provide users of the central service provider with the level of scrutiny required, but we must ensure that arrangements do not go too far and risk the addition of unnecessary costs to all parties.

We value the simplicity of invoicing arrangements and do not wish to receive, for example multiple, small value invoices per month for all of the various service lines that the central service provider undertake. The more complex the invoicing arrangements, the more that this will cost both the central service provider and individual parties to establish, implement and operate. The introduction of additional costs in this area could ultimately negate any benefits that users receive via greater transparency and scrutiny of the budget.

We are also mindful that the total annual value of the central service provider budget, in terms of the overall transportation bill, is small, therefore copious amounts of invoicing detail and complexity is not required, nor welcome. Instead British Gas would expect the current billing arrangements to continue, with the Gas Transporters charging Shippers via transportation charges. With the exception that the Xoserve costs are treated as pass-through items by the Gas Transporters and shown as such in their DCMF revenue reports. We believe this allows for the transparency and influence of Xoserve's costs without adding extra costs to any party.

The principle of establishing an annual budget process is an important and positive step towards ensuring greater engagement of all parties that are impacted by the provision of

systems and services by Xoserve. We concur this will be the most efficient way of achieving the flexibility and transparency that are missing from the incumbent arrangements.

We are not convinced that a move to direct invoicing by the central service provider is a prudent or necessary step to take. We provide further comment on this issue within our response to question five.

*3. What are your views on the measures we have identified to ensure regulatory oversight is maintained?*

Of the five possible regulatory oversight measures considered by within the consultation, we concur with Ofgem's view that there is merit associated with the introduction of the first three measures and that the fifth measure is not appropriate. However, we do believe that there is some merit associated with measure four, under certain circumstances.

Taking each of the five possible measures in turn:

- *'Placing an obligation on those who control the central service provider to do so in an efficient and economic manner. We need to consider further whether the obligation would be best applied through the UNC or in users' licences.'*

We concur that the introduction of an *'efficient and economic manner'* obligation upon those who control the central service provider would be appropriate. In terms of where the obligation should reside, we believe that as all of the identified user groups are licensed entities that *'through user's licences'* would be the most appropriate place for any obligation to be placed. This approach would ensure the engagement and commitment of all user parties.

- *'Putting in place provision for us to direct budget changes under specific circumstances. The only circumstance we consider appropriate, at this time, is where we conclude that the budget is not appropriate to allow the central service provider to deliver its obligations.'*

We would expect parties to be able to satisfactorily assess and set annual budgets and deal with budget changes as they arise. However, due to the potential for polarisation of views on some elements of the central service providers' role and service provision, the ability for Ofgem to provide regulatory oversight in prescribed circumstances seems to be a sensible approach.

- *'Ensuring that overspends of budget, which trigger a need for further funding from users, are notified to us. Given the incentive GTs and shippers have to ensure such situations do not occur we would expect this to be rarely used.'*

We agree that Ofgem oversight of any overspends of budget, that trigger a request to users for further funding would be a prudent approach. It will be necessary to ensure that appropriate financial parameters are established, that determine when a trigger for further funding is required.

- *'Putting in place provision for annual budget increases above an agreed percentage to come to us for approval before being applied.'*

There may be some merit for Ofgem to have oversight of large annual budget increases to ensure the efficiency of industry arrangements. Whilst the costs associated with current and future project work will vary, sometimes considerably, year to year, we would expect that standard operational costs should not vary significantly per annum.

However, should costs inexplicably rise, oversight by Ofgem, in addition to the scrutiny being applied by Board members may be relevant.

Measure two, ensures that a budget cannot be too low to impact delivery against obligations. We view this measure as being the equal and opposite to this, ensuring that an annual budget cannot be over-inflated.

It would seem reasonable and prudent to have protection at both extremes of any budgeting process. This is particularly important given the amount of industry reform related change that Xoserve will be engaged in over the next few years. These changes have the potential to be significant in cost, and Users will want to have absolute transparency and appropriate oversight of these change costs.

- *'Putting in place provision to restrict what costs could and could not be passed through in charges paid by consumers.'*

We concur with Ofgem's view that it is difficult to see how this requirement would work in practice, given that Ofgem do not regulate the prices that Shippers charge consumers.

*4. Do you consider there to be further barriers to adopting a new cost reflective charging methodology which we have not considered? What would be the cost to you of establishing a new cost reflective charging methodology?*

Further to our response to Question 2, we are predominantly concerned at the ability for the central service provider to be able to unpick and allocate costs of services and systems which relate to multiple constituent groups and multiple users. This is not necessary and will result in the creation of unreasonable costs associated with over complicated invoicing arrangements.

Xoserve costs are driven mainly by personnel and systems, which are highly integrated and considered as overhead type costs. Any methodology introduced to divide or scale up these costs to overall charges will be complex and will result in numerous rounds of methodology changes which will bring no benefit to the end consumer, simply adding costs to the industry.

For the materiality of sharing out ~£40m from the ~£4bn of transportation charges per annum, i.e. less than 1%, the current charging process works well enough as it is not regressive and ensures that everyone pays a share.

*5. Do you consider there to be further barriers of the central service provider directly invoicing users? What would be the cost to you of the central service provider directly invoicing users?*

The current invoicing arrangements undertaken by Xoserve on behalf of the Gas Transporters work well and we do not see any benefit in moving away from these established arrangements. Indeed, a move away from the incumbent position will introduce any additional set of risks and costs, which will add cost and destroy benefit.

Both the central service provider and users would incur additional costs. For example the central service provide will need to establish new, separate systems and processes, establish credit management facilities, address bad debt risk. Instead of invoicing six customers (the five GDNs and National Grid Transmission), Xoserve will have to invoice 40+ Shippers along with the Transporters, via a new system, ensuring all payments are received, queries are dealt with and any changes in methodology undertaken. The Transporters will continue to add their element of Xoserve costs to their T&D charges.

We estimate that our set up costs for the provision of new invoicing arrangements (i.e. direct invoicing from Xoserve) will be in the region of £0.3m with an ongoing operational cost of ~£30k per annum. These costs when extrapolated across the whole gas community will be

even more significant (40 shippers x £330k = £13.2m), for no benefit. We note that this amount equates to almost a third of the total annual cost of Xoserve. Given the relatively small total value of invoices expected, these additional costs – purely to process, validate and pay new invoices – appear to be disproportionate, given the robustness of the alternative solution, the current arrangements.

### **Corporate governance**

*6. Do you agree with our preliminary recommendation to apply the full co-operative model with retained GT ownership? Do you consider there to be greater benefits in establishing alternative arrangements? Please state your reasons why.*

We agree with the preliminary recommendation for the implementation of full co-operative governance arrangements with retained GT ownership. This would appear to be the most pragmatic solution which balances the issues associated with the change of arrangements, with the benefits of the changes which are clearly required. It is evident that ownership and control can be appropriately separated.

We concur that the light co-operative model would not deliver the benefits sought via the introduction of a Shipper Advisory Board. Further we concur that contracted services alternative is also not a feasible option due to the additional complexities of implementation.

*7. Do you agree or disagree with the principles of the Board structure we outline? Do you consider that these principles can be achieved through the arrangements outlined?*

We agree that the focus of transition to and implementation of, the new arrangements should be on the establishment of an appropriate Board structure and achieving a structure which divorces ownership from risk and control.

With regard to the Board structure principles outlined, we have the following comments:

- *all users of the central service provider to have a right to elect, and to remove, Board members while ensuring that no party can dominate*

This would appear to be a sensible approach, however arrangements need to be designed to be cognisant of the relative stakes that individual parties have in the services provided by the central service provider.

- *all users to bear the performance risk of the central service provider*

It is essential that performance risk is carefully defined to ensure that all users are fully aware of what the magnitude of any potential exposure to any performance risks may be. There will also need to be consideration of the treatment of different types of risk i.e. a project overrun versus negligent operation and to what extent the central service provider will be responsible for the latter, particularly if the Board agrees to the introduction of any performance incentive scheme.

- *the election of Board members who have relevant skills and expertise for overseeing a company such as Xoserve*

It is essential that the constitution of the Board is robust, both in terms of how it satisfactorily represents the various user groups and the individuals that sit on the Board. We would expect the skill set of any Board member to be significantly different to those which, for example currently sit on industry governance groups and agree that it is important that Board members have relevant expertise to oversee the company. In terms of the constitution of the Board, this will undoubtedly be a controversial issue to

resolve with multiple parties having differing view on appropriate composition which enables appropriate representation for all.

- *the GTs to retain ownership but for the right of non-ownership groups to sit on the Board to be defined, to ensure non-owners are not excluded from exerting control*

The principle of non-ownership groups being able to exert control on the activities of the central service provider is a key element of the reform, therefore we concur that it will be essential for this issue to be explicitly defined.

- *Board members to provide overall direction and stewardship, including providing them with the opportunity to challenge the central service provider's senior management*

We agree with this principle and this reaffirms the importance of ensuring that Board members possess the relevant skill set and experience and perform effectively in the role.

- *the appointment of an independent Chairman and potentially the Chief Executive and additional relevant senior management*

We agree with the principle that the Board should be responsible for the appointment of an independent chairman and ultimately responsible for the senior management positions. It is important that the senior management of the central management provider have representation on the Board to ensure delivery and accountability of operational activity; however it would not be appropriate for the central service provider to have a voting role on the Board.

- *flexibility in arrangements, e.g. to allow for the inclusion of iGTs in the future*

The current gas market arrangements are currently in a state of evolution, with many significant reforms expected to be delivered over the **next five years**. Therefore we believe it is essential that future central service provider arrangements are flexible to enable, rather than frustrate reform as it occurs.

Any future changes to the constitution of the Board will need to be undertaken in such a manner to ensure that the balance of representation across all user groups remain appropriate.

*8. Do you agree or disagree with our initial view that the details of the establishment and ongoing affairs of the Board are best left for the industry to develop? If you disagree please state what areas you consider that we should require through licence obligations.*

Given the importance of these proposed reforms and the current, busy strategic change agenda, it is appropriate to ensure that this process maintains traction. Given the potential for the polarisation of views across the various user groups, we believe that Ofgem has an integral part to play in development and delivery, to ensure that activities progress in an effective and efficient manner.

### **Transition and implementation**

*9. Do you consider that a licence requirement should be placed on one or more parties to ensure that implementation is progressed? If so, what do you consider a reasonable timescale in which full implementation can be complete?*

We are mindful that reform of this nature can take time to complete and become complex, with the potential to stall in the absence of clear guidance or ownership of delivery. Therefore we believe that putting into place a licence requirement to ensure implementation is progressed is a reasonable approach.

At this time we do not have a specific view as to the timescale required to achieve full implementation. However, the proposed reform must be afforded enough time as reasonably required in order to achieve an effective solution, though this must be balanced with a sense of efficiency. There are currently myriad other, more significant, reforms underway. Whilst we are fully committed to delivering the reforms proposed within this consultation, we do not wish to be engaged in an elongated process which would impact the resourcing of other important areas of industry activity.

*10. Do you have any views on CEPA's estimated cost of implementation? Please provide evidence of any additional costs you consider should be accounted for.*

Due to the limited level of detail provided to substantiate the ~£2m implementation costs, we are not able to accurately assess CEPA's estimated cost of implementation. We do however note that £2m is approximately 5% of Xoserve's annual budget and therefore is not an insignificant cost.

The changes required to the existing arrangements should be able to be achieved at a cost which is substantially less than estimated, given that no system changes will be required and with the assumption that there are no changes necessary to the incumbent invoicing arrangements.

It is essential that a more detailed view of costs are understood and agreed by industry parties at the outset of the process, to ensure that costs do not spiral, but remain within an agreed budget. The funding of these costs is also an important element to consider and something which also needs to be addressed and agreed upon at the outset of the process.

## **General**

*11. Do you have any other comments on any aspect of the CEPA report or this consultation letter?*

The performance and delivery of the current central service provider functions are important for ensuring that gas market arrangements run effectively. It is therefore essential that during the completion of this review and the actions that are resultant, the day to day running of Xoserve is not impacted, nor is performance delivery or the delivery of essential projects such as UK Link replacement or wider industry reforms.

In order to achieve an orderly, structured delivery of the final decision that will ultimately be published by Ofgem, a clear roadmap of activities to be undertaken will need to be established, including ownership for delivery. Without this we do have concerns that progress may be slow or not co-ordinated.

Oversight from Ofgem upon ongoing performance of gas industry arrangements during this review would be welcome; to ensure that there is no impact to wider industry reforms or detriment to end consumers.