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Dear Joanna,

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

National Grid Gas plc welcomes the opportunity to respond to this consultation. This response is made on behalf of National Grid Gas Distribution (NGGD).

Summary

Throughout the development phase we have been active participants at the work-groups and, accordingly, are broadly supportive of Ofgem's proposals. In addition to the questions raised by Ofgem's consultation, we believe a number of related issues should be considered. These are expressed below.

Timing - We think the implementation timescales will be challenging due to consultation timing, complexity of board governance changes, UNC and licence changes. We are also conscious that we are in a period where there are a number of change programmes: Nexus, Smart and DCC preparation are in the process of being delivered; hence we believe a more realistic date would be late 2014 for the development phase and potentially April 2015 for full implementation.

Board membership - We believe it is important that Board members are senior executives from sponsoring licensees who bring particular skills that will benefit Xoserve. Given the significance of Xoserve's service to the functioning of the competitive market, we believe it is important to ensure that obligations for all parties are clearly defined and that enduring, suitably robust licence conditions are developed for both transporters and shippers to use and fund Xoserve responsibly.

Implementation costs - We agree with Ofgem that implementation costs are likely to be of the order £2 million and consider that these should be recoverable by GDNs.

Finally, although not considered as part of the review; given the repositioning of Xoserve as a service provider to both shippers and gas transporters, there may be value in considering whether there is a case for incorporating the Joint Office within Xoserve at some point in the future,

Please find below our detailed answers to the individual consultation questions;

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 agree that the proposed integrated, centralised structure provides the optimum solution for Xoserve to develop into the Gas Industry Data Manager. We believe that embedding the UK-Link suite of systems within a single, self contained organisation represents the most efficient model for managing and controlling centralised services.. It is our view that both the timescale and cost of implementing the proposed model would be significantly greater if systems were to be disaggregated and awarded to different entities. Our response is based on the assumption that Xoserve remains as a single legal entity, carrying out largely the services it currently performs but with a greater degree of autonomy and emphasis on being the provider of gas industry, centralised data management services.

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 believe that the proposed arrangements for setting business plans, budgets and charges are sound in principle.

There are a number of matters which need to be fine tuned but, provided the business plan developed by the Xoserve board takes a medium term view of the developing requirements of the industry, we see a smooth transition between the current and proposed regime. It is important that the business plan is cognisant of all industry developments and that sums are built into the plan to accommodate these changes. While not all change will be delivered for the provisional budgets, the fact that Xoserve will not distribute profits and would be able to carry across a deficit or a surplus

into future years, should ensure that it is possible to be flexible in terms of budget and charge setting.

In terms of the invoicing mechanism, we have a preference for Xoserve's services, since they will be discretely defined in the UNC, to be invoiced directly to the service recipients. As Xoserve currently invoices Users for services, such as Data Enquiry Service, (otherwise know as SCOGES, as defined in Schedule 23 of SPAA), we believe the necessary transacting framework already largely exists.

In terms of budget setting, we believe that ultimately this should fall under the remit and control of the board. We anticipate a process where the business plan and annual budget would be proposed by the board, socialised and reviewed at the AGM, but ultimate authority for budget setting remains vested with the board. A key aspect of any budget setting round is ensuring that sufficient pressure is maintained to ensure efficient service delivery, while ensuring Xoserve is adequately financed. As such we see the board as the best place for ensuring this, and only in extreme circumstances would regulatory oversight be needed during the budget setting process, bearing in mind any surpluses would be retained by Xoserve for future service provision.

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

We believe that it should be possible for Xoserve to operate with minimal regulatory oversight. Given that the services it provides will be set out in the UNC, the main area that may need to be given a degree of scrutiny is the charging methodology and the resulting level of charges. We would anticipate that this would operate in a similar fashion to the current process for modifying the Agency Charging Statement ("ACS"). In terms of methodology, provided it remains in place for a number of years, (the transporter charging methodology has existed in its current form since Xoserve was created), the amount of regulatory oversight required on an ongoing basis should be relatively low.

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?

The time taken to develop a cost reflective charging methodology is a function of the accuracy and the level to which costs are ascribed. Simple cost reflective methodologies are frequently used in the ACS to allocate costs and it would be a relatively straightforward process to allocate costs on that basis. If an element of transactional cost reflectivity were to be overlaid on these market share charges, then the model takes on an extra layer of complexity. We believe in the first instance a

simple cost allocation model could be used, with an option to add complexity at a later stage. Given one of the questions that Ofgem is asking is the degree of regulatory oversight required, this could be an area where Ofgem may wish to be involved to a greater degree.

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

We do not believe there are any significant impediments to Xoserve invoicing shippers directly for its services. Perhaps one area that needs to be given some consideration is payment terms, credit arrangements and payment default. We would not wish to see Xoserve given rights to terminate shippers from the UNC, but equally we need to have terms and conditions that encourage compliance with settlement terms. As an alternative measure, in order to ensure its cash-flow was not unduly impacted by payment default, Xoserve's payment terms could have provisions that allowed contractual sanctions where it would have the right to withhold transaction services and, in the event of bad debt, some form of mechanism where shortfalls are passed through to users after a period of time. Given the critical nature of Xoserve's services to the efficient functioning of the competitive gas market, to ensure Xoserve's cash-flow is maintained, some consideration should be given to the introduction of a licence condition that mandates the payment of service charges, in the form of a "pay now; dispute later" obligation.

There are a number of issues that materialise in the "Xoserve-direct" invoicing model; all can be resolved but it further reinforces our view that these arrangements should not be targeted for implementation until 2015.

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 believe that a co-operative model with retained GT ownership is a suitable mid range solution for modifying the Xoserve FGO arrangements. The model would provide:

- More accountability, autonomy and recognition of Xoserve as the central systems IT service provider to the gas industry
- The FGO model could accommodate the incorporation of the central governance services, as currently provided by the Joint Office, and given that it is proposed that the ownership

model is unchanged, consideration should be given to incorporation of the Joint Governance Arrangements Agreement into the transporters' residual ASA.

- More flexibility for it to enter into data services not directly related to the operation of the GDNs and NTS, e.g. iGT services
- Retain all the aspects of a de-facto licensed & regulated IT service provider without requiring a new full licence to be drafted.
- A mutualised risk framework that does not require the owners to take a disproportionate degree of financial and / or performance risk.
- Retained safeguards through the ASA that our bespoke and specific GT invoicing service remains dependable and adequately resourced
- In summary, we see the repositioning of Xoserve as the Gas Industry Data Manager as a positive step that should provide benefits for all parties.

While we accept that the diversification of control should provide an Xoserve which is able to react to industry requirements, we are acutely aware that this results in a dilution of the control that transporters, as a group, have over Xoserve. We understand the industry's desire to be closer to the operation of Xoserve, but the quid pro quo for transporters is that we should no longer bear the performance risk associated with an ex-ante allowance funding arrangement. As such, we support the proposal that that our share of Xoserve's running costs should be paid as they are incurred through monthly invoices and subsequently recovered as a form of "pass-through" cost. The specific detail would be resolved as part of the next phase of development, but we could foresee an arrangement where transporter charges, as predicted in the Business Plan are incorporated into allowances, with an out-turn adjustment being applied in the following year to account for variances away from Plan.

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?

If there is one element of the proposal that will ensure these arrangements are successful, it is the selection and appointment of the shipper representation on the board. It is essential that appointees have senior management experience in their substantive organisations and bring to the board-room knowledge of how best to operate a de facto-regulated IT service provider. The exact mechanism for advertising, selection and introduction on to the board will need to be set out as part of the development process for transitioning to the new Xoserve model. There are still a number of issues that will need to be resolved in terms of the day-to-day operation of board, such as optimum constitution and how voting dead-locks would be concluded. While these constitutional matters may appear difficult to resolve, given that the role of the board is to ensure that Xoserve delivers its contractual obligations to its customers, there should be sufficient common purpose in the board-room to ensure these types of event are rare.

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.

We believe that the best way to implement the corporate aspects of the proposal is to allow the existing board and Xoserve themselves to undertake the necessary restructuring and recruitment activity. Providing commitments to implementing the arrangements, and realistic timescales are set-out in the project plan; there should not be any requirement for Ofgem to introduce new licence conditions on gas transporters to that effect.

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 consider that, provided that appropriate & satisfactory assurances are given to Ofgem, we do not see Licence obligations being necessary to deliver the required outcome. There is no reason why implementation should not be project managed and delivered by UNC parties, in conjunction with Xoserve.

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.

We agree that the project should be capable of being delivered for a provisional sum of £2 million. We would expect the principal cost elements to be the redrafting of the UNC (& supporting contracts) and project management costs, (which it is anticipated will need to be procured). Given our knowledge of the costs, as they related to the delivery of Phase 1 of the FGO project, and to some extent the costs of redrafting the UNC to support the Nexus work, we would view the preliminary budget as reasonable. It is assumed that no significant system changes would be triggered by the implementation of the proposed FGO regime.

Other than major elements of incremental costs, incurred through the procurement of external specialist services, it is assumed that all parties will bear their own embedded management costs associated with implementation.

In terms of cost recovery, the model adopted for Phase 1, where the cost ultimately materialised in the miscellaneous pass through term (MP_t) of the allowed revenue term, would seem a reasonable, and a regulatory transparent way of dealing with these incremental costs. During RIIO discussions, the Xoserve FGO review was viewed as an issue that would need to be resolved after RIIO

implementation and Xoserve costs would be reviewed as part of a “re-opener”. We would expect implementation costs to be considered as part of that revenue adjusting event.

General

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

Throughout the development and consultation process there appeared to be an aspiration to implement these proposals with effect from April 2014. We believe for a number of reasons that this is now too ambitious.

Consultation Timeline: Given that the responses to this consultation are scheduled for late June, it is unlikely that a conclusions document will be available before August. While we have a good understanding of the preferred option to be implemented, there is a significant amount work required to implement, including, but not limited to, an accession to the UNC, change of governance arrangement and redrafting of the UNC to recast the service responsibilities. Given our experience with complex, high volume of detail, far reaching UNC modifications, we know that this will take somewhere between 9 & 12 months. Our view is that the consultation and development process will not be concluded by April 2014.

Lead-in processes: To follow on from the above, certain aspects of the FGO arrangements need to be in place before full implementation – for instance, the appointment of new directors and the budget setting process for the new model.

Our considered view is that commencement by April 2015 will provide more time to ensure the proposals are thoroughly developed and provide sufficient opportunity for transitional issues to be addressed before the new arrangements become effective..

Should you wish to discuss any matter within this letter, please contact either myself or Alan Raper on 07810 714756, alan.raper@nationalgrid.com .

Yours sincerely,

Paul Rogers

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By email