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Dear Joanna,

**Consultation on implementing new funding, governance and ownership arrangements for Xoserve**

Scotia Gas Networks (SGN) welcomes the opportunity to provide our views on the future funding and governance arrangements for Xoserve.

Our response is structured to firstly provide a summary of our views. This is followed by detailed responses to each of the individual questions raised in Ofgem's open letter consultation. These detailed responses can be found under Appendix. A. We hope this will assist with your analysis of submissions on this important subject.

**Summary of our views**

Our key comments and views can be summarised as follows:

*Cooperative model with retained gas transporter ownership*

We support maintaining gas transporter ownership of the central service provider under the fully cooperative model. This would offer benefits in relation to a reduction in the need to establish new complex and costly legal ownership arrangements.



### *Xoserve as a central service provider*

We consider the current arrangement of a single service entity provides the best solution to industry requirements, particularly when the cost efficiencies that the current model provides are of paramount importance. The costs associated with the governance and management of a model which requires multi-party involvement would not result in any net benefits for the industry as a whole.

The fully integrated systems model which is supported by the current model is also of great importance. The process to physically partition systems between providers would be costly and would heavily impact on other industry organisations which rely upon Xoserve for services in terms of cost and service provision.

### *Budget setting, charge setting and invoicing arrangements*

We consider the involvement of all industry stakeholders in the process of budget setting to be crucial in ensuring that confidence and transparency around cost is maintained. We support this increased influence over how Xoserve's budget and spend is derived, especially in relation to the level of costs associated with change programmes, as one of the original concerns raised by the industry was the lack of transparency around costs and charges.

While this level of increased influence is welcomed, we would also wish for a long term strategic perspective to be maintained in relation to the setting of Xoserve's budget over the medium to long term.

The process of approving the annual Xoserve budget should remain with the Xoserve board, having taken into consideration views from the various stakeholder organisations during the annual consultation process. Migrating approval for the budget to stakeholder groups may increase the time period required to gain this approval and may also detrimentally impact on the ability of Xoserve to meet its service level requirements.

We understand it is Ofgem's preference to move to a regime which requires all of Xoserve's customers to fund the services they require on a direct 'customer to Xoserve' basis. We support this move as it will place direct responsibility on the parties requesting services and also those parties placing cost on the central agent.

To ensure that this process is made fully robust, the transferral of these risks and responsibilities must also be included in any subsequent changes to the current arrangements. For the process to work most efficiently, these changes must be required to be in place prior to the operation of any new arrangements (i.e. from day one).



### *Ensuring regulatory oversight and appropriate Licence conditions*

We agree the first option specified, that of introducing a form of obligation on those parties who control Xoserve to ensure that its operation is efficient, appears to be sensible.

We consider this could be facilitated as a Licence obligation on all parties, and also as a relevant objective to be appended to the UNC modification rules, in relation to future change requirements placed upon Xoserve. This would ensure parties consider the impact on the central service provider when raising changes to industry codes which may require extensive development of central systems.

We agree Licence requirements should be placed on all parties associated with the use of Xoserve's central services. This will ensure a timely introduction of the required changes. Such conditions would need to be binding on all parties equally to ensure equitable input and effort to this process.

### *Adopting a new cost reflective charging methodology and directly invoicing users*

In relation to the direct charging of parties by Xoserve, we agree it is essential to ensure parties are fully aware of the costs they are placing directly on Xoserve and subsequently the rest of the industry.

We already have in place a contractual relationship with Xoserve which is based on a cost reflective charging methodology, and as a result we would not envisage changes associated with the establishment of a new methodology to be costly. However, should this methodology become highly detailed, and require a large resource to validate and manage the charges resulting from such a contract, we would envisage costs increasing in this area.

We consider Xoserve directly invoicing users for its services is an essential pre-requisite for the successful implementation of increased user oversight and involvement in the running of the organisation. It will also be important for Ofgem to ensure that all parties subject to price control mechanisms are able to recover any additional costs associated with changes to Xoserve.

### *Principles of Xoserve board structure*

Xoserve board membership post-implementation of any new arrangements must continue to provide direction and governance at a corporate level. This will ensure Xoserve continues to operate on a highly professional basis and in-line with the obligations placed upon its board members under the Companies Act. It is of paramount importance that the board composition reflects these requirements in the experience of the members chosen to take-up these positions.



We do not consider decisions affecting the outcome or direction of industry change, whether related to the UNC or any other industry code, should lie with the Xoserve board. Interested parties should not consider that board representation would confer increased influence over the outcome of such decisions. Board membership should continue to ensure stakeholder organisations' interests are fairly represented and in a balanced manner, while still maintaining a strategic oversight of Xoserve's continuing ability to meet its customers' requirements.

The establishment of a board structure and associated governance should be developed in conjunction with all industry parties, but under the clear guidance and leadership of Ofgem, following the decision on the outcome of the future Xoserve model. The structure should provide for, and reflect the interests of, all parties with a direct material interest in the services provided by Xoserve, including the potential for future Independent Gas Transporter (IGT) representation, should IGTs be required to contract with Xoserve for the provision of central services moving forward.

#### *Timelines for implementation*

We consider the desired implementation date of April 2014 for a fully co-operative Xoserve model to be optimistic, especially considering the volume and complexity of changes required between multiple parties. We understand a more realistic implementation date of April 2015 was discussed during the CEPA consultation, and we would consider this to be a more achievable timeframe.

#### **Next steps**

Given the scale of potential changes being proposed, we consider it will be essential for Ofgem to work closely with the industry in developing these arrangements further. Strong project leadership will be essential to delivering the required outcomes, and we look forward to working with Ofgem in this regard.

We would suggest this will be best achieved through the creation of high-level steering group and sub-groups. Membership should appropriately reflect the interested parties directly affected by any changes to the scope and deliverability of services currently provided by Xoserve.

Should you wish to discuss any aspect of our submission further, please do not hesitate to contact either Joel Martin, Xoserve Contract Manager, at [joel.martin@sgn.co.uk](mailto:joel.martin@sgn.co.uk) or myself at [paul.mitchell@sgn.co.uk](mailto:paul.mitchell@sgn.co.uk).

Yours sincerely,

**Paul Mitchell**  
Regulation Manager

24 hour gas escape number 0800 111 999\*  
\*Calls will be recorded and may be monitored

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## Appendix. A

### SGN's response to the specific questions raised by Ofgem

***Q1. 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 consider the current arrangement of a single service entity provides the best solution to the industry requirements as a whole, particularly when the cost efficiencies that the current model provides are of paramount importance. The costs associated with the governance and management of a model which requires multi-party involvement would not result in any net benefits for the industry as a whole.

The fully integrated systems model which is supported by the current model is also of great importance. The process to physically partition systems between providers would be costly and would heavily impact on other industry organisations which rely upon Xoserve for services in terms of cost and service provision.

The creation of Xoserve at the time of Distribution Network Sales in 2005 was an integral component of ensuring the continuation of data services provided to SGN and the rest of the industry. We continue to rely upon the services Xoserve provide in relation to data provision and the arrangements which support the invoicing of transportation charges for our networks. The creation of Xoserve provided for a single, central service provider and ensured the industry was able to centralise and coordinate effectively its commercial interactions and dependencies.

The inherent benefits that such a single service model provides have been well document since Xoserve was conceived. These benefits include the provision of a single set of systems which in turn provide for uniform communications' protocols and the ability for a number of systems which rely upon each other and heavily interact, to sit with a single operator. This single service provision offers cost efficiencies and savings at the point systems require to be modified and also provides for strategic oversight in relation to the development of systems going forward. This has been demonstrated by the Project Nexus programme, under the direction of Xoserve, to re-design the central systems going forward from 2015.

We consider that moving away from the single service provider model would be complex, costly and require great upheaval for the industry as a whole. The governance, legal and commercial interactions required to facilitate the interactions between numerous service providers would again be complex and introduce unnecessary administration and red tape into the industry, ultimately resulting in a reduced ability of the industry to react to change requirements. Xoserve currently have the ability to source and procure IT services to support the central systems, and do so on a cost efficient basis that also ensures the integrity of the systems themselves is maintained.



Moving to a model which required multiple interactions between different service providers may dilute this important advantage, leading to a reduced quality of service to the industry and increased costs to all industry parties.

We would also highlight the experience and knowledge Xoserve has developed over the last eight years, building upon their previous experience when part of National Grid Transco, is an invaluable resource which should be considered when any plans relating to a multi-organisational model are being suggested. Constructing a regime which would require the services and systems Xoserve currently operate to be split up and divided between different operators would ultimately dilute this knowledge and experience, leaving the industry worse off as a whole.

The Gemini system, owned wholly by National Grid Transmission and maintained and developed on their behalf by Xoserve, is an integral part of the UK gas network infrastructure. It ensures the total system is balanced on a commercial basis and that physical volumes of gas meet UK customer requirements. The Gemini system also meets National Grid's requirements for their customers to book system entry and exit capacity requirements, thus assisting with National Grid's obligations as a Transmission system operator to maintain and develop the transmission system.

These two functions of the Gemini system are currently serviced within the same system and the balancing and nominations functionality rely upon data feeds from other central systems, managed by Xoserve. Therefore, to ensure a fully integrated flow of information from system to system it would seem logical for Xoserve to also continue to manage the Gemini system. However, should National Grid ultimately decide to migrate part or all of the Gemini system to an alternate service provider that would be a decision they would need to reach in conjunction with the rest of the industry.

***Q2. 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.***

Current budgeting arrangements are agreed by the Xoserve board. The considerations taken by the board in reaching decisions on yearly spend take into account all requirements, both regulatory and contractual, placed upon gas transporters as customers as well as owners of Xoserve over the full price control period. The board also considers wider industry requirements and developments in their decisions to allocate financial and operational resource to ensure customer requirements are met in a timely manner at the most efficient cost.



The three areas of budget setting, charge setting and invoicing arrangements are all integral to the successful operation of Xoserve moving forward under a cooperative model, and all have interdependencies of varying degrees. We have considered each of these areas below, with full recognition that the successful operation of each area is essential to maintain Xoserve's ability as a service provider to the industry that also operates in a financially robust manner.

*Our views on Xoserve's budget setting process:*

With the advent of a cooperative industry model governing the services Xoserve provide, we consider that the involvement of all industry stakeholders in the process of budget setting to be crucial to ensuring that confidence and transparency around cost is maintained.

The CEPA report considers that Xoserve stakeholders should have the ability to influence the budget setting through interaction between these groups and the board via both the contractual route as a customer and also at board level with the representation of shipper and potentially other organisations at this level. We support this increased influence over how Xoserve's budget and spend is derived, especially in relation to the level of costs associated with change programmes, as one of the original concerns raised by the industry was the lack of transparency around costs and charges.

While this level of increased influence is welcomed, we would also wish for a long term strategic perspective to be maintained in relation to the setting of Xoserve's budget over the medium to long term.

There is the potential for short term requirements, however important, to shift the emphasis away from strategic projects which deliver the requirement of the system's (and thus network) integrity to the industry as a whole over a longer period. Currently these activities are carried out by Xoserve to ensure gas transporter licence obligations are met. Where these obligations move away from gas transporters, either in whole or in part, to organisations which have not previously been involved in such projects there is the potential for this strategic perspective to be lost. We would therefore welcome the recognition that the board should maintain this medium to long term view when considering the requirement to approve annual budget setting.

The process of approving the annual Xoserve budget should remain with the Xoserve board, having taken into consideration views from the various stakeholders organisations during the annual consultation process. Migrating approval for the budget to stakeholder groups may increase the time period required to gain this approval and may also detrimentally impact on the ability of Xoserve to meet its service level requirements.



We also consider that the composition of the Xoserve board, both in terms of its breadth of experience and knowledge of operating a company the size of Xoserve, should ensure that stakeholder requirements are met or at least are integral to the decision making process. Xoserve board members will have requirements placed upon them in a legal capacity to ensure Xoserve is maintained as a fully robust operating entity both financially and as a service provider, and therefore should ultimately have control and responsibility for this process.

We would again emphasise that the composition of the Xoserve board should not only reflect the make-up of its customers, but should also ensure that the specific individuals comprising the board should be wholly cognisant of the requirements placed upon them in this capacity. Individuals who have a wide breadth of experience should be considered, and as should individuals who have a deep appreciation of the requirements of operating a company at a strategic level. The board composition in relation to the annual budget and the operational of Xoserve as a whole is critical to the success of a cooperative model.

*SGN's views on Xoserve's charge setting and invoicing arrangements:*

The current charge setting arrangements are covered under the umbrella of services gas transporters receive from Xoserve as a contracting customer. The Agency Services Agreement (ASA) specifies a number of services Xoserve are contracted to undertake on behalf of the gas transporters, thus satisfying a spectrum of gas transporter Licence and Uniform Network Code (UNC) obligations. These direct invoicing arrangements which include both ASA and User Pays services to the gas transporters are currently included within gas transporters' charging arrangements to gas shippers.

We understand it is Ofgem's preference to move to a regime which requires all of Xoserve's customers to fund the services they require on a direct 'customer to Xoserve' basis. We support this move as it will place direct responsibility on the parties requesting services and also those parties placing cost on the central agent.

From the commencement of the Xoserve Funding, Governance and Ownership (FGO) review, we have recognised that, where control over the operation of Xoserve is unbundled from gas transporter control to other industry parties, the risk and cost of these services should also migrate.





We understand that parties wish to have greater control over Xoserve services and also increased transparency of their costs. To ensure that this process is made fully robust, the transferral of these risks and responsibilities must also be included in any subsequent changes to the current arrangements. We understand that Ofgem have indicated that Licence and UNC / Supply Point Administration Agreement (SPAA) obligations may follow the conclusion of the FGO review. However, for the process to work most efficiently, these changes will be required to be in place prior to the new regime (i.e. from day one).

In relation to the direct charging of parties by Xoserve, we agree this is not only preferable to the current regime but essential to ensure parties are fully aware of the costs they are placing directly on Xoserve and subsequently the rest of the industry. Continuing the bundling of Xoserve costs within the generality of gas transportation charges will not provide a transparent platform to Xoserve's customers of the costs they are incurring, whether as part of the day to day running costs or as part of a specific change programme.

We understand that direct invoicing will require Xoserve to have in place new contractual agreements between parties and also to introduce new credit arrangements with parties to mitigate any risk associated with these contracts. However, we do not see this as being either overly costly or prohibitive to the introduction of these arrangements. Parties required to contract directly with Xoserve for these services will also be exposed to increased administration relating to the management of these contracts. However, we consider the increased control and influence over Xoserve, which industry parties have requested, requires this contractual oversight to ensure the regime will work effectively.

It will also be important for Ofgem to ensure that all parties subject to price control mechanisms are able to recover any additional costs associated with changes to Xoserve.

***Q3. What are your views on the measures we have identified to ensure regulatory oversight is maintained?***

We consider the options identified to ensure regulatory oversight appear to be balanced in their approach between ensuring an economic and efficient operation and providing for a flexible approach to required budget setting.

We agree the first option specified, that of introducing a form of obligation on those parties who control Xoserve to ensure that its operation is efficient, appears to be sensible. We consider this could be facilitated as a Licence obligation on all parties and also as a relevant objective to be appended to the UNC modification rules in relation to future change requirements placed upon Xoserve. This would ensure that parties consider the impact on the central service provider when raising changes to industry codes which may require extensive development of central systems.



We do not consider the second propose option to be necessary, as Xoserve and the controlling parties will be required to ensure the service provider operates in a fashion which facilitates the provision of obligated requirements. It is unlikely that a budget would be approved which would not facilitate these objectives.

We agree the third measure, which would require notification to Ofgem of budgetary overspends, would seem sensible and would place further emphasis on all parties to ensure costs are controlled.

We agree that the fourth and fifth measures detailed would not seem to be appropriate or necessary at this point in time for the reasons specified in Ofgem's open consultation letter.

***Q4. 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?***

A workable cost reflective charging methodology will require consensus and agreement between all industry parties to ensure that a fully developed and inclusive regime can exist and develop to meet industry requirements. As systems and process managed by Xoserve are complex, interlinked and interdependent, there may be significant time and resource spent on reaching a pan-industry position on an equitable charging methodology. We would suggest that a complex approach to such a charging methodology would increase the resource and cost associated with managing such arrangements. We would therefore aim to support simplified arrangements, which still provide the necessary transparency of costs and charges, but do not create burdensome contractual management on parties concerned.

As we have previously mentioned, we already have in place a contractual relationship with Xoserve which is based on a cost reflective charging methodology, and as such we would not envisage changes associated with the establishment of a new methodology to be overly costly. However, should this methodology become highly detailed, and requiring a large resource to validate and manage the charges resulting from such a contract, we would envisage costs increasing in this area.

***Q5. 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?***

As we have previously mentioned we consider Xoserve directly invoicing for its services to users is an essential pre-requisite for the successful implementation of increased user oversight and involvement in the running of the organisation. The formulation of multi-party contractual agreements and the further agreement of the terms and conditions associated with these agreements may require a prolonged period of negotiations which may lead to the delay in implementing the modified regime.



The specific ongoing costs to us as a gas transporter of implementing a direct invoicing regime would be unchanged from the current process, as we currently operates under these arrangements and has extensive experience of running the ASA contract with Xoserve. The establishment of these arrangements may require extensive development of the contractual framework between parties and would require dedicated resources to ensure that a sufficiently robust and inclusive model was implemented.

***Q6. 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***

Maintaining gas transporter ownership of the central service provider under the fully cooperative model would offer obvious benefits in relation to a reduction in the need to establish new complex and costly legal ownership arrangements.

This would also reduce the risk to the industry as a whole in moving to alternative arrangements. However, the retention of Xoserve's ownership by the gas transporters would, as we have previously stated, necessitate the migration of specific Licence and UNC obligations to parties who would control these services, and who in turn would exert their influence and control via stakeholder interaction. The performance risk in relation to the delivery of these services would also be required to align to the organisations that exert this control and not ultimately be borne by the owners of Xoserve.

***Q7. 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?***

Xoserve board membership post-implementation of any new arrangements must continue to provide direction and governance at a corporate level, ensuring that Xoserve continues to operate on a highly professional basis and in line with the obligations placed upon its board members under the Companies Act. It is of paramount importance that board composition reflects these requirements in the experience of the members ultimately chosen to take these positions.

We do not consider that decisions affecting the outcome or direction of industry change, whether UNC or any other industry code related, should lie with the Xoserve board and also that parties should not consider that board representation would confer increased influence over the outcome of these decisions. Board membership should continue to ensure that stakeholder organisations' interests are fairly represented and in a balanced manner, while still maintaining a strategic oversight of Xoserve's continuing ability to meet its customers' requirements.



We note board representation was discussed at some length during the CEPA consultation process and numerous variations were discussed in relation to each stakeholder groups' influence through its respective board member. We consider that while each respective stakeholder's board representative should ensure these interests are considered the Xoserve board should not take on the role of assuming responsibility for this.

***Q8. 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 consider the establishment of a board structure and associated governance should be developed in conjunction with all industry parties, but under the clear guidance and leadership of Ofgem, following a decision on the outcome of the future Xoserve model. The structure should provide for, and reflect the interests of, all parties with a direct material interest in the services provided by Xoserve, including the potential for future Independent Gas Transporter (IGT) representation should IGTs be required to contract with Xoserve for the provision of central services moving forward. The development of the board structure would therefore be best left to the industry to develop, and which in turn would allow the composition of the board to evolve and respond to changing industry requirements.

***Q9. 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 agree that Licence requirements should be placed on all parties associated with the use of Xoserve's central services. This will ensure a timely introduction of the required changes. Such conditions would need to affect on all parties equally to ensure equitable input and effort to this process. To successfully implement the changes associated with a fully cooperative model, there will be a requirement for a strong project management team to lead and oversee strong industry engagement (which has been witnessed throughout the CEPA consultation phase). This should ensure the required framework is discussed, agreed and implemented within a timeframe suited to all parties.

In relation to the desired implementation date of April 2014 for a fully cooperative Xoserve model, we would suggest this time period would appear to be overly optimistic considering the volume and complexity of changes required between multiple parties. We understand a more realistic implementation date of April 2015 was discussed during the CEPA consultation, and we would consider this to be a more achievable timeframe.



**Q10. 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 note the estimated costs detailed in CEPA's report and would presume these are a reasonable assumption of the costs associated with implementing a fully cooperative model. Each individual party will incur its own costs associated with both the development of the regime and the on-going associated support costs which would be material.

**Q11. Do you have any other comments on any aspect of the CEPA report or this consultation letter?**

We do not have any further specific comments regarding the CEPA report or Ofgem's open letter consultation on this subject.