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**OFGEM CONSULTATION ON IMPLEMENTING
NEW FUNDING, GOVERNANCE AND OWNERSHIP
ARRANGEMENTS FOR XOSERVE, THE GAS
TRANSPORTER CENTRAL AGENT**

XOSERVE'S RESPONSE TO THE CONSULTATION

OUR VISION

We, at Xoserve, will be recognised and valued for the excellence of our performance, the quality of our people, our customer engagement and the contribution we make to the efficiency of the UK energy industry

TABLE OF CONTENTS

- 1. EXECUTIVE SUMMARY 4
- 2. INTRODUCTION..... 7
- 3. REVIEW OBJECTIVES 9
- 4. SERVICE DELIVERY..... 10
- 5. BUDGET SETTING, COST ALLOCATION AND CHARGING 13
- 6. CORPORATE GOVERNANCE AND OWNERSHIP 25
- 7. TRANSITION AND IMPLEMENTATION..... 31
- 8. OTHER MATTERS 36

1. Executive Summary

- 1.1 This document is our detailed response to Ofgem's consultation on the implementation of new funding, governance and ownership arrangements for Xoserve, the Gas Transporter central Agent.
- 1.2 The consultation makes preliminary recommendations in respect of both the corporate governance and ownership of Xoserve Limited and the Gas Transporters' regulatory funding of the services that Xoserve provides in its prevailing capacity as the Gas Transporter central Agent ("the GT Agent"). We note that the consultation also proposes changes to the cost allocation, charging and invoicing arrangements operated by Xoserve. As such, we are responding to the consultation both as the Xoserve corporate entity and as the party contracted to the Gas Transporters ("the GTs") and Shippers to provide Agency Services.
- 1.3 We have assessed Ofgem's preliminary recommendations against our understanding of the key objectives of the review, namely:
- (a) To promote increased Agency proactiveness for the benefit of the broader industry;
 - (b) To support the transparency and efficiency of 'common Agent' costs;
 - (c) To position funding, risk and control of Xoserve and the central services it provides in the most appropriate way to support these objectives;
 - (d) To implement governance arrangements that recognise the importance of Xoserve services to a broad range of stakeholders and are consistent with new regulatory arrangements for GTs for 'common Agent' services; and
 - (e) To vary Ofgem's role in the setting of business plans and budgets for 'common Agent' services.
- 1.4 We support the preliminary recommendation to retain certain key features of the prevailing arrangements. The single common service provider model has delivered efficiency and process benefits to stakeholders for a number of years. Retention of the model not only protects those benefits but also provides assurance to both customers and employees of continuity of service scope and quality. Similarly, we feel that the proposed continuity of prevailing ownership arrangements would provide comfort to our employees and our service providers and therefore provide greater assurance to our customers of continuity of service.

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- 1.5 We recognise that, in general terms, the preliminary recommendations in respect of business planning and budget setting are appropriate, given the proposed repositioning of Agency Services costs outside of the GT Price Control arrangements, and that they have the potential to achieve the transparency of costs and outputs that customers would therefore be expected to require. However, we feel strongly that, albeit following a period of customer engagement around a draft Business Plan and budget, responsibility for approval of the Business Plan and budget should be positioned with the Board rather than with the industry. This approach recognises directors' obligations under the Companies Act, which include duties to have regard to the interests of all stakeholders, to have regard to the longer term consequences of their decisions and to promote the success of the company. It would also offer a more efficient and timely process that would avoid the risk of protracted and delayed decisions, giving the business confidence to continue to deliver services and to progress its Change Programme.
- 1.6 In order to ensure that there would be alignment in a future 'co-operative model' between obligations, funding, control and risk, we consider that decisions in respect of the positioning of obligations (in particular between licensees and parties to the Uniform Network Code ("the UNC")) should be a fundamental prerequisite to the determination of the contractual framework between Xoserve and its customers and thereby to the determination of appropriate charging and invoicing arrangements. We would expect this matter to be addressed at an early stage of any future implementation project, and it would be highly beneficial to all stakeholders if Ofgem were to include some clear guidance on this matter in its consultation conclusions.
- 1.7 The exact form of the cost allocation, customer contract and charging and invoicing arrangements will require extensive discussion during the development of the 'co-operative model'. Our priorities in this area would be to have surety of funding for all Agency Services, including the efficient financing of investments, and to ensure that the arrangements would enable Xoserve to fully recover its Agency Services costs in the event of customer failure to pay.
- 1.8 We consider that insufficient attention has been given to the high value that is placed by the industry on Xoserve's ability to offer and provide services other than Agency Services. It is important that the future 'co-operative model' arrangements do not constrain Xoserve's ability to continue to provide such services or stifle industry appetite to procure them. Indeed, a regulatory objective to promote increased proactiveness for the benefit of the broader industry should be matched by incentives on Xoserve to innovate and further expand its range of service offerings.

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- 1.9 We recognise that appointment to the Board of members who are nominated by organisations other than GTs should contribute to the alleviation of concerns around a perceived lack of transparency in Board level decisions. If the proposed corporate governance arrangement is to succeed and to serve the industry well, considerable thought needs to be given to the determination of an appropriate Board composition, the processes for initial appointment, refresh (including potential expansion) and removal, as well as the voting rights and responsibilities of its members. The primary duty of Board members is to exercise sound governance of Xoserve and to apply their skills, knowledge and experience to contribute to the realisation of the company's vision. There is a risk that, if Board members do not fully understand and give due attention to their primary duty, they may seek instead, for example, to re-open decisions already made under industry governance in respect of Agency Services or to promote the interests of their employers above those of Xoserve.
- 1.10 In order to give effect to a 'co-operative model', it would be essential to establish an industry implementation project with clear accountabilities and deliverables, as well as an appropriate governance framework, which would itself need to be 'co-operative' in nature. We would welcome the early appointment of key individuals, including an Implementation Leader and Project Manager, and clarity of their accountabilities. Great care would need to be taken to ensure that implementation of the 'co-operative model' would not increase costs, risk and complexity for the industry, or disadvantage or discriminate against any individual stakeholder or group of stakeholders. We consider that it would therefore be beneficial for the industry to develop at an early stage a set of "implementation principles" that, if applied consistently, would be expected to avoid such adverse outcomes.
- 1.11 Taking into account previous industry experience of progressing UNC and Licence changes, and experience of implementing User Pays arrangements, we consider that the April 2014 implementation of an alternative funding, governance and ownership model in line with the preliminary recommendations is an unrealistic aspiration, and that it would be more appropriate for the industry to work towards a later date. A suitable target for the industry to aspire to achieve implementation would be April 2015, although we have not assessed this timetable against other concurrent and therefore potentially competing or conflicting industry reforms. Clear direction on regulatory and industry priorities is essential to the determination of a realistic target date for implementation.

2. Introduction

- 2.1 This document is our detailed response to Ofgem's consultation on the implementation of new funding, governance and ownership arrangements for Xoserve, the Gas Transporter central Agent.
- 2.2 The consultation makes preliminary recommendations in respect of both the corporate governance and ownership of Xoserve Limited and the GTs' regulatory funding of the services that Xoserve provides in its prevailing capacity as the GT Agent. We note that the consultation also proposes changes to the cost allocation, charging and invoicing arrangements operated by Xoserve. As such, we are responding to the consultation both as the Xoserve corporate entity and as the party contracted to the GTs and Shippers to provide Agency Services.
- 2.3 We have focused our response on the preliminary recommendations and matters for discussion in the consultation letter, including the questions for consultation, and on the supporting material that is set out in the main body of the associated report prepared by Cambridge Economic Policy Associates ("CEPA") entitled "Future Arrangements for the Gas Transporter Central Agent" ("the CEPA Report").
- 2.4 We have not provided detailed comments on the extensive volume of documentation that is included in the five Annexes to the CEPA Report. We have reviewed the material to a level sufficient to enable us to provide informed responses to the consultation questions, and have noted that a number of matters discussed within the Annexes would require further detailed consideration with the industry as part of the implementation of new arrangements.
- 2.5 A robust assessment of the preliminary recommendations is dependent on having clarity of the key objectives and success criteria of the review. We have set out in Section 3 our understanding of those key objectives.
- 2.6 Our responses to the individual consultation questions are set out in a number of Sections as follows:
- (a) Section 4 addresses Question 1 in respect of service delivery;
 - (b) Section 5 addresses Questions 2 – 5 in respect of budget setting, cost allocation and charging;
 - (c) Section 6 addresses Questions 6 – 8 in respect of corporate governance and ownership;

(d) Section 7 addresses Questions 9 – 10 in respect of transition and implementation;
and

(e) Section 8 addresses Question 11 in respect of other matters.

2.7 Appendix 1 sets out an outline of the key activities that are likely to be necessary for the implementation of a 'co-operative model'. Our response to Question 9 provides further context for the outline.

3. Review Objectives

- 3.1 A robust assessment of the preliminary recommendations is dependent on having clarity of the key objectives and success criteria of the review.
- 3.2 From our reading of the consultation letter and CEPA Report, as well as the decision letter published by Ofgem in January 2012 and material prepared by CEPA for presentation and discussion at industry meetings held between November 2012 and January 2013, we understand that the key objectives of the review are as follows:
- (a) To promote increased Agency proactiveness for the benefit of the broader industry;
 - (b) To support the transparency and efficiency of 'common Agent' costs;
 - (c) To position funding, risk and control of Xoserve and the central services it provides in the most appropriate way to support these objectives;
 - (d) To implement governance arrangements that recognise the importance of Xoserve services to a broad range of stakeholders and are consistent with new regulatory arrangements for GTs for 'common Agent' services; and
 - (e) To vary Ofgem's role in the setting of business plans and budgets for 'common Agent' services.
- 3.3 We have responded to the consultation questions in the context of our evaluation of the extent to which the preliminary recommendations would meet these objectives.

4. Service Delivery

Consultation Question

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.

Key Points

- *We support the retention of the single common service provider model, with a 'common Agent' that continues to deliver the prevailing scope and nature of Agency Services and the associated Change Programme*
- *Retention of the model protects its inherent benefits and provides a basis for further development*

4.1 The single common service provider model was established as part of the sale by National Grid of four Gas Distribution Networks ("GDNs") in 2005. Following a period of extensive industry consultation, it was concluded at that time that the establishment of the model would deliver a number of stakeholder benefits in a multi-GT arrangement, including retention of access to the cost efficiencies associated with a single interface for all Shippers to manage their interactions with the GTs and the multiple use by both Shippers and GTs of common data and processes. Additionally, the model was established so as to enable additional non-regulated services to be delivered without the revenue being captured in the GTs' Price Controls, thereby removing a potential disincentive to offering additional services that was previously inherent in the regulatory funding arrangements.

4.2 The central service model has operated effectively since that time. The introduction of User Pays arrangements as part of GDPCR1 in 2008 varied the method of funding of a small number of Agency Services, but retained the single common service provider model.

4.3 We consider that retention of the single common service provider model would not only ensure that the industry continues to enjoy the model's inherent benefits, but would also deliver a number of additional positive outcomes for stakeholders:

- (a) Continuity of the single common service provider model should give stakeholders increased confidence to continue to work towards the establishment of Xoserve as a provider of Agency Services on behalf of the independent GTs in addition to the GTs;

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- (b) Retention of the prevailing model would avoid the significant costs, complexity and risks associated with delivering more fundamental change, including physical, financial and legal separation and a requirement for major redesign of key systems;
 - (c) Continuation of delivery of the prevailing scope and nature of Agency Services and the associated Change Programme would provide vital assurance to our employees and our service providers, mitigating the risk to our customers that, in response to a change of model, there may be a significant departure from the organisation of key people with critical skills, knowledge and experience; and
 - (d) Subject to relevant regulatory and contractual constraints and to appropriate commercial arrangements, retention of the model should allow Xoserve to continue to manage the data that it holds and to leverage the skills of its employees to develop and deliver bilateral services outside of its 'common Agent' role. It is important that the implementation of new arrangements would support Xoserve's ability to continue to provide these highly valued services in addition to fulfilling its 'common Agent' role.
- 4.4 Recognising that under the current model Xoserve already has discretion in how best to structure its operating model (e.g. in deciding upon the appropriate balance between 'in house' and 'bought in' services), we have not identified an alternative service delivery model that would have the potential to deliver benefits greater than those that would be expected to be realised by the retention of the prevailing model.
- 4.5 The end to end processes operated by Xoserve utilise the Gemini system (that is owned by National Grid Gas Transmission ("NGGT")) as well as the other parts of the UK Link suite (that are owned by Xoserve). Similarly, common data items are utilised across multiple systems and there is a degree of shared infrastructure and hosting for Gemini and other systems managed by Xoserve. Given this degree of integration, we consider that the scope of Agency Services should continue to include support for the Gemini system, including the provision of Change services.
- 4.6 We recognise that NGGT has a particular requirement that is reflected in the consultation letter to "retain the ability to specify changes to Gemini as and when required in order to meet its obligations", and that the scope of forthcoming changes to Gemini is likely to include the delivery of market reforms arising from the European Third Energy Package. We expect each individual customer or groups of customers to place great value on the ability to exercise control over those services which are critically important to them, in order to support their regulatory or contract compliance, enable them to deliver customer service and / or for other commercial reasons. In addition to the NGGT interest in European

change, examples of such services would include Shipper interest in Smart Metering and switching processes, and GTs' interest in timely, accurate invoicing of their transportation revenue streams. The relative prioritisation of delivery of and changes to services and systems is a matter that should be reflective of industry priorities and should be addressed both through the contract governance framework between Xoserve and its customers and through the corporate governance framework. Section 5 of our response includes a discussion of the importance of the contract governance framework to the effectiveness of the 'co-operative model, and Section 6 of our response considers further the requirement to design the corporate governance framework in such a way as to protect the particular interests of individual customers or groups of customers.

5. Budget Setting, Cost Allocation and Charging

Consultation Question

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.

Key Points

- Budgeting activities should take place in the context of a longer term business planning process, providing stakeholders with greater confidence in and visibility of future costs and outputs than would be the case under a 'one year' process*
- The authority for approval of a Business Plan and budget that takes account of stakeholder feedback should be positioned with the Xoserve Board*
- Early consideration needs to be given to the positioning of obligations, as this will inform the contractual framework and invoicing arrangements between Xoserve and its customers*
- Cost allocation, charging and invoicing arrangements need to be both transparent and efficient in order to give Xoserve's customers confidence in the efficacy of a 'co-operative model'*

5.1 The setting of budgets, allocation of costs and methods of recovery from customers are fundamental building blocks of the recommended 'co-operative model'. We discuss each of these matters in detail below, but would make a number of preliminary general observations:

- The arrangements would have to provide Xoserve with assurance that it would be fully funded for the provision of Agency Services, including in the event of financial failure of one or more of its customers;
- Arrangements would have to be sufficiently robust, transparent, inclusive and accessible in order to provide stakeholders with the necessary levels of confidence in the 'co-operative model'; and
- A great deal of care and attention would have to be given to the development of detailed arrangements prior to formal implementation.

- 5.2 Whilst there are clearly connections and dependencies between budget setting, cost allocation, customer contracts and charging, we have provided detailed responses on each aspect in turn, namely:
- (a) Business planning and budget setting (paragraphs 5.5 – 5.10);
 - (b) Cost allocation (paragraphs 5.11 – 5.12); and
 - (c) Customer contracts, charging and invoicing (paragraphs 5.13 – 5.19).
- 5.3 We have also given specific consideration in our response to other matters of funding and financial management relevant to the operation of a 'co-operative model', namely:
- (a) The ability of Xoserve to generate surpluses from the provision of both Agency Services and other services (paragraphs 5.20 – 5.22); and
 - (b) The financing of investment expenditure, both on an ongoing basis under a 'co-operative' model and during the transition from prevailing arrangements (paragraphs 5.23 – 5.26).
- 5.4 In order to aid understanding of our detailed responses on cost allocation and charging and invoicing, we set out working definitions as follows:
- (a) We define cost allocation as being concerned with the determination of the total cost of the provision of a service to a community of customers; and
 - (b) We define charging and invoicing as being concerned with:
 - (i) The identification of the customers from whom Xoserve recovers the costs of the provision of a service;
 - (ii) The determination of the costs to be recovered from each relevant customer in accordance with a charging methodology; and
 - (iii) The financial transactions necessary for the recovery of costs.

Business planning and budget setting

- 5.5 The preliminary recommendation states that the requirements for and funding of 'common Agent' services should be managed on an annual basis through direct engagement between Xoserve and its customers. We recognise that, in general terms, the preliminary recommendations in respect of business planning and budget setting are appropriate, given the proposed repositioning of Agency Services costs outside of the GT Price Control

arrangements, and that they have the potential to achieve the transparency of costs and outputs that customers would therefore be expected to require.

5.6 Whilst there are limited references in the CEPA Report to a longer term planning process, the preliminary recommendations emphasise strongly the need for an annual budget setting process. We recognise the validity of this need, but are concerned that a planning process that looks no further than one year ahead would offer stakeholders only a limited perspective of the range of Agency Services planning considerations. We have an established track record of preparing multi-year rolling Business Plans¹ on an annual basis. We expect that continuation of this approach under a 'co-operative model' would retain the current benefits, namely that:

- (a) It would provide customers with the business context for the outputs and costs for Plan Year 1 and thereby the budget for the forthcoming Financial Year;
- (b) It would help customers in their own financial planning, particularly to provide them with lead time to prepare for potential future changes in the level of their funding commitments;
- (c) It would require Xoserve to continue to retain the essential disciplines of strategic investment planning, resource planning and financial management, which would in turn help to provide stakeholders with confidence of security and continuity of future service provision
- (d) It would emphasise to customers their necessary commitment to the funding of Xoserve for the medium to longer term; and
- (e) It would ensure that outputs and costs for each Financial Year are considered on a number of occasions over an extended period of time, allowing previous forecasts to be challenged and reviewed, and thereby helping to build stakeholder confidence in shorter term forecasts, including the budget for the forthcoming Financial Year.

5.7 We would expect each annual Business Plan to consider outputs and costs for at least a three year period and probably for a five year period, although we consider that the term of the Business Plan would be a matter for discussion between Xoserve and its stakeholders.

5.8 The proposed change to GT Price Controls, such that the cost, risk and benefit of funding Xoserve would no longer be borne by the GTs, suggests that a co-operative approach to

¹ Our Business Plans typically look five years ahead, although we have previously developed a nine year plan in support of the recent RIIO-GD1 and RIIO-T1 GT Price Control Review processes.

business planning and budget setting should include arrangements that would help to address the potential concerns of some non-GT stakeholders, namely:

- (a) All customers would have access to a single, common set of information in respect of the Agency Services cost base, supported by the cost allocation and charging methodologies for the recovery of Agency Services costs from individual customers; and
- (b) All customers would have equal opportunity to put forward their views on how agreed industry priorities are taken into account in the formulation of Xoserve's Business Plan and budget.

5.9 The preliminary recommendations include a proposal that the Xoserve Board should seek industry approval of the budget for each forthcoming Financial Year. We would recommend as an alternative that whilst the industry should be consulted on the proposed Business Plan and budget, authority for approval should be positioned with the Xoserve Board. We would recommend this approach on the grounds that:

- (a) Xoserve's directors would have obligations under the Companies Act which include duties to have regard to the interests of all stakeholders, to have regard to the longer term consequences of their decisions and to promote the success of the company, and it would be wrong to allow the directors to be potentially impeded in their duties because of the views of an individual stakeholder or group of stakeholders;
- (b) It would reflect the authority that individual GTs and Shippers would effectively vest in the directors through voting for their appointment to the Board (although this is subject to obtaining clarity on the role of Xoserve's directors and their appointment process, as discussed in our response to Question 7);
- (c) It would mitigate the risk of protracted and delayed approval of the Business Plan and budget, giving the business confidence to continue to deliver services and to progress its Change Programme; and
- (d) Achieving approval by way of a voting process that includes all stakeholders would be a potentially lengthy and inefficient process to put into practice because of the large numbers involved²;

5.10 Board approval would take place following a period of stakeholder engagement. The scope and nature of the engagement process should be proportionate, concerned

² As at the start of June 2013, there is NGGT, five GDNs, 44 registered Shippers and 132 registered Traders who are signatories to the UNC

principally with changes to the previous Business Plan, service priorities, key outputs and the planned Change Programme, and with a lesser focus on recurring activities. Following initial approval as part of the introduction of the 'co-operative model', stakeholders would also be consulted on any changes to the associated cost allocation and charging methodologies that may be required from time to time,

Cost allocation

- 5.11 We have successfully operated a cost allocation model for a number of years, and model outputs are used to inform elements of the Agency Services Agreement Charging Methodology, of the Agency Charging Statement and of our 'Regulatory Reporting Pack' submission to Ofgem. We recognise that a conclusion to implement the preliminary recommendations would necessitate a review of the suitability of the continued use of the prevailing cost allocation model and of the extent to which it would be appropriate for the model to be amended.
- 5.12 A key consideration of the review would be to determine in the context of a 'co-operative model' the appropriate degree of accuracy of costs for the provision of individual services. A highly cost reflective model would be expected to be required where the primary purpose is to target costs at the stakeholders who benefit from individual services or cause costs to be incurred, but would be likely to be costly to maintain and challenging for stakeholders to understand and to have confidence in. The analyses included in Annex B of the CEPA Report illustrate the highly inter-related nature of systems and services, and give some insight to the practical challenges that would be involved in the development, maintenance and stakeholder understanding of a highly cost reflective model. Alternatively, where the primary purpose is to ensure that all costs are socialised amongst one or more stakeholder groups, it would be more likely that a 'low maintenance' model using a simple cost allocation methodology would be fit for purpose, and would build stakeholder confidence through its transparency and predictability.

Customer contracts, charging and invoicing

- 5.13 The CEPA Report does not regard the positioning of industry Code and Licence obligations as a driver for the determination of the funding and governance framework for Xoserve and the Agency Services that it provides, rather that their potential repositioning would be as a consequence of decisions on funding and governance that have been informed by other considerations.
- 5.14 In order to ensure that there would be alignment in a future 'co-operative model' between Xoserve's customers' Licence and Code obligations, funding, control and risk, we consider

that decisions in respect of the positioning of obligations (in particular between licensees and parties to the UNC) should be a fundamental prerequisite to the determination of the contractual framework between Xoserve and its customers and thereby to the determination of appropriate charging and invoicing arrangements. We would expect this matter to be addressed at an early stage of any future implementation project, and it would be highly beneficial to all stakeholders if Ofgem were to include some clear guidance on this matter in its consultation conclusions.

- 5.15 We have noted the views expressed in the consultation letter that Ofgem considers that there are benefits to be obtained from the establishment of “direct invoicing” arrangements. We interpret “direct invoicing” as meaning that Xoserve would submit invoice charges for providing Agency Services to both the GTs and Shippers in accordance with their service contracts with Xoserve and reflecting their respective industry Code and Licence obligations. In the event that a review of industry Code and Licence obligations concludes that certain obligations should be retained by GTs and that others should be repositioned, Shippers would, under this arrangement, receive charges relating to Xoserve’s provision of Agency Services through a combination of invoices directly from Xoserve (by the submission of Agency Services invoices) and via the GTs (by whatever method the GTs choose to use).
- 5.16 We would assume that the invoicing of Agency Services charges to the GTs would take place under a continuation of the prevailing Agency Services Agreement, albeit that some variation to the scope of services and certain contract terms and conditions may be required. To the extent that “direct invoicing” arrangements require the establishment of new contracts between Xoserve and Shippers (potentially in the form of a Shipper facing Agency Services Agreement), this would incur an additional cost overhead. We consider implementation costs further in our response to Question 10.
- 5.17 We consider that the introduction of “direct invoicing” arrangements would have a number of implications that would require careful consideration during the implementation project:
- (a) Recognising that the arrangements must be designed to protect the ongoing service provision for the community’s benefit, the contractual framework would have to be structured in such a way as to mitigate the risks to Xoserve (and consequently to our community of interest) of late payments, disputes and customer defaults, and to protect against the building up of further customer debt, potentially through the inclusion of Xoserve’s right to impose sanctions or suspend / withdraw services to individual parties. It may be appropriate to set up one or more credit committees similar in function and purpose to the existing Energy Balancing Credit Committee

and to require Xoserve's customers to put in place appropriate security and / or pre-payment arrangements;

- (b) There would need to be arrangements in place to ensure the sufficient transparency of information to individual customers to allow validation of charges, consistent with the review objectives of transparency of Xoserve's total costs. These arrangements would be likely to build on the cost base, cost allocation and charging methodology information that would be published as part of the Business Plan and budgeting process (and may have implications for the information provided by GTs to Shippers in respect of the share of Agency Service costs invoiced initially to the GTs);
- (c) The charging and invoicing arrangements should be industry efficient, and should not add unnecessarily to the administrative costs of Xoserve and its customers; and
- (d) The arrangements need to be appropriate for both the recovery of day to day operating costs and investment expenditure. We set out in paragraphs 5.23 – 5.26 further considerations in respect of the financing of investment expenditure.

5.18 We note that, under the prevailing arrangements, the very large majority of Agency Services costs are recovered directly from the GTs, and only a small proportion of costs (for non-Code User Pays Services) are recovered by Xoserve directly from Shippers. In the event that the review of the positioning of obligations and associated costs concludes that there is no material change required, it would be appropriate to give further consideration to the case for the introduction of "direct invoicing" arrangements.

5.19 Irrespective of future decisions on the positioning of industry Code and Licence obligations, the contract framework and charging and invoicing arrangements, Xoserve would be well placed during the implementation project:

- (a) To provide information and advice to GTs and Shippers in respect of its Agency Services, the beneficiaries of those services, and the associated industry Code and Licence obligations, noting that the review of services that has been documented in Annex A to the CEPA Report could also provide useful reference material; and
- (b) To provide useful insight into the practicalities of developing and maintaining invoicing processes, as well as developing and operating cost allocation and charging methodologies.

Ability of Xoserve to generate surpluses

5.20 We note that there is an expectation set out in the preliminary recommendations that Xoserve would be able to generate an income stream from the provision of Agency Services sufficient to allow it to make a surplus, which would either be retained for the purposes of building and maintaining working capital or used to offset future years' charges. Further work would be required during an implementation project:

- (a) To determine the appropriate level of margin that Xoserve would be allowed to earn over and above the recovery of budgeted Agency Services costs; and
- (b) To develop rules that, under exceptional circumstances, would allow for within year variation of budgeted charges for Agency Services in order to avoid significant shortfalls in short term funding or to return surpluses that have been accumulated unexpectedly.

5.21 We think that insufficient consideration has been given to the implications of carrying forward budget overruns, potentially resulting in a net liability position on the Xoserve Balance Sheet. In such a position, it may be difficult, or at least costly, for Xoserve to raise from third parties the funds required to sustain the business, and there may be legal restrictions on an insolvent Xoserve that would constrain its ability to trade. As such, it may be more appropriate to adopt a 'co-operative model' in which all Agency Services costs are recovered within year, although this principle would not necessarily apply to the recovery of investment expenditure. This is discussed further in paragraphs 5.23 – 5.26 below.

5.22 We also consider that insufficient attention has been given to the high value that is placed by the industry on Xoserve's ability to offer and provide services other than Agency Services. These services are provided under the prevailing arrangements on a bilateral and commercial basis governed by individual contracts between Xoserve and the paying customer. It is important that the future 'co-operative model' arrangements do not constrain Xoserve's ability to continue to provide such services or stifle industry appetite to procure them. Indeed, a regulatory objective to promote increased proactiveness for the benefit of the broader industry should be matched by incentives on Xoserve to innovate and further expand its range of service offerings.

Financing of investment expenditure

5.23 A key element for consideration during the development of a charging methodology statement would be the drawing up of a set of rules for the financing of systems investment expenditure. The nature of such expenditure is inevitably less regular and predictable than

the costs of day to day service provision, although a longer term planning approach, reflecting current arrangements and as discussed in paragraphs 5.6 – 5.7, would be expected to help support predictability and visibility for stakeholders.

5.24 We do not seek to prescribe here the detailed rules for the financing of investment expenditure, as we regard this as a matter that should be taken forward in discussion with stakeholders during an implementation project. However, we would like to take this opportunity to outline some matters for consideration in the development of such rules, noting that these are relevant irrespective of the accounting treatment adopted by Xoserve in respect of its investment expenditure:

- (a) Options for the sources of finance, including one or more of Xoserve's customer groups (in their capacity as recipients of Agency Services), third party systems service providers and financial institutions;
- (b) The relative cost efficiency of the sources of finance and the forms of assurance that may be required, particularly by financial institutions;
- (c) The period of time over which financing is required and costs are recovered³;
- (d) The timing of acquisition of investment funds as compared to the timing of investment expenditure; and
- (e) The purpose of the investment, noting that investment in systems infrastructure will often be required to sustain multiple services for all recipients of Agency Services, implying that funding contributions should be received from all members of all constituencies.

5.25 Reflecting the recommended change in the status of the Networks' ownership of Xoserve, we would not expect our shareholders to finance investment expenditure. Although there may be an option for one or more of the Network businesses to make short to medium term loans available to Xoserve, this would not be in their capacity as shareholders.

5.26 In addition to the ongoing financing of investment expenditure discussed above, the transition to a 'co-operative model' would require stakeholders to give special consideration to the funding and financing of projects that would be 'in flight' at the time of implementation. We consider that a viable proposition would be to apply the continuation of prevailing arrangements to all investments that are 'in flight' at the date of

³ Xoserve currently recovers capital expenditure through in year contributions from GTs in their capacity as customers, who, we understand, in turn add those costs to their Regulatory Asset Bases and include an allowed rate of return on the expenditure in future years' transportation charges to Shippers

implementation of the 'co-operative model' until such time as those investments are complete, and to apply new arrangements only to those investments that commence after the date of implementation of the 'co-operative model'.

Consultation Question

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

Key Points

- *The suitability of the measures is primarily a matter for licensees*
- *Regulatory oversight should be limited to outputs and costs associated with the provision of Agency Services only*

5.27 The suitability of the measures under consideration is primarily a matter for the licensed stakeholders that would have the ability to exercise control over Xoserve. As such, we do not offer any detailed observations on the suggested measures, but would make the following observations:

- (a) Each of Xoserve's customers will have an ongoing primary interest in ensuring that, to the extent that they rely on Xoserve to discharge certain of their regulatory and contractual obligations, they are able to exercise adequate control of the quality and cost of Xoserve services;
- (b) Ofgem's ability to direct budget changes under specific circumstances would have to be limited to costs and outputs for the provision of regulated Agency Services only. We consider that it would be inappropriate for Ofgem to direct or constrain the provision of bilateral services, as the decision to offer these is a matter for Xoserve and the commercial arrangements are a matter between Xoserve and its customer; and
- (c) In the event that obligations are placed on licensees to ensure that Agency Services are provided in an economic and efficient manner, they would be expected to discharge such obligations in their capacity as Xoserve's customers through their participation in the business planning and budget setting process.

Consultation Question

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?

Key Points

- The ability to adopt a new methodology is dependent upon its inherent complexity*
- The costs of methodology development would not be expected to comprise a significant element of the total costs of implementing a 'co-operative model'*

5.28 The ability of Xoserve to adopt a new cost reflective charging methodology is largely dependent upon the industry's ability to reach consensus and the consequent level of complexity of the cost allocation model and charging methodology. This matter is discussed further in the 'cost allocation' and 'customer contracts, charging and invoicing' paragraphs above.

5.29 We recognise that a review of prevailing methodologies would be appropriate as part of the implementation of a 'co-operative model', but do not envisage that wholesale change would be required.

5.30 Absent of clear guidance on the potential future cost allocation and charging methodology rules and requirements, we have not sought to estimate the costs of achieving the necessary changes to existing models. However, we consider it unlikely that the costs would represent a particularly significant element of the total cost of implementation of a 'co-operative model'.

Consultation Question

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?

Key Points

- *Cost allocation, charging and invoicing arrangements need to be both transparent and efficient in order to give Xoserve's customers confidence in the efficacy of a 'co-operative model'*
- *A "direct invoicing" arrangement would be expected to give rise to incremental costs in the Xoserve – Shipper interface*
- *The introduction of a suitably robust contractual framework with Shippers and other non-GT customers, including the associated financial transactions, would incur both development expenditure and incremental operating costs*

5.31 Our detailed comments on charging and invoicing arrangements are set out above within our response to Question 2.

5.32 An arrangement in which Xoserve would be required to submit invoices for the provision of Agency Services to both GTs and Shippers (and potentially other stakeholders in due course) would be expected to give rise to incremental costs in respect of the Xoserve – Shipper interface in the areas of:

- (a) Credit risk management;
- (b) Contract development and maintenance; and
- (c) Generation of invoices and cash collection procedures.

5.33 It should not be assumed that costs could be minimised by a simple extension of the contract framework for Non-Code User Pays Services, rather that a thorough review of the contract terms and conditions would be required to ensure that it would be fully fit for purpose for use within the context of a 'co-operative model'.

6. Corporate Governance and Ownership

Consultation Question

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.

Key Points

- *Given the proposed changes to the funding of Xoserve services, application of the full co-operative model with retained GT ownership would represent a balanced response to the change drivers*
- *We support retention of the prevailing ownership arrangements*

6.1 We have considered carefully the key features of the range of corporate governance and ownership models as summarised in Table 3.1 of the CEPA Report, and would make a number of observations as set out below:

- (a) The removal of Agency Services costs from the GT Price Control Review process would necessarily require the introduction of an alternative cost control framework, which is proposed to be achieved through the introduction of a 'co-operative model';
- (b) The introduction of a 'light co-operative model' would mean that non-GT stakeholders would be reliant on service contracts and the UNC to exercise control over Agency Services costs and provide them with the means to manage the performance risks associated with potential cost overruns and / or non-delivery of services; and
- (c) The introduction of a 'full co-operative model with all participants ownership' would address the perceived shortcomings of a 'light co-operative model' as outlined above, but would also introduce significant complexity to the implementation challenge and major uncertainty for Xoserve employees.

6.2 Given the proposed changes to the service funding model, assuming that there are changes to UNC and the range of options presented in the CEPA Report, we support the preliminary recommendation to introduce the 'full co-operative model with retained GT ownership' on the grounds that it would appear to represent a measured response to the perceived change drivers, whilst at the same time avoiding the cost, risk and complexity that would be associated with the change to 'all participant ownership'.

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- 6.3 We feel that continuity of the prevailing ownership arrangements would provide comfort to our employees and our service providers, and would therefore provide greater assurance to our customers of continuity of service.
- 6.4 The consultation letter states that “the proposed new governance arrangements (including new Board arrangements) would allow Shippers and GTs to collectively share corporate control of the central service provider, and in doing so, assume the performance risk of the company”. We set out below our understanding of three important aspects of this statement, and would welcome clarification on these matters within the consultation conclusions:
- (a) The capacity in which the GTs would share corporate control with Shippers would be as licensed entities and UNC signatories who are in receipt of Agency Services and have the right to participate in the appointment of directors, and not as owners of the company;
 - (b) The nature of the performance risk that would be assumed by Shippers and GTs is concerned in varying degrees with matters of service quality, regulatory compliance, reputation and financial efficiency; and
 - (c) Performance risk would be assumed by all Shippers and GTs, and would not be borne by individual Board members or only by the individual Shipper and GT organisations by which Board members are employed.
- 6.5 We consider that there is a logical consistency between the preliminary recommendations in respect of the retention of the single common service provider model and those in respect of the ‘full co-operative model’, reflecting the multiple usages of common systems, data and processes to deliver a range of services for the benefit of different customer groups.
- 6.6 We have not given any in depth consideration to the potential risks and benefits of the introduction of the ‘Contracted Services Alternative’ model. As the focus of the consultation and its preliminary recommendations are on the funding of Agency Services and on the governance of Xoserve as the provider of those services, rather than on the operating model for the method of provision of Agency Services, our initial thoughts are that the ‘Contracted Services Alternative’ would not provide a suitably focused response.

Consultation Question

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?

Key Points

- *Board arrangements must be consistent with duties in respect of the governance of Xoserve*
- *Board composition and voting rights are important to building stakeholder confidence*
- *The appointment of non-affiliated Board members can help to ensure informed and balanced decisions*

6.7 The role of Xoserve's directors and of the Board is not clear from our reading of the consultation letter and CEPA Report. We consider that the primary duties of the Xoserve Board should be in respect of the governance of the company rather than of the services that it provides. Of particular relevance are Companies Act obligations on directors which include duties to have regard to the interests of all stakeholders, to exercise independent judgement, to have regard to the longer term consequences of their decisions and to promote the success of the company.

6.8 As such, suitable candidates for Board membership should be those who can primarily bring skills, knowledge and experience in matters of corporate governance and who can make an effective contribution to the realisation of the company's vision. Expert knowledge of energy markets and industry Codes is already deeply embedded within the Xoserve workforce and across Xoserve's stakeholders, and this knowledge should continue to be relevant primarily to industry considerations, not to Xoserve's corporate governance.

6.9 We consider that decisions about what Agency Services are required are a matter for industry governance, and we would not expect those matters to be revisited by the Xoserve Board. We are concerned that some stakeholders would appear to view an alternative corporate governance framework as a means and opportunity to progress changes to UNC business rules in a different manner or to different timescales. We disagree with this view, and would encourage Ofgem to make clear through its consultation conclusions that the only acceptable route for variation to UNC development timescales and processes is through changes to Licence obligations and to UNC governance arrangements.

6.10 It would be most important to ensure that thorough consideration is given to the precise composition of the Board, to the processes for the initial appointment, refresh (including

potential expansion) and removal of Board members, to the balance of responsibilities of Board members to shareholders, customers, employees and other stakeholders, and to voting arrangements in respect of Board resolutions. Consideration should be given to the structuring of voting rights so as to ensure that the particular interests of individual stakeholders or stakeholder groups do not prevail unduly over the interests of others. There is a significant risk that sub-optimal arrangements could undermine stakeholder confidence in the Board and in Xoserve, and could lead to inappropriate and sub-optimal Board level decisions.

6.11 Table 3.2 of the CEPA Report identifies different categories of Board member:

- (a) In respect of Board members that are appointed to represent industry “constituencies”, there would be a need to determine the number of directors to be appointed, to clearly define the “constituencies” that they represent, and to have arrangements in place to accommodate potential future changes in the number and definition of “constituencies” (including, for example, a response to the introduction of Agency Services to the independent Gas Transporter community). It would also be essential to define what, in the context of being a director of Xoserve, “representing a constituency” would mean, and how this should be balanced with the need to operate and make decisions that are impartial and are in the best interests of Xoserve and its stakeholders. We note that the balance of constituency representatives on the Board could be influenced by the positioning of service obligations with different stakeholder groups and their relative exposure to funding commitments for the provision of those services;
- (b) In respect of Board members that are appointed from amongst Xoserve’s senior management, we recognise that there is an option for the Chief Executive Officer and a small number of others to be members of the Board. However, the role, rights and responsibilities of those Board members would need to be considered carefully. Whilst the current practice is for all members of the Xoserve Executive Team to attend Board meetings, they are not appointed as Board members; and
- (c) In respect of additional Board members, we would support the continued presence of an independent Chairman. We also consider that there would be merit in exploring further the appointment of non-affiliated Board members. These individuals would be likely to be selected for their relevant specialist skills and knowledge, and as they would not be representing any particular industry constituency, would bring potentially greater objectivity to Board decisions. If this

approach is adopted, consideration would need to be given to the number of non-affiliated Board members and their voting rights.

6.12 We have noted the proposal in the CEPA Report that Board members should receive remuneration. With the exception of fees paid to the incumbent Chairman, Board members do not currently receive remuneration in their capacity as Board members. The proposal would therefore give rise to incremental operating costs, which Xoserve would in turn expect to recover from all constituency members.

Consultation Question

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.

Key Points

- *The consultation conclusions should give the industry a clear mandate to develop the details of the establishment and ongoing affairs of the Board*
- *Monitoring of the early operation of new arrangements would be necessary to ensure their effectiveness*

6.13 We would expect Ofgem's conclusions from this consultation to provide clear direction to the industry on the key features of the 'co-operative model'. Thereafter, we think that is reasonable for Ofgem to allow the industry to develop and implement detailed arrangements. The exact role of Xoserve in establishing new Board arrangements needs careful consideration. Whilst we are arguably well placed to develop detailed thinking, there needs to be absolute clarity with and full support from the industry as these details are developed. There are also questions to be addressed concerning the 'handover' of corporate governance responsibilities from the prevailing Board to the new Board.

6.14 We do not consider that it would be appropriate to place Licence obligations on Gas Transporters and Shippers in respect of the establishment and operation of an alternative corporate governance framework for Xoserve. Standard Special Condition A15 of the GT Licence establishes a precedent for this, in that it places an obligation on GTs to appoint an Agency, but it does not prescribe the identity of the Agency or how the legal entity that is appointed as the Agency is to be governed. This is an important difference that was established at the time of Network Sales and needs to be maintained between contracting

for services in order to discharge Licence and Code obligations, and exercising corporate control of the entity that provides those services.

- 6.15 We also consider that there would be value in monitoring the operation of alternative corporate governance arrangements for a reasonable period following their implementation to ensure that they are effective and meet stated objectives. Some refinement may be necessary in the light of early experiences.

7. Transition and Implementation

Consultation Question

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?

Key Points

- *Timely and effective change implementation requires clarity of accountabilities, responsibilities and deliverables*
- *A suitable target to aspire to achieve implementation of alternative arrangements in line with the preliminary recommendations would appear to be April 2015*
- *Consideration should be given to a period of transitional arrangements prior to full implementation*

7.1 In order to ensure that implementation of the consultation conclusions is progressed in a timely and effective manner, it is essential that there is:

- Early appointment of key individuals, including an Implementation Leader and Project Manager, and clarity of their accountabilities;
- A clear definition available to stakeholders both of the outputs that are required to be delivered and of the identity of the parties that are responsible for their implementation; and
- A strong commitment from all stakeholders and constituencies to work together to give effect to a co-operative model.

7.2 The transition from prevailing arrangements to a 'co-operative model' necessarily demands a co-operative approach to achieving change. This would suggest that responsibility for implementation should be positioned with all key stakeholders in the co-operative model. However, care should be taken to ensure that responsibilities are not so widely distributed that decision making processes in respect of the transition and implementation are ineffective.

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- 7.3 The placing of responsibility on stakeholders through the introduction of Licence obligations might represent a suitable way forward for GTs and Shippers, although we note that this approach could not be extended to Xoserve unless it became a licensed entity.
- 7.4 We have noted the views expressed in Sections 4.4 and 5.2 of the CEPA Report that the full co-operative model with retained GT ownership could be implemented by April 2014. In order to test this assertion, we have carried out an initial review of the key activities that we consider would be likely to be required in order for the industry to achieve full implementation of the preliminary recommendations. We have sought not only to identify the key activities and their potential duration, but also to recognise the potential requirement for the sequencing of certain activities as a result of interdependencies between those activities. We are also mindful of the length of time that is normally required to progress UNC and Licence changes and to establish customer contracts, and of the time that was required previously to develop and implement the User Pays arrangements. By comparison, the scale of change envisaged for the introduction of a 'co-operative model' suggests that implementation timescales would be substantially greater.
- 7.5 We have assumed for the purposes of our initial review that:
- (a) Ofgem concludes at the end of this consultation that all key aspects of its preliminary recommendations are to be implemented, and publishes its conclusions to this effect at some point between the end of July 2013 and the end of September 2013;
 - (b) Consistent with the provisions of Special Condition 3F of the GDNs' Licences and Special Condition 6D of the NGGT Licence that are concerned with arrangements for the recovery of uncertain costs, an alternative model would take effect only at the start of a GT Price Control Formula Year, noting that GEMA would be required to direct changes to GT allowed revenues for Agency Services costs no later than 30 November prior to the start of the Formula Year;
 - (c) In addition to the recommended changes to the status of the Networks' ownership of Xoserve, to the corporate governance framework and to budgeting, cost allocation and charging arrangements, changes would also be required to industry documentation (principally but not necessarily limited to the Uniform Network Code and the Agency Charging Statement), to GT and Shipper Licences, and to contracts between Xoserve and its customers for the provision of 'common Agent' services; and
 - (d) Consistent with our normal practice and experience, business planning and budget setting processes would be required to commence in August for Board approval the

following January ahead of the start of the next Financial Year commencing in April. The Business Plan and budget would be developed from a latest understanding of required outputs and cost drivers. Plans developed during the RIIO-GD1 and RIIO-T1 GT Price Control Review processes could provide a point of reference, but should not be simply carried forward and adopted without further review or validation.

- 7.6 Our initial review indicates that completion of activities in readiness for the April 2014 implementation of an alternative funding, governance and ownership model in line with the preliminary recommendations is an unrealistic aspiration, and that it would be more appropriate for the industry to work towards a later date for implementation.
- 7.7 The outline plan in Appendix 1 sets out the findings of our initial review. It suggests that a suitable target for the industry to aspire to achieve implementation would be April 2015, although we have not carried out any validation of the completeness of the activities, their duration, their inter-dependencies or any external dependencies. Importantly, we have not assessed the plan against other concurrent and therefore potentially competing or conflicting industry reforms, and in the absence of clear industry priorities we would caution Ofgem and the industry against placing undue reliance on the outline plan.
- 7.8 The outline plan includes matters that are the responsibility of licensees and Ofgem as well as those that could be progressed by Xoserve.
- 7.9 We would expect that certain aspects of the arrangements would have to be introduced for a transitional period prior to the full implementation of the new arrangements from a specified effective date. This approach would enable Xoserve and the industry to develop on a co-operative basis a Business Plan and budget that would then become effective for the period following full implementation.
- 7.10 As noted in paragraph 7.7, it is highly likely that the development and implementation of a 'co-operative model' would run concurrently with a number of other key industry initiatives in which Xoserve, GTs and Shippers are already playing a significant part. These initiatives include the UK LINK Programme, gas settlement reform under the auspices of Project Nexus, the Smart Metering Implementation Programme, the Smarter Markets Programme and European Third Energy Package reforms. There are risks that:
- (a) Change congestion may impede the timely progression of not only the implementation of a 'co-operative model' but also one or more of the initiatives referenced above, requiring Ofgem and the industry to give clear direction on priorities;

- (b) Uncertainty of the detailed arrangements of the 'co-operative model' may undermine stakeholder confidence to progress other industry initiatives, particularly with regard to decisions to fund Xoserve for required systems investments; and
- (c) Implementation of a 'co-operative model' would place further demand on the same limited resources that already have significant commitments to other industry initiatives.

Consultation Question

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.

Key Points

- *CEPA appears to have identified the major cost types associated with the changes under discussion*
- *The estimates do not appear to take account of costs that would be incurred locally by individual stakeholders*
- *It is difficult to assess the criticality of cost estimates in the absence of a statement of benefits*

7.11 We note that Table 4.3 in Annex D of the CEPA Report provides an estimated range of implementation costs for each of the 'full co-operative model' options, that the estimate that is aligned to the preliminary recommendations is in the range £1.2m - £1.7m, and that both the lower and upper ends of the range are estimated to increase by £0.6m in respect of the 'all participants ownership' option. It would appear that no account has been taken in this Table of the costs already incurred in the production of the CEPA Report, nor of costs incurred in respect of the earlier consultation that preceded the January 2012 decision letter.

7.12 The cost items in Table 4.3 and the supporting notes in Table 4.2 would appear to identify the major expenditure types, although it is particularly difficult to assess individual estimates and their inherent level of confidence in the absence of more granular information about the scope and nature of each expenditure type and the approaches adopted to arrive at the estimates.

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- 7.13 The 'structural' change cost estimate relies upon a assumption that it would be possible to give effect to the preliminary recommendations through changes to the Articles of Association and potentially the Joint Governance Arrangements Agreement. The separation of ownership and control would require a significant rewrite of the "Structuring and Shareholders Agreement in relation to Xoserve Limited", and the costs of this exercise would appear not to have been factored into the estimate.
- 7.14 The commentary that supports Table 4.3 would appear to suggest that the estimates are limited to "costs at the centre". This would in turn imply that the estimates do not take account of incremental costs that would be incurred locally by Xoserve, Gas Transporters, Shippers and other stakeholders to give effect within their own organisations to the changes under consideration. There is, therefore, a risk that the full extent of the transitioning and implementation costs may be significantly understated.
- 7.15 We note also that the CEPA Report does not provide a comparison of the estimated costs to any anticipated benefits arising from the changes under consideration. The inclusion of a cost benefit analysis would allow stakeholders to assess the extent to which the case for change is sensitive to the completeness and accuracy of cost estimates.

8. Other Matters

Consultation Question

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

Key Points

- *The preliminary recommendations reflect a limited interpretation of previous decisions about the nature of a co-operative model*
- *The review has given insufficient consideration to the potential repositioning of GT obligations and changes to industry governance arrangements*

8.1 We note that both the CEPA Report and the preliminary recommendations in the consultation letter have adopted a particular interpretation of a key conclusion that was included in Ofgem's letter of 16 January 2012. That letter states that under a co-operative model "decisions about the future provision of data services supporting the supplier market will rest with the users of those services", and this has been interpreted as a requirement to change Xoserve's corporate governance arrangements. As such, neither Ofgem nor CEPA has made a clear link between the conclusions that were reached in January 2012 and the preliminary recommendations that are set out in this consultation. This makes it inherently difficult to assess whether the nature and scale of change proposed by the preliminary recommendations is both necessary and sufficient.

8.2 We observe that no serious consideration has been given to the possibility and viability of an alternative approach that would seek to give effect to user-driven decisions about data services through changes to the contractual framework for the provision of Agency Services by Xoserve to its customers. The discussion in respect of implementation activities and costs that is included in the CEPA Report anticipates that potentially significant changes to the contractual framework would be required, but does not consider the sufficiency of these changes alone to meet review objectives without also making changes to corporate governance arrangements.

8.3 We note also that the CEPA Report and the consultation letter have not considered:

- (a) The extent to which variations to industry governance in respect of the definition and delivery of Agency Services might contribute to the delivery of review objectives; and

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- (b) Any consequent requirement to reposition GT Licence and UNC obligations arising from the preliminary recommendations.

Appendix 1 – Outline Plan for Implementation of Co-operative Model

	Q4 '13	Q1 '14	Q2 '14	Q3 '14	Q4 '14	Q1 '15	Q2 '15
<u>Project Setup</u>							
Establish Industry Project Group, Terms of Reference, Deliverables and Governance							
<u>Corporate Governance and Ownership</u>							
Composition, voting rights, duties, appointment rules							
Run appointment process							
Operate new governance							
<u>Planning and Budgeting</u>							
Plan / budget principles							
Plan / budget development, including industry engagement							
Plan / budget approval							
<u>Funding, cost allocation, charging and invoicing</u>							
Framework and rule development							
Regulatory direction: restate GT allowed revenues							
<u>Other Matters</u>							
Customer contracts							
Code and Licence impacts (including CEPA input)							
<i>Potential requirement for statutory Licence consultation</i>							
Stakeholder communications							
<u>Implementation</u>							
Go live and monitor							

Note: Lighter shading indicates opportunity for early work on these topics