

Gas transporters, independent  
gas transporter, gas shippers,  
gas suppliers, Xoserve and other  
interested parties

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### **Xoserve - decision in relation to new funding, governance and ownership arrangements for the gas transporters' central agent**

Xoserve provides a range of essential services to support the GB gas industry including billing services, managing the booking of capacity, running the gas settlement systems and managing the change of supplier process.<sup>1</sup> We undertook a review of Xoserve's funding, governance and ownership arrangements to ensure that they would be fit for purpose, and provide the required responsiveness and flexibility in funding, in the context of future industry changes.

We sought views earlier this year on our preliminary recommendations for Xoserve's funding, governance and ownership arrangements.<sup>2</sup> The intent of our preliminary recommendations, and the other options proposed in the consultation, were principally to allow for wider participation by users in the decision making process and for all users<sup>3</sup> to directly fund service delivery.<sup>4</sup>

We have decided that the full co-operative governance model should be established. The gas transporters (GTs) will remain owners and changes to the way that Xoserve, who will be the central service provider (CSP) to the gas industry, is funded will be required to fully introduce co-operative arrangements and make all users accountable for the CSP. This letter summarises our decision. We provide more detail, including a discussion of responses and how we have reached our decision, in Appendix A. This decision in itself does not bring about any immediate changes to arrangements. There is further work to make the necessary changes to the legal and regulatory instruments in order to establish new arrangements and provide a framework for the ongoing operation of the CSP.

As a first step to achieving implementation we have published alongside this decision a report from our consultants, Cambridge Economic Policy Associates (CEPA).<sup>5</sup> It proposes a number of options for how the legal and regulatory framework can be changed. We will be holding a stakeholder workshop to discuss these options and the wider changes required to take this decision forward. The workshop will be held at our London office on 6 December 2013 at 1.30pm. If you would like to attend please contact Jacob Kane ([jacob.kane@ofgem.gov.uk](mailto:jacob.kane@ofgem.gov.uk), 020 7901 3889).

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<sup>1</sup> See: <http://www.xoserve.com/>

<sup>2</sup> Our consultation on implementing new arrangements (April 2013) can be found at: <https://www.ofgem.gov.uk/publications-and-updates/consultation-implementing-new-funding-governance-and-ownership-arrangements-xoserve-gas-transporter-central-agent>

<sup>3</sup> "Users", in the context of this document, refers to gas transporters and shippers.

<sup>4</sup> The decision to adopt these arrangements, known as the co-operative model, was published in January 2012 following a consultation process. For further details see:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=345&refer=Networks/GasDistr/RIIO-GD1/ConRes>

<sup>5</sup> See Appendix B - CEPA report (October 2013): <https://www.ofgem.gov.uk/ofgem-publications/84185/decisionappendixbcepareportonthelalandregulatoryimplementation.pdf>

## Summary of our decision

Our April 2013 consultation considered options for how a co-operative model could be applied in practice. There were three building blocks: how services should be delivered; budget setting, the allocation of costs and charging; and corporate governance and ownership. We are confirming our recommendations in these three areas. Our decision takes into account responses to our consultation and further information we have obtained since the consultation was published.

We have concluded that the arrangements we outline below will drive the desired changes in responsiveness, flexibility and transparency. We note that, for the most part, the industry supported the arrangements outlined. Further details of the responses received and our decision are in Appendix A. The key aspects of new arrangements that will need to be established are -

- A. **Delivery of services** – the integrated systems and services that the CSP provides for both GTs and shippers should be retained. It would be inefficient and complex to split service delivery based on the recipient(s) of each service.
- B. **Budget setting, cost allocation and charging** – all users will collectively fund the CSP which will require changes to the funding approach. A new cost allocation methodology will need to be established and the GTs' price controlled revenue allowance for Xoserve's expected operating cost will be removed. Alongside these changes transparency will be further reinforced through an inclusive annual budget setting process and an invoicing approach which ensures users have sight of the costs they are exposed to.<sup>6</sup>
- C. **Corporate governance and ownership** – governance arrangements will be in line with the full co-operative model resulting in all users taking a share in the control of the CSP and being accountable for the CSP's performance risk. To this end, users will be required to operate the CSP economically and efficiently. More inclusive board arrangements will be established with a robust and transparent process for election to the Board. The GTs will remain the owners as this is the simplest approach to take. However, their rights and liabilities as owners will be restricted.

This decision does not in itself result in any immediate changes to arrangements. We outline in Appendix A the further steps that will be required before implementation is complete. These steps can be summarised as follows –

- We will modify the GT licence, and potentially the shipper licence, to establish new arrangements for the CSP. We will also change the revenue allowance and modify the GT licences to establish new funding arrangements.
- The GTs will be required to change the articles of association and memorandum, which set out the rules for running the company.
- The industry will be required to derive a cost allocation methodology and associated statement of charges; and be required to raise modifications to the Uniform Network Code (UNC). It may also need to make further changes to, or establish new, service agreements between the CSP and service users.

As noted above, we have published a report by CEPA on the options for changing the legal and regulatory framework in order to establish new arrangements. The choice of option will dictate the details of the implementation steps outlined above. We will discuss these options in detail at our proposed industry work group. Following this we will take steps to progress necessary licence modifications. We expect new arrangements to be in place for April 2015 and will introduce licence obligations to ensure that a reasonable timetable is followed. We expect the industry to take the lead in progressing other implementation steps.

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<sup>6</sup> In contrast to now where the majority of Xoserve's costs are part of transportation charges.

## Next steps

We will be holding an industry workshop on 6 December 2013 to go through next steps and to discuss the options in relation to the legal and regulatory framework. Following this we intend to start the necessary steps to modify applicable licences early in 2014.

If you have any other questions related to this decision, please contact Jacob Kane ([jacob.kane@ofgem.gov.uk](mailto:jacob.kane@ofgem.gov.uk), 020 7901 3889).

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Andy Burgess'.

**Andy Burgess**  
**Associate Partner, Transmission and Distribution Policy**

## **Appendix A: Reasoning and our decision**

### **A. Delivery of services**

Our preliminary recommendation was to retain the current model whereby one body provides services to both GTs and gas shippers.

#### ***Respondents views'***

All agreed that retaining a single service provider, for both GTs and shippers, would be best because the cost of splitting delivery would outweigh any benefit given the highly integrated nature of the systems needed. Xoserve's response noted that a single CSP would provide the right framework for the potential incorporation of independent gas transporters (IGTs), and would also allow it to leverage the skills it has to provide additional services. An IGT considered there should be flexibility in the services that the CSP is required to deliver, ie not all services currently in the Agency Service Agreement (ASA)<sup>7</sup> need to be delivered centrally.

The majority of responses supported Gemini systems, currently owned by National Grid Gas (as owner of the National Transmission System) (NGGT), remaining part of the CSP's integrated suite of systems. NGGT emphasised the growing need to conform to international regulatory obligations and how the need to prioritise system changes to accommodate these must be balanced against the benefits of continued integration.

#### ***Our decision***

The optimal structure for delivering services is one which most efficiently supports users' requirements. For this reason our decision, noting the wide industry support, is to retain the CSP as one delivery body. Arrangements will not preclude the CSP from out-sourcing delivery to third parties, just as Xoserve does now.

The majority of the industry considers there is benefit in the Gemini systems remaining part of the integrated system. We recognise the concerns of NGGT, however we consider that the need to prioritise legislation driven changes may also apply to other users, albeit perhaps to a lesser extent given NGGT's unique position in relation to the Gemini systems. We suggest that there is therefore merit in putting in place a process to ensure such prioritisation occurs for NGGT and that this may also need to apply to other users.

CEPA's report, published alongside our consultation, discusses the services currently delivered under four categories.<sup>8</sup> The CSP will continue to deliver all services that the GTs are currently required to provide through UNC obligations, these are categorised as "core" services and "code user pays" services. The CSP will also continue to be able to provide additional services requested by users by means of bilateral contracts, known as "non-code user pays" services. Additionally, the CSP currently delivers a fourth category of services which do not have a formal definition but appear to predominantly relate to provision of services to fulfil GTs' licence obligations.

#### ***High-level requirements for implementation***

This decision provides a good opportunity for the industry to consider changes to the contractual framework that the CSP delivers services under to ensure it is appropriate going forward. This does not mean that the definitions of current core or code user pays services should be removed from the UNC but that there may be advantages in further services being defined in the UNC.<sup>9</sup> For example, the services currently delivered to discharge GTs'

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<sup>7</sup> The ASA is a multi-party contract between Xoserve and the GTs which includes the contractual terms under which Xoserve provides the services that allow the GTs to meet their licence and UNC obligations.

<sup>8</sup> For further information see CEPA's April 2013 report (Annex B, Appendix A): <https://www.ofgem.gov.uk/ofgem-publications/48108/cepabxoserveapr13.pdf>

<sup>9</sup> For further discussion of this see section 4.2.2 of the CEPA legal and regulatory implementation report (October 2013).

licence obligations will need to be either defined in the UNC or delivered through an alternative contractual arrangement between the GTs and the CSP.

In relation to formally requiring prioritisation of legislation driven systems changes, particularly for the Gemini systems, our initial view is that this can be achieved through contractual arrangements and/or the UNC modification process and that the industry is best placed to consider the most appropriate approach.<sup>10</sup>

## **B. Budget setting, cost allocation and charging**

Our consultation proposed changes intended to increase the transparency of funding arrangements as this was one of the key stakeholder concerns driving the review. Our preliminary recommendation to achieve greater transparency was to adopt more inclusive and flexible arrangements. To this end, we recommended -

- that the CSP be operated as a not-for-profit organisation
- an annual budget, developed in consultation with users and retention of some regulatory oversight to make sure consumers' best interests are protected
- funding to come from all users through establishment of a new charging methodology which imposes costs on those that drive the cost
- that the CSP invoices users directly rather than indirectly through the GTs.

As a consequence of these arrangements we noted that the current funding arrangement, whereby the GTs fund the CSP through their price control framework and charge shippers as part of transportation charges, would need to be changed.

### ***Respondents views'***

All responses supported new arrangements achieving the principles we outlined. There were different opinions on how this could be best achieved.

#### ***The budget process***

All recognised that greater industry involvement, including providing an environment to challenge, would be key to improving the transparency of the budget setting process. It was noted that this would only be achieved if the industry received high quality information from the Board including a demonstration of the efficiency of costs. Some responses highlighted that industry consultation should not detract from the need for the Board to ultimately set the annual budget. Xoserve raised concerns that insufficient consideration had been given to the impact of carrying forward budget overruns and that further consideration of the margin that it would be allowed to earn over and above the budget was needed.

For the most part responses agreed that regulatory oversight of the budget should be limited because new arrangements would provide users with the necessary tools to evaluate the efficiency of the costs proposed. However, some considered that we did not need any role in budget decisions, while others suggested we should play a greater role. For example, requiring our approval if an annual budget increase is above a defined threshold.

All agreed that an obligation to operate the CSP economically and efficiently should be placed on all users. One response noted that this could only be discharged if users are given the tools to do so. For example, through the Board providing relevant information on the process followed including, where applicable, evidence of market testing.

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<sup>10</sup> For an initial discussion of this see section 4.2.4 of the CEPA legal and regulatory implementation report (October 2013).

### *How costs are allocated between users*

Most responses agreed that changes would be needed to the current cost allocation methodology and that a consensus view would need to be reached in its development. All considered that the methodology would need to be simple while achieving the aim of transparency. One shipper raised concerns that applying cost reflective charging to individual service lines would not be efficient and might not be possible.

### *How costs are recovered*

The majority supported direct invoicing on the grounds that it would ensure visibility of charges to those users driving the cost. Reference was made to the existing direct invoicing arrangements for charging for non-code user pays and bilateral services. Costs might therefore be limited as an existing process could be utilised, albeit to recover additional costs and process additional invoices. Some noted that direct invoicing would need to be coupled with additional protections for the CSP in case of failure of one or more users.

Those that did not support direct invoicing reasoned that additional costs would be created with limited identifiable benefit. One shipper estimated the additional cost to be an initial £0.3m in set up costs and £30k per annum ongoing. It considered that the budget setting process was enough to provide the transparency desired and therefore costs should continue to be recovered through transportation charges.

### ***Our decision***

One of the objectives of new co-operative arrangements, as stated in our January 2012 decision, is that the costs of services should be recovered directly from users. To best achieve this we have decided that changes are needed to the budget process, the way costs are allocated and how they are recovered. The aim in meeting this objective is to improve the transparency for all users and increase the flexibility of funding, an important factor in ensuring an IT service provider can respond to the needs of its users.

### *The budget process*

The CSP will be run as a not-for-profit organisation with funding coming from all users. In order to establish appropriate charges the first step is to ensure a robust annual budget process. We understand there is a current annual budget process which can be built upon.

The Board will manage the annual process with input from the executive management team. CEPA's report<sup>11</sup> proposes that it may be useful to consider separate budgets for different cost categories: business run; change management; and demand/development costs for major projects. Ultimately it will be for the Board to decide the final budget but this will need to come at the end of a consultation process with users. The Board will be expected to use the information provided to it, including an assessment of the strategic long term aims of the organisation, in proposing a budget and justifying this budget to its users. To achieve the transparency users desire the quality of the information provided between parties is key.

If one or more users do not agree with the final budget decision there will be two possible processes for them to follow. However, the expectation is that these would be used in extremis and not as a matter of course. The majority of concerns should be addressed through the consultation process. The two possible processes are –

- *Appealing the budget to us:* if the budget is considered not appropriate for the CSP, and those who control the CSP, to deliver their obligations then it could be appealed. If, following assessment, we uphold the appeal then we will have the power to require changes to the budget. This power will be provided through licence requirements on one or more users.

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<sup>11</sup> See CEPA's April 2013 report (Annex C, Appendix D): <https://www.ofgem.gov.uk/ofgem-publications/48109/cepacxoserveapr13.pdf>

- *Removal of Board members*: users will have the right to remove Board members, making them more accountable to the CSP's users, as we discuss in further detail in section C.

The first of these routes is one of the tools which will be in place to achieve regulatory oversight. We have decided that minimising our role in budget decisions is appropriate as an annual assessment of costs by us would create burden and in our view bring limited benefit given the skills and tools available to others. Therefore, in addition to directing the budget in limited circumstances as noted above, we have decided that regulatory oversight will also be applied by -

- Requiring users, being the organisations which control and fund the CSP, to operate and develop it in an efficient and economic manner.
- Requiring notification to us in writing of within year changes to the budget which result in additional funding requests to users.

As part of the implementation phase we will consider whether these requirements are best enforced via the relevant licences or the UNC.

As a not-for-profit organisation the budget should be set to cover costs but we recognise that over/under recovery may occur, for example if demand differs from that forecast. We would not though expect within year budget changes to occur as a result of unplanned changes in costs given the process will be annual. The CSP will need to be able to carry small over/under spends on its own balance sheets.

#### *How costs are allocated between users*

The industry will need to develop a cost allocation methodology. It should seek to target costs on users based on their use of different services. The intention should be for those that drive additional costs to pay for them in order to further incentivise cost control. To do this, changes will be needed to the existing cost allocation methodology and associated charging statement, in particular to deal with any reallocation of services (as discussed in section A).

The CEPA report<sup>12</sup> may provide a good starting point for considering who should pay for different services. We support the industry consensus view that the methodology should not be overly complex and agree that this would detract from its transparency. We do not consider that cost reflectivity and simplicity are mutually exclusive and that a balance can therefore be achieved.

#### *How costs are recovered*

We do not wish to create undue additional costs and some responses indicated, although with limited quantification, that costs would increase if direct invoicing is used. We therefore consider that this issue warrants further debate however we are clear about what needs to be achieved – transparency and accountability – and that this can only be achieved if users are able to distinguish between transportation charges and charges for using the CSP.

Since our consultation we have considered further whether there is a way of achieving the required aims with indirect invoicing. We consider that the current mechanism for charging for code user pays services could be utilised, albeit the value of the transactions going through this mechanism would be greater than now. We understand that shippers would still be able to distinguish between transportation charges and CSP charges using this method.

<sup>12</sup> See CEPA's April 2013 report (Annex B): <https://www.ofgem.gov.uk/ofgem-publications/48108/cepabxoserveapr13.pdf>

We therefore consider that there are still two options that could deliver the transparency and accountability required -

- *Direct invoicing*: the CSP invoices and collects charges from users. The CSP would need to be protected from failure of one or more users to pay its invoice.
- *Indirect invoicing*: the GT invoices and collects charges from shippers and transfers funds to the CSP. This would work in the same way as code user pays services are currently invoiced.

We would like the industry to consider, given its practical experience, the merits of these options and take this forward in the implementation phase.

### **High-level requirements for implementation**

The new budget process, cost allocation methodology and invoicing arrangements will need to be defined in the contractual and regulatory instruments. Exactly where these requirements will be placed is dependent on the legal and regulatory framework option taken forward.

The cost allocation methodology needs to be adaptable over time, for example, to take account of new services or new groups of users. We therefore consider that, for services in the UNC, there is likely to be benefit in the methodology being included in the UNC.<sup>13</sup> For additional services not in the UNC a separate contractual arrangement and charging framework will be needed. This should be discussed and developed further by the industry through the implementation phase.

There should be no impact on service delivery from changing the funding mechanism. The timing of changes to the funding mechanism will therefore need to be considered carefully. Changing the cost allocation methodology will necessitate removing the GTs' regulated revenue stream related to Xoserve that is currently recovered through transportation charges. There is a mechanism, a reopener, in the GTs' price control framework to allow this. This mechanism requires us to review the outputs delivered against the costs provided so far and to change the ex ante allowance based on this assessment. We and the industry will need to consider the timing of this reopener as we will require information on costs by early summer 2014 if changes are to be fully effective by April 2015.<sup>14</sup>

If the methodology results in GTs facing a proportion of the CSP's costs then we will modify the price control framework to allow them to pass through these costs as part of transportation charges.

## **C. Corporate governance and ownership**

We outlined four models for co-operative governance that could achieve the aims of collective engagement and accountability, transparency and an alignment of the risk each user bears with their ability to control the CSP.

We recommended the full co-operative model with the GTs retaining ownership. The features of this model included establishing new Board arrangements, including shipper and GT involvement, and an appropriate separation of ownership and control. This separation would mean that the GTs, as the owners of the CSP, would be protected from risk which they could not control while also protecting other users from the GTs abusing their position as owners.

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<sup>13</sup> This was raised as part of our Code Governance Review (Phase 2), although was not taken forward as part of that work. See Code Governance Review (Phase 2) final proposals (March 2013), para.s 2.32 to 2.35: <https://www.ofgem.gov.uk/ofgem-publications/61109/cgr-2-final-proposals.pdf>

<sup>14</sup> Changes to funding for the GTs is considered as part of the Annual Iteration Process which concludes each November for changes that will take effect the following April. For further information see, for example, chapter 1 of the GD Price Control Financial Handbook: <https://www.ofgem.gov.uk/ofgem-publications/48130/gdfinhb.pdf>



We outlined some principles that the new Board should be established under. In particular, arrangements should be equitable and flexible to future change. We proposed that Board members be elected by constituency groups – one for the GTs and one for shippers.

### ***Respondents views'***

For the most part, responses agreed that implementing the full co-operative model with retained GT ownership would drive the greatest benefit. One response favoured the light co-operative model as it would achieve the desired outcome with minimal disruption and cost. Two shippers preferred the contracted services alternative where the CSP would be a procurement only body that contracts out delivery of services to other bodies. They considered that this would provide additional benefit by driving efficiencies and therefore it represented a better long term solution. However, they also recognised that additional cost and time would be required to implement this model.

In relation to Board membership, there was majority support for the proposed constituency voting method. Some responses referenced the Companies Act 2006 and the importance of Board members being able to carry out their obligations under the Act rather than representing the parties who elected them. Most responses also agreed that it would be important for members to have relevant experience and the necessary skills to govern an IT service provider. NGGT considered that it should have a seat reserved on the Board. Other responses noted that voting rights would need to be equitable and ensure no one party or group could dominate.

Two responses also suggested that the Joint Office of Gas Transporters'<sup>15</sup> functions should be incorporated into new arrangements.

### ***Our decision***

The principal aim of the new governance arrangements is for decisions about the future provision of services supporting the market to rest with the users of those services. We still consider that the full co-operative model with retained GT ownership is the most appropriate way to achieve this. It will provide the benefits sought while avoiding the additional cost and time of implementing the contracted services alternative. The full co-operative model means that, at a high level, the Board, comprised of members elected by both GTs and shippers, will exercise control of the CSP. The GTs remain owners but their rights and the level of risk they face is constrained as users will instead share the risk and control through obligations placed upon them.

Recognising that there was some support for adopting the contracted services alternative we note that new corporate governance arrangements will provide the right environment for future beneficial changes to the CSP's governance to be considered. However, we emphasise the need to allow these new arrangements to "bed in" before further change is considered.

The funding, governance and ownership review has focused on the CSP and the role it plays in the gas industry. As such we have not considered in detail the proposal to amalgamate the functions of the Joint Office of Gas Transporters with the CSP. A number of industry parties have emphasised the importance of having a clear separation of the two bodies' functions. Therefore there may be merit in keeping the current separation. There is clearly a role for the CSP in providing expert advice as part of the UNC modification process (which the Joint Office administers), given its experience in costing system developments. We encourage this relationship to continue. Equally, the Joint Office and UNC Panel should keep the CSP informed of upcoming developments that will require systems changes.

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<sup>15</sup> The Joint Office of Gas Transporters administers governance of the processes for modifying the UNC, the network code underpinning the GB gas industry. See: <http://www.gasgovernance.co.uk/>

### *Board structure*

Establishing a more inclusive and effective Board is an important part of the co-operative model. We outline below the key characteristics of this new Board. We are not proposing all the details of these characteristics - we still consider that the industry is best placed to establish arrangements that work for them. However, we will have a role in ensuring that they work in consumers' best interests both from the outset and on an ongoing basis.

We list below the main characteristics. Some of which some represent a continuation of existing arrangements while others will require changes. These characteristics are -

- The Board should be made up of an independent chair, non-executive members and an executive member(s). Executive members should be the Chief Executive, and potentially other senior management. Appointment of the non-executive positions will be through a transparent process. We are not proposing the number of Board members but in establishing arrangements best practice should be referenced.
- Members should have the relevant skills and expertise required for being members of a Board of an IT service provider and appropriate remuneration should be provided. We will not have a role in the choice of candidates or their remuneration.
- Board members will be accountable to users who will in effect act like shareholders of the CSP. A performance evaluation framework for members should be established to support the monitoring of the continued effectiveness of the Board. Users should also have the right to dismiss members via a transparent and robust voting process which does not allow for one user or group to have a disproportionate influence.

In coming to these conclusions we have taken account of the responses to our consultation, best practice as set down in the UK Corporate Governance Code,<sup>16</sup> and also the recent recommendations from the independent review of Elexon's governance.<sup>17</sup> In developing the details, we recommend that the industry be mindful of these publications.

In relation to the appointment of Board members, we still recommend the constituency voting approach which was outlined in our consultation. This approach involves different groups of users, with common characteristics, proposing and appointing Board members by way of a vote. The majority of responses did support this approach although we recognise that there are potential downsides. In particular, the possibility that those proposed do not have the relevant experience and skills or that once appointed they act in the best interests of those that appointed them rather than in the best interests of the CSP.

Both the UK Corporate Governance Code and the Elexon review make a number of statements about the independence of non-executive Board members. Some responses also suggested that the proposed constituency voting method might result in Board members that can never be truly seen as independent. We agree that the constituency voting approach is more likely to result in members that have an existing relationship with one or more users than an alternative approach. However, Board members will still be required to perform their duties, as laid out in the Companies Act 2006,<sup>18</sup> which should alleviate these concerns.

The Elexon review recommended an alternative approach whereby a nominations committee (made up of existing Board members) appoints new Board members. This is the current approach used for appointments to the Elexon Board. This approach certainly has merit. However, in relation to the specific objectives of this review and the CSP we consider that the potential downsides of constituency voting could be mitigated by: formalising the experience and skills needed to become a Board member; ensuring good governance of the Board by the chair; and establishing an inclusive process of re-election and dismissal of

<sup>16</sup> See: <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.pdf>

<sup>17</sup> Elexon administer and deliver the Balancing and Settlement Code (BSC) for the electricity industry. The recommendations in full can be found at: <http://www.elexon.co.uk/news/bill-knights-elexon-governance-review-published/>

<sup>18</sup> See Part 10, Chapter 2 General Duties of directors: <http://www.legislation.gov.uk/ukpga/2006/46/contents>

Board members. In the end it is in the best interests of all users that the Board works effectively and, as noted above, we consider that arrangements should be kept under review to ensure continued effectiveness.

### ***High-level requirements for implementation***

To establish these arrangements changes will be needed to licences, the UNC, and Xoserve's articles of association and memorandum. The changes to the different legal and regulatory instruments is dependent on the implementation approach taken forward. Common to all approaches is that the GTs, as owners of Xoserve, will be required to change the articles of association. This will be the instrument used to align performance risk and control on users and thereby protect the GTs as owners from disproportionate burden. These arrangements exist in similar bodies, for example National Grid Electricity Transmission owns Elexon but its rights and obligations are restricted.

The implementation phase will also need to consider how the process for modifying these governance arrangements over time will work. We consider it important that changes can be made in the future, potentially to accommodate new users or to implement further beneficial adaptations. This process should be clearly set out in advance and be designed in a way that ensures that changes cannot proceed without majority support. We also expect that approval for such changes would rest with us, just as the majority of modifications to the UNC do now, to ensure that they are in consumers' best interests.

We expect that there will be a period of transition to new Board arrangements. Various stakeholders and CEPA have discussed setting up of a "shadow" Board. We support the establishment of such transitional arrangements as soon as practicable.

## **D. Implementation**

We have outlined throughout this letter the high-level requirements for implementing new arrangements. The details are dependent on the option we take forward for the legal and regulatory framework, which are outlined in the CEPA report published alongside this decision.<sup>19</sup>

This report is an important first step in reaching a conclusion on the most appropriate method of establishing new arrangements. It outlines and makes an initial assessment of options for how the new funding, governance and ownership arrangements for the CSP can be legally implemented using existing instruments including GT licences, shipper licences and the UNC. The report makes two recommendations. Firstly, that modifying the shipper licence, as well as the GT licences, may be the most effective way of ensuring regulatory oversight of new arrangements. Secondly, that a service agreement(s) between the CSP, GTs and shippers is more appropriate for an IT and information service provider than the alternative approach of the CSP becoming party to the UNC. We will seek views on the options available before reaching a conclusion on the most appropriate approach.

Our role in implementation is primarily to ensure that changes to the regulatory framework appropriately establish new arrangements and provide a framework for the ongoing operation of these arrangements. The onus will be on the industry to propose the additional changes required to the legal/contractual framework, although we will continue to support them to achieve this.

The industry will need to commit resources to ensure implementation is progressed. We recognise that there are a number of other developments that may create competing priorities, however we consider that achieving appropriate governance and funding arrangements can only be beneficial in progressing other industry change programmes.

In relation to the timing of implementation, there was support for placing an obligation on one or more users to ensure new arrangements are delivered. The majority of responses

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<sup>19</sup> See the CEPA legal and regulatory implementation report (October 2013).

also considered that new arrangements could be in place for April 2015. Taking these views into account we have decided to place an obligation for arrangements to be delivered by April 2015 but, given the competing priorities that may arise, we intend to provide flexibility. There were mixed views on who should be required to deliver new arrangements. As the owners of Xoserve the GTs have an essential role to play in implementation and will therefore be required to make necessary changes, for example to Xoserve's articles of association. We are also considering the merits of modifying the shipper licence and will discuss this with the industry at our workshop in December.

We received limited comments on the implementation costs CEPA identified in its report. We recognise that there will be a cost to implementing changes to contractual arrangements. CEPA identified that costs could be incurred in relation to changing the contractual arrangements and in project managing implementation. We noted above (in section B) that there is a mechanism for changing the GTs' regulated revenue stream for funding Xoserve. This provides an opportunity for us to assess the costs incurred against the costs provided to the GTs for funding Xoserve. We are minded to include, within this assessment, provision for the recovery of additional costs that Xoserve incurs in implementing new arrangements. We would expect the efficiency of any costs incurred to be evidenced.