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Re: Xoserve – consultation on the legal and regulatory framework to establish new arrangements for the gas central service provider.

Dear Joanna,

Thank you for the opportunity to input into the consultation proposed in your open letter of February 17th, 2014. National Grid Gas Transmission (NGGT) has taken an active part in the development of options for improving the current arrangements for the provision of central transactional services and remains committed to working with industry participants in order to implement solutions which deliver greater efficiency, transparency and customer satisfaction.

Your consultation focuses on the four regulatory and legislative options proposed by Cambridge Economic Policy Associates (CEPA) in their report of October 2013. They offer the four permutations possible from two key questions:

- Question A: Can the UNC efficiently require parties to jointly participate in the governance and funding arrangements or is it more appropriate to include these requirements in each party's licence?
- Question B: Are there any additional benefits in Xoserve becoming a party to the Uniform Network Code (UNC) when compared to the service agreement approach?

Our responses to these two questions are as follows:

Question A: Licence Conditions v. UNC.

Under the current model, the authority to direct Xoserve's services sits with the Gas Transporters (GTs). This authority is balanced by the inclusion, in their Licences, of obligations to provide and

use Xoserve's services. Under the current model, therefore, GTs have control but also bear all the risk.

We believe that the current arrangements for the provision of central services have been a success and have delivered considerable value to the industry since the creation of Xoserve in 2005. That said we also recognise that change at the Central Service Provider (CSP) level is needed to support the ongoing evolution of the gas industry both at home and internationally. We welcome Ofgem's drive to deliver a fair, equitable and inclusive business model, recognising the drivers and ambitions, whether commercial or regulatory, of all stakeholders in the services provided by the CSP.

It is with this in mind that we consider the fair distribution of licence obligations to be the most appropriate mechanism for sharing the authority for setting the future direction of the CSP function. We recognise our customers' desire to become more involved in the decision making process which sits behind the provision of the CSP's services and feel that their input will better enable the CSP to maximise the benefits to be realised by all stakeholders.

With the proposed introduction of arrangements to give CSP decision-making capabilities to Shippers at industry and Board levels, it is reasonable, therefore, to expect that the devolution of GT authority to Shippers will be accompanied by a proportionate transference / sharing of responsibility.

We believe that achieving parity of obligation will be a critical success factor to the implementation of the new arrangements. Either UNC or Licence obligations could efficiently require parties to jointly participate in the governance and funding arrangements, but only insofar as all parties bear the responsibility at the same level of regulatory and legislative requirements (i.e. all controlled by the UNC or all controlled by licence).

The hierarchy of regulation and legislative requirements places licence obligations above compliance with the UNC by virtue of the Authority's greater ability to actively enforce compliance with the former and so we believe that the use of licence obligations, defining duties in relation to the CSP, for both Shippers and Transporters will better deliver the equitable and effective regulatory framework needed to ensure the new arrangements are successful.

In our opinion, failure to achieve parity with the levels of regulatory / commercial obligation applied to the new business model is likely to result in the need for subsequent re-work of the arrangements.

Question B: Xoserve as a party to the UNC.

The current model, with Xoserve delivering Code services to Shippers and Transporters, offers a clear line of sight for industry stakeholders utilising those services. Were this model to be retained under the new arrangements, the introduction of non-Transporter parties as “controllers” of significant numbers of those Code services would place an unfair and unmanageable contractual burden on GTs.

Under any contractual arrangement, there are, by necessity, two or more parties to any transaction; those who procure the service and those who provide it. With the proposed redistribution / sharing of CSP service authority to Shippers, the retention of the current model would see Shippers procuring services from GTs who were no longer the parties able to effect the timely and efficient delivery of those services. Where control of a service is to be removed from Transporters (e.g. in the case of Shipper-centric services such as neutrality) or has been shared with Transporters (e.g. in the case of the provision of invoicing services), then clear identification of the service provider is essential. This can best be achieved by having the CSP recognised as a party to the UNC.

The benefits of this approach are:

- Clear line of sight of UNC responsibilities for services offered by a fully cooperative CSP.
- Ease of maintenance of the UNC for the future evolution of the industry.
- A Uniform Network Code which accurately reflects the redistribution of licence obligations being proposed by the introduction of these revised funding, governance and ownership arrangements for Xoserve.

Preferences for implementation.

It is our view that Question A, relating to licence obligations, is of greater weight than Question B, seeking to define the CSP’s role within the UNC.

The CEPA options, numbered 1 to 4 in your letter, are summarised as follows:

- Option 1: Amend GT licences only. The CSP is not to be a party to the UNC.
- Option 2: Amend both GT and Shipper licences. The CSP is not to be a party to the UNC.
- Option 3: Amend GT licences only. The CSP is to become a party to the UNC.
- Option 4: Amend both GT and Shipper licences. The CSP is to become a party to the UNC.

Our preference, in descending order, is for Option 4 followed by Options 2, 3 and 1.

Having carefully considered the strategic aims of the Cooperative Model and the desire for our customers to have a greater stake in setting the direction of the services they require, the essential

nature of the services provided by the CSP and Ofgem's stated desire to have the CSP function operate with "light touch" regulatory oversight, we believe that Option 4 is the best choice to deliver an enduring and successful outcome for the evolving requirements of the industry through the RIIO period and beyond.

We consider that Option 2 will inevitably cause confusion and delay to UNC updates as responsibility for the delivery of a service is either left unaccounted for or assigned to a party which doesn't have sufficient authority to ensure its successful and timely delivery.

Option 3 delivers the contractual element of the new arrangements only. If not backed up by an equitable reappportionment of licence obligations, is likely to result in a rapid divergence between regulatory and contractual arrangements with negative legislative and commercial impacts to all parties involved.

Option 1 offers neither regulatory nor contractual resilience to the new arrangements with responsibility for the delivery of CSP services continuing to sit with Transporters whilst regulatory and commercial control is shared out to other industry stakeholders. We view this option as the least likely to succeed in delivering the industry's ambitions for the CSP.

In summary, our preference is Option 4 as we believe that it offers the greatest level of assurance to all stakeholders in the CSP function, enabling an equitable, transparent and fully engaged business model to be implemented.

Should you wish to discuss any of the points raised within this letter, please do not hesitate to contact me.

Yours sincerely,

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