



respect > commitment > teamwork

**CONSULTATION ON THE LEGAL AND
REGULATORY FRAMEWORK TO ESTABLISH
NEW ARRANGEMENTS FOR THE GAS CENTRAL
SERVICE PROVIDER**

XOSERVE RESPONSE

TABLE OF CONTENTS

- 1. EXECUTIVE SUMMARY3
- 2. PARTICIPATION IN CSP FUNDING AND GOVERNANCE.....4
- 3. FORM OF CONTRACTUAL RELATIONSHIP7
- 4. IMPLEMENTATION PROCESS11

1. Executive Summary

- 1.1 This document is Xoserve's response to Ofgem's consultation on the legal and regulatory framework to establish arrangements for the gas industry Central Service Provider ("the CSP").
- 1.2 We welcome this opportunity to contribute to the shaping of the future framework for the provision of central services to the gas industry. Our response majors on the form of the contractual relationship between Xoserve in its capacity as the CSP and the Gas Transporters ("the GTs") and Shippers, either by the CSP becoming party to the Uniform Network Code ("the UNC") or through one or more multiparty service agreements. We have also provided some observations on the Options for amending GT and Shipper Licences and / or the UNC so as to require Licensees to participate in the funding and governance of the CSP, as well as on the possible implementation approaches that are set out in the consultation letter. Detailed responses are set out in Sections 2-4 below, and include consideration of the extent to which the Options would meet Ofgem's stated objectives for the implementation of CSP arrangements.
- 1.3 Irrespective of the chosen form of contractual relationship between Xoserve and its customers, it is essential to the efficient and effective operation and management of the Xoserve business that contracts provide absolute clarity of requirements, in terms of the services that are to be delivered and the terms and conditions under which they are provided. Having his clarity will help Xoserve to understand its capability requirements, to access these through employees and vendor contracts, and to secure the necessary funding and financing of major investments in IT systems.
- 1.4 The considerations that we have set out in this consultation response in respect of the potential risks and benefits of both a service agreement approach and an arrangement in which Xoserve would become a party to the UNC indicate that either a wholly service agreement approach or a blend of the two approaches would most likely be required. A service agreement approach might suffice for the provision of CSP services, although there are potential incremental benefits from Xoserve, in its capacity as the CSP, becoming a party to the UNC. A prerequisite to Xoserve becoming a party to the UNC would be a review of the positioning of obligations that currently sit with GTs and Shippers, and of the extent to which these would become the responsibility of Xoserve.
- 1.5 To the extent that Ofgem considers it necessary to place a requirement in Licences to implement the new arrangements, delivery obligations should be placed in equal measure on both GTs and Shippers.

2. Participation in CSP Funding and Governance

Question 1: 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?

Key Messages

- The placing of common and unambiguous obligations on all parties would be consistent with the principles of a co-operative model, and would provide a sound basis for ensuring alignment of obligations, risk and control
- Due consideration needs to be given to the inclusion of iGTs in the CSP funding and governance framework, and to CSP services that are not defined by reference to the UNC

2.1 We have reviewed the Options that are set out in the CEPA report for amending GT and Shipper Licences and / or the UNC so as to require Licensees to participate in the funding and governance of the CSP. Since neither Option would place a regulatory obligation on Xoserve, we remain broadly neutral to the choice of Option.

2.2 We consider, however, that it would be in the spirit of a co-operative model and would encourage appropriate behaviours for all parties who are participating in the governance and funding of the CSP to have common and unambiguous regulatory obligations, and for those parties to face common consequences in the event of a breach of those obligations. This approach would support the realisation of the stated objective to ensure alignment of obligations, risk and control.

2.3 Failure to follow this approach could give rise to a scenario in which the co-operative model is imbalanced, in that the parties with the greater obligation might consider that they are entitled to a greater degree of control of the CSP, and that this might be challenged by those parties with the lesser obligation who nevertheless consider that they should have equal rights with other parties.

2.4 The Tables that are set out in Appendix 1 of the consultation letter indicate that, for the large majority of the proposed requirements (Tables A1.2 and A1.3), there is adherence to the principle of common regulatory obligations for both GTs and Shippers, by way of either amendment to Licences (Options 2 and 4) or to the UNC (Options 1 and 3).

2.5 The exception to this principle would appear to be in respect of the “core requirements” as set out in Table A1.1, where there is a mixture of proposed responsibilities on GTs and

Shippers as Licensees and on Networks as shareholders in Xoserve. We consider each of the requirements in turn in more detail in the following table.

Core Requirement	Xoserve Observation
<p>Establish the CSP as an entity, to be owned by the GTs (removing reference to the Agency and replacing with the CSP). This will be linked to any further requirements in the UNC.</p>	<p>The consultation proposes to change the GT Licence only for all Options. Whilst we recognise that Xoserve would continue to be owned by the Networks, we consider that it is important to differentiate between ownership of the company and the common responsibilities of industry parties to set up and manage the co-operative model for the CSP function that is performed by Xoserve. We therefore consider that it would be more appropriate for this requirement to be included in both GT and Shipper Licences (Options 2 or 4).</p>
<p>Obligation to modify the articles of association to bring in line with principles of governance.</p>	<p>We consider that modification of the articles of association of Xoserve is a matter for the Networks in their prevailing capacity as owners of Xoserve with responsibility for the corporate governance of the company. We therefore concur with the view that this requirement needs to be set out in GT Licences only.</p>
<p>Regulatory oversight measures - to provide for us to be notified of specified within year budget increases, allow for budget modification (in specified circumstances) and back-stop powers for GTs, as owners, to take control under our guidance in extremis.</p>	<p>A key feature of the co-operative model for the CSP is the setting of a Business Plan and budget by a more inclusive Xoserve Board (comprising GT and Shipper ‘representatives’) following a period of stakeholder engagement. We therefore consider that it would be more appropriate for regulatory oversight measures to be included in both GT and Shipper Licences (Options 2 or 4).</p> <p>We concur with the view that back-stop powers for the owners of Xoserve to take control in extremis should be set out in GT Licences only.</p>
<p>Triggering of the reopener to review GTs’ revenue allowances in relation to Xoserve, and any further change to licences to establish an alternative cost pass through mechanism (if required).</p>	<p>We concur with the view that this requirement needs to be set out in GT Licences only.</p>

2.6 We note that the consultation letter majors on potential changes to GT Licences, Shipper Licences and the UNC, and that it is almost entirely silent on the potential impacts on independent Gas Transporter (“iGT”) Licences and the iGT Uniform Network Code (“IGT

UNC”). Assuming that UNC and iGT UNC Modification Proposals appertaining to iGT Single Service Provision are implemented, there would appear to be a logical consequence that the iGTs should have the responsibility to participate in the funding and governance of the CSP. In selecting an Option for the positioning of CSP related obligations, we would encourage Ofgem to take a broad perspective across all relevant legal and regulatory instruments, and in particular to consider how to minimise the effort and overhead associated with maintaining appropriately aligned Licences and industry Codes.

- 2.7 It would be desirable that, as far as is reasonably possible, the positioning of CSP related obligations takes into account potential future expansion of the CSP service footprint and the number and identity of stakeholders in CSP services. For example, in the event that Xoserve in its capacity as the CSP were to be appointed as the provider of centralised registration services to the DCC, there might be a consequent responsibility on the DCC to participate in the funding and governance of the CSP, noting that this could be given effect through changes to the DCC Licence and / or the Smart Energy Code.
- 2.8 In its prevailing capacity as the Transporter Agency, Xoserve is responsible for the provision of a number of “non-Code services”, i.e. common services that discharge GT service obligations that are outside the scope of the UNC. We expect that there will be an ongoing requirement for Xoserve in its capacity as the CSP to continue to provide these services under a co-operative model. We would encourage Ofgem to ensure that, when selecting an Option for the positioning of CSP related obligations, the funding and governance of “non-Code services” are encompassed in the scope of parties’ responsibilities.

3. Form of Contractual Relationship

Question 2: Are there any additional benefits in Xoserve becoming a party to the UNC, when compared to the service agreement approach?

Key Messages

- The contractual framework must provide Xoserve with clarity of requirements for services and the terms on which they are delivered
- It is likely that the optimum solution would comprise a combination of changes both to the UNC and to prevailing service contracts between Xoserve and its customers
- A service agreement approach might suffice for the provision of CSP services, although there are potential incremental benefits from Xoserve, in its capacity as the CSP, becoming a party to the UNC
- A prerequisite to Xoserve becoming a party to the UNC would be a review of the positioning of obligations that currently sit with GTs and Shippers, and of the extent to which these would become the responsibility of Xoserve

3.1 Irrespective of the chosen form of contractual relationship between Xoserve and its customers, it is essential to the efficient and effective operation and management of the Xoserve business that contracts provide absolute clarity of requirements, in terms of the services that are to be delivered and the terms and conditions under which they are provided. Having this clarity will help Xoserve to understand its capability requirements, to access these through employees and vendor contracts, and to secure the necessary funding and financing of major investments in IT systems.

3.2 The considerations that we have set out below in respect of the potential risks and benefits of both a service agreement approach and an arrangement in which Xoserve would become a party to the UNC indicate that either a wholly service agreement approach or a blend of the two approaches would most likely be required. In the case of a blend of approaches, we have not sought to specify in this response which aspects of the contract relationship should be defined and governed by which means, but would propose that this be addressed as part of a wider programme of work to give effect to Ofgem's conclusions about the future funding, governance and ownership of Xoserve.

3.3 We set out below our thoughts on the key features of a contractual framework for the provision by Xoserve of CSP services (Section 3.4), and we then consider in turn:

- (a) The extent to which the service agreement approach might provide a suitable contractual framework for the provision of CSP services (Section 3.5), and would satisfy Ofgem's stated objectives (Section 3.6);
- (b) The potential benefits and disadvantages of an alternative approach in which Xoserve, in its capacity as the CSP, would become a party to the UNC (Sections 3.7 – 3.8); and
- (c) Matters which would need to be addressed in the event that Xoserve, in its capacity as the CSP, becomes a party to the UNC (Section 3.9).

3.4 We consider that a contractual framework for the provision by Xoserve of CSP services would define *inter alia*:

- (a) The services that are provided;
- (b) Which customers are in receipt of which services;
- (c) The terms on which services are provided;
- (d) The performance standards to which services are to be delivered;
- (e) How services are priced;
- (f) How service charges are invoiced and settled, including provision for non-payment and customer insolvency scenarios;
- (g) Liabilities (if any) in the event of service failure;
- (h) Service change procedures; and
- (i) Contract governance to review service performance and to consider service change requirements and their relative priorities.

3.5 We consider that a service agreement approach might provide a suitable contractual framework for the provision of CSP services for the following reasons:

- (a) It would provide those industry parties who are taking CSP services with clarity of the scope and boundaries of the responsibilities of the CSP;

-
- (b) It could be easily extended to include other industry parties in the event that the CSP service footprint expands in the future;
 - (c) It would provide a framework for a change prioritisation process that engages multiple stakeholders; and
 - (d) Considering the prevailing contractual framework for the provision of Agency Services:
 - (i) It would extend the application of the key concepts of the Agency Services Agreement, which has proven itself to be fit for purpose since the establishment of Xoserve; and
 - (ii) It would afford the opportunity to rationalise the existing User Pays arrangements, in which Xoserve contracts with the GTs for Code Services and with Shippers for non-Code services.
- 3.6 We note also that a service agreement approach would contribute to the delivery of two of Ofgem's stated objectives, namely to reinforce and facilitate a responsive IT and information service provider, and to implement new arrangements in the most simple and practical manner.
- 3.7 We consider that the potential incremental benefits of an approach in which Xoserve, in its capacity as the CSP, would become a party to the UNC could include:
- (a) A greater assurance for both Xoserve and its customers that its CSP activities are wholly integral to the successful operation of the GB gas market, leading to enhanced customer confidence to place reliance upon Xoserve and its CSP capabilities;
 - (b) The incorporation of CSP service change management processes into the scope of UNC governance, giving industry parties increased transparency of change delivery and prioritisation decisions (noting that these would be distinct from matters of corporate governance that would be addressed by the Xoserve Board);
 - (c) The application of UNC credit management rules so as to afford Xoserve greater protection of its primary revenue stream, and potentially to protect the industry from the consequences of the financial failure of one or more CSP customers; and
 - (d) Greater clarity of the extent and nature of CSP liabilities (and its protection against these) in the event of service failure.

3.8 However, we consider that the inclusion of CSP responsibilities in the UNC would give rise to a number of potential complications and difficulties, in that it would require:

- (a) A significant and complex step change in the structure and purpose of the UNC, in that it would no longer be concerned exclusively with obligations between GTs and Shippers, but would become a 'three way' arrangement between GTs, Shippers and Xoserve as the CSP, requiring special attention to be given to clarity of the boundary between obligations on UNC parties and the CSP responsibility to provide services that discharge those obligations;
- (b) Clarity of the scope and nature of CSP responsibilities that Xoserve would take on as a party to the UNC, with a likely prerequisite being the definition and agreement of the UNC obligations that are to be moved away from or between GTs and Shippers; and
- (c) Xoserve (and the industry) to bear the overheads associated with the maintenance and operation of a formal UNC role and ensuring compliance with UNC responsibilities.

3.9 Matters which would need to be addressed in the event that Xoserve, in its capacity as the CSP, becomes a party to the UNC would include:

- (a) Developing a sound understanding of the legal and contractual implications for Xoserve of being a party to the UNC;
- (b) Retention of the ability of Xoserve to continue to provide 'non-Code services' (that are defined by reference to GT Licences and not to the UNC) and bespoke services for individual customers;
- (c) Avoidance of the placing of a constraint on Xoserve to provide other central services that would discharge the obligations of industry parties under other industry Codes; and
- (d) The potential requirement to establish the CSP as a party to the iGT UNC or any other industry Code under which Xoserve might provide CSP services.

3.10 We do not seek to suggest that the matters outlined in Sections 3.8 and 3.9 are insurmountable, rather we note that their resolution is likely to require additional effort to be expended in order to fully realise the potential benefits of Xoserve becoming party to UNC.

4. Implementation Process

- 4.1 We note the schedule of implementation work streams that is set out in Section 2.1 of the consultation letter. Whilst we broadly agree with the scope of this schedule, we observe that:
- (a) Progression of the 'service allocation' stream is dependent upon decisions about the potential repositioning of UNC obligations between GTs and Shippers; and
 - (b) The schedule does not recognise the full scope of changes required to Xoserve's corporate framework, noting that additional items would be expected to include amendments to the status of share ownership, a review of the Articles of Association and other constitutional documentation, and consideration of the funding and financing model.
- 4.2 We note also that Section 2.2 of the consultation letter outlines options for progressing implementation. We are continuing to engage with the GTs to support them in their consideration of requirements for a programme manager and / or consultancy support, and with Shippers to understand their aspirations for a target co-operative model and delivery approach. Whilst we recognise the potential merits of managing implementation through UNC governance, we do not consider that this would be an appropriate vehicle for managing changes to Xoserve's corporate framework and to the rights of Xoserve's shareholders.
- 4.3 The consultation letter invites views on the placing in Licences of a requirement to implement the new arrangements. To the extent that Ofgem considers this to be necessary, we would suggest that, similar to the approach outlined in Sections 2.2 – 2.3 above that advocates the positioning with both GTs and Shippers of common obligations to participate in the funding and governance of the CSP, delivery requirements should likewise be placed on both groups of stakeholders.