

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

Date: 28 April 2016

## **Xoserve – decision on the legal and regulatory framework relating to the gas central data service provider**

In February 2014, we<sup>1</sup> issued a consultation<sup>2</sup> asking for your views on which option we should take forward with regards to the implementation of our decision to modify the existing legal and regulatory framework under which Xoserve<sup>3</sup> operates. These changes to the regulatory and legal framework are necessary to implement our decision on Xoserve's funding, governance and ownership (FGO) arrangements that was published in October 2013.<sup>4</sup>

We received useful feedback on our consultation, which we have carefully reviewed and considered in arriving at our decision. We have also considered our decision in the context of recent developments, notably our decisions to centralise supply point registration services in the Data and Communications Company (DCC) and the proposals by the Competition and Markets Authority (CMA) to reform the landscape for code administrators and system delivery organisations such as Xoserve. We are confident that the way forward outlined in this letter will enable industry to make important progress in preparing for a future world of licensed central bodies. We are now looking to the industry to progress the second phase of the FGO project in a timely manner.

We have concluded that:

- Out of the four options we consulted on (explained in table1, appendix 1 of this letter), option one should be taken forward.
- Appropriate Uniform Network Code (UNC) modifications should be proposed and progressed, to require parties to jointly participate in Xoserve's governance and funding.
- We have identified no additional benefits at this time from Xoserve becoming a party to the UNC in order to implement the funding and governance changes to Xoserve.
- We are proposing a licence change that will require Gas Transporters to deliver the new arrangements in full by 31 March 2017.

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<sup>1</sup> The terms "the Authority", "Ofgem", "we" and "us" are used interchangeably in this letter. The Authority is the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

<sup>2</sup> [Xoserve – consultation on the legal and regulatory framework to establish new arrangements for the gas central service provider.](#)

<sup>3</sup> Xoserve Limited (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>4</sup> [Xoserve - decision in relation to new funding, governance and ownership arrangements for the gas transporters' central agent.](#)

## Background

In summary, our decision in October 2013 on the review of Xoserve's FGO arrangements was that in order to ensure Xoserve is fit for purpose and provides the required responsiveness and flexibility in funding in the context of future gas industry changes, a full co-operative governance model should be established. This model means that Gas Transporters (GTs) and Shippers will be required to jointly participate in Xoserve's governance and fund its activities. Our decision also confirmed that there would be no change to the current ownership arrangements. The GTs will remain Xoserve's owners but the new governance arrangements will mean that Xoserve will have to respond to the needs of all its users.

Our February 2014 consultation was based on a previously published report<sup>5</sup> by consultants from the Cambridge Economic Policy Associates (CEPA) consortium, which proposed a range of feasible options to change the legal and regulatory framework to implement our October 2013 decision. In our consultation we summarised the findings of the CEPA report and our initial views.

We set out our view that the industry should lead on implementing our decision on establishing a cooperative model for Xoserve. We have been engaging with the industry through a programme overview board (POB), which industry participants have established in order to oversee the detailed implementation work. The timing of this decision following our February 2014 consultation has allowed us to take into account developments under the industry process.

Appendix 1 to this document sets out our decision in more detail. Appendix 2 sets out a summary of responses received to our February 2014 consultation.

## Progress update on implementation of co-operative governance model

Since we issued our decision in October 2013, the industry has been working on the detailed implementation of the new arrangements for Xoserve. This work has faced extensive delays. In order to facilitate this work, the GTs appointed KPMG as the project manager in December 2014.

The POB has open membership and is chaired by National Grid Gas plc. A number of working groups, which report to the POB, have been set up to address five specific areas of implementation: the delivery of obligations and contracts, Xoserve corporate governance, Central Data Service (CDS) governance, Xoserve business planning and budgeting, and charging and cost allocation.

In September 2015, the industry agreed a project plan which committed it to a two phase delivery of the new arrangements. Since agreeing the project plan in September 2015, the POB Chair and KPMG have been reporting to us on a monthly basis on the progress the industry is making on delivery of the programme. Phase one of the project was completed by 31 March 2016 (with the exception of one area, explained below), and phase two is expected to be completed by 31 March 2017, for the new arrangements for Xoserve to be in place from 1 April 2017. In phase one the industry has delivered (under each of the five work streams) the following:

- Obligations and contracts:
  - UNC modification 0565 was raised in November 2015 and work is progressing to consider and propose potential changes to the UNC.
  - Xoserve in parallel are progressing the work on the development of a new Data Service Contract (DSC).

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<sup>5</sup> [Future arrangements for the gas transporter central agent.](#)

- Central Data Service (CDS) governance:
  - The GTs and Xoserve have agreed that Shippers and iGTs can attend Agency Services Agreement (ASA) meetings and have issued a goodwill statement confirming that iGTs and Shippers will be invited to attend and participate in both ASA change and contract management meetings during 2016/17.
  - Draft terms of reference for the new arrangements from 1 April 2017 have been developed. The year leading up to 1 April 2017 will be used to review and refine these terms of reference, to ensure that a fit for purpose arrangement (consistent with new contractual arrangements) can be implemented from 1 April 2017.
- Business planning and budgeting:
  - The engagement process, by which stakeholders will participate in the development and review of the CDSP budget and business plan have been developed to increase the transparency and inclusivity of the annual business planning and budgeting process.
- Charging and cost allocation:
  - An interim cost assessment submission was provided by the GTs to Ofgem on 29 January 2016, in response to a request for information relating to the expected GT charges from CDSP for the remainder of the RIIO GD1 period. Further workgroups are scheduled to develop the cost allocation approach and charging methodology that will be implemented from April 2017. Once sufficiently developed, this will be provided to the UNC 0565 workgroup for finalising and implementation.
- Finally, on corporate governance:
  - The appointment of the four shipper appointed Directors to the CDSP Board has been delayed. A Shipper Nomination Committee has been formed to progress the appointment process, and they are working with headhunters appointed by Xoserve. The committee's work is ongoing, with the aim of having the new Directors appointed ahead of the July 2016 Board Meeting. Xoserve and its shareholders have amended the terms of reference for the Board, and other constitutional documents including the Articles and Shareholder Agreement in order to create vacancies for four additional Directors.

We welcome the work the industry has done to date to implement the new arrangements and are pleased to hear the industry is on track to deliver these in full by 31 March 2017.

It is also important to note that since we launched our review there have been a number of developments in the energy market. In particular:

- We referred the energy market to the CMA in June 2014. The CMA published its provisional decision on remedies (PDR) in March 2016<sup>6</sup>. Following its finding that the current code governance arrangements represent an adverse effect on competition, the CMA has recommended that the Department for Energy and Climate Change (DECC) make code administration and systems delivery a licensable activity. The CMA also recommended that Ofgem revise the wider code governance arrangements. We will work with Government and other stakeholders to implement the CMA's recommendations once it publishes its final report in June 2016.
- In February 2015, we published our decision to undertake a programme to introduce reliable, faster switching and, as part of this, to centralise registration services for gas and electricity under the DCC. The new arrangements are currently anticipated to go live in 2019.

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<sup>6</sup> [CMA Energy Market Investigation](#)

Notwithstanding these longer-term changes, we consider that the new Xoserve funding and governance arrangements are a step in the right direction in achieving the objectives of our review. In the short term, the funding and governance changes can deliver improvements in the responsiveness of the CDS provider (CDSP) to the needs of its customers and ultimately consumers. While further changes may be needed in order to implement the CMA remedies going forward, in the meantime, these changes will help parties prepare for the future.

## **Next steps**

### *Consultation on changes to the Gas Transporters licence*

Today we are also publishing a consultation<sup>7</sup> on proposed changes to the GT licence. To implement this decision, we propose to modify the existing Standard Special Condition (SSC) A15 and propose a new SSC referred to as SSC A15A in the GT licence. In addition, some consequential modifications will be required to other licence conditions as a result of our proposed modifications to SSC A15 and proposed new SSC A15A. If these licence changes are implemented, the licence will:

- Require GTs to raise and progress modifications to the UNC to include joint obligations on the users of Xoserve's services to govern and fund it (Part A of the proposed SSC A15A).
- Require GTs to modify Xoserve's company documents to allow for joint governance and restrict the distribution of profits (except where the Authority consents otherwise in writing) (Part B of the proposed SSC A15A).
- Provide for the Authority to amend Xoserve's budget if an appeal by a user of Xoserve's services is upheld (Part C of the proposed new SSC A15A).

To ensure that industry was sighted on the progress of the drafting of the new SSC A15A and the proposed amendments to SSC A15, and to seek early views on the proposed drafting, we published a consultation on these proposed changes in December 2015<sup>8</sup>. Having considered responses to the December 2015 consultation, we have made some further changes to the proposed licence drafting to provide clarity in certain areas.

We will consider any comments received on the consultation we have published today before publishing the statutory consultation, if appropriate, and deciding whether any changes to the GT licence should be made. Responses to this consultation should be submitted to Rupika Madhura, Head of Gas Distribution Policy ([Rupika.Madhura@ofgem.gov.uk](mailto:Rupika.Madhura@ofgem.gov.uk)) no later than 26 May 2016.

### *Funding of Xoserve RIIO GD1, GT1 reopener: assessment of gas transporters costs*

In the RIIO<sup>9,10</sup> price controls for gas distribution and gas transmission, we provided for an uncertainty mechanism to allow us to make changes to the funding arrangements of Xoserve to align it with the aims and objectives of our FGO conclusions following our review. Currently, Xoserve's costs are funded through GTs' RIIO price controls for the services it provides. From 1 April 2017, the CDSP under the new co-operative model will be funded based on the "user pays" principle.

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<sup>7</sup> [Consultation on proposed modification to Standard Special Condition \(SSC\) A15 \(Agency\) of the Gas Transporters \(GT\) licence and proposed new SSC A15A \(Central Data Service Provider\)](#).

<sup>8</sup> [Informal consultation on changes to Standard Special Condition A15 \(Agency\) of the Gas Transporters Licence](#).

<sup>9</sup> The RIIO-GD1 price control sets out the outputs that the eight Gas Distribution Networks (GDNs) need to deliver for their consumers and the associated revenues they are allowed to collect for the eight-year period from 1 April 2013 until 31 March 2021. The final proposal can be found [here](#).

<sup>10</sup> The RIIO-T1 price control set out the outputs for the gas and electricity network companies from 1 April 2013 to 31 March 2021. The final proposal can be found [here](#).

Subsequent to the industry agreeing a project plan in September 2015 to implement the co-operative model, we also initiated work to review the costs of GTs to fund Xoserve as per the uncertainty mechanism provided for in RIIO GD1 and GT1. We intend to make our final decision on the funding arrangements by September 2016. The new arrangements are expected to take effect from 1 April 2017. In the meantime, the current arrangements to fund Xoserve will continue to apply until 31 March 2017.

Finally, we welcome the commitment the industry has shown since agreeing the project plan in September 2015 to deliver the co-operative model for Xoserve. We continue to expect industry to deliver the full programme by 31 March 2017 for the new arrangements for Xoserve to be in place from 1 April 2017.

If you have any questions in relation to this letter, please contact Rupika Madhura, Head of Gas Distribution Policy at [Rupika.madhura@ofgem.gov.uk](mailto:Rupika.madhura@ofgem.gov.uk).

Yours faithfully,

A handwritten signature in blue ink that reads "M. Frerk". The signature is written in a cursive style with a light blue background behind it.

**Maxine Frerk**  
**Interim Senior Partner, Networks**

## Appendix 1: Xoserve – decision on the legal and regulatory framework relating to the gas central data service provider

We assessed four potential implementation options as set out in the CEPA report<sup>11</sup> and in our February 2014<sup>12</sup> consultation against our principal objective set out in the Gas Act 1986, and our general statutory duties. We also assessed the options against the objectives of the legal and regulatory framework, which are to:

- reinforce and facilitate a responsive IT and information service provider;
- ensure alignment of obligations, risk and control;
- provide a framework that can be industry led, while reserving regulatory powers that allow us to influence new arrangements in order to ensure the protection of the interests of existing and future consumers; and,
- be the most simple and practical to implement.

We have analysed the responses we received to the February 2014 consultation and have considered these responses in arriving at our decision. The timing of this decision and our consultation on the proposed licence changes is aimed at making sure that any amendments we make are aligned with the developments being made through the industry led implementation programme to establish the new governance arrangements for Xoserve.

Our **decision** is that:

- Option one (as set out in table 1 below) should be taken forward by the industry for implementation of our October 2013 decision on Xoserve funding, governance and ownership (FGO) review.
- Appropriate UNC modifications should be raised and progressed, to require parties to jointly participate in Xoserve’s governance and funding.
- We have identified no additional benefits as of now from Xoserve becoming a party to the UNC to implement the funding and governance changes to Xoserve.
- We are proposing a licence change that will require Gas Transporters (GTs) to deliver the new arrangements in full by 31 March 2017.

Our February 2014 consultation outlined four options whose differentiating factors are the legal instruments that would be changed in order to implement each element of the new arrangements (as outlined in section 1.2 above). Table 1 below summarises these four options.

**Table 1 - Elements of the legal framework and associated changes to instruments under each option**

Element	Option 1	Option 2	Option 3	Option 4
Core requirements	GT licence	GT and shipper licence	GT licence	GT and shipper licence
Principles of governance & funding	UNC	GT and shipper licence and UNC	UNC	GT and shipper licence & UNC
Shipper & GT obligations	UNC	GT and shipper licence and UNC	UNC	GT and shipper licence & UNC
Service requirements from the CSP	Service agreement	Service agreement	UNC	UNC
Charging methodology	UNC	UNC	UNC	UNC

<sup>11</sup> [CEPA report on the legal and regulatory implementation](#)

<sup>12</sup> [Xoserve – consultation on the legal and regulatory framework to establish new arrangements for the gas central service provider](#)

Service charge application	Service agreement	Service agreement	UNC	UNC
Co-operative governance arrangements	Articles of Association	Articles of Association	Articles of Association	Articles of Association
Requirement to provide code and non-code services	Service agreement	Service agreement	UNC	UNC
Requirement to provide bespoke services	Bilateral contracts	Bilateral contracts	Bilateral contracts	Bilateral contracts

Source: adapted from table 4.1 in the CEPA report

We noted that reaching a conclusion on the most appropriate option to take forward means considering the following:

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

We also asked for your views on whether one or more parties should be required to deliver implementation of the review's conclusions. We summarise the views expressed in response to the consultation and our policy decisions on these three areas below.

### **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?**

The proposed new arrangements will require GTs, Independent Gas Transporters (iGTs) and Shippers to participate in the governance of Xoserve and to fund it for delivery of services. Two options for requiring these parties to participate in these activities were considered: by modifying the UNC only; or through a combination of the UNC and licences.

Our February 2014 consultation set out our assessment of these options and our view was that the UNC is an appropriate instrument for placing requirements on parties to jointly participate in the co-operative arrangements. We set out that our preference is therefore for option 1 or 3 (of the options set out in table above).

We continue to consider the UNC is the appropriate instrument for requiring parties to participate in the co-operative arrangements and have not identified a need to include requirements in each party's licence in relation to this. We continue to consider that it is appropriate that there is a licence obligation on the GTs in relation to implementing the new arrangements, as discussed further below.

In assessing this option against the objectives we have decided that this option would be most appropriate for the following reasons:

- It would facilitate a responsive IT and information service provider by requiring suitable contractual arrangements (service agreements) to be established between Xoserve and its users. This would provide Xoserve with the security it needs to carry out its functions and allow users to monitor Xoserve's delivery success.
- Obligations and control would be aligned by placing joint requirements on users in the UNC. We think this would create the necessary symmetry because all parties would be

equally required to carry out their duties through the same document. Risk, obligations and control would be further aligned through changes the GTs would be required to make to Xoserve's company documents (the Articles of Association and Memorandum of Association).

- Regulatory oversight would be retained through provision for users to appeal the budget set by Xoserve. However, we expect that processes would be put in place to make sure that users have the opportunity to feed their views into the budget and planning process so that this option is only used in extreme circumstances.
- If obligations were to be included in licences, we recognise that we would have the ability to take action against non-compliance with the obligations, if we considered it appropriate to do so. However, in order to carry out its business, a user must comply with the obligations set out in the UNC and therefore we think there is a strong incentive to comply with the requirements of the UNC.
- Proposals to modify the UNC can be made by parties to it. The GT licence will require GTs to raise modifications to the UNC to bring into effect our decision.

To implement this decision we propose that the GT licence is modified<sup>13</sup> to:

- Require GTs to propose and progress modifications to the UNC to include joint obligations on the users of Xoserve's services to govern and fund it (Part A of the proposed standard special condition A15A).
- Require GTs to modify Xoserve's company documents to allow for joint governance and restrict the distribution of any profits (unless the CDSP has written consent from the Authority allowing it to distribute certain profits) (Part B of the proposed standard special condition A15A).
- Provide for the Authority to amend Xoserve's budget if an appeal by a user of Xoserve's services is upheld (Part C of the proposed standard special condition A15A).

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

Xoserve is not currently a party to the UNC. It is required to deliver services on behalf of GTs through a service agreement (the Agency Service Agreement). Under the proposed new arrangements a contractual arrangement is still required between Xoserve and the users of its services. Two options for this proposed new contractual arrangement were considered –

- Continue to use a service agreement approach but extend to capture other users of Xoserve's services.
- Make Xoserve a party to the UNC, with the UNC then capturing the contractual arrangements.

Our February 2014 consultation sets out our assessment of these options and our view was that using the current service agreement approach best meets the objectives. We set out that our preference was therefore for option 1 or 2 (of the options set out in table 1 above).

We have decided that the current approach of using service agreements should continue for now and therefore Xoserve will not become a party to the UNC as part of the implementation of FGO. This is because using a service agreement approach would be relatively quick to implement compared to a solution delivered through regulation. Xoserve becoming a party to the UNC would likely be a more complicated process.

However, we note that the CMA's considerations of an Adverse Effect on Competition (AEC) propose new arrangements which are wider in scope and could involve system delivery organisations such as Xoserve acceding to the relevant industry codes, if they became a licensed body. In its provisional findings, the CMA proposes the introduction of regulatory

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<sup>13</sup> [Informal consultation on changes to Standard Special Condition A15 \(Agency\) of the Gas Transporters Licence.](#)



oversight through further licences to achieve these wider objectives. As part of implementing this work we may consider how best to support these arrangements (and potentially service agreement objectives) through licence or code obligations.

To implement this decision we propose that the GT licence is modified<sup>14</sup> to:

- Require GTs to raise and progress modifications to the UNC to include obligations on the users of Xoserve's services to enter into a service agreement with it (Part A of the proposed standard special condition A15A).
- Require GTs to make sure the service agreement contains minimum requirements for Xoserve (Part B of the proposed standard special condition A15A).

### **Should one or more parties be required to deliver implementation?**

We have decided to require the GTs to deliver new arrangements for Xoserve by 31 March 2017. We appreciate this places obligations on GTs that are not placed on Shippers but we think this is reasonable given that the GTs are uniquely placed to deliver elements of the proposed new arrangements because they are Xoserve's owners.

This does not mean that the Shippers will not have to play their part in delivery. We expect all parties to actively participate in the implementation programme. Without this engagement there is a risk of arrangements being developed that do not fit users' requirements. Opportunity for Shippers' engagement will be further facilitated through modifications to the UNC which will aim to ensure that there are mechanisms for both GTs and Shippers to engage in Xoserve's on-going operations.

### **Conclusion**

Based on the analysis and our decision on each of the consultation questions, our decision is that option one out of the four options mentioned in table 1 is the most appropriate option to take forward to implement our October 2013 decision on FGO review of Xoserve.

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<sup>14</sup> [Informal consultation on changes to Standard Special Condition A15 \(Agency\) of the Gas Transporters Licence.](#)

## Appendix 2: Summary of responses to the consultation

All responses are published on our website.<sup>15</sup>

### **Question 1: Can the Uniform Network Code (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?**

Network companies felt that the UNC was not appropriate for requiring joint participation and therefore considered that parties' licences should be used. Shippers had mixed views though the majority thought that using the UNC was appropriate.

The benefits of using licences were highlighted as creating:

- Symmetry in the obligations on parties;
- Greater regulatory oversight including the ability for Ofgem to enforce obligations;
- Clearer and more transparent obligations.

Those who preferred using the UNC noted that it was an appropriate place to require such joint obligations.

Some parties also noted that using the UNC was not an appropriate way of requiring parties to deliver implementation of new arrangements.

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

The majority of parties favoured Xoserve not being a party to the UNC because:

- it would be more complex and create no discernible benefit;
- Xoserve's ability to continue to deliver services that are not required under the UNC may be hampered; and,
- using service agreements is easiest to implement.

However, there was support from some (particularly the Gas Transporters) for Xoserve becoming a party to the UNC. The reasons given were:

- ease of maintenance as it could keep contractual arrangements all under the UNC rather than creating an additional contract (the service agreement);
- more transparent relationship between obligations and delivery and therefore greater surety that Xoserve will be held responsible for successful delivery of services; and,
- creation of clearer counter-parties to rights and obligations.

### **Question 3: Should one or more parties be required to deliver implementation?**

Some parties felt that it would be difficult to get the review conclusions implemented without placing an obligation to deliver on one or more parties. Some considered that gas transporters were the best parties to obligate as they currently own Xoserve. Others felt that the obligation to deliver should be more collaborative and therefore should include Shippers.

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<sup>15</sup> [Xoserve – consultation on the legal and regulatory framework to establish new arrangements for the gas central service provider - response documents](#)