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Dear Rupika,

**Consultation on minded-to position on the review of gas transporter agency (Xoserve) costs in RIIO GD1 and T1.**

Thank you for the opportunity to respond to your consultation in relation to your minded to position on the review of gas transporter agency costs.

We do not agree with Ofgem's assessment of the future costs of agency services or the proposed change in the mechanism for gas transporters to recover these costs. We set out our detailed reasons for reaching this view within this response and would welcome further dialogue with Ofgem on this topic.

**Proposed Adjustment to Allowed Expenditure**

We consider it is sensible for Ofgem to adjust revenues from 1 April 2017 rather than over the entire GD1 price control period. However, we do not agree with Ofgem's proposed adjustment to allowed expenditure because we do not think this adequately reflects neither the type and cost of services, and the mechanism for delivering these, under a co-operative model that gas transporters are expected to deliver moving forward.

We are surprised Ofgem has chosen to use Xoserve's 2014/15 RRP forecast data submission as the basis for analysis, especially considering this relates to data more than twelve months old and clearly does not reflect the significant developments in building a co-operative model across the industry within that time. As a direct result, we consider this will lead to a significant impact on the quality of

services to customers if the full quantum of the Funding, Governance and Ownership (FGO) co-operative model changes are not recognised by Ofgem moving forward, and subsequently the revenues gas transporters will be allowed to recover. Ofgem will be aware the future FGO arrangements have been significantly reviewed since the time Xoserve's 2014/15 RRP submission was made. We understood the basis for Ofgem seeking a further cost assessment submission in January 2016 was to overcome this issue, and to gain a more accurate view on the costs of agency services in a post-FGO environment.

For instance, we consider the minded to position provides insufficient clarity on how Ofgem's proposed adjustments will aid the delivery of the new FGO charging methodology and/or the services that will be provided, the goal of which is to provide transparency and accountability over costs. If Ofgem was not clear on the reasons for the difference in costs between the 2014/15 RRP and January 2016 submissions, both Xoserve and gas transporters generally have always been available to answer any additional questions and provide supporting evidence where necessary. It is therefore disappointing to note Ofgem has referenced data in the 2014/15 RRP submission, which does not include all Xoserve costs and which does not accurately reflect the services that Xoserve will provide to the industry from 1 April 2017.

We are particularly concerned Ofgem's minded to position, as it stands, shows an apparent lack of understanding of the importance and impact of the FGO arrangements gas transporters are facilitating. This continues to be impeded by a lack of formal governance obligations on some industry parties to deliver the requirements of the FGO (similar to the formal licence obligations in place for gas transporters), something that we have previously raised with Ofgem on numerous occasions as a barrier to current industry change. We would be willing to provide Ofgem with as much evidence as is necessary to ensure the full impacts of FGO on future agency costs is properly understood before a final decision is made.

We suggest Ofgem's minded to position would benefit from spending additional time with gas transporters and Xoserve to better understand what has driven differences since the 2014/15 RRP was submitted. Following this, we would encourage Ofgem to revisit their analysis and consult on readjusted revenues.

#### **Proposed treatment of revised allowed expenditure: pass-through or allowance**

While we fully understand and support the need to ensure all gas transporter services are delivered to our customers as efficiently as possible, we do not believe it is fair or appropriate to change the mechanism by which services are funded and agency costs are recovered.

It is clear from the ongoing work to develop FGO co-operative arrangements that industry participants, other than gas transporters, will have a majority say in the future management, operation, delivery of services and budget setting processes of Xoserve moving forward. We therefore find it surprising Ofgem is proposing a change to the funding mechanism that effectively provides an *ex ante* allowance to gas transporters for the delivery of services that are not exclusively under gas transporters control. For example, the FGO co-operative model will include both gas transporter and shipper funding of core activities where costs are largely capacity driven and are beyond the individual control of any one party.

We understood Ofgem's previous position was that if FGO arrangements resulted in the gas transporters funding a proportion of central data service provider (CDSP) costs, and the totality of CDSP costs had been subject to the co-operative governance arrangements, Ofgem would modify the price control framework to allow gas transporters to pass through such costs as part of their transportation charges. We would welcome further clarification as to why Ofgem is now proposing to deviate from its previous commitment and without any clear additional evidence for doing so.

Our concern is that shippers, through their nominated board directors, will be able to dictate what the future services and investments of Xoserve can be as they will have more representatives on the board than the shareholders of Xoserve. Shippers will have four directors whilst the gas transporters will have three representatives plus one iGT representative. In a co-operative model this is not considered an issue, but it is not the case in an environment where gas transporters are still funding the industry and have allowances that will be allocated on an *ex ante* basis. This is further illustrated in Ofgem's minded to consultation where it is acknowledged there is "*...reduced confidence in the industry being able to adapt swiftly to joint-working and shared responsibility to govern Xoserve costs*".

We do not consider it is fair or equitable to make gas transporters accountable for costs not within their control, and this seems to deviate from an earlier stance on this issue that has the potential to change the approach adopted by gas transporters in delivering the FGO co-operative model. We consider Ofgem's minded to position is almost a reversal of their previous proposal to allocate costs to constituencies on a user pays basis, and undermines the very substantive work that has been undertaken to define the future methodology for the funding and governance of agency services in future. At the very least it will impact on reducing the number and type of change activities that are undertaken and reduce avenues for innovation. This will become more apparent when the impacts of the CMA report have been fully analysed, along with the recent developments following the BREXIT referendum result and the work that will be needed to unwind from EU ruling.

An alternative solution may be for Ofgem to build in an additional uncertainty mechanism for the recovery of costs at the end of RIIO-GD1. This could include the opportunity for gas transporters to recover additional costs that have been efficiently incurred, are outside of their control and have not been included as part of any revised allowances. We would be willing to discuss this potential option further with Ofgem.

### **Summary**

In summary, we do not agree with Ofgem's assessment of the future costs of agency services or the proposed change in the mechanism for gas transporters to recover these costs.

We are concerned Ofgem's minded to position would not contribute to the delivery of its ambitions for Xoserve to operate with increased flexibility and responsiveness, would leave the gas transporter and shipper constituencies facing different risk and reward profiles, and would undermine a fundamental principle of the co-operative model that risk and reward should be shared equitably amongst all industry participants.

We trust the above response will aid and assist Ofgem in developing its decision on the next steps for reviewing gas transporter agency costs. This is a very important matter for the industry as a whole, and it is important for Ofgem to ensure all relevant analysis of future agency costs have been taken into account before reaching a decision on this topic.

Should you require any further information with regards to this response then please do not hesitate to contact me at [paul.mitchell@sgn.co.uk](mailto:paul.mitchell@sgn.co.uk) .

Yours sincerely,

**Paul Mitchell**