

# **Industry Dialogue on xoserve Services**

## **Final Report**

## Contents

1	Executive Summary	3
2	Introduction	5
3	Features on xoserve's systems	7
4	Cost Requirements	9
5	xoserve Funding Arrangements	11
6	Service Standards	17
7	Governance	18
8	Progress with Deliverables	21
9	Issues and Risks	22
10	Conclusions and Recommendations	24
11	Next Steps	26
	Appendix 1	28
	Comments received from Companies and Organisations	
	Appendix 2	34
	Terms of Engagement	
	Appendix 3	37
	Workgroup Meetings	
	Appendix 4	38
	High Level Features of UK Link Replacement	
	Appendix 5	39
	Contracting Models	

## Executive Summary

- 1.1 This document sets out the views expressed and debated by the Workgroup established to take forward the Industry Dialogue on xoserve Services initiated by Ofgem as part of the GDPCR process. We have considered all of the five key areas identified in Ofgem's Terms of Engagement. A considerable degree of consensus has been reached on many of the areas.
- 1.2 The high level features of a replacement of UK Link were debated and we consider that a traditional price control approach should be adopted for funding these features. We understand that the cost estimates already provided to Ofgem are consistent with these features but were not qualified to comment on the reasonableness of the cost estimates. We recognised that there were considerable opportunities, beyond the high level features, for changes to the commercial regime and improvements in user functionality but that the timescales of the Workgroup process did not allow these to be sufficiently specified or costed. We recommend that a mechanism should be devised to recover incremental costs associated with agreed enhancements to UK Link.
- 1.3 We are not proposing as part of this Workgroup process any changes to the scope or standards of services provided by xoserve.
- 1.4 We looked at how the user pays principle could operate whilst looking at modifications. We felt there was potential to operate this principle but great care would have to be taken to ensure the funding and governance arrangements were clear and simple, to avoid additional uncertainty complexity and cost within the modification processes.
- 1.5 We have developed a more detailed understanding of the governance and charging framework that would be required to operate a user pays regime and also potential criteria to help identify whether any existing services would be more appropriately treated as user pays. We feel that significant additional development work will be required before the feasibility of any user pays service lines can be assessed. So far we have not identified a compelling case for introducing a new form of user pays to apply to existing services.
- 1.6 We recognise the importance of funding ongoing change to central information systems in order to allow development of the commercial regime. If transporters' allowed revenue does not specifically include a sufficient element to fund as yet unspecified change, there would be merit in developing a mechanism to meet xoserve's incremental costs. This could be funding from users either through direct, user pays, charges with the revenue treated as excluded from the price control, or through transportation charges supported by a user pays based adjustment to allowed revenues.
- 1.7 We recommend that, if Ofgem concludes that user pays is the best way of avoiding inappropriate barriers to the development of the commercial regime, work should continue to establish the detail needed to support a mechanism which would enable xoserve to obtain

additional funding to meet the cost of specified classes of change during the course of a price control period.

## 2. Introduction

- 2.1 Ofgem's second GDPCR consultation document<sup>1</sup> proposed an industry dialogue leading to an agreement between Shippers and Gas Transporters (GTs) on what central information system services are required from the GTs' agent and how the associated costs should be met. Ofgem felt that such a dialogue leading to an agreement between Shippers and GTs had the potential to produce a better outcome than traditional price control processes.
- 2.2 Ofgem produced Terms of Engagement for the proposed industry dialogue, which defined the outputs required to support their review of the GT price controls. The Terms of Engagement were discussed at an industry meeting on 9 October 2006 and are reproduced in Appendix 2 below. The Ofgem Terms of Engagement expected the industry dialogue to cover five key areas:
- (a) Features of xoserve's systems – the high level features of the gas industry central information systems following planned IS projects;
  - (b) Cost Requirements – the level of costs that dialogue participants are willing to incur in order to receive xoserve services;
  - (c) xoserve funding arrangements – which of xoserve's services should be funded through the price control;
  - (d) Service standards – the service standards to be associated with core services; and
  - (e) Governance – the governance arrangements that could be used to support a user pays approach to the funding of xoserve.
- 2.3 In addition to these key areas, eight deliverables were specified in the Terms of Engagement. Progress against these deliverables is summarised in section 8 of this report.
- 2.4 It was also agreed at the 9 October meeting that the Joint Office be asked to chair and act as secretariat for a Workgroup to consider the issues involved. This was agreed and all notes of meetings, presentation material and other relevant documents have been made available on the Joint Office website<sup>2</sup>. The Workgroup meetings were well attended and the areas covered at each meeting are summarised in Appendix 3 of this report.
- 2.5 This report seeks to set out the views expressed and debated at the Workgroup meetings. Risks and issues identified by the Workgroup are recorded in Appendix 6. Each of the five key areas is considered in the following sections together with the Workgroup's recommendations and proposals for next steps. The report has been debated by Workgroup attendees with a

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<sup>1</sup> Available from [www.ofgem.gov.uk](http://www.ofgem.gov.uk)

<sup>2</sup> [www.gasgovernance.com/industryinfo/xoserveGroup/](http://www.gasgovernance.com/industryinfo/xoserveGroup/)

view to achieving consensus that it fairly reflects Workgroup views. Comments provided by the companies that have expressly written to provide views are in Appendix 1.

### 3. Features of xoserve's systems

- 3.1 Ofgem's Terms of Engagement suggested that a key objective of the industry dialogue was to create an opportunity for GTs and Shippers to reach an agreed position on the high level features of major IS projects planned for the price control period, in particular the project to replace key elements of the UK Link suite of systems<sup>3</sup>.
- 3.2 Shippers were given the opportunity to discuss what functionality they are willing to pay for through transportation charges and what functionality they consider imposes excessive costs on their business. As part of this discussion, the Workgroup also considered whether there are any services that should be explicitly excluded from the scope of the gas industry central systems operated by xoserve, and whether any elements of the existing systems were redundant.
- 3.3 The full range of services currently supported by UK Link was reviewed by the Workgroup. It was recognised that all the existing service lines support processes required by the UNC or GT licences and, as such, none were identified that could be excluded from scope or were considered to be redundant. It was agreed, however, that it was important for competition that Shippers continued to face a level playing field when using these core processes.
- 3.4 The Workgroup discussed the potential high-level features for a UK Link Replacement. These were documented, together with the underlying assumptions that support the features (see Appendix 4).
- 3.5 The Workgroup recognised that new or modified service lines are likely to be required by the time that the UK Link Replacement business requirements need to be specified (2010). However, the Workgroup considered it impossible to define with any confidence the likely business requirements of such undefined change, especially in sufficient detail to enable reliable cost estimates to be made. The Workgroup agreed that changes to current industry arrangements, in the form of strategic reform or business as usual changes, will undoubtedly occur over the next three to five years which will need to be considered as part of the UK Link system replacement project, and the funding mechanism will need to be determined.
- 3.6 Shippers on the Workgroup emphasised that it was desirable to include functionality within the UK Link replacement specification to carry out supply point administration for iGTs. However, it was recognised that funding for this is outside the GT price controls and that there is no firm definition of the required commercial framework at present. The Workgroup also noted that commercial discussions are ongoing between xoserve and the iGT's regarding the provision of services.

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<sup>3</sup> References to UK Link in this report should be read as including the Sites & Meters and Invoicing95 systems, but excluding Gemini

- 3.7 The Workgroup also considered the potential impact on the UK Link replacement project of relatively significant regime changes, such as replacing RbD with meter point reconciliation. Whilst changes of this nature could be defined and cost estimates produced, there was no appetite to agree funding for the necessary impact assessment to be undertaken, let alone to propose including a funding allowance in core Price Control allowances. It was concluded that any such changes should be managed through industry consultation and funding managed through an appropriate mechanism. This would apply whether any such change was implemented before, after or coincident with the UK Link replacement, although replacement may provide a window of opportunity for such changes to be introduced in a relatively cost effective manner.
- 3.8 Whilst the Terms of Engagement were not seeking agreement on the detailed aspects of the UK Link Replacement project, the Workgroup felt that there was an insufficient level of detail available at this stage to support reliable cost estimates for variations from the current services to be prepared. The introduction of Automatic Meter Reading was used to illustrate the difficulties of preparing cost estimates when the future regime is not fully defined and costs are dependent on decisions regarding precisely how a new approach is to be implemented.
- 3.9 To overcome this dilemma and to ensure that there are no inappropriate barriers to future development of the commercial regime, the Workgroup is recommending that a mechanism should be devised to recover incremental costs associated with agreed enhancements to UK Link. The options are discussed further in Section 5 below.
- 3.10 During the Workgroup discussions, xoserve committed to undertake industry consultation on UK Link business requirements prior to completing the detailed design of its replacement, which is scheduled to commence in 2010. This was welcomed by Shippers.

#### 4. Cost Requirements

- 4.1 Ofgem's Terms of Engagement suggested that both GTs and Shippers should consider the costs associated with a given level of functionality and that the industry dialogue should reach a view on a reasonable level of costs required to carry out the project to replace UK Link. The dialogue was also asked to seek to quantify, at a reasonable level of detail, any reductions in xoserve's operating costs that could be expected to arise following the project.
- 4.2 The cost estimates provided to Ofgem by xoserve are consistent with the high level features of the UK Link Replacement considered by the Workgroup (referred to in paragraph 3.4 above). Because of the crucial importance of UK Link to the operation of the gas industry regime, and the necessity of all players following standard procedures through common systems, the Workgroup concluded that economically and efficiently incurred replacement costs should be funded by traditional price control allowances.
- 4.3 The majority of the work to replace UK Link will be put out to tender and so xoserve did not feel able to share its present cost estimates with the Workgroup. However, in order to help the Workgroup understand the magnitude of the costs involved, xoserve informed the Workgroup that the projected cost of the complete IS investment programme over the next seven years, comprising of a number of individual projects including UK Link Replacement, was approximately £65m.
- 4.4 Even if the replacement cost estimates had been provided, Shippers considered that they would not be in a position to assess the reasonableness of these replacement costs and a traditional price control approach, with an estimate of efficient costs established by Ofgem, should be adopted. It was not possible to consider the incremental costs associated with changes to services, at this time, because there was no definition of the incremental business requirements that might be required.
- 4.5 Whilst xoserve indicated that the drivers for UK Link replacement are largely to ensure continuity and efficiency of the current service, it was accepted that an additional key driver for the design should be the total cost of ownership, in particular the ongoing operating costs including the prospective cost of change. Some Shippers indicated that they might be willing to fund additional costs associated with system design which facilitated subsequent (if undefined) change and which minimised costs for the industry as a whole – additional xoserve costs should be allowed if this provides (greater) consequential savings for Shippers.
- 4.6 Following the replacement of a significant system, it was agreed that it is unlikely operating cost savings will be achieved in the first year of operation because of the time required to embed modified processes and to rectify any implementation issues. As UK Link replacement is targeted for implementation in 2012, any operating efficiencies are therefore likely to be realised beyond the end of the forthcoming price control period. Hence the Workgroup took the view that any operating cost efficiencies due to the replacement of UK Link were outside the

scope of the current dialogue. However, this should be an ongoing fundamental part of the work undertaken by the system replacement project.

## 5. xoserve Funding Arrangements

5.1 Ofgem's second GDPCR Consultation Document consulted on a number of options for the funding of xoserve services, including a user pays approach. In the event that a user pays approach is adopted, it will be necessary to decide:

- (a) which of xoserve's services should be core services (and hence funded using ordinary price controlled allowed revenues) and
- (b) which of xoserve's services should be subject to user pays (and hence funded outside the price controlled allowed revenues).

5.2 While Ofgem has not yet made a decision on the funding of xoserve, the Workgroup undertook to develop a more detailed understanding of how a user pays option could look, as directed by Ofgem in the Terms of Engagement. Three particular areas were considered: criteria for identifying user pays services; contracting models and user funding of change.

5.3 The Workgroup developed a set of criteria for identifying services that are candidates for user pays:

- (a) The key stakeholders for the service line should be Users so that they have the necessary incentive concerning the quality and cost of the service provided;
- (b) Users should have discretion on whether or how to use the service so that any additional costs incurred by xoserve are charged to the appropriate User and the quality of the service could be reflected in a different level of usage;
- (c) A significant proportion of the cost to deliver the service line should be usage dependent, otherwise there are inappropriate incentives on Users;
- (d) The benefit from treating the service line as user pays should outweigh the cost of the additional complexity of a user pays regime.

5.4 The Workgroup accepted that, for existing service lines, the strongest candidates to be funded by all users, via a user pays approach, were those where all four criteria apply. However, it may also be appropriate for a user pays approach to be adopted for other service lines provided the final criteria was met – the additional complexity and cost of applying a user pays approach should not outweigh the benefits of doing so. xoserve applied the identified criteria to each of the 242 Agency Services Agreement service lines. Twelve service lines were subsequently reviewed by the Workgroup. The application of the criteria to all nineteen of the high level service line categories was also reviewed by the Workgroup. On the basis of all four criteria applying, five high level categories were identified as candidates for considering the case for applying a user pays approach:

- (a) Provide Query Management

- (b) User Admission & Termination
- (c) Must Reads
- (d) Provision of Services in Relation to Obligations under GT licence
- (e) Provision of User reports and information.

Risks and issues identified in relation to treatment of these candidates under a user pays funding mechanism are detailed further in Appendix 6.

- 5.5 The Workgroup recognised that not all individual service lines within the above high-level categories would necessarily be appropriate for a user pays approach. Similarly, some service lines for which a user pays approach is appropriate may exist within other high level categories.
- 5.6 In order to assist Workgroup discussions, xoserve provided the Workgroup with illustrative service line costs for relevant service lines within the five candidate high-level service lines. However, the Workgroup felt unable to recommend implementation of a User pays approach in these cases in the absence of further, more detailed, work to define individual user pays service lines and consider issues such as whether appropriate incentives would be generated by the approach. In addition, wider industry consultation was recommended prior to any firm decisions being taken with respect to implementation<sup>4</sup>. Consequently, the Workgroup has not taken a view on what proportion of xoserve's costs should be attributed to user pays.
- 5.7 For new and existing services that meet the user pays criteria, two contracting models were considered by the Workgroup (see Appendix 5 for further details):
- (a) Model A (Regulatory Model) utilises the existing UNC and ASA contractual arrangements and was the early preference expressed in Ofgem's 2nd GDPCR Consultation Document.
  - (b) Model B (Direct Contracting) reflects the current arrangements for xoserve's non-ASA services.
- 5.8 The key difference between the two models is that users would contract directly with xoserve under Model B rather than contracting solely with the GTs. As such, Model A retains the existing structure whereby the GTs instruct xoserve, and funding arrangements are directly regulated by Ofgem. By contrast Model B provides for a more direct relationship between xoserve and its users, with less direct oversight of funding by Ofgem.
- 5.9 The Workgroup considered the benefits of the two models in the context of baseline services, funded by the traditional approach of an allowance in the main price controls, and volume

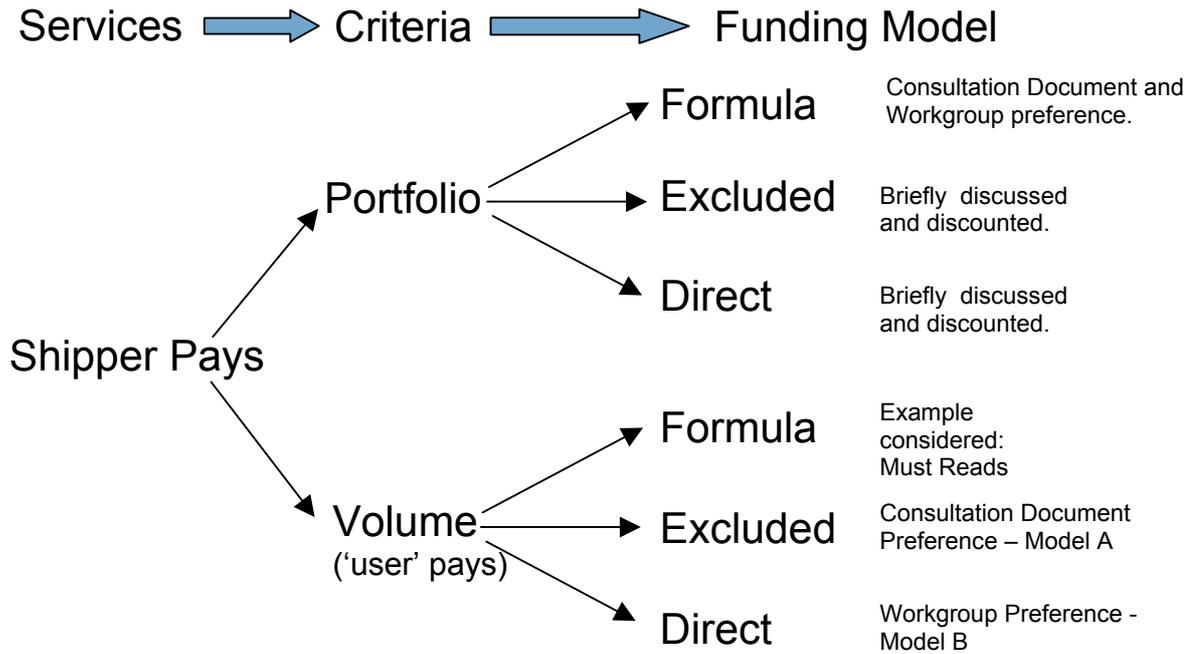
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<sup>4</sup> Workgroup views on the next steps which should be taken to support consideration of a user pays approach are provided in Section 11 of this report.

driven services directly funded by a user pays approach. The conclusions are summarised in the table below.

Model	Key Benefits	
	Model A	Model B
Baseline Services (Core)	<ul style="list-style-type: none"> <li>▪ GTs have service level obligations under UNC</li> <li>▪ Ensures all stakeholders in the loop</li> </ul> <p style="text-align: right;">✓</p>	<ul style="list-style-type: none"> <li>▪ Increased risks between GTs and Agent</li> <li>▪ Shippers do not have direct recourse under UNC</li> </ul> <p style="text-align: right;">✗</p>
Volume Driven & Commercial Services (User Pays)	<ul style="list-style-type: none"> <li>▪ No value added by GTs involvement</li> <li>▪ Potential for increased delay or reduced service levels</li> </ul> <p style="text-align: right;">✗</p>	<ul style="list-style-type: none"> <li>▪ Shipper to Agent direct relationship may enable better service levels and increased leverage for shippers</li> </ul> <p style="text-align: right;">✓</p>

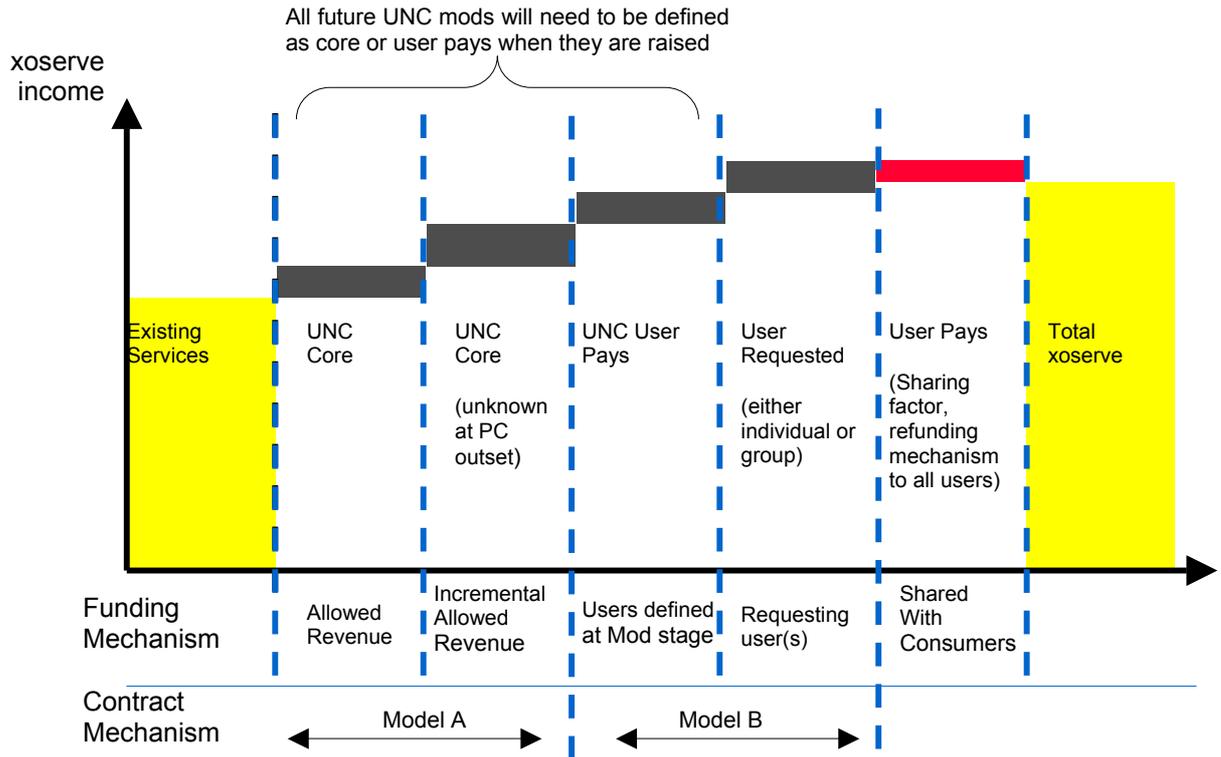
- 5.10 If a user pays approach is introduced to support the funding of some services, the Workgroup expressed a clear preference for this to be within the Model B framework. However, this view was subject to sufficient transparency and governance arrangements being introduced to allow appropriate scrutiny of xoserve's charges, costs and revenue, reproducing to some extent the regulatory safeguards which are present under Model A.
- 5.11 A variant of model A was also considered for services with volume driven costs, whereby they would be charged for by the GTs based on usage but without the revenue being excluded from the price controls. This would therefore involve an additional (cost reflective) transportation charge being introduced, an Agency transportation charge, to collect revenue based on usage of these services. Since maximum allowed revenue would be unchanged, a consequential reduction in other transportation charges would be necessary. This approach created concerns among Workgroup attendees because of the additional complexity of transportation invoicing, the indirect relationship between Users and xoserve and the lack of clarity over incentives.
- 5.12 The different funding approaches and contracting models considered by the Workgroup for existing services are further illustrated in the following diagram, reflecting that Shippers (and hence consumers) ultimately pay for xoserve services in all scenarios. The question is which charging approach is most effective in terms of reflecting costs incurred on behalf of each User and generating the appropriate incentives for efficient provision by xoserve and efficient demand by users.



5.13 The application of user pays principles to changes in services, as opposed to continuing provision of existing services, was considered separately by the Workgroup. Change to a service line or introduction of a new service line could be triggered by implementation of a UNC modification or by a direct request from one or more Shippers to xoserve. The resulting change costs are likely to be a combination of one-off investments in systems and processes and the enduring cost of operating the new or modified service.

5.14 Currently GTs, via xoserve, fund all changes to central systems, on the assumption that these costs are allowed for in the GT price controls. This change is a combination of investment to ensure the continuity and cost effectiveness of services, and commercially driven change, for example to comply with UNC modifications. As already referred to in paragraph 4.2, the Workgroup felt that investment to sustain the central information systems should continue to be funded by appropriate allowances within the GT price controls. The Workgroup also noted that there is an existing mechanism within the UNC for users to fund systems change (Class 3 Modifications) but that this has never been utilised. It was believed that this was at least partly because of a lack of clarity over the sharing of costs were the route to be followed as opposed to the usual route of a standard UNC modification which leads to all Shippers bearing costs through the transportation charges they face. The Workgroup acknowledged that this approach has been satisfactory to date although the existence of fixed price control allowances mean that while the GTs, and hence xoserve, have a strong incentive to operate efficiently and minimise costs, they also have an incentive to resist change which would increase their costs even where such change may have clear benefits for end consumers.

- 5.15 If the cost of change has not been adequately reflected in GTs' price control allowances, (or the change concerned is not self financing, or initiated by a third party), an additional mechanism to fund change is required. Two approaches for users to fund the incremental costs of industry agreed change are:
- (a) Through price control adjusters and hence additional allowed revenue – if maximum allowed revenue increases, increased costs would be passed through to Shippers and hence shared in line with the transportation charging methodologies; and
  - (b) A direct charge to users based on a sharing methodology or a specific usage related charge – a user pays approach with any associated income excluded from price controlled revenue.
- 5.16 Under either of the above approaches, the time period over which the cost of the change is recovered needs to be considered, especially since xoserve change costs generally involve investments in systems which are expected to operate on an ongoing basis.
- 5.17 The following graph illustrates a potential approach to funding xoserve costs, including various categories of change. Under this approach, a traditional price control approach would be used to identify and provide funding for existing core services provided through xoserve, including consideration of any known changes to services in the price control period. In addition, an allowance can be provided for potential changes, which by definition cannot be known with any confidence at the time the price control allowance is set. Each of these allowances would be captured under contracting Model A, the regulatory model. In addition, the approach envisages direct contracting between xoserve and users under contracting Model B for service variations. This may involve a new or changed service implemented as part of a UNC Modification and, as such, the modification process would need to be amended to establish the funding route. In principle this would cover which of the columns in the diagram the Proposal sits in, and a proposed structure and level of charges to be implemented as part of the Proposal – which may be an addition to an existing charge, or be a new, user pays, category. Great care would have to be taken to ensure the funding and governance arrangements were clear and simple, to avoid additional uncertainty, complexity and cost within the modification process.
- 5.18 The model also envisages change that is outside the governance of the UNC, for example a specific tailored service which a single Shipper may request from xoserve and which would consequently only be provided to that Shipper at an agreed price. This final category is closest to a non-regulated commercial agreement but would still need to comply with the established governance framework and would potentially be subject to Ofgem oversight. Finally the approach recognises that as new and enhanced services are provided and paid for under a Model B user pays approach, there is potential for xoserve to make excess profits through the use of regulated assets. The approach therefore also allows for an adjustment mechanism through sharing factors, leading to reduced charges for all xoserve users.



5.19 The Workgroup considered how charges (and refunds) might be allocated under a user pays approach. In some circumstances the volume driven services involved can provide a clear cost driver and usage measure which could support specific charges. However, in the interests of simplicity and cost minimisation development of a sharing methodology may be appropriate. Where a usage measure or the transportation charging methodology is not appropriate, a suitable proxy may be to identify the market sectors impacted and apportion costs by number of supply points or throughput across impacted market sectors, potentially with a weighting to reflect sector complexity. The Workgroup acknowledged that many other options existed, but attendees emphasised the importance of not creating unduly complex and hence expensive mechanisms. It was also agreed that an agreed sharing methodology could be included in the UNC or a Charging Methodology as part of the governance surrounding a user pays approach.

## **6. Service Standards**

- 6.1 Ofgem's Terms of Engagement recognise that the RPI-X framework provides a strong incentive to reduce costs. This incentive can be balanced by specifying a range of outputs and standards of service, which regulated entities are required to deliver. Ofgem asked the Workgroup to consider the service standards that should apply to core services.
- 6.2 The Workgroup considered the current standards applying to xoserve activities in three areas:
- (a) Transportation Standards - defined in the UNC.
  - (b) Availability and recovery standards – defined in the UK Link Manual.
  - (c) Volume constraints – defined both in the UNC and UK Link Manual.
- 6.3 Many of these standards are reflected in the Agency Services Agreement between xoserve and the GTs.
- 6.4 Having undertaken a review of the current standards, the Workgroup did not propose any change. The Workgroup recognised that if there was general dissatisfaction within the industry over the standard of service, the opportunity was always available for Users to raise UNC Modification Proposals. The absence of such Proposals was taken as an indicator of relative satisfaction with the present standards.

## 7. Governance

- 7.1 For a user pays model to be effective in funding existing xoserve services or promoting the introduction of new or changed services within a price control period, clarity regarding governance of the approach is essential. In particular, clarity is required regarding how agreement is reached on:
- (a) how much a service should cost, and
  - (b) who should bear the cost associated with that service.
- 7.2 For Model B to operate effectively, the Workgroup recognised the importance of transparent governance. In the event that Ofgem is minded to introduce a user pays funding mechanism, detailed governance arrangements would need to be developed and agreed prior to implementation. A potential approach is:
- (a) A framework for user pays services is developed and forms an ancillary document to the UNC – providing reassurance to stakeholders by defining the governance framework and providing a mechanism by which it can be developed and modified;
  - (b) Establishment of a Charging Methodology for user pays services – this would be agreed between GTs/xoserve and users and provide reassurance for users that there would be no inappropriate, anti-competitive behaviour since the methodology would be followed;
  - (c) An annual Charging Statement is published giving the charge applying to each established user pays service for the forthcoming year, together with information to support the level of the charge as derived in accordance with the Charging Methodology – this would cover only services provided to all users with those provided to one or a group of users excluded on the grounds of commercial confidentiality; and
  - (d) Users contract directly with xoserve for the delivery of services through a standard contract – requiring the development of a new contract but providing consistency as well as flexibility for the delivery of services.
- 7.3 The Workgroup felt that this approach was required only where a service line is delivered in a non-competitive environment. Where there is genuine competition for the service provided by xoserve, such that users could look elsewhere rather than solely approaching xoserve, then the Workgroup recognised that conventional commercial arrangements provided sufficient protection for users.
- 7.4 Each aspect of this outline governance framework is considered in the following sections. The Workgroup did not consider the framework contents in detail, but identified some areas that should be included:
- (a) Standard terms and conditions;

- (b) Process for contracting;
  - (c) Obligation to publish a charging methodology;
  - (d) Obligation to calculate and publish charges consistent with the charging methodology;
  - (e) Frequency of review of charges;
  - (f) Duty on transporters to ensure Transporter Agency enters into contracts on non-discriminatory basis; and
  - (g) Rights of appeal or determination.
- 7.5 Further more detailed work will be required to develop this framework, with implementation supported by a UNC Modification Proposal – facilitating industry wide consultation and development of any potential framework. The Workgroup recognised that modification of GT Licences may also be necessary, or at least desirable, to reinforce the framework.
- 7.6 The Charging Methodology would stipulate how the charge for a user pays service would be evaluated. It was proposed that the fixed and variable elements of allowed xoserve costs be apportioned to service lines using an agreed methodology. The charge for a service line would be based on the variable costs (including financing costs with respect to capital investment) associated with the particular service, new service or service enhancement, plus a proportion of the fixed costs associated with the service line. The proportion of fixed costs would need to balance the incentive on xoserve to provide services against the risk of stranding costs.
- 7.7 Forecast volumes for the charging year would be used to derive a unit base charge for the service which was to be subject to a user pays approach. The Workgroup felt that future volumes are likely to be lower than at present if a service is moved to a user pays model since companies would naturally look to maintain and enhance their competitive position in light of the changed approach. A margin would also be applied to all base charges reflective of the risk associated with delivery of the service line.
- 7.8 The charging methodology could also enshrine requirements such as being non-discriminatory. Further work would be required to develop and consult the industry regarding the detail of any such Charging Methodology.
- 7.9 For changes to services, the funding arrangements need to be clear before commitments are made by GTs, xoserve and users. For user requests, whether supported by a UNC Modification Proposal or a direct agreement with xoserve, the Workgroup assumed that user pays charges would be agreed by the users involved in accordance with the framework established within the UNC. If a subset of Users are requesting and funding the provision of a service, and consequently funding the development cost, then the framework would need to

commit to a 'buy-in' arrangement to enable charges to be adjusted in the event of late entrants seeking to utilise the service.

- 7.10 For UNC Modifications, the proposed funding route and consequent cost sharing between stakeholders would be part of the UNC modification process and would only be implemented following direction by Ofgem. Ofgem's directions would, therefore, need to establish which of the potential funding routes apply in each case. There is a risk that industry developments will be delayed by debates about funding shares, and additional costs incurred because of abortive impact analysis work by xoserve to generate the information needed to support debate on the likely level and structure of any user pays charge. The Workgroup agreed there would be merit in ensuring the governance was clear such that such debates and additional costs were minimised. For example, by providing for set categories of service into which each proposed change would sit, the appropriate funding and sharing mechanism would flow automatically according to the category of change involved.

## 8. Progress With Deliverables

8.1 Against the background of the information provided in this final report, the table below summarises the progress made by the Workgroup against the eight deliverables specified in the Terms of Engagement.

a) High-level features.	High-level features accepted group did not identify any existing features that are likely to become redundant.
b) Costs to fund UK Link replacement.	No change to existing cost estimates. Shippers not well placed to validate cost estimates. Recognition that mechanism is required to allow for future change.
c) GT Operating efficiencies.	Any efficiency gains will be in DN price control period 2013-2018.
d) User pays principles	Set of high level principles established.
e) Core and user pays services	Candidate user pays service line categories have been identified but further development and cost benefit analysis is required to prior to identifying the feasibility of individual user pays items.
f) Proportion of xoserve's costs that are core	All existing services are core but more detailed discussion of the user pays approach may identify benefits from applying a user pays approach to some core services.
g) Service standards	No change proposed as part of the Workgroup process.
h) Governance arrangements	Outline approach identified with detail to be developed if Ofgem believe this is worthwhile.

8.2 The Workgroup felt that within the timescale for the dialogue it was not possible to draw firmer conclusions on the deliverables and that further more detailed discussion and development would be needed before a user pays approach could be adopted, as outlined in Section 11.

## 9. Issues and Risks

This Section provides an overview of some key issues and risks associated with the potential introduction of a user pays approach as identified by the Workgroup.

- 9.1 Significant additional work would be required to establish a sound framework for a user pays approach, were Ofgem to decide that implementation is appropriate. Targeting implementation to coincide with implementation of the GDPCR process would create an extremely challenging timetable, which would not allow for sufficient industry consideration of the approach and introduce a risk that the best solution would not be implemented.
- 9.2 Implementation of a user pays approach would introduce additional complexity into the existing processes, and consequently additional cost. Extra administrative costs would arise for xoserve and Shippers through monitoring, invoicing and invoice queries associated with user pays charges. Extra costs would be added to the Modification process for all involved. These additional costs might outweigh any benefits accrued.
- 9.3 If a process is implemented which requires detailed payment arrangements to be debated and agreed as part of the Modification process, there is a risk that this will add to the time (and consequently cost) taken for change to be developed and implemented; that xoserve would incur additional costs to carry out impact assessments and establish the level of user pays charges; and that parties may be discouraged from raising UNC Modification Proposals. The need for user pays arrangements to be established could have an impact on the Urgent Modification process.
- 9.4 There is a risk that a user pays approach could create inappropriate incentives. For example, if applied to queries raised, query submission levels could drop due to Shippers seeking to save costs, thereby having an adverse effect on industry data quality. As data quality inaccuracies can be the result of a previous Shipper's failure to discharge its obligations fully, the introduction of a transaction charge for this service could also present the incoming Shipper with unreasonable costs for carrying out the remedial activity to correct the data and so discourage competition.
- 9.5 If a user pays charge is introduced with respect to User Admission & Termination, there is a risk that this could discourage competition because new entrants could view this as a barrier to entry. Similarly the introduction of further charges on participants who wish to exit the industry, beyond those of undertaking due UNC procedures, could be viewed as excessive and unwarranted.
- 9.6 There is a risk that if a user pays charge is levied in respect of telephone calls to the Information Centre and email enquiries, there would be increasing usage of the Internet Access to Data (IAD) service which may experience unmanageable volumes. There is also a risk that queries/enquiries would be raised directly via ConQuest and/or a large increase in S47

(Nomination Enquiries) or S48/S49 (Nominations) IX batch transactions, placing increased pressure on the UK-Link system itself.

- 9.7 There is a risk that the xoserve's revenue from user pays charges may be unreasonably high or low. For example, if Shipper A and Shipper B request the same service (or one of such a similar nature), xoserve might charge each as if they were the only recipient and so be over-rewarded (neither recipient would have information which would allow them to know they were being charged fairly for the development of the service requested). Equally If the forecast volumes on which the usage charge has been based and the actual take-up volumes of the service do not closely align the expected revenue will not be adequately recovered, especially if the introduction of a charge leads to a reduced level of take-up.
- 9.8 There is a risk that funding of the UK Link Replacement may not be set at an appropriate level and a suitable mechanism will not be adopted to provide funds to reflect industry agreed changes to its scope. There is a risk that this effectively inhibits beneficial development of UK Link as part of the replacement design.
- 9.9 There is a risk that no appropriate mechanism will be implemented which provides appropriate funding for future UNC changes and that there will be insufficient transparency regarding the extent and cost of change which has been reflected in price control allowances. This potentially discounts areas of potential industry change/reform i.e. AMR/Individual Supply Point Reconciliation and leads to a lack of transparency at the onset of a formula period.
- 9.10 There is a risk that there would be insufficient clarity of the potential governance of user pays arrangements between UNC obligated services and commercially driven services.

## 10. Conclusions & Recommendations

- 10.1 There is likely to be significant regime change before, coincident with, and after the replacement of UK Link scheduled for 2012. The Workgroup considered it impossible to define with any confidence the likely business requirements of such undefined change, especially in sufficient detail to enable reliable cost estimates to be made. It was recognised, that certain changes in the commercial regime and/or improvements in User functionality will undoubtedly occur and should be accommodated as part of UK Link replacement and these should be funded appropriately. The approach recommended by the Workgroup was to fund the high level features as agreed by the Workgroup via traditional price control allowances, undertake more extensive consultation prior to 2010, and thereafter utilise a mechanism for funding any agreed additional regime changes.
- 10.2 Shippers considered that they would not be in a position to assess the reasonableness of UK Link replacement costs and a traditional price control approach, with an estimate of efficient costs established by Ofgem, should be adopted. Any operating cost efficiencies are not expected to be realised prior to 2013.
- 10.3 The Workgroup has developed a more detailed understanding of the governance and charging framework that would be required for user pays services to be introduced and operated, but significant additional development work will be required before the feasibility of any user pays service lines can be assessed and, if appropriate, implemented. The Workgroup has proposed criteria for identifying existing user pays services; a contracting model and a governance approach that would provide the necessary reassurance and transparency to stakeholders. However, significant risks and issues have been identified in this report. Workgroup attendees have emphasised that these would need to be resolved and the impact quantified prior to organisations being able to offer support to introduction of a user pays approach. Appendix 6 summarises these issues and risks.
- 10.4 The Workgroup proposes no change to standards of service as a result of this dialogue. Any such change can be proposed as part of the existing arrangements.
- 10.5 The Workgroup recognised the importance of funding ongoing change to central information systems so that barriers are not created to the further development of the commercial regime. If transporters are not allowed revenue at the start of the price control period to fund such changes, then a mechanism is required to recover incremental costs from users, either through direct, user pays, charges with the revenue treated as excluded from the price control, or through transportation charges supported by an adjustment to allowed revenues.
- 10.6 The Workgroup identified that certain service lines, such as query management, may be suitable for charging on a transaction basis but it was not believed that the revenue from these would be substantial. Likewise, the efficiency benefit derived from changes in user behaviour would be small. There is a risk that the additional complexity and cost of introducing transaction

charges may outweigh the benefits, and the Workgroup recommends that an impact assessment accompanies any proposal to introduce user pays charges in order to provide an opportunity for full consultation and reassurance that the benefits will outweigh the costs.

## 11. Next Steps

11.1 The Workgroup strongly recommended that further detailed work would be required prior to implementation of any revised funding and governance arrangements in line with user pays principles. This section sets out a proposed course of action which could help to establish a suitable framework and identify not only services which might be funded by a user pays approach but also the structure of the associated user pays charges. This is, however, dependent on a decision by Ofgem as to whether or not it is appropriate for a user pays approach to be adopted. In the interests of efficiency and economy, it is suggested that further development should only be undertaken after Ofgem confirms the way in which it proposes to reflect a user pays approach in price controls.

11.2 Across all of the current 242 service lines:

- Identification would be carried out by the GTs of which services they consider are most appropriate for a user pays approach, and a recommendation made as to which should be pursued
- Agreement of the services to pursue would be sought from users and subject to final approval by Ofgem
- Cost forecasts would be prepared for each of the service lines recommended for user pays by the GTs.

11.3 A detailed analysis would be conducted to evaluate how user pays funding of any system changes would be applied. This would be agreed by GTs and shippers prior to final approval by Ofgem.

11.4 The contractual and governance framework would be developed by the GTs and Shippers in agreement with Ofgem. Following this agreement the GTs would, through the UNC Modification Process, raise and progress:

- The required UNC Modification.
- The xoserve services Ancillary Document

This assumes that the primary governance would be through the UNC. Alternatively amendments to the GT licences would be proposed by Ofgem through the normal licence modification procedures.

A standard xoserve-shipper contract would be drawn-up and agreed which was consistent with the provisions of the UNC and/or licence.

11.5 Under whatever terms are provided within the UNC and/or licence, the charging methodology would be prepared and consultation would take place.

- 11.6 Following approval of the charging methodology, the GTs or xoserve would issue the charging statement which would conform to the charging methodology and consultation would take place in accordance with the process set out in the UNC and/or licence.
- 11.7 The following high level timeline illustrates how these processes might fit together. The Workgroup believe this timeline is extremely challenging and relies on the necessary clarity being obtained at each stage of the process, and that it may be more practical for user pays services and funding to be agreed as part of the current price control review discussions for implementation during the price control period rather than necessarily being introduced on 1 April 2008. Some Shippers attending the Workgroup wish to emphasise that pursuing this work, especially within a tight timescale, would require shippers to dedicate scarce resource to this issue for little apparent benefit.

	2007												2008							
	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A				
<b>Direction from Ofgem</b>	[Redacted]					<i>Report submission and feedback from Ofgem</i>														
<b>Finalise existing services/usage/costs</b>	[Redacted]					<i>Estimation/ quantify services, accurate cost breakdown of services, identify additional effort, financial assessment/ reckoning</i>														
<b>Supporting documents &amp; frameworks</b>	[Redacted]									<i>Charging methodology &amp; statements, UNC documents &amp; changes</i>										
<b>Internal changes</b>	[Redacted]												<i>Mechanism for monitoring service usage, contracts developments, communication processes, cash collection &amp; credit management, system changes</i>							
<b>Modification process</b>	[Redacted]																<i>Appropriate agreements, mechanisms and changes (to UNC and</i>			
<b>New Price Control period</b>	[Redacted]																[Redacted]			

## Appendix 1 – Comments Received from Companies and Organisations

### British Gas Trading

British Gas Trading (BGT) would like to take this opportunity to provide its view on the output from the Work Group, specifically with regard to the eight deliverables as defined within the groups terms of engagement.

#### **a) the high level features of the central information systems following the project to replace UK Link, including whether any existing features are likely to become redundant.**

BGT strongly believe that the UK Link replacement project provides the industry with an opportunity to thoroughly review existing practices and governance and provide a platform to deliver industry reform, which is beneficial to the industry as a whole.

The current position, that the scope for the UK Link replacement system is a like for like replacement of the current functionality within UK Link, is not satisfactory and does not provide an all important and necessary forward looking view of the structure and future development and reform of gas industry arrangements.

The current UK Link system was designed and implemented in 1996 and the new replacement system is due to be implemented in 2012. With the level of change which has occurred across the gas industry over the past ten years, the ongoing reform that will undoubtedly occur in the future and an assumption that the replacement system will have a similar shelf life as the current system, it is not practical to potentially develop a new system which has the same level of basic functionality in line with current arrangements.

We would consider this to be a shortsighted approach, with the potential risk that a future system being in existence in 2022, which is not fundamentally different to that which was originally introduced in 1996.

The industry should therefore take this opportunity to ensure that the replacement system is not only fit for purpose to deliver gas industry arrangements as they are defined today, but more importantly are appropriately future proofed. It is therefore essential that the issue of appropriate levels of funding and the arrangements for delivering this be properly considered.

BGT believe that it is a fair assumption to make that the gas industry and its governance arrangements will not remain static over the next five years and that an amount of fundamental change and/or reform will be developed and implemented. A number of areas of potential change/reform have been identified by the xoserve during the work of the group, including:

- AMR
- Meter Point Reconciliation of Smaller Supply Points
- Significant changes to the structure of transportation charges
- Change to the AQ Review process
- Changes made from the review of Supplier Licences
- Provision of SPA service for Independent Gas Transporters
- Sub-division of LDZs

It is therefore essential that future change/reform should be considered now, and not only limited to the aforementioned, as the output of industry change/reform could lead to existing features of UK Link becoming redundant or fundamentally changed.

As part of its discussions the group identified that changes/reform can be initiated from numerous sources and at times, at relatively short notice or with short implementation timescales. Further that

the industry has to react to statutory, mandatory and regulatory change as and when it occurs, in addition to ongoing changes raised by market participants and that ultimately this should be considered appropriately as part of this debate.

**b) the level of costs that Ofgem should include in price control allowances to und the project to replace UK Link.**

Further to our comments provided under a) above, it is important that the issue of future industry change/reform is recognised and that an appropriate funding mechanism is developed and agreed as part of the price control allowance consultation exercise, to enable and ensure that the costs associated with any future change/reform, which takes place during the design specification phase of the UK Link replacement project and has an impact on such, is allowed for.

BGT concur with the group's view that Shippers are not in a position to assess the reasonableness of the initial cost estimates, provided by xoserve, associated with the replacement of UK Link.

Further we believe that the costs associated with the development and implementation of the UK Link replacement system, should be fully funded by price control allowances and should include any additional functionality that is identified, via industry change/reform, over and above the basic 'vanilla' like for like approach currently being proposed.

**c) the level of GT operating efficiencies that are likely to be achievable following the project to replace UK Link.**

We agree that at this time it is not possible to identify any specific efficiency gains and that these should be delivered post implementation of the replacement system in 2012, during the following price control period. However, we believe that the issue of operating efficiency should be an ongoing and fundamental part of the work undertaken by the UK Link replacement project and that operational savings need to be understood so they can be captured and considered at the appropriate time.

Consideration should also be given to the impact to the industry as a whole i.e. in some circumstances higher costs to Gas Transporters may produce lower industry costs and deliver benefit to customers.

**d) the principles that should be used to determine whether a service should be treated as a core service or user pays (in the event that a user pays approach is adopted).**

BGT concur with the issues detailed within the Issues and Risks element of the report and would like to add that although a set of high level principles were identified, the output of the work to date is inconclusive and that further detailed work would be required prior to any agreement being reached, as detailed within the Next Steps element of the report.

**e) which services should be treated as core services and which (if any) services should be subject to user pays.**

Through its work to date, the group has identified five candidate service lines, all of which require further discussion and development before individual Shippers would be in a position to provide a clear and objective view on exactly which service lines could and should be subject to user pays.

By default, service lines which are not ultimately deemed as user pays, should be treated as core services. Shippers currently find themselves in a position where they cannot provide any definitive indicators for or against a user pays mechanism, and will be unable to provide such a view until they know exactly what the governance arrangements, charging methodologies and the unit charge costs for each potential user pays service will be.

Further consideration should also be given to efficiency incentives and cost reflectivity i.e. to ensure that there is an appropriate level of visibility of xoserve costs going forward, to ensure that Shippers can assess whether charges are cost reflective.

**f) the proportion of xoserve's costs that should be associated with core services in the event that user pays funding arrangements are adopted.**

BGT agree with the group's view at this time that all existing services remain core.

The group were provided with details of the costs associated with xoserve service lines, which in turn enabled xoserve to provide the group with some indicative unit charges costs for the five candidate user pays service lines.

It is important that only costs associated with the delivery of a specific user pays service line, be included within user pays funding arrangements and recovered ultimately via the associated unit charges and excluded from funding provided for core services. There is also a requirement to ensure that the core services provided by xoserve are not undermined and that the allocation of revenues is appropriate.

The costs associated with the monitoring and delivery of user pays services are currently unknown and will need to be clearly identified and detailed as part of the evaluation work required to assess the benefit and appropriateness of the delivery of any user pays service.

**g) the service standards that should apply to core services..**

BGT agree with the view of the group not to propose at this time, any change to the existing service standards, as defined within the UNC and UK Link manual. However, individual parties are able to raise modification proposals as appropriate should this area need to be addressed in the future.

It may also be prudent to revisit this area as part of the design and specification process of the UK Link replacement system.

**h) the governance arrangements that could support a user pays model.**

Although an outline approach to potential governance arrangements has been identified by the group, it is clear that there is a lot of further work which needs to be undertaken before a definitive governance model could be developed and be formally consulted upon.

Prior to further, detailed work being initiated, the concept of whether a user pays service is viable needs to be established. We suggest that any governance model would need to reflect that those utilising user pays services expect a degree of influence within the governance arrangements.

As part of the user pays discussions, BGT have had concerns over the perceived move by Gas Transporters to apply a user pays approach to all future industry changes to systems (which flow from UNC modification proposals) from April 2008. There are clearly differing views within the group as to how changes should be funded i.e. under the existing arrangements against user pays principles for all change.

As discussed by the work group, although UNC modifications are raised by either a GT, Shipper or an authorised Third Party, the source of these modifications can be driven by other influences such as legislation changes or wider industry reform changes (e.g. Ofgem, DTI) to the consumers benefit. It would therefore be inappropriate in the future to label all user-initiated changes as 'user pays'. Indeed changes raised by users may also provide savings or efficiencies to GT's.

Any move away from the existing arrangements, where the majority of changes resulting from approved UNC modifications are progressed as Class 2 changes, towards a regime where user pays principles exist for all change, will provide an additional level of uncertainty, complexity and cost to the modification process. It may even stifle the raising of change and industry reform by industry participants.

Modification proposals do not currently and will not in the future fall neatly into the illustration detailed with 5.17 of the report, as regardless of who raises a proposal, the benefit of such will not always solely lie with the proposer.

It is BGT's view that clarity is required in this area and that a clear distinction is made between user pays principles associated with service lines and industry change.

## RWE npower

RWE npower is of the opinion that Query Management Services (section 5.4a) should remain a core service as detailed within the ASA and UNC. The services provided to the industry are of benefit to all parties and any change to the existing regime would incur unnecessary costs in terms of development and implementation, user pays charges and ongoing administrative costs to track and monitor usage for validation purposes.

RWE npower is of the opinion that proposals for all changes to be funded through a user pays mechanism is not viable and will result in a negative and damaging approach to change development.

For example;

The Health & Safety Executive (HSE) introduces a number of changes to existing Gas Emergency arrangements, the change will have the following impacts:

- Changes to processes & procedures
- Changes to file formats
- Changes to timescales
- Changes to reporting
- Changes in communication methods

The above change has been driven by the HSE and other regulatory bodies and the reasons for implementation and the benefits of which have been debated, discussed and agreed at an industry level. The change will mean changes to both Gas Shipper/Supplier and xoserve systems as well as associated processes and procedures.

In this instance Gas Shipper/Supplier costs to implement the change internally could potentially be high without the requirement to also fund the changes to xoserve systems through a user pays charge. In this example xoserve would need a mechanism to fund the costs of making the necessary changes to its systems and associated processes, etc. The most viable route of acquiring the required funding is through an allowance adjustment mechanism with the costs scoped and documented as a result of industry consultation and review.

A further example of the difficulties associated with the introduction of a user pays funding model could be the implementation of Modification Proposal 006. This Proposal was raised by energywatch on behalf of consumers and, whilst related to AT Link/Gemini systems as opposed to UK Link, it is not unreasonable to assume that energywatch may in future seek information provision about UK Link related transactions and processes which require a similar level of system development. Modification Proposal 006 was of no direct benefit to National Grid NTS and was not supported by the majority of Shippers. In the event a user pays model had been in place it is difficult to see how Shippers would have agreed a mechanism for sharing the material system development costs arising from implementation of this Modification Proposal, nor why they should be obliged to pay for them.

## Scotia Gas Networks

SGN is supportive of efforts to consider and define a possible high level framework whereby:

- existing and new xoserve services, provided for the benefit of all parties or the gas market generally, should be funded through allowances in the DN and NTS price controls and charged to Users,
- incremental changes, determined to be required for the specific benefit of a User or group of Users should be funded by those Users that request and /or benefit from that service.

We believe this would improve efficiency by providing appropriate cost signals to those requesting the change and provide an incentive for Users to reduce the cost burden for all participants. Where developments are determined not to improve overall efficiency, they would be funded by those specifically requesting the change. This will help ensure more appropriate cost targeting and ensure participants are not exposed to inappropriate or unnecessary costs for changes they do not support or will not benefit from.

SGN also believes a “user pays” model would help address our concern that at present Transporters bear the entire funding risk, particularly in relation to Shipper or Third Party Modification Proposals, where we have limited control or influence over whether, how and when change is implemented. This is a particular issue where changes are introduced mid price control as no funding arrangements will have been provided. We support the Workgroup’s suggestion that a mechanism may be appropriate to allow Transporters to adjust allowable revenues and recover incremental costs not included in the price control, where specific Users have not been identified.

SGN agrees that should Ofgem determine there is merit in pursuing a “user pays” approach, a considerable amount of detailed work is required to determine those services that it would be appropriate to fund through a “user pays” mechanism but also to develop a contractual and regulatory framework to support such a regime. We believe wider industry consultation is required before details are developed further and a full impact assessment would need to be undertaken. We believe it would be extremely challenging to complete this work to coincide with the forthcoming GDPC; initial proposals are due to be published in May 2007 and final proposals are currently scheduled for December 2007. However it may be appropriate to consider an approach which retained price control funding for existing services and introduced “user pays” arrangements for new or incremental services, which would be treated as excluded services for price control purposes. This could be introduced at an appropriate point within the next price control period. This could then be monitored with a view to potentially implementing a “user pays” model, that could include appropriate existing core services for the following price control period commencing 2013. At the same time further consideration could be given to whether xoserve should be separately licensed. Such initiatives could be considered as part of the industry consultation on UK Link business requirements prior to completing a detailed design of its replacement. This is scheduled to commence in 2010.

We note that some Shippers have expressed concern that a “user pays” arrangement will introduce additional uncertainty, complexity and cost to the modification process. We believe such concerns can be addressed and need not be to the detriment of all. As mentioned above, we believe a “user pays” model should help ensure changes bring tangible additional benefit either for all participants or a specific group of participants, and such information should be taken into account when determining implementation and funding. However we acknowledge concerns regarding potential complexity and believe it is important that a balance is struck to ensure overall efficiency. We acknowledge proposals won’t always fall in to neat categories and there will on some occasions be different views on beneficiaries and funding. We believe it is essential that such issues are taken into account in developing arrangements but as a general rule they should be addressed at the Modification Proposal stage. Under a “user pays” model the benefit should only be realised by those willing to pay. Likewise funding should be by those likely to benefit. In this way arrangements should be fairer, reducing potential for cross subsidy and free riding.

In summary, we believe Transporters must be able to recover costs associated with existing services through the price control mechanism for the forthcoming price control period. It is also important to ensure that the provision of non-core services won’t in any way impact on our ability to provide such core services, particularly where we have contractual or regulatory obligations to provide such services and service levels are attached. It must be recognised that in any period there will be a finite level of resource available to consider and implement changes. It would not be in participants’ interests to allow non-core services to be implemented to the detriment of essential core business activities. This will need to be taken into account in considering the priority level and implementation timescales and funding arrangements for non-core services.

## **Scottish and Southern Energy**

SSE supports the main conclusions contained in the final report produced by the Workgroup. Assuming further work on ‘user pays’ is agreed we think it is important to prioritise effort. From the

initial work done only a limited number of service lines were identified as potential cases for 'user pays' and even for these there is a question mark as to whether they would satisfy the fourth criteria i.e. the benefit from treating the service line as user pays outweighing the cost of the additional complexity of a user pays regime. Additionally the costs to xoserve of currently supporting these service lines do not appear to form a significant part of their total budget. We would therefore support concentrating effort on the arrangements for funding change to central systems. We see this as critical not only when considering industry requirements as part of the forthcoming UK Link replacement but also to help with any change proposals prior to the UK Link replacement which will be more difficult to justify the nearer we get to the date when UK Link is replaced, indeed at some point we can envisage a cut off with such proposals having to be added as potential enhancements to the UK Link replacement project.

## **Wales & West Utilities**

Wales & the West have played an active part in the xoserve services workgroup and are supportive of the conclusions and recommendations contained within the final report and in particular the move to a user pays environment in a timely but controlled manner. Although all the deliverables have not been fully completed a significant amount of work has taken place in determining the next steps and possible future framework for user pays arrangements. In conjunction with the impact assessment being carried out by Ofgem we hope that this work will continue and the concept of user pays brought to fruition. Key areas of work that need to continue are establishing the level of current services that could transfer to user pays and, more crucially, a framework and governance arrangements for future industry change. Under the current regime it is the GTs that are subject to financial risk as a result of changes requested by shippers. This is obviously a position which is inappropriate and that cannot continue. Wales & West Utilities would welcome the opportunity to participate in future dialogue as recommended within the final report.

## **xoserve**

xoserve supports the conclusions and recommendations of the Industry Dialogue on xoserve Services as contained in the final report prepared by the Workgroup. In particular, we would like to emphasise the need for clarity and transparency in the arrangements for funding change to central information systems in order to avoid frustrating the change process. The opportunity to improve industry processes presented by the need to replace UK Link will be missed if funding routes are not clearly defined.

The quantitative impact assessment planned by Ofgem will be crucial in determining the priorities for user pays. There is likely to be considerable further work required to develop the governance arrangements, in particular the contractual issues. We are very happy to continue to play a full role in the next steps as proposed in the report.

## **Appendix 2 – Terms of Engagement**

The objective of the dialogue is for industry to reach an agreed position on what central information system services are required, the level of costs, how the associated costs should be met, and the service standards that should apply to key services.

### **Group composition**

The dialogue could take the form of a working group of industry representatives; however it is up to participants to decide how best to progress discussions. We expect shippers, GTs, National Grid NTS, xoserve and IGTs to participate in the industry dialogue. We would also expect other interested parties, in particular consumer representatives, to have the opportunity to participate if they wish. The group should comprise a diverse and balanced representation of different interests, including both large and small, domestic and I&C shipper representatives. Participants in the dialogue should be of a suitable level of seniority to be able to represent their organisations.

### **Issues to be considered during the industry dialogue**

We expect the industry dialogue to cover five key areas:

1. Features of xoserve's systems - the high level features of the gas industry central information systems following planned IS projects,
2. Cost requirements - the level of costs that dialogue participants are willing to incur in order to receive xoserve services,
3. Xoserve funding arrangements - which of xoserve's services should be funded through the price control,
4. Service standards - the service standards to be associated with core services, and
5. Governance - the governance arrangements that could be used to support a user pays approach to the funding of xoserve.

### **Features of the xoserve's systems**

A key objective of the industry dialogue is to create an opportunity for GTs and shippers to reach an agreed position on the high level features of major IS projects planned for the price control period, in particular the project to replace key elements of the UK-Link suite of systems. In particular, shippers should have the opportunity to discuss what functionality they are willing to pay for through transportation charges and what functionality they consider imposes excessive costs on their business.

As part of this discussion, participants in the industry dialogue should also consider whether there are any services that should be explicitly excluded from the scope of the gas industry central systems, and whether any elements of the existing systems are redundant.

The project to replace UK-Link is not scheduled to occur until several years into the next price control period. Ofgem does not expect agreement on the detailed aspects of the project. The dialogue should aim to achieve a sufficient level of detail to enable cost estimates to be prepared for the purposes of setting price control allowances.

### **Cost requirements**

Both GTs and shippers should consider the costs associated with a given level of functionality. The industry dialogue should reach a view on a reasonable level of costs required to carry out the project to replace UK-Link and any other major IS projects planned for the price control period. It should also seek to quantify, at a reasonable level of detail, any reductions in xoserve's operating costs that could be expected to arise following the project.

In order to form a view on the expected level of costs, it may be necessary for relevant parties to make commitments regarding the process going forward. For instance, it may be necessary to set a deadline for conclusion of negotiations on the detailed aspects of the project to replace UK-Link.

### **xoserve funding arrangements**

The GDPCR Second Consultation Document consults on a number of options for the funding of xoserve, including a user pays approach. In the event that a user pays approach is adopted, it will be necessary to decide:

which of xoserve's services should be core services (and hence funded using ordinary price controlled allowed revenues) and

which of xoserve's services should be subject to user pays (and hence treated as excluded services for price control purposes).

While Ofgem has not yet made a decision on the funding of xoserve, it is appropriate to develop a more detailed understanding of how a user pays option could look. The dialogue should consider the principles that should be applied in order to determine whether a service should be treated as a core service or a user pays service.

Once a view on the principles has been established, the dialogue should apply these principles in order to form a view on which services should be treated as core services and which should be treated as user pays. It will be necessary to consider both xoserve's current set of services and, at a relatively high level, xoserve's future services during the next price control period (for instance following the project to replace UK-Link).

In addition, the dialogue should reach a view on what proportion of xoserve's costs should be attributed towards the provision of core services/user pays services (see below). It will be necessary to consider both the services that xoserve currently provides and, at a relatively high level, xoserve's future services.

### **Service standards**

The RPI-X framework provides a strong incentive to reduce costs. This incentive can be balanced by specifying a range of outputs and standards of services which regulated entities are required to deliver.

The industry dialogue should form a view on the service standards that should apply to core services. Dialogue participants may decide that it is overly cumbersome to develop a formal service standard to apply to each individual core service, and develop an alternative set of arrangements.

As part of this process, dialogue participants should review the service standards set out in the UNC. GTs and shippers may conclude that it is appropriate to amend the UNC to reflect the outcome of discussions.

### **Governance**

For a user pays model to be effective in promoting the introduction of services between price control reviews, the parties need to be able to agree:

how much the service should cost, and

who should bear the cost associated with the service.

We welcome the views on how the governance regime could work, including whether the arrangements would form part of the UNC, the SPAA or some other vehicle, and the process that would be followed in order to establish a user pays service.

## Deliverables

Nominated representatives (including at least one transporter and one shipper representative) should provide a presentation to Ofgem during early December 2006. The presentation should describe the structure of the report to be provided to Ofgem, and progress so far.

The final product of the industry dialogue should be a report that:

1. describes how dialogue participants have fulfilled the terms of engagement,
2. sets out an agreed view on:
  - a) the high level features of the central information systems following the project to replace UK-Link, including whether any existing features are likely to become redundant,
  - b) the level of costs that Ofgem should include in price control allowances to fund the project to replace UK-Link,
  - c) the level of GT operating efficiencies that are likely to be achievable following the project to replace UK-Link,
  - d) the principles that should be used to determine whether a service should be treated as a core service or user pays (in the event that a user pays approach is adopted),
  - e) which services should be treated as core services and which (if any) services should be subject to user pays,
  - f) the proportion of xoserve's costs that should be associated with core services in the event that user pays funding arrangements are adopted,
  - g) the service standards that should apply to core services, h the governance arrangements that could support a user pays model, and
3. lists which companies and organisations agree/disagree with the views expressed in the report.

The deadline for the draft report is 19 January 2007, with the final report to be submitted by 23 February 2007.

### Appendix 3 – Workgroup Meetings

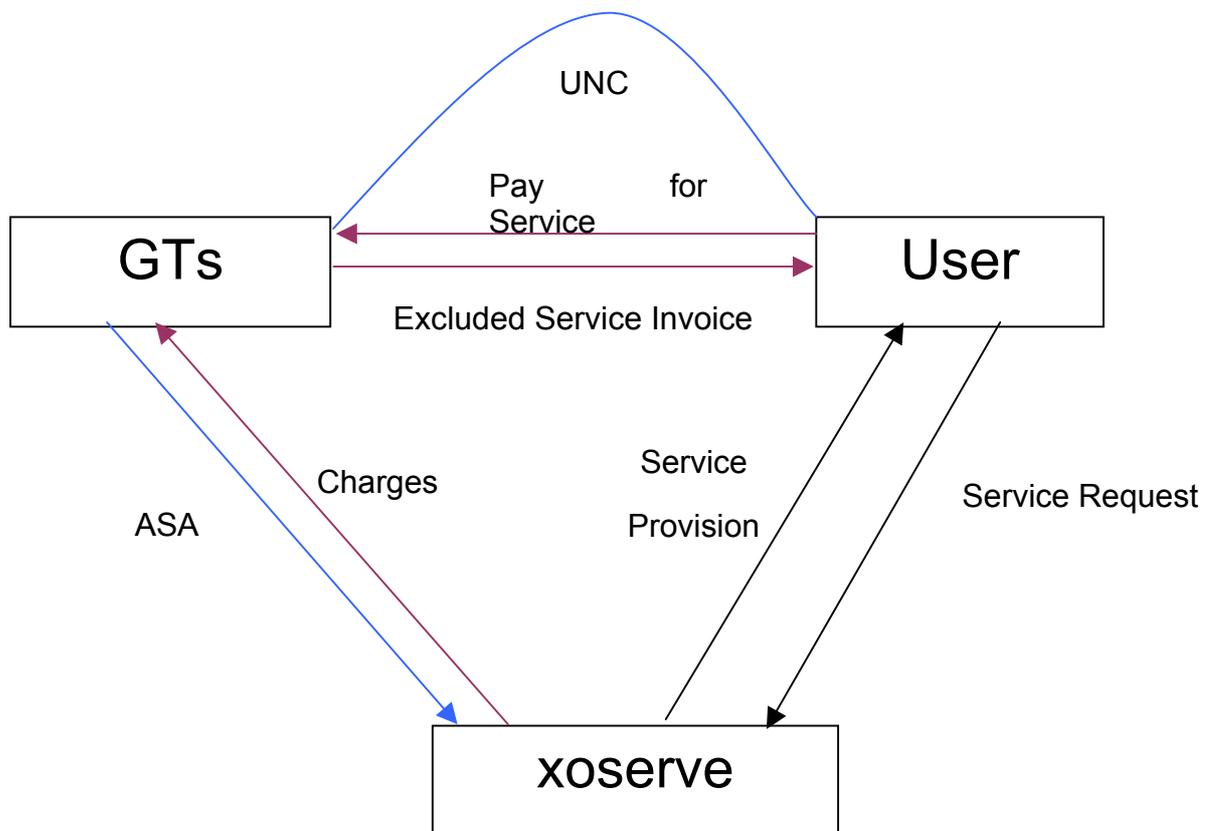
Date	Areas Covered
9th October 2006	- Introduction, Background and Terms of Engagement.
24th October 2006	- Work Plan, Review of Service Lines, Service Standards.
8th November 2006	- Cost Implications, Principles and Governance of User Pays.
22nd November 2006	- Review of Service Lines Against User Pays Principles, Operating Efficiencies.
5th December 2006	- Progress Report to Ofgem.
12th December 2006	- Update from Ofgem Meeting, Outstanding Issues.
10th January 2007	- ASA Service Cost, Governance and Charging Methodology, Indicative Charges, Final Report
31st January 2007	- Review of Draft Final Report.
13 <sup>th</sup> February	- Final Report agreement.

## Appendix 4 – High Level Features of UK Link Replacement

- Supports service lines currently defined in the ASA and associated UNC processes.
  - Systems to support service lines with improved efficiency and flexibility
  - Assumption of same service lines as at present
  - Consistent services and obligations across all distribution networks.
  
- Scope to improve interfaces with users in order to make use of new technologies.
  - Replacement will evaluate best possible solutions to benefit users
  - Mechanism tailored to nature of interface
  - Aim to improve user interface at minimal cost.
  
- Design intended not to preclude the potential integration of SPA processes for iGTs.
  - Design will avoid features that could be barriers
  - Cannot be guaranteed where future regime is uncertain
  - Design to ensure no reduction in service standards to existing users.
  
- Assumed no major change in transaction rates.
  - System will be built to accommodate estimated future transactions
  - Based on assumption that process numbers are to be similar to that at present.
  
- Flexible design to reduce the cost of likely future change.
  - Data model will be aligned to business model
  - Modular design will limit the scope of inputs resulting from future change
  - Intention to design system so as to reduce the process time to implement changes.
  
- Sufficient storage capacity to meet future data growth for the next five years.
  - Assumption based on current transaction rates
  - Existing data retention policies will be applied
  - Storage capacity to ensure no loss of system performance.
  
- No significant regime changes before commencement of replacement. Assumed that the following regime changes are not included in the high level features:
  - AMR
  - Meter point reconciliation of smaller supply points
  - Significant changes to the structure of transportation charges
  - Change to the AQ review process
  - Changes made from the review of supplier licences
  - SPA for iGTs
  - Sub-division of LDZs.

**Appendix 5 – Contracting Models**

**Model A**



**Model B**

