

FGO

DSC – Liability of CDSP

1 Background

1.1 Introduction

1.1.1 This paper discusses the issue of liability of the Central Data Services Provider (CDSP) to core customers (ie UNC parties) under the Data Services Contract (DSC).

1.1.2 The framework in which the CDSP is being established is as follows:

- (a) a new licence condition in the Gas Transporter licences will require the establishment of the CDSP and the DSC;
- (b) the CDSP's Board will comprise directors nominated by its core customers (ie shippers, GTs, IGTs). The direction and policies of the CDSP will be set by the Board;
- (c) the CDSP will be 'not-for-dividend'. Services to core customers are provided (in effect) at cost.¹ Losses of the CDSP are passed to the core customers;
- (d) the shareholders of the CDSP (as such) will have no financial interest in the CDSP (in terms of profits or losses) and will not control its Board;
- (e) as a result, the CDSP will in effect be a mutual company whose stakeholders (and economic owners) are its core customers; and
- (f) core customers will have visibility of the CDSP's risk management approach under the contract management provisions of the DSC.

1.1.3 This paper sets out some relevant background factors and then looks at different possible kinds of liability of the CDSP.

1.2 Mutual CDSP

1.2.1 As above, the CDSP will in effect, be a mutual organisation, which cannot distribute a profit to, or recover losses from, its shareholders. Its charges to core customers are set to recover all of its costs, including liabilities and losses (net of any amounts recovered from any other person). It follows that any liabilities which the CDSP is liable to pay will be funded by the core customers. Liabilities cannot operate as financial incentives for performance by the CDSP of the DSC (such incentives would require the service provider to be able to make a profit or loss, and ultimately to become insolvent).

1.2.2 Any liability arrangements are therefore overall a 'zero sum game'. To the extent to which the DSC does provide for financial liability of the CDSP to any core customer, that can be seen as a decision by the core customers collectively to mutually insure the relevant risk (through the medium of the CDSP).

¹ The CDSP may earn a margin on services to provide a working capital cushion.

1.2.3 It should be noted that core customers might have non-financial remedies in law against the CDSP for breach of the DSC - such as an injunction.

1.3 Insurance

1.3.1 The CDSP will hold insurance like any business. Certain of those ordinary insurances may cover the CDSP's public or statutory liability.

1.3.2 It might also be possible for the CDSP to insure specifically against certain kinds of contractual liability. That would represent a decision by the core customers to fund (through premiums) a liability insurance scheme. If such a decision were taken, the CDSP could be liable to core customers, up to the limit of funds recovered under the insurance.

1.3.3 Such a scheme would have complications, including allocation between core customers of excesses and maximum liability amounts, the duty of the CDSP to defend claims, possible contributory fault issues, and so on.

1.3.4 If available insurance may be costly, complex, would not provide blanket cover, and would need to be arranged separately for different kinds of liability / risk. If parties wish, Xoserve can look into the possibility of such insurance in greater depth, but it is doubted to be a worthwhile option.

1.4 Role of board

1.4.1 If the CDSP were to incur a liability under the DSC, it can be assumed to flow from some failure of the CDSP to act in accordance with the terms of the DSC. The mutually nominated Board is ultimately responsible for setting the management policies and controls which should mean the inherent risk of this happening is mitigated.

2 Approach to possible liabilities

2.1 Categories of liability

2.1.1 Categories of possible liability of the CDSP to core customers are:

- A liabilities in respect of the provision of services, for example by reference to service levels. These liabilities could be quantified, as liquidated damages (like the current UNC compensation rules) or unquantified (open damages);
- B liabilities for breach of other provisions of the DSC (ie other than service provision), such as breach of confidentiality or data processing obligations. Such liabilities might be created by indemnity provisions;
- C liabilities in tort (such as negligence) in connection with the provision of DSC services. Typically a commercial contract would (to the extent possible) exclude the possibility of making claims of this kind, as it may otherwise be seen as a way of bypassing the agreed position on liability under the contract; and
- D liabilities unconnected with the DSC which arise in law, for example statutory liabilities (such as occupiers liability) or other tort or regulatory liabilities. Liability of this kind would in principle be equally likely to arise towards a third party as a core customer.

2.2 Category A: Service-related liabilities

- 2.2.1 We do not consider it is worthwhile providing for service-related liabilities. They would be complex to develop and implement (potentially re-running issues around the charging debate).
- 2.2.2 Such liabilities are more often viewed as incentives for performance than true compensation for loss. As noted above, liabilities cannot operate to incentivise the CDSP.
- 2.2.3 There is no particular reason to believe that a service failure, where it occurred, would be likely to affect particular customers only within a given constituency.
- 2.2.4 A service liability which was owed towards a particular constituency of core customer could be funded by that constituency.² That is the constituency which meets the costs of providing the service and achieving a given service level and service resilience. Thus, while a service failure might affect one constituency more than another, the circularity of the liability-recipients funding the liability would arise within the relevant constituency.
- 2.2.5 It is thought unlikely that liabilities of this kind could readily be insured.

2.3 Category B: Contract liabilities which are not service liabilities

- 2.3.1 Liabilities of this kind are intended to compensate (or indemnify) a party for loss resulting from a breach of a contract provision.
- 2.3.2 The cases where such liability might arise include breach of confidentiality, IPRs and data processing obligations.
- 2.3.3 Because such liabilities are not related to particular services, they would be funded by all parties, as part of a central CDSP cost-base. This means that if included (or not excluded), such liabilities would operate as a kind of risk allocation (risk of the CDSP failing to comply with a relevant obligation) among the parties. It would therefore be appropriate to consider limits of liability, by claim and/or by total amount in a year, if such liabilities are allowed for.
- 2.3.4 The rationale for allowing for (or not excluding) liabilities of this kind would be that if the relevant risk occurred, it would be likely to occur in a way which did impact some core customers only, rather than core customers generally.
- 2.3.5 It is ultimately a question for Xoserve's core customers whether they wish to include or exclude such liabilities, for different kinds of DSC breach. The arguments for excluding such liabilities include:
- (a) they would 'recycle' funds (the zero-sum game), entailing payment risk for all core customers;
 - (b) simplicity – the development and administration of a liability regime would be complex;
 - (c) equality – the 'no liability' approach is a non-discriminatory rule (so all customers are treated in the same manner);
 - (d) there is no particular reason to believe the relevant risks are likely to occur, or that (if they did occur) they would be particularly likely to impact some parties only;

² Subject to discussion in the charging methodology work stream.

- (e) the risks will be managed by the Board, and customers will have visibility of CDSP's risk management approach through the DSC contract management processes.
- 2.3.6 The arguments for including liabilities include that otherwise the consequences of a given risk would lie where they fall; a party might have no other remedy for a loss it had incurred.
- 2.3.7 Xoserve's own view is that for reasons of practicality and simplicity it would be preferable to exclude such liabilities (to the extent legally permissible).
- 2.4 Category C: Tort liabilities related to the DSC.**
- 2.4.1 As noted above we consider this kind of liability should be excluded (so far as possible) in any event.
- 2.5 Category D: Liabilities outside DSC**
- 2.5.1 Liabilities of this kind might in principle be incurred to any person, not just a core customer, and there seems no good reason to put core customers in a different position than third parties. Therefore it is proposed such liabilities would not be excluded.
- 2.5.2 Any liabilities in Category D which are not excluded and any regulatory fines imposed on CDSP would need to be funded by all parties, as part of the central CDSP cost-base.
- 2.6 Further considerations**
- 2.6.1 Distribution of risk occurrences. Another potentially relevant factor is whether incidences or consequences of risks which might give rise to a CDSP liability, are likely to occur in a way which affects particular core customers only, or are likely (if they occur) to affect all core customers, or all core customers of a given constituency.
- 2.6.2 The proposed position is not incapable of being changed. If experience showed that the absence of mutually-funded liabilities was having a material and unfair impact on core customers, the DSC could be changed through a code modification. In our view the better starting position is to assume that this will not be the case, and avoid the complexity until and unless it is shown to be necessary.
- 2.6.3 Given that the CDSP cannot be provided with a direct financial incentive to manage risk, its core customers' position is closer to that of the shareholders of an ordinary company. They are entitled to be satisfied that internal risk management policies are set and implemented in an appropriate way to control the risks they are exposed to. A customer of a service provider would not normally expect this, but the core customers' position (given the mutual arrangement) is different. As noted above, the contract management processes will give customers visibility of the CDSP's approach to risk management.
- 2.6.4 For third party services (ie services provided, for a margin above costs, to parties other than core customers), it is unlikely that the same position can be achieved in respect of category A liabilities. The Third Party Services Policy will define the framework within which the CDSP can accept liabilities in providing such services.
- 2.6.5 It might be argued (on grounds of symmetry) that the DSC should exclude liability of core customers for breach of DSC provisions. In our view this is not appropriate – there is no rationale for the community socialising the consequences for the CDSP of a risk resulting from the actions of a particular customer. Individual customers should be incentivised to manage such risks properly.