

28th September 2021

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and

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Dear BEIS and Ofgem,

CONSULTATION ON THE DESIGN AND DELIVERY OF THE ENERGY CODE REFORM

Please find attached Xoserve's responses to the questions asked by your consultation team in respect of the above-mentioned consultation. We also plan to submit these via the online survey portal.

This letter provides an overview of key tenets of our detailed responses, enabling us to articulate our various thoughts and ideas together in one logical sequence.

We hope you find our input of interest. My team and I would be delighted to discuss this in more detail with you or to answer any questions you might have.

The context for Xoserve's insights

Xoserve has a unique role within the energy industry. As the gas industry's Central Data Service Provider, Xoserve is central to Britain's gas market. We hold the register of details about the nation's gas supply, including information such as who supplies an address, meter reading history and daily national consumption covering all c. 24 million gas meters on the UK mainland. We provide services to gas suppliers, shippers and transporters, helping Britain's gas market to run efficiently and reliably. We process information about gas flows across the entire network to ensure National Grid can maintain system balance between supply and demand, and to ensure gas distribution networks invoice the shipping community accurately for carrying gas to premises. And we manage the processes around the appointment and activation of the Supplier of Last Resort.

We are responsible for a broad scope of activities, covering (for gas) the activities performed by Elexon, Genserv and Electralink in the electricity market. This means that we are the only industry body with experience of managing and operating the critical central services for gas.

The challenge of Net Zero

The task ahead to deliver Net Zero is immense and we don't believe it can be delivered unless all energy industry participants work together, supported by a flexible, dynamic and innovative institutional framework which drives the nation's future energy strategy. We therefore see BEIS-Ofgem's desire to simplify the code arrangements as a critical part of the journey to Net Zero and we fully support the initiative.

The codes that govern the energy industry have served consumers and industry well in the past, but it is now appropriate that they evolve to facilitate the coordinated, cross-industry change that will be essential to support the transition to Net Zero, ensuring that the whole end to end energy system that supports the delivery of energy to UK homes and businesses is fit for the changes to come.

We have responded to the consultation questions that we feel qualified to comment on in both the attached response form and via the online portal. However, there are some overarching, high level, thoughts that we would like to share here, to aid understanding of our thinking.

Xoserve's overarching thoughts

The importance of retaining gas industry expertise

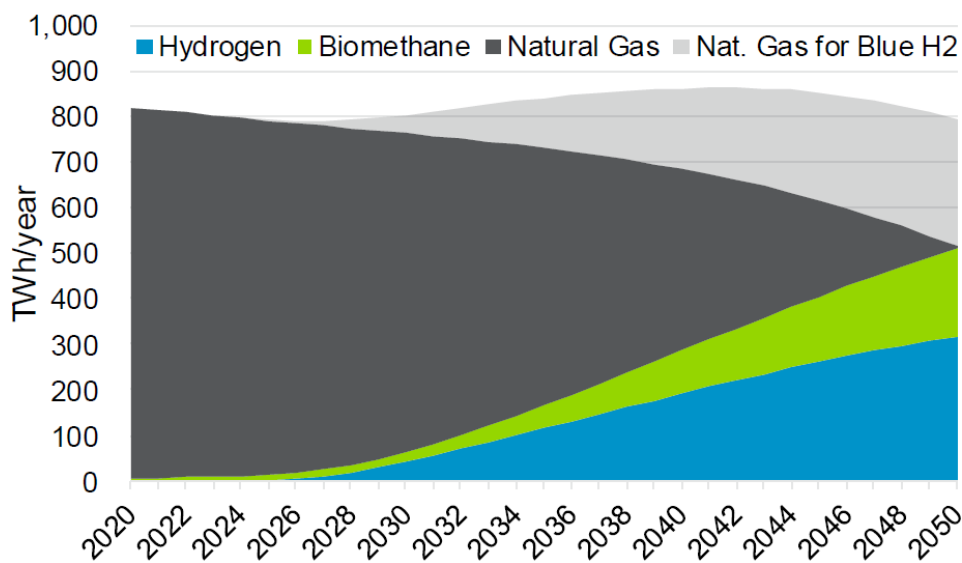
To date, the UK's transition to Net Zero has had a strong focus on electrification, driven by the deployment of renewable electricity and distributed electricity generation alongside the anticipated roll-out of electric vehicles and electric heat pumps.

However, we think it is important to recognise that the gas industry is and will remain a key component of the journey to Net Zero, over the lifetime of any arrangements which arise from this consultation.

Gas plays a critical role in powering businesses and around 85% of homes use gas on a daily basis. It is also currently used to generate 35-40% of UK electricity. Consumers (whether domestic or industrial) need to be supported by policy and regulation appropriate to gas to ensure that their bills remain affordable and access to heat is not disrupted. We have therefore concluded that the transition to Net Zero cannot be successful without the increasing use of low carbon gases, such as hydrogen and biomethane, and the creation and deployment of innovative new technologies, such as carbon capture. The Government's UK Hydrogen Strategy, published in August 2021, acknowledged the importance of hydrogen as a new low carbon solution which can help the UK to achieve Net Zero by 2050.

The figure below, which is drawn from research commissioned by the Energy Networks Association¹, highlights the way natural gas and other gases could continue to be used in the future, as the energy system transitions Net Zero.

¹ [Pathways to Net-Zero: Decarbonising the Gas Networks in Great Britain, Navigant](#)



If carbon capture is to be part of the solution, there will also be an increasing need for the capture, transportation and sequestration of carbon dioxide. The gas sector is uniquely placed to deliver this.

Thus, under most forecasts, gas(es), coupled with carbon capture and storage, will remain part of the energy mix for the foreseeable future. We feel strongly, therefore, that in the absence of distinct institutions focused on gas, there is a risk that opportunities for gas(es) to contribute to the Net Zero agenda could be missed and that the interests of Government and gas consumers could be overlooked.

Further, there are also important differences between the gas and electricity industries:

- gas is traded on a daily rather than on a half hourly basis;
- gas needs to be transported physically, taking longer to move across the country;
- gas presents different safety considerations;
- gas is easier to store than electricity; and
- the gas markets differentiate between the role of shipper and the role of supplier.

These, and other distinctive characteristics of the gas industry, have resulted in variations in the design of industry codes between gas and electricity. As a result, it may never be possible to bring into complete alignment the codes for electricity and gas markets. We therefore believe it is critical to have institutions with expertise and experience to support the gas industry and gas consumers through the evolution of the energy industry and the transition to Net Zero. If gas and electricity were to be merged, we fear that the loss or weakening of gas knowledge and expertise that might result would severely damage the capability of the energy market and Government to react effectively and responsively to the types of issues the gas market is currently experiencing.

Xoserve's unique gas industry expertise and our innovative and efficient approach to delivering change and data solutions means that we are well placed to ensure that the gas industry's potential to successfully facilitate the transition to Net Zero, while navigating the implications of any future market challenges, is fully realised. We look forward to a continuing, and perhaps expanded role, in helping BEIS-Ofgem to achieve the Government's targets.

The importance of evolution, rather than revolution

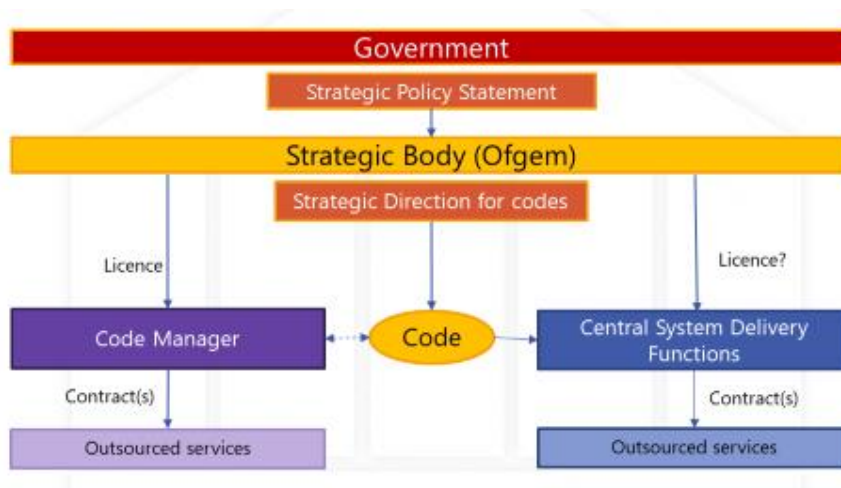
There are aspects of the current governance arrangements in gas which have worked well. For example, the arrangements have:

- provided a stable platform for gas settlement for over 30 years;
- allowed the interests of all market participants to be heard; and
- supported substantial industry change, including fundamental reforms such as the introduction of retail competition.

We feel strongly that the success of any code governance reform lies in the ability to retain the best parts of the current governance model, augmented by new arrangements. We therefore believe that an evolutionary, rather than revolutionary approach is necessary, building on what’s currently in place. This will ensure the retention of industry-specific expertise, avoiding institutional “memory loss” which would be to the detriment of informed decision making and could also significantly damage and hamper the ability of gas(es) (including hydrogen or biomethane) to play a key role in moving to Net Zero.

The benefits in bringing together Code Manager and Central System Delivery Function accountabilities

We fully endorse the desire to simplify the current arrangements. We understand that BEIS-Ofgem are proposing the following as Option 1 in the consultation:



We think any governance structure that results in multiple organisations with too many levels is directionally wrong, increasing complexity and cost, while likely slowing responses to change and reducing efficiency. Given this, and looking at the current structure of the gas industry, we wonder if there is a more ambitious approach which merits consideration: the amalgamation of accountability for the code manager and central system delivery function activities into a single organisation, which can then integrate the operationalisation of the strategic direction for codes into one seamless approach: in effect, a “code integration function”.

We believe this would be in the interests of both the Government and consumers because it would:

- combine the assessment, management and delivery of industry-wide change into one holistic activity, considering both the operational and systems implications of code changes simultaneously;
- as a result, improve the efficiency of code changes, allowing them to be delivered more quickly with resulting reduction in industry overhead for the benefit of end consumers; and
- simplify the governance structure for code management, reducing the number of industry bodies and thus saving cost for the benefit of consumers.

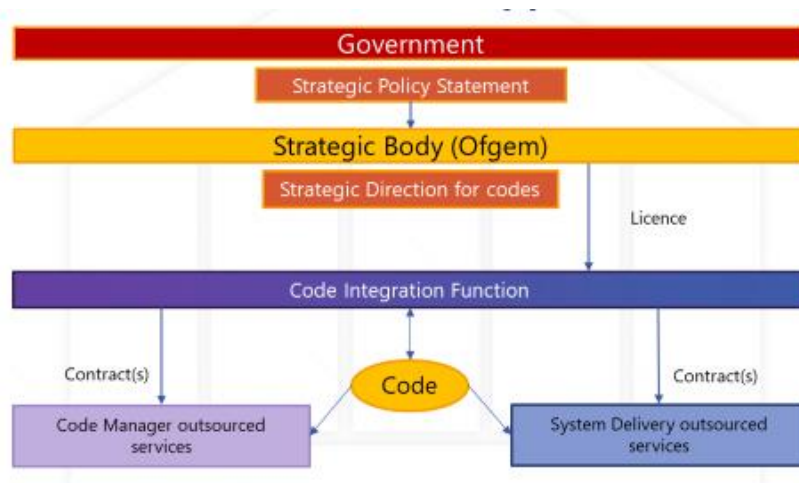
We recognise that there are potential concerns associated with bringing together Code Manager and Central System Delivery Function responsibilities, the two most obvious being: (i) potential conflicts of interest, whereby the Code Manager is commercially incentivised to prioritise changes with big system impacts from which it profits, and (ii) a potential reduction in competition. We consider these concerns can be easily resolved.

Conflicts of interests could be mitigated by:

- establishing arms-length, commercial contracts for the delivery of certain services under the “code integration function”, with appropriate levers included in the arrangements to robustly assure the delivery activities;
- ensuring that the “code integration function” is explicitly focused on delivering what is in the best interests of consumers and the transition to Net Zero, via its licence; and
- employing a not-for-profit organisation to act as the “code integration function”, thereby removing any financial incentives that might inadvertently have given rise to conflicts.

This approach could also encourage competition, by requiring the “code integration function” to consider the merits of outsourced delivery, procured via competition (in the same way that RECCo has procured services to deliver Code Management responsibilities).

Our vision looks something like this:



As previously mentioned, we consider that gas and electricity codes should be managed separately.

Xoserve can help to realise this vision. Xoserve has unparalleled knowledge, expertise and breadth of view across the gas industry and, through the recent separation of the systems delivery (now performed by Correla) from the its role as Central Data Services Provider for the gas industry, Xoserve now has the independence to assure the system delivery activities, on behalf of customers, without being conflicted by being the organisation doing the delivery. In other words, we have separated the roles of code delivery management from systems delivery.

Following these changes, Xoserve:

- remains a not-for-profit company, which does not benefit from promoting (or constraining) industry change;
- operates at arms-length from Correla, managing the contract with them and assuring delivery performance from them;
- has a singular focus on the delivering outcomes; and
- has become a procurement, contract/ commercial management and performance assurance specialist.

Consequently, as a result of its experience, capabilities and demonstrable ability to embrace and deliver change, Xoserve is extremely well-placed to rapidly evolve to perform the role of code integration function. We could develop, or procure, any capabilities not available internally, presenting a quick and low risk solution to this area of change and enabling Ofgem to focus on developing the strategic direction.

Regardless of the outcome of the consultations, Xoserve has started to work more closely with the code administrator for gas, the Joint Office of Gas Transporters, to ensure that gas market participants (and thus end consumers) can leverage the synergies arising from more closely combining our respective activities and understanding of the codes.

Method of selecting organisations to appoint to new roles

We support the use of competition wherever this will deliver value and believe there are good reasons for considering how best to take advantage of competition when selecting organisations to perform roles in the energy market.

However, our experience is that competition based on price point, adherence to proposed commercial terms and the evidencing of a broad set of commercial credentials tends to favour commercial entities whose financial performance and broad portfolio of contractual arrangements supports the agreement of high risk, low price contracts in specific circumstances. Such organisations, while excellent at delivery of business services, may not have the deep industry expertise, historical knowledge and contextual understanding to make the reforms a success.

We believe it is in the best interests of both Government and consumers for BEIS-Ofgem to be able to consider all organisations with the right skills and experience. Any selection process which excludes some parties from consideration, such as those who are not able to bid due to their unique industry position or those who cannot accept contractual liabilities as they are set up as “not-for-profit”, might not be in the best interests of consumers.

Xoserve’s unique gas industry experience and expertise places us well to fulfil a broader role in the gas industry, combining our delivery focus with code management as outlined above. Our knowledge of the gas market and considerations of the various stakeholders within it is unparalleled and our “not for profit” status delivers good value compared to companies whose owners/ shareholders have an expectation of a certain level of profitability. Further, we are an established organisation, with mature

internal governance arrangements, meaning that any set up costs for the extended scope would be minimal. Yet, our not-for-profit status and the current restrictions on our activities, would prevent us from bidding in a competition, depriving the energy market of the opportunity to engage us for such a role. We feel this would be an opportunity missed.

We would therefore welcome further dialogue with Ofgem / BEIS on the use of alternative approaches outlined in the consultation for selecting organisations to perform code governance roles in the new arrangements.

Licensing of Central System Delivery Functions

We recognise that BEIS-Ofgem are at the early stages of considering whether this is desirable. The conversations that the current consultations on both the Design and Delivery of the Energy Code Reform and the Energy Future System Operator have initiated are important and this topic has featured in many conversations we have had with market participants over the last few weeks.

Even if the vision for a combined “code integration function” that we shared earlier on is not realised, and BEIS-Ofgem conclude that the government’s strategic vision can be more effectively delivered through a split of accountabilities across the two, we can see the benefits in the Central System Delivery Functions being licenced in their own right, as this would:

- ensure that the Central System Delivery Functions are accountable to the strategic body directly, allowing BEIS-Ofgem greater ability to direct industry-wide changes; and
- normalise the arrangements for determining the funding for the Central System Delivery Functions, as funding (assumed to be set by the strategic body) and priorities would be aligned.

However, we believe that there are some wider dynamics to consider when contemplating this approach, namely:

- The way that the strategic body chooses to enforce licence conditions. If fines form part of the enforcement toolkit, this could create a challenge for those Central System Delivery Functions that are non-profit-making organisations, and therefore do not have the ability to accrue reserves which can be used to fund fines.
- For Xoserve specifically, there are implications for our funding, governance and ownership (FGO) arrangements. Xoserve is created via a licence obligation on the gas transporters, governed by a Board comprised of nominees from each of our customer constituencies and funded through a fully transparent annual business planning process. A direct licence to Xoserve would remove any perception (by other gas market participants) of bias towards the gas transporters but would likely have an impact on the gas transporters’ view of their own licence obligations. It might also be appropriate to review the nature and membership of our Board. Consideration of the impact on our customers of any change in funding process would also need to be factored in.

Simplifying Gas Codes

Although outside the scope of this consultation, we feel it’s appropriate to indicate our continued support for the simplification and consolidation of Codes. We believe that rationalising the gas arrangements by bringing together the UNC and IGTUNC would yield consumer benefits by accelerating the simplification of the code manager landscape, reducing costs and enabling the faster delivery of code changes. Given the current level of alignment between the two codes, we believe this could be achieved relatively quickly.

In conclusion

We hope you find our thoughts above, and our detailed responses to the consultation questions, of interest and would be delighted to spend some time with BEIS and Ofgem to discuss this further.

We also look forward to supporting you, the gas industry, representatives of gas consumers and the wider stakeholder community in developing and creating an energy codes governance landscape which facilitates and accelerates the decarbonisation agenda in the UK, while also minimising costs and complexity, encouraging innovation and maintaining resilience of this part of the critical national infrastructure.

If there are any areas of our response that you would like to discuss with us in more detail, please contact me on stephanie.ward@xoserve.com or 0121 229 2033.

Kind regards,

A handwritten signature in black ink that reads 'Stephanie Ward'.

Stephanie Ward
Chief Executive Officer