

# Consultation

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## Consultation on National Energy System Operator's performance incentives framework for BP3

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We are consulting on our performance incentives framework for National Energy System Operator (NESO), for the one-year business plan cycle commencing 1 April 2025 and ending 31 March 2026 (BP3). We would like views from any stakeholder with an interest in NESO. This includes the system operator and all industry parties who will be impacted by our regulation of NESO.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at [ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential and, if possible, put the confidential material in separate appendices to your response.

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## 1. Introduction

### Section summary

This section explains the purpose of this consultation, how it fits within wider work on National Energy System Operator (NESO), and our next steps following consultation.

### What are we consulting on

- 1.1 We are inviting stakeholder input on our proposed performance incentives framework for NESO, for the business plan period commencing 1 April 2025 and ending 31 March 2026 (BP3). This includes key features of our performance assessment, business plan requirements and assessment, cost regulation and the role of stakeholders and external scrutiny.

### Context and related publications

- 1.2 In March 2024, the Department for Energy Security and Net Zero (DESNZ) and Ofgem jointly issued a statutory consultation<sup>1</sup> proposing to grant<sup>2</sup> an Electricity System Operator Licence and a Gas System Planner Licence, which are to be held by NESO once it is designated as the Independent System Operator and Planner (ISOP)<sup>3</sup>.
- 1.3 NESO will be an expert, impartial body with responsibilities across both the electricity and gas systems, charged with driving progress towards net zero while maintaining energy security and minimising costs for consumers. NESO will be an independent, not-for-profit public corporation, licenced and regulated by Ofgem. NESO will continue the roles and responsibilities carried out by the

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<sup>1</sup> <https://www.ofgem.gov.uk/consultation/national-energy-system-operator-neso-licences-and-other-impacted-licences-statutory-consultation>

<sup>2</sup> In the March 2024 consultation, it is proposed that the Secretary of State of DESNZ will make a licensing direction (using powers under section 167 of the Energy Act 2023) by which the Electricity System Operator (ESO)'s existing transmission licence is converted, with effect from Day 1 of NESO, into the Electricity System Operator Licence held by NESO. The Gas System Planner Licence is proposed to be granted to NESO as the Independent System Operator and Planner (ISOP) (as designated) by the Secretary of State. References to "Day 1" or "NESO Day 1" in this document mean the first day of NESO (i.e. the date when both designation of the ISOP and the ISOP licences come into effect).

<sup>3</sup> <https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role>

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current Electricity System Operator (ESO), as well as taking on longer-term planning, forecasting and market strategy activities in respect of gas. It is also taking on new and enhanced responsibilities, including providing expert advice, supporting energy system resilience, and driving the coordinated development of the whole energy system.

1.4 As the ESO transforms into NESO, the ESO's regulatory framework will need to evolve with it. In December 2023, we published our 'Consultation on the policy direction for the Future System Operator's regulatory framework'<sup>4</sup>. We published a summary of stakeholder feedback to this consultation and our response as part of the NESO statutory licences consultation<sup>5</sup>. As explained further in those documents, we plan to introduce changes to NESO's regulatory framework in three key phases:

- i. at 'Day 1' of NESO, expected in **Autumn 2024**;
- ii. following the conclusion of the current business plan period (BP2) in **April 2025**; and
- iii. following the end of the RIIO-2 price control period in **April 2026**.

1.5 We believe that a phased approach minimises delivery risk and will help us more effectively achieve our long-term objectives<sup>6</sup> for an enduring NESO regulatory model. With three stages, there will be appropriate opportunities to obtain stakeholder input, apply lessons learned from the post-Day 1 period, and align the framework appropriately with the new network price controls after RIIO-2<sup>7</sup>.

1.6 Under this phased approach, we have previously consulted on critical, initial changes for Day 1<sup>8</sup>. In summary, for the remainder of BP2 we expect NESO's performance to broadly continue to be regulated through the arrangements

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<sup>4</sup> <https://www.ofgem.gov.uk/consultation/consultation-policy-direction-future-system-operators-regulatory-framework>

<sup>5</sup> We provided a summary of stakeholder responses in our joint statutory consultation on National Energy System Operator (NESO) licences and other impacted licences, in section 6.3.4: <https://assets.publishing.service.gov.uk/media/66053b92f9ab41001aeea46b/statutory-consultation-on-national-energy-system-operator-licences-and-other-impacted-licences.pdf>

<sup>6</sup> Our regulatory framework objectives are set out in Chapter 3: <https://www.ofgem.gov.uk/consultation/consultation-policy-direction-future-system-operators-regulatory-framework>

<sup>7</sup> For more details, please see: <https://www.ofgem.gov.uk/decision/decision-frameworks-future-systems-and-network-regulation>

<sup>8</sup> <https://www.ofgem.gov.uk/consultation/consultation-associated-documents-proposed-neso-licences-regulatory-framework-documents>

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which are currently in place for the ESO for BP2, but with targeted amendments to reflect NESO's not-for-profit organisational design and new activities. This should ensure a continued strong focus on NESO's performance as changes are implemented in a pragmatic and proportionate way within the middle of an existing business plan assessment period.

- 1.7 We are now consulting on wider changes to our performance incentives framework for BP3, which commences in April 2025. This will be our second phase of implementing the new NESO regulatory framework and will be the last business plan cycle within the RIIO-2 framework.

## **Overview of our BP3 proposals**

- 1.8 For BP3, we are proposing a more tailored performance incentives framework for NESO that focuses on delivery of key objectives and major priorities. This involves changes to the existing framework, including fully consistent treatment of new and pre-existing NESO roles and a broader change to the performance assessment approach and associated business planning and reporting requirements.
- 1.9 We are not proposing any major changes to cost regulation and the role of stakeholders from the current incentive scheme approach. Instead, our changes focus on amendments within the existing framework structures to ensure these key components remain as effective as possible for the last year of RIIO-2.
- 1.10 We are not resetting aspects of the ESO's RIIO-2 price control that were previously set, such as Network Innovation Allowance (NIA)<sup>9</sup> for BP3. In addition, we are not consulting on staff-level incentives or on further changes to the licence for BP3. This reflects the impracticalities of making any wider changes in such short timeframes before the start of BP3, as well as providing us with a larger window to gain experience of how our policies operate in practice from Day 1 into BP3, before proposing any further changes.
- 1.11 We intend to consider changes needed to these areas and other aspects of the performance incentives framework in detail as part of the development of a more enduring framework. We will consider if and where any changes could lead to more effective regulation of NESO, for April 2026 onwards.

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<sup>9</sup> [Business Plan 2 Final Determinations - Electricity System Operator | Ofgem](#)

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1.12 Overall, we believe our proposals for BP3 will lead to a more robust performance incentives framework that ensures NESO focuses on achieving key outcomes and major priorities at an efficient level of spend. This should result in NESO maximising benefits for consumers and industry.

1.13 Table 1 provides an overview of our proposals for the key components of the performance incentives framework for BP3.

**Table 1: Overview of key proposals for NESO’s performance incentives for BP3**

<b>Component</b>		<b>Chapter</b>	<b>Proposal for BP3</b>
Performance incentives	Performance assessment	Chapter 2	A cross-cutting assessment of NESO’s performance against the achievement of its BP3 Performance Objectives and delivery of value for money.
	Performance expectations		We will set performance expectations by deciding on the key Performance Objectives NESO should achieve by the end of BP3, as part of our Business Plan assessment process.
Business Plan and assessment	Business Plan content	Chapter 3	We propose that NESO’s Business Plan sets out the key Performance Objectives and Success Measures for BP3, as well as a proportionate update on associated costs.
	Business Plan assessment		<p>The Business Plan process will follow the same stages as in BP2.</p> <p>As part of Ofgem’s determination process, Ofgem will: assess the Performance Objectives; undertake a Value for Money assessment; and outline reporting requirements for BP3, including regular reports on progress and spending, and Performance Measures.</p> <p>We will continue to a Value for Money assessment using a similar approach to BP2. However, we will not undertake a Red Amber Green (RAG) rating of IT investments as we will use the previous ratings and ongoing monitoring through the Cost Monitoring Framework (CMF) to inform our assessment for BP3.</p> <p>Our proposals for Performance Measures for BP3 will largely be unchanged from BP2.</p>



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Cost regulation		Chapter 4	No change to the cost assessment approach used for Day 1.  We will continue to use the CMF, with reporting updates for BP3 to reflect the different stages of development for investments covered by the CMF.
Stakeholder and external scrutiny		Chapter 5	We propose to keep the same platforms for stakeholder scrutiny as at Day 1 (including the role of the NESO Performance Panel), but we will review the approach to the end-of-scheme events to establish whether there are changes that can maximise engagement from BP2.

## Next steps and timings of decisions

- 1.14 This consultation closes on 27 September 2024. Alongside this consultation, we are consulting on NESO’s Business Plan Guidance document. This sets out our detailed expectations, assessment approach and timings for NESO’s Business Plan for BP3.
- 1.15 We will publish a decision on the performance incentive framework for BP3 and NESO’s Business Plan Guidance document later this year. We intend to publish a further consultation later this year on supporting documents, such as the NESO Roles Guidance and the NESO Performance Arrangements Governance Document, which will set out our proposals for the detailed implementation of our policy decisions for BP3.
- 1.16 We expect to further engage next year on NESO’s performance incentives framework for the business plan period commencing in April 2026. This will be the third stage in our phased approach to NESO’s regulatory framework and the first period following the end of the RIIO-2 framework.

## How to respond

- 1.17 We want to hear from anyone interested in this consultation. Please send your response to the person or team name on this document’s front page. We have
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asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

- 1.18 We will publish non-confidential responses on our website at [www.ofgem.gov.uk/consultations](http://www.ofgem.gov.uk/consultations).

## **Your response, your data and confidentiality**

- 1.19 You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.
- 1.20 If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.
- 1.21 If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations (see Appendix 4).
- 1.22 If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

## General feedback

1.23 We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand, or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send any general feedback comments to [stakeholders@ofgem.gov.uk](mailto:stakeholders@ofgem.gov.uk)

## How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. Choose the notify me button and enter your email address into the pop-up window and submit.

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Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:

**Upcoming** > **Open** > **Closed** (awaiting decision) > **Closed** (with decision)

## 2. Performance incentives

### Section summary

This section outlines our proposals for NESO's incentives framework for BP3. This includes our performance assessment approach including; the methodology, application and outcome, and how we will set performance expectations.

### Introduction

- 2.1 This chapter sets out our proposals for NESO's performance incentives for the one-year BP3 period. We propose a cross-cutting assessment of NESO's performance against the achievement of its plan aims and delivery of value for money. We will set performance expectations by deciding on the key performance objectives NESO should achieve by the end of BP3 as part of our ex-ante Business Plan determinations process.
- 2.2 Throughout this chapter, and the following chapters, we refer to a number of different components and documents used to define NESO's outputs and incentives framework. For reference, these are listed and defined in Appendix 2.

### Performance assessment

#### Background

- 2.3 For Day 1, we have proposed to broadly continue with the same incentives scheme design in place for the ESO for its RIIO-2 BP2 assessment period, with targeted amendments<sup>10</sup>.
- 2.4 The Day 1 performance assessment is an evaluative assessment of performance across two parts. Firstly, we have proposed the continuation of the existing 'BP2

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<sup>10</sup> These include the removal of the financial elements of the current ESO incentive scheme, so it concludes as a reputational scheme; an additional qualitative assessment to the current performance assessment approach to incorporate new NESO roles and activities; and targeted changes to remove reporting burden and processes that are now clearly unnecessary and do not create value.

Roles Assessment' methodology which has been in place for the ESO for BP2. For BP2, Ofgem will score the ESO's performance from 1 to 5 in delivering three overarching roles over a two-year Business Plan period against pre-set ex-ante evaluation criteria. The evaluation criteria broadly consider whether NESO has delivered its business plan deliverables on time; the quality of those delivered outputs; evidence from stakeholders; performance against specific metrics; and its demonstration of value for money.

- 2.5 The second part of the assessment, 'ISOP Implementation Assessment', will look to assess the work carried out by the ESO/NESO to establish the ISOP and its new roles more generally, based on proposed new expectations<sup>11</sup>.

## **Consultation position**

- 2.6 For BP3, we propose to continue to conduct an evaluative assessment of NESO's performance but with changes to the overall methodology. We propose to apply a single consistent methodology to our NESO performance assessment that is applicable to all NESO activities, meaning the assessment is no longer divided into three roles. We propose to undertake a cross-cutting assessment of NESO's performance, which will consider:

**(1) NESO's achievement of business plan aims; and**

**(2) NESO's delivery of value for money.**

- 2.7 For these two components, we will assess the extent to which overall NESO performance has met, exceeded, or fallen below our expectations.
- 2.8 In assessing **NESO's achievement of business plan aims** (part (1) of the BP3 assessment method), we will focus our assessment on how well NESO has delivered its Performance Objectives. NESO's Performance Objectives will be the key objectives NESO plans to achieve by the end of BP3, across the full spectrum of its activities. The Performance Objectives will be focussed on the biggest priorities for NESO that maximise benefits for consumers and the energy sector. As such, our assessment will be more explicitly and transparently focussed on the biggest issues, rather implicitly doing this through an aggregation of NESO's performance against multiple, granular deliverables and

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<sup>11</sup> Proposed in Chapter 5 in the ISOP Roles Guidance: [ISOP Roles Guidance \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/consult/condocs/isop/isop_roles_guidance)

- activity-based expectations. For example, we expect there will be less Performance Objectives compared to the number of discreet deliverables outlined in the Delivery Schedule for BP2, but that each individual Performance Objective will be more overarching and impactful than a BP2 deliverable.
- 2.9 Performance Objectives will be set at a stretching level of ambition, such that if achieved by NESO, this would be equivalent to an 'exceeding expectations' performance outcome. Further details on performance expectations can be found later in this chapter.
- 2.10 We propose to adapt our assessment methodology away from using five distinct, stand-alone evaluation criteria in BP2. Instead, we propose to consolidate the existing criteria and apply a cross-cutting assessment of NESO's performance focused on whether or not NESO has successfully delivered its agreed Performance Objectives and to an appropriate quality.
- 2.11 Within our assessment, we will use the main elements of the existing evaluation criteria in BP2. For example, stakeholder views and feedback will continue to be a key factor. In addition, we will consider Success Measures for each Performance Objective, which should evidence *how* each Performance Objective has been delivered.
- 2.12 We propose to continue to set reporting requirements for Performance Measures (e.g. key performance metrics), a stakeholder survey, and an obligation to publish regular reports outlining progress against the Performance Objectives. These will act as reputational incentives in their own right. However, they may also be used as relevant Success Measures and will therefore be used to inform our cross-cutting assessment, where appropriate or relevant.
- 2.13 Whilst we expect that the Performance Objectives and Success Measures should comprehensively capture key areas of performance over BP3, we recognise that NESO's role and the environment it operates in is dynamic. Therefore, we will also maintain a discretion to consider other important areas of NESO's performance that may emerge during BP3. For example, where there have been unexpected events or new priorities. We will clearly outline how and where these factors have influenced our overall conclusion on whether the NESO has met, fallen below or exceeded our expectations.
- 2.14 Our assessment approach will consider all aspects of NESO performance, and we intend to publish a focused assessment report that will emphasise the most

significant performance areas that have driven our overall view of NESO's performance.

- 2.15 In assessing **NESO's delivery of value for money** (part (2) of the BP3 assessment method), we propose to assess: NESO's overall spending compared to the initial BP3 forecast, the extent to which delivery has out-turned as planned and how well any deviations have been explained and evidenced. We will consider how NESO has responded to any key areas flagged in our Business Plan assessment, as well as how NESO has performed generally against pre-defined value for money expectations (in line with the expectations set for BP2<sup>12</sup>).
- 2.16 Our Value for Money assessment will be cross-cutting across NESO's Business Plan. Our assessment report will focus on the major areas that have driven our overall grade.
- 2.17 Further details on the Business Plan content and assessment are set out in Chapter 3. The specific changes to our performance assessment approach will be outlined for consultation in the NESO Performance Arrangements Governance Document later this year.

### **Rationale for consultation position**

- 2.18 We have proposed a cross-cutting application of our assessment as the existing application to 3 ESO roles would not reflect the full range of NESO responsibilities. We believe that setting our assessment across all NESO activities, rather than by a pre-set grouping, will enable us to undertake a more holistic assessment of NESO's overall performance. This will avoid duplication in our assessment of key objectives that span across different roles/activities. In addition, it will allow for a more targeted assessment of the most important areas of performance across the plan, instead of having to undertake several function-specific assessments that may be of lower relative value. This should mean our performance discussions with NESO and the resultant actions taken by NESO are focused on the areas that can maximise benefits for consumers and industry.

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<sup>12</sup> Set out in Chapter 2 of the NESO Performance Arrangements Governance Document: [The Independent System Operator and Planner Reporting and Incentives Arrangements Governance Document \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/publications/consultation-papers-and-statements/consultation-papers/consultation-paper-2018-001)

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- 2.19 Our proposed assessment method reflects our objective to incentivise NESO to have a greater focus on targeting the optimal key outcomes and major priorities, and the quality with which these will be delivered.
- 2.20 For clarity, whilst our assessment method focusses on the key outcomes and major outputs, we are not proposing a lower level of scrutiny of NESO's performance, particularly in areas where there are ongoing performance concerns. We will still carry out our core regulatory role of regular and effective monitoring of NESO's activities and we may consider its performance against more granular activities as part of our overall assessment. Where relevant, performance against specific outputs will be picked up through the reporting and assessment of Success Measures associated with the Performance Objectives. We will still continue to pay close attention to stakeholder feedback on NESO's performance to understand how well Performance Objectives are being met. This will ensure NESO continues to be held to high levels of accountability.
- 2.21 We believe the key elements of the existing evaluation criteria in BP2 capture NESO's overall performance across its responsibilities. However, we are not defining these as distinct criteria for BP3 as we believe the focus of our assessment should remain on whether NESO is able to deliver the most important outcomes and to a high quality. We will consider supporting evidence (such as stakeholder input, Success Measures and other reporting requirements), as and when appropriate within our assessment. This flexible application will lead to a more tailored and bespoke assessment of Performance Objectives and thus enable a more effective overall assessment of NESO performance.
- 2.22 We will continue to undertake a Value for Money assessment to ensure NESO is clearly accountable for delivering value for money to consumers. We do not plan to change our approach from BP2 as we continue to believe this is an effective approach to applying scrutiny and incentives on spending. However, a cross-cutting assessment will enable us to more accurately reflect the more cross-cutting nature of NESO's costs, avoiding duplication in our assessments.
- 2.23 Our assessment report will be focused to provide a clear signal to NESO and wider stakeholders on the significant performance areas that have driven our overall assessment. Ofgem's view of overall NESO performance – the extent to which NESO's performance has met, exceeded or fallen below our expectations, will be set out for clarity and transparency. This reflects the need to provide an



objective and transparent point of reference for NESO to take account of when making senior staff remuneration decisions<sup>13</sup>.

## Performance expectations

### Background

- 2.24 The ESO's Roles Guidance was first introduced in 2017<sup>14</sup> for the primary purpose of providing additional expectations on the behaviours expected of the ESO to co-ordinate and direct the flow of electricity onto and over the electricity transmission system, in an efficient, co-ordinated and economic manner. Since then, it has undergone frequent edits and additions to reflect the evolution of the ESO's regulatory framework. This includes incorporating expectations related to the ESO's performance and incentives, including the behaviours we expect from the ESO to exceed expectations. The latest version of the ESO's Roles Guidance<sup>15</sup> both sets expectations which underpin the incentives framework and obligations in the licence.
- 2.25 For Day 1, we plan to continue with up-front performance expectations outlined in the NESO Roles Guidance<sup>16</sup>. This document will provide guidance on NESO's roles and activities and the behaviours we expect from NESO in carrying these out pursuant to its statutory functions, duties and licence conditions.
- 2.26 For Day 1, we have proposed targeted changes to the expectations set for the ESO's three existing BP2 roles, with the aim of incorporating additional expectations for new NESO activities that are already closely aligned with existing ESO roles. We have also proposed some additional expectations for NESO in relation to the implementation and delivery of new NESO roles and

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<sup>13</sup> NESO's proposed new licences require that staff remuneration decisions follow an Ofgem-approved policy. Please see Condition F7 (Remuneration Policy and Expenses Policy) of NESO's proposed licences for more details: <https://www.ofgem.gov.uk/consultation/national-energy-system-operator-neso-licences-and-other-impacted-licences-statutory-consultation>

<sup>14</sup>

[https://www.ofgem.gov.uk/sites/default/files/docs/2017/07/future\\_so\\_reg\\_framework\\_july\\_2017\\_working\\_paper.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2017/07/future_so_reg_framework_july_2017_working_paper.pdf)

<sup>15</sup> <https://www.ofgem.gov.uk/sites/default/files/2023-10/Updated%20ESO%20Roles%20Guidance%202023-25.pdf>

<sup>16</sup> [ISOP Roles Guidance \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/consultation/national-energy-system-operator-neso-licences-and-other-impacted-licences-statutory-consultation)

activities which are less closely aligned with the three existing ESO roles. This approach was taken to enable a pragmatic and proportionate way of integrating new expectations within the middle of an existing business plan period.

## **Consultation position**

- 2.27 For BP3 we propose that the NESO Roles Guidance should focus on providing guidance on how NESO can best meet its licence obligations. We propose this will be done by clarifying the 'meets expectations' text of the Roles Guidance for BP2. The guidance would therefore have greatest use from an enforcement perspective rather than establishing incentives expectations. However, in future, for April 2026, we expect to introduce greater changes to the guidance. For example, to reorganise the content by NESO's activities or new licence structure rather than the pre-existing three ESO Roles.
- 2.28 As a result, we propose that our BP3 incentives expectations will be primarily underpinned by NESO's Performance Objectives. We expect NESO to develop, test and propose its Performance Objectives and Success Measures as part of writing its Business Plan. Ofgem's Business Plan determinations will then further consider NESO's plan and either confirm we agree these are suitable Performance Objectives and Success Measures or if necessary, add, remove or amend the Performance Objectives to provide additional clarity on our expectations for NESO's performance. Further details on the Business Plan process are outlined in Chapter 3.

## **Rationale for consultation position**

- 2.29 We consider that it would be beneficial to create a clearer distinction between licence guidance and our incentives expectations to ensure each area can be tailored to its purpose and used most effectively. In addition, a clearer distinction and greater clarity between performance expectations under NESO's incentives scheme and how NESO should meet the minimum standards set in NESO's licence would improve both the enforceability of the licence and our incentives processes.

- 2.30 For incentives purposes, we believe a shift in focus towards Performance Objectives will be more effective at setting clear expectations. Currently for BP2, the Roles Guidance sets around 370 expectations over 80 pages. The granularity of the Roles Guidance makes it difficult to strike the right balance between providing clarity on expectations and providing NESO with the incentive and autonomy to focus on how best to deliver key strategic priorities. This is because the existing level of detail in the Roles Guidance does not clearly draw out these priorities and our expectations for performance in these areas. As a result, we believe NESO's Performance Objectives, as outlined earlier in this chapter, should instead drive performance expectations for BP3. We propose that these new, more strategic-focused expectations, which Ofgem will agree and/or provide further clarity to, will replace the current 'exceeds' expectations text in the Roles Guidance.
- 2.31 We still consider that it is beneficial to provide additional guidance on NESO's licence obligations as part of its overall regulatory framework. This can support key standards in the licence (such as those in Condition C1 of the new NESO licence). Given the time available and competing priorities, we consider it would be beneficial to broadly maintain the existing minimum licence standards for BP3. This will allow us to conduct a fuller review of NESO's licence and associated guidance for the regulatory framework from April 2026.
- 2.32 For clarity, this proposal does not remove Ofgem's ability to set additional or more granular expectations that are of relevance for the incentive scheme, if needed. This could take place through our Business Plan determination or within the scheme, such as through open letters, or licence changes.

### **Consultation questions**

NESOQ1. Do you agree with our proposed approach to the performance assessment for BP3?

NESOQ2. Do you agree with our proposed changes to setting performance expectations for BP3?

## **3. Business Plan and plan assessment**

### **Section summary**

This section outlines our expectations for NESO's Business Plan for BP3 and our proposals for Ofgem's assessment of the Business Plan.

### **Introduction**

- 3.1 This chapter sets out our proposals for NESO's Business Plan and Ofgem's assessment of the Business Plan for the BP3 period. We propose that NESO's Business Plan sets out Performance Objectives and a proportionate update on associated costs for BP3. We no longer require a regulatory financial submission from NESO given its not-for-profit financial framework.
- 3.2 The stages involved in NESO producing a Business Plan and Ofgem's assessment will remain the same as in BP2. Ofgem's Business Plan determination will include: an assessment and determination of Performance Objectives, a Value for Money assessment and a decision on reporting requirements, including the Performance Measures for BP3.

### **Business Plan content**

#### **Background**

- 3.3 Day 1 is expected to take place within the middle of an existing Business Plan period (BP2). As such, the Business Plan submitted by the ESO in August 2022<sup>17</sup> will remain in place until March 2025.
- 3.4 The Business Plan for BP2 included details on proposed costs, activities and deliverables for delivering the ESO's RIIO-2 strategy over BP2. We previously

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<sup>17</sup> [nationalgrideso.com/document/266156/download](https://nationalgrideso.com/document/266156/download)

set expectations<sup>18</sup> that the content of the Business Plan for BP2 would include an update on: a Delivery Schedule setting out granular deliverables, internal costs in agreed Business Plan Data Tables (BPDT), IT costs<sup>19</sup>, shared services and other areas of the price control that needed updating.

## Consultation position

- 3.5 We propose that the headline components of the Business Plan remain the same for BP3. However, we expect a greater emphasis on the most important and impactful outcomes that NESO can deliver. We propose that the Business Plan is built around the Performance Objectives which NESO should achieve by the end of BP3.
- 3.6 NESO's Business Plan should outline how the Performance Objectives are aligned with NESO's statutory duties (including how NESO has regard to the strategic priorities set out in the Strategy and Policy Statement (SPS)<sup>20</sup>, RIIIO-2 ambitions (where relevant), and/or industry needs. Also, NESO should reflect how commitments made by the ESO in BP2 are encompassed by Performance Objectives or sit within its new organisational structure for BP3. In addition, each Performance Objective should be supported by Success Measures, which provide clarity on *how* these key objectives should be delivered. For example, this could include the delivery of milestones for a product/system, feedback from stakeholders, metrics or evidence on the delivery of benefits. This would replace the existing requirement to set out granular deliverables and success measures in a detailed Delivery Schedule.
- 3.7 For costs, we propose that these will no longer need to be split into three ESO roles, however NESO should provide an update using similar cost categories to BP2. Costs should be proportionate to the level of information already received through the Cost Monitoring Framework (CMF).

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<sup>18</sup> The specific guidance on the contents of the business plan for BP2 is set out in the Business Plan Guidance document: [Business Plan Guidance document \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/business-plans/business-plan-guidance)

<sup>19</sup> The specific guidance on the contents of IT investments for BP2 is set out in the ESO Business Plan: IT Investment Plan Guidance document: [ESO Business Plan: IT Investment Plan Guidance \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/business-plans/eso-business-plan-it-investment-plan-guidance)

<sup>20</sup> As required in Condition C2 of NESO's proposed new licences.

3.8 We expect NESO to set out:

- Forecast costs for BP3, with no requirement for an additional strategic narrative<sup>21</sup>;
- IT investments and non-IT investments, in line with the existing CMF;
- Enabling Functions costs (previously Shared Services); and
- Cost Benefit Analysis (CBAs) for new activities and investments that NESO chooses to undertake for BP3, which have not been included in previous RIIO-2 plans and which are additional to the new activities and responsibilities that have already been justified in the decision to create NESO.

3.9 For completeness, we no longer require a financial submission from NESO given its not-for-profit financial framework. Further details on our expectations for the Business Plan content is provided in our NESO Business Plan Guidance document, which we are consulting on alongside this document.

### **Rationale for consultation position**

3.10 Our proposals for the content included in the Business Plan reflect our intention for NESO to provide a greater focus and transparency on its most impactful outcomes and outputs. As we move towards annual business plan cycles for NESO, we believe the existing Business Plan output requirements create a risk of overly concentrating on a level of detail that is too granular to be beneficial to achieve this. By shifting the focus of the content in the Business Plan from a detailed Delivery Schedule, we believe this will shift NESO's focus more firmly onto achieving these strategic outcomes and outputs and optimise the amount of resource put towards achieving those outcomes.

3.11 For the avoidance of doubt, our proposal to focus the Business Plan on key outcomes and outputs should not be interpreted as a lessening of NESO's accountability to the ESO's RIIO-2 commitments. Whilst the Business Plan will focus on Performance Objectives, we continue to expect NESO to deliver the full commitments made by the ESO under RIIO-2, or alternatively clearly explain

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<sup>21</sup> For BP2, we required a strategic narrative to accompany cost data. The strategic narrative was a summary explanation of quantitative data provided on proposed operations and investment plans during the RIIO-2 period.

where and why previous commitments may have changed. NESO should reflect how these commitments fit into its Business Plan for BP3 to ensure transparency and accountability across the RIIO-2 period.

- 3.12 We believe that there is a continued important role for Ofgem when it comes to verifying the value for money of NESO's plans. This means we expect to receive a similar level of up-front cost justification as we do today but with changes to reflect the level of information already received through the CMF. This will avoid duplication through multiple reporting routes. In addition, costs will not need to be structured by the existing ESO roles. This change aligns with our proposed changes to the Value for Money assessment, outlined in Chapter 2.
- 3.13 We have proposed modifications to cost requirements included in the Business Plan for BP3 (outlined in more detail in our proposed Business Plan Guidance document), to reflect the justifications already received for certain investments and remove reporting we believe no longer adds value from BP2.
- 3.14 For IT investments, the level of justification required will depend on whether the investment is already included in the CMF and hence has the appropriate level of scrutiny. For non-IT investments, we expect to receive cost information to ensure a consistent baseline of information for our assessment across both IT and non-IT investments. Similarly, we only require CBAs for new activities and investments that have not already been justified in the decision to create NESO, as the benefits of these new responsibilities have already been considered. Finally, we no longer require a strategic narrative for forecast costs as we have reflected through the BP2 process that this does not add value beyond the justifications already provided in the Business Plan itself.

## **Business Plan assessment**

### **Background**

- 3.15 Before the start of BP2, the Business Plan process involved the ESO producing a draft Business Plan before consulting on a final Business Plan. Ofgem then issued a Draft and Final Determination on the ESO's Business Plan. In our Draft Determination, we set out for consultation: our grading of the ESO's two-year delivery schedule, our Value for Money assessment, key performance measures for BP2, and any other aspects of the price control which were being reviewed.

Our assessment involved determining how well the business plan reflected stakeholder views and Ofgem's expectations, as set out in the Roles Guidance. The Business Plan, and our determinations, helped to set a benchmark for the performance assessment process.

## **Consultation position**

- 3.16 We propose that broadly the same Business Plan process remains in place for BP3. For clarity, this will involve requiring NESO to consult with stakeholders before producing a final Business Plan. As part of NESO's consultation on its Business Plan, we expect NESO to develop, test and propose its Performance Objectives and Success Measures, as outlined in the section above. Ofgem will then also consult on our initial view of the Business Plan (a Draft Determination) before providing a final comment on the plan (a Final Determination).
- 3.17 We propose Ofgem's Business Plan determination will largely focus on three elements: our assessment and determination of NESO's Performance Objectives; our Value for Money assessment; and our proposals for reporting requirements, including the Performance Measures for BP3.
- 3.18 When making our determination of NESO's Performance Objectives, our assessment will consider whether the Performance Objectives and Success Measures:
- sufficiently cover key areas and priorities for the energy system and consumers (including by reflecting priorities in the SPS), appropriately link back to and build on the ESO's overall RIIO-2 ambitions, and reflect wider stakeholder priorities;
  - are suitably stretching and ambitious; and
  - are clear and measurable.
- 3.19 Our consideration of NESO's Success Measures will focus on how well they are specified and their relevance to the Performance Objective they relate to. We may add, remove or amend the Performance Objectives to ensure clarity on how NESO's performance will be considered. We will explain these changes, as part of our determinations, to provide clarity on the reasons.
- 3.20 We propose to continue to assess value for money. Through our Value for Money assessment, we will make a determination on two aspects: whether the



proposals in the Business Plan, including any new investments, have been sufficiently justified to be undertaken and funded by consumers; and whether the plan has demonstrated overall value for money for consumers. We will not undertake a Red Amber Green (RAG) rating for IT investments.

- 3.21 For reporting requirements, we propose to set the frequency and content of within-scheme reporting against Performance Objectives and value for money, as well as Performance Measures. We do not propose to make any major changes to the Performance Measures for BP3 compared to BP2. However, in future, for April 2026, we expect to further consider the most appropriate Performance Measures for NESO.
- 3.22 Further details of our assessment approach are outlined in the NESO Business Plan Guidance document, which we are consulting on alongside this document.

### **Rationale for consultation position**

- 3.23 We have proposed to keep the same core processes in BP2 in place for BP3 to ensure stakeholders have the same appropriate routes to input into the Business Plan process. We believe this will ensure stakeholders continue to have the ability to challenge and comment on both NESO's Business Plan, including whether they agree with the proposed Performance Objectives and Success Measures, and Ofgem's Business Plan Determination.
- 3.24 Ofgem's determination on Performance Objectives will set clear and up-front performance expectations for BP3, which underpin the design of the performance incentive approach, as set out in Chapter 2. Our assessment will consider the several factors outlined above to ensure the Performance Objectives and Success Measures proposed by NESO are stretching and accurately capture performance. Where we consider the Performance Objectives or Success Measures are not suitable, this will be highlighted through our determinations to set a clear point of reference and align expectations in the incentives process.
- 3.25 We continue to see Ofgem playing an important role in providing an independent, regular verification of the value for money of NESO's plans. Therefore, we continue to believe an assessment of NESO's proposed costs and value for money should continue to remain a key part of our business plan approval process. Our RAG ratings of the ESO's IT investments during the BP2

incentive scheme and ongoing monitoring through the CMF, will be reflected in our Value for Money assessment for BP3. As such, we do not expect that undertaking a RAG rating at the start of BP3 will add additional benefit to the existing levels of scrutiny on NESO's costs. For the avoidance of doubt, this approach does not preclude us from using a RAG rating if we deem it necessary for BP3, or from April 2026 onwards, when RIIO-2 ends.

- 3.26 Given the short timeframes between now and the start of BP3, we expect limited change to the performance measures used from Day 1. For April 2026, we expect to introduce greater changes to the performance measures to better reflect the full spectrum of NESO roles (such as NESO's new gas planning activities).

### **Consultation questions**

NESOQ3. Do you agree with our proposed requirements for NESO's Business Plan?

NESOQ4. Do you agree with our proposed approach to assessing NESO's Business Plan and the stages involved in the Business Plan process?

NESOQ5. Do you have any views on performance measures for BP3?

## 4. Cost regulation

### Section summary

This section outlines our proposals for the regulation of internal costs through BP3. We do not propose to change our approach to the cost regulation framework from Day 1. We will continue to use the Cost Monitoring Framework (CMF), with reporting updates for BP3 to reflect the different stages of development for investments covered by the CMF.

### Background

- 4.1 For Day 1, we proposed that NESO will continue to be funded through a pass-through funding approach given the dynamic and evolving nature of its activities, and the need for it to adapt quickly in response to wider developments. However, to ensure NESO is clearly accountable for delivering value for money for consumers, we proposed to continue our regular, independent scrutiny of spending through the value for money component of the performance assessment process.
- 4.2 In addition, we proposed that the concept of Demonstrably Inefficient and Wasteful Expenditure (DIWE) should remain and be embedded into NESO's licence. Whilst we do not think it would be feasible or appropriate to disallow costs under a not-for-profit model, for Day 1, any instances of DIWE will be dealt with via the enforcement process<sup>22</sup>. This will help to retain a clear distinction between poor demonstration of value for money and more serious spending failings, with different levels of regulatory response and consequences.

### Consultation position

- 4.3 We do not propose any material changes to our approach to the cost regulation framework from Day 1 – we will continue to provide assurance on spending under the pass-through model, through an ex-ante and ongoing assessment and

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<sup>22</sup> For more details, please see: [Enforcement Guidelines \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/enforcement-guidelines)

a requirement for regular reporting on the value for money NESO is demonstrating through its activities.

- 4.4 We propose to continue to use our CMF, that sets out a detailed framework to monitor NESO's costs. We expect to receive a similar level of granularity on costs through the CMF as for Day 1. However, we propose to make updates for BP3 for proportionality and to avoid a duplication of current reporting: for example, for new investments, we expect to receive the same level of granularity on costs as currently set out in the CMF for Day 1. However, we are not proposing to require NESO to replicate information for existing IT investments through the CMF as many projects are at the end of the delivery stage and we already have received this data during BP2. Further details on the specific BP3 changes to the CMF will be outlined for consultation in the NESO Performance Arrangements Governance Document later this year.

## **Rationale for consultation position**

- 4.5 Whilst NESO's legal duties will encourage it to consider consumer impacts and overall cost efficiency, NESO will be funded entirely by consumers and central government will not be directly involved in its budget setting. As a result of this, Ofgem has a crucial role in providing an independent, regular verification of the value for money of NESO's plans. Therefore, we believe an assessment of costs should continue to remain a key part of our Business Plan approval process for NESO, and that value for money should remain a central component of the performance assessment process.
- 4.6 Our proposals on CMF will ensure we are able to apply robust scrutiny and incentives on spending and can continue to build confidence on NESO's IT related investment and expenditure. Our proposed proportionality changes will minimise duplicative and unnecessary reporting, which will free up resource in Ofgem and NESO for activities which deliver benefits.

## **Consultation questions**

NESOQ6. Do you agree with our overall approach to cost regulation for BP3?

## 5. Stakeholder and external scrutiny

### Section summary

This section outlines our proposals for the role of the NESO Performance Panel and stakeholder input into the incentive scheme for BP3. We propose to keep the same platforms for stakeholder scrutiny as at Day 1 but will review the approach to end-of-scheme events to establish whether there are changes that can maximise engagement from BP2.

### Background

5.1 For Day 1, our planned regulatory framework for NESO includes several routes for external input. We administer the NESO Performance Panel, which comprises industry parties and independent experts, and which is responsible for providing recommendations to us on NESO's performance assessment. In addition, we seek wider views from industry through an end-of-scheme event and calls for evidence. We also require NESO to undertake a regular, independently administered stakeholder satisfaction survey.

### Consultation position

5.2 We propose to maintain the same platforms for stakeholder input as proposed for Day 1. Similarly, we propose to keep the same arrangements and role in place for the NESO Performance Panel. However, we expect to review the approach to end-of-scheme stakeholder events to establish whether there are changes that can help maximise engagement and the contribution of stakeholder views at these events.

5.3 Further details on the specific stakeholder arrangements will be outlined for consultation in the NESO Performance Arrangements Governance Document later this year.

## **Rationale for consultation position**

- 5.4 Given the vital service-provision role of NESO to the energy industry, we continue to think it is important that there are easily accessible routes for stakeholders and external parties to provide feedback on NESO's performance and hold it to account. As such, we do not plan to change the existing avenues and frequency that stakeholders can provide input into the incentive scheme for BP3.
- 5.5 However, we think that the approach to end-of-scheme stakeholder events may need to be further reviewed for BP3. We will reflect on past experience from BP2 to establish whether there are changes that can help maximise engagement and the contribution of stakeholder views at these events. We will consult on the specific details of the BP3 stakeholder arrangements in the NESO Performance Arrangements Governance Document later this year.
- 5.6 Finally, we do not plan to make changes to the NESO Performance Panel for BP3. This reflects the impracticalities of making any wider changes in such short timeframes before the start of BP3, while also providing us with a window to gain greater experience of how the NESO Performance Panel operates from Day 1 and into BP3 before proposing any further changes for April 2026 onwards. Therefore, we will further consider the role of the NESO Performance Panel, alongside other existing and potential future channels for stakeholder scrutiny, for the next Business Plan cycle in April 2026.

## **Consultation questions**

NESOQ7. Do you agree with our overall approach to stakeholder and external scrutiny for BP3?

## Appendices

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## **Appendix 1 - Consultation questions**

This annex lists the consultation questions in this document.

### **Performance incentives**

NESOQ1: Do you agree with our proposed approach to the performance assessment for BP3?

NESOQ2: Do you agree with our proposed changes to setting performance expectations for BP3?

### **Business Plan and plan assessment**

NESOQ3: Do you agree with our proposed requirements for NESO's Business Plan?

NESOQ4: Do you agree with our proposed approach to assessing NESO's Business Plan and the stages involved in the Business Plan process?

NESOQ5: Do you have any views on performance measures for BP3?

### **Cost regulation**

NESOQ6: Do you agree with our overall approach to cost regulation for BP3?

### **Stakeholder and external scrutiny**

NESOQ7: Do you agree with our overall approach to stakeholder and external scrutiny for BP3?



## Appendix 2 – Glossary of NESO-specific framework terms

### Guide to NESO outputs and incentives components

Element	Description
Activity	A subset of responsibilities within a function.
Business Plan	Details NESO’s Performance Objectives, associated Success Measures, Major Deliverables and costs for the Business Plan cycle.
Business Plan cycle	The business plan cycle is the period for which the business plan is applicable. The business plan cycle which covers the incentive scheme starting on 1 April 2025 and ending on 31 March 2026 is called BP3.
Delivery schedule	A grouping of deliverables for either a role or the Business Plan in BP2.
Electricity System Operator (ESO)	The entity which is expected to be designated as ISOP in 2024.
Evaluation criteria	The criteria used by the NESO Performance Panel to measure the ISOP’s performance for each role in BP2.
Function	A group of NESO activities as set out and defined by NESO in the Business Plan.
Incentives scheme	The process over a Business Plan cycle to assess NESO’s performance.
Major deliverable	Specific, measurable and timebound outputs that are key to achieving the Performance Objectives for the annual Business Plan submission. In most cases, we would expect delivery of these Major Deliverables to be relevant Success Measures.
NESO Performance Arrangements Governance Document	A document which sets out the logistics and detailed mechanics of the incentives scheme, including guidance on how NESO performance should be evaluated and what it should report.
NESO Performance Panel	A mix of independent experts and industry representatives that are responsible for reviewing the NESO’s plans and performance, as well as performing an end of scheme evaluation of NESO’s performance.

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NESO Roles Guidance	Sets out our expectations for how NESO should comply with its obligations.
Performance Measure	A measure of the NESO’s performance, including performance metrics, stakeholder satisfaction and other regularly reported evidence.
Performance Objective	An annual key outcome or output aligned with NESO regulatory duties and industry needs, with associated Major Deliverables and Success Measures.
RIIO-2 period	RIIO-2 covers the period starting 1 April 2021 and ending on 31 March 2026.
Role	One of the three roles used to structure obligations under the incentive framework for BP2: control centre operations; market development and procurement; and system insight, planning and network development.
Strategic aim	Key outcomes that NESO intends to achieve to deliver its overall organisational vision, including its strategy for delivering these outcomes. Strategic aims are set in the medium to longer term, beyond the annual Business Plan submission, and provide clarity on what is underpinning NESO’s Performance Objectives.
Success Measure	Supporting evidence used to evidence <i>how</i> each Performance Objective has been delivered.
Value for Money assessment	Considers whether NESO has delivered value for money, striking the optimal balance between maximising benefit delivered from outputs whilst minimising costs.

## **Appendix 3 – Privacy notice on consultations**

### **Personal data**

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

#### **1. The identity of the controller and contact details of our Data Protection Officer:**

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at [dpo@ofgem.gov.uk](mailto:dpo@ofgem.gov.uk)

#### **2. Why we are collecting your personal data:**

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

#### **3. Our legal basis for processing your personal data:**

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

#### **4. With whom we will be sharing your personal data:**

Unless you indicate otherwise, we may make your response, as provided, available online. If you indicated to us that your response is confidential, we will not publish it online and nor will we share your personal data with any other organisations.

#### **5. For how long we will keep your personal data, or criteria used to determine the retention period:**

Responses will be stored for reference until we have established a more stable and enduring regulatory regime for the NESO.

#### **6. Your rights:**

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data

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- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3<sup>rd</sup> parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

**7. Your personal data will not be sent overseas.**

**8. Your personal data will not be used for any automated decision making.**

**9. Your personal data will be stored in a secure government IT system.**

**10. More information:**

For more information on how Ofgem processes your data, click on the link to our "[ofgem privacy promise](#)".