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Ofgem
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5 July 2024

Submitted via email to FSO@ofgem.gov.uk

Re: Consultation on Associated Documents to the proposed NESO licences – regulatory framework documents

Dear David,

Energy UK broadly welcomes the consultation on proposed changes to the Associated Documents (ADs) that would be established under National Energy System Operator's (NESO) proposed new licences. Energy UK agrees that further consultation on an enduring NESO regulatory framework would also be appropriate.

The previous consultation on the Policy Direction for the Future System Operator's Regulatory Framework primarily pertained to long term arrangements. Energy UK is, therefore, pleased to see further work to establish the guidance, governance and funding arrangements for the NESO's license frameworks. As the system operator transitions from a private, for-profit agency to a publicly-owned, not-for profit entity, ensuring that reputational incentives and penalties for performance are sufficient and well implemented is crucial, both for the current price control period and future operations.

With respect to the proposed changes to each of the three ADs, Energy UK has the following comments.

Proposed Independent System Operator and Planner (ISOP) Roles Guidance

Energy UK broadly supports the minor changes proposed for the three existing BP2 roles. These changes appear proportionate as interim changes and reflect the expected scope of the NESO, although further changes would be welcome.

The proposed content in chapter 5 of the guidance document on implementation of the ISOP is welcome. This implementation period will be occurring at the same time as key workstreams, namely the Strategic Spatial Energy Plan (SSEP), Review of Electricity Market Arrangements (REMA), Transmission Network Use of System (TNUoS) charging reforms, and connections reform. Guidance should be added to chapter 5 to establish clear guidelines for how the NESO is to coordinate activities with other ongoing workstreams and how this should be managed around and in line with implementation workstreams.

The NESO is due to take on a number of responsibilities from Day 1, perhaps most significantly the operation of the gas network. Ofgem must ensure that the three core BP2 assessment roles are sufficient to hold the NESO to account for delivery across these new responsibilities. More clarity on where NESO roles, including those outlined in chapter 5, begin and end, and how the NESO will interface with other bodies is needed in this space and others. Energy UK acknowledges that as long as these measures are quickly consulted on and reviewed prior to the end of BP2, the proposed changes to the three core roles should be sufficient at present.

Far more granular guidance on transparency is necessary from Day 1, along with the a framework for stakeholders to regularly review said guidance. Ofgem and the ESO currently intend the NESO to transition to a reputation-led incentive regime and away from financial incentives prior to the end of BP2. The NESO will need to be highly technical, specialist and deliver cutting-edge innovation across

a broad range of areas, requiring consultation and engagement with a wide range of experts from across the sector to ensure the best possible outcomes are delivered.

For Ofgem to hold the NESO to account effectively, particularly in the context of significant staff turnover risking a loss of Ofgem's institutional knowledge, there must be sufficient transparency for both Ofgem and external stakeholders to scrutinise the NESO's performance. The NESO's own monitoring and Ofgem investigations/ assessments must make service level issues sufficiently visible for them to be included in the strategic assessment to enable sufficient ability for the sector to continue to hold the NESO to account for delivery.

More work is needed prior to Day 1 of the NESO to establish effective guidance for transparency. While the word 'transparency' and its associated route words are mentioned 39 times in the proposed guidance document, it remains relatively high-level. Given the level of technical granularity needed if the NESO is to be reputation-led from Day 1, far more specific detail on the approach to transparency is necessary.

One recommendation from Energy UK members has been introducing a requirement and associated guidance on responding to requests or communications from industry stakeholders. Establishing requirements for how quickly the NESO responds to requests would be a welcome measure.

Market participants are best placed to inform the NESO's priorities and challenge performance across the organisational priorities. The NESO will need to ensure that there are effective conditions in place to enable customers and stakeholders to engage on these matters effectively. Any obligation to respond to stakeholders, particularly where an established quota of the number of inquiries on a specific topic is set out, should require the NESO to take appropriate action to address concerns or set out why action is not being taken.

Energy UK members have also raised concerns around the exact reasoning behind the striking of various aspects of the old versions of the AD's, including text on ancillary services and on financial transparency. It would be helpful if Ofgem directly engaged with stakeholders on these specific concerns.

Proposed ISOPRI Arrangements Governance Document

Removal of incentive reward / penalty

Energy UK is pleased that Ofgem is proposing to obligate the NESO to produce license arrangements for how it will take into consideration the regulatory assessment for senior staff financial incentives decisions. It is also welcome that, prior to the end of BP2, key remuneration and performance metrics will continue to be made available for stakeholders.

As Ofgem is proposing that the NESO start on a non-profit basis from Day 1, prior to the conclusion of BP2, Ofgem must further review how to drive incentives and penalties and be realistic about the impact that the various levers might have in practice. In truth, the only truly effective lever in Ofgem's toolbox going forward from Day 1 of the NESO will be reputational risk. It is for this reason that some deeper measures pertaining to reputational risk should be implemented into the governance framework now.

Appropriate measures could include the use of external audits and public hearings, run by a body such as the National Audit Office (NAO) or Public Accounts Committee (PAC). Ofgem could similarly hold public hearings should licensed parties breach their obligations. Given DESNZ's future role in assessing Ofgem's and the NESO's compliance with the Net Zero Duty, there may be a similar difficulty in accountability. A DESNZ board could be used in a similar way to evaluate Ofgem and NESO performance here.

Assessment of new NESO responsibilities and activities

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Energy UK is pleased to see some additional clarity on the performance assessment criteria for Day 1 of the NESO. The principal to assess both the delivery of existing BP roles and the delivery of the ISOP is appropriate, as is the proposal to use the Performance Panel to lead the End of Process Review.

While the Performance Panel has improved transparency and engagement with the industry, both essential for this assessment role, Energy UK members have raised concerns about how resource intensive the Panel is. There are also concerns about the Panel's over-reliance on the ESO, meaning failings are not always identified or managed. Efforts to address these shortcomings might involve implemented guidance on the use of the Transparency Forum and the Data Portal with respect to performance assessment. Both of these processes have been well received.

There remains little certainty on the exact assessment criteria the Performance Panel will use, especially with respect to how performance will impact the remuneration of senior staff members. In general, however, it was felt that 'not-for-profit' organisations could not support the level of bonus payments likely to be sufficient to drive behaviour. Therefore, as reputation is the key lever here, Energy UK would support the Board being required to make information on bonuses public. This information would support external scrutiny, and would need to be supported by a robust, consistently applied, and transparent approach to awarding bonuses.

Streamlining and improving the regulatory process for BP2

It is positive to see that Ofgem is aware of stakeholder concerns that streamlining regulations for the NESO, at a time when it is set to take on a number of activities during a time of significant industry change, could result in oversight that is too light touch. The activities outlined to streamline the frequency or detail of some reporting requirements appear appropriate. There remain some concerns from Energy UK members that lessening the reporting frequency for plan delivery to the 18-month and End of Scheme point may be too infrequent given the quantity of work that is expected to occur over the next few years.

While Energy UK agrees with Ofgem's assessment that there is less value to be obtained in the cost-benefit-analysis (CBA) for BP2 from performance insight of specific metrics compared to value-based outputs, Energy UK would emphasise that more detail is needed on the regularity of reporting and the number of performance metrics. Whilst performance metrics can be said to distract from outcome-based assessment, they can help provide transparency to the wider industry and support external scrutiny. This transparency and external scrutiny will become more rather than less important as the NESO takes on more powers. If more data is publicly accessible to enable scrutiny, Energy UK would support the move to fewer performance metrics, but Ofgem should apply caution when streamlining in this area.

Whilst Energy UK appreciates the flexibility afforded how the Performance Panel produces its final recommendations, Ofgem should provide some greater guidance surrounding under what circumstances differing reporting methods would be used. Given how vital this period is for industry, clarity is needed on reporting standards, especially with respect to the implementation of the ISOP.

Overall, efforts to streamline NESO's workload elsewhere within the body should free up capacity for essential reform and implementation activities. Given the importance of reform during this period, the emphasis should be on frequent engagement with industry, at least in the coming two years. Relaxation of reporting frequency can be prioritised at a later date.

Proposed FSO Transition Funding Governance Document

Energy UK supports the proposal to reformulate the funding governance document to focus on the maintenance of the intragroup contract between National Grid plc and the NESO and on Day 1 reporting requirements. Energy UK trusts that Ofgem will endeavour to ensure industry are kept abreast of these reports and how they might, in any way, affect other workstreams related to governance reform.



The voice of the energy industry

Energy UK will continue work to support the governance reform process wherever possible, and Energy UK and its members would welcome any further engagement on this work.

Yours sincerely,

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