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27 September 2024

Response to Consultation on National Energy System Operator's performance incentives framework for BP3 and the associated NESO Business Plan: Guidance Document

Dear David,

Thank you for the opportunity to respond to your consultation on National Energy System Operator's performance incentives framework for BP3 and associated NESO Business Plan Guidance Document.

Who we are

NESO lies at the heart of the energy system as an independent, public corporation responsible for planning Great Britain's electricity and gas networks, operating the electricity system and creating insights and recommendations for the future whole energy system.

At the forefront of our efforts is delivering value for consumers. We work with government, regulators and our customers to create an integrated future-proof system that works for people, communities, businesses and industry, where everyone has access to clean, reliable and affordable energy.

NESO's primary duties are to enable the government to deliver net zero, promote efficient and coordinated systems for electricity and gas, while ensuring security of supply for current and future consumers. NESO will take a whole system approach, looking across natural gas, electricity and other forms of energy and will engage participants in all parts of the energy ecosystem to deliver the plans, markets and operations of the energy system of today and the future.

Our key points

- We support Ofgem's proposed approach for performance assessment, as it represents a significant and positive step towards a more strategic and proportionate framework, recognising the changes that are required as the ESO transitions to NESO. Applying a single, consistent performance framework across all NESO activities will ensure performance discussions are focused on the right areas - those that drive the most benefits for consumers and industry. This is reflected in the requirements for NESO's BP3, which will be more strategic, articulating the most impactful and overarching objectives that NESO will achieve.
- We agree that a high performing NESO should have an ambitious plan but it's also important that it's achievable. The transition to NESO and the new roles it will undertake already represents a significant degree of ambition, which will be reflected in BP3. The current proposal suggests all Performance Objectives should be stretching and ambitious, with Success Measures reflecting an exceeding of expectations. However, we believe it important to be clear on what is required for Performance Objectives and supporting Success Measures to meet expectations as well as exceed expectations.

- We are supportive that the value for money (VfM) criteria has increased in prominence in the new framework, as we are committed to ensuring VfM for consumers. It will be important for us to work closely with Ofgem to ensure a transparent framework on how assessments are made. We look forward to further engagements with Ofgem to gain clarity on this, ideally seeking to agree a clear approach to VfM that is as objective, and data driven as possible whilst still reflecting a more strategic and proportionate framework.
- We recognise that the timelines for the business plan process for BP3 are compressed due to the unique circumstances of the transition to NESO. It is important that Ofgem and NESO follow a robust process, which allows and encourages stakeholder input and feedback. However, the constrained timelines will likely mean that Ofgem's final determination will occur after the start of the BP3 period. We will continue to work closely with Ofgem to determine whether there is opportunity to reach a final determination before the start of the BP3 period. Failing that, NESO will be operating at risk. Although we acknowledge this risk can be mitigated through extensive engagement with Ofgem throughout our development of BP3, we would note that as a non-profit public corporation, any costs already incurred would need to be recovered from consumers, to avoid the risk of financial instability of NESO, regardless of final determination.
- We welcome Ofgem's proposals on stakeholder and external scrutiny in BP3. Stakeholder engagement is a critical element in all the activities we deliver. This engagement holds us to account for delivery of what we've committed to, as well as supporting us to design and develop our plans. We will work with Ofgem to look at the range of stakeholders we both engage with, to make sure feedback is fully representative of a whole system view and to identify potential improvements to the stakeholder engagement approaches for our incentives performance assessment.

We look forward to engaging with you further, both on the points raised within our response, but more broadly as the regulatory framework continues to develop over time. Should you require further information on any of the points raised in our response please contact Laurence Barrett, Regulatory Strategy Manager, at laurence.barrett@nationalgrideso.com.

Yours sincerely

Zoe Morrissey

ESO Director of Legal & Regulation

Appendix 1: Consultation Question Responses

Performance incentives

Question 1: Do you agree with our proposed approach to the performance assessment for BP3?

We support Ofgem's proposed approach to the performance assessment for BP3.

The transition of the ESO to NESO represents a significant change in our roles and responsibilities, with new statutory duties and licence obligations. We believe a move to a more strategic regulatory performance framework is an important step forwards, to ensure that performance discussions are focused in the right areas, namely those that drive the most benefits for consumers and industry. Ofgem's proposed approach is the first step towards a more strategic and proportionate framework.

We welcome the proposals to apply a single consistent methodology, building on the existing performance criteria but with an increasing focus on achievement of business plan delivery aims and delivery of value for money (VfM). We support the proposal for Performance Objectives that are more impactful and overarching in nature, underpinned by Success Measures that can be used to hold us to account. This allows the most relevant aspects of other criteria, such as stakeholder feedback or metrics, to be directly linked to specific Performance Objectives, creating a more effective assessment approach.

We are supportive that the VfM criteria has increased in prominence in the new framework, as we are committed to ensuring VfM for consumers. As an organisation entirely funded by consumers, it is important that any activities or investments we undertake represent good VfM, and Ofgem's ongoing focus in this area will ensure NESO is held to account. However, whilst the principles behind VfM are clear, the actual process by which this is assessed is more subjective. We believe that increasing transparency on how assessments are made would be beneficial and we look forward to engaging with Ofgem to gain clarity on this part of the framework, ideally seeking to agree a clear approach to VfM that is as objective, and data driven as possible, whilst still reflecting a more strategic and proportionate framework.

We also look forward to engaging with Ofgem to support the development of the NESO Performance Arrangements Document, ahead of the consultation later in the year. This will provide the next layer of detail behind the regulatory framework, consolidating the direction of travel set out in these consultations.

Question 2: Do you agree with our proposed changes to setting performance expectations for BP3?

We agree with the rationale set out in the consultation on creating a clearer distinction between licence guidance and incentives expectations.

The existing ESO Roles Guidance currently serves a dual purpose, and this can create confusion about how it is being used in different circumstances. The proposal to focus the Roles Guidance on how NESO can best meet its licence obligations provides welcome clarity and brings the Guidance in line with the approach taken in many of the other Associated Documents.

It therefore makes sense for the incentives performance expectations, which seek to drive performance above and beyond our licence obligations, to then be more directly linked to our performance against our business plan. Using Performance Objectives, with specific and tailored Success Measures, creates a clear view of what good performance looks like.

We agree that a high performing NESO should have an ambitious plan, and this should be reflected through ambitious Performance Objectives and Success Measures but it's also important that it's achievable. The proposed approach is that to ensure our Performance Objectives and Success Measures are suitably stretching and ambitious, they should be set in such a way that achieving them would be equivalent to an "exceeding expectations" performance outcome. Whilst we agree that there is benefit in understanding how we could exceed expectations, we believe it is important

to be clear on what is required to meet expectations as well. Without such clarity, there is a risk of confusion on what our performance assessment would be, in the circumstances that the Success Measures were not fully met.

We look forward to engaging with Ofgem and wider industry to ensure we develop Performance Objectives and Success Measures which are appropriate, deliverable and meet the aims of the performance framework.

Business Plan and plan assessment

Question 3: Do you agree with our proposed requirements for NESO's Business Plan?

We agree with Ofgem's proposed requirements for our business plan. The proposals reflect the intent to move to a more strategic and proportionate approach, in line with the performance assessment framework.

Upon transition to NESO, we will take on new statutory duties and must have regard to the strategic priorities set out in the Strategy and Policy Statement (SPS). It therefore makes sense for our business plan to clearly articulate how our Performance Objectives are aligned to these. We also recognise and support the required continuity across the RIIO-2 regulatory period and agree that this can be achieved through setting out Strategic Aims which explain the link between BP3 and the original medium-term strategy for RIIO-2.

The Business Plan Guidance document sets out several principles that our Performance Objectives should meet, and we agree that these appear sensible and aligned to the overall aims of the BP3 performance framework. However, we have already outlined above the need for balance when it comes to ensuring that Performance Objectives are set at a suitably stretching level of ambition. We agree that they, and the supporting Success Measures, should be ambitious but believe it important to have clarity on how our performance against them can meet expectations as well as exceed expectations.

We are committed to transparency to ensure that both Ofgem and our stakeholders are able to understand our progress against our business plan and hence agree with the need for the BP3 Performance Tracker. We also recognise that this would reflect a more proportionate approach set out in the proposals compared to the BP2 Delivery Schedule.

We welcome the increased flexibility to move away from a business plan structured around the three ESO Roles. This allows us to focus the plan on the most impactful outcomes and outputs and importantly, reflect the fact that the breadth of NESO is significantly larger than the ESO's.

We broadly agree with the requirements set out in both consultations regarding internal costs and value for money. As a public, not for profit, corporation that is entirely funded by consumers, it is important that we provide transparent cost data to ensure that we are delivering VfM for consumers and the wider energy sector. We welcome the decision to no longer require a Strategic Narrative alongside the Business Plan Data Template (BPDT) and look forward to further engagement with Ofgem to agree the format and template to be used for the BP3 BPDT submission.

Where our Performance Objectives are a continuation of existing activities, we agree with the requirement to explain how these have evolved from BP2. This is particularly important given the shift towards a more strategic business plan, to provide confidence that we remain committed to delivering activities set out in previous plans or providing a clear explanation of why these are no longer appropriate. BP3 should explain how the Performance Objectives are driving benefits, but we support the proposals to not require updates to CBAs for existing activities or investments. Instead, we agree BP3 should require CBAs on new activities/investments, or those that have materially changed. Similarly, we support the proposals for requirements for existing and new IT investments,

as well as non-IT investments, as this will ensure the BP3 assessment focuses on the most notable cost areas to ensure VfM.

Question 4: Do you agree with our proposed approach to assessing NESO's Business Plan and the stages involved in the Business Plan process?

We support the proposals to retain the same core processes to assess BP3 that were used for BP2. It is critical that stakeholders have ample opportunity to feed into both our developing business plan as well as Ofgem's resulting determinations on this plan. We explain further in our response to Q7 our ongoing commitment to ensuring appropriate stakeholder scrutiny.

We want to highlight that the constrained timescales will mean that Ofgem's final determination will occur after the start of the BP3 period. We will continue to work closely with Ofgem to determine whether there is opportunity to reach a final determination before the start of the BP3 period. Failing that, NESO will be operating at risk. Although we acknowledge this risk can be mitigated through extensive engagement with Ofgem throughout our development of BP3, we would note that as a non-profit public corporation, any costs already incurred would need to be recovered from consumers, to avoid the risk of financial instability of NESO, regardless of final determination.

We agree that Ofgem's determination process should largely focus on an assessment of our proposed Performance Objectives, an assessment of VfM and a view on reporting requirements and Performance Measures. BP3 represents an important shift in how a business plan will look and what it will cover. We look forward to engaging with Ofgem and stakeholders as we develop Performance Objectives, culminating in our Draft Business Plan consultation later in the year. We would welcome further engagement with Ofgem to better understand what the VfM assessment for BP3 will look like, ideally seeking to agree a clear approach to VfM that is as objective, and data driven as possible, whilst still reflecting a more strategic and proportionate framework.

Question 5: Do you have any views on performance measures for BP3?

We agree with Ofgem that appropriate Performance Measures can provide a reputational incentive in their own right. This includes transparent reporting against our Performance Objectives, as well as stakeholder surveys and metrics. The proposals are to not make any major changes to the Performance Measures for BP3 compared to BP2. However, we do see a potential overlap between Performance Measures and Success Measures and would be keen to understand how the two differ and interact. For example, it is possible that an existing metric or RRE could be an appropriate Success Measure for a Performance Objective, whereas we recognise others may be broader and less attributable to an individual Performance Objective.

Whilst we understand Ofgem's view not to make any major changes to the Performance Measures for BP3, we feel that any reported measure should feed directly into the assessment methodology and associated evidence should align to the wider framework. We think there is benefit in these being looked at on an individual basis as we develop the detail of the framework, to ensure they are effective and to avoid any unnecessary reporting burden.

Beyond this, we welcome Ofgem's commitment to introduce greater changes to the Performance Measures for April 2026 to better reflect NESO's full spectrum of activities.

Cost Regulation

Question 6: Do you agree with our overall approach to cost regulation for BP3?

We fully support the ongoing use of the cost pass-through model to fund NESO, with appropriate assurance activities to ensure that NESO is delivering VfM. We are committed to VfM for consumers and our new statutory duties further strengthen this requirement. Ofgem has a crucial role to play in holding the NESO to account in this area, including reviewing our spending against the new licence

obligation to take all reasonable steps to avoid expenditure which is demonstrably uneconomical, wasteful or inefficient.

We also welcome the ongoing use of the Cost Monitoring Framework (CMF), as we believe this has been effective in improving our performance in this area. We support the proposals for proportionate information provision for new IT investments, such that they can effectively flow into the CMF for ongoing scrutiny.

Stakeholder and external scrutiny

Question 7: Do you agree with our overall approach to stakeholder and external scrutiny for BP3?

We welcome Ofgem's position on stakeholder and external scrutiny in BP3.

Stakeholder engagement is a critical element in all the activities we deliver. This engagement holds us to account for delivery of what we've committed to, as well as supporting us to design and develop our plans. We know that we must work collectively across the energy industry, and with stakeholders outside of the energy industry, to achieve the shared goal of a net zero carbon energy system. The interconnected nature of the energy industry means we need to bring stakeholders with us as we work to facilitate decarbonisation. We also believe that making decisions alongside our stakeholders and factoring in their diversity of views should lead to better outcomes for customers and consumers.

We remain committed to listening to and responding to stakeholder views as we develop our Regulatory business plans and deliver our activities. As NESO, we will continue to follow engagement best practice and regularly engage with stakeholders through a variety of channels e.g. email, webinars, face to face events, surveys and working groups. The feedback we gather through this engagement will help shape the Performance Objectives set out in our Business Plans.

BP3 will be developed using feedback gathered across BP2, as well as any views gathered on our new responsibilities as NESO. Stakeholders will have the opportunity to give their thoughts on our draft BP3 document in a consultation later this year.

We are also engaging regularly with our Independent Stakeholder Group (ISG) who provide scrutiny and challenge on the contents of our plan. We have expanded the membership of this group to include industry expertise that will help inform our new NESO responsibilities and provide a whole energy system view. We have held four meetings with this group since May 2024, with more meetings planned throughout the development period of BP3.

We will work with Ofgem to look at the range of stakeholders we both engage with to make sure feedback is fully representative of a whole system view. We will also work with Ofgem to identify improvements to the stakeholder engagement methods for our incentives performance assessment, including stakeholder surveys and the stakeholder end of scheme events.

Appendix 2: Business Plan Guidance Document

Our responses to the questions above provide broad comments and views on the proposed Business Plan Guidance Document. We also have a few specific points on this document, which we set out below.

- The BP Guidance document sets out the requirement for NESO to explain how it is delivering Value for Money (VfM) for consumers through our BP3 proposals and the processes for Ofgem’s determinations, including an assessment on VfM. We fully support these requirements but think it important for the document to recognise that this is referring to existing, *and future*, consumers. Many of NESO’s activities will be future facing, and the narratives we provide will reflect this.
- The BP Guidance document refers to NESO’s duty to have regard to the SPS on several occasions (paras: 2.6, 3.2, 3.7, 3.10, 3.23 & 4.5). The first three of these references accurately describe the duty, but the final three are less specific in the use of language. For instance, they talk about being “aligned with”, “best meet” and “reflecting” the SPS. We would propose that these references are re-worded to continue to use the phrase “have regard to” the SPS.
- The BP Guidance document sets out the requirements associated with Enabling Functions in paras 3.31-3.33. This includes reference to Operational Service Agreements (OSAs). Whilst we understand the requirements to provide information on OSAs, we would note that OSAs are different from the Enabling Functions (e.g. with regards to exit provisions). We therefore propose that the OSA requirements are pulled out in a separate section within the guidance document.