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Consultation on the Performance Arrangements Governance Document and Licence Expectations Document for NESO for the RIIO-2 Business Plan 3 period

Dear David,

Thank you for the opportunity to respond to Ofgem's consultation on the Performance Arrangements Governance Document and Licence Expectations Document for NESO for the RIIO-2 Business Plan 3 period.

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 duty is to promote three objectives: enabling the government to deliver net zero, promoting efficient, coordinated and economical systems for electricity and gas and the economy and efficiency of energy businesses and 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.

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Our key points

NESO Performance Arrangements Governance Document (PAGD)

- We welcome the changes to the PAGD that reflect Ofgem's policy direction decision published in November, including one public assessment at end-year, and an assessment methodology that considers business plan aims and delivery of value for money.
- We do not believe the BP3 performance arrangements will achieve Ofgem's objective of streamlining the reporting processes. Overall, the arrangements are broadly similar to the current BP2 framework. We will seek a proportionate approach for all outstanding reporting requirements (Cost Monitoring Framework, value for money, Performance Objectives progress updates and other Reported Metrics) as we engage with Ofgem over the Determinations period.
- We recognise the ongoing use of the Cost Monitoring Framework (CMF) in BP3, however seek alignment with Ofgem on the steps needed to remove this additional regulatory reporting requirement in the future to reflect an outcome-based framework.
- We support considering the role of stakeholders to enable a more strategic performance assessment. We look forward to working with Ofgem to agree an appropriate question set and approach to surveys that align with our development of wider stakeholder measurement and insight frameworks now and ongoing.
- We have also included some focussed but important comments on specific paragraphs within the guidance in our full response.

Licence Expectations Document

- We welcome the changes to the NESO Licence Expectations document to remove the performance related expectations that are now part of our Business Plan 3. This allows the document to focus on providing guidance on how we best meet certain licence obligations.
- We support the move away from a three Roles based structure, given these Roles are no longer used within our broader regulatory framework. However, we note that the document still retains many of the legacy expectations associated with past business plans, rather than being purely focused on guidance relevant to our electricity system operator and gas system planner licences.
- We understand that Ofgem has the intention for a more substantial reform of the Licence Expectations document as part of its ongoing work to develop a NESO regulatory framework for post RIIO-2. We agree that a more comprehensive overhaul is needed to resolve some of the legacy references to past business plans and improve the effectiveness of the guidance. As such, we are reserving many of our more detailed views for that process, rather than

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focusing on the document for the BP3 period. Therefore, whilst we will have regard to the Licence Expectations document (in line with Condition C1 of our licences), this may result in identifying areas which are out of date and so should not have a bearing on NESO's activities. Where we do so, we plan to share these views with Ofgem for further engagement.

- We note the more specific additions Ofgem has proposed in the areas of strategic energy system planning (primarily focused on CSNP) and in the area of establishing NESO and provide some more detailed comments on these areas in Appendix 1.

We look forward to engaging with you further. Should you require further information on any of the points raised in our response please contact Simon Targett, Regulatory Incentives Manager at simon.targett@nationalenergyso.com or Laurence Barrett, Regulatory Strategy Manager at laurence.barrett@nationalenergyso.com.

Yours sincerely

Zoe Morrissey

NESO Director of Legal & Regulation

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Appendix 1: Consultation Responses

NESO Performance Arrangements Governance Document (PAGD)

We welcome Ofgem's proposed NESO PAGD for the BP3 period and are supportive of the changes that reflect their policy direction decision published in November, including one public assessment at end-year, and an assessment methodology that considers business plan aims and delivery of value for money. We also support their objective of improving and streamlining processes.

Overall, we feel the arrangements as set out in the PAGD are broadly similar to the current BP2 framework. We therefore do not believe Ofgem will achieve its objective of streamlining processes based on this guidance. We note that further requirements are to be confirmed as part of their BP3 determinations. We will work with Ofgem and seek a proportionate approach for all outstanding requirements which aligns to its objective.

Performance arrangements process

We support Ofgem's proposed removal of a mid-scheme review process and the intent to provide ongoing feedback to NESO during BP3 through our regular monitoring meetings which have been maintained from BP2. We believe this change was needed to reflect the fact BP3 is a one-year period rather than a two-year period. This change does not streamline the arrangements process as it results in the same review process as BP2 over one financial year. We look forward to agreeing an engagement strategy and feedback process which is coordinated, proportionate and benefits both ourselves and Ofgem.

Performance assessment

We welcome Ofgem's simplified guidance for how it will assess our achievement of business plan aims based around Performance Objectives and associated Success Measures as set out in our BP3 plan. This also includes the move to a below / meets / exceeds expectation grading which reflects their policy direction decision in November of which we are supportive.

We note that the proposed value for money assessment follows a similar approach to BP2. It is important for us to work closely with Ofgem to ensure a transparent framework on how the assessment is carried out at the end of the business plan period. We look forward to further engagements with Ofgem to gain further clarity on this, ideally seeking to agree a clear approach to value for money that is as objective, and data driven as possible whilst still reflecting a more streamlined and strategic framework.

Performance reporting requirements

We welcome the replacement of the previous detailed delivery schedule reporting with reporting on progress against our Performance Objectives as set out in our BP3 plan.

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The BP3 Performance Tracker which will set out the specific information that we should provide to fulfil our reporting requirements for the Performance Objectives will be published after Ofgem's BP3 Determinations (to be published after the start of BP3). Details on additional Reported Metrics will also be confirmed at the same time. To ensure there is sufficient time to develop the internal processes required to begin BP3 performance reporting in May, we would need these details agreed much earlier and we are pleased that bilateral discussions with Ofgem on these requirements have already begun.

Stakeholder survey requirements

We support considering the role of stakeholders to enable a more strategic performance assessment of NESO's delivery. We are keen to ensure that any measurement aligns to key outcomes and feedback can be used to drive meaningful and actionable change that can be tracked.

We look forward to engaging with Ofgem as these develop and working to agree an appropriate framing and approach to capturing feedback that aligns with our development of wider stakeholder measurement and insight frameworks.

Cost Monitoring Framework (CMF) reporting

We note the ongoing use of the CMF in BP3 and believe this has been effective in improving delivery and performance in the Data, Digital and Technology space. We also note the new inclusion of NESO's performance exiting from the Transitional Services Agreement with National Grid.

We would like to highlight that the CMF was implemented as a regulatory reporting requirement to increase visibility of delivery and performance across our IT investments. We believe that we have made significant progress in this area over the BP2 period and Ofgem's feedback in BP2 has suggested they are now much more confident that we have the processes in place and ability to deliver our ambitious IT commitments. We will seek alignment with Ofgem on the steps needed to remove this additional regulatory reporting requirement in the future to reflect an outcome-based framework.

We note that Ofgem will confirm the full scope of the CMF as part of its BP3 determinations, following their review of our proposed costs for BP3. We look forward to engaging with Ofgem further on this through the determinations period and will seek a proportionate approach for these requirements which fulfils Ofgem's intent to streamline and simplify the arrangements.

Other points

We would like to highlight other points/suggested changes as follows:

- **2.14/2.16** – We ask that Ofgem considers including "or as otherwise agreed with Ofgem" against the expected dates for the end-year performance report and event. This would

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build in flexibility, aligning to the flexibility built into the Ofgem performance assessment publication date (in 2.22).

- **3.3** – This wording does not currently align with Condition F1.3 of our licences. We suggest that the final sentence should change to "how well NESO has demonstrated that it has had regard to any key areas of feedback...".
- **3.11** – We suggest that the third bullet should be expanded to express not only that such developments could impact on Success Measures or Major Deliverables being achieved but also on whether they remain appropriate. This links to 4.14 and the expectation on NESO to deviate from its business plan in appropriate cases.
- **3.13** – We suggest removing the word "proactively" from the third bullet as it suggests additional reporting requirements over and above that set out in the reporting schedule in Chapter 4. NESO proactively providing a large amount of additional information to Ofgem may not be helpful or efficient for either Ofgem or NESO.
- **3.17** – Condition F1.4 of our licences sets out a range of considerations for whether our expenditure might be considered to be uneconomical, wasteful or inefficient. While some of these are captured in 2.17, we suggest that further detail is added from the Condition F1.4 principles. In particular, it could be stated that expenditure in line with Ofgem approved policies is efficient and that any assessment should be made based on the knowledge and information that was reasonably available at the time.
- **2.6 and 3.29** – Whilst we agree that Ofgem's review of NESO's performance should be taken into consideration for senior management performance related remuneration, this is determined by the remuneration policy, as per Condition F7.5 of the licences. The remuneration policy is still to be finalised but we consider paragraphs 2.6 and 3.29 will likely require amendment to ensure alignment with the remuneration policy.
- **4.15** – We suggest changing "will not" to "are not expected to be". It may not be helpful for Ofgem to categorically rule out changes.
- **4.34** – We consider that the opening wording should state that NESO should "seek to ensure that" before the following list. Some of these requirements are too vague to be implemented as licence obligations. In particular, the references to "easy to understand" and "a fair and complete picture". Whilst we agree with the bullet points as clear aims of the reporting, these should not be absolute obligations.
- **4.34** – For consistency with 4.33, we suggest the fourth bullet should include "unless agreed otherwise with Ofgem".

Licence Expectations Document

Section 8 Managing electricity connections and implementing connections reform

The Licence Expectations Document provides updated guidance on the areas of electricity connections and connections reform. We broadly agree with the proposed changes across this section.

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Section 10 Strategic energy system planning

The Licence Expectations Document provides guidance on strategic energy system planning. In this section we have the following comments:

1. *"Conducting fit-for-purpose analytical assessments, including by (but not limited to):*
 - *Identifying and recommending solutions to material network issues before they incur significant additional costs."*

We would welcome further clarity on what constitutes "material" network issues.

2. *"Producing clear, accessible and timely NOA and CSNP publications."*

We believe it would be clearer to add a caveat that the reference to NOA relates to the tCSNP2 refresh publications.

3. *"Ensuring proactive coordination between the different assessments of solutions to transmission network needs (e.g. ensuring coherence between the NOA and CSNP assessments, assessments for Network Services Procurement and offshore wind connections)."*

We would welcome additional clarity on whether the "assessments" referred to in this guidance statement refer to CBA assessments or some other assessment.

4. *"Development of a new Cost Benefit Analysis tool which fairly compares licensee options against third party alternatives."*

We would welcome clarity on whether this refers to a CBA tool that is part of the NOA/tCSNP/CSNP which considers the third-party options in the network planning process (and interested persons?) or whether it is a CBA model that considers the delivery mode (e.g. TO delivery vs competition).

5. *"Throughout the above, NESO should clearly set out expectations from stakeholders, and especially from regulated network companies (ET, GT, ED and GD where appropriate) with regards to the information it will need and when, to ensure NESO can carry out its obligations to a high standard and on time. This should be part of any specific methodology, and where relevant be reflected in amendments to existing and/or new codes and code procedures."*

"Leads on developing a methodology together with stakeholders, to enable the development of whole energy system modelling and recommended solutions, that span beyond electricity transmission network, e.g. electricity distribution, gas transmission and gas distribution network, or the wider energy system such as optimising the development of existing or new loads and/or generation, to solve needs identified for the whole system."

We would welcome further clarity on how the references to gas distribution within these guidance statements fit in with CSNP.

6. *"Develop capabilities in options identification of non-network solutions such as batteries, demand side response and electrolysis to produce Hydrogen to co-optimize the network and wider energy system. When developing capabilities, utilise stakeholder engagement and consider third party solutions at option identification stage."*

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We expect "non-network solutions" (which we take to mean 'non-electricity transmission network solutions') to be identified by the SSEP.

Section 11 Establishing a fully independent NESO

The Licence Expectations Document provides guidance on establishing a fully independent NESO. In this section we have the following comments:

1. *"NESO currently still receives some services from National Grid plc (such as IT)..."*

We note that not all of NESO's IT services are provided by National Grid and it may be helpful to make this clear.

2. *"Ensure transparency is a key principle underpinning NESO's activities and engagement with the sector, by proactively understanding stakeholder needs."*

We believe this statement conflates two separate things around transparency and stakeholder needs. Whilst we agree both are important, it would be clearer if this was separated into 2 independent guidance statements.

- "Ensure transparency is a key principle underpinning NESO's activities and engagement with the sector."
- "Ensure NESO conducts robust engagement and collaboration with a diverse range of stakeholders in order to proactively understand stakeholder needs."

3. *"Ensure there is transparency on NESO's decision-making processes, including by being clear with stakeholders on the reasons underpinning any decisions or recommendations that materially impact them."*

We believe that this guidance statement is too broad in nature and isn't something that could ever be achieved in practice. NESO's licence condition C1.4(b) provides a **reasonable endeavours** obligation to provide clear decisions and recommendations, and the Licence Expectations should be aligned to that. Otherwise, the Licence Expectations would be expanding the scope of the licence, rather than explaining what is expected.

4. *"Demonstrably understand the impact of moving from a private to public entity, including by proactively ensuring all internal processes (including on expenditure, expenses, remuneration etc) are in line with Ofgem and Government requirements and/or guidelines"*

Whilst we recognise the link to requirements or guidelines taking effect under the licence, this guidance statement appears to be much broader in nature, by covering changes to processes generally from becoming a public entity, without any clear link to the licence. We would like further clarity from Ofgem on whether the breadth of this guidance statement is actually intended and if so, how it is linked to the licence. In some cases, this would appear to cover obligations and policies which NESO has become subject to as a public corporation, but which fall under the remit of DESNZ or other government departments and in relation to which we would not expect Ofgem to have a regulatory role.

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General comments

The Licence Expectations Document has been developed from the previous BP2 Roles Guidance document. Given that the latter not only provided guidance on licence requirements but also included aspects associated with performance, there are many references that linked to activities that were set out in previous business plans. Whilst some of these references have been removed with the change in focus of the Licence Expectations document (i.e. by removing the “exceeds expectations” from the document), there are still some legacy references remaining.

We understand that Ofgem has the intention for a more substantial reform of the Licence Expectations document as part of its ongoing work to develop a NESO regulatory framework for post RII0-2. We agree that a more comprehensive overhaul is needed to resolve some of the legacy references to past business plans and improve the effectiveness of the guidance. As such, we are reserving many of our more detailed views for that process, rather than focusing on the document for the BP3 period. Whilst we will have regard to the Licence Expectations document (in line with Condition C1 of our licences), this may result in identifying areas which are out of date and so should not have a bearing on NESO’s activities. Where we do so, we plan to share these views with Ofgem for further engagement. In the meantime, we have highlighted some examples below (note, this is not an exhaustive list). The Licence Expectations document:

- Refers to “Full implementation of Energy Forecasting Project Roadmap commitments for 2018-21.” Given BP2 covers the period Apr 2025 – Mar 2026, this reference is out of date.
- Refers to “outcomes in its RII0-2 Business Plan” in regard to data use and exchange. Whilst the reference links to historic plans as well as our BP3, we believe licence expectations should not be referring to activities set out in business plans.
- Refers to the “Future of Gas Steering Group or equivalent”. NESO has formally stood down this group and established the new Gas Advisory Council (GAC) in its place.

The Licence Expectations document also retains a distinction in timeframes, between guidance statements that apply from the start of the BP3 period, to statements which apply by the end of the BP3 period. This is another legacy reference to the previous Roles Guidance document and a link to business planning cycles. We believe that guidance on how best to meet licence expectations within a period should not be timebound in this manner.

Although we welcome the move away from a structure based around Roles (as per the Roles Guidance), we note that the document still follows a similar approach of guidance by activity area. The document lists the relevant licence conditions that apply to each activity, but there is not a clear link between each guidance statement and a specific licence requirement. Ideally, a document setting out licence expectations should be structured around each licence condition that is being considered to provide the clearest guidance on how best to meet each licence obligation.