

## Annex to Centrica Submission: A Model for Establishing an Expert Review Panel to Enhance NESO's Accountability and Decision-Making Process

### Introduction

1. This Annex proposes a model for a review mechanism to improve NESO's governance and end-to-end decision making. The review mechanism would be specified by Ofgem as a condition in NESO's licence. At the end of this Annex we include an example licence modification. The key points we submit are:
  - a) NESO, as a newly formed body with significant powers, needs to be accountable and have robust and transparent decision-making processes. Any prospect of judicial review (JR) alone is insufficient to ensure NESO's accountability.
  - b) Poor decision making by NESO will have serious consequences for consumers, energy security, investment, and the UK's ability to reach its climate targets.
  - c) We propose a specialised expert review panel be put in place that is able to review NESO decisions. Our proposed review panel would be able to examine a NESO decision and:
    - uphold the decision;
    - set aside the decision and require NESO to remake the decision in line with the review panel's guidance; or
    - correct the decision itself.
  - d) Checks and balances of this type will not only correct individual mistakes but will also improve the rigour of decision-making in general.
2. NESO's remit is important and ambitious. According to Ofgem, "*NESO will inherit all existing responsibilities and functions from NGENSO, along with additional long-term roles related to the gas system*".<sup>1</sup>
3. In addition to taking over the existing ESOs roles, Ofgem have noted that NESO will have "*roles across the energy system, NESO will help plan and deliver the integrated system needed to secure our energy security, net zero and affordability goals*".<sup>2</sup> Crucially, NESO will also be

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<sup>1</sup> Joint DESNZ/Ofgem, [Statutory consultation on National Energy System Operator licences and other impacted licences](#), March 2024. Page 14

<sup>2</sup> Joint DESNZ/Ofgem, [Statutory consultation on National Energy System Operator licences and other impacted licences](#), March 2024. Page 13

given a range of duties under the Energy Act 2023 - and its primary duties are to promote net zero, energy security, and cost efficiency.<sup>3</sup>

4. This represents a significant change that will have far-reaching implications for the energy sector – Ofgem has also noted the significance of this: *“These transformations present significant hurdles for our electricity and gas infrastructure, necessitating careful consideration of the institutional frameworks governing these systems.”*<sup>4</sup>
5. NESO will be operating as a unique style of public corporation, according to Ofgem: *“NESO will be independent, not only of other commercial energy interests, but also from the operational control of government”*.<sup>5</sup> These expanded responsibilities will inevitably bring risk – particularly given the scale and complexity of the transition. Ofgem itself recognises that the implementation of NESO's framework carries a risk of *“hastily delivering major changes without time for sufficient policy development, particularly given the importance of ensuring that NESO has legitimacy in the eyes of the wider energy industry”*.<sup>6</sup>
6. NESO's decisions will have far-reaching impacts on critical national infrastructure, energy security, investment in energy infrastructure, the design and operation of markets, and the UK's ability to meet its climate change targets.
7. It is imperative to recognise that as a body exercising a public function, NESO will play a critical role in shaping the energy market. Even though NESO will not be a regulator in a traditional sense, in carrying out its statutory functions it will be an essential component of the energy system, and NESO will make decisions – some of which will be as significant as the decisions Ofgem makes. However, NESO will be operating within the market itself, taking on both operational and strategic responsibilities. This means that NESO's decisions will directly influence the actions and plans of energy market participants – from guiding investments to steering the direction of market development, NESO's activities will have far reaching consequences across the sector. As a result, NESO will have substantial impact on consumers, affecting energy prices, supply reliability, and the speed at which transition to net zero will happen. Given the gravity of NESO's role, poor decision-making by NESO will derail progress in its work and the wider economy, and is likely to be unfair to both stakeholders and consumers. A stable and reliable environment for managing the energy system is also a key factor for attracting investments in the sector.
8. Given the anticipated impact of NESO's decisions and its role as a trusted and expert institution providing independent advice to the government and Ofgem, it is therefore imperative that there is a mechanism to ensure that NESO's decisions will be transparent,

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<sup>3</sup> See section 163 of the [Energy Act 2023](#). And also the joint DESNZ/Ofgem, [Statutory consultation on National Energy System Operator licences and other impacted licences](#), March 2024. Page 15

<sup>4</sup> Joint DESNZ/Ofgem, [Statutory consultation on National Energy System Operator licences and other impacted licences](#), March 2024. Page 14

<sup>5</sup> Joint DESNZ/Ofgem, [Statutory consultation on National Energy System Operator licences and other impacted licences](#), March 2024. Page 13

<sup>6</sup> Joint DESNZ/Ofgem, [Statutory consultation on National Energy System Operator licences and other impacted licences](#) March 2024. Page 51

accountable, proportionate, and reviewable. It is appropriate that NESO's decisions can be reviewed at a proportionate cost and within a reasonable timeframe.

### **NESO needs to be accountable and have robust decision making**

9. The system reforms and new governance structure from NGESO to NESO, coupled with strengthened powers raises important questions about *how* NESO is going to achieve its objectives.<sup>7</sup> NESO will be at the centre of consumers, government, and market participants. And for stakeholders subject to and/or impacted by NESO's decisions, there is a big question as to whether NESO is going to have a transparent and fair decision-making process.
10. Review processes are key to ensuring that statutory functions are carried out effectively, proportionately, and in line with stated objectives. The prospect of review encourages more careful consideration of different perspectives, testing assumptions, and clear explanations of how they have balanced competing priorities or trade-offs. And so in turn it provides for accountability in the face of potential errors, disproportionate decisions, and misjudgements. This 'challenge effect' can be especially important for a body like NESO as it is establishing its decision-making processes and culture under Ofgem's regulatory framework.
11. Over time, feedback and guidance from the review panel can help identify areas where NESO's decision-making approaches may need refinement - for example if certain types of decisions are frequently challenged or overturned. NESO can learn from this to make its future decision-making more robust. The panel's published decisions will also enhance transparency by revealing more of the evidence and arguments behind key judgements.
12. However, the currently envisaged mechanisms for NESO's accountability are weaker than what the existing ESO is subject to, despite NESO being given more wide-ranging powers that will affect far more stakeholders. NESO decisions are not directly appealable.<sup>8</sup> Ofgem is responsible for monitoring NESO's compliance with its statutory duties and Ofgem can issue enforcement notices to NESO if it breaches its licence conditions. We do not believe that this provides for a strong enough incentive for NESO to make transparent and robust decisions.
13. Market participants that are subject to NESO's powers (which include a significant range of powers akin to economic regulation) will have to rely on JR to formally review a NESO decision. Using JR to maintain accountability of a body such as NESO is insufficient.
14. There are at least four reasons for this:
  - a) First, JR is expensive and slow.
  - b) Second, JR does not necessarily test a decision beyond determining if it was illegal, irrational, or procedurally unfair.

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<sup>7</sup> The primary duties are to promote net zero, energy security, and cost efficiency. NESO is also required to consider competition in the energy sector, the whole system, facilitating innovation, and the impact of energy sector activity on consumers.

<sup>8</sup> Ofgem's modifications to NESO's license can be appealed but it would appear that market participants' only option for appealing the decisions of NESO would be via judicial review.

c) Third, a judge hearing a JR has no specialist expertise. This is important because NESO will be taking highly technical decisions.

d) Fourthly, establishing a dedicated expert review body for NESO would provide a more accessible and specialised forum for review, and open up a platform for a diverse range of interests to be heard and issues resolved.

15. Instead, there needs to be an accessible, specialised expert review body that can impart binding guidance and correct decisions if NESO gets it wrong. A fast, affordable review mechanism is crucial during NESO's first years as a “first of its kind” body.

**NESO should be subject to a proportionate standard of review which is capable of balancing various interests**

16. Given how consequential the decisions of NESO are going to be to an array of regulated entities (providing and servicing critical national infrastructure to consumers), bodies which exercise public functions (Ofgem, Ofcom, Ofwat, and the CAA for example) are kept accountable via formal appeal processes. As noted above, despite the fact that NESO will be an independent body from Ofgem, it will still carry out an important public function in the energy sector. Vesting these important functions in a new body without an effective review mechanism would be unprecedented.

17. When considering how to design an effective review mechanism, it is instructive to examine other models that have been adopted for other UK bodies exercising public functions. The nature and scope of the powers and functions should inform the design of its appeals and review processes. Appeal mechanisms range from fully judicial bodies like the Competition Appeal Tribunal (CAT) to more specialised appeal panels like the Competition and Markets Authority (CMA). The CMA, while not a court, possesses the technical expertise necessary to handle appeals related to economic considerations effectively.

18. NESO will make decisions that span over a range of areas, that are both economically and technically complex, and material to the energy sector – all of which necessitate a review mechanism that can examine the substance of NESO's decisions. An expert review panel would strike the right balance between being sufficiently judicial to provide effective oversight and having the practical expertise to collaborate with stakeholders and resolve disagreements efficiently. Such a panel would possess the relevant knowledge to conduct reviews within a relatively short timeframe, ensuring timely resolution of disputes.

19. The Capacity Market pre-qualification appeals processes is an existing mechanism that exemplifies a robust review framework for consequential decisions made by NGESO. This process provides a clear example of how an appeals system is applied to ensure accountability and improve decision making quality. Under this established framework, NGESO, in its capacity as the Electricity Market Reform Delivery Body, is responsible for determining which potential bidders pre-qualify for participation in Capacity Market auctions. Recognizing the significance of these pre-qualification decisions, the process includes a two-tier appeals mechanism. Parties can first appeal to NGESO itself (Tier 1) and then escalate the matter to the Authority (Tier 2) if they remain unsatisfied with the outcome. As a final resort, parties can seek redress through the courts.

20. The existence of this appeals process underscores the importance of providing stakeholders with accessible and effective means of challenging decisions that have significant consequences for their operations and the wider market. Allowing disputes to be resolved at lower levels (Tier 1), the mechanism reduces the need for costly court proceedings. Additionally, the publication of Ofgem's Tier 2 appeal decisions enhances transparency and contributes to developing precedent that can inform future decision making.
21. It is important to note the fact that this appeals process was put in place for ESO highlights the recognition among policymakers the need for robust accountability measures when it comes to the consequential decisions of bodies like NGESO. The Capacity Market pre-qualification appeals process serves as a compelling example of an existing accountability mechanism that has proven effective in ensuring the quality and integrity of decisions made by bodies operating within the energy sector.
22. The need for a review mechanism in respect to NESO's decisions is more than just desirable – but essential given the uncertainty around its decision-making process. With the transition from the existing ESO to NESO, there will be a major overhaul in governance structure (including scaling back checks and balances that will previously have applied to ESO) and the practicalities of how NESO will make and communicate their decisions are still being developed (and will continue to develop in NESO's early days) – this creates an accountability gap at a critical time. In this context, a decision review mechanism is not a 'nice to have' but a crucial element to ensure NESO's governance framework is effective, and its decision-making process is procedurally fair.
23. NESO is being created to address a specific need in the market – a more cogent 'whole system' network planning approach to enable the transition to net zero. NESO will be operating between the regulator, market participants and consumers – and will need to be carefully designed so that it can successfully operate between these interests.
24. Careful consideration is needed as to how NESO, as a novel type of public function corporate body, will be held accountable to stakeholders for its decision-making. Given the scope and importance of NESO's role in the energy sector, it is crucial to design a robust governance framework that includes appropriate checks and balances, such as an expert review panel and clear avenues for appeal. This will help ensure that NESO's decisions are proportionate, transparent, and aligned with its objectives, ultimately fostering a stable and predictable environment in the energy sector that benefits all consumers and stakeholders.

#### **Designing a proportionate, cost effective, expert review panel for NESO**

25. The key requirements for an effective and proportionate review process are:
  - a) Independence
  - b) Expertise
  - c) Timeliness of decision-making
  - d) Jurisdiction – the power to give effect to its rulings
  - e) Appropriately resourced

26. Given the significant impact that NESO's decisions will have on the sector and market participants, and its ability to achieve net zero targets and secure energy security, we propose the establishment of a dedicated review panel that has the competence to assess NESO's decisions made in respect to NESO's Electricity System Operator Licence and Gas System Planner Licence pursuant to NESO's statutory functions under the Energy Act 2023. The review panel will assess whether NESO has adhered to its duties and made effective proportionate decisions.
27. To ensure that NESO adheres to its duties and makes decisions that can stand up to scrutiny in transparent manner, the decisions should be challengeable and reviewed based on the merit of the decision. JR alone is insufficient for the reasons outlined above.
28. And to prevent frivolous reviews, challengers should be required to demonstrate to the review panel that the disputed decision's impact on their company meets a de minimis monetary value. The threshold for challenging a decision could be varied depending on the specific role or function being exercised by NESO. This higher threshold would then ensure that only challenges with substantial merit are referred to the review panel. Implementing a tiered approach to the de minimis monetary value based on the role or function being exercised will strike a balance between preventing frivolous challenges and ensure stakeholders have a route to raise legitimate concerns about NESO's decisions. In practice the CMA developed just such a flexible approach to de minimis appeals in its sector specific appeals jurisdiction.<sup>9</sup>
29. When a NESO decision is referred to the panel by a challenger, the review panel should decide by whether the de minimis threshold is met and whether the challenger has sufficiently set out how NESO has failed to meet its duties and/or has made an unmerited decision. The panel should then decide whether to grant permission to proceed with the panel review of the decision. If permission is granted, the panel will conduct a thorough review process, assessing the decision's merits, its alignment with NESO's duties and objectives, and its potential impact on stakeholders.
30. **Independence:** The independence of the review panel would be secured through the appointment of an impartial chair and diverse membership. The membership would include experts from various relevant fields, consumer body representatives and relevant academics. Panel members should be required to declare any conflicts of interest and set rules around impartiality.
31. **Expertise:** The composition of the review panel should include experts from the electricity and gas sectors, representatives from consumer bodies and environmental organisations, academics with expertise in energy policy, and an independent legal chair – this will ensure a balanced perspective across the panel.
32. The review panel will be able to draw on a broad range of expertise which should cover technical, economic and legal policy perspectives. Experienced sector panellists will ensure that the review panel has the necessary knowledge to reassure the industry that it can

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<sup>9</sup> See, for example, paragraph 3.47 of the [CMA's recent decision on the appeals of Heathrow Airport's H7 price control](#): "It is common ground that the CMA should only interfere with the CAA's Final Decision if we consider that the error identified is material."

sensibly review complex technical decisions. Having a well-represented review panel will encourage NESO to ensure it considers a range of relevant perspectives in its decision making.

33. **Timeliness of decision-making:** Given the fast-moving pace of the sector, stakeholders should be confident that there is a path to the timely resolution of any review. The review panel should be subject to strict timelines – we propose challenges be submitted within 28 days of the decision, and that the review panel should have 90 days of granting permission to proceed.
34. **Jurisdiction:** The review panel need to have meaningful powers to correct flawed decisions in order to give the review process ‘teeth’ and provide stakeholder with the confidence that the review mechanism is able to produce substantive outcomes. Once the review panel has completed its review of a NESO decision the panel should be able to:
  - a) uphold the decision;
  - b) declare the decision as being flawed or disproportionate, and set aside the decision and require NESO to remake the decision in line with guidance proposed by the review panel; or
  - c) substitute its own decision.
35. **Appropriately resourced:** To ensure the review panel is efficiently resourced, we propose a hybrid funding model. This would involve a combination of case fees paid by the parties bringing challenges (covering the direct costs associated with each specific challenge) and ongoing funding for a semi-permanent secretariat and specialist resources, recovered through NESO’s charges to industry participants. The combination of case fees and ongoing funding from market participants should ensure that the review panel has efficient resources. This cost sharing mechanism strikes a balance between the ‘user pays’ principle and the recognition that maintaining an effective review mechanism delivers wider benefits to all stakeholders.
36. We anticipate that the review panel oversight and guidance will help refine NESO’s decision-making processes over time and leading to more robust and effective decisions.
37. We note finally that there is overlapping purpose and scope between our proposed NESO review panel and the ESO’s Performance Panel. It would be worth considering the possibility of merging the two panels. Both panels aim to assess the performance and decision-making of the system operator – with the review panel focused on specific decisions and the Performance Panel focused on evaluating overall performance against predetermined criteria. Combining these two functions could potentially streamline the evaluation process and reduce administrative overhead.



## Example license modification

### New Condition: NESO Review Panel

- 1) The licensee must establish and maintain a review panel (the "NESO Review Panel" or "Panel") for the purpose of dealing with challenges ("Reviews") to certain decisions made by the licensee.
- 2) The licensee must appoint an independent executive Chair for the Panel with a remit to appoint other panel members and a secretariat. The Panel must consist of a pool of panel members to deal with Reviews.
- 3) The licensee must mandate the Chair to ensure that the NESO Review Panel for any individual Review consists of at least three members which must include:
  - a) a legally qualified chair; and
  - b) two other members with relevant expertise.
- 4) A person ("challenger") materially affected by a decision made by the licensee may challenge it by referring it to the NESO Review Panel.
- 5) Where a licensee's decision is referred to the NESO Review Panel, the panel must decide whether:
  - a) the challenger is materially affected by the decision;
  - b) the challenge to the decision in question is of greater than de minimis value; and
  - c) the challenger has sufficiently set out how the licensee has failed to meet its duties and/or has made an unmerited decision.
- 6) If the NESO Review Panel grants permission for the challenge to proceed under paragraph 4, it must conduct a review of the decision. The NESO Review Panel must decide whether the decision under challenge is right or wrong on the merits.
- 7) Upon completing a review, the NESO Review Panel may:
  - a) uphold the licensee's decision;
  - b) quash the decision and require the licensee to remake it in accordance with the panel's guidance; or
  - c) substitute its own decision for that of the licensee.
- 8) Challenges to the licensee's decisions must be submitted to the NESO Review Panel within 28 days of the decision being published. The panel must complete its review within 90 days of granting permission for the challenge to proceed.



- 9) The licensee must meet the costs of the Chair of the Panel and the panel secretariat from its own resources.
- 10) Proceedings before the NESO Review Panel are to be conducted in accordance with rules issued from time to time by the Chair, including in relation to case fees.
- 11) The costs of individual Reviews may be funded by case fees including fees to be paid by a challenger for initiating a review.
- 12) The licensee must abide by decisions of the Review Panel (including as to case management) within such time as the Panel stipulates. This is a duty owed to those affected by it.