
ADE RESPONSE

Ofgem Consultation on the NESO BP3 Performance Incentives

27TH SEPTEMBER 2024

Context

On behalf of our mission to Empower Energy Demand, the ADE welcomes the opportunity to respond to Ofgem's consultation on the NESO Performance Incentives Framework for BP3.

Our mission is to embrace the value of a decarbonised, demand-led energy system, creating a future where households, businesses and industry are properly rewarded. The current electricity system is creaking under the demands of a rapidly changing system. We must harness the millions of EVs, heat pumps and the immense industrial demand we have right now to lower bills and keep our electricity system operable. Instead, we're fighting against them. Even more than that, industrial energy is decarbonising with long-term consequences for our energy system – creating new infrastructure and unlocking even greater sources of flexibility. The Government, Ofgem, the CCC and others all recognise that households, businesses and industry should play an active role in a decarbonised electricity system. Now is the time to make this a reality.

Summary

We agree with Ofgem's proposals for the NESO BP3 performance incentives, with the caveats laid out below. These include that in moving away from the assessment criteria that has been set for ESO throughout BP2 to a more 'holistic' performance assessment in BP3, it is important to ensure that the level of scrutiny from Ofgem is heightened as they transition to a public body. The NESO must not be treated as the same as ESO for Day 1, with details on what they are doing to achieve their new roles and responsibilities made clear. Specific emphasis on stakeholder engagement and investments must be a primary consideration when assessing the NESOs performance. Transforming a private entity into a public body with immense power and influence over the future of critical national infrastructure cannot, and should not, be underestimated. It requires reformation, not evolution. In our recent report [Demanding More](#) we have recommended that the requirements laid out in the licence must reflect the additionality of their new role, setting out clearer expectations. This must be carried into the NESO's Business Plan, Business Plan Guidance, Roles Guidance and in Ofgem's performance assessment.

We encourage Ofgem to read our report in full, as part of our consultation response, as it heavily relates to the content under discussion in the Guidance.

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

Notions that the ESO can simply evolve for the first few years of NESO poses a distinct threat to the objectives this transition is trying to achieve, especially in light of the new Clean Power by 2030 Mission. In our recent [Report](#) we laid out recommendations to make licencing and requirements more extensive including that it should be standard practice for NESO to demonstrate proportionality testing for its decisions.

Moving away from the three current performance assessment roles, to move towards achievement against NESOs business plan aims and value for money seems to be removing scrutiny rather than adding it. The success of this change will be entirely dependent on the above licence changes and level of detail contained within the NESOs Business Plan Objectives. Particular focus on the evidence submitted through the Success Measures will also be important. Stakeholder views and feedback must continue to be at the centre of Ofgem's assessment, not just in the form of a stakeholder survey, in how the NESO has taken the feedback into consideration and any reasoning for not doing so. This level of scrutiny should be reflected in Ofgem's determinations for BP3. We support the acknowledgement from Ofgem that the nature of NESOs role will become dynamic and henceforth the requirements from Ofgem should adapt to these changes and be reflected in the assessment report. We look forward to seeing the focused assessment report that will provide more detail of Ofgem's expectations on significant performance areas and the specific changes that will be made in the NESO Performance Arrangements Governance Document.

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

Continuing with the same incentives with minor additions to account for the NESO's new role is not going to achieve the reformation that is required. Roles and responsibilities have continually been added to the as-yet non-existent NESO without enough reflection on the enormous changes needed within the company it is being formed from. The scale of industry concerns with ESO performance have been underestimated and therefore the incorporation of stronger safeguards in the SPS and licence has not occurred. Amendments are needed to the NESO licence to reflect the additionality it is supposed to provide to the legislation and the clearer expectations that are needed for particularly reputational incentives. The Roles Guidance must therefore reflect these changes throughout BP2 and BP3, into the enduring licence and Guidance post April 2026.

We support the NESOs incentives and licence requirements being separated for assessment and that additional guidance should be given to NESO for the conditions set out section C1 of the licence. We would also support the guidance becoming more specific to the NESOs requirements post 2026, yet question if this should happen sooner. The above changes to the NESO licence conditions in the meantime could mitigate this issue.

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

We agree with the proposed requirements for the NESO Business Plan, particularly that 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'. We emphasise the importance of this in the NESO's IT spending, as there have been various occurrences that raise significant fears over the IT capabilities of ESO. Continual delays in delivering ancillary market reforms that would allow more demand side participation have been attributed to the need for control room IT upgrades and it has been reported on several occasions

that control room engineers simply do not trust aggregated portfolios of small assets. This cannot come under less scrutiny with the revised performance assessment.

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

Clarity on how Ofgem intend to assess the NESO Success Measures should be given in the assessment report. Particularly now that the NESO incentives are primarily reputational, the value for money assessment should certainly 'remain a key part of our business plan approval process'. This could be supported by changes within the NESO licence that set clearer expectations that are needed when reputational incentives are the core regulatory lever. We agree that more specific detail on the requirements for the NESO should be implemented following BP3.

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

See above answer to Question 4 and below to Question 6 on the importance of ensuring that the correct measures against IT investment are implemented. It is laid out in the consultation that the overarching Value for Money Assessment will supersede the IT specific RAG. However, it is later suggested that Ofgem will incorporate the BP2 RAG Ratings for ESO's IT investments into the BP3 Value for Money assessment. Clarity is needed from Ofgem on the benefit of using old ratings in an area as dynamic as IT investments for the reasons we mention in our response on its importance.

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

Despite agreeing that information should not be duplicated through the CMF, updates on existing IT investments should be provided into BP3. As above, IT incapacities pose increasing risks to achieving satisfactory outcomes for the electricity system, let alone the whole energy system. Thus, progress on IT investment should be consistently reported against. "Changes on [ESO's] legacy systems" are cited repeatedly over the years as reasons for delayed deliverables, one would assume that ESO's investment in future systems would prioritise adaptability, meaning it is imperative that this is monitored throughout BP3.

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

We support the implementation of end-to-end scheme events with industry stakeholders and keeping the NESO performance panel. Endemic concerns over transparency, stakeholder involvement, and accountability have been raised by industry across multiple occasions and consultations. This must be a central assessment criteria implemented by Ofgem and proven by NESO in their Business Plan

Performance and Success Measures. Ofgem has a role to play in connecting transparency to accountability. These requirements must also be supported by the licence.

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