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By email:

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Date

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Contact

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Dear David,

SP Energy Networks (SPEN): Response to Ofgem's consultation on the National Energy System Operator's performance incentives framework for BP3.

SPEN welcome the opportunity to respond to Ofgem's consultation on the proposed National Energy System Operator's (NESO) performance incentives framework for Business Plan 3 (BP3). SPEN are the Transmission Owner (TO) for Central and South Scotland, and we work closely on a day-to-day basis with the current Electricity System Operator (ESO). This includes coordination on facilitating transmission connections, the Holistic Network Design (HND) and HND Follow-Up Exercise. The latter has represented a step-change in network planning and investment, made possible through the collaboration of TOs and the ESO. We are supportive of the NESO building capabilities to strategically coordinate the enduring Central Strategic Network Plan (CSNP). A deliverable CSNP, which aims to eventually cover other energy vectors, is dependent on collaboration with stakeholders utilising the expertise of existing parties, including TOs. As such, it is essential that stakeholder views and feedback are forming a critical aspect of determining the NESO's performance against its objectives and success measures.

A summary of our response can be viewed below alongside our detailed comments in response to the consultation questions, which are set out in Annex 1 of this response.

Summary:

Preserving the Importance Stakeholder Views and Feedback

We have significant concerns that stakeholder views will not be taken into any meaningful consideration when determining the success measures of the NESO. It is essential that the expertise and knowledge of network owners and operators who are best placed to assist the NESO are duly considered and not underestimated. This is important to ensure that the NESO is fulfilling its roles and responsibilities in operating a co-ordinated, economic, and efficient network, and as such, there must be an avenue to ensure that stakeholder views are considered and valued in more ways than just the threat or reputation damage should the NESO neglect to address valid feedback from stakeholders on the NESO's performance.

We believe that it is imperative that Ofgem ensure the NESO is held to account and that stakeholder views are given equal weighting to the other measures which factor into the determination and evaluation of the NESO's performance against its objectives and success measures.

We note the NESO's advisory role to Government and Ofgem, established within the Energy Act 2023. As such, we agree with the need for advice from expert bodies, and therefore recommend that the advisory role should have clear processes established for representing the views of industry stakeholders, including network Licensees, utilising their detailed network-specific knowledge, experience, expertise, and direct operational engagement with generators and stakeholders.

NESO setting its own Performance Objectives and Success Measures

We seek clarity from Ofgem on how it intends to ensure that stakeholders have sufficient confidence in the NESO's ability to meet stakeholder needs when the NESO will provide the baseline for what determines successful delivery of its objectives. Ofgem is in effect asking the NESO to advise on how it wishes to be regulated, what objectives it should have and what successful measures should be used to determine whether it has met the objectives. We believe that the successful measures and criteria sitting behind the metric to evaluate the NESO's performance should be mandated by Ofgem having considered what the NESO's objectives are and to ensure that stakeholder views are incorporated into the overall NESO performance incentive framework.

Please do not hesitate to reach out should you wish to discuss any of the issues raised in this response.

Yours sincerely,

A handwritten signature in black ink that reads "N Lowe".

Nia Lowe
Head Of Regulation and Government Policy

Annex 1 – Responses to Consultation Questions

Q1 - Do you agree with our proposed approach to the performance assessment for BP3?

Overall, we agree with Ofgem's position to ensure the BP3 incentives expectations will be based on the NESO's performance objectives. We would emphasise the need to ensure stakeholder views are a material assessment metric in determining the NESO's delivery of its performance objectives.

We agree that in light of the changing roles and responsibilities for the NESO from those applicable to the ESO, a new approach to the assessment of the NESO's performance is warranted. We support that aspects of the ESO's RIIO-2 price control will not be reset. It remains unclear how Ofgem will assess the NESO's deliverability on the NESO's achievement of business plan aims when determining overall performance. As such, we would encourage Ofgem to consult on its decision-making criteria to allow stakeholder to adequately assess and evaluate whether the approach being taken by Ofgem will sufficiently cover the two main assessment factors or whether there will be a need to assess additional factors.

We broadly agree with the proposed incentive structure for the NESO, given that strong financial incentives are less relevant for a public body. However, the transition to the NESO provides an opportunity to create a robust set of incentives focused on outcomes expected by stakeholders, customers, and consumers. In particular, the NESO will continue to have a significant role in the management of the connections process and its many customer relationships, at a time of significant reform.

We see this as a key area where high performance is critical to meet customer expectations, and where we would expect to see direct reputational incentives for the NESO in relation to delivering an effective reformed connections model as well as ensuring high-quality connection offers are presented to customers. We believe an effective way of meeting these important outcomes, in order to restore customer confidence in the current connections process is with strong links to staff remuneration. Given the strategic importance of connections reform for industry as a whole, this should not be treated as part of a broader performance incentive across the NESO's range of activities, which weakens the specific incentive to deliver for connection customers, and strongly reduces the transparency of NESO incentivisation. We recommend that managing the connections process should be incentivised in of itself, within the overall performance incentive framework.

Q2 - Do you agree with our proposed changes to setting performance expectations for BP3?

We are concerned that stakeholder views and feedback are only going to be considered as a potential factor in assessing the overall performance of the NESO. We are supportive of Ofgem's proposals to maintain a similar approach to that of BP2 and the assessment of the NESO's performance against the same metrics, although we would stress the importance of ensuring stakeholders are able to raise concerns and have confidence in those concerns being addressed. Despite welcoming Ofgem's position that stakeholder's views and feedback are essential to hold the NESO to account, we remain concerned that the practicalities of relying on a reputational burden to ensure that the NESO accounts for stakeholder concerns seems flawed. Without adequate backing to the importance of stakeholder feedback, the proposals diminish the overall ability for stakeholders to hold the NESO to account.

We agree that the current approach for BP2 does not align with the public body nature of the NESO and as such there needs to be an alternative approach to determining and incentivising the NESO's performance. We agree that the NESO staff remunerations should be indexed to the outcome of the performance incentive assessment and evaluation against the success measures.

Q3 - Do you agree with our proposed requirements for NESO's Business Plan?

We would highlight that it is imperative to ensure the NESO is obligated to follow a similar reporting obligation as other regulated businesses working in networks. We welcome Ofgem's proposals for the requirement of the NESO to set out forecast costs for BP3, IT and non-IT investments, enabling function costs, and a cost benefit analysis (CBA) for new activities and investments that the NESO chooses to undertake for BP3. In terms of the CBA, we would encourage Ofgem to require the NESO to publish its CBA methodology and to engage with stakeholders to ensure all material factors are being considered with regards to certain activities, particularly where network operators are concerned. As the NESO will assume some of the historically TO related roles and responsibilities, we would encourage Ofgem to ensure that TOs and other relevant stakeholders are able to feed into the CBA methodology to ensure we have confidence in the NESO's ability to deliver on its new activities.

Q4 - Do you agree with our proposed approach to assessing NESO's Business Plan and the stages involved in the Business Plan process?

We believe that Ofgem is best placed to determine the assessment of business plans and it will be a matter for the NESO to engage with Ofgem on.

Q5 - Do you have any views on performance measures for BP3?

We request further clarity from Ofgem and DESNZ on the role of Licence obligations in regulating the NESO. Typically, Licence enforcement action can result in substantial financial penalties for Licence holders. With a publicly owned NESO, it is not clear how NESO will be strongly and transparently held to account for meeting its full set of Licence obligations, and what actions Ofgem envisage taking to address instances of noncompliance.

Q6 - Do you agree with our overall approach to cost regulation for BP3?

We believe that Ofgem is best placed to determine the cost regulation for BP3, and it will be a matter for the NESO to engage with Ofgem on.

Q7 - Do you agree with our overall approach to stakeholder and external scrutiny for BP3?

We are not confident that Ofgem can truly hold the NESO to account if there are failures on the NESO to deliver on its licence conditions. It remains unclear how Ofgem intends to enforce compliance with licence conditions for the NESO, particularly due to Ofgem's enforcement powers of licence revocation or a penalty, as it would go against the interest of consumers and taxpayers should the NESO be subject to this. We understand from the consultation that Ofgem intends to incentivise the senior management of the NESO through risks to professional reputations and evaluation of compensation awards. We are not convinced that this metric will provide sufficient safeguards that the NESO will deliver on the critical infrastructure requirements to maintain security of supply and a resilient network. We propose that there should be a collaborative approach between TOs, ESO / NESO, DESNZ, the Devolved Administrations and Ofgem, which is necessary for network and spatial planning via the SSEP. The NESO alone would not have the requisite knowledge or experience to make these complex decisions. The result would be a NESO that will have the trust and support of the energy industry, while alleviating concerns over accountability as network operators will be involved in the process throughout. As such, implementing a collaborative approach will ensure stakeholder views are being factored into the overall delivery of the NESO's objectives and will ensure confidence among stakeholders.

We believe that industry stakeholders and external parties must be able to input into the performance metrics undertaken by Ofgem to raise any concerns over the performance of the NESO. Similar to the existing performance evaluation of the ESO, we believe continued, meaningful input from stakeholders will help Ofgem in continuing to shape the NESO while also addressing network owners

and operators concerns once the NESO is fully operational. We have reservations that the only real incentive sitting behind the NESO to deliver on its objectives and ensure network companies have confidence in the NESO is centred around the risk of reputational damage. Network owners and operators will need to have their views factored into the amalgamation of the performance review and subsequent outcome; not merely a consideration which may or may not be factored into the overall measurement of the NESO's performance.

We are concerned that as the roles and responsibilities of the NESO expand, there appears to be less consideration given to stakeholder views and feedback, reflected in the way Ofgem proposes to factor feedback into the performance incentive assessment. Stakeholder views and feedback would often be based on expert detailed and historical knowledge around some of the new roles and responsibilities that historically sat with network licensees. It is critical for network owners and operators to have their expert views and considerations feed into the overall performance assessment for the NESO. We would encourage Ofgem to consider obligating the NESO to address material concerns with stakeholders and ensure that any valid concerns raised are addressed or mitigated to ensure that network owners and operators remain confident in the NESO's performance of its new roles and responsibilities.

We note the NESO's advisory role to Government and Ofgem, established within the Energy Act 2023. We agree with the need for advice from expert bodies, and therefore recommend that the advisory role should have clear processes established for representing the views of industry stakeholders, including network Licensees. TOs and DNOs have detailed network-specific knowledge, experience, expertise, and direct operational engagement with generators and stakeholders. Therefore, they should be involved through formal processes in supporting the NESO in its advisory role to Government and Ofgem where advice relates to electricity networks. Without this engagement, there is a risk that advice is provided that does not accurately or fully reflect network issues, which the NESO may not be fully aware of given their more strategic role in the design and operation of the network.