

Decision

Decision on the enduring regulatory framework for NESO

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This document sets out our decision for the enduring regulatory framework for National Energy System Operator (NESO) which will apply from 1 April 2026 onwards.

Our decision aims to strike the right balance between the key competing objectives of enabling NESO to deliver excellence and capitalise on its independent unique expertise to lead the energy system transition, while retaining sufficient incentives and regulatory oversight to ensure robust and successful performance outcomes.

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Executive summary

NESO was established to play a significant role in the energy transition, through operating and delivering an efficient, coordinated, secure and flexible clean energy system for all.

The design of our regulatory framework is important in supporting NESO to deliver critical outcomes in the interests of consumers whilst striving for excellence. Our regulation of NESO must be tailored to reflect its unique characteristics and organisational set-up. Therefore, we have decided to introduce a suite of changes compared to our historic approach to regulating the Electricity System Operator (ESO). Our revised framework will apply from 1 April 2026 onwards, and it will build on the major framework changes we introduced previously at NESO's go-live in October 2024 and at the start of the RIIO-2 Business Plan 3 (BP3) period, which began on 1 April 2025.

Overall, we have decided to establish an enduring regulatory framework that seeks to facilitate NESO's delivery of major energy system outcomes, at a cost that maximises value for consumers. Our approach will be dynamic, targeted and proportionate, such that we will focus attention on the most consequential or valuable outcomes, which may change over time as delivery or new events occur.

Our framework will continue to provide strong incentives and accountability through robust mechanisms that leverage stakeholder expertise, provide appropriate cost scrutiny, and set clear safeguards if minimum standards are not met. We will continue to carry out an annual, public assessment of NESO performance, and strengthen the role of an independent stakeholder panel in these processes. We will also set clear and enforceable licence obligations which provide clarity on the minimum outcomes NESO should achieve through its activities. These mechanisms will be supported by requirements for NESO to ensure senior staff financial incentives are aligned with our published assessments of NESO performance. Finally, our cost regulation will balance the need for NESO to deliver new and emerging energy system priorities at pace, with the need to ensure that all spending is well managed and delivers good value, including by improving public transparency of NESO spending.

Our decision has been shaped by the views of stakeholders over the last 18 months, including the feedback we have received in response to our consultation and workshops held in May 2025. Overall, stakeholders broadly supported our proposed framework design but raised some specific challenges and alternative suggestions in some areas.

This feedback has been particularly valuable for our thinking on the design of stakeholder panels, which is the main area where our decision has evolved compared to our consultation proposals.

We have set out a summary of our decisions for the regulatory mechanisms for the enduring regulatory framework for NESO below:

Performance incentives (Chapter 3): We have decided to maintain a public evaluative assessment, focussed on NESO's achievement of Performance Objectives¹ and its delivery of value for money. This will include continued requirements for regular, proportionate reporting that allows Ofgem and stakeholders to monitor and track NESO's progress throughout the year. For April 2026, this will broadly be the same framework as BP3. We will continue to review and, if necessary, refine these arrangements based on experience over time.

Business Plan and plan assessment (Chapter 4): NESO's Business Plans and our determinations of these plans will continue to provide up front clarity on performance expectations for NESO, as well as transparency to stakeholders on NESO's key objectives, commitments, and spending. We have decided that Business Plans should be submitted every two years on an enduring basis, commencing from 1 April 2026. We have decided to continue with the existing broad requirements for NESO's Business Plan development and the same process for Ofgem's determinations, as introduced for BP3, but with more flexibility on how NESO can best engage industry when developing its plan.

We have also decided that NESO should publish and maintain a Strategic Aims document to underpin its shorter-term Business Plans. This will ensure the framework maintains a clear, longer-term focus but with regular opportunities to review and reset nearer-term objectives and spending plans.

There will not be any major changes to the content NESO must produce in its Business Plans from BP3. NESO's plans will continue to be centred around its two-year Performance Objectives and robust cost justifications, supported by clear Success Measures, Major Deliverables and cost forecasts for both Year 1 and Year 2.

Cost regulation (Chapter 5): We have decided to continue with a pass-through model for NESO's costs, supported by ongoing value of money assessments, and backstop licence requirements not to incur any inefficient expenditure. NESO's cost monitoring and reporting should be proportionate to the quality of up-front justification, year on

¹ NESO's Performance Objectives will be the key strategic outcomes NESO plans to achieve by the end of a business plan cycle, across the full spectrum of its activities.

year changes in expenditure, and past performance. We consider that there is significant opportunity to review how cost information is reported and monitored compared to RIIO-2 to avoid overlaps and unnecessary duplication. In addition, we will feed the lessons learned from the BP3 process and stakeholder views to improve transparency on NESO's costs into our development of NESO's detailed licence requirements and associated documents, which we intend to consult on later this year.

Stakeholder mechanisms (Chapter 6): We have decided to make changes to our stakeholder mechanisms to strengthen the role of stakeholder feedback and to ensure this remains a critical aspect of our performance assessment process. We have decided to establish a new stakeholder panel, called the 'Independent Challenge Panel' (ICP). The ICP will have a similar role/remit as the existing NESO Performance Panel but will focus more on providing comprehensive and co-ordinated feedback on stakeholders' views of NESO's performance. The ICP will produce a public report that will inform Ofgem's annual assessments and will also convene within scheme to discuss interim feedback and stakeholder survey results.

We have reflected on stakeholder feedback regarding the independence of this group and have decided it will be led by NESO's customers and consumers, rather than administered by NESO. Ofgem will set key legal requirements, principles and parameters for the group. Ofgem will also appoint and manage the independent ICP Chair, who will in turn have a key role in ensuring the panel operates effectively and delivers its objectives. We have decided to not place any default restrictions on NESO establishing additional, informal stakeholder groups. However, NESO will be required to engage effectively with the ICP and ensure coordination with any additional mechanisms NESO may choose to use to gather stakeholder feedback on its plans and performance.

We have decided to maintain a published, NESO-run stakeholder survey as a key mechanism for gathering wider stakeholder feedback on NESO's performance. We have also decided to move to an ongoing (rather than periodic) call for evidence, where stakeholders can submit feedback directly to Ofgem at any time throughout the scheme.

We have decided to review, and where valuable strengthen, the existing package of incentives and obligations on NESO in relation to its decision-making transparency. In addition, we have decided to increase the frequency of engagement between the ICP and NESO board and Ofgem directors.

Licence obligations and enforcement (Chapter 7): We have decided to move towards a strategy of primarily setting outcomes-focused licence obligations to underpin the minimum standard expected from NESO, focusing the use of prescriptive requirements and detailed approvals to situations where this has clear value and/or

there is a risk of consumer detriment. There will not be any changes to our existing enforcement approach.

For April 2026, we intend this approach to focus on improving and clarifying minimum standards through the existing principle-based obligations in Condition C1 and the NESO Licence Expectations Document. We expect to remove some existing Ofgem approvals that we consider have limited value and are unaligned with our principles and objectives.

Staff-level incentives (Chapter 8): We have decided to set new principles-based requirements in NESO's licence to ensure there is clear and transparent link between NESO's senior management incentives and Ofgem's regulatory outcomes.

Regulatory finance (Chapter 9): We have decided that a non-profit NESO model necessitates a minimal Ofgem regulatory finance role – largely focused on setting core obligations. For April 2026, we have decided to review and consolidate the existing regulatory finance reporting alongside our cost reporting requirements.

Innovation (Chapter 10): We have decided that NESO should continue to have access to the same innovation funding mechanisms as other network companies for RIIO-3. For Strategic Innovation Funding (SIF), NESO will have access to a ringfenced pot that will be defined within the SIF Governance Document. This is subject to further Ofgem consultation.

For Network Innovation Allowance (NIA), NESO will be able to request additional funding, if needed, for the remainder of the five-year period as part of its subsequent Business Plan submission for the business plan cycle commencing in April 2028. We expect NESO's innovation funding to be materially reviewed and reset on an enduring basis alongside future network price controls.

Overall, we consider our framework design strikes the right balance between the key objectives of enabling NESO to deliver excellence and capitalise on its independence and unique expertise to lead the energy system transition, while retaining sufficient incentives and regulatory oversight to ensure robust and successful performance outcomes.

We will further consult on the detailed implementation of these framework decisions, through changes to NESO's licences and associated documents later this year. This will provide stakeholders with a further opportunity to provide feedback on key detailed aspects of NESO's regulation, including its key licence obligations, reporting requirements, the specific requirements on senior staff incentives and the approach to consolidating cost reporting.

1. Introduction

Section summary

This section explains the purpose of this document, key context on National Energy System Operator (NESO) and its regulatory framework, and our next steps following this decision.

Purpose of this document

- 1.1 This document sets out our decision on the enduring regulatory framework for National Energy System Operator (NESO), which applies from 1 April 2026 onwards. This includes all aspects of our regulatory framework: performance incentives; Business Plan requirements and assessment; cost regulation; stakeholder mechanisms; licence obligations and enforcement; senior staff-level incentives; regulatory finance; and innovation.

Context and related publications

- 1.2 On 1 October 2024, NESO was established as an expert, impartial body with key responsibilities relating to planning and operating the energy system.² NESO has a leading role in driving a secure and cost-effective transition to a clean energy system, and its overarching duties and objectives are unpinned by legislation.³ NESO continues to deliver the roles and responsibilities carried out previously by the Electricity System Operator (ESO) in addition to new and enhanced, whole-system responsibilities. These newer responsibilities include providing expert advice to Ofgem and Government, supporting energy system resilience, and strategically planning the whole energy system.
- 1.3 NESO is an independent, not-for-profit public corporation which is licensed and regulated by Ofgem. Our regulation is a key part of the governance model for

² [Decision notice to establish National Energy System Operator \(NESO\) | Ofgem](#)

³ NESO's statutory duties are set out in the Energy Act 2023. These obligations include a duty to promote objectives around net zero, security of supply, and efficiency, as well a duty to have regard to competition, consumer impacts, whole system impacts, and innovation. Please see sections 163-165 of the Energy Act 2023 for the specific duties' wording.

NESO; it provides independent oversight of NESO’s performance delivering its statutory duties, which in turn supports NESO’s operational independence from the government.

1.4 In December 2023, we published our ‘Consultation on the policy direction for the Future System Operator’s regulatory framework’.⁴ We published a summary of stakeholder feedback to this consultation and our response as part of the NESO statutory licences consultation.⁵ As explained further in those documents, we are introducing a suite of changes to NESO’s regulatory framework in three key phases:

- **for Day 1 of NESO until the end of NESO’s second business planning period (BP2)**, from 1 October 2024 until 31 March 2025;⁶
- **for BP3**, the one-year Business Plan period from 1 April 2025 and ending 31 March 2026; and
- following **the end of the RIIO-2 price control period**⁷ in April 2026, which is the focus of this document.

1.5 For Day 1 of NESO (i.e. the first key phase outlined in paragraph 1.4 above), we introduced several key changes from the regulatory framework that previously applied to the ESO.⁸ This included two new licences, the introduction of a not-for-profit financial framework, and targeted amendments to incentive arrangements to integrate NESO’s newer roles.

1.6 For BP3⁹ (i.e. the second key phase outlined in paragraph 1.4 above), we introduced major changes to the performance incentives framework for NESO, to increase focus on NESO’s delivery of key objectives and priorities. This included changes to the assessment approach and associated business planning and reporting requirements to deliver a more outcomes-focussed framework. These changes aimed to ensure our regulatory assessments are targeted at the issues which matter the most and have the most impact on outcomes for consumers.

⁴ [Policy direction for the Future System Operator’s regulatory framework](#)

⁵ [Response to statutory consultation on National Energy System Operator licences and other impacted licences](#)

⁶ BP2 covered the two-year period from 1 April 2023 to 31 March 2025.

⁷ RIIO-2 covers the period starting 1 April 2021 and ending on 31 March 2026.

⁸ [Decision on Associated Documents to the anticipated NESO licences – regulatory framework documents](#)

⁹ [Decision on NESO’s performance incentives framework for BP3 | Ofgem](#)

- 1.7 With the end of the RIIO-2 price control period approaching, we have considered our enduring approach to regulating NESO from April 2026 and beyond. For this stage, we have reviewed all aspects of NESO’s regulatory framework to consider if, and where, the implementation of further changes could lead to more effective regulation of NESO. Our review has built on stakeholder feedback and our experience gained through regulating NESO to-date, but has also reflected on changes to the way NESO is governed and the new roles it has.
- 1.8 As NESO has a different organisational design from all other energy network companies, it will not be part of Ofgem’s RIIO-3 price controls. However, we have sought to ensure NESO’s regulatory processes are compatible with the new network price controls for RIIO-3 where appropriate.¹⁰

Our decision-making process

- 1.9 In May 2025, we consulted on our proposals for the enduring regulatory framework for NESO which will apply from 1 April 2026 onwards. Details of our specific proposals can be found in our consultation document.¹¹
- 1.10 We received a total of 14 non-confidential responses and have published them on our website. We also held workshops on our proposals in May 2025 and have published a summary of views from these workshops on our website. A summary of the responses to the consultation is included in Chapters 3 to 10.
- 1.11 Broadly, stakeholders were supportive of our proposals for the enduring regulatory framework. However, stakeholders questioned whether the application of our regulatory mechanisms, in practise, would be able to deliver strong incentives and accountability. Stakeholders stressed that there needs to be further clarity on how NESO will be held accountable through the performance incentive scheme and stakeholder feedback; tangible consequences for poor performance; and clear safeguards through the licence and enforcement.

¹⁰ RIIO-3 covers the period starting 1 April 2026 and ending on 31 March 2031. Further details on network price controls can be found here: [RIIO-3 Sector Specific Methodology Decision – Overview Document](#)

¹¹ [Consultation on the enduring regulatory framework for NESO](#)

- 1.12 Our design of NESO’s regulatory framework has been shaped through extensive engagement with stakeholders, the review of comparator organisations, and the lessons learned from our past regulation of ESO and NESO.¹²
- 1.13 Overall, our decisions for the enduring regulatory framework are broadly consistent with the proposals set out in our consultation. However, we have reflected on the views provided by stakeholders and have made changes to the design of stakeholder panel. We have also tailored our approach to innovation funding to better reflect NESO’s role in this space. We have set out any specific changes from our consultation position and our rationale throughout the rest of the document.

Next steps

- 1.14 Alongside this decision, we have published a final version of the NESO Business Plan Guidance. This sets out our detailed expectations, assessment approach and timings for NESO’s Business Plan for the enduring regulatory framework, which will commence with the business plan cycle from 1 April 2026. We expect NESO to engage with stakeholders before producing its Business Plan for the business plan cycle commencing in April 2026 later this year.
- 1.15 We intend to publish a further consultation later this year on changes to NESO’s licences and associated documents, such as the NESO Licence Expectations Document and the NESO Performance Arrangements Governance Document (PAGD). These documents will set out our proposals for the detailed implementation of our policy decisions set out in this document. Key areas where we intend to seek further views include:
- The specific obligations placed on NESO in Condition C1 related to how NESO must undertake its activities, and the associated NESO Licence Expectations Document;
 - The detailed methodology and criteria for assessing NESO’s performance and its performance reporting requirements;
 - The detailed implementation and specific requirements for the stakeholder panel and wider within-scheme stakeholder mechanisms;

¹² Please see Chapter 2 of our May 2025 consultation for more information.

- The specific requirements on NESO to further align senior staff incentives with regulatory outcomes; and
- Our approach to improving transparency of NESO spending and consolidating cost reporting.

1.16 Whilst this document sets out our decisions for an overall regulatory framework design for NESO that we expect to apply on an enduring basis, we also intend to be dynamic and expect our approach to regulation will evolve going forward. Therefore, we will continue to review and further consider, if necessary, any changes that are needed to improve our regulatory framework after the business plan cycle beginning in April 2026.

General feedback

1.17 We believe that feedback is at the heart of good policy development. We are keen to receive your comments about this report. We would also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments

Please send any general feedback comments to stakeholders@ofgem.gov.uk.

2. Overall approach to NESO regulation

Section summary

This section explains our overall approach to NESO regulation. This includes: a summary of our different regulatory tools and how we intend to apply them, as well as summary of the overall impact of our decision and how this meets our objectives and principles.

Summary of our enduring regulatory framework approach

- 2.1 In summary, many of the core regulatory framework levers that previously applied to the ESO and NESO will continue to exist for NESO from April 2026 onwards. This includes:
- Clear licence obligations which set the minimum standards we expect from NESO, with the potential for enforcement action when these are not met;
 - A regular, transparent business planning process, which will define the outcomes NESO should achieve and be held to account for;
 - A public, evaluative incentive scheme which will assess how well NESO has delivered its Business Plan objectives and acts as the main reputational incentive on NESO;
 - Requirements for NESO to ensure this annual assessment and any enforcement action is a material factor in its decisions on senior staff remuneration;
 - Stakeholder feedback mechanisms, which will provide key routes for stakeholders to influence NESO's performance assessments and which act as an early warning signal for emerging issues; and
 - A flexible pass-through funding model, supported by ex-ante and ex-post value for money assessments, to ensure consumer money is being spent appropriately.
- 2.2 Whilst our core regulatory levers remain largely consistent with past frameworks, we are materially adapting *how* we apply these levers, in line with our objectives and principles. The key change is that we intend to adopt a more outcomes-focussed approach to NESO's overall regulation compared to our past regulation of the ESO. This will build on the changes we have already implemented for BP3,

where we materially evolved NESO's Business Plan requirements and performance assessment approach.

- 2.3 We consider this framework provides us with a comprehensive toolkit which we can deploy flexibly to respond to different performance issues. From the feedback received through our consultation and industry workshops, we understand that some stakeholders still have some questions and uncertainty about how we would use these tools to hold NESO to account in practice. To provide some greater transparency on how NESO's regulatory framework could be applied in practice, we have provided some illustrative scenarios in Annex 1.

Impact of our decision

- 2.4 Overall, we consider our decision on these regulatory tools for an enduring regulatory framework will deliver a robust and effective package of regulatory mechanisms and levers that is well aligned with our objectives and principles (as summarised below). The full details of these objectives and principles are set in Annex 2.

Objective: drive high performance

Main ways our framework will achieve this:

- An annual public performance assessment which is focussed on the most impactful outcomes for the energy sector and consumers – creating strong reputational incentives.
- Clear and enforceable licence requirements outlining the minimum performance standards NESO must meet.
- The Business Plan, combined with our subsequent Business Plan determinations, establish the key performance expectations that NESO will be measured against.
- More frequent within-scheme feedback on performance from stakeholders through the stakeholder panel and Ofgem/NESO senior engagement, in addition to direct engagement between the Ofgem and NESO Boards to relay the final annual performance assessment.
- Requirements on NESO to ensure its senior staff incentives materially reflect Ofgem's assessments and any enforcement actions.

Objective: ensure accountability

Main ways our framework will achieve this:

- Public Business Plan outlining NESO's key commitments and forecast spending, used as a key input into NESO's annual performance assessments.
- Regular, public performance reporting on progress against the plan and spending.
- Requirements on NESO to collect, understand and transparently respond to stakeholder feedback.
- Enforcement where minimum licence standards not met.

Objective: foster independence

Main ways our framework will achieve this:

- Greater focus on Business Plan outcomes rather than granular outputs, providing NESO with the flexibility to determine how to best deliver its roles.
- Overall shift to more outcomes-based requirements rather than prescriptive requirements will give NESO more discretion to determine how to best meet its legal obligations.
- Greater use of transparency requirements to support independence and ensure the appropriate level of regulatory oversight and scrutiny.

Objective: encourage organisational flexibility

Main ways our framework will achieve this:

- Pass-through funding model - enabling NESO to respond to new developments that may emerge within Business Plans.
- Focus on outcomes provides NESO with discretion on how to best to deliver its roles and objectives.

Objective: promote stakeholder trust

Main ways our framework will achieve this:

- Strengthened role for stakeholder input through enhanced stakeholder mechanisms.
- Creation of an independent panel which is better focused on providing clear and comprehensive stakeholder views as opposed to carrying out a full

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regulatory performance assessment, has comprehensive stakeholder representation and more meaningful engagement with NESO.

- Requirements on NESO to understand and respond to stakeholder feedback, coordinated through the independent panel.
- Other stakeholder mechanisms, such as a regular survey on stakeholder satisfaction, ongoing call for evidence and requirements on NESO to provide transparency.

3. Performance incentives

Section summary

This section outlines our decision for NESO's performance incentives. This includes our performance assessment approach and the level of detail the framework should oversee.

Summary of consultation proposal

- 3.1 We proposed to maintain a public evaluative assessment, focussed on NESO's achievement of strategic outcomes and its delivery of value for money. This will include continued requirements for regular, proportionate reporting that allows Ofgem and stakeholders to monitor and track NESO's progress throughout the business plan cycle. For April 2026, this will broadly be the same framework as BP3. We set out our intention to continue to review and refine these arrangements based on experience over time. We also set out our intention to further consider the specific, detailed reporting aspects as part of our consultation on the NESO PAGD.

Stakeholder responses

- 3.2 Stakeholders broadly supported our proposed approach to performance incentives. Stakeholders agreed that an outcomes-based regulatory approach, alongside continued regular reporting, will ensure NESO is more explicitly focused on the areas that have the greatest importance and value to the energy sector and consumers.
- 3.3 However, stakeholders stressed the importance of ensuring meaningful accountability within the proposed approach. Several stakeholders emphasised the importance of maintaining sufficiently prescriptive and granular targets – particularly for areas of poor performance. In particular, some stakeholders felt the Success Measures developed by NESO for BP3 were not sufficiently clear and tangible. Clear performance measures were seen as critical to enhance transparency, improve accountability and provide a clear framework against which stakeholders can hold NESO to account for performance. Several stakeholders suggested specific areas that NESO should be assessed on,

including: NESO's contribution to economic growth, emissions reductions, system reliability as well as its core operational roles.

3.4 A few stakeholders suggested other measures to improve accountability and strengthen reputational incentives from the performance incentive scheme. One suggestion was for NESO to publicly name individuals responsible for each Performance Objective as they believed this would strengthen reputational incentive on the individuals within the organisation. Another suggestion was for Ofgem to publish the minutes from regular Ofgem/NESO performance meetings to provide greater transparency.

3.5 One stakeholder suggested Ofgem consider the use of corporate-level financial incentives, as well as reputational and remuneration incentives. This stakeholder felt that that these can drive high performance and help fund higher-risk investment/innovation – citing as an example the use of the Balancing Services Incentive Scheme (BSIS) in previous incentive schemes for the ESO.

Our decision and rationale

3.6 We have decided to maintain a public evaluative assessment, focussed on NESO's achievement of Performance Objectives and its delivery of value for money. Our decision is in line with the position set out in our consultation.

3.7 We believe that a public Ofgem assessment should continue to exist to ensure robust and credible reputational incentives on NESO in the absence of profit incentives. In addition, a public assessment provides an objective and transparent point of reference that NESO should be required to take account of for senior-staff remuneration decisions (as discussed later in this document).

3.8 We consider that an outcomes-focussed performance assessment is most suited to NESO for the reasons set out in our consultation. We note the concerns raised by some stakeholders around the level of detail included in an outcomes-focussed assessment methodology and the importance of ensuring effective accountability. For clarity, our performance incentives framework allows us to be dynamic and flexible such that we can consider performance against more granular performance measures as part of our assessment for areas where we see emerging concerns or material risk. We consider that our framework enables the development of clear, appropriate and tangible performance measures through the Business Plan process (outlined in Chapter 4) - and we encourage all

stakeholders to input their views into the upcoming process for NESO's April 2026 Business Plan to ensure stakeholder views and priorities are reflected. We consider the experiences and lessons learned from the first iteration of this process for BP3 will help further strengthen the next set of Performance Objectives and Success Measures. For further explanation of how we consider our overall framework design will create strong accountability, please see Chapter 2 and Annex 1.

- 3.9 We also note the suggestions for specific areas on which NESO should be assessed. For clarity, this current decision is on the overall performance assessment framework as determinations on specific aspects of NESO's activities are not within scope. However, we encourage stakeholders to submit their views on specific Performance Objectives and Success Measures as part of the next Business Plan process.
- 3.10 We do not consider it appropriate for Ofgem to require NESO to outline publicly the senior-staff responsible for each of its Performance Objectives. We believe it is NESO's role to determine how best to provide transparency to stakeholders on senior-level accountabilities. Additionally, we consider that many of NESO's Performance Objectives are likely to be cross-cutting and interrelated. As such, there should be a collective responsibility on NESO's senior management to ensure NESO maximises the value of its total delivery and that the full package of Performance Objectives is delivered successfully.
- 3.11 We note the other detailed suggestions including the request for transparency on the performance discussions held between Ofgem and NESO during the year. We will consider these issues further alongside our development of the NESO PAGD, which we intend to consult on later this year.
- 3.12 We decided that organisational financial incentives would not apply to NESO as part of our joint decision with government on NESO's Day 1 licence. We continue to believe that applying a combination of well-designed organisation level reputational incentives with an appropriate link to senior-staff remuneration will deliver greater consumer benefits, for the reasons set out in our response document.¹³ Similarly we consider the use of overly mechanistic target-based incentives, such as BSIS, to be an ineffective way of driving positive consumer outcomes for an organisation with the characteristics of NESO, as outlined in more detail in our Day 1 decision.

¹³ Please see 1.2: [Response document - Statutory consultation on National Energy System Operator licences and other impacted licences](#)

4. Business Plan and plan assessment

Section summary

This section outlines our decision for NESO's Business Plans, including the Business Plan cycle length, the Business Plan process, the publication of supporting Strategic Aims, and our expectations for the content of NESO's Business Plan.

Business Plan cycle and process

Summary of consultation proposal

- 4.1 We proposed the overall business plan cycle length should be two years on an enduring basis. This will take effect with the first business plan cycle commencing 1 April 2026 and ending 31 March 2028.
- 4.2 We proposed to continue with the same broad requirements for NESO's Business Plan development and the same process for Ofgem's determinations established for BP3. We proposed these processes should take place under less constrained and more appropriate timelines compared to BP3. In addition, we proposed to amend requirements on how NESO engages with stakeholders on its Business Plan to provide greater process and timeline flexibility. We proposed to still require NESO to meaningfully engage with stakeholders before publishing a final Business Plan and to ensure the Business Plan reflects stakeholder views and feedback provided to NESO throughout the duration of the previous Business Plan cycle. We proposed to not set requirements for a formal publication of a draft plan by a specific date.
- 4.3 We set out further details on our expectations for the Business Plan process in our NESO Business Plan Guidance, which we consulted on alongside our consultation on the enduring regulatory framework.

Stakeholder responses

- 4.4 Stakeholders broadly agreed with our proposals. Stakeholders noted that the development of Business Plans on a two-year, recurring basis would avoid placing an excessive burden on NESO, Ofgem, and industry stakeholders providing

feedback, whilst remaining sufficiently dynamic to adapt to an evolving energy landscape.

- 4.5 Stakeholders continued to support the process for Ofgem’s determinations. One stakeholder noted that the formal consultation provides structure and transparency, allowing industry to provide meaningful feedback throughout the Business Planning process. However, several respondents requested that Ofgem strengthen the consultation parameters surrounding NESO’s future Business Plan development. It was suggested that Ofgem should retain a formal obligation for NESO to consult publicly on its draft Business Plan. This would ensure all stakeholders have a formal and transparent route to provide feedback outside of the NESO-run forums.
- 4.6 In light of previous experience in BP3, there were also concerns raised around the timing of NESO’s Business Plan final submission. Several stakeholders, including NESO, suggested Ofgem should stipulate another date for this first business plan cycle under the enduring regulatory framework.

Our decision and rationale

- 4.7 We have decided to maintain our proposed approach to the Business Plan cycle and process, in line with our consultation position.
- 4.8 We agree with stakeholders that a two-year business plan cycle will better align with our principles of being dynamic and proportionate. It will also strike the right balance between enabling NESO to provide updates on its activities and costs in response to energy system developments, without creating an overly burdensome process.
- 4.9 We have decided to maintain our consultation position to introduce greater flexibility as part of the process for NESO to develop its Business Plan. We note that NESO’s engagement with stakeholders is already formalised through the licences and the associated NESO Business Plan Guidance.¹⁴ We recognise stakeholder concerns; however, we believe giving NESO more autonomy to set its own process can help maximise effective stakeholder engagement. This is based on our previous experience in BP3, where there was limited stakeholder engagement through NESO’s formal engagement process. This approach is also in

¹⁴ See Condition G1 of NESO’s licences.

line with our overall intention to set outcomes-based requirements on NESO rather than prescriptive obligations, unless we see material risks. We note from NESO's response that NESO's plan development will be informed by a robust programme of stakeholder engagement. If we see issues with NESO's approach to this engagement, we may reconsider more prescriptive requirements for the enduring process.

- 4.10 We also consider that greater process flexibility would be beneficial for the upcoming Business Plan process. This is due to the continued constrained timelines resulting from NESO's recent introduction, the consequent challenges of fitting in a full formal consultation process, and benefits of ensuring Ofgem's determination process concludes before 1 April 2026.
- 4.11 Furthermore, to reflect the unique timeframe challenges for the Business Plan submission for April 2026, we will work with NESO to consider whether additional time could be provided compared to the final submission date set out in the NESO Business Plan Guidance for the enduring process. This will give NESO adequate time to develop robust, reliable plans and meaningfully engage with stakeholders. We expect this process will not be subject to the same constraints for future submissions, including for the Business Plans from April 2028 onwards.

Strategic Aims

Summary of consultation proposal

- 4.12 In our May consultation, we proposed that NESO should establish a new set of Strategic Aims to support its Business Plan submission for April 2026. We outlined that the Strategic Aims should consider the major sectoral changes and impacts that NESO intends to achieve to deliver its overall organisational vision, including its strategy for delivering these. We considered that the Strategic Aims should set out what NESO is seeking to achieve in the medium- to longer-term, beyond its shorter-term Business Plan submission. Therefore, Strategic Aims should provide clarity on what is underpinning NESO's shorter-term objectives, commitments and investments.
- 4.13 We proposed that the Strategic Aims can be a separate document from NESO's Business Plan submission and can be published earlier where beneficial. We set out that the Strategic Aims will provide key context for NESO's next Business Plan

but will not form part of the formal Business Plan assessment and determinations process.

- 4.14 We proposed that NESO should have discretion over the time horizons it sets for its Strategic Aims and the exact frequency at which it reviews these. However, we proposed that these Strategic Aims should be reviewed at least every 6 years. NESO should keep the Strategic Aims under review and update and re-publish its Strategic Aims at an earlier point if it feels these have become materially out of date.
- 4.15 We proposed that NESO should engage and consult with stakeholders on the first iteration and any subsequent major changes. We will publicly comment on NESO's Strategic Aims where appropriate, for example where we believe NESO's strategy is misaligned with government policies and key regulatory expectations, and/or does not fully consider stakeholder views.
- 4.16 We set out further details on our expectations for NESO's Strategic Aims in our consultation on the NESO Business Plan Guidance.

Stakeholder responses

- 4.17 Stakeholders welcomed the requirement that NESO should update its Strategic Aims to support its Business Plan submission for April 2026. Stakeholders noted that this will offer much-needed clarity to industry and stakeholders regarding NESO's objectives and responsibilities, enabling more effective oversight and accountability. Respondents also welcomed the requirement for NESO to consult on these Strategic Aims to ensure they align with the needs and expectations of the wider energy system.
- 4.18 Several stakeholders suggested that a minimum review of NESO's Strategic Aims every six years is too infrequent. Instead, stakeholders suggested these aims should be updated every two to four years. It was suggested that given the current pace of change in the industry, a review every 6 years is likely to render the aims insufficiently dynamic or would require them to be so broad that they may lose their strategic value.
- 4.19 One stakeholder felt Ofgem should have a stronger role in the development of NESO's Strategic Aims. It was suggested that Ofgem should consider providing more guidance and structure to this process to ensure NESO's Strategic Aims

clearly set out what NESO is trying to achieve in the medium- to long-term, particularly for the first iteration of this process.

Our decision and rationale

- 4.20 We have decided to implement our proposed requirements for NESO to develop Strategic Aims, in line with our consultation position.
- 4.21 We agree with stakeholders that NESO should update its Strategic Aims at an earlier date than every 6 years where changes in the energy sector mean they have become out of date. For clarity, the requirement proposed should be seen as a backstop and NESO will be required to keep these under review and re-publish its Strategic Aims at an earlier point (e.g., after 4 years) if these have become materially out of date or inaccurate.
- 4.22 We do not believe it would be appropriate to introduce more prescriptive requirements on NESO's Strategic Aims than those contained in the draft NESO Business Plan Guidance. Whilst we have provided minor clarifications in the final version of the NESO Business Plan Guidance, we believe NESO should be given a high degree of autonomy around how it develops its Strategic Aims to align with our objective to foster independence, but with appropriate engagement with Ofgem and stakeholders.

Business Plan content

Summary of consultation proposal

- 4.23 We did not propose any major changes to the Business Plan content requirements developed for BP3.
- 4.24 In line with our proposal for a two-year business plan cycle, we proposed that NESO's Business Plan content (e.g. Performance Objectives, Success Measures, Major Deliverables and costs) will have a two-year time horizon. In addition, NESO would be required to set out clear Success Measures, Major Deliverables and costs for both Year 1 and Year 2 of the two-year Business Plan period.
- 4.25 We set out further details on our expectations for the Business Plan content in our consultation on the NESO Business Plan Guidance.

Stakeholder responses

- 4.26 Stakeholders supported our continuation in approach to Business Plan content requirements.
- 4.27 A few respondents provided detailed suggestions for what NESO should include in its Business Plan as Performance Objectives, Success Measures and Major Deliverables. One stakeholder suggested Ofgem provide examples of what is expected from NESO or include additional detail around expectations for Performance Objectives, Success Measures and Major Deliverables in NESO's Business Plan, to ensure this is as clear as possible for stakeholders.
- 4.28 One respondent suggested Ofgem should encourage NESO to include additional elements and clarification in its Business Plan, including risk assessments, dependencies, expected deliverables tied to partner organisations and to ensure stakeholder inputs are clearly evidenced.

Our decision and rationale

- 4.29 We have decided to implement our consultation position to not make any major changes to the Business Plan content requirements for BP3.
- 4.30 For clarity, the existing guidance document sets out our expectations for the content that NESO should include in its Business Plan, including: what NESO plans to deliver over the business plan cycle; how these will be delivered; drivers for its costs (and where relevant CBAs); and evidence of how stakeholder views have been incorporated in the plan. We believe the level of detail included in this document strikes the right balance between ensuring clarity for NESO and transparency for stakeholders on what we expect NESO to set out in its plan, whilst also providing NESO with the ability to exercise sufficient independence and discretion to determine how it will meet these requirements. As such, while we have added a few minor changes for clarity, we have not made any material changes to the drafting of this document.
- 4.31 We encourage stakeholders to submit their views on specific areas that NESO should include in its Business Plan through the Business Plan development process for the business plan cycle commencing in April 2026.

5. Cost regulation

Section summary

This section outlines our decision on the regulation of internal costs for the enduring regulatory framework for NESO. This includes our overall approach to the cost regulation framework and cost reporting.

Summary of consultation proposal

- 5.1 In our May consultation, we set out several broad models for how we could design our cost regulation for NESO. One key choice was the extent to which we should continue with a flexible pass-through funding mechanism versus setting fixed ex-ante budgets (such as a government department budgetary approval model). With a pass-through model, another key choice was around how detailed our assessment of NESO's costs should be – either continuing to use a dynamic ongoing cost assessment or using a higher-level, more strategic cost assessment.
- 5.2 We proposed NESO is funded through a pass-through model, with Ofgem assessing costs using a dynamic ongoing cost assessment.
- 5.3 We proposed to review the way existing cost information is reported and monitored to ensure the requirements are proportionate and provide value. This could include a consolidation of our existing cost reporting framework and templates alongside our financial reporting and processes, outlined in Chapter 9. For example, moving to a single cost reporting template that is used for all processes, and ensuring the submission of this information is only required at the relevant stages of our assessment processes. We outlined our intention to consult on the specific details, as part of our consultation on the NESO PAGD, later this year.

Stakeholder responses

- 5.4 There was broad support for our proposal. Stakeholders were in favour of the flexibility as this model allowed NESO to respond to wider energy sector developments. They also agreed that the existing dynamic cost assessment

approach, coupled with NESO being required to only spend in-line with its legal and statutory duties, is sufficient to avoid inefficient expenditure.

- 5.5 A few stakeholders favoured Ofgem setting an ex-ante budget based on a detailed, up-front cost estimate from NESO instead of a pass-through funding approach. They considered that this approach would provide increased upfront certainty by sharpening NESO's focus on producing more accurate cost estimates at an appropriately granular level of detail (including sensitivities and contingencies) and allow Ofgem (and stakeholders) to assess and, where needed, challenge these estimates before costs are actually incurred.
- 5.6 Several stakeholders shared concerns with NESO's existing cost transparency, with calls for greater transparency at a more granular level of detail (for example, cost forecasts and actual costs per Performance Objective). In addition, they reflected that Ofgem's proposal to streamline reporting must not reduce the visibility or granularity of cost information.
- 5.7 NESO agreed with our proposal, reflecting the cost assessment approaches outlined under a pass-through model (dynamic and strategic) exist on a spectrum. NESO stated that over time, they expect to build confidence to demonstrate that a move towards a strategic cost assessment will be justified.

Our decision and rationale

- 5.8 We have decided to implement our consultation position to fund NESO through a pass-through model, with Ofgem assessing costs using a dynamic ongoing cost assessment. We will consult on the specific details, as part of our consultation on the NESO PAGD, later this year.
- 5.9 We continue to believe a pass-through funding approach aligns with our principles and objectives for the enduring regulatory framework. In combination with our cost assessment approach, it places an incentive on NESO to deliver the best overall outcomes for the energy system and make ongoing trade-offs about whether expenditure delivers value for money.
- 5.10 We agree with stakeholders that a pass-through funding approach is appropriate for NESO given the dynamic and evolving nature of its activities, and the need for it to adapt quickly in response to wider energy sector developments and emerging roles. We believe this would be materially constrained under a fixed ex-ante budget.

- 5.11 In addition, our dynamic, ongoing cost assessment approach is designed to provide robust assurance on NESO's spending under a pass-through model. We agree with NESO that in practice, our assessment approach will be adaptable for different areas and over time. The level of justification and information required will depend on the materiality of changes year-on-year and the level of confidence in spend, with material uplifts or greater concerns in spend requiring greater justification. However, even where greater trust and confidence is built, we still consider that a certain minimum level of bottom-up cost data and justification will be needed for us to carry out our role as NESO's economic regulator.
- 5.12 We recognise stakeholder's requests for greater transparency on NESO's costs, and we agree that NESO can improve the level of cost transparency provided as part of its BP3 Business Plan submission. In our BP3 Final Determinations we set expectations on NESO to publish a more detailed breakdown of its costs and accompanying narrative and that this should be as granular as the information provided directly to Ofgem. We will feed the lessons learned from this process and the views of stakeholders into our development of NESO's detailed licence requirements and associated documents, which we intend to consult on later this year.
- 5.13 For clarity, we do not intend to reduce transparency on NESO spending as part of our consolidation of cost reporting. Instead, we are aiming to lift unnecessary burden, such as requirements to provide various cost submissions in different formats. We consider consolidating cost reporting requirements and templates can reduce complexity and consequently improve clarity and transparency.

6. Stakeholder mechanisms

Section summary

This section outlines our decisions on the role of a NESO stakeholder panel and stakeholder input for the enduring regulatory framework.

NESO stakeholder panel

Summary of consultation proposal

- 6.1 In our May consultation, we proposed to establish a new requirement for an independent stakeholder group, called the 'Independent Challenge Panel'.
- 6.2 We proposed the Independent Challenge Panel would be an enhanced stakeholder group compared to the existing NESO Performance Panel. We proposed that the Independent Challenge Panel would continue to have a similar role/remit as the current NESO Performance Panel, i.e. to (1) input to NESO's Business Plan; and (2) provide views on its performance. However, we proposed the panel would be tasked with a more flexible remit, focused more on the collection, coordination and sharing of stakeholder feedback (rather than running a parallel performance assessment). This would be achieved through more frequent meetings, wider stakeholder representation on the panel, and more frequent and meaningful engagement with NESO.
- 6.3 We set out our view that the Independent Challenge Panel would produce a co-ordinated, public report of stakeholders' views on NESO's performance that will inform Ofgem's annual assessments. We proposed this report will focus on aspects the panel is best placed to comment on, such as how well NESO has delivered its Performance Objectives and how well it has engaged with stakeholders and responded to feedback throughout the year in general. We proposed this to be delivered alongside NESO's end-of-year reporting rather than several months after the end of the scheme.
- 6.4 For the design of the Independent Challenge Panel, we originally proposed this would in practice mean a consolidation of the two separate stakeholder groups that currently exist (the Ofgem-run NESO Performance Panel and NESO's Independent Stakeholder Group (ISG)).

- 6.5 We proposed that the Independent Challenge Panel would be administered by NESO. We set out that Ofgem would set the key principles and parameters that NESO is required to follow (such as the role and remit of the panel, type of membership, broad frequency of meetings, independence requirements, and key outputs), and NESO would then have discretion around how these requirements are best met in practice.
- 6.6 We set out our intention to consult on the specific principles and parameters for the Independent Challenge Panel, as part of our consultation on NESO's licences and the NESO PAGD, later this year.

Stakeholder responses

- 6.7 Stakeholders supported the continued use of an independent stakeholder group in our regulatory framework. Stakeholders noted that such a group would provide essential challenge and scrutiny of NESO's Business Planning processes and enhance transparency and accountability. Stakeholders also supported our proposal to increase the frequency of panel meetings and the more flexible role for the group in providing views on NESO's performance, as opposed to carrying out a full parallel regulatory assessment.
- 6.8 However, stakeholders were split on our proposal for the group to be administered by NESO. Several stakeholders were strongly opposed as it was viewed that this would compromise the group's independence and create potential conflicts of interest. This would result in a lack of trust in both the group and NESO's ability to meaningfully act on stakeholder feedback. There were particular concerns about NESO leading on the selection process for the chair and panel members and NESO overseeing the delivery of the group's performance report.
- 6.9 It was suggested by several stakeholders that the panel should be administered directly by Ofgem (or, as an alternative, by another independent third party selected by Ofgem for this purpose).
- 6.10 In addition, stakeholders raised concerns around our proposal to merge Ofgem's existing NESO Performance Panel and NESO's ISG. Several stakeholders noted their belief that consolidating the two groups would effectively ask the group to assess its own judgment and effectiveness in challenging the ambition of NESO.

This would compromise the group's ability to challenge NESO or its ability to assess performance (or both).

- 6.11 A few stakeholders suggested Ofgem could improve upon the existing approach. For example, through providing additional clarity between the roles of the NESO Performance Panel and ISG and creating more alignment between the groups so that ISG can feed into the NESO Performance Panel.

Our decision and rationale

- 6.12 We have decided to establish a new, independent stakeholder group, called the 'Independent Challenge Panel' (ICP). However, having reflected on the responses to our consultation, we have made some key changes to its governance and operation compared to our consultation proposal.
- 6.13 We have decided that the ICP will have the same broad role and remit as outlined in our consultation, i.e. providing both input to NESO's Business Plans and feedback on its performance in delivering those plans. It will meet with NESO at least once before the start of a business plan cycle to share views on NESO's Performance Objectives and Success Measures, and then at least every 6 months to discuss stakeholder feedback on NESO's performance against its plan. The ICP will also produce a public end-of-year report outlining stakeholder's views on how well NESO (1) achieved its Performance Objectives and (2) engaged with stakeholders to respond to feedback more generally, following a closed discussion session without NESO present. This report will be a key consideration in Ofgem's annual performance assessment.
- 6.14 In practice, the ICP will replace the existing NESO Performance Panel but with a stronger focus on the collection, coordination and sharing of stakeholder feedback. We expect this will be achieved through a wider spectrum of stakeholder members, including consumer representatives. We will not place any default restrictions on NESO establishing additional, informal stakeholder groups (such as the ISG). However, NESO must ensure there is effective coordination between its engagement with the ICP and any other channels it chooses to use to gather stakeholder feedback on its plans and performance. For example, we will set an expectation that through its engagement with the ICP on Business Plans, NESO should clearly explain and summarise the feedback from any other stakeholder engagement it has received or undertaken.

- 6.15 Following consideration of the consultation responses, we have decided that that the ICP will be led by NESO's customers and consumers and not (as originally proposed) owned and administered by NESO. Ofgem will set the key principles and objectives for the ICP and the ICP Chair, who will be appointed and managed by Ofgem. The ICP Chair will then have responsibility to ensure the overall effective operation of the panel, including that the key principles and objectives are met.
- 6.16 The ICP Chair will be responsible for approving the process for appointing panel members, the initial membership and any subsequent changes. Given NESO's unique knowledge of its stakeholders and customers, we expect NESO to run the process to appoint members, working closely with and in line with the process agreed with the independent Chair.
- 6.17 The ICP Chair and panel members will be responsible for the co-ordination, drafting and delivery of the panel's annual report, and for liaising with NESO to agree meetings logistics (potentially with the support of a nominated Technical Secretary panel representative). Where the panel is insufficiently resourced to self-administer these tasks, Ofgem or NESO would be available as a back-up, subject to the Chair's agreement that this doesn't infringe on the panel's independence. The Chair would also have the responsibility to relay the panel's key end-of-year messages to senior levels within Ofgem and NESO.
- 6.18 Whilst NESO will not own or administer the panel, it will be required to engage effectively with the ICP and to facilitate its successful operation, including by ensuring senior-level availability for the relevant meetings and providing the input and contributions needed.
- 6.19 We will consult on the detailed implementation and specific requirements for the ICP, as part of our consultation on NESO's licences and the NESO PAGD, later this year.
- 6.20 Overall, we believe our revised decision will create a stakeholder group that should provide industry and consumers with confidence that the panel is independent and representative of stakeholders and their views. We consider this enhanced panel will have the ability to have greater interaction and more meaningful engagement with NESO to hold it to account for its performance.
- 6.21 We believe it is appropriate and beneficial for the panel to carry out both forward-looking and backward-looking roles, despite the reservation from some responses to our consultation. There are clear synergies from the panel being involved in both helping to shape NESO's future Performance Objectives and Success

Measures and providing views on current performance against these. We also note that the current NESO Performance Panel has successfully undertaken both these tasks for several years. Nevertheless, NESO has the freedom to establish other, bespoke stakeholder groups for different purposes where it considers this is beneficial. The requirement for NESO to coordinate its ICP discussions with its wider feedback collection should avoid the unnecessary duplication of activities and/or disaggregation of views.

- 6.22 We have reflected on the concerns raised from stakeholders around the independence of a panel that is owned and administered by NESO. We believe our revised decision for the ICP to be stakeholder-led, and for its Chair to be appointed by Ofgem, should remove the risk of perceptions that it could be disproportionately led or influenced by NESO. Additionally, we believe a self-administered approach will also support the ICP's independence from Ofgem and remove existing process barriers which may limit NESO and the panel's ability to have more frictionless engagement.
- 6.23 We have also heard the calls from stakeholders that better representation of the breadth of NESO's stakeholders is needed on the panel, and a more effective and agile approach is needed to update membership. We continue to believe NESO should have a role in helping to inform membership as it is best placed to understand and share insight on its stakeholder base. We believe any independence concerns from NESO's involvement will be mitigated by placing a responsibility on the Ofgem appointed independent Chair to approve the process for appointing members, as well as any changes to the ICP membership.

Within-scheme feedback

Summary of consultation proposal

- 6.24 We proposed to maintain the requirement for NESO to conduct regular Stakeholder Satisfaction Surveys every six months during the business plan cycle. Additionally, we proposed requiring NESO to use the ICP to discuss key interim feedback and survey results and to demonstrate any plans or activities in response to the feedback.
- 6.25 We did not propose to continue having a time-limited call for evidence at a specific fixed time at the end of each scheme. Instead, we proposed to maintain

an ongoing call for evidence where stakeholders can submit feedback directly to Ofgem at any time throughout the scheme. We stated this would be an available option to any stakeholder where they do not consider their views have been sufficiently raised or considered through the ICP and stakeholder survey routes.

- 6.26 We set out our intention to consult on the detailed within-scheme feedback requirements as part of our consultation for the NESO PAGD, later this year, including any revised detailed survey requirements.

Stakeholder responses

- 6.27 Stakeholders were supportive of our proposal to continue to require NESO to conduct Stakeholder Satisfaction Surveys every six months. This was seen as important to provide ongoing insights and allow NESO to provide agile responses to customer needs. Some stakeholders questioned the independence of the survey (and its assessment), seeing that it is led by NESO, and requested further details on the process for development and design of the survey. One respondent suggested that surveys could be complimented with "deep-dive workshops" on key themes.
- 6.28 Stakeholders were generally supportive of our proposal to introduce an ongoing, rather than time-limited, call for evidence. Stakeholders recognised the ability from this proposal to provide real-time feedback, allowing Ofgem to react more quickly and effectively to industry concerns as they occur. However, questions were raised about the practicalities of this approach. Specifically, what level of information, how often, and in what way would Ofgem manage the volume of incoming feedback from industry stakeholders, whilst also avoiding any potential overburden on Ofgem.
- 6.29 A couple of stakeholders, whilst supporting the proposal, stated their preference for a continuation of a periodic call for evidence. This was seen as a useful prompt for industry to provide feedback that is structured, balanced and comprehensive. It was seen that without it, there is a risk that less feedback is provided overall, and that feedback will not be duly considered when assessing performance at the end of the business plan cycle.

Our decision and rationale

- 6.30 We have decided to maintain our consultation position regarding within-scheme feedback.
- 6.31 We continue to believe stakeholder surveys provide a useful requirement and metric to support NESO and Ofgem’s understanding of stakeholder feedback. Requiring NESO to regularly discuss feedback from the survey with the panel will enable a more cohesive use of stakeholder mechanisms within our incentive scheme. Also, this approach should support our objective to promote stakeholder trust as it enables a clear and more effective channel for stakeholder feedback to be addressed. If and when necessary, we would welcome further discussions between the panel and NESO on specific areas of focus.
- 6.32 For clarity, NESO will continue to be required to commission a Stakeholder Satisfaction Survey from an independent, reputable market research company, as in BP3. To ensure independence, the key aspects of the Stakeholder Satisfaction Survey, including the specific questions asked, research methods, types of participants, and the methodology used to summarise survey result, must be approved by Ofgem. For the avoidance of doubt, we will consider all aspects of the approach to stakeholder surveys and consult on the specific details as part of our consultation on the NESO PAGD, later this year.
- 6.33 We recognise concerns from stakeholders around how in practise our ongoing call for evidence will work. We will ensure feedback throughout the scheme feeds into our assessment of performance in a timely manner, feeding into Ofgem’s engagement with NESO and the panel discussions where appropriate. This will lead to a more cohesive, enhanced and timely process for stakeholders to scrutinise NESO’s performance. In addition, whilst we have not decided to issue a time-specific call for evidence, we will seek to improve our communication at the end of the business plan cycle with stakeholders, to ensure there is a clear prompt for industry to provide any views they do not consider have been sufficiently raised or considered through the ICP and stakeholder survey routes.

Decision transparency and review

Summary of consultation proposal

- 6.34 We did not propose to introduce any additional, fundamentally new mechanisms (such as a new review panel that can overturn NESO decisions or a more regular public forum with NESO and Ofgem to discuss key issues).
- 6.35 We proposed to review, and where valuable strengthen, the existing package of incentives and obligations on NESO in relation to its decision-making transparency. We stated that our review would include looking at:
- Relevant obligations on decision-making and transparency currently set out in Condition C1 and the NESO Licence Expectations Document; and
 - The specific requirements for the report provided by the ICP.
- 6.1 We noted our intention to undertake this detailed review and share proposals as part of our consultation on NESO's licences and associated documents, later this year.

Stakeholder responses

- 6.2 Several stakeholders agreed with our position that effective mechanisms for engagement are already in place. However, many suggested a range of ideas for additional, fundamentally new mechanisms for engagement with NESO.
- 6.3 A couple of stakeholders called for the introduction of a 'Town Hall' style meeting hosted by NESO's executive leadership team. This follows a general trend from respondents that there should be a strengthening of the relationship between NESO's board and senior leadership and stakeholder groups evaluating and feeding into NESO performance. It was suggested this would enhance transparency, build trust, and offer stakeholders a regular opportunity to engage directly with leadership.
- 6.4 Several stakeholders commented on changes needed to NESO's licences to improve decision-making and transparency, including Condition C1. It was suggested that Ofgem strengthen specific licence conditions relating to data sharing principles and adopt recommendations from the Energy Data Taskforce regarding industry data sharing practices.

- 6.5 Finally, one stakeholder suggested the introduction of a 'Super Complaint' mechanism, allowing designated trade bodies to escalate serious concerns through a formal process that triggers a required NESO response and Ofgem-approved action plan.

Our decision and rationale

- 6.6 Overall, we do not consider that we need to introduce any additional, fundamentally new mechanisms. However, as outlined in our consultation, we plan to review, and where valuable strengthen, the existing package of incentives and obligations on NESO in relation to its decision-making transparency, including Condition C1 and the NESO Licence Expectations Document. We value the input from stakeholders on changes needed to NESO's licences and will consider these as part of our consultation on the licences, later this year.
- 6.7 In addition, as part of this consultation, we intend to further explore the suggestions for the ICP to engage with NESO and Ofgem at more senior levels than the existing Performance Panel. We agree with stakeholders that there is potential value in the ICP building greater relationships with the NESO Board and senior Ofgem staff, particularly when it comes to relaying key feedback. This will ensure further accountability/transparency to stakeholders and incentives on NESO to proactively understand/address concerns.
- 6.8 We note from our recent experience that stakeholders have not found significant value in our current end-of-scheme event, which is an existing public forum for stakeholders to ask NESO questions on its performance. These open sessions have typically had limited attendance and low levels of stakeholder input. NESO currently runs more timely, specific, public engagement sessions across its activities throughout the business plan cycle, enabling more effective engagement and transparency on its decision making.
- 6.9 We also do not plan to introduce further formal escalation processes. We believe the current routes for stakeholders to raise concerns are sufficiently robust (as outlined in the rest of this chapter) and enable Ofgem to use its discretion to determine the seriousness of an issue and the best regulatory response. NESO is also currently required to evidence how it is addressing key themes from feedback. We will further examine the wording of these obligations as part of our review of existing requirements.

- 6.10 Overall, we believe improving the existing mechanisms will strike the right balance between improving transparency and proportionality.

7. Licence obligations and enforcement

Section summary

This section outlines our decision for NESO's licence obligations and Ofgem's enforcement approach for the enduring regulatory framework. This includes changes to NESO's licence obligations and Ofgem approvals.

Licence obligations

Summary of consultation proposal

- 7.1 Overall, we proposed to adopt an enduring strategy of progressing towards primarily outcomes-based obligations to underpin the minimum standards expected from NESO. We proposed to focus the use of regulatory approvals and prescriptive obligations to situations where these are clearly necessary or beneficial. For example, where there is a clear risk of material misalignment between Ofgem and NESO that could undermine consumer interests, or where specific outputs or deadlines must be met to facilitate key energy sector processes/outcomes.
- 7.2 For April 2026, we proposed to focus on:
- Reviewing, improving and clarifying the outcomes-focussed obligations which currently underpin the minimum standards expected from NESO's activities (primarily set out in Condition C1 and the NESO Licence Expectations Document);
 - Fundamentally reviewing our approach to the NESO Licence Expectations Document so that it focusses on providing clear and necessary guidance in relation to key licence obligations; and
 - Targeted removal of certain existing Ofgem approvals that we consider have limited value and are now unaligned with our principles and objectives. We would instead use new or existing principles in NESO's licences to set the required outcomes we expect. Our initial view was that this could include areas such as NESO's Expenses Policy for travel under Licence Condition F7 and the form/format of various NESO documents.

- 7.3 We proposed to consult on any licence changes, as well as the NESO Licence Expectations Document, later this year.

Stakeholder responses

- 7.4 Stakeholders broadly supported our proposals. Stakeholders noted the proposal aligns with our objectives and principles for the enduring regulatory framework and will also help to reduce unnecessary regulatory burden and enable NESO to focus on delivery for consumers. However, stakeholders requested further information on the proposed changes, particularly to limit the use of regulatory approvals.
- 7.5 One stakeholder disagreed with our proposals as they believed Ofgem should continue to adopt a 'twin-track' approach that balances prescriptive obligations (e.g. timeliness of connection offers) and outcomes-based obligations (e.g. stakeholder engagement). In particular, it was suggested that prescriptive licence conditions must be used where other licence holders have reciprocal obligations. This would be critical to ensure clarity of roles and responsibilities for stakeholders and consumers and accountability.
- 7.6 Stakeholders outlined areas to consider for licence changes, including: requiring granular outputs from NESO's Business Plan in the licence (one stakeholder suggested, instead, a removal of dates in the licence); specific data sharing requirements/coordination protocols with network operators; and transparent reporting mechanisms that demonstrate alignment with strategic energy planning objectives. Another suggestion was for Ofgem to introduce a licence requirement for NESO to produce a remediation plan if there is evidence of underperformance.
- 7.7 NESO noted that it would be beneficial to identify which changes are needed to for April 2026 and which changes could continue on slightly longer timescales.

Our decision and rationale

- 7.8 We have decided to implement our proposed strategy of progressing towards primarily outcomes-based obligations to underpin the minimum standards expected from NESO, in line with our consultation position.

- 7.9 Our overall approach should strike the right balance between our regulatory objectives of accountability, fostering organisation independence and flexibility and the principle of proportionality by being dynamic and targeted. This would mean, in practice, we would continue with a 'twin-track' approach: we would make changes towards outcomes-focused obligations in areas where prescriptive requirements may cause harm, but we would continue to maintain and/or strengthen our prescriptive licence requirements on areas where this has clear consumer value.
- 7.10 We welcome suggestions for further requirements to improve accountability and ensure NESO sufficiently takes into account Ofgem's regulatory outcomes and assessments. We will further consider any changes to our approach as part of our licence consultation, later this year. In addition, we will consider all other specific suggestions for changes to NESO's licences, as well as provide further detail on our proposed changes and the timelines for when we will make these changes, in our consultation on the licences later this year.

Enforcement

Summary of consultation proposal

- 7.11 We did not propose a change from our existing published approach to enforcement.¹⁵
- 7.12 We set out our intention to informally consult, followed by a formal consultation later this year, on whether a version of the ongoing 'fit and proper person' requirements, as used already in the Supply Licence, should apply to other types of licence holders, including NESO. This should create an additional valuable control and support NESO in a positive, transparent and effective compliance culture.

¹⁵ For more details please see: [Enforcement Guidelines](#)

Stakeholder responses

- 7.13 Stakeholders broadly supported our approach. However, a key theme through responses was for clarity on our enforcement process to ensure accountability and prompt corrective action. One stakeholder noted that enforcement actions should be seen as an absolute last resort, rather than a primary driver of NESO's compliance. It was stated that Ofgem should ensure appropriate regulatory mechanisms are in place to minimise its recourse to enforcement actions.
- 7.14 NESO agreed that the existing enforcement mechanisms are suitable. NESO requested that Ofgem's Enforcement Guidelines should be updated to acknowledge the practicalities of Ofgem's enforcement approach given NESO operates under a not-for-profit framework.

Our decision and rationale

- 7.15 We have decided to continue with our existing published approach to enforcement.
- 7.16 We expect to consult formally later this year on whether a version of the ongoing 'fit and proper person' requirements, as used already in the Supply Licence (Standard Licence Condition 4C), should apply to other types of licence holders, including NESO. This should ensure NESO only attracts and retains senior managers with the capabilities and background to contribute to a positive compliance culture.
- 7.17 We continue to believe our existing approach to enforcement is appropriate and provides an effective safeguard in the presence of poor performance. For clarity, only in the case of suspected or confirmed non-compliance with the licence, would we use our enforcement tools. To drive high performance and ensure accountability in the case of poor performance, NESO is incentivised through strong reputational incentives and financial incentives on senior staff, as outlined elsewhere in this document. Further details on the process we expect to follow for poor performance is outlined in Annex 1 below.
- 7.18 For clarity, our enforcement approach will be the same enforcement approach as for other licensees. However, under a not-for-profit framework, we will likely place more emphasis on enforcement orders and directed remedies than financial penalties. We will require NESO, through its licences, to take into account any

enforcement action when determining senior staff performance-based remuneration to reinforce incentives on senior managers to promote a culture of compliance.

- 7.19 We do not expect to make any changes to our Enforcement Guidelines for NESO. This is because we believe it is important that Ofgem retains full discretion around when and how it will use its enforcement and other investigation powers.

8. Senior staff incentives

Section summary

This section outlines our decision for regulatory requirements related to NESO’s senior staff incentives.

Summary of consultation proposal

- 8.1 In our May consultation, we set out three options for how we could ensure an appropriate link between Ofgem’s performance assessments and NESO’s senior staff incentives. This included: retaining the existing licence requirements for NESO to produce a Remuneration Policy which is published by NESO and approved by Ofgem (current approach for BP3);¹⁶ replacing the existing approach of approving a Remuneration Policy with new principle-based requirements in NESO’s licence; or introducing a licence requirement, similar to comparator not-for-profit organisations (such as Welsh Water and Scottish Water), that sets prescriptive requirements and/or a methodology for how NESO should account for Ofgem performance assessment outcomes in its Remuneration Policy.
- 8.2 We proposed to replace the existing policy approval with a new set of principle-based requirements. We proposed to continue to review the effectiveness of this approach over time. If examples were to emerge of NESO insufficiently taking into account Ofgem’s regulatory outcomes, we would consider introducing stronger requirements on NESO, such as a prescriptive methodology, or ex-post measures to block bonus payments (such as those recently introduced in the water sector).¹⁷
- 8.3 We proposed to consult on the specific licence changes to implement the principles-based requirements, later this year.

¹⁶ See Condition F7 of the ESO licence and Condition F5 of the GSP licence.

¹⁷ For further details, please see: [Protecting customer interest on performance-related executive pay – recovery mechanism guidance](#)

Stakeholder responses

- 8.4 Stakeholders supported our proposal, welcoming the intention for a stronger link between senior-staff remuneration and performance. It was noted that our proposal seemed to strike the right balance between ensuring increased transparency on how decisions are made by NESO on staff bonuses in relation to the outcomes of Ofgem’s performance assessment, without detailing the exact methodology.
- 8.5 Several stakeholders welcomed the proposal but pushed for greater accountability. It was suggested that senior-staff incentives must be underpinned by a greater level of granularity in the framework and that this should be linked to individuals responsible for delivery. This would allow for a more direct and justifiable link between performance outcomes (such as the delivery of Performance Objectives) and the awarding of financial incentives.
- 8.6 One stakeholder called for detailed transparency requirements, suggesting NESO publish aggregated information about NESO senior-staff incentives, salary, bonuses and pension for those earning over a certain threshold.
- 8.7 NESO broadly agreed with our proposal, expecting that the principles set would align with the principles that have been developed for the approval process of its Remuneration Policy for BP3. NESO did not support the option of setting prescriptive requirements given the robust nature of governance already established. They stated this would not be appropriate as it would not foster trust at this early stage of NESO or allow sufficient independence under the full scope of NESO’s objectives and strategy.

Our decision and rationale

- 8.8 We have decided to replace the existing policy approval with a new principle-based requirement, in line with our consultation position. We will continue to review the effectiveness of this approach over time.
- 8.9 We believe there should be a clear and meaningful link between NESO’s senior management remuneration and Ofgem’s assessment of NESO’s performance. This should drive high performance and ensure the credibility of the regulatory framework. We agree with stakeholders that setting principle-based requirements on NESO’s approach to senior staff remuneration will provide greater upfront

clarity on our key expectations and improve enforceability compared to our existing approach. Equally it will avoid us needing to review and approve all aspects of NESO's Remuneration Policy, some of which have less need for regulatory scrutiny. This is also in line with our overall licence decision in Chapter 7.

- 8.10 We do not believe more granular, overly mechanistic, target-based financial incentives are appropriate given the focus of NESO's role and objectives on strategic/long-term outcomes. In addition, overly prescriptive requirements on individual staff would not support collective responsibility or align with our key objectives to foster independence and the principle of proportionality in designing our regulatory framework. Our aim is to provide NESO's board with sufficient independence and discretion to determine how to best set up NESO for success. As explained in Chapter 3, we see it as the collective responsibility for NESO's senior management to deliver the suite of Performance Objectives to a high standard. However, we also consider that NESO should have sufficient leeway to reflect on specific areas of performance in its decision making for individual staff. We will further consider the precise wording of our senior staff remuneration principles as part of our licence consultation, later this year.
- 8.11 We agree with stakeholders that transparency around the NESO Board's senior remuneration decisions is important, particularly where the Board is given relatively more discretion and flexibility around these decisions. As a public body, NESO is already expected to publish certain information on senior-staff remuneration as part of its framework agreement with the government.¹⁸ We intend to review these existing requirements to see if further requirements are needed, as part of our consultation on NESO's licences later this year. This could include additional requirements for NESO to justify its decisions and explain publicly how these have materially considered Ofgem's performance assessment.
- 8.12 Overall, we consider that our proposal will incentivise NESO in multiple ways to ensure it is sufficiently factoring in Ofgem's regulatory outcomes and assessments into its senior staff remuneration decisions. This includes incentives to comply with the licence, reputational incentives from the need to justify decisions publicly, and incentives to avoid further regulatory changes in the future which could reduce existing levels of discretion.

¹⁸ [National Energy System Operator \(NESO\) framework document - GOV.UK](#)

9. Regulatory finance

Section summary

This section outlines our decision on NESO’s financial regulatory framework. This includes our proposal for Ofgem’s ongoing role and reporting requirements.

Summary of consultation proposal

- 9.1 We proposed that Ofgem will have a minimal enduring role in the regulation of NESO’s finances. We proposed that we would continue to set core obligations on NESO to calculate revenues in a manner which ensures it does not make or incur a lasting financial profit or loss,¹⁹ maintains the right financial resources,²⁰ and has regard to relevant government guidelines.²¹ However, we considered that Ofgem should not need to carry out a detailed audit, review or approve of NESO’s revenue calculations, or that NESO should be part of a full price control Annual Iteration Process (AIP). We noted that certain reports and assurances may remain necessary, with specific details to be consulted upon later this year.
- 9.2 For April 2026, we proposed to review, rationalise and consolidate, where appropriate, the existing financial process and reporting alongside our cost reporting (as outlined in Chapter 4). We set out our intention to consult on any detailed changes, as part of our consultation on NESO’s licences and associated documents, later this year.

Stakeholder responses

- 9.3 There was broad support for our proposal for a minimal role for Ofgem in the regulation of NESO’s finances. This was seen as reflective given NESO’s move from private to public ownership and to a not-for-profit regulatory model with government responsibility in this area.

¹⁹ See Condition F1.15 of the ESO licence and F1.9 of the GSP licence.

²⁰ See Condition F4 of the ESO licence and F3 of the GSP licence.

²¹ See Condition F4.12 of the ESO licence and F3.12 of the GSP licence.

- 9.4 Several stakeholders noted that given NESO is now a not-for-profit organisation, Ofgem should ensure that the financial framework and associated reporting are aligned with the rules and regulations associated with this status. It was recommended that Ofgem consider whether additional reporting or further independent audits or disclosure obligations are appropriate in this context.
- 9.5 NESO supported our position on regulatory finance, agreeing with our ambition to reduce reporting burden where possible.

Our decision and rationale

- 9.6 We have decided that Ofgem should have a minimal enduring role in the regulation of NESO's finances, in line with our consultation position. To ensure a simpler, more effective financial process that is proportionate and focused on consumer outcomes, we will not require the full existing Regulatory Reporting Pack (RRP),²² Agreed Upon Procedures (AUPs) or Regulatory Financial Performance Reporting (RFPR)²³ for the enduring regulatory framework for NESO. Existing information received through these processes that remains of value (e.g. end-of-year cost data), will be consolidated with other relevant requirements. We will consult on the specific details of this approach later this year.
- 9.7 Many of the existing financial reporting processes and requirements are a product of the ESO's previous private sector/for-profit financial framework under the RIIO-2 price control - rather than something we will need or use actively to drive and monitor NESO's performance. We believe these reports add minimal value in our new regulatory framework.
- 9.8 Additionally, we consider Ofgem's role in revenue calculations: setting budgets, reporting of outturns; holding NESO to account for unjustified variances; and conducting annual revenue true-ups to fall outside of Ofgem's remit, given that NESO is now accountable to parliament.²⁴

²² [Decision on modifications to the ESO Regulatory Instructions and Guidance and Regulatory Reporting Pack for RIIO-2](#)

²³ [Decision on 2024 modifications to the Regulatory Financial Performance Reporting \(RFPR\) for RIIO-2](#)

²⁴ NESO is accountable to Parliament for its Annual Report of its activities together with its audited accounts after the end of each financial year, as well as required to publish the report on its website. For more details, please see: [National Energy System Operator \(NESO\) framework document - GOV.UK](#)

- 9.9 We note that NESO is already required to audit its annual accounts as part of its framework agreement with HMG.²⁵ Where further independent assurance is needed on NESO's accounts and revenue calculation, that would not duplicate existing requirements, we will consider the use of external auditing requirements.
- 9.10 Overall, we believe that clearer, more effective processes and reporting will better align with our principle to be proportionate in our regulatory framework and direct regulatory focus on the areas that matter most for consumers.

²⁵ [National Energy System Operator \(NESO\) framework document - GOV.UK](#)

10. Innovation

Section summary

This section outlines our decision for NESO’s innovation funding. This includes our overall approach to funding innovation and the use of specific innovation funding mechanisms such as the Network Innovation Allowance (NIA) and Strategic Innovation Fund (SIF).

Summary of consultation proposal

- 10.1 In our May consultation, we set out several options for how to fund NESO innovation in an enduring regulatory framework. This included NESO continuing to have access to distinct innovation funding - either through the same funding mechanisms as network companies or through new, standalone mechanisms. An alternative option presented was for NESO to be funded through its cost pass-through model.
- 10.2 We proposed that NESO should have access to distinct innovation funding, through the same innovation funding mechanisms as network companies (NIA and SIF). We proposed NESO’s access to NIA and SIF funding will be governed by the same governance documents as other network companies.
- 10.3 In addition, we proposed that NESO will be able to apply for NIA funding for a five-year period, as part of its Business Plan submission for the business plan cycle commencing in April 2026. We set out our expectation that NESO’s innovation funding will be materially reviewed and reset on an enduring basis alongside future network price controls.
- 10.4 For April 2026, we proposed that Ofgem will decide on NESO’s NIA funding as part of our Business Plan determination process. NESO will be able to request additional funding, if needed, for the remainder of the five-year period as part of its next Business Plan submission for the business plan cycle commencing in April 2028.
- 10.5 We set out our expectations for NESO’s NIA funding request, which aligns with our expectations set for network companies for RIIO-3, in our consultation on the NESO Business Plan Guidance.
- 10.6 We proposed to consult on specific changes to NESO’s innovation funding through our consultation on NESO’s licences and associated documents, later this year.

Stakeholder responses

- 10.7 Overall, there was broad support for our proposal to continue with the use of a distinct innovation funding mechanism which is separate from NESO's pass-through model for its other business expenditure. This will enable NESO to fund innovation projects that may have lower technological readiness and/or higher risks, but ultimately greater benefits for the energy system and consumer. Stakeholders supported the use of the same innovation mechanisms as other network companies as this should ensure consistency with network price controls and facilitate collaboration and knowledge-sharing on innovation projects.
- 10.8 However, a few stakeholders questioned the effectiveness of our innovation funding proposal as NESO's role and ownership structure differs from other network companies. From the responses received, it was outlined that NESO's innovation funding should place a greater focus on whole-system innovation projects that are cross-vector and consumer focused. This is because NESO has an expanded remit and a lack of commercial interest in comparison with other network companies. In particular, a few stakeholders suggested innovation should be mandated as one of NESO's Strategic Aims to ensure a greater focus on cross-industry solutions.
- 10.9 NESO agrees with our proposals for NIA funding. For SIF, NESO proposed Ofgem should consider an updated mechanism to allow NESO to access robust funding for substantial transformational projects - designed with the flexibility to enable NESO to respond effectively to future system challenges.

Our decision and rationale

- 10.10 We have decided that NESO should have access to distinct innovation funding through the same innovation funding mechanisms (NIA and SIF) as network companies. For NIA, NESO will have the same access and will be governed by the same governance documents as other network companies. For SIF, NESO will have access to a separate ringfenced pot, the specific details of which will be set out within the SIF Governance Document which we will consult on later this year.
- 10.11 In alignment with our principle to co-ordinate regulatory processes where appropriate, we continue to believe there is benefit in ensuring consistency for

NIA funding with other network companies in RIIO-3. This is critical given one of the key objectives of the funding is to support collaboration.

- 10.12 In addition, we believe NESO should continue to be part of the SIF funding mechanism to ensure NESO is able to be an effective project partner for network-led projects through RIIO-3. Also, a continuation of this mechanism should reduce complexity and a need to administer a more resource-intensive process before the start of RIIO-3.
- 10.13 However, we agree with NESO and other stakeholders that NESO's evolving role should be more accurately reflected in our funding approach. As such, our decision to create a ringfenced pot for NESO's SIF funding, with tailored criteria, should support NESO's focus on transformational, whole-system innovation projects that are consumer focused. This approach will therefore enable NESO to play a greater role in strategic direction setting and review SIF applications in areas of NESO responsibility, without creating a conflict of interest by accessing the same funding pot as other network companies.

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Appendix 1 – Further explanation of how we will operate our regulatory framework

This annex is designed to provide greater explanation and transparency to stakeholders around how we expect to operate our regulatory framework for NESO in practice. This includes a summary of how the different levers outlined in this document will work together as a whole, as well as some illustrative examples of how we may respond to different performance scenarios.

Summary of how our regulatory levers work together

Figure 1 provides an overview of how the different elements of our regulatory framework fit together in practice to incentivise NESO to deliver a high standard of performance. In summary this achieved through:

1. Setting clear performance expectations;
2. Regular, ongoing processes to monitor, discuss and provide feedback on NESO's performance against these expectations; and
3. An annual, end-of-year process that ensures NESO is accountable for its performance, through reputational and senior staff financial impacts.

1) Establishing clear performance expectations

Our regulatory approach is built around setting clear, outcomes-focussed performance expectations for NESO. These include:

- Incentives-related expectations – which set out what NESO must deliver to achieve a high-performance assessment outcome and which are established every two years through the Business Plan process.
- Licence requirements – which reflect the minimum standards we expect from NESO and are set and updated on an ongoing basis.

The Business Plan process is critical for defining what NESO should be seeking to achieve and what it will be measured against. On an enduring basis, this will occur every two years, starting from April 2026. Through this process, NESO will work with its stakeholders, including the ICP, to define its key Performance Objectives (which set the key outcomes it will achieve) and Success Measures (which should define how those outcomes are measured). NESO will also produce its two-year costs forecast and provide clear and transparent justification for its spending.

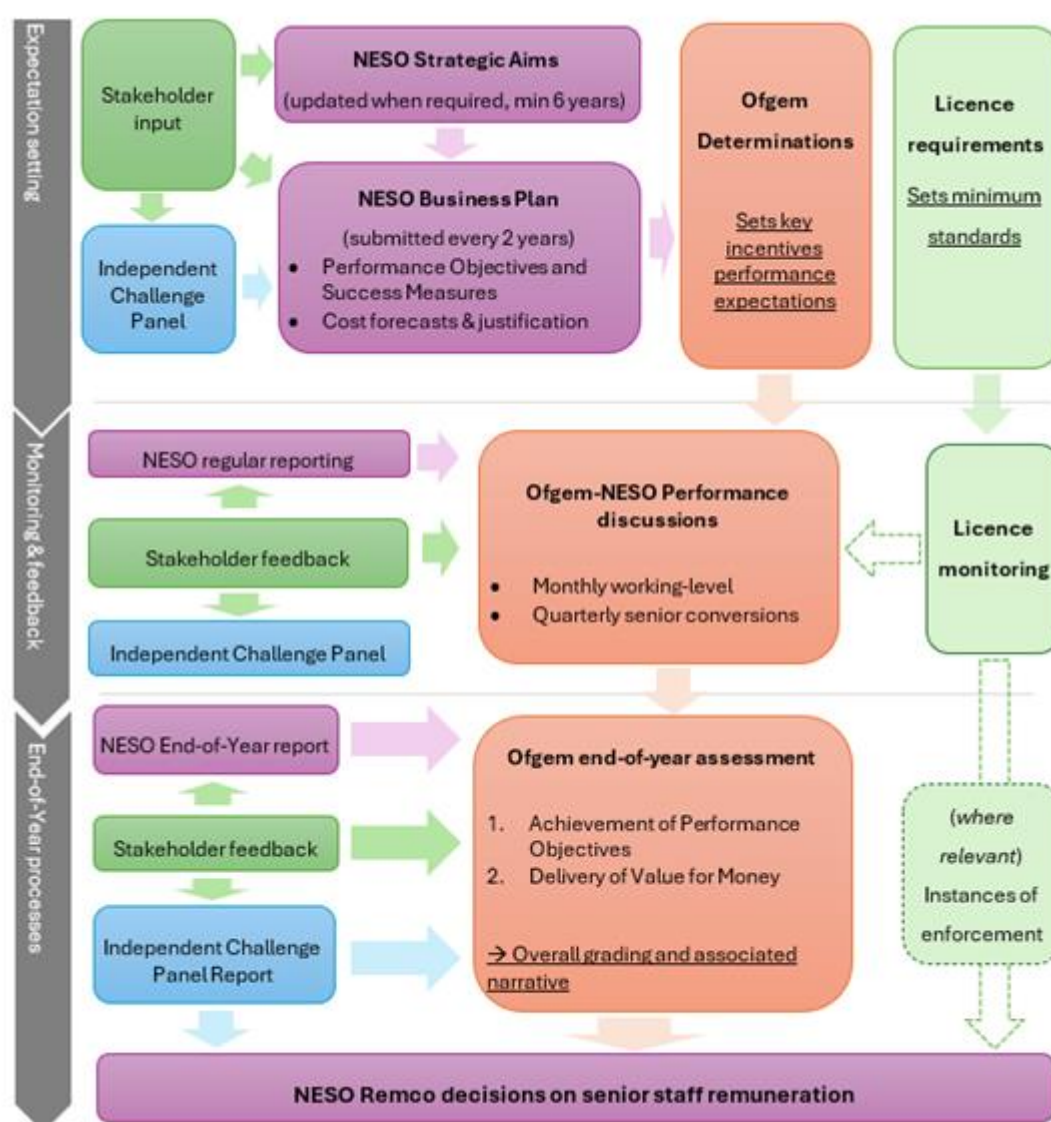
Ofgem will then make determinations on the Business Plan. Where we consider there are gaps or elements missing from the Performance Objectives and Success Measures, we may set additional performance expectations. We will also perform a value for money

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assessment to establishing our level of confidence with NESO's expenditure. This public determination defines what NESO will be measured against at the end of each year in its annual performance assessment by Ofgem.

Licence requirements will set the minimum standards NESO should meet. Whilst we are aiming to move to predominantly outcomes-focused requirements, we will maintain prescriptive requirements where in consumer's interest. Whilst we expect to update the licence on an ongoing basis, the Business Plan process is also an opportunity to materially review the licence to ensure newer expectations are captured.

Figure 1 - Overview of the performance monitoring and assessment process for NESO



2) Ongoing monitoring and feedback

A key feature of our regulatory framework is ongoing monitoring, assessment and feedback sharing. This helps to minimise the risk of misaligned expectations between NESO, Ofgem and stakeholders on NESO's performance. This also helps NESO to understand where it may need to course correct to avoid smaller issues materialising into bigger ones.

Whilst the end-of-year processes (described below) ultimately create accountability and incentives on NESO, we see these ongoing processes as critical tools for us and stakeholders to influence and steer NESO's performance.

To support monitoring, NESO produces within-year reporting on its progress against the Performance Objectives and Success Measures, as well as its value for money.

These reports, combined with information received from our general monitoring and stakeholder engagement, inform monthly meetings between NESO and Ofgem to provide feedback and discuss and understand issues. On a quarterly basis, we will hold senior-level meetings to ensure key messages are being discussed and heard at a senior level. This will likely include at least six-monthly meetings between the Ofgem and NESO CEOs and Chairs. Where relevant and appropriate, we may also raise any emerging concerns with NESO about its delivery of licence requirements – with the aim of intervening before a breach occurs.

Stakeholder feedback is a critical part of the within-period processes. Feedback collected through our ongoing call for evidence will inform both our monthly and quarterly meetings with NESO. At the six-month stage, NESO will produce satisfaction survey results which will help provide a clear benchmark for all parties to understand stakeholder sentiment on NESO's performance. This will be a key input to our six-monthly conversations with NESO. The ICP and NESO will also meet at this stage, using the survey to identify and discuss key performance themes. NESO will provide transparency on the actions it is taking in response. This meeting will have senior representation from NESO.

3) Creating accountability through the End-of-Year processes

At the end of each year, Ofgem will produce a final assessment of NESO's performance against the expectations set through the Business Plan process. This will assess two key aspects: firstly, NESO's achievement of its Performance Objectives and secondly, NESO's deliver of value for money. In addition to the information collected throughout the year, we will consider NESO's End-of-Year Report and a report from the ICP's report on stakeholder's views.

Our end-of-year assessment will be published and result in an overall grade for NESO, alongside a clear explanation of the main factors driving this grade. This will create a strong reputational incentive on NESO as well as a clear Ofgem position which NESO's Remuneration Committee will be required to take account of in its decisions on senior staff remuneration. To reinforce the messages in the report, we expect Senior Ofgem representatives to attend NESO's Board to explain our assessment. NESO will then be required to provide transparency on its final staff remuneration decisions and explain how our assessment has been taken into account.

In the event that we have undertaken any enforcement actions against NESO following a licence breach, NESO would also be required to ensure this is strongly reflected in its staff remuneration decisions.

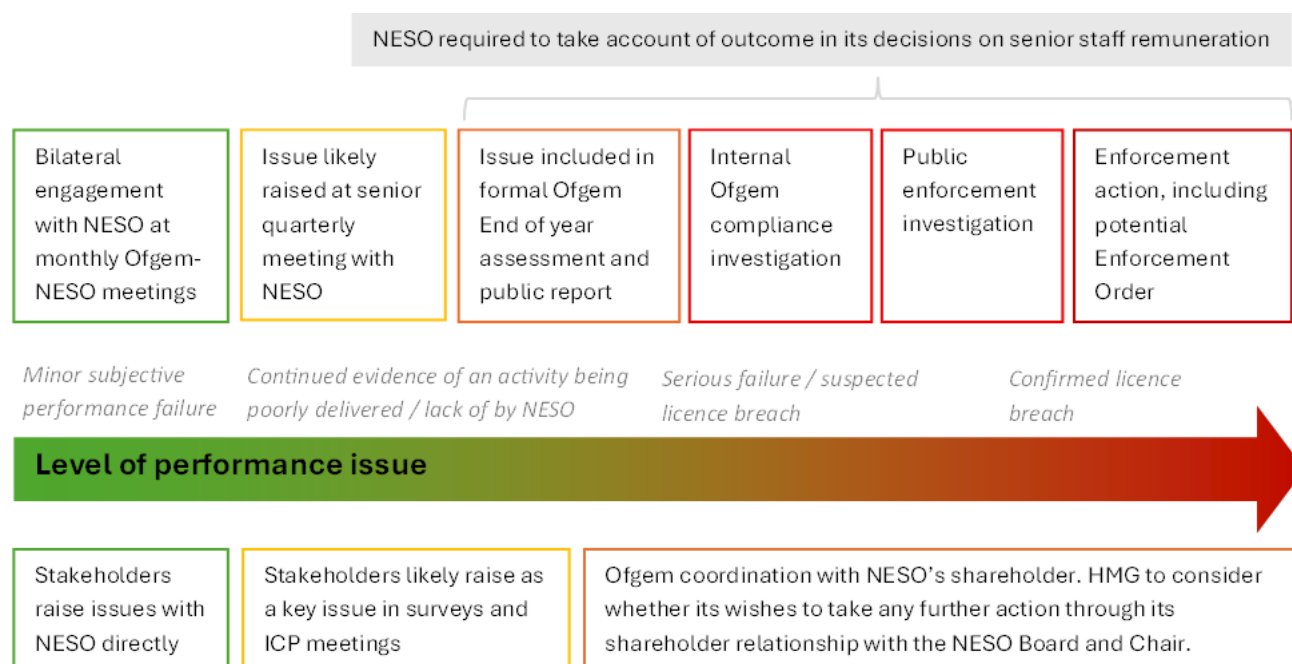
Illustrative performance scenarios

This section provides some illustrative examples of how we might respond in different NESO performance scenarios.

Please note that our framework design is intentionally agile and flexible. This reflects the complex and dynamic nature of NESO's roles and enables us to respond to different performance issues in a way that reflects the specific context and circumstances. The performance scenarios are therefore intended to be illustrative, to aid stakeholder understanding.

Figure 2 illustrates how we might respond to NESO performance under varying levels of performance concern. In summary, we would expect smaller concerns to be addressed through regular ongoing bilateral discussions. Larger (unaddressed) performance issues would be a prominent feature of senior quarterly meetings and our annual public assessment. Finally, serious failings would be dealt with through formal enforcement proceedings and actions. In the most serious failings, we could make formal recommendations to the government to consider the role of the NESO Board Chair.

Figure 2 – *Illustrative overview of our response to performance issues*



To further illustrate how we intend to use our regulatory toolkit in practice, we have set out below several scenarios around NESO's performance and how we intend to create accountability in these circumstances.

Scenario 1: More progress is needed on a known major energy sector priority

Situation: Stakeholders and Ofgem consider that NESO needs to do more to address a major energy sector priority. For example, there is a view that NESO could be more proactive in addressing rising system balancing costs.

Actions we would take to create accountability

We will engage with NESO during its Business Plan development to ensure the priority is factored into its Performance Objectives and Success Measures. Where this is not sufficiently done so, we will make our performance expectations clear in our Business Plan determinations. Where appropriate, we may also require additional reporting to shine a spotlight on progress (e.g. through a specific reported metric). We will also ensure clear minimum standards are set out in the licence for priority activities.

During the year, we will assess how well NESO is performing against the Performance Objective on an ongoing basis, drawing from the feedback of stakeholders (including the ICP and stakeholder survey). If we consider more can be done, we will provide feedback to NESO – likely culminating in the topic being raised at a senior quarterly meeting. If performance is not addressed by the end of the year, this would impact our end-of-year assessment and be clearly highlighted in our public assessment report, leading to

reputational impacts and consequences for senior staff remuneration. If there is a clear breach of minimum standards, we would also consider enforcement.

Scenario 2: A new unforeseen priority emerges

Situation: A major new sector priority emerges through the Business Plan period that we consider needs more attention from NESO. For example, this could be a priority that emerges because of wider policy development or an emerging performance concern identified through our stakeholder feedback mechanisms.

Actions we would take to create accountability

As part of the development of its Business Plan we will encourage NESO to ensure its Performance Objectives are as comprehensive as possible. Therefore, where unexpected activities emerge, there will be a good chance that they already fit within existing outcomes in the Performance Objectives. Where this is not the case, we would use our within-scheme process to bring this within the scope of the incentives assessment. For example, we would highlight this issue as part of our monthly meetings and senior quarterly engagement, ensuring there is a clear record of the discussion. That will then give us the ability to reflect NESO's performance in this area in the end-of-year assessment, without the risk of surprises in our assessment.

Where we have expectations for NESO to carry out some material new work, we would also consider using our powers to formally request advice (for one-off work) and/or establish a clear plan for updating the licence to ensure there are clear roles and requirements (for an enduring responsibility).

Scenario 3: Unexpected failure that causes material harm

Situation: An action taken by NESO causes serious negative impacts for stakeholders and/or consumers.

Actions we would take to create accountability

We will ensure that NESO has a clear and comprehensive set of minimum standards in its licence that captures foreseeable major risks. We would also ensure key system priorities are captured in NESO's Performance Objectives.

A perceived major failure would likely result in an immediate investigation to establish whether NESO has breached its licence. Where this is apparent or confirmed, we would take enforcement action in line with the approach we take for other Ofgem-regulated licensees. This could result in a public enforcement remedy, such as an enforcement order. We also expect any instances of enforcement or serious failures to be a material consideration by the NESO Board when setting senior staff incentives. We will set clear

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licence requirements to ensure there is alignment between senior staff incentives and regulatory performance.

We would also coordinate with NESO's shareholder to share findings in this situation, as they may wish to consider whether to use their own levers, including their relationship with NESO's Board and Chair.

Appendix 2 – NESO framework objectives and principles

This annex provides an overview of the objectives and principles that underpin the design of our regulatory framework tools and will continue to guide how we regulate NESO in practice.

Regulatory framework objectives

Our aim is to develop a regulatory approach which delivers the following five objectives:

- **Drive high performance.** Incentivise excellent performance, cost-efficiency, non-discrimination, transparency and innovation by NESO to maximise energy sector and consumer benefits.
- **Ensure accountability.** Ensure NESO is held to account for its performance against its duties, legal obligations, and Business Plans.
- **Foster independence.** Provide NESO with the autonomy to exercise its expertise and to self-determine how to best meet its statutory duties and strategic objectives.
- **Encourage organisational flexibility.** Support and facilitate NESO to react quickly to emerging energy system developments.
- **Promote stakeholder trust.** Provide all stakeholders with confidence that NESO is making decisions in the energy sector's best interests, carrying out effective engagement, and listening to and acting on feedback

Regulatory framework design principles

The following principles will guide *how* we design our regulatory approach:

- i. **Be proportionate.** The level of oversight will be appropriate to NESO's role, ownership and governance. We will focus regulatory attention on NESO activities that matter most or have the highest risk to consumers.
- ii. **Be dynamic in our regulation.** Our regulation will accommodate the high pace of change in the sector. We will be agile in our approach and (re)scale the depth of our oversight with NESO's performance record and the level of risk across its different activities.

- iii. **Create clear and tangible performance measures.** The framework will appropriately recognise high performance and include incentives to avoid (and accountability for) poor performance and non-compliance.
- iv. **Leverage stakeholder expertise.** Stakeholders will have opportunities to scrutinise/feedback on NESO's plans and performance, and the ability to appropriately contribute to Ofgem's regulatory assessments and decisions.
- v. **Promote transparency in our regulation.** Processes for evaluating NESO's performance will be fair and clear to all impacted parties.
- vi. **Coordinate our regulatory processes.** Our approach will align with Ofgem's other regulatory regimes (e.g., RII0-3), with government accountability mechanisms outside of the regulatory framework (e.g., National Audit Office, UKGI's shareholder responsibilities), and will account for the evolving landscape of interactions, roles and responsibilities between NESO, Ofgem and Government.

Appendix 3 – Glossary of NESO-specific framework terms

Guide to NESO outputs and incentives components

Business Plan

Details NESO's Performance Objectives, associated Success Measures, Major Deliverables and costs for the Business Plan cycle.

Business Plan cycle

The Business Plan cycle is the period for which the Business Plan is applicable. The Business Plan cycle is a two-year period, commencing with the incentive scheme starting on 1 April 2026 and ending on 31 March 2028.

Electricity System Operator (ESO)

The entity which was designated as the Independent System Operator and Planner (ISOP) in 2024.

Incentives scheme

The process over a Business Plan cycle to assess NESO's performance.

Independent Challenge Panel (ICP)

A panel of that name, stakeholder-led, and comprised of NESO's customer base that are responsible for providing challenge and feedback on NESO's plans and performance across the Business Plan cycle.

Major deliverable

Specific, measurable and timebound outputs that are key to achieving the Performance Objectives for the annual Business Plan submission. In most cases, we would expect delivery of these Major Deliverables to be relevant Success Measures.

NESO Performance Arrangements Governance Document (PAGD)

A document which sets out the logistics and detailed mechanics of the incentives scheme, including guidance on how NESO performance should be evaluated and what it should report.

NESO Performance Panel

A mix of independent experts and industry representatives that are responsible for reviewing NESO's plans and performance, as well as performing an end-of-scheme evaluation of NESO's performance during RIIO-2.

NESO Licence Expectations Document

Sets out our expectations for how NESO should comply with some of its obligations.

Performance Objective

A major outcome that NESO intends to achieve by the end of the two-year Business Plan period, with associated Success Measures and Major Deliverables.

Reported Metrics

Additional reporting requirements that support NESO's accountability to stakeholders and apply reputational incentives which are supplementary to our public performance assessment.

RIIO-2 period

RIIO-2 covers the period starting 1 April 2021 and ending on 31 March 2026.

RIIO-3 period

RIIO-2 covers the period starting 1 April 2026 and ending on 31 March 2031.

Strategic Aims

A set of published aims which explain what outcomes NESO intends to achieve over the medium- to longer-term to deliver its overall organisational vision. The Strategic Aims should set out the overall impacts and major sectoral changes NESO is aiming to achieve and NESO's strategy for delivering these.

Success Measure

Success Measures should be key indicators that show how the outcome within a Performance Objective will be attained in practice, and which should help provide clarity on how successful delivery of a Performance Objective should be measured.

Value for money assessment

Considers whether NESO has delivered value for money, striking the optimal balance between maximising benefit delivered from outputs whilst minimising costs.