

Reference
Cadent-NESOPerf

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NESO Framework Development Team
Ofgem
10 South Colonnade
London
E14 4PU

Cadent Gas Limited
Pilot Way Ansty Park
Coventry CV7 9JU
United Kingdom
cadentgas.com



By Email: NESOregulation@ofgem.gov.uk

Consultation on the enduring regulatory framework for NESO

An effectively performing NESO demonstrating the right behaviours and culture is critical to a successful energy transition. The regulatory performance framework for the NESO is going to be critical to support this and help to meet the needs of its various and diverse stakeholders. We think it imperative that there is a strong and effective performance framework in place that provides the clarity and challenge to the NESO on what their stakeholders need and how they are seen as performing.

We have set out in our answers to the consultation question in the Annex below, a range of options that would deliver a stronger performance framework which will enable the NESO to build trust and confidence with its stakeholders. In particular, we would urge the retention and further empowerment of the Performance Panel for an interim period as the NESO develops its new obligations. Both this Panel and the Ofgem NESO facing team must be appropriately and diversely resourced to monitor and drive ongoing performance and reflect the needs of all of the stakeholders being served.

For example, there needs to be representation from all the sectors being served and covering disciplines from whole system resilience, forecasting and strategic planning.

Cadent Gas Limited

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Coventry CV7 9JU United Kingdom
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As always, we would be more than happy to discuss any of these points with you in more detail.

Yours sincerely

Dr Tony Ballance
Chief Strategy and Regulation Officer



Annex: Our response to specific questions posed by the consultation

Performance incentives

1. Do you agree with our proposal to continue with an evaluative performance assessment that is aligned with our BP3 approach?

To support the NESO in establishing itself as a trusted and respected entity playing a key leadership role in the energy transition, will require further measures than those set out in this consultation.

At a high level we support the move to more outcome-based regulation however, we think this must be underpinned by much more effective incentives to give industry stakeholders confidence that the right behaviours will be consistently observed.

Firstly, we think there is greater scope for financial incentives on the NESO. We have set out our thinking on this in our answer to Q3 below.

Secondly, whilst we support the establishment of the new Independent Stakeholder Panel (ISP), we see benefit in keeping a distinctly separate Performance Panel at least for an initial period as the NESO's performance develops against its new obligations and understands the expectations of stakeholders. In addition, we would strengthen the role of the Performance Panel by giving it the ability to propose changes to performance targets and measures, that Ofgem then has the power where justified to veto. We think retaining a fully independent, appropriately resourced Performance Panel, with real power to influence the NESO's behaviours is a critical step in building and maintaining industry confidence in the NESO as an independent body. This would remove the risk of the focus on performance being diluted given the ISP would have other activities to deliver in parallel. We think there is strong value from a dedicated performance panel that really can challenge and test performance across all the outcomes required.

Thirdly, as the NESO's performance is incredibly critical, we believe a clear Ofgem commitment to effectively resource their NESO facing team is of vital importance. Without the conventional financial and reputational regulatory levers, there is a much greater reliance on effective and visible 'contract management' of the NESO by Ofgem. The industry needs to see Ofgem actively engaging, monitoring and influencing to help drive the required improvements in performance.

Given the NESO is ultimately a government owned organisation, we are unsure of the long-term effectiveness of relying on largely reputational incentives, which may become less impactful over time.

We believe the changes we have set out would provide a more effective basis for a framework that will drive high sustained performance and continuous improvement rather than a minimum standard.

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Business Plan and plan assessment

2. Do you agree with our proposals for the Business Plan and plan assessment (including the specific proposed requirements in our draft NESO Business Plan Guidance document)?

We support the Business Planning and plan assessment proposals. One detail we would ask to be reconsidered is the approach to setting requirements for the publication of a Business Plan by a specific date. We understand the challenge of knowing what may happen in the future and the desire to retain flexibility, however we believe this must be balanced with supporting the industry's ability to plan and resource their input into the Business Planning process. We therefore suggest a final backstop or 'no later than' date is provided, or some other mechanism to give stakeholders confidence.

Cost regulation

3. Do you agree with our overall approach to cost regulation and reporting?

We broadly support the approach to cost regulation, however, as we have noted above, we think there is scope for more effective incentivisation which could directly and indirectly impact costs.

Whilst we accept that outside of senior staff, it is far too prescriptive to constrain other individuals' performance. It is however possible to use year on year increases in overall salary 'pots' to establish an effective incentive that can be linked to organisational performance.

The bulk of year-on-year cost changes will be through the indexation of salaries and remuneration from one year to the next, as most roles in place on 31 March will also be there on 1 April. The level of this indexation could be linked to rewards and penalties from the performance framework. For example, the overall remuneration pot could increase by more than the default indexation measure if targets have been met or exceeded. Basic minimum standards being met could deliver a basic level of indexation. If minimum standards have not been met, then a below inflation overall increase could be applied.

Senior staff could then determine how the overall pot is allocated, and there would still be freedom to give individuals higher or lower increases whilst ensuring the cumulative impact is within the indexed budget.

Such an approach would give all NESO staff strong incentives to deliver against their organisation's targets, whilst providing management flexibility for targeted individual remuneration. It would drive the high-performance culture that is required, but which is hard to see being effectively pursued at pace without all staff having a stake.



This performance framework could be modified over time and could even be used to provide industry confidence that cost efficiencies are being taken seriously through a well-designed 'profit sharing' component.

In a cost pass through organisation, it is important to provide industry confidence that the business is motivated to minimise costs.

Stakeholder mechanisms

4. Do you agree with our proposal for a new NESO stakeholder challenge panel?
5. Do you agree with our changes suggested to within-scheme stakeholder feedback?
6. Do you have any suggestions for new and additional mechanisms or licence obligations that could improve NESO's accountability to stakeholders?

We support the creation of a new NESO appointed ISP but at this time we do not support the merger of the Performance Panels duties into the ISP. As noted in our response to Q1 above, we believe a separate independent expert NESO Performance Panel should be retained with new powers designed to drive the right behaviours in the NESO and build industry confidence. Performance is a live issue, and strong performance is required to build industry trust. Once the Performance Panel has seen performance driven to a stable effective level, the merger of the Performance Panel into the ISP may be possible without adversely impacting outcomes.

Retaining the separate Panel would also act as some protection against the risk of the NESO becoming overly focussed on delivering for Ofgem and Government at the expense of industry. For the NESO to become a trusted industry leader, it will need to demonstrate that it is satisfying the requirements of industry stakeholders as well as Ofgem and Government. Even the perception of getting that balance wrong will damage the NESO's overall short- and longer-term effectiveness, not least by discouraging industry's active engagement which will only be sustained if it is felt to be making a real difference. Getting the balance wrong could also increase the likelihood of the NESO falling back to minimum standards rather than working in close partnership with industry to urgently solve the challenges we all need to face together.

We support the proposals for an enduring escalation route for stakeholder feedback. However, this must have the same disciplines applied as with a set timed consultation process. A respondent to a consultation expects to have their issues published, and a clearly articulated response provided within reasonable timescales. Stakeholders utilising the enduring feedback process must be confident that their issues will be published alongside the Ofgem response, in a timely fashion. This will give industry confidence that this is a value adding process that they can use. We would therefore ask Ofgem in their

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response to this consultation to set out how they will provide such assurances, as without these, stakeholders are unlikely to see such a route as worthwhile.

We agree that regular industry surveys are important, particularly to measure trends. We could be keen for a NESO survey to have a sensible standard 'Killer Question' so that any respondent can provide an efficient sense check on how they perceive the NESO's overall performance. Given suitable volumes and long-term use, this would provide an accurate measure of whether the NESO's performance is improving or not over time.

As a further measure to drive NESO performance so that it can become a trusted industry leader, we believe there would be merit in the ability of certain bodies to publicly escalate a serious performance concern through a "Super Complaint" similar to those already existing for consumer bodies under the Enterprise Act 2002.

A Super-Complaint would trigger a formal process leading to a NESO response and Action Plan which Ofgem approves and must then be delivered within the overall performance framework. Giving named Trade Bodies this power, would not result in spurious submissions as these are credible professional organisations that will understand the need to retain such a power only for extreme circumstances. Having this option available would allow serious widely held concerns to be aired and considered seriously and promptly. The existence of such a measure would also drive the NESO to fully exhaust all steps to avoid such a complaint being raised in the first place.

Licence obligations and enforcement

7. Do you agree with our overall approach to NESO's licence obligations and enforcement?

We agree with the overall approach, and as noted above, the effectiveness of the licencing regime will depend critically on the resourcing and experience of the Ofgem NESO regulatory team.

In Para 7.10 it says:

"Our targeted removal of certain approvals will also help us achieve our overall objectives to rebalance the framework so that it focusses on the issues that matter most. "

We would welcome clarity on what these issues are and how they are identified.



Senior staff incentives

8. Do you agree with our proposal for NESO senior-staff level incentives?

We agree with the proposed approach but as we have noted elsewhere in our response, we believe a much stronger incentive on performance could be designed so that all staff have incentives as well as the Senior Executives.

Regulatory finance

9. Do you agree with our overall approach to NESO's financial regulatory framework and reporting?

We support the overall approach. One aspect we would welcome further consideration is the importance of setting accurate budgets. The NESO's costs feed through to customer charges, and predictability is of great value in how impacted bills may vary. There therefore could be value in an incentive in place so that the forecast costs are as predictable and stable as possible. Stable and predictable costs will also contribute to building confidence in the NESO.

Innovation

10. Do you agree with our proposal for innovation funding for NESO?

We think there are issues with the innovation proposals when it comes to how they interact with other network licensees.

Firstly, the consultation refers to using innovation funding to drive efficiencies in the NESO operations. Other network licencees are not allowed to use Innovation funding for BAU activities including enabling efficiency improvements. It would seem more practical to adopt the same approach for the NESO and incentivise ongoing efficiencies through other mechanisms.

Secondly, and more importantly, the current regulated innovation schemes involve licencees making a contribution, so they have 'skin in the game'. This is generally 10% with scope for revisions away from this where justified. Such a contribution which effectively comes from the licencees owners, would create an imbalance in the commercial drivers where an innovation project involves collaboration between the NESO and other network licencees. This is likely to harm the smooth operation of a collaboration project and cause significant challenges particularly when issues arise with a live project. To address this imbalance, either the NESO's owner would need to provide a separate funding contribution, or perhaps more realistically, collaborative projects working with the NESO should not be subject to a network contribution.