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Consultation on the enduring regulatory framework for NESO and the NESO Business Plan: Guidance Document

Dear David,

Who we are

NESO lies at the heart of the energy system as an independent, public corporation responsible for planning Great Britain's electricity and gas networks, operating the electricity system and creating insights and recommendations for the future whole energy system.

At the forefront of our efforts is delivering value for consumers. We work with government, regulators and our customers to create an integrated future-proof system that works for people, communities, businesses and industry, where everyone has access to clean, reliable and affordable energy.

NESO's primary duty is to promote three objectives: enabling the government to deliver net zero, promoting efficient, coordinated and economical systems for electricity and gas and the economy and efficiency of energy businesses and ensuring security of supply for current and future consumers. NESO will take a whole system approach, looking across natural gas, electricity and other forms of energy and will engage participants in all parts of the energy ecosystem to deliver the plans, markets and operations of the energy system of today and the future.

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Our key points

- We believe Ofgem's proposals for our enduring regulatory framework broadly strike the right balance, building on the already significant changes introduced through BP3, whilst continuing to develop and transition to a more strategic framework over time. Our regulatory framework must support our delivery of critical outcomes in the interests of consumers and reflect that our unique characteristics and role as NESO requires a bespoke framework. We recognise the feedback stakeholders have provided throughout the process of developing and changing NESO's regulatory framework, particularly around the level of Ofgem scrutiny and approach to ensuring accountability. Driving high performance through clear accountability, whilst promoting stakeholder trust with a framework that is proportionate, dynamic and transparent is vital.
- We welcome the commitment Ofgem has made to working with us to align what is needed to fulfil their function and our own internal budgeting and reporting activities. This is critical to ensure that duplication and regulatory burden can be minimised, whilst still ensuring appropriate regulatory oversight. Similarly, we support Ofgem's intent to continue to review and refine these arrangements over time. We look forward to working with Ofgem to ensure that the framework continues to drive optimal value for consumers in a way that best meets both Ofgem's and NESO's requirements in the most proportionate way.
- We support Ofgem's proposals to review our licence obligations and to remove certain Ofgem approvals that have limited value and are unaligned to the objectives and principles of the regulatory framework. We are committed to supporting Ofgem in identifying obligations where improvements could be made and ensuring that the Licence Expectations Document provides the clarity and guidance needed.
- Our stakeholders, and the feedback they provide us, are critical to our ability to deliver great outcomes for the industry and consumers. Having clear accountability mechanisms in place for stakeholders is important, and we continue to look for ways to develop and improve our engagement. However, we do not believe that Ofgem's proposal to create an Independent Challenge Panel (ICP), by merging the roles and remit of the Performance Panel (PP) and our Independent Stakeholder Group (ISG) would deliver the benefits Ofgem states. In fact, we believe there would be negative consequences that would result in poorer outcomes. The proposal risks losing existing member expertise, the roles and remit are sufficiently different between the PP and ISG that identifying the right members for the ICP would be very challenging, restricts a broadened/more strategic role for ISG and creates a perceived conflict of interest. Ofgem has tested their proposals with our ISG, and they are in broad alignment with our views. We also do not have confidence that the proposed benefits will materialise in terms of increased visibility, opportunity for a quicker pace of stakeholder views and reduced stakeholder fatigue. We therefore urge Ofgem to reconsider its proposal and instead look to improve upon the existing approaches.

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We look forward to engaging with you further. Should you require further information on any of the points raised in our response please contact Laurence Barrett, Regulatory Strategy Manager at Laurence.Barrett@neso.energy.

Yours sincerely

Zoe Morrissey

NESO Director of Legal & Regulation

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Appendix 1 Consultation Question Responses

Performance incentives

Q1. Do you agree with our proposal to continue with an evaluative performance assessment that is aligned with our BP3 approach?

We agree with Ofgem's proposals to maintain an evaluative performance assessment, focussed on our achievement of strategic outcomes and delivery of value for money. We recognise the changes that were introduced for BP3, particularly the move to a less granular assessment approach, using Performance Objectives underpinned by clear and measurable Success Measures. This approach creates clear expectations on NESO for delivery, which can be used by Ofgem and stakeholders to hold us to account. Alongside this, a strong focus on value for money ensures we will continue delivery of the areas that have the greatest importance and value to the energy sector and consumers.

We believe there is benefit in continuity of approach for ourselves, Ofgem and for wider industry. We will be able to build on the learnings from BP3 when developing our next business plan and will have a clearer understanding of Ofgem and industry expectations. We consider this improved understanding will allow a more effective assessment approach and make it easier for stakeholders to provide feedback to us and Ofgem. We welcome the commitment Ofgem has made to working with us to align what is needed to fulfil their function and our own internal budgeting and performance activities. This is critical to ensure that duplication and regulatory burden can be minimised, whilst still ensuring appropriate regulatory oversight through evaluative performance assessment.

Business Plan and plan assessment

Q2. 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 broadly agree with Ofgem's proposals for the Business Plan and plan assessment (including the specific proposed requirements in the draft NESO Business Plan Guidance document).

We support Ofgem's position of a 2-year Business Plan based upon Performance Objectives (POs) and Success Measures (SMs), similar to BP3. We believe that it provides continuity for stakeholders who are not supportive of further reductions on detail, and it allows us to build on the learnings from BP3.

We support the removal of a Draft plan submission as this allows us to take a flexible approach to engaging stakeholders in a more effective way. Our plan development will still be informed by a robust programme of stakeholder engagement. We will use feedback already gathered during the BP2 period and during BP3 development along with information from engagements across our projects to help bring a cohesive set of whole system views into the plan. We aim to hold some virtual feedback sessions throughout August which will be open to everyone, and we will continue to use our Independent Stakeholder Group (ISG) to critique and adjust our proposals.

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Further to this, statement 3.7 of the Business Plan Guidance says that: *“NESO must engage with Ofgem on key aspects of the plan to a sufficient level of detail and sufficiently far in advance of the Business Plan submission, as agreed with Ofgem, to enable Ofgem to provide early feedback on the draft Business Plan. Our review at this stage will be focussed on providing feedback on key areas, rather than a full plan assessment.”* We will continue to engage with Ofgem to gain a better understanding of what the expectations are in terms of engagement to a *“sufficient level of detail”* and *“sufficiently far in advance of the Business Plan submission”*. We’d also like to understand what the early feedback from Ofgem will look like to enable us to effectively review and action as appropriate.

Statement 3.8 of the Business Plan Guidance says that: *“NESO must publish a final version of its Business Plan by the 15th working day in October the year prior to the start of the Business Plan cycle, or at another time agreed with Ofgem.”* Whilst we believe these timings will work on an enduring basis, once the regulatory framework and supporting business plan guidance is determined, the timescales for a submission for our next business plan covering the period from April 2026 are more challenging. We are engaging with Ofgem bilaterally on this timing, to provide confidence that a slightly later submission date, supported by early and effective engagement ahead of the final plan, can still provide Ofgem with sufficient time to deliver their determination ahead of April 2026.

We recognise the requirement for the development and publication of Strategic Aims to provide the broader context on what we are seeking to achieve in the medium to longer term. These will then support our next Business Plan submission for April 2026. We are keen to work with Ofgem to better understand the expectations on Strategic Aims, as set out both in the policy consultation and the Business Plan Guidance.

Finally, we look forward to working with Ofgem on the requirements set out in the Business Planning Guidance, to ensure we are meeting them in an efficient and proportionate way, via the new Value for Money framework. We would also welcome further engagement with Ofgem to better understand the requirements around IT investments, to ensure that we still provide the information required by Ofgem but have the flexibility to propose more effective approaches in how we achieve this.

Cost regulation

Q3. Do you agree with our overall approach to cost regulation and reporting?

We agree with Ofgem that NESO should continue to be funded through a pass-through model to allow the flexibility to respond to changing circumstances. We have seen the benefits of this approach throughout the RIIO-2 period, where we have been able to change priorities and focus on new activities that were not originally included in our business plans. Given the dynamic nature of the energy sector and NESO’s role within it, we believe this flexibility is critically important.

Ofgem presents two options using a pass-through model. Option 1 assesses costs using a dynamic ongoing cost assessment, with the level of scrutiny and justification proportionate to the quality of up-front justification, year on year changes in expenditure, and past performance.

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Option 2 assesses costs using a higher-level, more strategic costs assessment, with a focus on top-down costs and hence a materially reduced level of cost scrutiny. In practice, we see these options as a spectrum, balancing regulatory oversight against regulatory risk. We recognise the need for effective cost assessment, as well as the feedback from stakeholders on the level of scrutiny. In demonstrating value, we need to be able to support the level of costs we incur and show that the process of challenge and approval has been robust. We are continually looking to improve and develop these processes to build more confidence. We therefore have a clear expectation that whilst Ofgem proposes to follow option 1, similar to their existing approach, over time we will be able to build confidence to demonstrate that a move towards option 2 will be justified.

We agree with Ofgem that Option 3 is not suitable for NESO at this time, as it would unduly restrict us from adapting to wider energy sector developments, a significant risk over the 2-year horizon of the business plan.

We welcome the commitment Ofgem has made to working with us to align what is needed to fulfil their function and our own internal budgeting and reporting activities. This is critical to ensure that duplication and regulatory burden can be minimised, whilst still ensuring appropriate regulatory oversight. Similarly, we support Ofgem's intent to continue to review and refine these arrangements over time, and we look forward to working with Ofgem to ensure that the framework continues to drive optimal value for consumers in a way that best meets both Ofgem's and NESO's requirements in the most proportionate way.

Stakeholder mechanisms

Q4. Do you agree with our proposal for a new NESO stakeholder challenge panel?

Our stakeholders, and the feedback they provide us, are critical to our ability to deliver great outcomes for the industry and consumers. Having clear accountability mechanisms in place for stakeholders is important, and we continue to look for ways to develop and improve our engagement. However, we do not believe that Ofgem's proposals to create an Independent Challenge Panel (ICP), by merging the roles and remit of the Performance Panel (PP) and our Independent Stakeholder Group (ISG) would deliver the benefits Ofgem states. In fact, we believe there would be negative consequences that would result in poorer outcomes:

- Losing existing member expertise: Whilst we recognise the rationale of a consolidated group providing continuity and potentially more coordinated feedback, in practice the roles and remit are sufficiently different between the PP and ISG that identifying the right members for the ICP would be very challenging. Combined with the need to ensure our broader stakeholder base as NESO is represented, this risks losing the expertise of our ISG, which has been an invaluable resource to NESO in building our business plans.
- Restricting strategic scope of ISG: Recent discussions with our ISG have identified new opportunities for the group to provide input on a broader range of strategic topics, beyond just supporting and challenging the development of our business plans. Broadening the

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scope any further to include the responsibilities of the PP would likely represent a significant challenge.

- Perceived conflict of interest: A NESO-led ICP risks a perceived conflict of interest, between the same group acting as our critical friend setting the strategic direction for business plans and then holding NESO to account for delivery. We recognise this can be mitigated with appropriate governance and processes but experience from individuals who have sat on similar panels (e.g. some ISG members) suggests that it is hard to remain as critical and independent in such scenarios.

Ofgem have engaged with our ISG on the proposals and received clear feedback in alignment with the above points.

Furthermore, we do not have confidence that the proposed benefits will materialise in terms of increased visibility, opportunity for a quicker pace of stakeholder views and reduced stakeholder fatigue. We therefore urge Ofgem to reconsider its proposals and instead look to improve upon the existing approaches. For example, this could include providing additional clarity between the roles of the PP and ISG and creating more alignment between the groups so that ISG can feed into the PP (e.g. inviting the PP Chair to certain ISG meetings and/or sharing meeting minutes and reports between the groups). There could also be benefit in using the ISG to review and challenge NESO's stakeholder engagement approach as a regular agenda item (as per similar other industry groups), which can then feed into PP via a quarterly update from the ISG.

We also believe there are improvements that can be made to how the PP works, to enhance the effectiveness and independence of this group in holding NESO to account:

- Our experience to date through RIIO-2 has shown that there are often widely varying views and scores from PP members. This often results in an average towards the middle i.e. meeting expectations, a position which is then discussed within the Panel to get final agreement. We believe that the changes introduced in BP3, and that we support going forward, will enable a more strategic assessment, with a clearer set of expectations that the PP can assess us against. This should result in a more aligned view of performance.
- Linked to this point is the approach Ofgem take to support the PP. This includes preparing a briefing pack for the PP, facilitating their assessment and writing the report on their behalf. We believe the more strategic style business plans, with clear expectations should make it easier for the PP and may remove the need for a briefing pack from Ofgem.
- The membership of the PP needs to reflect our broad stakeholder base whilst still ensuring that there is the right member expertise and knowledge. We believe that there is benefit in reviewing the guidance that Ofgem use to recruit members, particularly in situations where members seek to handover responsibilities within their organisation. The PP membership has yet to be reviewed/updated by Ofgem since we've transitioned from the ESO to NESO meaning gaps in representation in areas including gas.

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Q5. Do you agree with our changes suggested to within-scheme stakeholder feedback?

We support Ofgem's proposals for regular stakeholder surveys and for us to demonstrate any plans or actions in response to the feedback received. NESO recognises the importance of stakeholder trust in our success and regulatory compliance. To address previous challenges and ensure robust engagement, we are implementing a transformative approach to listening, collaborating, and delivering for stakeholders across our end-to-end activity. By using tangible measures, directly linked to the areas stakeholders have told us matter to them, we will measure performance against criteria that helps us to prioritise our activity in real time and allows more agile design and response to stakeholder needs. Internally we are introducing a Trust Index based on four key drivers: credibility, reliability, impartiality, and ease of working with us. These criteria align with Forrester's Trust Levers and will guide our improvement activities. Regular surveys and real-time performance measures will provide ongoing insights and allow agile responses to customer needs. Through more proactive engagement, open communication and consistent service excellence we aim to grow and sustain our customers' confidence and trust in our balanced actions and decisions. We are keen to engage with Ofgem on our proposals in this area to ensure we are able to align our internal and external measurement approaches.

We agree that replacing a time-limited call for evidence with ongoing feedback from stakeholders may provide greater flexibility on when stakeholders can input evidence. We recognise the importance of providing customers and stakeholders with appropriate channels to escalate their concerns and feedback if they feel it hasn't been addressed. It will be important to ensure there is a clear pathway via NESO feedback channels and balanced feedback, and we look forward to working with Ofgem to understand how this will work in practice to drive the benefits they propose.

Q6. Do you have any suggestions for new and additional mechanisms or licence obligations that could improve NESO's accountability to stakeholders?

We agree with Ofgem that there are already effective mechanisms in place to allow stakeholders to hold us to account and do not believe that any fundamentally new mechanisms would provide significant further benefits. However, we recognise that there is always room for improvement, and we look forward to working with Ofgem to increase the value of the existing suite of obligations and incentives.

We agree with Ofgem that there are already effective mechanisms in place to ensure decision transparency and support the proposal not to introduce any additional, fundamentally new mechanisms. We agree with Ofgem that the creation of a "NESO review panel", with the ability to challenge NESO's decisions, would create significant risks to the independence of NESO and our ability to drive outcomes for consumers at pace.

We welcome the opportunity to work with Ofgem to review C1 and to fully review the Licence Expectations Document and provide more detail on these areas in our response to Q7.

Licence obligations and enforcement

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Q7. Do you agree with our overall approach to NESO's licence obligations and enforcement?

We support Ofgem's proposals to review our licence obligations and to remove certain Ofgem approvals that have limited value and are unaligned to the objectives and principles of the regulatory framework. We are committed to supporting Ofgem in identifying obligations where improvements could be made and ensuring that the Licence Expectations Document provides the clarity and guidance needed. However, we note that there will be a lot of detail to work through in the coming months and it will be important to allow sufficient time and resources to achieve this. Therefore, we believe that it would be beneficial to identify which changes need to be aligned to the timescales of the new framework (i.e. April 2026), and which changes could continue on slightly longer timescales.

We agree with the proposed enduring strategy of progressing towards outcomes-based obligations to underpin minimum standards as striking the balance between appropriate oversight and minimising burden / allowing for NESO independent decision-making. It will be important to work through the detail to address the balance of flexibility and clarity in each case and we are committed to working through this with Ofgem.

We agree there is a need to review Condition C1. We suggest starting afresh to articulate what the purpose of the condition is, given its origin (in ESO's transmission licence) was for a purpose which is no longer relevant. It is important that its intent and wording is clear and assists stakeholders.

We agree that the NESO Licence Expectations Document (LED) should be reviewed in detail and work done to make it clear and accessible. The current document is difficult to apply to NESO. As for C1, we believe that starting afresh will be a more effective route than reviewing and refining the existing document.

We broadly agree that existing enforcement mechanisms are suitable. In line with the objective of fostering independence, and to ensure clarity, we would ask that Ofgem's enforcement policy is updated to acknowledge the latitude given to NESO in implementing its statutory objectives (aligning the formal policy with public statements that Ofgem has made elsewhere).

Senior staff incentives

Q8. Do you agree with our proposal for NESO senior-staff level incentives?

We agree with Ofgem's proposal to replace approving the NESO Remuneration Policy with a principle-based requirement in NESO's licence and welcome the opportunity to engage with Ofgem to develop the principles-based requirements for our licence to support Ofgem's future consultation on licence changes. We would expect that these would align with the principles that have been developed in collaboration with Ofgem through the approval process of our Remuneration Policy.

We do not support a prescriptive methodology in determining outcomes, given that the requirement of taking account of Ofgem performance assessment is already established under NESO's approved Remuneration Policy and overseen through the governance of the Remuneration Committee. Any regulatory change introducing a prescriptive methodology would

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be without cause, would not consider NESO's statutory position of independence alongside its corporate and shareholder governance structure, and the overall scope of NESO objectives and long-term delivery alongside its regulatory Business Plan.

NESO has set up a Remuneration Committee since establishment, made up of Non-Executive Directors, including Shareholder representation from UK Government Investments. It has been designed around robust corporate governance, making clear and transparent decisions to avoid conflicts of interest around the compensation of the Executive Committee.

The Remuneration Committee is responsible for deciding how the Executive Committee are remunerated, including assessing individual and company performance related targets and outcomes. These targets and performance-related pay awards are set with reference to the Ofgem Business Plan determination process alongside other key objectives deemed appropriate by the NESO Board to meet corporate strategy, which are then translated into performance-related pay decisions.

As set out in the approved Remuneration Policy, the Remuneration Committee will take account of the formal performance report from Ofgem and this will include NESO Board engagement. The Executive Committee annual performance-related pay awards will not be confirmed or paid prior to the formal Ofgem report being provided to the NESO Board. This ensures the Remuneration Committee can assess performance-related pay with full visibility of NESO's regulatory outcomes.

It should be noted that the Remuneration Committee has the discretion to adjust bonus payments when it deems appropriate. In an unlikely event, this could be utilised to reduce or recover performance-related pay where there has been a confirmed enforcement decision by Ofgem, particularly if this breach has contributed to material consumer or industry harm.

Given the robust nature of governance already established, and approval of the Remuneration Policy, it is not considered that Option 3 is appropriate. 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. Disclosures on remuneration will be explained in the Remuneration Report published in NESO's Annual Report and Accounts and submitted to Ofgem through Ofgem's financial reporting process.

Regulatory finance

Q9. Do you agree with our overall approach to NESO's financial regulatory framework and reporting?

We support Ofgem's proposals on regulatory finance, particularly the ambition to reduce the reporting burden where possible and we are committed to working with Ofgem to understand what this might mean.

Innovation

Q10. Do you agree with our proposal for innovation funding for NESO?

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Due to the pace of change within the industry and NESO's expanded remit, we support Ofgem's proposals in line with Option 1, that NESO continues to have access to distinct innovation funding.

This could be a continuation of Network Innovation Allowance (NIA) funding, and we support Ofgem's proposals for NIA funding for a five-year period as part of our business plan submission. We welcome the option to request additional funding in our April 2028 business plan, should this be needed.

Alongside, we propose an updated Strategic Innovation Fund (SIF) mechanism to access robust funding for substantial transformational projects. This update should be designed with the flexibility to enable NESO to respond effectively to future system challenges. It will enable us to perform the wider roles in SIF that Ofgem want us to play, such as supporting the setting of challenges and providing advice on the project bids received. It will also 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 consumers.