



Department for
Energy Security
& Net Zero

Statutory consultation on National Energy System Operator licences and other impacted licences

Joint DESNZ/Ofgem

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March 2024



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Foreword / Introduction

Foreword Secretary of State

The UK is on a journey to net zero. That will mean radical change across every part of our energy system. We have already made great progress at an unprecedented pace. Indeed, the UK is the first major economy to halve its emissions – having cut them by more than 50% between 1990 and 2022, while also growing our economy by 79%. Moreover, our ever-expanding renewables sector is admired across the world. In 2010, just 7% of our electricity came from renewables. Today, it is 40%.

The Government's ambitions for decarbonisation, long-term economic growth and energy security will transform our energy system, and it is vital that we have the right institutional arrangements in place to deliver them. Last year, through the Energy Act 2023, we secured the powers needed to establish a new organisation with responsibilities across both the electricity and gas systems, charged with driving progress towards net zero while maintaining energy security and minimising costs for consumers.

National Energy System Operator (NESO) will be that organisation. It will be an expert body, with high levels of engineering capability. It will have a whole system remit looking across electricity, gas, and hydrogen. And it will have the organisational design, incentives, and accountability to be independent and act impartially in the best interests of consumers. NESO will take on key operational roles in electricity, and planning roles in gas and hydrogen, and will among other vital functions undertake the new Strategic Spatial Energy Plan underpinning our ambitions for transmission network acceleration. NESO will be independent – not only of other commercial energy interests, but also from the day-to-day operational control of government.

I am delighted today to put out for consultation NESO's first electricity and gas licences.

Foreword Ofgem CEO

Meeting the UK's ambitious net zero goals requires a transformation across the energy system, including dramatic change to how we generate electricity, how we heat our homes, power our vehicles, and how our electricity and gas networks are built and operated.

We and the government have committed to creating a new system operator which is genuinely independent, capable of taking on a wider remit as the energy system becomes ever more complex and with interests that are fully aligned with those of consumers. This vital role, to be undertaken by NESO, is required to deliver a resilient and secure net zero energy system, provide expert and impartial advice to government and Ofgem, a whole systems approach to network planning across fuels and technologies, and further drive competition across the energy sector.

Our publications today are hugely significant milestones. This joint statutory consultation on NESO's new licence conditions, alongside the consequential changes to other impacted licence conditions, brings together multiple important policy areas. The licence conditions establish the activities, operations and working arrangements that we believe NESO should undertake. A well-defined, robust framework of licence obligations will ensure NESO has the clarity it needs to step up and deliver its critical new roles and will ensure Ofgem can effectively execute our regulatory responsibilities.

We have worked closely with the Department for Energy Security and Net Zero (DESNZ), National Grid plc (NG plc), National Grid Electricity System Operator Ltd (NGESO) and National Gas Transmission plc (NGT) to plan, prepare for and implement the regulatory changes that are needed to create NESO. As we move forward, cooperation from industry stakeholders and consumer groups will be crucial for success. We welcome all responses and look forward to working with the wider energy sector to ensure that our proposals best support the implementation of NESO.

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General information

Company name: National Energy System Operator

On 22 January, NGESO announced that the name of the company that we are establishing, and which has previously been referred to as the Future System Operator (FSO), will be 'National Energy System Operator' (NESO).

Part 5 of the Energy Act 2023 defines the term Independent System Operator and Planner (ISOP). In future, the company will be designated as the ISOP with the functions, powers, and duties of the ISOP under the legislation and all legal documents such as its licences and the industry codes will use that (statutory) terminology, but the company will be known using the company name, NESO. This is much the same as the current arrangements in which the company holds an electricity transmission licence and is the electricity system operator but has the company name National Grid Electricity System Operator.

For simplicity and clarity, this document will refer to NESO or ISOP except when referencing previous documents and consultations which used the terms FSO and ISOP.

Until NESO is created, NGESO will continue to operate under its current name.

Why we are consulting

NESO will have two licences through which it will be regulated by Ofgem: an Electricity System Operator (ESO) licence covering its obligations regarding its electricity functions, and a Gas System Planner (GSP) licence covering its obligations regarding its gas functions.

The licences will include conditions for: the business conduct and independence of NESO; its strategic and operational functions; its roles including the provision of advice, analysis, and information to government; and its obligations concerning energy industry codes and charging. NESO's statutory duties, as provided in the Energy Act 2023, including promoting net zero, energy security, and cost efficiency, will also be regulated by Ofgem as 'relevant requirements'.¹

In this document, we are providing background on the context, roles, rationale, and structure of these two licences and consulting on them. We are also offering a response to recent government and Ofgem consultations on NESO.

In August 2023, Government and Ofgem jointly published the second FSO policy consultation and project update² which included new proposals for security and resilience roles for NESO and a proposed power for the Secretary of State (SoS) to direct NESO in national security related circumstances.

¹ 'Relevant requirements' are defined in section 25(8) of the Electricity Act 1989 and in section 28(8) of the Gas Act 1986, respectively.

² <https://www.gov.uk/government/consultations/future-system-operator-second-policy-consultation-and-project-update>

Statutory Consultation on National Energy System Operator (NESO) Licences and Other Impacted Licences

On 19 September 2023, Ofgem published its non-statutory consultation on draft ESO and GSP licence conditions.³ Ofgem also published two further non-statutory consultations. The first was on the 'Policy direction for the Future System Operator's regulatory framework'⁴ which set out the key features of NESO's financial regulation. The second, the 'Draft amendments to other impacted licences'⁵ published on 14 December 2023, proposed draft amendments to other impacted licences which would be required as a result of designating NESO.

In parallel, the Government announced in November⁶ that NESO will work with government to produce a Strategic Spatial Energy Plan (SSEP), which will define the optimal location of generation and infrastructure required to meet forecast demand and our 2050 net zero targets.

On 13 December, Ofgem published its decision on NESO's role in Centralised Strategic Network Planning (CSNP)⁷. To reflect NESO's new roles here, we are proposing new licence conditions in this consultation on Future Energy Pathways (FEP), CSNP, and SSEP, which were not included in Ofgem's initial consultation on the draft ESO and GSP licence conditions.⁸

From these various consultations and announcements, we now seek to bring together the rationale behind the different elements of NESO's first licences into this one document. We provide summarised background on the drivers for change, our approach to the licence and previously-consulted-on policy including the range of roles we expect NESO to undertake. Following this, we provide a summary of the content of NESO's Electricity System Operator and Gas System Planner licences, with further detail and specifics broken down by individual condition to be found in the annexes.

These first NESO licences will be granted (or treated as granted⁹) by the Secretary of State using powers provided for in the Energy Act 2023.

What we are consulting on

This consultation brings together the outputs of multiple non-statutory consultations across NESO licences, new roles, financial design and incentives, and consequential changes to other licences. It provides the complete proposed NESO Day 1 licence conditions, subject to the conclusion of this statutory consultation.

³ <https://www.ofgem.gov.uk/publications/future-system-operator-fso-draft-licences-consultation>

⁴ <https://www.ofgem.gov.uk/publications/consultation-policy-direction-future-system-operators-regulatory-framework>

⁵ <https://www.ofgem.gov.uk/publications/future-system-operator-draft-amendments-other-impacted-licences>

⁶ [Transmission Acceleration Action Plan](#)

⁷ <https://www.ofgem.gov.uk/publications/decision-framework-future-system-operators-centralised-strategic-network-plan>

⁸ Also, in parallel, the Government in January consulted on the '*future ownership of Elexon: licence and code changes*'. The creation of NESO as a public corporation and the associated purchase of NGESO necessitate a change in ownership for Elexon, because Elexon is currently wholly owned by NGESO. However, we do not respond to this recently closed consultation in this consultation document.

⁹ Under the Energy Act 2023 s.167 the SoS may, rather than granting the electricity system operator licence, direct that the current transmission licence is converted into the new licence, thereby retaining associated documentation and previous decisions. In this case, the new electricity system operator licence would be 'treated as granted'. See section 4.6 for more information.

Statutory Consultation on National Energy System Operator (NESO) Licences and Other Impacted Licences

In addition to the new licence conditions and amendments to existing licence conditions, we are also consulting on the licence terms for both the ESO and GSP licences, as well as the Direction and Schedule for the ESO licence.

We are consulting on modifications to the following NESO held licences once granted (or treated as granted) by the Secretary of State:

- Electricity System Operator Licence Conditions
- Gas System Planner Licence Conditions

We are also consulting on modifications to the following licences which will be impacted by the creation of NESO:

- Electricity Transmission Standard Licence Conditions
- National Grid Electricity Transmission plc Special Conditions
- SP Transmission plc's and Scottish Hydro Electric Transmission plc.'s Special Conditions
- Electricity Generation Standard Licence Conditions
- Electricity Interconnector Standard Licence Conditions
- Electricity Supply Standard Licence Conditions
- Electricity Distribution Standard Licence Conditions
- All Electricity Distribution Special Conditions (including additional changes to Scottish Hydro Electric Power Distribution plc.'s Special Conditions only)
- Smart Meter Communication Licence
- National Gas Transmission plc (NGT) Gas Transporter Licence (Part C) Special Conditions
- All other Gas Transporter Licence Special Conditions
- Gas Transporter Standard Special Conditions (Part A)
- Gas Transporter Standard Licence Conditions

The proposed modifications, reasons and effects are set out in the annexes to this document. These modifications will have effect on the date that designation of the ISOP comes into effect. This will be on a date after this consultation closes on the 9 May 2024.

Consultation details

Issued: 28 March 2024

Respond by: 9 May 2024

Enquiries to:

Electricity Systems Team
Department for Energy Security and Net Zero
3-8 Whitehall Place
London
SW1A 2EG

And

Future System Operation
Office of Gas and Electricity Markets
10 South Colonnade
Canary Wharf
London
E14 4PU

Email: NESOproject@energysecurity.gov.uk and FSO@ofgem.gov.uk

Consultation reference: Statutory consultation on National Energy System Operator licences and other impacted licences

Audiences:

Energy suppliers, generators, transmission owners, distribution networks, engineering standards bodies, energy sector research groups, consumer groups and any other organisations with a direct interest.

Territorial extent:

Great Britain

How to respond

We would prefer you to respond via email, please ensure you respond to both email addresses below.

Email to: nesoproject@energysecurity.gov.uk and FSO@ofgem.gov.uk

If you would like to send a hard copy, please send copies to the following addresses. As this is a joint consultation, please ensure you send copies to both addresses below.

Write to:

Electricity Systems Team
Department for Energy Security and Net Zero
3-8 Whitehall Place
London
SW1A 2EG

And

Future System Operation
Office of Gas and Electricity Markets
10 South Colonnade
Canary Wharf
London
E14 4PU

When responding, please state whether you are responding as an individual or representing the views of an organisation.

DESNZ and Ofgem will share all responses received with each other.

Confidentiality and data protection

Information you provide in response to this consultation, including personal information, may be disclosed in accordance with UK legislation (the Freedom of Information Act 2000, the Data Protection Act 2018, and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential, please tell us, but be aware that we cannot guarantee confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not be regarded by us as a confidentiality request.

We will process your personal data in accordance with all applicable data protection laws. See our [privacy policy](#).

We will summarise all responses and publish this summary on [GOV.UK](#). The summary will include a list of names or organisations that responded, but not people's personal names, addresses or other contact details.

Quality assurance

This consultation has been carried out in accordance with the Government's [consultation principles](#).

If you have any complaints about the way this consultation has been conducted, please email: bru@energysecurity.gov.uk.

Chapter 1: Strategic context

1.1 Executive summary

The Energy Act 2023 sets the legislative framework for a new, publicly owned Independent System Operator and Planner, which will be known as the National Energy System Operator (NESO). NESO will take on responsibilities across electricity, gas and hydrogen, including all the existing functions of NGENSO, so it is able to take an enhanced whole system approach to planning and operating the energy sector.

With roles across the energy system, NESO will help plan and deliver the integrated system needed to secure our energy security, net zero and affordability goals. NESO will be independent, not only of other commercial energy interests, but also from the operational control of government. This means it will be in a position to use its expertise to advise government and Ofgem on the critical decisions ahead.

An overview of NESO's existing and new roles is provided in Chapter 2. Detail on the financial framework of NESO is set out in Chapter 3, alongside our approach to reflecting Transitional Service Agreements (TSAs) in the licence.

The Government has worked together with Ofgem to ensure NESO's first licences set it up for success. NESO will have two licences through which it will be regulated by Ofgem: an Electricity System Operator (ESO) licence covering its obligations regarding its electricity functions, and a Gas System Planner (GSP) licence covering its obligations regarding its gas functions.

These two licences will be granted by the Secretary of State using powers in the Energy Act 2023 to the body being designated as the ISOP.¹⁰ Details of these licences can be found in Chapter 4 and Annex C-G. Draft versions of the licences and further policy roles have been consulted on in recent months and this document seeks to summarise stakeholder views and provide government and Ofgem responses.

Information is provided on the approach taken to drafting NESO's licences, financial design and incentivisation. Alongside this is an explanation of the licence conditions and the rationale or the conditions in the new licences. The consequential impacts on other licences of designating NESO are set out in Chapter 5.

We have published four consultations on NESO recently (which referred to the FSO and ISOP) and welcome the detailed feedback received. Government and Ofgem responses and decisions on these consultations can be found in Chapter 6.

Finally, next steps following this consultation are discussed in Chapter 7.

¹⁰ Legally, the 'ISOP' or Independent System Operator and Planner, the name given to NESO in Part 5 of the Energy Act 2023

1.2. Background and drivers for change

Progress is well underway to meet the unique challenge of a rapid shift toward a net zero energy system. Innovations in renewable technology and novel approaches, including large-scale data utilisation, have opened up fresh opportunities for establishing a secure and decarbonised energy system at minimal cost. These transformations present significant hurdles for our electricity and gas infrastructure, necessitating careful consideration of the institutional frameworks governing these systems. To achieve a comprehensive view of the energy system, we recognised the need for an expert body with robust engineering expertise, a broad mandate across the energy system (encompassing electricity, gas, and hydrogen), and an organisational structure that ensures independence, impartiality, and alignment with consumer interests.

NESO will assume this pivotal role. It will inherit all existing responsibilities and functions from NGESO, along with additional long-term roles related to the gas system. NESO's operational independence will allow it to adopt a holistic energy system approach in its operations, planning, and network development, free from day-to-day government control or commercial interests within the broader energy sector.

Depending on a number of factors, including agreeing timelines with key parties, our aim is for NESO to be operational in 2024. In this consultation, the day when NESO is first established and operational when the first NESO licences come into force is referred to as Day 1.

Chapter 2: Roles and duties of NESO

This section provides an overview of NESO's new statutory duties and Day 1 roles. This is intended to be background information on the content of the licences. The majority of these roles were covered in our previous 'FSO second consultation and policy update' document and Ofgem's 'FSO Day 1 licence draft consultation'. The main exceptions to this are the CSNP¹¹ and SSEP¹² roles which have undergone policy development in parallel and so were not included in those previous consultations. We welcome comment on how these roles are articulated in NESO's licence.

2.1 Existing National Grid Electricity System Operator (NGESO) roles

The licences must ensure NESO will continue smooth delivery of the existing roles currently carried out by NGESO, while also promoting a new approach to system operation to enable the success of net zero.

These existing roles of NGESO include the electricity control centre operations, electricity market development and transactions, and electricity system insight, planning, and network development.¹³

For these activities, we have taken the approach of modernising and making housekeeping changes to the relevant licence conditions in NGESO's licence for NESO's Day 1 Electricity System Operator licence, as well as reflecting the statutory duties of NESO.

2.2 New roles and duties

2.2.1 Statutory Duties

NESO is given a range of duties under the Energy Act 2023 which govern how it carries out its functions. The primary duties are to promote net zero, energy security, and cost efficiency. NESO is also required to consider competition in the energy sector, the whole system, facilitating innovation, and the impact of energy sector activity on consumers.

It also holds duties to have regard to the strategic priorities set out in the Strategy and Policy Statement (SPS), to respond to requests for advice from government and Ofgem, and to keep developments in the energy sector under review. Finally, it has a power to request information from energy sector businesses.¹⁴

¹¹ Ofgem [consulted on CSNP](#) in July 2023, and made [a decision in December 2023](#).

¹² Announced in the Transmission Acceleration Action Plan <https://assets.publishing.service.gov.uk/media/65646bd31fd90c0013ac3bd8/transmission-acceleration-action-plan.pdf>

¹³ More details of the existing activities undertaken by NGESO can be found in the ESO Roles Guidance [ESO roles guidance \(ofgem.gov.uk\)](#)

¹⁴ For more detail see [Part 5 of the Energy Act 2023](#)

Ofgem regulation of NESO statutory duties as relevant requirements

We intend for Ofgem to regulate NESO's application of its statutory duties.

The licences do not seek to replicate these duties which already exist, though they will make references to them. Instead, we propose to use secondary legislation¹⁵ to make these duties 'relevant requirements' in the Electricity Act 1989¹⁶ and Gas Act 1986.¹⁷ This extends Ofgem's powers to impose penalties or make orders when "relevant conditions" and "relevant requirements" are breached or suspected to be breached. This allows Ofgem to monitor the performance of NESO against its duties without replicating them within the licence.

2.2.2 Gas functions

As proposed in the FSO Second Policy Consultation and Update in August 2023¹⁸, NESO will take on gas strategic planning, gas forecasting, and market strategy functions.

This includes NESO coordinating a strategic planning gas options assessment process from Day 1, where:

- 1) NESO will publish an independent view of gas network capability and its statement of system needs;
- 2) NGT (and potentially other parties in the future) will produce a response to the needs set out by NESO under (1), which may include a proposal of options to satisfy the need(s);
- 3) NESO will produce a form of gas options assessment/advice document that will include analysis and recommendations/advice to Ofgem on the proposals under step (2);
- 4) NESO will submit its analysis/advice on proposals and options (from step (3)) to Ofgem for further decisions on funding.

NESO will also undertake medium-/long-term gas supply and demand forecasts, as an output of the Future Energy Pathways process. These assumptions and forecasts are likely to feed into the strategic planning process, as well as being communicated to wider industry. NESO will also coordinate and lead Future of Gas (FoG) forums and participate in the development of gas market projects currently delivered through the Gas Markets Plan (GMAP).

As set out in Powering Up Britain¹⁹, to complement existing security of supply standards focussed on supply infrastructure capacity, NESO will deliver a new medium range (at 5 and 10-year time intervals) Gas Supply Security Assessment on an annual basis. This assessment will consider gas supplies according to availability, reliability, and deliverability across specific time horizons. This assessment will be published and form the basis of advice for government and Ofgem in the space of gas future operability planning.

For NESO to fulfil its gas functions, we have proposed NESO becomes a new class of signatory in the Uniform Network Code (UNC). This would include being able to provide modification

¹⁵ Section 330 of the Energy Act 2023 makes provision for consequential amendment. This allows minor and technical changes to other legislation to be made as a consequence of the Energy Act.

¹⁶ Schedule 6A

¹⁷ Schedule 4B

¹⁸ <https://www.gov.uk/government/consultations/future-system-operator-second-policy-consultation-and-project-update>

¹⁹ <https://www.gov.uk/government/publications/powering-up-britain>

proposals and representations, as well as a representative to the UNC Panel. Whilst we are proposing changes to licence conditions to enable NESO to become a new class of signatory under the UNC, we are not currently proposing any change to the Joint Office Governance Arrangements, or to the ownership structure of the Central Data Service Provider (CDSP) for Day 1 of NESO. We are proposing that NESO signs a Data Services Contract with the CDSP and have made some additional changes to licence conditions to reflect this new NESO-CDSP relationship.

In Ofgem's previous consultations, including the 'Consultation on the policy direction for Future System Operator's regulatory framework'²⁰ we proposed that for Day 1, National Gas Transmission (NGT) will recover gas charges to pass through to NESO to fund the latter's gas functions. This proposal will enable NGT to recover this funding through the General Non-Transmission Service Charge²¹, and the appropriate charging framework and statements will transparently highlight this process to those being charged within the gas industry.

Our proposed licence conditions across NESO's GSP licence and NGT's Gas Transporter Special Conditions reflect the implementation of the Day 1 gas funding process, with the necessary obligations on NESO to notify the amounts of funding required from NGT, and NGT to recover this funding as a System Operator pass through item within their System Operator allowed revenue.

2.2.3 Advisory role

Government and Ofgem will make important policy and regulatory decisions over the coming years, across many areas of the energy system to ensure progress towards net zero. Many of these decisions would benefit from the expertise of NESO, and being able to draw on specific targeted advice from NESO will help ensure any decisions made consider network impacts and are based on robust evidence. This role is underpinned by legislation, as section 171 of the Energy Act 2023 places an obligation on NESO to comply with requests for the provision of advice, analysis, or information from Ministers or Ofgem.²²

2.2.4 Energy Resilience

Following our previous consultation, we have decided that NESO should take on a whole energy system role to understand and plan system security and resilience across electricity and gas and the interactions between them. The key purpose of this is to provide whole system coordination and analysis, allowing independent, expert advice, analysis, and information to government and Ofgem, alongside strategic coordination and preparation for emergencies across energy vectors. These roles will evolve over time. However, the Day 1 functions set out in NESO's Day 1 GSP licence, include whole system risk identification, season ahead and emergency readiness, and post-event and post-season analysis. We have set out further detail on these roles in section 6.1.1.

²⁰ [Consultation on the policy direction for the Future System Operator's regulatory framework | Ofgem](#)

²¹ The General Non-Transmission Services Charge is levied by National Gas Transmission (NGT) to recover non-capacity related revenue, which feeds into its Gas System Operator allowed revenues under NGT's Gas Transporter Licence Special Conditions.

²² [Energy Act 2023 \(legislation.gov.uk\)](#)

2.2.5 Secretary of State directions in connection with risks related to national security

Following our previous consultation, we have decided to include a provision, stemming from powers in legislation,²³ in NESO's Day 1 licence conditions that allow for the Secretary of State to direct NESO to take, or not take, certain actions, including where there is a risk relating to national security that may detrimentally impact the resilience, safety, or security of the energy system, or the continuity of essential services. The Secretary of State would only exercise this power and issue a direction where it believes it is in the interests of national security to do so.

NESO will be required to comply with any such direction issued by the Secretary of State, and take any action specified in that direction, where it is within its power and control.

Existing Secretary of State powers relating to National Security are not designed to be used pre-emptively before an emergency has taken place, whereas national security concerns may not necessarily be urgent, but rather arise out of a long-term risk that government is managing. A licence condition has been drafted to fill this gap and is part of this statutory consultation.

2.2.6 Strategic Spatial Energy Plan

Government announced, in the Transmission Acceleration Action Plan²⁴, that a SSEP should be developed to define the optimal mix and location of generation and energy infrastructure to meet GB forecast demand and net zero targets, and that NESO should work with government and other parties to develop this plan. The outputs of this plan will clarify the network infrastructure needed to accommodate this generation siting, with further network infrastructure planning subsequently carried out via the CSNP.

Existing electricity transmission network planning conditions have been modified for NESO's ESO licence and new licence conditions have been drafted for both NESO licences to reflect the transition to the CSNP and the SSEP.

Given that the scope and detail of the SSEP will be set out in a commission from the Secretary of State, the licence condition has been drafted to set out the obligation to comply with the commission. As part of Government's commission to the NESO, we intend to set out further detail on the scope of the SSEP, including how wider constraints on land and sea use will be considered throughout the development of the SSEP (including, but not limited to, environmental impacts and how community voices will be engaged).

2.2.7 Centralised Strategic Network Plan

In December 2023, Ofgem published the decision on the framework for NESO's CSNP.²⁵ NESO will be responsible for creating a new CSNP that will provide an independent, coordinated, and longer-term approach to wider network planning in GB to help meet the Government's net zero ambitions. At first, the longer-term CSNP publication will focus on the electricity transmission network – onshore, offshore and interconnectors – as well as developments in natural gas

²³ Electricity Act 1989 Section 7(3)(a) and Gas Act 1986 Section 7B(5)(a)

²⁴ <https://www.gov.uk/government/publications/electricity-networks-transmission-acceleration-action-plan>

²⁵ [Decision on the framework for the Future System Operator's Centralised Strategic Network Plan \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/consultation/decision-on-the-framework-for-the-future-system-operator-s-centralised-strategic-network-plan)

transmission and hydrogen. The CSNP will subsequently evolve and expand across the whole energy system.

This licence condition contains a requirement on NESO to create a CSNP including high-level obligations regarding the timing, scope, and content necessary to produce such a plan. It also contains an obligation on NESO to develop a CSNP Methodology, in consultation with Ofgem, SoS, and other interested parties, and which will be approved by Ofgem. This drafting is aligned with the policy already set out in Ofgem's decision document. To ensure continuity the current Network Options Assessment (NOA) and the Electricity Ten Year Statement (ETYS) sections of the licence have been retained, with the expectations that their use will be phased out as the CSNP is further developed.

Chapter 3: Financial arrangements, Transitional Service Agreements and further legislation

To ensure NESO can deliver on its roles and functions, it must be a stable and robust corporate body able to function as a standalone organisation. We have therefore been developing the financial arrangements to enable the move from a private to a public model, considering the Government's guidance on public corporations. As the electricity system operator separates from NG Plc, various previously shared services are also being separated, in a considered and safe manner, to enable NESO to be completely independent.

NESO also requires a stable wider legislative framework reflective of the existence of Part 5 of the Energy Act 2023. This includes, for instance, updating various references to the holder of a 'transmission licence' to 'electricity system operator licence', and making various updates in other legislation to reflect the public nature of the body.

The policy in this section is intended by way of background and context to the draft licences rather than for consultation.

3.1 Financial arrangements update

Our response to the NESO financial arrangements consultation which confirms financial policy can be found in section 6.3. Below is a further update to this policy. Detail on how we're implementing this policy in the licence can be found in section 4.4.

The broad regulatory financial framework for NESO was consulted on previously in December 2023 and Ofgem's full response to this consultation is outlined in Section 6.3. In summary, NESO will be a not-for-profit organisation. Its shareholder – the Government – will not receive an enduring return or face downside loss, it will be fully funded by consumers through a 'fast money' model, and it will be regulated against its actual financial positions. NESO's performance will be primarily regulated through robust reputational incentives for the organisation, with appropriate links to staff remuneration.

This section provides a further update on how NESO will transition to a full not-for-profit model including the time limited arrangements that are required to reflect guidance on government investments. NESO's regulatory framework will be supported by financial arrangements provided by government, including a working capital facility, to manage cash flows and a process for managing the transition between ESO and NESO regulatory models.

While NESO will not earn an enduring regulatory profit, it will initially be structured to wind down its Regulatory Asset Value (RAV) and compensate the taxpayer for the cost of providing that capital over a time limited period. This will, in line with broader government guidance on public corporations, ensure that taxpayers are not disadvantaged by the creation of NESO while driving consumer affordability by lowering (and ultimately completely removing) the cost of managing this capital risk.

On designation by the Secretary of State, NESO's licence will carry over a regulatory finance position from its predecessor, NGESO. NESO's RAV will represent capitalised spending that NGESO had undertaken on behalf of consumers, but which it has not yet recovered from them. Under the current regulatory framework for NGESO, a weighted average cost of capital (WACC) provides the primary basis of NGESO's regulated return on this capitalised spending, remunerating it for the cost of 'lending' its RAV to consumers.

The move to an all 'fast money' for NESO will result in no future spending being capitalised for regulatory purposes. NGESO's accumulated RAV balance will be retained, but without further capitalisation of spending, its RAV will no longer grow over time, instead depreciating to zero over a seven-year period. This is aligned with the current regulatory depreciation period for NGESO's capital expenditure (with the exception of NGESO's offices, which will have their depreciation period reduced to seven years also).

The cost of providing capital to support the outstanding balance of the RAV during its depreciation period will be borne by government and so, ultimately, taxpayers. To ensure that taxpayers are not disadvantaged, Government is adopting HM Treasury's guidance on the use of public money, the Green Book²⁶ and Managing Public Money²⁷, which sets the so-called Social Time Preference Rate of utilising taxpayers' money at any one point, rather than another in the future, at 3.5% in real terms. In this manner, taxpayers will be appropriately recompensed for the cost of supporting NESO's RAV while it depreciates through a charge²⁸ which will phase out over the period of the RAV's depreciation while lowering costs for consumers versus the status quo.

This licence consultation sets out how we propose to implement NESO's financial framework, including the aspects described in this section. Some aspects of the detailed implementation approach (such as the specific RAV depreciation profile method and the indexation measure used on RAV to enable a return in real terms) will be brought forward by Ofgem through subsequent consultations on associated licence documents. Ofgem intends to adopt a similar detailed methodology as is used currently for NGESO's RAV depreciation.

3.2 Approach to Transitional Services Agreements

On Day 1, Transitional Service Agreements (TSAs) will be in place between NESO and NG Plc for continued access to business services which cannot be separated by this point, in order to ensure NESO can continue to run the business and fulfil its obligations. The majority of these services will flow from NG Plc to NESO, but a minority will be reverse TSAs with services flowing from NESO to NG Plc. The work being undertaken to agree the TSAs will also capture Long Term Agreements (LTAs) with NG Plc for services that will be in place beyond 'Day 2'. 'Day 2' is reached when NESO has exited the TSAs and is operating its business services completely independently from NG Plc, with LTAs remaining in place only where appropriate.

NESO's licences will contain a requirement that they use reasonable endeavours to ensure that it is able to operate without TSAs by the time these agreements expire or as soon as practicable thereafter. NESO will produce an independence report showing how they will achieve this and

²⁶ <https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government/the-green-book-2020>

²⁷ <https://www.gov.uk/government/publications/managing-public-money>

²⁸ remaining RAV * Social Time Preference Rate

will need to notify Ofgem if they propose to make any material change to, extend the duration of, or terminate any TSAs.

3.3 Ensuring a stable legislative footing

The designation and licensing of NESO²⁹ are made possible by powers in the Energy Act 2023. The fact that, once NESO is licensed, the electricity transmission system will be operated by the holder of an ‘electricity system operator’ licence rather than a ‘transmission licence’, for example, gives rise to the need to update other legislation that is drafted on the basis of the current regulatory arrangements and will no longer work as intended unless it is amended.

We expect that most, if not all, of the necessary changes will be made by means of regulation under s.330 of the Energy Act 2023. These will need to be laid before Parliament in draft and approved by both Houses before the Secretary of State can make them.

In addition to changes to energy sector legislation reflecting the new regulatory arrangements, we expect the regulations under s.330 to amend a number of non-energy sector pieces of legislation that relate to public bodies, to reflect the fact that NESO will be a new public body. Examples include the lists of organisations to which provisions of the Equality Act 2010, Freedom of Information Act 2000, and Public Records Act 1958 apply. The NESO will also be required to consider the environment, for example through the Natural Environment and Rural Communities Act 2006 and the Environment Act 2021.

The regulations to make consequential amendments are expected to come into force on the date when NESO assumes its new responsibilities (to coincide with the coming into force of its licence), and its licences are written with this in mind. As such, references to legislation contained within the licences may in some instances refer to the legislation as it will be amended by the regulations.

²⁹ Referred to in legislation as the Independent System Operator and Planner or ISOP

Chapter 4: Approach to licence drafting

The Energy Act 2023 provides for NESO to hold two licences:

- 1) An Electricity System Operator (ESO) licence (under the Electricity Act 1989); and
- 2) a Gas System Planner (GSP) licence (under the Gas Act 1986).

As set out in Section 2.1, once these licences are granted (or treated as granted) by the Secretary of State, Ofgem will be responsible for monitoring and regulating NESO's compliance with its licence obligations, and NESO will be accountable to Ofgem for its compliance with, or any breach of, these licence obligations.

Ofgem consulted on the majority of NESO's new licence conditions in September 2023 through their non-statutory licence condition consultation for NESO's two new licences. At the time, some conditions were not included (e.g. the financial design and incentives conditions). There have also been separate policy consultations on new roles that were launched and concluded during the second half of 2023 (e.g. 'FSO second consultation and policy update' and CSNP).

This consultation therefore brings together the outputs of multiple non-statutory consultations across NESO licences, new roles, financial design and incentives, and consequential changes to other licences. It provides a complete draft of NESO's new Day 1 licence conditions, subject to the conclusion of this statutory consultation. Our responses to those consultations are set out in Chapter 6.

4.1 Approach and process of drafting licence conditions

Our intent when developing the licences has been to ensure NESO will continue smooth delivery of the existing roles currently carried out by NGESO, while also promoting a new approach to system operation to enable the transition to net zero. The draft ESO and GSP licences are informed by existing electricity system operator and gas obligations that currently sit in the electricity transmission and gas licences. The policy intent and content of a significant portion of these licence conditions – that set out the obligations around existing roles and standard regulatory frameworks – will largely stay the same in the new NESO licences, but with updated language and structure where relevant.

We also identified amendments to other impacted licences required as a result of creating NESO which also form part of this consultation. We will also use provisions in the Energy Act 2023 to implement changes to the industry codes required to facilitate the transfer of existing NGESO functions to NESO and to allow NESO to take on new roles. This will be consulted on separately prior to Day 1.

The following are four key drivers for new or significantly modified licence conditions:

- **New statutory duties:** Throughout the licence, reference to NESO's duties will be introduced where appropriate and similarly references to the general duties of Transmission Licensees (as set out in section 9 of the Electricity Act 1989) will be removed where appropriate. As set out in the 'Future System Operator - Second Policy Consultation and Update', we expect NESO's activities to evolve over time. Ofgem will

consider NESO's new statutory duties while regulating NESO, and it is for NESO to balance the considerations in their duties and demonstrate how it has done so.

- **New/enhanced roles:** To introduce new/enhanced roles, including the provision of advice to government and Ofgem, roles relating to resilience and critical national infrastructure, compliance with national security directions, spatial and system planning and NESO's gas functions.
- **New ownership model:** Account for the public ownership model design and oversight by removing/modifying licence obligations that are aimed at regulating a private company and may no longer be applicable to or proportionate for a publicly owned organisation. For example, this includes removing and amending licence obligations aimed at maintaining business separation between NGESO and NG plc that were introduced as part of the legal separation of NGESO.
- **Alignment between fuels:** Aligning gas and electricity licence obligations to bring these functions under one organisational design for NESO. This has been achieved by consolidating and amending licence conditions (for example, business conduct and impartiality) to align across both licences.

Process – Existing roles and corresponding licence conditions

Where appropriate, licence conditions have been carried over into the new proposed draft licences with amendments to reflect the policy intention that NESO will take on NGESO's existing roles. Licence conditions that are considered to no longer be required, due to the creation of NESO and its establishment as a public corporation, have been removed or subsumed into other licence conditions as appropriate.

In cases where it was felt it would improve the clarity of the licence by grouping similar concepts together, there are instances where we propose multiple existing conditions in NGESO's licence should be combined into a single condition in NESO's ESO licence. For example, with the obligations related to network charging and the Assistance for Areas with High Electricity Distribution Costs Scheme.

Process – New roles and corresponding licence conditions

For licence conditions relating to new roles, where appropriate, new roles have been captured in an amended existing licence condition or new conditions have been created where there is no clear existing licence condition.

4.3 Modifying licences after Day 1

The ESO and GSP licences that NESO will hold have been added to the licensable activities under Section 6 of the Electricity Act 1989 and Section 7AA of the Gas Act 1986 respectively. This enables Ofgem to use its powers post Day 1 under Section 11A of the Electricity Act 1989 and Section 23 of the Gas Act 1986 respectively to modify the ESO and GSP licences.

Ofgem will be able to use its usual powers to modify the conditions of NESO's ESO and GSP licences in future, and to change other licences where they are impacted by these modifications.

Additionally, the Energy Act 2023 confers powers on the Secretary of State and Ofgem to make modifications to NESO's licence and codes for a period of three years beginning when NESO is first designated.

4.4 Financial framework and performance regulation

Our response to the NESO financial arrangements consultation which confirms financial policy can be found in section 6.3. A further update to this policy is provided in section 3.1. Detail on how we're implementing this policy in the licence can be found below.

As noted in Chapter 3 and further outlined in Chapter 6, the design of NESO's financial and funding framework is a material change from the traditional price-control model used for monopoly energy network companies, and to that which currently exists in NGESO's licence.

We have therefore taken the opportunity to rationalise and streamline the licence to reflect NESO's not-for-profit status, as shown in more detail in the annexes to this document. In summary, we have:

- Removed redundant NGESO licence requirements and processes, which are not relevant to a not-for-profit entity;
- Kept and amended NGESO financial licence conditions that remain relevant to NESO, but with updates to reflect the NESO's different financial framework and new ownership model;
- Consolidated relevant existing NGESO financial licence conditions where appropriate, including combining existing conditions on allowed funding; and
- Created a new location for conditions related to NESO's performance regulation, including its business planning and reputational incentives.

As set out in Chapter 6, we intend to implement changes to NESO's performance and incentives framework in phases. This will include essential changes introduced for Day 1, with a more enduring framework established at appropriate later points, including the end of NGESO's current RIIO-2 business plan in April 2025.

For NESO's Day 1 licence conditions, we have focussed on establishing the key foundational requirements of NESO's future business planning and performance assessment framework, including by establishing necessary associated documents that will later define the full details. We expect to consult on the Day 1 version of these associated documents shortly, with further consultations on the enduring post Day-1 arrangements to follow. This approach will allow us to adapt and evolve NESO's regulation in an agile manner, reflecting its transition to a standalone, independent, and trusted organisation.

4.5 Structure and content of NESO's ESO and GSP licences

There will only be one legal person designated as the ISOP, namely NESO. As such, there is no need to differentiate between Standard and Special conditions for NESO's ESO and GSP licences.

We have proposed a chapter structure for NESO's ESO and GSP licences that is aligned across both of the licences, with conditions grouped together by theme:

- Section A: Definitions and interpretation
- Section B: Business conduct and independence
- Section C: Strategic and operational functions
- Section D: Provision of advice and information
- Section E: Industry codes and charging
- Section F: Finance and funding
- Section G: Regulatory reports and assessment

The following section sets out the high-level contents of each of these sections and the approach taken to the drafting.

Annex B to this consultation contains the detailed reasons and effects for every condition of the new ESO and GSP licence conditions. This Annex B sets out the licence conditions we are consulting on in NESO's two licences in the way that they will appear in that licence. For each condition, we have set out:

- the purpose of each condition;
- whether it is a new condition or is based on existing provisions in NGESO's licence; and
- the equivalent condition in NESO's GSP licence if applicable.

Where we have indicated that there is an Associated Document related to the licence condition, this means an Ofgem owned document.

4.5.1 Electricity System Operator and Gas System Planner licences

The intention is for the powers in the Energy Act 2023 to be used to make a licensing direction (see Annex C) for the Secretary of State to direct that the transmission licence currently held by NGESO is converted, from Day 1, to have effect as an 'electricity system operator' licence held by NESO. We have therefore taken the approach that existing documents published by NGESO that have already been approved by Ofgem would not need to be re-published by NESO on Day 1 and would not require new approval by Ofgem. It also provides continuity for the industry codes currently administered by the NGESO. The proposed draft licence conditions reflect this assumption where applicable.

This consultation operates as a consultation by the Secretary of State under Section 167(6) of the Energy Act 2023 in respect of the proposal to make a licensing direction. The form of licensing direction for the ESO is set out in Annex C.

The Energy Act 2023 powers provided for NESO to hold a new GSP licence, for the licensing of its gas system planning activity that comprises the strategic planning and forecasting in connection with the development of pipe-line systems and other arrangements for the

conveyance of gas. In accordance with the provisions of the Energy Act 2023, this GSP licence will be granted to NESO as the ISOP (as designated) by the Secretary of State.

The new roles mentioned in chapter 2 have been integrated into the appropriate sections of the licences. The section descriptions below explain which existing NGESO activities and new activities are contained in which licence conditions.

The new Electricity System Operator and Gas System Planner licence conditions can be found in Annex E and G.

Section A: Definitions and interpretation:

This section sets out the definitions and interpretation provisions for the licence.

It includes the defined terms used in each licence, and provisions to support the interpretation of licence conditions, clauses and the powers of the Authority in respect of the licence (e.g., in issuing directions).

This section also sets out the process for making licence modifications for housekeeping changes. This process reflects that which already exists across Ofgem's regulatory regime in the licences of other regulated entities, including NGESO.

Section B: Business Conduct and Independence

This section of the licence contains conditions that provide obligations to ensure NESO's independence from industry, and the conduct of its activities. This section also covers procedures related to NESO's interactions with government, including certain provisions on operational independence and obligations on NESO to comply with directions issued by the Secretary of State related to national security. There are also licence conditions setting out the requirements and restrictions related transitional services.

It also sets out obligations and provisions on protecting confidential data and confidential information within NESO. This includes ringfencing provisions and obligations on the licensee in respect of disclosure of data, which replaces the previous System Operator Functions Information (SOFI) provisions and Electricity Market Reform (EMR) ring fence in the Special Conditions of NGESO's electricity transmission licence.

The ESO licence contains a condition in this section related to fair treatment of users of the electricity transmission system. This has been carried over from NGESO's licence into the ESO licence, but a gas equivalent in the GSP licence has been determined to be unnecessary.

Section C: Strategic and Operational Functions

This section contains the licence conditions related to NESO's strategic and operational functions. In the ESO licence this is principally within the electricity sector, including the electricity control centre activities, market activities and network planning activities. In the GSP licence this is principally within the gas sector, including new functions on gas strategic planning, gas forecasting (and production of Future Energy Pathways) and market strategy role.

In the ESO licence this section contains some existing activities of NGESO where we have not proposed significant changes for NESO, conditions that have been amended to reflect NESO policy decisions, and new conditions to implement NESO policy. It includes modified conditions

related to existing NGESO control room activities, EMR and balancing services activities, connections, network planning, and innovation.

In the GSP licence this section includes the new gas activities including gas supply security, market strategy and network planning.

In both licences there are also new conditions related to the new energy resilience and critical national infrastructure activities, which will evolve into fully whole energy system functions across the electricity and gas sectors. This section also outlines obligations related to NESO and innovation, e.g. the Electricity/Gas Network Innovation Strategy and includes new conditions related to the new system planning conditions to implement Ofgem's CSNP decisions and the Government's Strategic Spatial Energy Plan.

Both licences contain an updated version of what is currently Condition C28 (Functions for an efficient, co-ordinated, and economic system operator) of NGESO's licence. This condition has been retained to allow Ofgem to close out the ESO's existing business plan as well as making sure that how NESO should carry out some of its activities is clearly set out.

Section D: Provision of advice and information

This section contains the licence conditions related to NESO's advice and information activities, including NESO's duty to provide advice to government and Ofgem, and NESO's power to request information from other industry parties.

This section contains existing activities of NGESO, where we haven't proposed significant changes for NESO including the data assurance provisions and requests for information from Ofgem. In the ESO licence only this also includes requests for information from Ofgem related to offshore electricity transmission.

Section E: Industry codes and charging

This section of NESO's ESO licence contains conditions for its obligations related to industry codes and network charging. This section contains existing NGESO conditions that have been modified for NESO and no new conditions. Given the ongoing work on Energy Code Governance Reform, we have aimed to only propose amendments to the conditions related to industry codes where required to implement NESO policy decisions and the Elexon ownership decision. This has been done to avoid changing the conditions substantively several times in a short period.

It is our view that NESO policy decisions have not had a significant impact on the existing NGESO codes and charging obligations that will be transferred to NESO, other than the Elexon ownership decision.³⁰ Therefore, the majority of amendments to the conditions in this section are relatively minor.

This section of NESO's GSP Licence contains licence obligations related to its involvement with the Uniform Network Code (UNC), interactions with gas transporters (e.g. NGT) and other participants within the gas industry.

³⁰ [The future ownership of Elexon - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/news/the-future-ownership-of-elexon)

This includes a new condition to reflect the policy proposal for NESO to accede to the UNC, including the ability to make modification proposals and representations, and provide a representative to the UNC panel.

We have aimed to only provide for licence obligations in this section that reflect new NESO policy decisions and are not proposing any pre-emptive changes on the basis of Energy Code Governance Reform.³¹

Section F: Finance and funding arrangements

This section covers the necessary funding and financing obligations for NESO. It includes provisions related to NESO's allowed costs, network revenues, innovation funding, accounting, financial governance, payments to the Authority and remuneration and expenses. There are also obligations relating to budgeting and non-profit requirements.

In the GSP licence only, this section will also feature several conditions related to NESO receiving its gas funding through gas network charges (as part of the pass-through process from NGT to NESO consulted on in Ofgem's December 2023 publication on NESO's regulatory framework). This includes licence obligations related to the process of notifying NGT of its forecast gas costs, and how the subsequent received revenues are trued up and allocated to its costs.

Section G: Regulatory reports and assessment

This section, in both licences, contains licence conditions on the regulatory reporting and assessment requirements for NESO. This includes the necessary obligations for performance and incentive reporting, plans, and costs submissions, reporting and requirements on Transitional Services and general obligations related to NESO's business and regulatory planning.

4.6 Licence direction, terms, and schedule

The terms of the ESO licence and the conditions of that licence (see Annex E) will be scheduled to the licensing direction. The terms sit at the start of a licence and define the entity being licensed, the basis upon which that licence is granted and that the licence shall take effect from designation and shall continue until such designation is revoked (unless the licence is revoked for some other reason by Ofgem). The schedule to the terms sets out the grounds on which the licence may be revoked by Ofgem, including failure to comply with an enforcement order or financial penalty or an insolvency related event. Whilst reflecting the particular nature of NESO, for instance that NESO will not apply for its licence but be treated as granted it by the Secretary of State, the terms of NESO's licences largely keep to the modern equivalent of existing licences.

The GSP licence will not be made by direction, but the terms of the licence and schedule will be the same as for the ESO licence subject to any relevant changes to take account of the statutory basis for the GSP. The proposed terms of the GSP licence and schedule are in Annex G.

³¹ [Energy code reform: implementation consultation](#)

Chapter 5: Other impacted licences

Amendments to other impacted licences will be required once the Secretary of State designates and grants licences to NESO as the ISOP under the Energy Act 2023.

The complete list of consequential changes to licences can be found in Annex I.

We propose that modifications to the following licences will be required:

- Electricity Transmission Standard Licence Conditions
- National Grid Electricity Transmission plc Special Conditions
- SP Transmission plc's and Scottish Hydro Electric Transmission plc's Special Conditions
- Electricity Generation Standard Licence Conditions
- Electricity Interconnector Standard Licence Conditions
- Electricity Supply Standard Licence Conditions
- Electricity Distribution Standard Licence Conditions
- Electricity Distribution Special Conditions (including additional changes to Scottish Hydro Electric Power Distribution plc's Special Conditions only)
- Smart Meter Communication Licence
- National Gas Transmission plc (NGT) Gas Transporter Licence (Part C) Special Conditions
- Gas Transporter Standard Special Conditions (Part A)
- Gas Transporter Standard Licence Conditions

Throughout these licences we have made the following changes:

- Updating cross references
- Adding and updating defined terms related to the creation of NESO
- Updating references to the System Operator and NGESO
- Updating references to transmission licensees

The overall changes we are proposing to the electricity licences reflect NESO taking on all of the existing activities of NGESO. Because NGESO has roles in electricity system planning and connections, codes and administering charges and government schemes, there are references to NGESO and their licence conditions throughout the licences of other electricity licensees and the Smart Meter Communications Licence. In addition, there are changes to the Electricity Transmission licences required to reflect that NESO will be a public corporation, rather than part of National Grid Plc like the NGESO, and to reflect the Elexon ownership policy.

Similarly, in the gas licences, we have proposed changes to update references, add new terms, and update defined terms. We have also made changes to the NGT Gas Transporter Special Conditions to reflect the implementation of the Day 1 gas funding process, to enable NESO's gas strategic planning function, as set out in more detail in Section 2.2.2.

We are not proposing changes to electricity licences or the smart meter communications licence influenced by NESO policy as part of these changes. Instead, all of the changes proposed reflect NESO taking on the existing activities of NGESO and to keep conditions in the other licences

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aligned with the approach taken for NESO's ESO Licence. Ofgem intends to make the changes required to other licences to implement the CSNP decision at a later time.

Chapter 6: Responses to previous consultations

In recent months, both government and Ofgem have published NESO-related consultations, covering policy, design, and implementation. This consultation precedes final decisions on NESO's two new licences and as such is an appropriate place to respond to the recent set of consultations which have led up to it. We are grateful to respondents and appreciate that some have responded to more than one of these consultations. We hope that bringing the responses together makes consideration of them easier.

In this consultation we respond to:

- 6.1 - The FSO second policy consultation and update – published 4 August 2023³²
- 6.2 - The FSO draft licences consultation – published 19 September 2023³³
- 6.3 - The policy direction for FSO's regulatory framework consultation - Published 14 December 2023³⁴
- 6.4 - Amendments to other impacted licences consultation – Published 14 December 2023³⁵

Given the large number of responses, this document contains a summary of responses rather than setting them out in full. However, we recognise the level of detail which sits beneath this and all non-confidential responses to Ofgem (led and joint) consultations will be published on Ofgem's website. Government and Ofgem have carefully considered all responses. The evidence and views provided have informed our approach to decisions and next steps.

6.1 Response – Second Policy Consultation and Update

On 4 August 2023, we published our 'FSO second consultation and policy update' document.³⁶ We consulted on two new elements of NESO policy: new security and resilience roles and a power allowing the Secretary of State to direct NESO in certain limited circumstances related to national security. We also provided an update on the overall implementation of establishing NESO, the Day 1 roles, and other potential future roles of NESO.

Below we set out a summary of stakeholder responses to the two questions we asked and our response.

³² <https://www.gov.uk/government/consultations/future-system-operator-second-policy-consultation-and-project-update>

³³ <https://www.ofgem.gov.uk/publications/future-system-operator-fso-draft-licences-consultation>

³⁴ <https://www.ofgem.gov.uk/publications/consultation-policy-direction-future-system-operators-regulatory-framework>

³⁵ <https://www.ofgem.gov.uk/publications/future-system-operator-draft-amendments-other-impacted-licences>

³⁶ Note that we then referred to the FSO, whereas now we refer to NESO.

6.1.1 Security and resilience roles

Our proposal in the consultation was for the FSO (now NESO) to take on a role in relation to resilience and security on Day 1. This was proposed to include understanding and planning system resilience, preparation for emergencies, and learning from emergencies.

The question asked at consultation was: *Do you have any views on the new FSO security and resilience roles?*

Summary of stakeholder responses

Stakeholders were broadly very supportive of NESO taking on the resilience and security roles, particularly acknowledging the benefits of a whole system approach. Whilst no stakeholders disagreed with NESO taking on these roles, some highlighted that there was limited information and detail to sufficiently comment and therefore would welcome further engagement to provide that clarity. One stakeholder called for a clearer rationale for the need for these roles and why NESO is best placed to deliver them (i.e. rather than Ofgem or government). A few stakeholders recommended an indicative timeline to aid understanding of how and when roles will develop over time to cover gas/the whole system. It was also raised that industry needs to have full clarity on the scope of NESO's activities in relation to resilience to prevent any disruption if an emergency situation arises, and also greater clarity on whether there would be any resource implications for other actors to support the role.

A common theme was the need for more transparency and stakeholder engagement as part of these new roles. Some stakeholders raised that NESO will need to gather input, advice, and data from relevant industry bodies, particularly the gas industry and those with prior experience, to ensure it provides appropriate advice to government and Ofgem. There were also calls for greater transparency (unless there's a demonstrable risk to system security) on any advice so industry can be informed and benefit from any learnings and analysis. There were a few stakeholders that mentioned that where emergency planning for gas is undertaken by NESO, careful alignment and expert input must be given from the gas system operator.

A few stakeholders highlighted that government seemed to be transferring some of its roles to NESO and, if so, a clear delineation is needed between the roles of government and other stakeholders, including NGT, to avoid ambiguity and duplication. It was also noted that there needs to be a clear line of accountability under the Gas Safety (Management) Regulations (GSMR)³⁷ and a few stakeholders urged extensive engagement with the Health and Safety Executive for assurance on this.

Some stakeholders suggested to carefully consider the transitional arrangements, and any handovers in roles, to ensure that it does not impact systems resilience and ability to respond in times of crisis. There was a suggestion for NGESO to shadow government or attend relevant meetings ahead of time to help with transitional arrangements.

A few stakeholders also flagged the general point that NESO needs to have sufficient expertise and resources to deliver on these roles, as well as its wider obligations. There were references to the potential of hydrogen to strengthen energy security, to the benefits of flexible management of demand and to the maximisation of data from smart meters and low carbon technologies.

³⁷ [Gas Safety \(Management\) Regulations 1996](#)

There were also suggestions for considering how the risks would impact on NESO and different pathways to the net zero energy system.

Government/Ofgem response

We are pleased that stakeholders broadly agree with our position, which remains that the proposed Day-1 NESO security and resilience functions are introduced. As an independent technical body, NESO will be best placed to provide government and Ofgem with expert and impartial advice to inform evidence-based energy policy that will ensure delivery of a resilient and secure energy system.

We recognise the concerns regarding the need for greater clarity on the detail of the proposed functions. We have engaged with NGESO and NGT over the past year to develop the detail of the proposed security and resilience functions for Day 1 and, as NESO scales up capabilities, at its end state. We will consider stakeholder comments and suggestions as we continue to engage with NESO on operationalising these roles going forward. These functions will include whole system risk identification, season ahead and emergency readiness, and post-event and post-season analysis, and we have set out more detail on these roles below to provide greater clarity:

- **Whole system risk identification:** NESO will provide annual assessments of energy system resilience covering the full range of risks facing the sector, with deep dives on areas of particular concern. The intention is for the first assessment to progress through a staged approach to completion in summer 2025. This function will also include providing DESNZ with advice on which systems, sites and assets across the electricity sector should be designated as Critical National Infrastructure (CNI). As an independent technical body with a whole system remit with specific obligations for future system planning, NESO will be well placed to carry out these functions.
- **Season ahead readiness:** NESO will carry out annual season ahead system readiness assessments. Winter ahead reporting is currently conducted separately between the electricity and gas sectors with limited technical cross-cutting oversight of winter readiness. There is also minimal cross sector assessment of readiness for summer risks, which are set to increase as the impacts of climate change (extreme heat, drought) increase and diversification of supply sources continues. NESO will be well placed to provide season ahead readiness assessments, taking a whole system view. The intention is for the first winter ahead assessment to be produced in October 2024 and the first summer ahead assessment to be produced in April 2025.
- **Emergency readiness:** NESO will advise DESNZ and industry on the state of emergency processes, identifying best practices and providing advice for how those processes can be improved. This will include consideration of regulation or existing emergency processes to ensure whole system impacts are considered and no unintended consequences. The intention is for NESO to run an initial review of emergency response processes in 2025, focussing on the electricity system, and publish their first report by end of 2025. Further annual reports will be produced annually.
- **Post event analysis:** DESNZ and Ofgem will, jointly or separately depending on the event, commission NESO to run reviews following events and emergencies that have had impacts across multiple organisations, infrastructure systems or sectors to identify

unexpected impacts and record any lessons learned. Delivery of function will be ad-hoc, based on requests from DESNZ / Ofgem. NESO will be responsible for providing analysis of the electricity sector from Day 1. The timeline for scale up of responsibility to include gas and whole energy system is still to be determined.

- **Post season analysis:** The NESO will run reviews following each winter and summer to provide analysis of performance over the season, identifying lessons for the following year. This analysis will focus on overall energy security, including the interactions across organisations, different infrastructure types or sectors. Reviews will be initiated by DESNZ and Ofgem. The first post-winter review should follow winter 2024 and cover electricity and, with the support of DESNZ / GSO, the interactions between electricity and gas. NESO intends to take on gas for the post-winter 2025 review. The first post-summer review should follow summer 2025 and will cover electricity and, with the support of DESNZ / GSO, the interactions between electricity and gas. The intention is for NESO to additionally take on gas for the post-summer 2026 review.
- NESO will, as part of the above assessments and reports, provide recommendations for mitigations to address any risks and issues identified.

NGESO delivered a public webinar on 26 February 2024 to provide stakeholders with greater clarity on the upcoming security and resilience functions and their plans for operational delivery. Following this, we will work with NGESO and NGT to provide stakeholders with further information on the detail of the security and resilience functions and their operational delivery, where relevant, including indicative timelines for scaling up NESO functionality.

In relation to the transition to NESO, plans, processes, and responsibilities for emergency response will remain unchanged for Day 1 to ensure stability and clarity. Any future change to emergency response processes and roles would be subject to further policy development and would require further engagement, including with the existing Network Emergency Coordinator (NEC) for gas. An assessment would also be needed as to whether new or amended primary legislation would be required before a change to roles would be implemented.

NGESO are making good progress building up additional resource, expertise, and structures for delivering on their 'Day 1' NESO roles and responsibilities. We are working closely with NGESO to build their capability to deliver roles and functions they are taking on from DESNZ. NGESO are also engaging closely with NGT to develop processes for taking on responsibility for elements of gas post 'Day 1'. In relation to concerns on having a clear line of accountability for Gas Safety (Management) Regulations (GSMR), we can confirm that this will remain unchanged for 'Day 1'.

We also recognise the concerns raised around transparency of NESO's advice and remain committed to ensuring NESO's functions and activities are delivered in the most transparent and balanced way possible. We will work with NESO to ensure that any advice shared with government is made available, subject to security limitations, to relevant stakeholders across industry to ensure that key lessons are learned.

6.1.2 Secretary of State directions in connection with risks related to national security

Our proposal in the consultation was for the SoS to have a power to direct the FSO (now NESO) to take, or not take, certain actions where there is a risk relating to national security that may detrimentally impact the resilience, safety or security of the energy system, or the continuity of essential services.

The question asked at consultation was: *Do you have any views on this proposed national security power, and duty on the FSO?*

Summary of stakeholder responses

Stakeholders generally understood and were supportive of the need for this power, given the importance of the energy system and continuity of essential services. However, there were some calls for more clarity on how and when SoS intended to use this power, including further detail on the scenarios in which this would be undertaken and clarity on what constitutes a ‘risk relating to national security’. A number of stakeholders also expressed the view that any political intervention in energy security and/or resilience, must only be taken as an absolute last resort, whilst ensuring that this power is not abused in any way. One suggested that the scope should be very tightly defined and be limited to long-term strategic threats.

There were a few questions on what happens if complying with this licence condition impacts other legal requirements of NESO contained in primary or secondary legislation, and therefore whether a power of this importance should be enacted in primary legislation. It was also argued by others that any actions taken by NESO should not contravene its statutory duties.

There were a few stakeholders that highlighted they thought the proposed new duty would benefit from an assessment against existing national security legislation to ensure it adds value, and further clarity on how this power would align with existing legislation. Another raised that the power should be mirrored in industry codes and would welcome further opportunities to discuss this.

A large number of stakeholders recommended that in any circumstances where the national security power is used, appropriate information is shared within the industry where appropriate to do so, to ensure relevant stakeholders are aware and updated on any potential disruptions to market activity and ensure it does not undermine investor confidence. Although there was also acknowledgement that there will be circumstances where full transparency is not possible due to the nature of national security.

There were a number of questions around the impact that this power will have on other industry participants, and whether the intention is for NESO to be instructed to require others to undertake/cease activities, e.g. via code changes. There were also questions around whether there would be a process for compensation if a decision or direction affects others negatively.

Government/Ofgem Response

We are pleased that stakeholders generally understood and were supportive of the need for this power and our position remains to include this national security provision in NESO’s licenses. In our assessment of existing legislation, we identified a limited ability to provide direction on

national security issues in the energy system³⁸, with existing legislation focussing on emergency powers where there is imminent severe risk to life. Those powers are not designed to be used pre-emptively before an emergency has taken place, whereas national security concerns may not necessarily be urgent, but rather arise out of a long-term risk that government is managing. However, the direction in connection with risks relating to national security has not been limited to long term, strategic threats as national security threats may materialise on any timescale.

We set out provision for the national security power in licences to achieve the desired policy outcome through existing statutory vires, removing the need for additional primary legislation. The national security power is not intended to override any existing legislation or national security provision, nor provide new powers for NESO to direct others, but rather to require NESO to comply with a national security direction issued by the Secretary of State where it is within its power and control. We are considering a provision for the unlikely event in which NESO's compliance with a direction incidentally results in other licensees incurring exceptional costs or rendering them unable to comply with their licence. The power, along with any such provision (if decided), will be reflected in the industry codes.

The Secretary of State could only exercise this power to issue a direction where there is a risk relating to national security that may detrimentally impact the resilience, safety or security of the energy system, or the continuity of essential services, and it is in the interest of national security that a direction should be issued to NESO. We will work with NESO ahead of Day 1 to provide more clarity on the scenarios in which the power could be used.

We acknowledge comments from stakeholders on sharing information on a national security direction to relevant parties. Where a national security threat is relevant to other parties in the sector, we will notify and advise industry stakeholders through normal channels as appropriate, with the level of detail subject to security limitations.

6.1.3 Other general stakeholder responses

Stakeholders generally welcomed the need for NESO to build up capabilities on taking a whole system approach in its roles and further energy sources and technologies. These included heat, nuclear and electric vehicles, as well as resilience and security. There were also some stakeholders who had concerns around the resourcing of NESO and their ability to take on all of these roles.

Some respondents also raised a need for clarification on gaps in skills, knowledge, and the level of resources of NESO. Many stakeholders want to ensure that any gaps within these areas are filled to ensure the required expert knowledge needed is in place in advance of Day 1.

A number of stakeholders raised concerns around the need for more transparency of NESO as well as the roles it will take on, mentioning that what has been shared so far around the roles and responsibilities of NESO by Ofgem and the Government is still not clear. Some also suggested a more effective communication with stakeholders is required on planning and preparedness.

³⁸ Electricity Act 1989 Section 7(3)(a) and Gas Act 1986 Section 7B(5)(a) may require a licence holder to comply with any direction given by the Authority or Secretary of State as to such matters as are specified in the licence or are of a description so specified.

There were calls from a few stakeholders for clarification on the roles between the different parties, with some specifically calling out for more detail on NESO's role in relation to Regional System Planning³⁹, spatial planning, future system network regulation and whole energy system.

There were a few stakeholders who expressed a need for clarification around timeframes and data transparency. Some stakeholders specifically called for clarification of when NESO will be in a position to take on strategic responsibilities for hydrogen, as well as the call for accelerated adoption of roles on hydrogen. There is concern that with little clarity on timeframes, and on when NESO would be ready to take on strategic planning responsibilities for hydrogen, there is a risk that NESO will not be able to take the critical strategic decisions to unlock investment in a timely manner.

A few stakeholders offered or expected to be involved in assisting NESO going forward, especially around bringing in new technologies.

Government/Ofgem response

We recognise the importance of ensuring that NESO is resourced and able to take on all of its planned roles. We expect NESO's role and remit will continue to evolve over time, and its ongoing capacity will need to keep pace with this. Government, together with Ofgem and the ESO, is establishing a robust process to consider potential new roles for NESO and ensure it is not overburdened at any point in time and has the time it needs to build up necessary resource and expertise. Similarly, Ofgem will also consider NESO's capacity and resourcing, and any operational impacts on existing core functions when making decisions to give NESO additional new roles.

We also understand the importance of transparency as NESO undertakes its activities. In our previous consultations, we emphasised this key aspect of NESO's decision-making, and the importance of the provision of transparent and accessible data across the energy sector. There will be roles that NESO takes on – both on Day 1 and beyond – that requires greater handling and care of sensitive data and what can be shared in the public domain, particularly in roles related to energy resilience and national security (as above). Nevertheless, we continue to emphasise the importance of ensuring NESO's functions and activities are delivered in the most transparent and balanced way possible.

We acknowledge concerns around clarification of the roles of the different parties involved. At a high-level, Government is responsible for setting energy policy direction across Great Britain. Ofgem is the independent economic regulator for the gas and electricity sector. This means they are responsible for areas such as ensuring consumer protection, enabling competition and innovation, and ensuring compliance against the regulatory framework. In the context of NESO, Ofgem will be responsible for incentivising high performance, whilst continuing to make decisions on network investment plans through existing network regulation. NESO will be the whole system planner, operator of the electricity system and expert advisor to government and Ofgem as the key decision makers. Government is developing a framework agreement which will set out the relationship between government as shareholder and NESO, which we plan to publish shortly after designation. We have consulted on the Strategy and Policy Statement (SPS), which both

³⁹ <https://www.ofgem.gov.uk/publications/ofgem-green-lights-regional-energy-planning-roles-speed-net-zero-transition>

Ofgem and NESO have a statutory duty to have regard to. This sets out our energy policy priorities to ensure strategic alignment with both organisations, and the roles and responsibilities between DESNZ, Ofgem, and NESO. The SPS was laid in Parliament on 21 February and will be designated as an official document once it has received an affirmative resolution by both Houses. The SPS, this document and the draft NESO licences provide further detail on NESO's Day 1 roles.

We appreciate all those who have offered to support and work with NESO once established. To aid transparency of its roles, NGESO has recently undertaken a number of webinars to update and gather input on how they intend for these roles to develop over time and will be further engaging with stakeholders as it develops its roles.

In December 2023, DESNZ published the Hydrogen Transport and Storage Networks Pathway⁴⁰, which set out the next steps in our vision for the strategic development of UK hydrogen transport and storage (T&S) infrastructure. This included setting an ambition for NESO to formally take on strategic planning activities for hydrogen T&S from 2026, subject to further work on the scope and detail of these activities and supporting policies. To help deliver this work, the Government is aiming to launch a consultation in summer 2024 on the scope of NESO's activities for strategic planning for hydrogen.

6.2 Response – Draft Licences consultation

We consulted on initial drafts of NGESO's ESO and GSP licences in September 2023. The consultation received 13 responses, one of which was partially confidential. We have published the non-confidential responses we received alongside this consultation, as well as a log of the Ofgem responses to all the non-confidential responses to the consultation. This section aims to summarise the major points and the points that were raised by a significant number of stakeholders, we have only addressed more minor points in the response log.

Given that much of the drafting across the ESO and GSP licences are the same, we have grouped the comments related to both licences first, followed by responses that only relate to one of the licences.

6.2.1. NESO's ESO and GSP licence

Q1. Does the draft ESO licence capture the policy intent set out by the joint 'Proposals for a Future System Operator' and 'Future System Operator: second policy consultation and project update' consultations?

Q2. Does the draft GSP licence capture the policy intent set out by the joint 'Proposals for a Future System Operator' and 'Future System Operator: second policy consultation and project update' consultations?

In this section we have summarised and responded to the comments received that apply to both of NESO's licences, the ESO and GSP licences, for example, where the same content or principle is replicated across both licences.

⁴⁰ <https://assets.publishing.service.gov.uk/media/657ad276095987000d95e0ad/hydrogen-transport-and-storage-networks-pathway.pdf>

Comments on drafting throughout the licences

Most stakeholders expressed the view, that overall, the draft licence conditions capture the policy intent set out in the joint second policy consultation and project update and reflect the provisions of the Energy Act 2023. Most respondents provided further comment on the contents of the draft licences.

A number of stakeholders expressed positive views of the approach taken to modernisation of existing NGESO licence conditions and had positive feedback on the style of the ESO and GSP licences. A DNO made a suggestion that further modernisation could be made, in line with the style of the RIIO-ED2 special conditions.

NGESO expressed the view that they 'do not think it is helpful to make reference to the FSO's 'Primary' and 'Secondary' duties in the licence'. They also said that the proposal to use the Roles Guidance document to clarify the expectations has 'limitations'. Some stakeholders raised questions about what would happen if the licence and NESO's duties in statute were in conflict.

A number of parties raised the need for transparency in their responses. The areas in particular that parties felt transparency would be important in are the advisory duty, the ISOP information request power, and balancing services. Two parties also suggested that a general transparency obligation should be introduced into the licence.

Ofgem response

We welcome that most stakeholders agreed that the licence drafting on the whole reflected the policy intent, and that they agreed with the approach we have taken to drafting the licences. We have implemented some of the further modernisation changes highlighted in responses.

We have taken onboard the feedback on the way statutory duties were referred to in the draft licences. In the current drafting we have removed the defined terms Primary Duty and Secondary Duty and have instead referred to duties under the Energy Act 2023 as a whole where appropriate. It is the Government's policy that these obligations will become relevant requirements under the Electricity Act 1989 and Gas Act 1986 which means they will be regulated by Ofgem.⁴¹ While Ofgem will consider whether NESO is meeting these obligations when assessing NESO's performance, in the licence itself we have decided to redraft the references to avoid the licence potentially coming into conflict with legislation. We have also moved away from the approach of providing further clarity on the expectations for the new NESO duties in the Roles Guidance. We have carefully drafted the licence to avoid it coming into conflict with NESO's duties in statute, but in the unlikely event this were to occur the obligations in statute would take precedence.

We agree that transparency will be important to NESO building trust in its new central role in the energy system. We have considered the suggestion to add a specific transparency licence condition, but we felt it was not appropriate to introduce a general transparency obligation given NESO will also be taking on new activities in areas like National Security where this would not always be appropriate. Ofgem intends to use transparency obligations in the incentive framework, similar to what is currently done for NGESO, to drive transparent behaviour from NESO for the activities where this would be appropriate. It is our view that the existing NGESO transparency obligations related to balancing services are sufficient for NESO, and that NESO

⁴¹ Further detail is set out in Section 2.2.1 above.

should use its judgement on what is appropriate to be made public as part of performing the advisory duty and using the ISOP information request power.

Comments on Section B: Business conduct and independence

One respondent felt that a 'backstop date within the licence to ensure there is an identifiable end-date for the Transitional Services ... may not be appropriate.' NGESO raised similar concerns related to these provisions. A number of respondents provided a wide range of specific feedback on the drafting in condition B1.

Some respondents asked for further information on the policy intent behind condition B4 (Compliance with directions related to national security). In particular, further clarification of which situations government felt the power was required for and expressed a view that the licence condition should be re-drafted to limit it to 'long-term strategic risks' and not 'short-term operational issues'.

The responses that mentioned the information ring fencing obligations were generally positive. Four respondents mentioned that the information ringfencing obligations should not be a barrier to sharing information between NESO and TOs, as well as NESO and NGT in the performance of their functions. However, three respondents did raise some concerns about the information sharing across the electricity and gas sectors under NESO, and wanted further clarity on the intent and permissions around how information gathered across NESO's two licences will be shared and used. Respondents also felt that the provision should ensure there are appropriate protections around information that NESO holds related to resilience, and information gathering from third parties as well as appropriate protections related to TSAs.

Ofgem response

Since the consultation we have done further work with government and NGESO to refine the obligations related to independence and Transitional Services in the licence. With the new drafting we are aiming to strike the right balance to ensure the independence of NESO while not making the obligations so onerous that they would need to be regularly derogated from for NESO to function. This has led to significant drafting changes to a number of conditions in Section B: Business conduct and independence, with the most significant changes coming in condition B1 (Independence Requirements and compliance obligations).

We have confirmed with government that the licence drafting in condition B4 (Compliance with directions related to national security) is in line with their policy intent, we have shared the feedback from stakeholders on areas of the policy that were felt to be insufficiently clear and these questions have been addressed in the government response to the Second Policy Consultation.

We welcome the positive response to the ring fencing provisions in this section of the FSO licences. We agree with stakeholders on the need to ensure there is appropriate protections around sensitive information, and we are also not seeking to create unnecessary barriers to information sharing, including across electricity and gas. DESNZ and Ofgem agree that part of the intention to set up NESO is that it will be a whole system body, and so we don't want to place unnecessary restrictions within NESO that will prevent it working effectively with other networks to deliver its functions (e.g. whole system planning). However, we have made some changes to the information ringfencing licence conditions drafting to strike the balance between appropriate and necessary information protections and enabling the performance of NESO's functions.

Comments on Section C: Strategic and operational functions

NGESO provided a number of comments and suggestions on the drafting of Condition C1 (Functions of the ISOP) which they feel 'could more clearly set out the roles and activities of the FSO'.

A few respondents noted some drafting issues with Condition C2 (Licensee's regard to Strategy and Policy Statement). NGESO and one other respondent asked for further clarification of on this condition.

A number of respondents requested further clarity on the licence conditions implementing NESO's functions assessing energy resilience and Critical National Infrastructure (CNI). This included questions on the scope of these functions, and the level of engagement and sharing of findings/outputs that NESO (as well as Ofgem and DESNZ) will undertake with industry and materially affected parties.

Gas Distribution Networks (GDNs) raised questions on the focus of these roles, and particularly why the drafting we consulted on in September appeared to focus on the delivery of these functions in the electricity sector. This in turn led to questions on why the conditions related to energy resilience featured in both of NESO's new ESO and GSP Licences, and how these functions would indeed cover the whole energy system. There were additional questions on what the future of the resilience and CNI roles would look like, and whether 'whole energy system' itself needed defining within the licence and the licence conditions implementing these specific functions.

Ofgem response

Since the consultation, we have done further work developing the implementation of, and the approach to the regulation of NESO.⁴² With this in mind we have redrafted condition C1 (General obligations on ISOP activities) to reflect these policy developments and to generally improve the clarity of the condition. This includes changes to group obligations into categories, ensure alignment with the Roles Guidance, and allow flexibility in the use of guidance for this condition in the future, as we develop an enduring regulatory approach. We have also made changes to ensure compatibility with NESO's statutory duties, including removing references to the statutory duties in several places.

We have corrected the erroneous drafting in condition C2 (Licensee's regard to Strategy and Policy Statement) that implied that the Business Plans were backward looking. We would also like to clarify that while both Ofgem and NESO have an obligation to have regard to the SPS, Ofgem reports to parliament, and NESO will report to Ofgem through the business plan process to avoid duplicate reporting.

Whilst the focus of NESO's energy resilience functions will be on electricity transmission on day 1, the intention is for NESO to develop its capabilities and to allow the expansion of this role across electricity and gas. Since our September 2023 non-statutory licence conditions, we have amended the drafting to be more specific to allow for the Security of State to request an expansion of this role across the whole energy system, and to speak specifically about electricity and gas when referring to whole energy system here. For this reason, we have drafted the resilience licence conditions across both ESO and GSP licences, and this is the same rationale for certain other conditions where licence obligations have been replicated across licences for

⁴² [Consultation on the policy direction for the Future System Operator's regulatory framework | Ofgem](#)

the performance of functions. This includes the CNI function on NESO, which allows a level of discretion on NESO to expand this role to assess CNI across electricity and gas.

In respect of engagement with wider industry, we have drafted clearer language across the energy resilience licence condition that Ofgem approved resilience reports and assessments must be shared to materially affected parties. This is in addition to the requirement of NESO to engage with certain industry parties in producing these reports. We have not obligated a response or publication based on Parts A and B of the energy resilience condition, as there may not be a one size fits all response on what Ofgem, DESNZ or NESO is able to share in relation to risks and threats with the wider industry. Where Ofgem or DESNZ believe a response is required for the wider industry, this will be done as clearly and transparently as possible on the basis of information received. We would also expect NESO, Ofgem and DESNZ to appropriately engage with materially affected parties if energy risks and threats need to be communicated to such parties and require additional engagement.

Since our previous consultation, the network planning and early competition related licence conditions have now been added to this section to reflect the Decision on the framework for the FSO's CSNP.⁴³

Comments on Section D: Provision of advice and information

A number of network licensees provided specific feedback on Condition D2 (Information requests by the licensee). In particular, they mentioned that 'the FSO should consult with all licensees when drafting and updating the ISOP information request statement'. A transmission owner and DNO suggested that NESO should draft 'the ISOP Information Request Statement ... in coordination with Ofgem and the TOs before it is consulted upon'. A further respondent expressed the view that 'a clear understanding of any obligations placed on other licensees in this regard is crucial.'

Ofgem response

The licence drafting makes it clear that NESO must consult with impacted stakeholders when drafting the ISOP Information Request Statement, which we feel is important. As NESO will be responsible for drafting the ISOP Information Request Statement and the related stakeholder engagement, we will pass the points raised by stakeholders on to NESO to consider. It is not our intention to place a licence obligation on other licensees to respond to ISOP Information Requests, as there is already an obligation in the Energy Act 2023 for them to do so.

Since our consultation we have decided that the Regulatory Instructions and Guidance condition should be moved to the new Section G: Regulatory reporting and assessment alongside the other regulatory reporting obligations.

Comments on Section E: Industry codes and charging

Given that the content of NESOs proposed ESO and GSP licence drafting is significantly different in the industry codes and charging sections we did not receive any comments that were applicable across the licences related to Section E of the licences.

⁴³ [Decision on the framework for the Future System Operator's Centralised Strategic Network Plan | Ofgem](#)

6.2.2. NESO's ESO licence

Q1. Does the draft ESO licence capture the policy intent set out by the joint 'Proposals for a Future System Operator' and 'Future System Operator: second policy consultation and project update' consultations?

In this section we have summarised and responded to the comments received that were only applicable to NESO's draft ESO licence.

In response to the proposed drafting of the licence conditions in Section B of the ESO licence, a respondent questioned why the term 'unduly' has been added in a couple of paragraphs in conditions B3 (Conduct of ISOP Business) and B6 (prohibition on discriminating between users).

In response to the proposed drafting of the licence conditions in Section C, a response raised the importance of the Centralised Strategic Network Plan. One respondent raised a number of concerns related to how NGESO currently perform their balancing obligations.

Ofgem response

We have added 'unduly' in some places in NESO's licences where we felt that there would otherwise be a risk of the licence being in conflict with NESO's statutory duties in the Energy Act 2023. It is our expectation that there may be times where the obligations in s.163 and s.164 in particular may mean it is NESO's duty not to take the most economical decision only, or to discriminate between users for justifiable reasons that allow NESO to carry out its duties in the Energy Act 2023.

We agree with the importance of the Centralised Strategic Network Plan and are pleased that the relevant licence conditions are now part of the draft licences we are consulting on. We have considered the feedback related to NGESO's balancing activities and believe it is outside the scope of the changes required to establish NESO. We recognise the need for NESO to promote wide access to balancing services and for implementation of balancing services to be managed well. We believe that the current framework sets suitably strong and clear requirements on the licensee to deliver on this, without stifling innovation and development of services against system needs. It is not our policy intent to change the balancing obligations materially for NESO Day 1.

6.2.3. NESO's GSP licence

Q2. Does the draft GSP licence capture the policy intent set out by the joint 'Proposals for a Future System Operator' and 'Future System Operator: second policy consultation and project update' consultations?

In this section, we have assessed and summarised comments raised on NESO's new GSP Licence, and the obligations set out. We have also provided a summary of our response.

While respondents generally agreed that our draft GSP licence captured the general policy intent, several respondents did request further detail on the proposals set out, including on the expected impact to other licences and documents. With NESO taking on new roles within the gas sector, there were several responses looking for a greater understanding of the scope of these roles, particularly in reference to the areas of strategic planning, market arrangements, resilience and security of supply.

A respondent raised concerns on the clarity of NESO's gas strategic planning role, including around accountabilities and managing potential duplication and differing views of planning assumptions. The GDNs also requested clarity on defining gas strategic planning for NESO, particularly looking for greater delineation and understanding on what activities will be performed at the gas transmission and distribution levels.

GDN respondents also asked about the specifics on the market arrangements condition, including the clarity of scope and what the crossover was between this new function and code governance reform, the future Regional Energy Strategic Planner (RESP) role and any of the commercial arrangements in the UNC.

Respondents also raised questions on the area of gas supply security. This included responses from GDNs on NESO's new medium term gas supply security assessment, asking about whether this should consider interactions across electricity and hydrogen, and further clarity on whether this would be planning at the transmission or distribution level. Two GDNs also asked about the interaction between NESO's functions, its new statutory duty on security of supply and the existing duty on gas transporters to plan networks to a 1-in-20 security standard.⁴⁴ These respondents reiterated the importance of NESO planning the network in line with the 1-in-20 standard on the same basis as other gas transporters.

Two respondents raised questions on NESO's relationship with the UNC and our proposed drafting, which suggested slightly different arrangements to our policy intent for NESO to become a new class of party to the UNC. Three respondents also suggested that there would be impacts on existing UNC governance and modification rules, and that there may be need to review the licence conditions in the Gas Transporter Licence: Standard Special Conditions (Part A) covering UNC arrangements, Joint Office Governance Arrangements, and the Central Data Services Provider within the existing gas transporter licence. One respondent advised to avoid making major changes to the UNC prior to Code Governance Reform.

Ofgem response

With the publication of our non-statutory consultation to other impacted licences in December (as well as changes to other licences forming part of this statutory consultation), we have been able to review these consultation responses against the overall licence framework. For instance, we have provided greater clarity on NESO's gas strategic planning role by publishing our proposed changes to NGT's Gas Transporter Licence Special Conditions and highlighting the interaction and trade-offs in strategic planning between NESO and NGT. Nevertheless, we do recognise that changes to industry codes and to associated documents will provide further detail on NESO's new gas functions, and these proposed changes will be shared as part of future consultations.

We acknowledge the comments on greater detail on NESO's gas strategic planning role and understanding the delineation at the transmission and distribution levels. We have therefore amended the language in NESO's licence condition obligating its strategic planning to focus the outputs more specifically on assessing the National Transmission System, and more directly ensure its planning outputs have regard to the 1-in-20 security standard. We have also included text for NESO's medium term Gas Supply Security Assessment to consider long-term arrangements as appropriate and redrafted the condition on NESO's gas market arrangements

⁴⁴ Gas Transporters have licence obligations to ensure that their pipeline system must, taking into account tools and operational mechanisms available to the Gas Transporter, to meet a peak aggregate daily demand only likely to be exceeded in 1 in 20 years (winters).

to be clearer and more reflective of the Future of Gas (FoG) and Gas Markets Plan (GMaP) it will be delivering.

As part of this statutory consultation, we confirm our policy position for NESO to accede to and become a new class of party to the UNC. We believe the changes proposed in the GSP Licence and in the Gas Transporter Licence Standard Special Conditions (Part A) cover the necessary arrangements to ensure NESO becomes a new class of party to the UNC. We have also amended the existing conditions here to enable NESO to propose modifications, provide a UNC Panel representative and have access to the CDSP, as well as other amendments to capture the impacts in licence on UNC governance and rules. We do appreciate that changes to the UNC itself and to the UNC modification rules will be required to fully enable this proposal, and these changes are being worked through as part of the Cross-Code Working Group.⁴⁵ Changes to the UNC (and to other industry codes) will form part of a future statutory consultation. Also, whilst we do not want to inhibit or obstruct future changes that may come from Code Governance Reform, we propose making the necessary changes in the UNC to reflect NESO becoming a new class of member, and ensure the organisation has a balanced, critical whole system roles across both electricity and gas industry codes.

6.2.4. Approach to associated documents

Q3. Do you have any other views or comments relating to the proposed approach to associated documents?

NGESO expressed the view that our initial view of likely changes is reasonable but highlighted further documents to consider. Another respondent suggested a workgroup should be formed to support the update of the associated documents, while other respondents requested more clarity on the process that will be followed to update the associated documents.

Ofgem response

We welcome the feedback from NGESO and have added the documents they have suggested to our list to consider when we are updating associated documents.

We do not have plans at this time to convene a working group to support the redrafting of associated documents as we don't feel this would be proportionate, but we plan to follow the normal modification processes as set out in the licences. Further detail on the timeline for these changes can be found in the 'Next Steps' section of this document.

6.2.5. Consequential impacts

Q4. Have we correctly identified the major consequential impacts of the FSO licence proposals on other licences? Any further comments are welcome.

Overall stakeholders felt it was difficult to form a full view at this stage of whether we have correctly identified the major consequential impacts, but with the caveat that several felt that we had broadly identified the correct impacts. Some respondents noted that further changes may

⁴⁵ As part NESO implementation, we have established a Codes Change Programme. Further details of this can be found here: [Decision letter for Ofgem's Call for Volunteers – FSO Codes Change Programme](#)

be required to support the financial and network planning changes that were not included in this consultation.

NGESO and one other respondent also provided further details on licences and definitions that they felt may be impacted.

Ofgem response

Since this consultation was published, we published a further consultation with draft impacts on other licences where we took onboard the feedback we received here.

6.3 Response – policy direction for NESO’s regulatory framework

On 14 December 2023, Ofgem published a consultation on the ‘Policy direction for the Future System Operator’s regulatory framework’.⁴⁶ This sought views on the key features of NESO’s funding model and financial regulation, as well as Ofgem’s emerging thinking on the regulatory mechanisms that should be used to steer and manage NESO’s performance.

Ofgem’s consultation proposed that NESO should operate under a not-for-profit regulatory framework and be funded by consumers using a ‘fast money’ approach (where all forecast costs are recovered through charges in the year NESO expects to incur them). The consultation also set out Ofgem’s view on the case for changes to the existing approaches used to regulate NGESO and its intention to focus on the use of robust and appropriately targeted reputational incentives to drive NESO’s performance. Ofgem considered that changes should be introduced in a phased manner; prioritising the most critical aspects for Day 1 and introducing broader changes following the conclusion of NGESO’s current business plan period in April 2025, with further changes following the end of the RIIO-2 price control period in April 2026.

Below we set out a summary of stakeholder responses to the four questions Ofgem asked and Ofgem’s response.

6.3.1 NESO’s financial framework

The question asked at consultation was: *Do you have any views on our proposed financial regulatory framework for the FSO?*

Summary of stakeholder responses

Overall, stakeholders broadly agreed with our proposed financial regulatory framework, including the not-for-profit approach, and proposal to fund NESO using a fast money method. However, some stakeholders expressed some concerns about the impact of fast money funding on the volatility of Balancing Services Use of System (BSUoS) charges and whether it could create barriers to longer term investment.

Several respondents asked for more detail on how the funding approach would work in practice, including how the Government would ensure NESO is able to manage its short term cashflows;

⁴⁶ [Consultation on the policy direction for the Future System Operator’s regulatory framework | Ofgem](#)

how this would impact existing industry charging arrangements; and how cross-cutting costs would be allocated between electricity and gas charges.

Ofgem response

We intend to implement the financial framework outlined in our December consultation. This is because we continue to believe this framework will best achieve our objectives for NESO and maximise benefits for consumers (as explained further in the rationale sub section of Chapter 2 of that consultation document), and also given the broad support from stakeholders. We note the caution from some stakeholders about a fast money model. Based on the nature of NGESO's capital investments (and going forward our expectation of NESO's expenditure), we don't consider this will lead to unmanageable charge volatility. However, we will keep this under review and could consider bespoke funding solutions for certain investments in future if it is clear this is needed. We also do not consider a fast money approach would create barriers to long-term investment by NESO, as through the NESO business planning process both NESO and Ofgem will have clear incentives (including through their respective statutory duties) to bring forward and facilitate investment which provides benefits to the energy system and consumers.

As noted in section 3.1, government can confirm that from Day 1 it will provide an appropriately sized working capital facility to allow NESO to manage differences between revenues collected through BSUoS charges and actual incurred expenditure. This is in line with the approach used for NGESO today (with National Grid plc currently providing NGESO with a working capital facility), and Ofgem are not planning to change the existing BSUoS charging arrangements or fixed tariff regime as part of the implementation of NESO. To ensure costs are appropriately allocated between electricity and gas charges, we intend to require NESO to produce and follow a cost allocation methodology which is approved by Ofgem. Further details on this are set out in the proposed licence conditions.

6.3.2 NESO's performance regulation

The question asked at consultation was: *Do you have any views on our emerging thinking on how we should regulate the FSO, including our objectives, the case for change, and potential future options?*

Summary of stakeholder responses

Overall, stakeholders largely agreed with our emerging thinking on the overall direction of travel for regulating the performance of NESO in the future, including our suggested objectives and case for change. Although most respondents generally welcomed a focus on outcomes and more streamlined/targeted approaches to regulatory assessments in the future, there was a general concern from a number of stakeholders about adopting a 'lighter touch' regulatory model. This was particularly in the early stages of NESO's existence and for areas where there are ongoing concerns about NGESO's current performance. A number of respondents suggested that regulation would need to be dynamic and responsive to the level of performance concern, with more detailed regulatory oversight on areas where there is greater concern.

Several respondents noted that the removal of financial incentives meant there needed to be effective alternative regulatory methods, and requested more specific details on how Ofgem would design reputational incentives that are sufficiently robust. Most supported a regular public

Ofgem assessment of NESO and for there to appropriate links between regulatory outcomes and NESO's staff incentives.

Several stakeholders stressed the continued importance of robust cost oversight by Ofgem to ensure NESO is incentivised to avoid excessive costs to consumers, with some suggesting the need for annual cost thresholds/benchmarks with links back to incentives.

Ofgem response

We appreciate respondents' initial feedback on our direction of travel for NESO performance regulation. This will inform our next stage of more detailed policy development on the enduring approach to NESO regulation which we plan to introduce in phases over the course of the next two years. We plan to work further with stakeholders to discuss more specific details and approaches to reputational incentives.

We recognise the concerns from some stakeholders in relation to the case for lighter touch regulation. For the avoidance of doubt, we still consider that NESO needs to be clearly accountable for its performance and that there should be firm consequences in the event of underperformance. Nevertheless, we believe that there are elements of the current NGESO framework (including some reporting and assessment approaches) that are a mainly a by-product of a for-profit regime. Our aim is to shift our regulatory focus firmly onto the areas that matter most. This may mean that rather than receiving and assessing a granular amount of detail by default, we target key areas and more strategic indicators (including industry feedback) but maintain our ability to delve further into details as and when required.

We also agree that the framework needs to be dynamic, and where there are areas of clear ongoing performance concern then that may merit the application of more targeted and detailed regulatory oversight. From Day 1, Ofgem will still have existing powers in relation to information gathering and the ability to adapt and change regulation in response to emerging situations. For example, we consider our regular scrutiny of NGESO's IT delivery and expenditure (via the Cost Monitoring Framework⁴⁷) should continue for NESO from Day 1.

We agree that Ofgem has an important role assessing the cost efficiency of NESO's activities. NESO will be required to submit plans and reports justifying its expenditure which we plan to assess both ex-ante and ex-post as part of our regulatory processes. We also intend to reinforce licence obligations on NESO to not incur inefficient expenditure in the absence of financial disallowance powers (as set out in Condition F1 or our proposed licence conditions).

6.3.3 NESO's accountability to stakeholders

The question asked at consultation was: *What role should industry stakeholders and external parties have in holding the FSO to account, and what platforms are needed to achieve this?*

Summary of stakeholder responses

Almost all respondents commented that stakeholders and external parties should play a strong role in holding NESO to account, particularly with the removal of financial incentives. Respondents felt that stakeholder views should continue to be a key input into NESO's performance evaluation and should be published for transparency.

⁴⁷ [The Electricity System Operator Reporting and Incentives Arrangements: Guidance Document \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/publications/consultations-published-and-forthcoming/2022/04/the-electricity-system-operator-reporting-and-incentives-arrangements-guidance-document)

Many respondents suggested the continued need for a regularly scheduled stakeholder panel/forum/group for NESO to hear the views of its stakeholders. A few stakeholders mentioned the need for these to have diverse representation so that the interests of smaller entities and new entrants are not excluded. Some respondents suggested different platforms may be needed to existing approaches, such as a public assessment by a shareholder committee or international comparators.

Several respondents noted that in order for stakeholder and external parties to effectively hold NESO to account, it was important that there is transparency around NESO's plans, decision-making processes and outputs (such as its methodologies and models).

Ofgem response

We recognise the importance of stakeholder scrutiny and feedback for holding NESO to account. This feedback should support and inform Ofgem's regulation and help ensure we are placing our focus in the right areas. We also note the important role stakeholders have within the regulatory frameworks of other comparator organisations to NESO, such as independent system operators in other countries.

From Day 1 to April 2025, Ofgem intends minimal change to the existing opportunities stakeholders have to influence NGESO's performance assessments (such as the stakeholder survey, regular call for evidence, and the Performance Panel). Ofgem will continue to engage with stakeholders on how arrangements should develop as we move towards an enduring regulatory framework from April 2025 onwards. We also agree that transparency is an important enabler for wider external scrutiny and will take these views into account as we develop more detailed enduring reporting requirements.

6.3.4 Implementation NESO's regulatory framework

The question asked at consultation was: *Do you have any views on our approach to implementing changes?*

Summary of stakeholder responses

Overall, a substantial majority of respondents agreed with the phased approach to implementing the regulatory framework outlined in our consultation. Reasons given included the relative short timescales to Day 1, the need to minimise delivery risk, and a desire for stakeholders to be consulted on major changes. Other respondents noted that the extent of changes should reflect levels of trust in NESO and how this develops over time.

A few stakeholders, including NGESO, mentioned the need to ensure the regulatory framework from Day 1 reflects NESO as a new organisation, including its new roles. They noted there could be potential risks from moving too slowly and not making more fundamental changes to performance regulation from Day 1, particularly if any current elements have been identified as not fit for purpose.

Ofgem response

We continue to consider that the phased implementation approach outlined in our December consultation is most appropriate, particularly given the support for this from most respondents. We have not identified any material risks to consumers through our preferred phased implementation approach. Moreover, we consider that there is a risk from hastily delivering major

changes without time for sufficient policy development, particularly given the importance of ensuring that NESO has legitimacy in the eyes of the wider energy industry.

We recognise comments about the importance of ensuring the performance framework captures all NESO roles from Day 1. We consider this can be achieved through targeted changes to the existing performance regulation regime for NGESO rather than major change immediately from Day 1.

Our draft licence sets the foundation of NESO's not for profit regulatory framework for Day 1. We plan to implement many of the detailed aspects of NESO's reporting and performance regulation arrangements through further consultations on associated licence documents from Spring onwards. The changes to the NGESO framework that we plan to introduce at Day 1 for NESO through the licence, associated documents to the licence and enforcement guidelines include:

- Material changes to the financial and funding framework for NESO to reflect its not-for-profit status;
- Updates to enforcement guidance to clarify the approaches used for NESO;
- Replacing cost disallowance powers with new licence obligations in relation cost inefficiency;
- Removal of the financial elements of the current NGESO 2023-25 incentives scheme, so that it concludes as a reputational scheme;
- Targeted changes to the current performance assessment approach to include additional assessment of how well NESO has developed and undertaken its new roles and established itself as an independent entity;
- Additional requirements for NESO to set out in its remuneration policies how it will take account of Ofgem regulatory outcomes in its senior staff remuneration;
- The key foundational requirements for the next, new business plan submission by NESO in April 2025; and
- targeted changes to remove clearly unnecessary reporting burden and processes that do not create value.

6.4 Response – Amendments to other licences consultation

Ofgem consulted on initial drafts of the impacts on other licences from the creation of NESO in December 2023. The consultation received 9 responses, one of which was confidential. We have published the non-confidential responses we received alongside this consultation, as well as a log of the Ofgem responses to all the non-confidential responses to the consultation. This section aims to summarise the major points and the points that were raised by a significant number of stakeholders, we have only addressed more minor points in the response log.

6.4.1. Impacts on other licences

Q1. Have we correctly identified the impacts of the FSO licence proposals on other licences?

Most respondents who provided a view felt that the main impacts of the NESO licence proposals on other licences had been identified in our consultation. Two respondents highlighted that new roles for NESO, such as the CSNP, could lead to impacts on other licences. NGESO felt that

further consideration is needed to 'ensure that the actions of ESO taken before its change in ownership and designation as the ISOP will still take effect under the relevant licence.'

Ofgem response

We welcome this feedback from stakeholders. It is not our intention that the changes to other licences required to implement the CSNP will form part of NESO implementation changes to other licences. The majority of these changes will be taken forward by Ofgem separately, but we have proposed one immediate change to National Gas Transmission plc's (NGT) Gas Transporter Licence Special Conditions in relation to NESO delivering its Future Energy Pathways. We agree with NGESO that the continuity of NGESO's existing activities as they transfer to NESO is important and government has set out the details of the licencing direction that will give this effect as an Annex to this document.

6.4.2. Further amendments

Q2. Are you aware of any further amendments that may be required to other licences?

Most respondents did not raise further amendments that they felt would be required to the other licences to enable the implementation of NESO. Of those that did, one mentioned that references to the innovation funds would need to be updated in line with the financial conditions. Two provided further detailed comments. A further respondent mentioned that further changes will be needed to the industry codes and related documents.

Ofgem response

We welcome this feedback from stakeholders, we have addressed the further detailed comments, along with all the feedback received in the log published alongside this document. We agree that further changes will be needed related to innovation funding, which have been incorporated into the latest draft. We also agree that changes will be needed to the industry codes, which are being taken forward in the Cross Code Working Group.⁴⁸

6.4.3. Additional comments

Q3. Do you have any other comments?

Most respondents provided further comments. In this section we have grouped them together by theme to aid understanding.

NESO's Gas Functions and the Uniform Network Code (UNC)

One respondent recognised that the most material changes being proposed in relation to NESO's new gas functions were in NGT's Gas Transporter Licence Special Conditions, principally to enable NESO's gas strategic planning process. This respondent did suggest further consideration on some of the text in NGT's Special Conditions, including on the publications and outputs, and treatment of confidential information in the strategic planning process, as well as commenting on the Transmission Planning Code (TPC) requirements of NGT's Licence in light of NESO becoming a key stakeholder in respect of the TPC.

⁴⁸ [Decision letter for Ofgem's Call for Volunteers – FSO Codes Change Programme | Ofgem](#)

One respondent focused their comments primarily on the Uniform Network Code (UNC). This response outlined support with the proposition of creating a relationship between NESO and UNC, but did raise concerns over the creation of a new class of UNC signatory and how this aligns with current governance. The respondent outlined that further work and thought would be required to facilitate NESO's accession to the UNC, and consideration of the impact on governance arrangements like UNC Panels, referring to the day 1 proposal for NESO to be a non-voting UNC Panel representative. The respondent also asked about future intentions for NESO to become a UNC Panel voting member, and to discuss other UNC obligations that may need to apply to NESO (specifically referring to the Joint Office Governance Arrangements in the Gas Transporter Licence).

Another respondent did recognise that in order to facilitate NESO's strategic planning, further changes would be needed to the UNC itself to enable this. Both of these respondents did also comment on the future relationship between Ofgem and NESO and how this might impact the independence of NESO in relation to its UNC related activities. Their comments also requested Ofgem's view on NESO's relationship with the regulator in respect of NESO raising UNC modification proposals, and the interaction with Ofgem role in the UNC, and both parties having regard to strategic priorities issued by government.

Ofgem Response

In response to the comments received in this non-statutory consultation, we have made further changes to NGT's Gas Transporter Licence: Special Conditions. These changes intend to clarify the details, interactions and outputs as part of NESO's gas strategic planning process, as well as establish more appropriate treatment and sharing of confidential information (alongside changes we have proposed to the GSP Licence) between NGT and NESO. We have also proposed a change to reflect NESO's production of its Future Energy Pathways in the gas sector in Special Condition 9.21.⁴⁹ We have also made a change to outline NESO as a named party to consult when reviewing the TPC.

Our proposal remains that NESO will become a new class of party and accede to the UNC. We welcome the support of this proposed relationship, and equally recognise that further work and changes will be needed to the UNC and its wider framework and governance to ensure the success of NESO acceding to the UNC. As highlighted above, changes to the industry codes are being taken forward in the Cross-Code Working Group, and the UNC changes will form a part of a future statutory consultation. Although we are aware the implementation of NESO will have an impact on industry relationships and arrangements, Ofgem will continue to assess UNC modification proposals from any party with the same level of regulatory independence, and against the relevant objectives, as we currently do.

We do recognise the points raised by consultation respondents that changes to other elements and obligations of the UNC framework should be considered. We remain of the view that NESO should provide a non-voting representative to UNC Panel on day 1. Any change to this position should be considered in longer time (post day 1) once more careful thought has been given to the impact a voting representative may have on the balance of the UNC Panels. We have made additional amendments to the Gas Transporter Licence: Standard Special Conditions (Part A). The changes reflect NESO having access to the Central Data Services Provider (CDSP) and signing a Data Services Contract as part of NESO's proposed UNC membership. Other more

⁴⁹ Gas forecasting on a Y+1 basis is currently obligated in NGT's licence, and subsequently discharged via the Future Energy Scenarios. With NESO delivering the Future Energy Pathways under the GSP Licence, we have removed the need for NGT to produce the gas future energy scenarios in its licence.

minor amendments have been made to the Gas Transporter Licence: Standard Special Conditions (Part A) and to the Gas Transporter Licence Standard Conditions following consideration of consultation responses.

Security and Resilience

One respondent raised the view that Secretary of State's power to instruct NESO to take certain measures in response to issues related to national security 'may equally have the consequence of impacting the ability of electricity network licensees to comply with their Licences, so similar powers for licence derogations for network licenses should be introduced and applied as required.' The respondent also raised that they believe that NESO's system security and resilience roles should 'be one of collaboration and coordination alongside TOs' due to the 'extensive experience with planning system resilience' of network licensees.

Ofgem response

Ofgem have conferred with government colleagues and they have confirmed their policy intention is that directions related to national security to NESO will not impact other licences to the extent that changes to other network licences are required. We agree that NESO will need to coordinate and collaborate with networks to deliver its system security and resilience roles.

Chapter 7: Next Steps

For the purpose of this statutory consultation, the earlier chapters and descriptions focus on providing an overview of our considerations when designing new elements of the regulatory framework or amending current components. This is with the intention of making it easier for stakeholders to engage with these considerations and our decision-making process.

We are aware that the detailed regulatory framework and connected documents provide helpful context to these considerations. We have therefore included these as annexes to the main consultation document. The complete list of these documents is outlined and explained below. This consultation focusses on the creation and modification of licence conditions.

Further regulatory changes will be required to establish NESO, which will include updates to various Associated Documents. This may include some of those listed in the Reasons and Effects document (Annex B). We intend to consult on relevant Associated Documents and on code modifications in due course.

7.1 NESO licences (GSP and ESO)

Following consultation close, we will consider responses received which will be published on the DESNZ and Ofgem websites, unless marked confidential. Following NESO licences taking effect, they will be published on DESNZ and Ofgem's website. A decision notice will be published specifying when the modifications will be in effect.

7.2 Other impacted licences

Similarly, for other impacted licences, following consultation close, and consideration of any responses, a decision notice will be published specifying the date the modifications will be in effect.

7.3 Licence direction

As described at section 4.6 above, the Government proposes to make a licensing direction by which the existing transmission licence of NGESO is converted into NESO's electricity system operator licence. This consultation operates as a consultation by the Secretary of State under Section 167(6) of the Energy Act 2023 in respect of the proposal to make a licensing direction. The form of licensing direction is set out in Annex C. The terms of the licence (see Annex D) and the conditions of the licence (Annex E) will be scheduled to the licensing direction.

7.4 Annex table

Annex Reference	Document Title
A	Notice of statutory consultation for NESO and other impacted licences
B	Reasons and effects
C	Electricity System Operator Licence Direction
D	Electricity System Operator Licence Terms
E	Electricity System Operator Licence Conditions
F	Gas System Planner Licence Terms
G	Gas System Planner Licence Conditions
H	Licence Drafting Principles
I	Electricity Transmission Standard Licence Conditions
J	National Grid Electricity Transmission plc Special Conditions
K	Scottish Power Transmission and Scottish Hydro Electric Transmission Special Conditions
L	Electricity Generation Standard Licence Conditions
M	Electricity Interconnector Standard Licence Conditions
N	Electricity Supply Standard Licence Conditions
O	Electricity Distribution Standard Licence Conditions
P	Smart Meter Communication Licence
Q	National Gas Transmission plc's (NGT) Gas Transporter Licence (Part C) Special Conditions
R	Gas Transporter Standard Special Conditions (Part A)
S	Gas Transporter Standard Licence Conditions
T	All Electricity Distribution Special Conditions (including additional changes to Scottish Hydro Distribution Special Conditions only)
U	All other Gas Transporter Licence Special Conditions
V	Analytical Annex of Additional NESO Roles

Glossary

ANCAR	Annual Network Capability Assessment Report
DESNZ	Department of Energy Security and Net Zero
CBA	Cost Benefit Analysis
CNI	Critical National Infrastructure
CSNP	Centralised Strategic Network Planning
Day 1	The first day of the NESO (i.e. the effective date of designation of the ISOP)
Day 2	The Day when NESO has exited the Transitional Service Agreements and is operating its business services completely independently from NG plc., with Long Term Agreements remaining in place where appropriate.
Electricity distribution	Electricity distribution networks carry electricity from the high voltage transmission grid to industrial, commercial and residential buildings.
Energy Act 2022	The Energy Bill which received Royal Assent on 26 October 2023, and which sets the overarching legislative framework for the NESO.
EMR	Electricity Market Reform
ESO	Electricity System Operator
FEP	Future Energy Pathways
FoG	Future of Gas
FSNR	Future System Network Regulation
FSO	Future System Operator – Previous working name for NESO
GDN	Gas Distribution Network
GFOP	Gas Future Operability Planning
GMaP	Gas Market Action Plan
GSO	Gas System Operator
GSP	Gas System Planner
GTYS	Gas Ten Year Statement
IA	Impact Assessment
ISOP	Independent System Operator Planner (NESO described in the Energy Act 2023)
LTA	Long Term Agreements
NEC	Network Emergency Coordinator
NESO	National Energy System Operator (the working name was previously Future System Operator (FSO))
Net zero	Refers to the balance between the amount of greenhouse gas produced and the amount removed from the atmosphere. The UK is required by law to reach net zero carbon emissions by 2050.
NG plc	National Grid plc
NGESO	National Grid Electricity System Operator Limited
NGT	National Gas Transmission plc
NOA	Network Options Assessment

Statutory Consultation on National Energy System Operator (NESO) Licences and Other Impacted Licences

RAV	Regulated Asset Value
RIIO	Revenue = Incentives + Innovation + Outputs
SoS	Secretary of State
SPS	Strategy and Policy Statement
SSEP	Strategic Spatial Energy Plan
T&S	Transport and storage
TSA	Transitional Service Agreement
UNC	Uniform Network Code
WACC	Weighted Average Cost of Capital

This consultation is available from: <https://www.gov.uk/government/consultations/national-energy-system-operator-neso-licences-and-other-impacted-licences-statutory-consultation> or www.ofgem.gov.uk/energy-policy-and-regulation/policy-and-regulatory-programmes/future-system-operation-fso

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