

## WHERE ARE WE WITH CATOS AND WHAT CAN WE LEARN FROM OFTOS?

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When we planned this series, we were hoping to include as the eighth instalment, an analysis of the revised environmental regime post-Brexit and its impact on the OFTO regime. However, the changes that we expected to be announced in late 2020 have not yet materialised. We will be keeping an eye out for those changes, so there is likely to be an addendum to this series in due course.

We are also closely following the UK Hybrid Forum and the work being done as part of the Offshore Transmission Network Review<sup>1</sup>. We look forward to providing further updates in due course, as the questions around coordinated transmission grids (coordinated as between wind farm sites and coordinated with country to country interconnectors) are, and will remain, of key relevance to readers of these articles in our OFTO series.

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### WHAT IS A "CATO"?

Currently, onshore transmission assets in Great Britain ("GB") are delivered by three Transmission Owners ("TOs"): National Grid Electricity Transmission ("NGET") in England and Wales, SP Transmission in the south of Scotland, and Scottish Hydro-Electric Transmission in the north of Scotland.

Following early successes and savings delivered by the OFTO regime, Ofgem launched the Extending Competition in Transmission ("ECIT") project in early 2015 to

*"introduce additional competition in the delivery of new, separable, and high value onshore electricity transmission investment"*<sup>2</sup>.

This project developed the policy that was intended to deliver onshore transmission assets by a Competitively Appointed Transmission Owner ("CATO"). Loosely put, the CATOs were set to become the onshore version of the OFTOs. In its January 2018 *Update on competition in onshore electricity transmission*, Ofgem referred to its June 2017 update which stated that it was *"deferring further development of the Competitively Appointed Transmission Owner (CATO) regime until the timing of the necessary legislation is more certain"*<sup>3</sup>.

The delay in enacting the primary legislation required to implement the CATO regime is hardly surprising – parliamentary time has been monopolised by Brexit for the last few years. With the transitional period over, and Brexit now a reality, we (and no doubt the rest of the energy industry) have high hopes for the next energy bill; however, enabling delivery of carbon capture and storage, and hydrogen are both high on the agenda, and it is therefore not clear whether the CATO regime will be prioritised.

In any case, the delay has given the OFTO regime further time to mature, and has also given stakeholders (including Ofgem) time to learn the lessons from that mature market. It is vital the lessons learnt from the OFTO regime are transferred to the CATO regime once enacted.

## IDENTIFYING THE CATO ASSETS

Identification of an asset to be tendered under the CATO model is more complex than identifying OFTO assets (although there have been situations to date where it has proved difficult to precisely delineate between Generator and OFTO assets). While a new offshore wind farm clearly needs a connection to the grid, the OFTO regime has not delivered an integrated offshore network that might provide a model for identifying assets in the onshore context. The policy papers published to date state that suitable assets would be “*new, separable and high value*”<sup>4</sup>:

**"Identification of an asset to be tendered under the CATO model is more complex than identifying OFTO assets."**

- *New: Construction of transmission asset where none currently exists or where the new assets will completely replace existing ones;*
- *Separable: Ownership boundaries can be clearly delineated, so responsibility for each asset can be clearly established; and*
- *High Value: The expected project capital expenditure is £100m or greater.*

For an “indicative view” of the CATO project pipeline, Ofgem directs stakeholders to its website for “Strategic Wider Works” projects<sup>5</sup>, and also directs stakeholders to the Network Options Assessment<sup>6</sup> undertaken by National Grid Electricity System Operator.

With OFTO projects becoming larger and more complex, a true offshore network may yet develop, and the principles for asset identification that are applicable to the CATO regime may end up being applied to the OFTO regime in due course. The delineation of assets issue will become even more challenging when coordinated/hybrid projects are realised.

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## THE TENDER PROCESS

Under the OFTO regime, a developer who wants to build an offshore wind farm approaches Ofgem to request that a tender is started. It is the developer’s choice whether that is a tender for an OFTO build or generator build tender (although to date only the generator build model has been adopted). The CATO regime differs in that the existing TO in the relevant country will identify potential projects, carry out feasibility studies and obtain planning permission.

Since CATO projects will in many cases be reinforcements or upgrades of particular sections of the National Electricity Transmission System (“NETS”), it is unlikely that there will be a single generating station that faces the risk of stranding if the project is delayed or if it fails. In addition, there is no alternative onshore that allows a generator to build its own transmission links or reinforcements – these would always be built by the relevant TO. The CATO regime simply aims to choose the best TO to do that job rather than relying on incumbents.

In contrast to the OFTO regime, which as mentioned has yet seen an OFTO build model put to use, the CATO regime is only CATO build, either late in the process after planning permission has been obtained by the relevant TO or much earlier when the TO has carried out feasibility studies. It may be that the CATO regime overtakes the OFTO regime in this respect, and that lessons learned under the CATO regime can be passed back to the OFTO regime once the CATO regime is up and running, as analysis of performance, speed of delivery and issues that arise might finally unlock the OFTO build model.

## PROPERTY ISSUES AND PROPERTY RIGHTS

While the OFTO regime requires land rights to be acquired onshore and offshore, the CATO regime is simpler as only onshore rights are required, cutting out some of the complexities that comes with offshore rights, such as identifying owners of crossed or proximate cables and pipelines (which has always proved more difficult in an offshore environment).

In addition, the CATO will be licensed and able to deal with landowners directly to acquire the rights that it needs, giving it appropriate statutory powers to smooth this process.

Our **earlier article** on acquisition of property rights for OFTOs explores these issues in depth.

## REVENUE AND REVENUE ADJUSTMENTS

Licensing and the revenue mechanisms for CATOs will bring a lot of interesting issues. Strategic Wider Works already have the ability to impact projects connecting not only to the NETS but also to distribution networks; reinforcements on the NETS mean such works can be avoided or delayed on distribution networks, thereby reducing costs for embedded generation projects. Network charging (across distribution and transmission networks) has been at the heart of Ofgem’s Targeted Charging Review<sup>7</sup> and Network Access and Forward-Looking Charge Arrangements<sup>8</sup>.

With the proposed CATO tender revenue stream of 25 years (in line with the current OFTO tender revenue stream), this will be out of sync with the eight-year price controls that apply for onshore TOs. This will inevitably have a knock-on impact on pass through of costs and distribution of network charges – local charges for specific users, and the “residual” charge that is paid by all users. Some of these issues were explored in our **earlier article** on income adjusting events.

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One of the most critical issues for both the OFTO regime and the CATO regime is what happens at the end of the allowed revenue stream. Ofgem recently (11 March 2021) issued a consultation on the OFTO regime, considering “*the possibility of extending the regulatory revenue period and how any such process should be operated*”. The consultation<sup>9</sup> closes 13 April 2021, and the key issues being considered are “*whether extensions to the regulatory revenue periods should be granted, whether assets could be re-tendered, and whether a new tender revenue stream should be established*.”

As this work stream kicks off, Ofgem states it expects to issue a more detailed consultation later in 2021, and it is likely that whatever is decided for the OFTO regime will be carried across to the CATO regime.

## KEY TAKE AWAYS

Although the OFTO market is mature and CATOs have not yet kicked off, there will be lessons to be learned both ways, and an opportunity to align regimes and simplify regulation.

Projects exist to do this: the ongoing ECIT project and the Offshore Transmission Network Review that was launched by the Department of Business, Energy and Industrial Strategy (BEIS) in July 2020. Their work is ongoing and there is still time to get involved.

If you would like to discuss any of the issues raised in this article or in the rest of the OFTO series, please contact the authors or email us **here**. All of the articles published in our OFTO series can be found **here**.

[1] Offshore transmission network review – GOV.UK ([www.gov.uk](http://www.gov.uk))

[2] [https://www.ofgem.gov.uk/system/files/docs/2018/01/competition\\_update.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/01/competition_update.pdf)

[3] Ibid

[4] FACT SHEET for ECIT Policy ([ofgem.gov.uk](http://ofgem.gov.uk))

[5] Strategic Wider Works | Ofgem

[6] Planning the future electricity network through our Network Options Assessment | National Grid ESO

[7] Targeted Charging Review: Significant Code Review | Ofgem

[8] Reform of network access and forward-looking charges | Ofgem

[9] Offshore Transmission Owner (OFTO) End of Tender Revenue Stream – Consultation concerning policy development | Ofgem

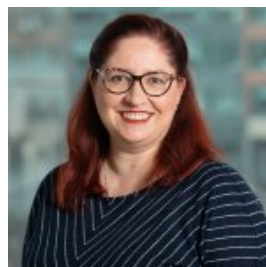
## KEY CONTACTS



**MARTIN LUCAS**  
PARTNER • LONDON

T: +44 20 7814 8101

[mlucas@wfw.com](mailto:mlucas@wfw.com)



**MARIANNE ANTON**  
COUNSEL • LONDON

T: +44 20 3314 6330

[manton@wfw.com](mailto:manton@wfw.com)

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