

Insights

THE WAIT FOR CATOS IS NEARLY OVER... VOLUME 4

Sep 17, 2024

INTRODUCTION

As part of the government's wider review of the electricity transmission network via the Integrated Transmission Planning and Regulation Project, and after its successful introduction of competition to offshore transmission assets and their owners (**OFTOs**), Ofgem has continued to consult on introducing competitive tenders for the design, build and operation of onshore transmission assets, thereby creating Competitively Appointed Transmission Owners (**CATOs**).

In the three previous volumes of this introductory series on CATOs we have considered the specific characteristics of CATOs, the difference between the development models proposed by Ofgem in its consultation – “early”, “late” and “very late” – and the proposed revenue stream and incentives.

In this, the fourth volume in the series, we focus on Ofgem's work in 2024 on finalising an “early” model of competition and look ahead to a busy Q4 for those with an interest in the commercial model, tender process and tender regulations for that competition.

A QUICK REFRESHER...

Given the pace of policy movement, transmission networks including CATOs have fallen somewhat in the public consciousness behind more high profile developments in relation to nuclear energy, wind and solar energy generation, low-carbon heat networks, hydrogen production and CCUS in discussions around energy transition. By way of reminder, a CATO is a competitively appointed transmission owner, selected by Ofgem via a competitive tender process and licensed to construct, own and maintain new onshore electricity transmission assets in Great Britain.

A CATO might be one of the existing transmission players or a new entrant to the market. In either case, the government's objective is clear: competitive tenders will increase innovation and efficiency with the aim of creating better value for end-customers because competitive pressures will expose true costs and competing bidders can put downward pressure on those project costs. As stated in its November 2023 Transmission Action Plan, the Government expects that CATOs could save end-customers up to £1 billion by 2050.

We have previously discussed how, in order for an onshore electricity transmission project to be eligible for tendering under the CATO programme, the project must be: (i) new i.e. construction of a new asset where one does not exist or a complete replacement of an existing asset; (ii) separable i.e. clearly delineated ownership boundaries must exist in order for responsibilities to be established as between the CATO and the main transmission system operator; and (iii) high value i.e. where the expected capital expenditure is anticipated to exceed £100 million.

We have also outlined how the Government has considered that the parameters of the CATO tender processes might include: (i) “early model” competition i.e. a competition between asset bidders that happens before the detailed asset design work has been done (such that the CATO would take responsibility for preliminary works, environmental impact assessments, design and all procurement, construction, financing, maintenance and operation obligations thereafter); (ii) “late” competition where a tender takes place after planning consent approval is granted for the relevant transmission asset; and (iii) “very late” competition, effectively an OFTO-style arrangement which occurs in relation to the operation and maintenance of assets that have already been constructed.

On 26 October the Energy Act 2023 received Royal Assent. This enacted the changes in primary legislation required to allow for the competitive tendering of onshore electricity transmission projects and the appointment and licensing of CATOs. However, interested parties still awaited the full set of regulations which will set out how the regime will be implemented.

SO WHAT'S NEW?

In its December 2023 “Update on development of competition in onshore electricity transmission” Ofgem outlined that: *“[w]e intend to focus our work in 2024 on finalising an “early model” of competition... [w]e consider that early competition can maximise the level of innovation delivered through the competitive process, whilst also allowing for earlier supply chain engagement from bidders relative to late competition.”* BCLP has tracked activity in this space for nearly a decade, and 2024 has seen a step-change in the pace and nature of developments. Importantly:

- in February 2024, the Electricity System Operator (**ESO**) published its “Early Competition Implementation – Update”. An Ofgem consultation, launched in that month, resulted in the Decision, published in July 2024 that has brought much needed clarity on issues such as the Cost Benefit Analysis methodology that will underpin identification of suitable projects for competition, conflict mitigation arrangements to ensure the Transmission Owners (**TOs**) receive no unfair advantage in the process, clarity on Transmission Network Use of System over/under recovery issues, and how Ofgem intends to approach issues relating to CATO/tender failure;
- in March 2024 the ESO published its second transitional “Centralised Strategic Network Plan”, which proposed: (i) a co-ordinated onshore and offshore network design for the connection of 21GW offshore wind generation; and (ii) reinforcements to the electricity transmission network

in support of the government's decarbonisation and Net Zero objectives. Ofgem's consultation on these arrangements, which contained proposals for a funding framework for the onshore electricity transmission projects recommended by the ESO and proposals to introduce a project scope change governance process for onshore electricity transmission projects closed last week. Stakeholders will await Ofgem's decision with interest; and

- in one of the clearest signals yet of gathering momentum, a September article by Andrew McAlinden, Network Competition Senior Delivery Manager at the ESO, highlighted that: *"[w]ith legislation and policy now in place, the door is open for private finance to help deliver a new generation of infrastructure..."*

... WHAT'S NEXT?

We anticipate a number of concrete developments before year end. In particular, in its July Decision, Ofgem confirmed its support to the ESO in continuing to develop and work towards implementing the Early Competition regime in onshore transmission networks. In practical terms this means:

- Ofgem will continue to work on appropriate changes to the existing TO licences and ESO licence to fulfil its obligations under the forthcoming role as the National Energy System Operator;
- Ofgem will also commence drafting of the transmission owner licence that would be awarded to the successful CATO;
- the ESO has developed and proposed a commercial model which is currently under review by Ofgem. A consultation is expected before year-end; and
- Ofgem will develop tender regulations for Early Competition in conjunction with the ESO and Department for Energy Security and Net Zero with a consultation expected imminently.

...AND WHAT'S THE OPPORTUNITY?

Net Zero will, by necessity, require large amounts of electrification in the UK. Private finance will be needed to meet a large part of the £58 billion investment that the ESO's "Beyond 2030" Report identified as required to reinforce and upgrade the UK's electricity transmission system and meet Net Zero objectives. In this context, the ESO (soon to be National Energy System Operator) has identified a significant pipeline of 23 projects (ranging between £100m and £3 billion in capex value) of which 11 have been identified as suitable for early model competition.

Whilst end-customers should benefit from private sector innovation and potential cost savings, CATOs also represent assets with a stable, long-term (up to 35 years) return, partially inflation-linked and with minimal regulatory risk. It is likely that the tender process will be reduced by 20 weeks through the inclusion of a single ITT stage (compared to previous CATO tendering proposals which

involved two stages) and this is likely to ameliorate bid-cost risk significantly. All of which adds up to CATOs representing a proposition likely to be of significant interest to many infrastructure investors.

HOW CAN WE HELP?

The final months of 2024 look set to be a busy and exciting period for those with an interest in the CATO sector. With decades of experience of real estate, planning and zoning law, construction and finance expertise and lessons learned from roles on a number of the OFTO transactions, the BCLP team is well placed to assist its clients in this space. We would welcome conversations with investors, contractors, and other organisations likely to participate in early competition projects for further discussion of the model, project pipeline and investment opportunities.

PREVIOUS VOLUMES:

[Now that's what I call CATO: volume 1](#)

[CATO - better late than never? volume 2](#)

[Show me the CATO! funding and financing - one follows the other: volume 3](#)

MEET THE TEAM



Kevin Atkins

London

kevin.atkins@bclplaw.com

[+44 \(0\) 20 3400 4693](tel:+442034004693)



Matthew Daffurn

London

matthew.daffurn@bclplaw.com

[+44 \(0\) 20 3400 4692](tel:+442034004692)



Alexander Hadrill

London

alexander.hadrill@bclplaw.com

[+44 \(0\) 20 3400 4740](tel:+442034004740)

This material is not comprehensive, is for informational purposes only, and is not legal advice. Your use or receipt of this material does not create an attorney-client relationship between us. If you require legal advice, you should consult an attorney regarding your particular circumstances. The choice of a lawyer is an important decision and should not be based solely upon advertisements. This material may be “Attorney Advertising” under the ethics and professional rules of certain jurisdictions. For advertising purposes, St. Louis, Missouri, is designated BCLP’s principal office and Kathrine Dixon (kathrine.dixon@bclplaw.com) as the responsible attorney.