

## **Quick Guide to the CATO Regime – November 2016**

This guide provides you with an overview of the key policy proposals and decisions related to the development of the CATO regime for the tendering of onshore electricity transmission assets.

Some of the more detailed proposals in this guide were recently out for consultation, so may be subject to change. This document is intended to provide a quick guide on how we currently consider the CATO regime may work.

All consultation documents can be found on the [extending competition in electricity transmission](#) website.

### **What is a CATO?**

A CATO is a competitively appointed transmission owner. Under our proposed competitive regime, the CATO will be granted a licence to own and operate onshore transmission assets on the basis of competitive tendering.

### **Why are we developing the CATO regime?**

In previous policy reviews, we identified that the introduction of competition to onshore high voltage transmission assets would create significant benefit for consumers through capital and operational cost savings on specific projects. As well as cost savings, it will also provide us with cost benchmarks that may be helpful in our regulation of monopoly delivered networks. We also expect that competition will lead to increased innovation across the project development and operations process, which may be beneficial to consumers in other ways (e.g. through identifying efficiencies for future project development).

We currently plan on being in a position to be able to commence the first CATO competition from 2018.

### **What projects will we tender?**

We will use competitive tendering for onshore transmission assets that are required to meet a need on the transmission system, and that are new, separable and high value. A final tender checkpoint will ascertain if the project meets the criteria to be tendered under the CATO model.

New	Separable	High Value
<ul style="list-style-type: none"> <li>•Construction of transmission asset where none currently exists or where the new assets will completely replace existing ones.</li> </ul>	<ul style="list-style-type: none"> <li>•Ownership boundaries can be clearly delineated, so responsibility for each asset can be clearly established.</li> </ul>	<ul style="list-style-type: none"> <li>•The expected project capital expenditure is £100m or greater.</li> </ul>

## Potential CATO Projects

We are currently considering a submission from National Grid for their transmission project called North West Coast Connection (NWCC) to connect the proposed new nuclear power station at Moorside, Cumbria. We are considering both the current need for this project as well as its suitability for CATO tendering. We expect to consult on our findings by late 2016.

We are working with the System Operator (SO) and other network companies to clarify the future pipeline of potential CATO projects. For an indicative view of potential projects coming forward refer to our website for [SWW projects](#). The SO also publishes an annual list of potential large new projects through its Networks Options Assessment.

We will make assessments of the suitability of projects for tendering when needs cases for those projects are submitted to us by the Transmission Owners (TOs).

## Roles and Responsibilities under the CATO model

In the near term (for projects to start construction during [RIIO-T1](#)<sup>1</sup>) we will appoint CATOs after a project has secured planning consent. We are calling this the **late CATO model**. It will be the responsibility of the relevant regional TO (National Grid, SHETL, or SPT) to undertake any preliminary works necessary to progress the project to the point of securing consent for the project.

The TO will be required to:

- Undertake the relevant preliminary works;
- Produce the tender specification outputs by the start of the Final Tender Checkpoint, and place the outputs into a data room;
- Provide support during the tender, including responding to bidder clarifications and maintaining the data room with up-to-date information.

Following the tender, the CATO will then be responsible for construction and operation of the project. The terms under which CATOs will be expected to do this will be set out through a combination of the electricity transmission licence

<sup>1</sup> RIIO T1 is our price control that sets out what the existing onshore transmission network companies are expected to deliver and details of the regulatory framework that supports effective and efficient delivery for energy consumers over the eight years from 2013 – 2021.

granted to them by us, as well as contractual agreements with the SO, linked to industry codes and standards. CATOs will be subject to the same basic regulatory framework as all other TOs.

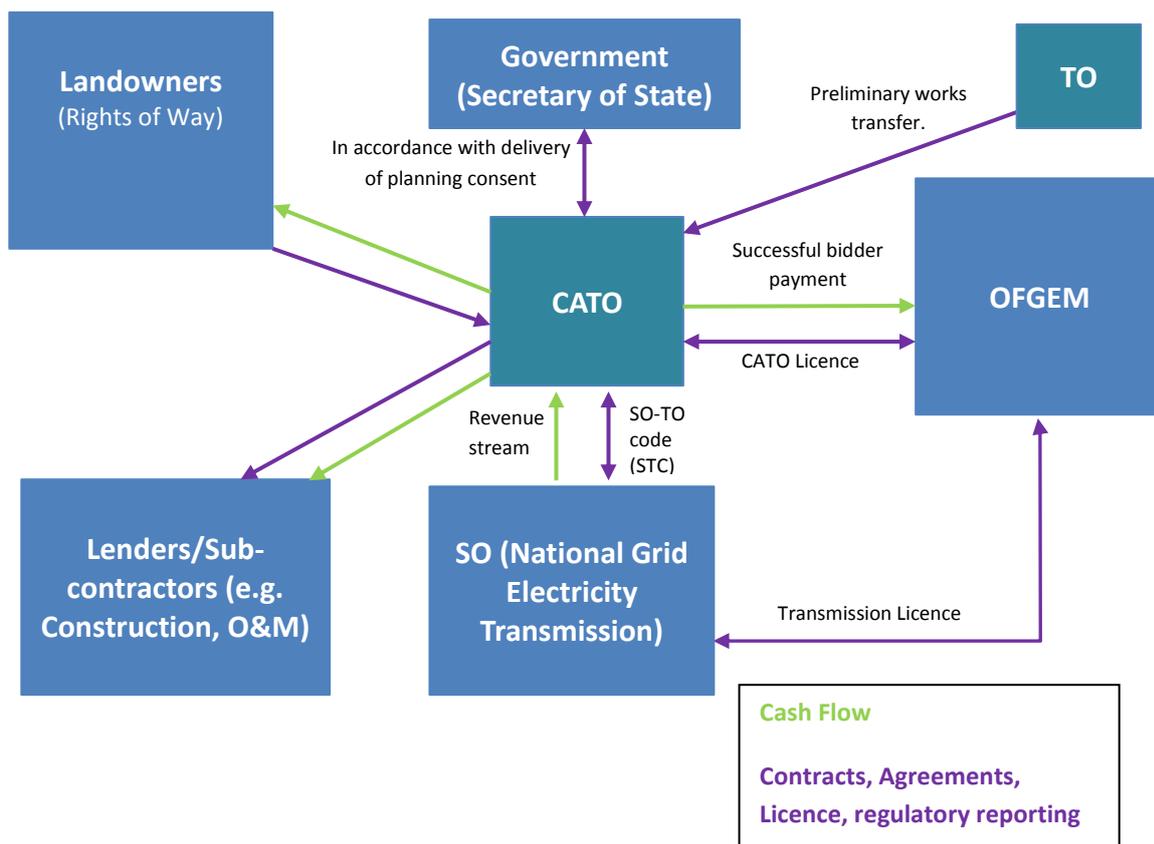
Each CATO will:

- hold a licence granted by us – this will say how much CATOs get paid, including performance adjustment, but also mean they have obligations to us (e.g. reporting) and to the SO;
- need to comply with the industry codes and standards as all TOs do. We'll make sure these codes and standards are updated to reflect CATO policy.

Further detail on the proposed CATO obligations and incentives is provided later in this guide.

## CATO Linkages

The proposed interlinkages and money flows that will apply to the CATO are outlined at a high level in the diagram below:



## How will we appoint CATOs?

In our [August consultation](#) we outlined our proposals for the late CATO model, including the tender process and high level considerations for assessment at the ITT stage. We proposed:

- A three stage tender process (below) comprising an enhanced pre-qualification stage, an outline proposals stage and invitation to tender stage.



- That CATO bidders will undertake detailed design work and supply chain engagement during the tender process to enable them to provide robust, fixed price bids at the ITT stage.
- That the ITT stage evaluation will focus on a combination of price and robustness/deliverability of proposals, weighted equally. Evaluation will focus on areas such as design, approach to construction, management of risk, and overall project management, as well as cost.
- That we will typically start the ITT stage once project certainty is established through planning consent being in place.

All preliminary works for the project, including planning consents and land rights, will transfer to the CATO on appointment (i.e. at licence grant/financial close).

## CATO Revenue Arrangements

Proposed Revenue Arrangements
Revenue to be paid through an annual Tender Revenue stream (TRS) bid during the tender process.
25 year revenue term, usually commencing from completion of construction.
Revenue stream should be largely fixed, with a limited number of reopeners.
Asset depreciation period aligned with the revenue term.
Assets would remain the property of the CATO at the end of the revenue term and will most likely be subject to ongoing price control.
Gains made by CATO through debt refinancing should be subject to some sharing mechanism with consumers.
The proportion of annual revenue indexed to inflation should be proposed by bidders.

## Performance Incentives for CATOs

In our [August consultation](#) we proposed performance incentives to reinforce CATO obligations under the regulatory framework.

The table below outlines the proposed baseline incentives for a CATO. We expect that these incentives might vary dependent on the size and complexity of each project. We will consider bespoke approaches on a project by project basis, for example potentially commencing revenue before construction is complete where the construction period is particularly lengthy.

Category	Proposed baseline CATO incentive
Safety	Compliance with existing law.
Reliability	Availability based financial incentive with penalties for poor performance and bonuses for outperformance to ensure CATOs' assets will be available when they are needed. This would complement a range of technical requirements and operational processes in the wider regulatory framework.
Availability	Availability based incentive and obligation to develop a Network Access Policy (NAP).
Connections	Financial penalty worth up to 0.5% of annual base revenue for failure to meet obligations to connect additional users to the CATO's network.
Asset delivery	'Payment on completion' – CATO revenue stream typically starts once construction is complete.
Environmental outcomes	SF6 incentive (to minimise leakage) – financial incentive based on performance against a target leakage rate. CATOs to report annually on transmission losses, business carbon footprint and work on visual amenity (where relevant, e.g. for new asset investment).
Asset management	Asset management incentive – periodic reporting on asset condition alongside a performance bond on asset condition at the end of the revenue term.

## Early build CATO

In the longer-term (for projects to start construction during RIIO-T2<sup>2</sup>) we are also considering running the tender earlier and broadening the scope of the CATO's responsibilities to include high level system design and securing planning consent for a project (early build CATO). We are still in the early stages of developing how this model might be applied.

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<sup>2</sup> RIIO T2 will be the transmission price control beyond 2021.

## Contact Us

We expect to be able to provide further information on the late CATO model in mid-2017 once we have considered stakeholder responses to our August consultation and further developed our policy proposals.

For further information on CATO Policy Development see the Ofgem website or contact us at [NTIMailbox@ofgem.gov.uk](mailto:NTIMailbox@ofgem.gov.uk)

You can also subscribe to our [newsletter](#) which provides updates on the activities in Ofgem's competitive networks, including events and policy highlights.