

Implications of Ofgem's Targeted Charging Review decision

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Energy analysis: Ofgem has announced its decision following the Targeted Charging Review (TCR), that residual charges will be levied in the form of fixed charges for all households and businesses and to remove liability for the transmission generation residual from generators. Kirath Bharya, associate at Gowling WLG, discusses the implications of the decision for market participants and consumers.

Original news

Ofgem has announced its [decision](#) following the TCR, in which residual charges which recover the fixed cost of providing existing pylons and cables, and the differences in charges faced by smaller distributed generators and larger generators were examined (known as Embedded Benefits). Ofgem has decided that residual charges will be levied in the form of fixed charges for all households and businesses. Ofgem has also decided to remove liability for the Transmission Generation Residual from generators and making changes to one of the Embedded Benefits received by smaller distribution generators in relation to balancing services charges.

What is the background to the TCR?

The TCR is part of Ofgem's wider review of network access and charging, which is reviewing how licensed electricity network operators recover the costs of maintaining and balancing their networks. Ofgem is proposing to use the principles of reducing distortion, fairness and proportionality to assess its charging reforms.

Ofgem categorises network charges as either:

- 'forward-looking' charges which are intended to send signals to users about how future network charges will change depending on how they behave. These charges are designed to encourage users to use the networks efficiently
- 'residual' charges which recover the remainder of the costs that are not covered by the forward-looking charges

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The aim of the TCR is to reform the residual charges and certain related 'embedded benefits'. Embedded benefits are the benefits that have been traditionally associated with electricity generating stations that are connected to distribution networks rather than transmission networks. Ofgem believes these benefits are responsible for market distortion, hence the need for reform.

On 28 November 2018, Ofgem published the '[Targeted Charging Review: minded to decision and draft impact assessment](#)'. The consultation covered reforms on the way in which Ofgem recovers the costs of the networks used to transport electricity. Ofgem then published its '[Future Charging and Access programme—consultation on refined residual charging banding in the Targeted Charging Review](#)' in September 2019. In November 2019, it published its '[Targeted Charging Review: Decision and Impact Assessment](#)'.

What are the key assessments/decisions made in the final decision paper?

Residual charges

The main principle of the TCR decision is to introduce fixed network charges (ie standing charges that apply by reference to the agreed capacity of the connection), rather than network charges linked to usage.

Ofgem's view is that fixed charges are fairer than those based on usage, because larger more sophisticated consumers can avoid charges linked to usage, with the result that the costs are borne by the smaller less sophisticated consumers.

For non-domestic consumers, there will be:

- a single set of transmission residual charges
- a set of distribution residual charges for each of the 14 distribution service areas which will be charged:
 - for small low voltage connected consumers, on the basis of net usage volume (because agreed capacity data does not exist)
 - for all other consumers, on the basis of fixed charges within bands determined by a consumer's voltage level, and (where further segmentation is required) based on agreed capacity for larger consumers with available data (and net consumption where agreed capacity data is not available)

Embedded benefits

The term 'embedded benefits' describes the different transmission charging arrangements (including balancing system charges) for smaller embedded generators (those connected to the distribution network) versus larger generators. They relate to the ability of generators connected to the distribution network (rather than the transmission network) to avoid certain charges.

Ofgem reformed embedded benefits prior to the TCR. In April 2018, Ofgem published its ['Impact Assessment and Decision on industry proposals \(CMP264 and CMP265\) to change electricity transmission charging arrangements for Embedded Generators'](#). The 2018 consultation reduced the Triad avoidance payment which is paid to embedded generators when they generate surplus power at times of high demand on to the transmission network (therefore reducing the demand constraints on the transmission network).

The TCR decision removed the following embedded benefits.

Transmission generation residual (TGR) charges

The current charging arrangements allow for large generators (ie those with a capacity of over 100 MW) to receive a fixed rebate (ie a negative charge) for being connected to the transmission network. This is due to a cap set on the level of transmission network charges which generators should pay. Smaller embedded generators do not receive this rebate and they were therefore seen to be at a disadvantage to larger generators. The TGR is now zero, ie the negative charge no longer applies.

Balancing system use of system (BSUoS) charges

These are charges paid by suppliers and generators based on their generation or net demand on the transmission system. For electricity suppliers, the charge is based on the supplier's net supply volume (ie the amount it has supplied to customers, net of any electricity it has bought from distribution-connected generators).

There are two types of embedded benefits that relate to BSUoS charges:

- BSUoS charges (payments)—smaller embedded generators can get paid for helping suppliers reduce their contribution to the costs of balancing the system (ie the supplier's BSUoS charges). Ofgem is removing this benefit to embedded generators and will therefore reduce the income to distribution-connected generators
- BSUoS charges (avoided charges)—smaller embedded generators avoid paying generation BSUoS charges which other generators who are connected to the distribution and transmission

networks have to pay. Ofgem is reforming the way these avoided charges are dealt with under a separate taskforce to consider whether distribution-connected generators should be liable to pay BSUoS charges. As at the date of this Practice Note, conclusions of this taskforce are due to be submitted to Ofgem by the end of June 2020 for Ofgem's consideration. This might increase the charges payable by distribution-connected generators

When will the changes be implemented?

Ofgem decided that the reform to the transmission residual charges should be implemented with effect from 1 April 2021, and the reform to the distribution residual charges with effect from 1 April 2022. The embedded benefits are due to be removed in 2021.

The changes will be implemented by way of modifications to industry codes. Proposed modifications will be considered through workgroups prior to being assessed by code panels and submitted to Ofgem to allow for implementation.

To facilitate Ofgem's implementation of its proposals, Ofgem may consider using its powers under 'Duty to Cooperate' electricity licence conditions (SLC C19 of the electricity transmission licence, SLC 20.10 to 20.12 of the electricity distribution licence and SLC 11.11 to SLC 11.13 of the electricity supply licence). This may include requiring licence holders to undertake reasonable requests in respect of planning, project assurance and/or co-ordination/systems integration. Ofgem may also issue a 'backstop direction', for example, where development of the modification under the standard industry code process is not meeting the expected policy direction or timescales for implementation.

What do you expect are the likely impacts of changes to come out of the TCR and how will these likely affect market participants?

The changes proposed in the TCR decision will produce different effects on different consumers. The shift in balancing the allocation of these charges means that some types of consumer will pay more while other types of consumers will pay less.

The TCR decision arrived at the following conclusions in respect of the impact of the changes on consumers:

- the majority of domestic consumers will benefit from the new charges. However, some domestic consumers who use the least electricity could face an increase in the charges they pay

- some non-domestic consumers may pay face higher charges. This may be the case where consumers have benefited from reduced contributions because of investing in on-site generation, reducing their contribution to the existing system

Embedded generators may face a reduction in revenues due to reduced embedded benefits. Ofgem is of the view that all types of generation should face network charges reflective of the costs they impose on the system.

Suppliers will also be impacted by the changes. Suppliers will seek to mitigate their financial exposure to the new changes by passing on costs to consumers and paying embedded generators less for the benefits associated with their output.

Interviewed by Samantha Gilbert.

The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor.

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