

## Clarification Request Issued to Ofgem

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As agreed on the DCP359 'Ofgem Targeted Charging Review (TCR) implementation – customers: who should pay?' first meeting, we are seeking clarity as to Ofgem's intention in relation to Final Demand and the subsequent applicability of a residual fixed charge please. Essentially, the interpretation of 'proportionate' has resulted in differing views in terms of it being either (i) proportion of Final Demand out of 'total' demand, or (ii) reference to a 'practical' assessment (which may, not **must**, include a consideration of relativity).

Paragraph 3.57 (1) of the TCR Decision states:

*"Final demand: This must be defined as electricity which is consumed other than for the purposes of generation or export onto the electricity network. Generation only and storage only sites will therefore be exempt from residual charges. An appropriate process must be established to assess and identify or, where a practical and proportionate approach cannot be identified, to robustly estimate final demand for the purposes of residual charging."*

Specifically regarding the reference to a "proportionate approach" in the third sentence, is it Ofgem's intent that code modification workgroups develop a suitable process for identifying Final Demand that must take into account the proportion of non-Final Demand electricity consumed at the site, and that the 'proportion' calculated is directly used to determine a level of 'discount' applied; thus, does total demand at the site less non-Final Demand (electricity consumed for the purpose of generation or export onto the network) equal Final Demand (which pays the residual fixed charge)?

In other words, (i) does 'proportionate' Final Demand take account (net) of non-Final Demand electricity consumed at the site, measured or estimated (both being a forecast for charging purposes), or (ii) is the relative demand used as a basis to determine whether a residual fixed charge should be applied at all?

For example, a 'site' has consumption of 10,000kWh/annum, of which 1,000kWh is for the purpose of generation (or export onto the network) and so deemed to not be Final Demand.

In the case of (i) is the banded fixed residual demand charge that the site pays applied at 90%, or is the full 100% of the residual demand charge applied (subject to a potential threshold)?

In the case of (ii) is the banded residual demand charge that the site pays always 100% as there is 'some' Final Demand (which may be an amount above a threshold), or zero where (e.g.) Final Demand was below a certain threshold? So a threshold would be used to determine if a site is a 'Final Demand Site' and therefore receives 100% of the charge, and if not, then presumably it's a generation or storage site and therefore pays a zero residual demand charge.

Depending on the answer the site may be 'banded' based on the 9,000kWh or 10,000kWh (or associated Final Demand agreed capacity), therefore may receive a lower charge.

## Ofgem Response

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Thanks for your email re- Final Demand.

In the TCR we have not taken a view regarding your specific question on proportionality.

Paragraph 3.58, in the section entitled ‘Aspects for network licensees to consider and develop’ may provide some more helpful context:

*Network licensees, or the DNOs or ESO only where specified, must consider and seek to identify the most appropriate arrangements in relation to the following aspects and develop modification proposals consistent with the SCR Decision Principles set out above in relation to:*

...

*(2) A mechanism for identifying which sites should be classified as final demand (as opposed to generation or intermediate demand) for the purpose of determining their applicable contribution to residual charges. An appropriate process must be established to assess and identify or, where a practical and proportionate approach cannot be identified, to robustly estimate sites with final demand for the purposes of residual charging. **Industry should consider and build on thinking undertaken through development of the proposed solution being considered under CMP280 and CMP281 and DCP341 and DCP342, as well as considerations under the approach developed by the Low Carbon Contracts Company (LCCC) when estimating charges for a CfD generator and work undertaken by Elexon and the LCCC on how to charge Final Consumption, as they consider relevant.** Where necessary, network licensees should also consider possible methodologies for robustly estimating sites with final demand, including potential numerical approaches such as considering the relative proportions of import to export at a site.*

In this context, ‘practical and proportionate’ suggests there should be a balance between being able to identify final demand, in a way that balances the benefits of accuracy, against the costs and activities required for implementation.

As with all modification proposals and alternatives, we expect that solutions will be justified by the workgroup.

## Related Information

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### **Decision Principles (3.53) of (‘The Decision’)**

*Reforms to residual charging should meet the TCR principles of reducing harmful distortions, fairness and proportionality and practical considerations, as outlined above and described further in Annex 1 to our minded-to decision. This includes but is not limited to the aspects outlined below, which should be a focus of the modification proposals. We note that in developing the code modification proposals, NGESO and the DNOs will also have regard to the need to better facilitate the relevant code objectives. This section outlines how we expect the Decision Principles to be applied by the workgroups, followed by the Design Parameters. **\*\*I’ve removed the fairness element from the below the try and keep it as brief as possible\*\****

- **Reducing harmful distortions:** *The TCR residual charging reforms aim to reduce the harmful distortions caused by the current residual charging methodology which encourages some network users to take measures to lower their contributions to residual charges. Changes should seek to reduce the potential for and impact of any harmful distortions introduced as a result of changes to the residual charging arrangements. Residual charges that cause network users to adjust their investments or operational decisions are distortionary and can lead to inefficient use of the networks. They have the potential to distort competition between different network users. As some network users avoid charges, this increases the charges to other network users, further distorting usage and investment. Any method of residual charging*

will lead to some distortions, but harmful distortions should be reduced as far as possible so that the energy system works efficiently and in the interests of consumers.

- Residual charges help to recover the costs of expenditure required to efficiently maintain and operate the national electricity network from which all connected users benefit. Where residual charges incentivise behaviour such as load reduction which reduces the share of charges paid for by that user, this results in an increase in the share to be paid by other network users. This in turn increases the incentive for other users, who then pay an increased proportion of the residual charge, to take action to reduce their charges.
- **Harmful distortions can impede a level playing field for competition between network users and encourage users to invest in technologies to reduce their demand from the network, for example by generating electricity on-site. Such investment may only be economic when avoidance of residual network costs is taken into account, with the generation having no effect in reducing network or system costs. (emphasis added)** Residual charges based on a fixed or agreed capacity basis may incentivise users to reduce their agreed capacity or disconnect from the grid entirely.

- **Proportionality and practical considerations:** achieving changes in a proportionate and practical manner.
- Any proposals need to be proportionate to the issue being addressed, solutions should draw on existing data and systems where possible and involve proportionate changes to systems and charges.
- **Proportionality considers whether a solution would deliver benefits through improving performance against the other TCR principles, and whether this could be done with minimum disruption for industry and the relevant stakeholders. If the same benefits of reform, considering performance against the TCR principles of reducing harmful distortions, fairness and proportionality and practicality considerations, could be delivered with lower disruption or at a lower cost, then it is likely to be a more proportionate response.**
- A three stage test is to be applied considering: whether the measure is suitable to achieve the desired end, whether the measure is necessary to achieve the desired end, and whether the measure imposes a burden on an individual that is excessive to the objective sought to be achieved.
- **Practical considerations include identifying the steps in the charging process which might have to change to implement our direction and to assess the potential cost of a policy change. A non-exhaustive list of aspects relevant to practical considerations include metering requirements, data collection, data processing, charge calculation, billing and calculation systems and settlement.**

When you consider the above with the below which is set out sequentially in the decision document, it appears the question around proportionality may have already been answered:

## Design Parameters

### Allocation of residual charges

- 1) **Residual charges are to be applied to demand customers only and to all sites with final demand. (emphasis added)**
- 2) Distribution residual charges are to be apportioned as they are today between EDCM and CDCM customers as per the applicable charging model.
- 3) Following apportionment, all applicable distribution and transmission residual charges are to be allocated to users connected to each voltage level across the system (LV, HV, EHV and, for transmission residual charges, transmission voltages) on the basis of the aggregate net consumption volumes of those network users in each charging year connected at each voltage level.
- 4) Residual charges are subsequently to be further allocated to applicable customer segments as defined below, with distinct arrangements for unmetered customers.
- 5) The level of the charge for each segment will be calculated annually, in line with the current approach, to recover remaining allowed revenue once the forward-looking charges have been applied.