

Advisory Group

# Effects of Low Fixed Charge Regulations: scope of project

For discussion

9 December 2014

**Note:** This paper has been prepared for the purpose of the Retail Advisory Group. Content should not be interpreted as representing the views or policy of the Electricity Authority.

## 1 Recommendation

- 1.1.1 It is recommended the Retail Advisory Group (RAG):
- a) **agree** to undertake the Research project: effects of the Low Fixed Charge Regulations consistent with the scope and approach assigned by the Authority Board
  - b) **note** the project scope and approach has been revised from what was agreed between the RAG and the Authority Board in [October 2013] and now focuses on the competition, reliability and efficiency effects of the Electricity (Low Fixed Tariff Option for Domestic Consumers) Regulations 2004 (LFC Regulations)
  - c) **agree** the proposed process for undertaking the research project.

## 2 Rationale

- 2.1.1 The RAG Terms of Reference state that the Authority will discuss the proposed work plan with the Chair of the RAG before providing it to the RAG for its consideration and agreement.
- 2.1.2 The Authority's 2014/2015 work programme states that the RAG will investigate the competition and efficiency effects of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 (LFC Regulations).

## 3 Introduction

- 3.1.1 The RAG was initially assigned the project in August 2013 but the start date was deferred in October 2013 until early 2015.
- 3.1.2 The proposed scope and approach has been revised from what was assigned to the RAG to focus on the CRE effects of the LFC Regulations.

## 4 Scope

- 4.1.1 The revised scope and approach was endorsed by the Board in November 2014.
- 4.1.2 The revised scope focuses on CRE effects of the LFC Regulations. It excludes considering issues with, or alternatives for, achieving the social and environmental objectives sought from the LFC Regulations.
- 4.1.3 The revised project scope also excludes considering whether the LFC Regulations should be retained, amended or revoked.
- 4.1.4 A comparison between the previous and proposed project scopes is provided in Table 1.

**Table 1: Previous and new project scope**

Previous scope	New scope
Review of the effects of the LFC Regulations on competition, reliable supply and efficiency and determine the net benefits or net dis-benefits.	Review and quantify the effects of the LFC Regulations on competition, reliable supply and efficiency to determine the net benefits or net dis-benefits.
Recommend alternative options for achieving the social and environmental outcomes sought from the LFC Regulations.	

## 5 Identified issues with the LFC Regulations

- 5.1.1 Issues with the LFC Regulations relating to competition, efficiency and reliability can be described as follows:
- a) Do the LFC Regulations inhibit efficient distribution pricing and efficient retail pricing?
  - b) Do the LFC Regulations inhibit the efficient operation of the industry and adversely affect retail competition due to increased transaction costs?
  - c) Do the LFC Regulations inhibit retail competition by inhibiting innovation?
- 5.1.2 The answers to these questions will inform whether the LFC Regulations have adverse effects on the electricity market and potentially the net benefits or net dis-benefits.
- 5.1.3 These questions arise from issues identified by industry participants and consumer representatives in recent years:
- a) *reduced competition between retailers by impeding innovation.* This occurs especially in delivering new tariff options, including time-of-use and demand-side management options
  - b) *cross-subsidies between consumer groups.* This occurs because the fixed daily charge of 30c/day does not recover a retailer's fixed costs of electricity supply. Retailers respond by increasing standard fixed daily charges and variable charges on all tariffs.
  - c) *increased costs of retail entry by increasing administrative costs.* This occurs because retailers incur additional costs to ensure that their systems and products are compliant with the LFC Regulations. One electricity retailer supplying commercial and industrial customers has cited the LFC Regulations as one of the main reasons why their business does not expand into supplying residential customers.
- 5.1.4 Issues relating to the social welfare and environmental objectives of the LFC Regulations have also been identified. For example, there is a concern the LFC tariffs are not well targeted because low-use consumers are often not low income consumers (e.g. double income households with no children). Electricity consumption is probably not an accurate proxy of low-income and many low-income households have above average electricity consumption.

## 6 Approach and process

- 6.1.1 The Authority Board identified an indicative timeline and milestones for the project, but has not specified an approach to the project. The RAG needs to decide its approach, in particular how it obtains information about the competition, efficiency and reliability effects of the LFC Regulations. The options include:
- a) rely on member discussions and requests to participants for information
  - b) invite relevant people to attend RAG meetings during the development phase of February to May 2015 (preferred option)
  - c) a Working Group could be set up comprising a cross-section of consumers, retailers and distributors during the development phase (February – May 2015) to help inform your discussion paper on LFC Regulations.
- 6.1.2 The recommended options are a) and b). The option to establish a working group is not recommended because a working group is more suited to dealing with technical matters. A working group will also take time to establish.
- 6.1.3 A timeline of the major deliverables is set out below in Table 2.

**Table 2: Project deliverables**

Stages and deliverables	Start date	Completion date
<b>Stage 1 – Scoping and approval</b>		
RAG approves project scope and approach	Dec 2014	Feb 2015
<b>Stage 2 – Examine effects of the LFC Regulations on CRE</b>		
Develop RAG discussion paper	Feb 2014	May 2015
Brief Board on the RAG's discussion paper	June 2015	July 2015
Consultation period – 12 weeks consultation after	July 2015	Sept 2015
RAG discusses feedback post consultation period and the next steps	Oct 2015	Nov 2015
RAG findings presented to Authority Board	Dec 2015	Dec 2015

- 6.1.4 The timeframes for the project will be confirmed once the process and approach is settled based on feedback from RAG members.
- 6.1.5 The Board will decide on the next steps for the project after receiving the RAG's findings.
- 6.1.6 The current expectation is for the Authority to provide the results of the LFC project to the Minister and MBIE.

## **7 Communications Approach**

- 7.1.1 The RAG chairperson has no media relations role and may not speak on behalf of the Authority in regard to matters on which the Group has advised, or is advising, the Authority. Media responsibilities lie with the Authority (see the Advisory Group's Terms of Reference, clause 9.2) thus the Authority will manage communications for this project.