

1407LINE1

12 November 2014

Investigator's report on an alleged breach of regulation 14(1)(c) of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 by The Lines Company Limited on 1 April 2007

Prepared by: Peter Wakefield
Senior Investigator

Recommendations

1. The investigator recommends that the Compliance Committee (Committee):
 - (a) **note** the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 (Regulations) are complex and open to interpretation
 - (b) **note** there are varying opinions, including varying opinions by different external legal providers, as to whether the variable tariff for The Lines Company Limited (TLC) low fixed charge tariff (LFC tariff) is a variable charge as defined in regulation 4(1) of the Regulations, and is therefore permitted under regulation 14(1)(c)(ii) of the Regulations
 - (c) **note**, in terms of the Authority's Prosecution Policy, there is no reasonable prospect of conviction that TLC has breached regulation 14(1)(c)
 - (d) **discontinue** the investigation as to whether TLC has breached regulation 14(1)(c)
 - (e) **note** the Regulations are best clarified through the regulatory amendment process
 - (f) **approve** Compliance writing to the Ministry of Business, Innovation and Employment (MBIE) with the details of the investigation and recommending that the Regulations be clarified.

Rationale

2. There are varying opinions, including varying opinions by different external legal providers, as to whether the variable tariff for TLC's low fixed charge tariff (LFC tariff) is a variable charge as defined in regulation 4(1) of the Regulations, and is therefore permitted under regulation 14(1)(c)(ii) of the Regulations.

3. Under clause 14.5 of the Authority's Prosecution Policy, the Committee may recommend to the Board that it take prosecution action under regulation 24(2) of the Regulations if the Committee determines that:
 - (a) the evidence that TLC has committed an offence under regulation 24(2) of the Regulations is sufficient to provide a reasonable prospect of conviction
 - (b) prosecution is required in the public interest.
4. In the circumstances of the varying legal opinions, there is no reasonable prospect of conviction that TLC has breached regulation 14(1)(c). Under regulation 24 of the Regulations the Authority would need to prove beyond reasonable doubt that TLC knowingly breached 14(1)(c).
5. The Regulations are complex and open to interpretation and would be best clarified through the regulatory amendment process.

Legal basis

6. This is an investigator's report prepared under clause 6.5 of the Prosecution Policy. The Prosecution Policy sets out how the Authority will exercise its discretion in relation to monitoring, investigating, and enforcing compliance with the Electricity Industry Act 2010 (Act) and regulations made under the Act.
7. As the Prosecution Policy requires, this report sets out sufficient detail to enable the Committee to decide whether to take any further action regarding the alleged breach.

Circumstances and analysis of the alleged breach

8. In December 2005, TLC as a distributor began direct-billing its customers. On 1 April 2007, TLC changed its LFC tariff from being based on kWh consumption to being based on peak kW demand. TLC determined that the average consumer for the purposes of the Regulations had a peak demand of 1.9 kW.¹
9. Since 2011, the Authority has received and considered two complaints that TLC's peak kW demand charging breached the Regulations. The Committee's decisions on these complaints are set out in the 'Previous decisions' section below.
10. Subsequent to those decisions, in February 2014, the Authority received a complaint from [REDACTED] on TLC's methodology for calculating the kW demand for an average consumer under the Regulations.
11. In March 2014, the Authority requested Strata Energy Consulting Limited (Strata) review TLC's compliance with the Regulations. Strata completed its report and reached several conclusions including recommending that the Authority obtain a legal opinion on the definition of 'variable charge' in the Regulations.

¹ From 1 April 2014, TLC assessed the kW demand for the average consumer on its network to be 2.4kW.

12. In April 2014, the Authority sought a legal opinion from Buddle Findlay on whether the variable charge for TLC's LFC tariff was a variable charge as defined by the Regulations.
13. Buddle Findlay opined that the variable charge in TLC's LFC tariff was not a variable charge under regulation 4(1) of the Regulations and that TLC had consequently breached regulation 14(1)(c) by recovering charges for something that was not provided for under that regulation.
14. On 27 June 2014, the Committee appointed an investigator to formally investigate TLC's alleged breach of regulation 14(1)(c). When it notified TLC of the Committee's decision to appoint an investigator, Compliance provided TLC with copies of:
 - (a) the memorandum on which the Committee made its decision
 - (b) the report from Strata referred to in the memorandum
 - (c) Buddle Findlay's opinion.
15. Being an investigation of an alleged breach of the Regulations, Compliance did not publicise the investigation.²
16. On 22 July 2014, MBIE provided the investigator with a copy of an internal Ministry of Development³ email dated 29 June 2004, indicating that when the Regulations were drafted, it was intended that a variable charge based on kW demand was a variable charge under the Regulations.
17. TLC requested an extension to 29 August 2014 to enable it to fully respond to the notified investigation.
18. On 6 August 2014, the investigator and legal staff met with TLC and its legal and economic advisors to discuss the alleged breach. At the meeting, the investigator confirmed that the two issues behind the alleged breach were those in paragraph 24 of the memorandum to the Compliance Committee, summarised as:
 - (a) the variable charge component in the TLC tariff did not vary according to the amount of electricity consumed (as required under the definition of 'variable charge' in regulation 4(1))
 - (b) the variable charge for TLC's LFC tariff is based on kW demand derived from peak usage, rather than the entire amount of electricity consumed in a year in kWh.

On 29 August 2014, TLC responded to the notice of investigation, outlining its view that it had not breached the Regulations. TLC supported its response with legal opinions from James Farmer QC and Russell McVeagh, along with a report from Sapere Research Group Limited.

² Publicising an investigation is a requirement under the Electricity Industry (Enforcement) Regulations which do not apply in this case.

³ MBIE's predecessor

19. TLC responded that:
- (a) its variable charge does vary according to the amount of electricity consumed: the quantity (kW) is based on consumption during the qualifying six two-hour load control periods. The amount of electricity consumed during these periods (whether established by time of use meter or by applying a profile) determines the quantity (kW) for the purpose of the variable charge that TLC charges the customer
 - (b) contrary to the view expressed in Buddle Findlay's opinion, the Regulations do not require the variable charge to be based on total annual consumption in kWh. TLC considers that regulations 10(3) and 16(2)(a) expressly contemplate that variable charges may differ according to consumption at different times of the day or year, as TLC's charges do.
20. On 5 November 2014, the investigator received an external legal opinion on TLC's response (follow-up legal opinion).
21. The follow-up legal opinion, which considered TLC's two legal opinions:
- (a) maintains the view that TLC's LFC tariff does not comply with the Regulations
 - (b) clarifies that the original legal opinion provided to the Authority did not suggest that any individual variable charge must vary according to the amount of electricity consumer over a year
 - (c) concludes that if an LFC tariff only contains one variable charge, and not multiple variable charges, that single variable charge must vary according to the amount of electricity that a consumer consumes over a whole year. TLC's LFC tariff contains just one variable charge, but that variable charge only varies according to electricity consumption in certain periods. A consumer's electricity consumption over the rest of the year has no bearing on the variable charge in TLC's LFC tariff at all. The follow-up legal opinion therefore maintained the view that TLC's LFC tariff does not comply with the Regulations.
22. However, the investigator agrees with the reasoning in TLC's response, and disagrees with the view in the follow-up legal opinion. The Regulations do not require the variable charge to be based on total annual consumption. Regulation 16(2)(a) permits distributors to set different variable charges for controlled and uncontrolled load or for electricity consumption at different times of the day or year. Regulation 16(2)(a) therefore allows the variable charge to cover times of peak demand, which aligns with TLC's LFC kW demand charge that is based on consumption during the six two-hour load control periods of greatest consumption over 90 days.
23. Therefore, the investigator accepts TLC's view that the variable charge in its LFC tariff does comply with the definition under regulation 4(1) of the Regulations because the variable charge varies in accordance with the six two-hour load control periods of greatest consumption.

24. MED's email dated 29 June 2004 also support's TLC's view. The email indicates that the legislative intent at the time of drafting the Regulations was that a variable charge based on kW demand was a valid variable charge under the Regulations.
25. Regulation 23(c) requires distributors to provide the Authority with calculations on LFC tariffs and the alternative standard tariffs. TLC has provided calculations showing that the average domestic consumer on its network has an average peak demand of 2.4kW. TLC's calculations provided under regulation 23(c) show how an average domestic consumer on TLCs LFC tariff option would pay no more than on any alternative option.
26. The position that TLC's LFC tariff is compliant with the Regulations can create a confusing position for certain consumers:
 - (a) a TLC consumer with a kW demand greater than the average consumer (i.e. 2.4 kW) but with an annual kWh consumption less than the average consumer (i.e. 8,000 kWh) would not be better off on TLC's LFC tariff
 - (b) however, because the consumer's retailer uses 8,000 kWh as the threshold for the average consumer (as opposed to TLC's 2.4 kW demand measure), the consumer would be better off on its retailer's LFC tariff
 - (c) similarly, a TLC customer with a kW demand of less than 2.4 kW and annual kWh consumption of greater than 8,000 kWh would be better off on TLC's LFC option but worse off on the retailer's LFC option.

Relevant provisions

27. Regulation 4 of the Regulations provides:

4 Interpretation

- (1) In these regulations, unless the context otherwise requires,—
average consumer means,—
 - (a) in relation to a consumer whose home is in the Lower South region, a person who purchases or uses 9 000 kWh of electricity per year in respect of that home; or
 - (b) in relation to a consumer whose home is elsewhere in New Zealand, a person who purchases or uses 8 000 kWh of electricity per year in respect of that home

variable charge means a charge that varies according to the amount of electricity consumed (for example, cents per kilowatt hour).

28. Regulation 14(1) of the Regulations provides:

14 Regulated distributor tariff option

- (1) An electricity distributor must ensure that any arrangement it has with an electricity retailer in respect of a home that is on a bundled low fixed charge tariff option, and that any arrangement it has with a domestic consumer in

respect of a home that is on a split-charging low fixed charge tariff option, complies with the following minimum requirements:

- (a) the electricity distributor must not charge more than 1 fixed charge for the line function services supplied to the home; and
- (b) that fixed charge must be not more than 15 cents per day, excluding goods and services tax; and
- (c) the electricity distributor may not recover any charges associated with the delivered electricity supplied to the home other than by all or any of the following:
 - (i) the fixed charge referred to in paragraph (b); and
 - (ii) a variable charge or charges; and
 - (iii) any fees for special services; and
 - (iv) any fee payable for providing or reading any meter that is owned by the electricity distributor; and
 - (v) any fee payable for providing any relay that is owned by the electricity distributor.

Previous decisions

- 29. In July 2011, Grey Power New Zealand complained to the Authority that TLC's pricing methodology breached the Regulations. In September 2012, the Committee decided not to take further action on the matter, but issued compliance advice to TLC to improve its coordination with retailers on its network. This was because retailers use 8,000 kWh per year as the consumption of the average consumer, in contrast with TLC's use of 2.2 kW (at the time) as the demand for an average consumer.
- 30. On 30 November 2012, the Authority received a complaint from [REDACTED] that TLC would not put him on the LFC tariff. TLC's reasoning for this was that if it did so, [REDACTED] power bill would exceed a bill for an equivalent amount of consumption under the standard pricing option due to his high kW demand. This was despite [REDACTED] electricity consumption being less than 8,000 kWh per year.
- 31. On 30 January 2013, the Committee considered [REDACTED] complaint and decided that TLC had breached regulation 15(1) of the Regulations. The Committee issued a warning letter to TLC requiring it to comply with this regulation. TLC breached regulation 15(1) because in certain circumstances, an average consumer defined in the Regulations as using 8,000 kWh per year would pay more in total per year for the fixed and variable charges under TLC's LFC tariff than it would under any of TLC's alternative tariff options.

Correspondence

- 32. A copy of all relevant correspondence held by the investigator and the Authority relating to the alleged breach is attached in Appendix A.

Options for the Committee

33. The Committee has the following further options with respect to the alleged breach covered in this report:
- (a) take no further action;
 - (b) issue a compliance advice letter;
 - (c) issue a warning letter;
 - (d) require TLC to undertake remedial action; or
 - (e) recommend to the Board that the Authority take prosecution action.

Appendix A Relevant correspondence

Date	From	To	Information
21 Feb 2014	██████████	Carl Hansen	Complaint
Mar 2014	Strata Consulting Limited	Peter Wakefield	Review of TLC's Compliance with low fixed charge regulations
5 May 2014	Buddle Findlay	Jude Murdoch	Advice on TLC's Compliance with low fixed charge regulations
27 June 2014	Peter Wakefield	Compliance Committee	Memorandum to Compliance Committee recommending investigation
4 July 2014	Peter Wakefield	TLC	Notification of investigation
22 July 2014	MBIE	Peter Wakefield	Copy of email dated 29 June 2004 indicating the intent of the regulations considered a kW charge to be a valid variable charge
29 Aug 2014	TLC	Peter Wakefield	Response to notice of investigation
12 Nov 2014	Buddle Findlay	Jude Murdoch	Follow-up advice on TLC's Compliance with low fixed charge regulations

From: [REDACTED]
To: [Carl Hansen](#)
Cc: [Peter Wakefield](#); [Roger Sowry](#); [Ross Hill](#); [s.bridges@ministers.govt.nz](#); [Judi Jones](#); [trevor.mallard@parliament.govt.nz](#); [REDACTED]
Subject: Re: Additional Complaint against The Lines Company
Date: Friday, 21 February 2014 2:36:05 p.m.
Attachments: [ATT00001.jpg](#)
[39982 \[REDACTED\] NIT_FINAL.docx](#)
[39982 \[REDACTED\] Recommendation_FINAL.docx](#)

Dear Mr Hansen

Further to my 18 July 2013 follow-up complaint against The Lines Company (TLC) I am now providing further information for consideration at the Compliance Committee's meeting on 28 Feb 2014 (as per your previous email to me). However this information is also relevant to my earlier complaint and the EA's response to that and subsequent actions.

First some background.

As you are aware, in 2013 the Electricity Authority (EA) found TLC was in breach of the conditions of its partial exemption from the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 - henceforth LFC regulations - as granted in September 2005.

Nevertheless, following the EA's warning letter early last year and the subsequent machinations, TLC publicly continued to maintain the position that in fact it had been entitled to apply the exemption to a much broader group of customers than the exemption provided for, and also implied in public that this position was supported by the EA.

The obvious point of this farce has been for TLC to avoid making proper reparations to customers that were unlawfully removed from TLC's LFC tariff in July 2012, and in fact I am aware of customers who have requested the appropriate corrections after May 2013 (which is when TLC started allowing customers to reapply) but have been summarily rebuffed. There is also the issue of some other potentially very large number of customers that TLC failed to put onto their LFC tariff in the earlier years, based on the false claim that those customers were covered by the exemption.

On the other hand it is the EA's stated responsibility and obligation to monitor and enforce the LFC regulations. Quoting directly from the EA's website: "The Authority is also responsible for monitoring compliance, investigating alleged breaches, and if necessary, taking enforcement action in relation to [the LFC regs]".

I believe your organisation has failed to do this with due care and rigour, and that a very large part of the blame for the current mess (not to mention direct financial harm to a very large number of customers) falls directly at your feet.

Here's a selection of examples, incomplete, but enough I believe to make the point:

- The EA failed to monitor and enforce mandatory reporting of information as required by 22(b) and 23(i), such that King Country Energy provided no returns at all over many years, was simultaneously failing to promote their LFC tariff as also required, with an end result that only a very low number of customers were receiving the appropriate LFC tariff. I can only assume

similar sloppiness applies elsewhere also.

- The EA has failed to clarify and enforce the regulations where they clearly and unequivocally state in 4(1)(b) that the average consumer (in my part of NZ at least) is one that "purchases or uses 8 000 kWh of electricity per year" in respect of their home. Instead the EA have allowed TLC to use a gross distortion of this, claiming this is "equivalent" to a 2.2 peak kW demand as used by TLC. Furthermore the documents I have received from the EA indicate TLC have not provided any further evidence or justification or updates of this 2.2 kW value since 2009. Even then the original argument and calculations given to justify it to the EA (in Dec 2009) were as dodgy as hell yet again blithely accepted without question by the EA.
- The EA has (to date) completely failed to require TLC to make proper reparations to all customers that it unlawfully removed in July 2012 from its regulated LFC tariff, or to properly document or justify this. This also despite me being told by Peter Wakefield (in the early stages of his investigation into my complaint) that if TLC was found to be in breach that then they would be required to make the appropriate reparations and corrections to historical billing of all affected customers. Clearly Peter understood the basic principles of justice when he said this to me, but subsequently your Compliance Committee has apparently seen fit instead avoid its obligation to protect those customers from TLC's blatant and unlawful abuse of its exemption.
- The EA has apparently endorsed a definition of "single line" (as used in regulation 28 of the LFC regs) that is clearly inconsistent with TLC's original application and subsequent supporting information, including maps and so on, resulting in TLC still being able to unlawfully apply its exemption to far more customers than what it applied for in 2005. No wonder TLC's ██████ exclaimed (in her email) "this is very good news" after hearing what the EA was giving its tacit approval to!

As a result of some of these failings, I was subsequently left with little choice but to lay yet another complaint against TLC with the Electricity and Gas Complaints Commissioner. The polite version of this complaint is that TLC incorrectly removed me from their LFC tariff in July 2012 and then unreasonably continued to argue that I had not been eligible prior to this time. They continued this obnoxious behaviour after May 2013, and as I understand it, also with the full knowledge and apparent blessing of your organisation.

That complaint (as outlined above) has been upheld by the Commissioner, Judi Jones, and a binding decision against TLC has been very recently issued by her office.

I believe the Commissioner's careful and clear analysis of the situation means this must be acted upon by the EA and that TLC must therefore finally be required to make proper reparations and corrections for all those other customers that were unlawfully removed from TLC's regulated LFC tariff in July 2012. My original complaint to the EA was not just on my behalf - it concerned all affected customers - and yet the EA effectively did nothing to ensure that justice was properly done, and seen to be done, apart (apparently) from the minimum needed to placate me.

It is not acceptable that the EA mimics Pontius Pilate and simply washes its hands of the matter, perhaps suggesting these other affected customers can deal individually and directly with TLC. That is simply unrealistic, especially in the face of TLC's continuing obnoxious and dishonest behaviour. What is required instead is direct and effective action from your organisation to put things right, and for this also to be seen to be done.

The Commissioner's analysis also has direct relevance to my 18 July 2013 complaint concerning the homes connected to the 10K26 transformer in Owhango. As I have pointed out to you previously, this transformer was not included in the list TLC submitted to the MED staff in support of their application for an exemption in 2005. Similarly the transformer supplying my home was not included, a factor which the Commissioner included in her final analysis and decision.

Even the most "generous interpretation" for the meaning of that list of transformers makes it clear that the MED staff and responsible Minister were NOT provided direct information about the connected properties and that therefore TLC could not have intended their application to cover the connected properties. Just as clearly, the MED staff involved and the responsible Minister of the time must also have understood that.

Copies of the most important documentation relating to this decision can be downloaded directly from the following links (the first three files are as provided to me by the EGCC except that I have renamed the files for clarity, and the last is a copy of the letter concerning the final binding decision with my signature to confirm acceptance of it).

[REDACTED]

[REDACTED]

I have also attached Microsoft Word files (exactly as provided to me by the EGCC's staff yesterday) that contain the text (unsigned) of Judi Jones' proposed recommendation and final recommendation. These documents allow for more convenient searching, and copying of extracts, as compared the copies in the links above. However please note that there are additional appendices and so on in the scanned copies (as per the above links), that are missing from the Word documents.

Finally, as well as the EA addressees, please note that I have also copied this to the Minister of Energy the Hon Simon Bridges, the Hon Trevor Mallard (who approved the original exemption), and also to the EGC Commissioner, Judi Jones.

Yours sincerely,

[REDACTED]



strata

ENERGY CONSULTING

Review of TLC Compliance with Low Fixed Charge Regulations

**Prepared for:
The Electricity Authority**

March 2014

Preface



Strata Energy Consulting Limited specialises in providing services relating to the energy industry and energy utilisation. The Company was established in 2003. Strata Energy Consulting provides advice to clients through its own resources and through a network of associate organisations. Strata Energy Consulting has completed work on a wide range of topics for clients in the energy sector in both New Zealand and overseas.

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Executive Summary

Low Fixed Charge Regulations

The Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 (Regulations) regulate how retailers and distributors will charge for electricity to low use domestic consumers.

A low use consumer means a domestic consumer who, in respect of his or her home, purchases or uses less electricity per year than an average consumer purchases or uses per year in respect of a home in the same region.¹

An average consumer means:

- (a) in relation to a consumer whose home is in the Lower South region, a person who purchases or uses 9 000 kWh of electricity per year in respect of that home; or
- (b) in relation to a consumer whose home is elsewhere in New Zealand, a person who purchases or uses 8 000 kWh of electricity per year in respect of that home.²

The regulations also prescribe that variable charge or charges in a low fixed charge tariff option must be such that the average consumer would pay no more in total per year for the fixed charge and the variable charges than the average consumer would pay in total per year for those same matters on any alternative tariff option.³

A variable charge means a charge that varies according to the amount of electricity consumed (for example, cents per kilowatt hour).⁴

Note that the example in the definition above is not a "charge". It is a rate. The charge would be based on kWh consumption multiplied by the rate.

Based on the above extracts from the Regulations it is clear that variable charges relate to the amount of electricity consumed or used by either the low use consumer or the average consumer. Electricity consumption is measured in kWh.

The tariffs offered by the Lines Company lead to charges that are not directly based on consumption. They are based on the rate at which electricity is consumed which is kWh/h that is kW. For most domestic consumers, the kW demand is derived from the average kWh consumption of a sample of consumers.

Domestic consumers are not being charged for the amount of electricity consumed during a chargeable demand period. The variable charges are based the rate at which they consume electricity.

In using this approach, TLC appears to be in breach of the Regulations.

¹ Regulation 4

² Ibid

³ Regulation 9

⁴ Regulation 4

The methods used by TLC to derive the kW demand of the average domestic consumer during the chargeable demand period are not subject to Regulations and no compliance issues arise.

It is not clear how arrangements with retailers operating on the TLC networks are managed to ensure that retailers and TLC can meet the requirements of Regulations 8 and 14.

There is no requirement to have more than one regulated distributor tariff option. However, the regulated tariff option must meet the requirements of Regulation 14, which requires a variable charge (or charges).

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Introduction

2. The Electricity Authority (EA) has commissioned Strata Energy to undertake the following:
 - (a) Review The Lines Company's (TLC) formulae, graphs and explanations of their Low Fixed Charge tariff criteria;
 - (b) Comment on relevant aspects of Sapere's "Assessment of Compliance of TLC's Low Fixed Charge Tariff";
 - (c) Provide a report on the compliance of the TLC Pricing with the Low Fixed Charge Regulations.

Background

3. The Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 (Regulations) regulate how retailers and distributors will charge for electricity to low use domestic consumers.
4. The Regulations were introduced in October 2004. Despite considerable objections from industry participants they were welcomed by others who saw potential benefits to low power users and low income earners, including pensioners. In June 2005, the then Energy Minister, the Hon Trevor Mallard, issued a press release on the success of the Regulations saying:

"Under the regulation, the low fixed charge option must have a fixed daily charge of no more than 30 cents per day (excluding GST, after the deduction of prompt payment discount). The low fixed charge tariff option must also be cheaper for a consumer using less than 8000 kWh per year compared to the similar standard tariff option."⁵
5. The final sentence, while expressing the political intent, is not strictly correct, according to Sapere in their report to TLC "Assessment of Compliance of TLC's Low Fixed Charge Tariff" dated 26 March 2013 (Sapere Report). The Sapere Report states "There is no requirement that a low use consumer must pay a lower total annual charge than the average consumer for a given level of electricity consumption"⁶. Sapere illustrates how a LFC consumer with an annual consumption of 6000 kWh can pay more on a compliant LFC tariff than it would pay on a standard tariff.⁷
6. However, it is interesting to note that the MED on its web site dated 15 June 2012 states:

⁵ <http://www.scoop.co.nz/stories/PA0506/S00268/cheaper-electricity-bills-from-new-regulation.htm>

⁶ Sapere Report p3

⁷ Ibid p6

“Domestic consumers consuming less than 8000 kWh, per year must pay less on a low fixed charge tariff option than on any corresponding tariff option (from 1 April 2009, this increases to 9000 kWh per year for consumers in the lower South Island (Christchurch and below, excluding the West Coast)”.⁸

7. From the above it can be assumed that the Regulations were not drafted in accordance with the government’s guidelines or intentions or that the Regulations are based on charging requirements which would not allow a LFC consumer to ever pay more on the LFC tariff than on the alternative tariff when consumption is less than 8000 kWh.
8. The objective of the Regulations is to:
 - (a) ensure that electricity retailers offer a low fixed charge tariff option or options for delivered electricity to domestic consumers at their principal place of residence that will assist low-use consumers and encourage energy conservation;
 - (b) regulate electricity distributors so as to assist electricity retailers to deliver low fixed charge tariff options⁹
9. A low use consumer means a domestic consumer who, in respect of his or her home, purchases or uses less electricity per year than an average consumer purchases or uses per year in respect of a home in the same region.¹⁰
10. An average consumer means:
 - (a) in relation to a consumer whose home is in the Lower South region, a person who purchases or uses 9 000 kWh of electricity per year in respect of that home; or
 - (b) in relation to a consumer whose home is elsewhere in New Zealand, a person who purchases or uses 8 000 kWh of electricity per year in respect of that home.¹¹
11. The Lines Company is located in a region where (b) applies.
12. Each low fixed charge tariff option that an electricity retailer makes available in respect of a home must be of one of the following types:
 - (a) a bundled low fixed charge tariff option, under which the electricity retailer is the only person that charges the consumer directly in respect of the delivered electricity supplied to the home; or
 - (b) a split-charging low fixed charge tariff option, under which:

⁸ <http://www.med.govt.nz/sectors-industries/energy/electricity/regulatory-framework/electricity-industry-regulations/electricity-low-fixed-charge-tariff-option-for-domestic-consumers-regulations-2004>

⁹ Regulation 3

¹⁰ Regulation 4

¹¹ Ibid

- (i) the electricity distributor charges the consumer directly under a regulated distributor tariff option in respect of some services associated with the delivered electricity supplied in the home; and
 - (ii) the electricity retailer charges the consumer directly in respect of the rest of the delivered electricity supplied to the home.¹²
- 13. The electricity retailer must ensure that any low fixed charge tariff option that it makes available in respect of a home complies with the following minimum requirements:
 - (a) the electricity retailer must not charge the consumer more than 1 fixed charge for the delivered electricity supplied to the home; and
 - (b) in the case of a bundled low fixed charge tariff option, that 1 fixed charge must be not more than 30 cents per day, excluding goods and services tax; and
 - (c) in the case of a split-charging low fixed charge tariff option, the fixed charge must be not more than 30 cents per day (excluding goods and services tax), less the amount charged directly to the consumer by the electricity distributor under a regulated distributor tariff option¹³
- 14. The above extracts from the regulations require retailers to make a low fixed charge tariff option available to low use consumers and prescribe minimum requirements that the retailer must meet even if a split charging arrangement is in place whereby a distributor charges consumers directly for distribution services.
- 15. The regulations also prescribe that variable charge or charges in a low fixed charge tariff option must be such that the average consumer would pay no more in total per year for the fixed charge and the variable charges than the average consumer would pay in total per year for those same matters on any alternative tariff option.¹⁴
- 16. A variable charge means a charge that varies according to the amount of electricity consumed (for example, cents per kilowatt hour).
 - (a) A delivered electricity package is the same as another delivered electricity package if the nature of the goods and services to be supplied are the same, or substantially the same in terms of features like meter and relay configuration allowing for load control, prepayment meters, time of day or winter-summer electricity consumption, and kilovolt-ampere (kVA) rating.
 - (b) In these regulations, references to an electricity distributor doing anything to or for domestic consumers includes doing so directly or indirectly via the electricity retailer.¹⁵
- 17. The Regulations continue by prescribing how distributors have to charge to assist retailers who offer a low fixed charge option.¹⁶ They also prescribe that the variable

¹² Regulation 7

¹³ Regulation 8

¹⁴ Regulation 9

¹⁵ Regulation 4

charge or charges in a regulated distributor tariff option must be such that the average consumer would pay no more in total per year for the fixed charge, and variable charges charged in accordance with regulation 14(c)(i), and (ii) than the average consumer would pay in total per year for those same matters on any alternative distributor tariff option¹⁷.

TLC Pricing Methodology

Pricing for low fixed charge option

18. TLC has stated in a letter to the Compliance Committee that it "...is proud that its time-of-use tariffs and other actions have helped its customers to better understand and control their electricity usage, keeping their charges down and lowering demand on TLC's network (which in turn reduces the need for TLC to commit to more capital expenditure on its network, which would increase prices)".¹⁸
19. In the same letter TLC makes the point that "The Authority has confirmed that if a variable charge is based not only on the amount of electricity consumed but also the time at which it is used (ie a "time-of-use tariff"), then the average usage pattern of an average consumer (based on sampling and data analysis) is the relevant benchmark for assessing compliance with regulation 15(1)."
20. The letter provides an explanation of the methodology used by TLC to design its time-of-use tariffs, as follows, "In 2009 TLC took a sample of its consumers whose annual consumption was between 7,000 kWh and 9,000 kWh. It measured their consumption in a 92 day peak-use period, which showed that the average usage pattern of those consumers in that period was around 1515 kWh. That figure was then converted to a load factor (sic) of 2.2 kW using a formula.¹⁹ The LFC tariff option was then set to be equivalent to TLC's alternative (standard) option at that point (2.2 kW). That is, a consumer with the average usage pattern for TLC's average consumers would pay no more on TLC's LFC tariff option. TLC is willing to update its sampling on a regular basis and will discuss this with the Authority".
21. TLC's Pricing Methodology is therefore based on providing its customers with a demand related (kW) pricing signal which is consistent with the EA's Pricing Principles, in particular that "Prices are to signal the economic costs of service provision²⁰".
22. However, this particular pricing methodology is inconsistent with the objectives of the Regulations, which are based on assisting low use domestic consumers (to reduce their electricity costs) and encouraging energy conservation (by having a higher kWh charge than the standard tariff). The conflict between the Regulations and the EA's

¹⁶ Regulations 13 to 17

¹⁷ Regulation 15.1

¹⁸ Letter from TLC to Compliance Committee dated 12 March 2013 *Alleged Breach of Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004*

¹⁹ Load factor is the ratio of average consumption in a period to the consumption based on the maximum demand in the period

²⁰ Appendix A - *Decision-making and economic framework for distribution pricing Decisions and reasons*, EA 5 March 2013

Distribution Pricing Principles has been noted in the recent Castalia review of Electricity Distribution Businesses' Pricing Methodologies.²¹

23. The TLC domestic tariff is a fixed charge plus a \$/kW charge based on winter peak consumption. In order to obtain the kW demand of consumers who do not have time of use (TOU) meters, TLC has developed a sophisticated profiling approach that uses TOU meters on representative loads to provide profiles that can derive kW demand based on kWh consumption for specific categories of consumers. These profiles could also be used to allocate usage into control periods, seasons or specific times of the day²².
24. The inconsistency with the LFC Regulations arises from the definition of "variable charge" in the Regulations, which is "a charge that varies according to the amount of electricity consumed (for example, cents per kilowatt hour)".
25. This example is not helpful as it confuses the charge (total \$) with the unit cost (c/kWh) ie the rate per unit consumed. There appears to be a similar confusion of the term "charge" in Regulation 16.1 which forbids "variable charges for domestic consumers that are tiered or stepped according to the amount of electricity consumed".
26. The "amount of electricity consumed" refers to a consumer's energy consumption ie the amount of kWh used in a year (the average consumer is defined to consume 8000 kWh in a year).²³ TLC's pricing is, however, based on the highest rate at which an average consumer uses electricity in particular periods (average of the six highest kW demands in the winter period), and not on the amount of electricity consumed over a year.
27. TLC has obtained a legal opinion that a "load cost" constitutes a variable charge under the Regulations. This opinion does not closely examine the context of the definition, it confuses the rate of consumption with the amount of consumption and equates conservation of energy with reduction in marginal losses.
28. TLC has developed a report to the EA which attempts to overcome the inconsistencies between its Pricing Methodology and the requirements of the Regulations. This TLC report shows how the kW demand of the average consumer is developed using a statistical analysis of the representative domestic consumers' consumptions as described in para 20. It then identifies the standard variable charge as a kW*\$/kW. This charge together with the fixed daily charge is the alternative tariff option with which the low fixed charge option is compared for the average consumer to ensure that the average consumer would not pay more in a year than on the alternative option.

²¹Review of Electricity Distribution Businesses' 2013 Pricing Methodologies Report to the Electricity Authority Castalia, November 2013

²² The use of approved profiles for allocating energy consumption has been used for reconciliation purposes since the introduction of full retail competition in the electricity market.

²³ See *The ambit of variable charges under the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004* by Russell McVeagh, August 2011.

29. TLC then proceed as if the Regulations prescribed that:

The variable charge or charges in a low fixed charge tariff option must be such that the average consumer with an average winter peak demand of "x" kW would pay no more in total per year for the fixed charge and the variable charges (based on their rate of energy consumption) than the average consumer with an average winter peak demand of "x" kW would pay in total per year for those same matters on any alternative tariff option.

30. Effectively, TLC has qualified the definition of an average consumer by misinterpreting the definition of variable charge.

31. TLC has gone to a lot of effort to fit a square peg into a round hole, but unless the Regulations are amended by either a change to the definition of variable charges or by the inclusion of an exemption for the TLC approach, the company must either change its pricing methodology or probably be in breach of the Regulations.

Load Factor

32. In its 2014 disclosures, the average 2.4 kW for the purposes of Regulations is derived as shown below.

Table 1 Derivation of Demand for Average Consumer

2014 Pricing year	Installations: PPR between 7-9,000 kWh/annum	Total consumption, - annual sept2012-sept2013	Uncontrolled consumption only - annual Sept 2012-Sept2013	Uncontrolled consumption - 92 day period 2013 winter	Average usage pattern (proportion of uncontrolled consumption in 92 day period)
		Sum kWh			
total	1980	15,811,644	10,761,055	3,347,837	31.11%
2014					
	LFC Ave. consumer.		8000 kWh		
	LFC Uncontrolled annual consumption. 60/40		4800 kWh		
	31.11% UN 92 Day portion		1493 kWh		
Convert consumption into demand using current pricing formula					
2014 formula:					
kW Load = ((0.001782 x 92 day uncontrolled energy consumption + 2.114) x ½)					
	31.11% UN 92 Day portion	1493 kWh			
	kW load	2.39 kW			

"Average Consumer" for purposes of Low fixed charge tariff set at **2.4 kW** for disclosure year 2014-2015.

33. One of the features of a peak demand tariff is that the average c/kWh price depends on the load factor of the supply where the load factor is the ratio of the average kWh consumed to the maximum kWh that could be consumed during a given period.

34. The load factor can be expressed as kWh/kW/hours in the period. For the example given above the annual load factor is 8000 kWh/2.4 kW/8760 hours which is 0.38 or 38%.
35. For a load of 2.5kW the load factor at 8000 kWh is 0.37²⁴. The following tables show how charges could vary for an average consumer depending on whether the tariff is based on a standard load factor or a standard demand for domestic consumers whose demand is derived from their kWh consumption.

Table 2 Equivalent Tariffs for 2.5kW Consumer

Parameters	Standard Tariff	LFC Tariff
Daily Charge \$	0.5	0.15
Peak charge \$/kW	200	251.1
Annual Consumption	8000	8000
Peak Demand kW	2.5	2.5
Average variable c/kWh	6.25	7.85
Annual Charge \$	682.5	682.5

36. Table 2 shows that the annual charges under both tariff options are the same for the average consumer if all domestic consumers are assumed to have a demand of 2.5kW and the average consumption is 8000 kWh.

Table 3 Comparison of Charges for 2.5kW Consumer at varying Load Factors

Load Factor	Derived Annual kWh	Standard Tariff			LFC Tariff		
		Annual Charge \$	Average Annual c/kWh	Average Variable c/kWh	Annual Charge \$	Average Annual c/kWh	Average Variable c/kWh
1	21900	682.5	3.12	2.28	682.5	3.12	2.87
0.9	19710	682.5	3.46	2.54	682.5	3.46	3.18
0.8	17520	682.5	3.90	2.85	682.5	3.90	3.58
0.7	15330	682.5	4.45	3.26	682.5	4.45	4.09
0.6	13140	682.5	5.19	3.81	682.5	5.19	4.78
0.5	10950	682.5	6.23	4.57	682.5	6.23	5.73
0.4	8760	682.5	7.79	5.71	682.5	7.79	7.17
0.37	8000	682.5	8.53	6.25	682.5	8.53	7.85
0.3	6570	682.5	10.39	7.61	682.5	10.39	9.55
0.2	4380	682.5	15.58	11.42	682.5	15.58	14.33
0.1	2190	682.5	31.16	22.83	682.5	31.16	28.66

37. Table 3 illustrates that the annual charges for all levels of consumption are the same for the low use and the average consumers. The only difference is that the kW demand charge has been increased to compensate for the reduction in the daily charge. However, the amount paid per kWh of consumption varies depending on the

²⁴ The tariff parameters and the kW demand are from the Sapere Report p7

load factor of the supply. For a consumer with a specific level of demand there is no advantage in switching from the standard tariff to the LFC option, no matter what its kWh consumption level is.

38. A potential issue with this approach is that the c/kWh for the variable charge reduces with the level of consumption. This would appear not be consistent with Regulation 16(1) which states

- (a) A regulated distributor tariff option must not contain—
 - (i) variable charges for domestic consumers that are tiered or stepped according to the amount of electricity consumed

39. This regulation appears to confuse the rate with the charge to be used and would also be inconsistent with the objective of encouraging energy conservation.

Table 4 Comparison of charges for consumers with Load Factor of average consumer

Derived Demand kW	Annual kWh	Standard Tariff			LFC Tariff		
		Annual Charge \$	Average Annual c/kWh	Average Variable c/kWh	Annual Charge \$	Average Annual c/kWh	Average Variable c/kWh
6.2	20000	1416.6	7.08	2.50	1604.2	8.02	3.14
5.6	18000	1293.2	7.18	2.78	1449.2	8.05	3.49
4.9	16000	1169.8	7.31	3.13	1294.3	8.09	3.92
4.3	14000	1046.4	7.47	3.57	1139.3	8.14	4.48
3.7	12000	923.0	7.69	4.17	984.4	8.20	5.23
3.1	10000	799.6	8.00	5.00	829.5	8.29	6.28
2.5	8000	682.5	8.53	6.25	682.5	8.53	7.85
1.9	6000	552.7	9.21	8.33	519.6	8.66	10.46
1.2	4000	429.3	10.73	12.50	364.6	9.12	15.69
0.6	2000	305.9	15.30	25.00	209.7	10.48	31.39
0.3	1000	244.2	24.42	50.00	132.2	13.22	62.78

40. Table 4 shows that if all domestic consumers are assumed to have a load factor of 0.37, which is the load factor of the average consumer, the maximum demands and the average variable charges, can vary over a wide range of annual kWh consumption. In this case, the low use consumer is always better off on the LFC tariff than on the standard tariff. The major drawbacks are that the distributor cannot apply a single c/kWh rate to all consumers and actual demand could be significantly different from the derived demand if the consumer has a higher or lower load factor than the average consumer.

41. The TLC tariffs are more complex than the simple annual tariffs illustrated above and TLC has developed a standard profile which maps kW load to kWh consumption which effectively allocates a load factor to each consumption level which enables it to calculate a kW load based on the measured consumption over the 92 days winter period. The consumer’s average winter kW demand is used to bill the consumer.

42. One drawback with the peak demand pricing approach, as pointed out by Sapere, is if the actual consumption pattern varies from the average consumption pattern, the low use consumer could pay more on the LFC tariff. Also, the variable charge is based on a \$/kW rate and not a c/kWh rate as envisaged in the Regulations and consequently the derived c/kWh for the variable charge reduces with increase in consumption, which is not consistent with energy conservation.

Derivation of kW Demand

43. Table 1 illustrates the derivation of the kW demand for an average domestic consumer used by TLC for the purpose of the Regulations. This kW demand is used in the comparison of the charges for an average consumer taking supply on the LFC option or on an alternative option.
44. The method used by TLC to derive the average kW demand for consumers that consume between 7,000 and 9,000kWh has not been examined by Strata in any detail. However, there appears to be no dispute over its validity and it is consistent with applying a load factor to calculate demand in kW from consumption in kWh.
45. In the process of calculating the demand, TLC applies the ratios set out in Regulation 9(a) for separately charged, controlled and uncontrolled any-time electricity consumption; these are 40% of total consumption is controlled and 60% is uncontrolled.
46. During the standard 92-day winter period used to measure chargeable demand, the proportion of uncontrolled consumption is 31.11%. That ratio is applied to the annual uncontrolled consumption quantity to calculate the kWh used to derive the chargeable kW used for the LFC tariff.
47. The question arises as to whether the ratio of the uncontrolled consumption to controlled consumption in the control period should be used for calculating the annual uncontrolled consumption?
48. The answer would surely be no. As explained by TLC, the annual averages are based on the LFC Regulations. The 92-day uncontrolled percentage is based on measured quantities. By applying this to the average annual figure, the resulting kWh represents the uncontrolled kWh to be used for charging purposes.
49. TLC is basing its charges on the winter period consumption, not on the total consumption.
50. In any case, neither the Regulations or the Code require a specific method that a distributor must use to calculate the kW demand for a domestic consumer so there is no question as to whether the approach used by TLC is compliant.

Selection of LFC Consumers

51. The Regulations are directed primarily at retailers, but even where a distributor is supplying services directly to consumers, the relevant retailer must ensure that certain minimum requirements are met.²⁵
52. Distributors have obligations to assist retailers in meeting the minimum requirements relating to low use consumers but are only obliged to provide low fixed charge options for those consumers who have opted for the retailer's low fixed charge tariff option.
53. TLC appears to base its allocation of consumers on LFC tariff on the basis of the criteria used to define a LFC consumer and not on the basis of the consumers that have selected a low fixed charge option from their retailers. It is possible that LFC consumers on the TLC LFC tariff option pay more than an average consumer on the standard option, which would be contrary to the intent of the Regulations but not the content.²⁶ In those circumstances, the distributor should not allocate consumers who are not on a retailer's LFC tariff to its own LFC tariff, if the consumer will be disadvantaged.
54. It is not clear how arrangements with retailers operating on the TLC networks are managed to ensure that retailers and TLC can meet the requirements of Regulations 8 and 14.

Single Tariff for All Domestic Consumers

55. The EA has raised the issue of whether TLC could have a single tariff for all domestic consumers that would meet the requirements of the Regulations.
56. Regulation 14(2) allows a distributor to have only regulated tariff options as follows:
"If a home is not on a low fixed charge tariff option, the electricity distributor's arrangement with the electricity retailer in respect of that home must treat that home as not being on a regulated distributor tariff option (unless the electricity distributor has only regulated distributor tariff options)"²⁷.
57. There is no requirement to have more than one regulated distributor tariff option. However, the regulated tariff option must meet the requirements of Regulation 14, which requires a variable charge (or charges).

Sapere Report

58. The report discusses the Regulations and observes "It would be simple, yet incorrect, to assume a 'low use consumer' must pay a lower total annual charge than the 'average consumer' for a given level of consumption' but the Regulations do not require this".

²⁵ Regulation 8

²⁶ Sapere report page 5

²⁷ Regulation 14(2)

59. The Regulations require only that:

“The variable charge or charges in a low fixed charge tariff option must be such that the average consumer would pay no more in total per year for the fixed charge and the variable charges charged in accordance with regulation 8(d)(i) and (ii) than the average consumer would pay in total per year for those same matters on any alternative tariff option.”

60. Sapere’s first graph illustrates that a LFC consumer on a LFC tariff will always pay less when its consumption is less than the average consumer’s and will always pay more when its consumption is higher than the average, provided that the tariffs are based on annual kWh consumption²⁸.

61. Sapere goes on to illustrate that the Regulations allow for different tariff structures by referring to Regulation 4(2). and considers a number of possible tariff structures (that presumably would comply with Regulation 4(2)) as follows:

- (a) A seasonal kWh based tariff that might capture all consumption during a high demand period such as winter
- (b) A “peak” time of day period kWh component with a general annual kWh charge
- (c) A capacity or peak demand charge tariff

62. This particular Regulation states:

“A delivered electricity package is the same as another delivered electricity package if the nature of the goods and services to be supplied are the same, or substantially the same, in terms of features like meter and relay configuration allowing for load control, prepayment meters, time of day or winter-summer electricity consumption, and kilovolt-ampere (kVA) rating.”

63. The regulation does not provide for a “peak demand charge tariff”, but it does provide for a capacity charge based on kilovolt-ampere (kVA) rating.

64. These tariffs would have been more meaningful if they had been less hypothetical and related to actual tariffs in use in New Zealand. The vast majority of electricity is sold through retailers, and only a few innovative distributors are moving towards critical peak pricing or fully cost reflective tariffs. One of the impediments to innovative pricing that has been identified by distributors is the Low Fixed Charge Regulations. This is because the Regulations do not cater for these sorts of innovations.²⁹

65. However, the quantitative examples using the hypothetical tariffs do raise some interesting points.

66. In the section dealing with non-average customers, which deals with average and low use consumers, the point is made that the definition of “a low use consumer is based on annual consumption, and that where a tariff structure has variable charges other than total kWh consumed ...there is not a direct relationship between the total annual

²⁸ Sapere Report p3

²⁹ Castalia Report pi

charge and the total kWh consumed". This reinforces the criticism of the limitations on innovative tariffs posed by the Regulations as the Regulations do not allow for variable charges other than for kWh³⁰.

67. The Sapere examples for seasonal and peak time of day tariffs illustrate situations where the charges are based on periods other than the full year. Anomalies can occur such that some consumers with less than the average consumption can pay more per annum than they would on an alternative tariff despite using less than 8000 kWh per annum³¹. The average consumer would not pay more on the LFC than it would on the alternative tariff so the the tariff would be compliant with the letter of the Regulations, but as the LFC consumer would pay more on the LFC tariff than on the standard tariff for consumption of less than 8000 kWh, the LFC tariffs would not be compliant with the intent of the Regulations.
68. The example on peak demand defines the average consumer as having a peak demand of 2.5kW but the Regulations define the average consumer as having annual consumption of 8000 kWh, so it is not relevant. However, Sapere comments that "It is possible for low use consumers who have differing patterns of consumption to the average consumer to fall on either side of the cross-over point"³². That suggests that a low use consumer could pay more in total on the LFC tariff for consumption less than 8000 kWh than if it were on the alternative option.
69. In analysing the TLC Methodology, Sapere confuses capacity charging with peak demand charging. Capacity relates to the rating of the consumer's installation in kVA or in amperes. Demand in kW relates to the rate of consumption of kWh.

Conclusions and Recommendations

Conclusions

70. The tariffs used by TLC appear to be inconsistent with the requirements of the Regulations. TLC apply variable charges that are not directly based on the annual consumption or usage of electricity (in kWh) but are based on the average maximum rate of consumption (kW) in a chargeable period derived from a statistical analysis of the consumption of a sample of the total number of domestic consumers.
71. The legal opinion received by TLC and provided to the Authority on whether kW charges are consistent with the definition of variable charges in the Regulations appears to be incorrect.
72. TLC appears to be in breach of the Regulations.
73. The method used to derive the average maximum demand in a chargeable period is not subject to the Regulations or the Code and, therefore, compliance is not an issue.

³⁰ This point is disputed by TLC and Sapere

³¹ Sapere Report p6

³² Ibid p7

74. TLC could be charging low use consumers more on the low fixed charge option than on the alternative option but, while this is not consistent with the intent of the Regulations, it is not inconsistent with the Regulations.
75. It is not clear how arrangements with retailers operating on the TLC networks are managed to ensure that retailers and TLC can meet the requirements of Regulations 8 and 14.

Recommendations

76. It is recommended that:
 - (a) The Authority should consider obtaining a legal opinion on the definition of variable charges in the Regulations; and
 - (b) If the legal opinion supports the conclusions in this report, the Compliance Committee should consider whether TLC is in breach of the Regulations.

5 May 2014

To

Jude Murdoch
Legal Counsel
Electricity Authority
Level 7, ASB Bank Tower
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Copy to

Peter Wakefield, Senior Investigator
peter.wakefield@ea.govt.nz

From

Dipti Manchanda
Tony Dellow

By Email

jude.murdoch@ea.govt.nz

Dear Jude

The Lines Company's compliance with the Low Fixed Charge Regulations

1. In your email of 8 April 2014, you asked us to review the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 and Strata Energy Consulting's report entitled *Review of The Lines Company Compliance with Low Fixed Charge Regulations*. You also asked for our advice on whether the variable charge in the Low Fixed Charge tariff set by The Lines Company complies with the regulations. This letter outlines our advice.

2. **Background**

The Strata report assesses whether the variable charge in the LFC tariff set by The Lines Company complies with the regulations. The Strata report concludes that The Lines Company's LFC tariff is inconsistent with the regulations because the variable charge is not based on the amount of electricity a consumer consumes, measured in kWh. Instead, the variable charge is based on the rate of a consumer's consumption of electricity, measured in kW.

3. **Our advice**

Although The Lines Company's variable charge is based on kW, The Lines Company calculates a consumer's kW load based on the amount of electricity (in kWh) that the consumer consumes. The Lines Company's kW charge is therefore based on an "amount of electricity consumed" as required by the regulations' definition of "variable charge". However, the variable charge does not comply with regulation 14(1) of the regulations because The Lines Company charges consumers based on the amount of electricity consumed in six two-hour peak periods, rather than per year, and

the variable charge is tiered or stepped according to the amount of electricity consumed in breach of regulation 16(1)(a).

4. Our understanding of how The Lines Company sets the variable charge in its LFC tariff

The Lines Company charges consumers based on an assessment of their peak kW load, or, for consumers with time of use meters, on their actual kW demand. A consumer's kW demand is derived from the amount of electricity the consumer consumes, measured in kWh, as follows:

- (a) The Lines Company develops a profile for an average consumer, based on all consumers whose annual consumption of electricity is between 7,000 kWh and 9,000 kWh. The Lines Company then uses this profile for an average consumer to derive a formula that converts consumption in kWh to a kW load.
- (b) The Lines Company obtains a measure of the amount of electricity a consumer has consumed, in kWh. For a consumer that has a time of use meter, this measure is the average of six readings taken over peak consumption times in a 92-day winter period. For a consumer that does not have a time of use meter, this measure is based on the consumer's total kWh consumption over the same 92-day period.
- (c) For a consumer who does not have a time of use meter, The Lines Company then applies the formula derived in step (a) to that consumer's kWh measure, as determined in step (b), to give The Lines Company a value that is used as the consumer's kW load. For a consumer that has a time of use meter, their kWh measure, as determined in step (b), is converted to a kW load. The consumer is then charged based on \$/kW.

As required by regulation 15(1), The Lines Company sets its LFC tariff so that the average consumer on its LFC tariff pays no more in total per year than the average consumer pays in total per year on any of its alternative tariff options.

5. The Lines Company's kW based charge is based on an amount of electricity consumed

Regulation 4(1) defines "variable charge" as "*a charge that varies according to the amount of electricity consumed*". The Strata report concludes that because the variable charge in The Lines Company's LFC tariff is based on kW, not kWh, it is not a variable charge under the regulations. We disagree. The measure of kW that The Lines Company uses to charge its consumers is derived from the amount of electricity a consumer has consumed, measured in kWh. A formula is applied to the amount of electricity a consumer consumes to convert a measure of kWh to kW. We therefore consider that the variable charge in The Lines Company's LFC tariff is based on an "amount of electricity consumed".

6. The Lines Company's LFC tariff contains a single variable charge

A distributor's LFC tariff can only consist of a fixed charge, a variable charge or variable charges, fees for special services, a fee for providing or reading a meter owned by the distributor, and/or a fee for providing a relay owned by the distributor (regulation 14(1)). A variable charge is "*a charge that varies*" (regulation (4(1))).

The regulations allow a distributor to include different variable charges in its LFC tariff for electricity consumed at different times of the year (regulations 14(1)(c)(ii) and 16(2)(a)). However, we consider that The Lines Company's LFC tariff includes a single variable charge, based on a consumer's electricity consumption during six two-hour peak periods in winter. The LFC tariff does not include a second variable charge of \$0.00/kWh for the rest of the year.

A rate of \$0.00/kWh is not "*a charge*". A consumer would only ever be charged \$0.00 under that rate, meaning that The Lines Company does not charge consumers based on the amount of electricity they consume over the rest of the year. Even if a rate of \$0.00/kWh is "*a charge*", that charge would not be a "variable charge". No matter how much electricity a consumer consumes outside the six two-hour peak periods, a consumer is always charged \$0.00 for that consumption. The charge does not "*vary*". We are therefore of the opinion that The Lines Company's LFC tariff contains just one variable charge.

7. The variable charge in The Lines Company's LFC tariff does not comply with the regulations

Despite being based on a measure of kWh, we consider that the variable charge in The Lines Company's LFC tariff does not comply with the regulations for two reasons:

(a) The variable charge is based on peak usage, so does not fall within the definition of "variable charge"

The definition of "variable charge" in regulation 4(1) refers to "*the amount of electricity consumed*". The regulations also consistently refer to amounts of electricity consumed and charges "per year" and "in total per year" (for example regulations 9(2), 10(3), 15(1) and 16(2)). This suggests that "the amount of electricity consumed" in the definition of "variable charge" in regulation 4(1) refers to the entire amount of electricity a consumer consumes in a year.

The only variable charge in The Lines Company's LFC tariff, however, is based on an average amount of electricity consumed over six two-hour peak periods, rather than the entire amount of electricity consumed in a year. Therefore, we consider that the variable charge in The Lines Company's LFC tariff does not comply with regulation 14(1) of the regulations because its "variable" component does not meet the requirements of regulation 14(1)(c)(ii).

(b) The variable charge is tiered or stepped according to the amount of electricity consumed

Even if the regulations do allow The Lines Company to base the variable charge in its LFC tariff on the electricity a consumer consumes at peak periods, rather than all of the electricity a consumer consumes in a year, we consider that the variable charge fails to comply with the regulations in another respect. Regulation 16(1)(a) prohibits distributors from imposing variable charges "that are tiered or stepped according to the amount of electricity consumed" as part of their LFC tariffs. The focus of that regulation is on the variable charge component of an LFC tariff.

To assess compliance with regulation 16(1)(a), it is necessary to analyse the amount of electricity each consumer consumes in kWh compared with the variable charge in each respective consumer's bill. Because The Lines Company's LFC tariff contains a single variable charge, the relevant points of comparison are how much electricity a consumer consumes *in a year* and how much a consumer is charged under the variable charge component of the LFC tariff. For The Lines Company's LFC tariff to comply with regulation 16(1), the marginal price of each kWh of electricity consumed should be the same no matter how much electricity a consumer consumes in a year. Put another way, two or more consumers who consume different amounts of electricity in a year, but consume the same proportion of their total electricity consumption in the six two-hour peak periods, should pay the same average price for each kWh of electricity consumed.

The way that The Lines Company sets the variable charge in its LFC tariff breaches regulation 16(1)(a). Because the LFC tariff only contains a variable charge for electricity consumed within six two-hour peak periods, the average price (and therefore the effective marginal price) of each kWh of electricity consumed in a year decreases as consumers use more electricity in a year. The variable charge therefore is tiered or stepped according to the amount of electricity consumed.

8. Please let us know if you wish to discuss this further.

Yours faithfully
Buddle Findlay



Tony Dellow
Partner

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18 June 2014

Memorandum on an alleged breach of regulation 14(1)(c) of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 by The Lines Company Limited

Prepared by: Peter Wakefield
Senior Investigator

Recommendation

1. It is recommended that the Committee:
 - (a) **appoint** an investigator to investigate an alleged breach of regulation 14(1)(c) of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 (LFC Regulations) by The Lines Company Limited (TLC).

Rationale

2. The Authority received a complaint concerning TLC's use of 2.2 peak kW demand as the equivalent of the average consumer who purchases or uses 8,000 kWh of electricity per year, for the purposes of the LFC Regulations.
3. The Authority has received external legal advice that TLC's low fixed charge tariff (LFC tariff) is in breach of regulation 14(1)(c).

Background and circumstances

4. In December 2005, TLC as a distributor began direct-billing its customers. This enabled TLC to have a split-charging LFC tariff option under regulation 7(b) of the LFC Regulations.
5. In 2005, TLC met with the Ministry of Economic Development (MED) (as it was then) and discussed its intention to bill the variable charge under the LFC Regulations based on kW demand. MED's view was that kW demand was a variable charge.
6. On 1 April 2007, TLC changed its LFC tariff from being based on kWh consumption to being based on peak kW demand. TLC determined that the average consumer for the purposes of the LFC Regulations had a peak demand of 1.9kW.

7. In December 2009, TLC provided information to the Electricity Commission (Commission) outlining its calculation of the demand for an average customer. TLC advised that it was changing the peak demand for an average customer from 1.9kW to 2.2kW. The Commission received this information but did not provide any indication as to whether it approved or disapproved of it.
8. In July 2011, Grey Power New Zealand complained to the Authority that TLC's pricing methodology breached the LFC Regulations. In September 2012, the Committee declined to take action, but issued compliance advice to TLC to improve its coordination with retailers on its network. This is because retailers use 8,000 kWh per year as the consumption of the average consumer, in contrast with TLC's use of 2.2 kW as the demand for an average consumer.
9. In October 2012, TLC's Chief Executive met with the Authority and advised it was awaiting further legal advice confirming the legality of its approach. TLC's Chief Executive indicated that if this legal advice found no legal basis for TLC's approach, TLC would change its pricing approach and have only a regulated distributor tariff option under the LFC Regulations.
10. On 1 November 2012, TLC provided a copy of the relevant legal advice that concluded that TLC's use of peak demand-based charging for the variable charge component of its LFC tariff complied with the LFC Regulations.
11. On 30 November 2012, the Authority received a complaint from [REDACTED] that TLC would not put him on the LFC tariff. TLC's reasoning for this was that if it did so, [REDACTED] power bill would exceed a bill for an equivalent amount of consumption under the standard pricing option due to his high kW demand. This was despite [REDACTED] electricity consumption being less than 8,000 kWh per year.
12. On 30 January 2013, the Committee considered [REDACTED] complaint and decided that TLC had breached regulation 15(1) of the LFC Regulations. The Committee issued a warning to TLC requiring it to become compliant. TLC breached regulation 15(1) because in certain circumstances an average consumer defined in the LFC Regulations as using 8,000 kWh per year would pay more in total per year for the fixed and variable charges under TLC's LFC tariff than it would under any of TLC's alternative tariff options.
13. On 8 March 2013, TLC's acting Chief Executive met with the Authority and on 12 March 2013 responded to the warning letter. In its response, TLC stated that it considered its LFC tariff complied with the LFC Regulations, and that it would demonstrate this to the Authority with data showing the average annual consumption of its average consumers.
14. On 26 March 2013, TLC provided the Authority with a one page document of how it determined the demand for an average consumer.
15. On 19 June 2013, TLC provided the Authority with a report it had commissioned from Sapere Research Group Limited (Sapere) on TLC's compliance with the LFC

Regulations. Sapere's report advised that TLC's LFC tariff complied with the LFC Regulations.

16. On 21 February 2014, [REDACTED] made a number of complaints to the Authority including that:

"The EA has failed to clarify and enforce the regulations where they clearly and unequivocally state in 4(1)(b) that the average consumer (in my part of NZ at least) is one that "purchases or uses 8 000 kWh of electricity per year" in respect of their home. Instead the EA have allowed TLC to use a gross distortion of this, claiming this is "equivalent" to a 2.2 peak kW demand as used by TLC. Furthermore the documents I have received from the EA indicate TLC have not provided any further evidence or justification or updates of this 2.2 kW value since 2009. Even then the original argument and calculations given to justify it to the EA (in Dec 2009) were as dodgy as hell yet again blithely accepted without question by the EA."

17. On 28 February 2014, the Committee declined to take action on [REDACTED] complaints concerning TLC's application of its exemption from the LFC Regulations.
18. On 7 March 2014 TLC, in the normal course of business, provided the Authority with information required under regulation 22 of the LFC Regulations, including information on its updated calculation that the average consumer's kW demand's had increased from 2.2kW to 2.4kW. TLC provided this information in respect of its pricing effective 1 April 2014.
19. On 14 March 2014, the Authority requested Strata Energy Consulting Limited (Strata) to review TLC's compliance with the LFC Regulations. On 24 March 2014, Strata completed its report and made several conclusions, including that:
- TLC's LFC tariff appears to be inconsistent with the requirements of the LFC Regulations. TLC applies variable charges that are directly based not on the annual consumption of electricity (in kWh). Instead, TLC uses the average peak kW demand in a chargeable period derived from a statistical analysis of the consumption of a sample of all domestic consumers
 - the legal opinion from TLC's lawyers on whether TLC's kW demand approach aligns with the definition of "variable charge" in the LFC Regulations appears incorrect
 - TLC could be charging low-use consumers more on the LFC tariff than on the alternative option. However, while this might be inconsistent with the intent of the LFC Regulations, it is not inconsistent with regulation 15(1) of the LFC Regulations
 - it is not clear how TLC manages arrangements with retailers operating on its networks to ensure that retailers and TLC can meet the requirements of regulations 8 and 14 of the LFC Regulations.

20. Strata recommended that the Authority obtain a legal opinion on the definition of variable charges in the LFC Regulations.
21. On 8 April 2014, the Authority sought an external legal opinion on whether TLC's demand-based LFC tariff has a variable charge as defined by the LFC Regulations.
22. The opinion concluded that the variable charge in TLC's LFC tariff was not a variable charge as defined under regulation 4(1) of the LFC Regulations. Consequently, TLC breached regulation 14(1)(c) by recovering charges that are not permitted under that regulation.

Analysis

23. Under the definition in regulation 4(1) of the LFC Regulations, "variable charge" means "a charge that varies according to the amount of electricity consumed (for example, cents per kilowatt hour)".
24. Compliance considers that the variable charge in TLC's LFC tariff does not meet this definition for two reasons:
 - (a) the variable charge in TLC's LFC tariff is based on kW demand derived from peak usage in six two-hour peak periods in a 92-day period. It is therefore possible for two consumers on this tariff to have identical kW demand from their usage in their respective six two-hour peak periods, but to consume different quantities of electricity in kWh over this period. Because TLC would charge these consumers the same amount, the variable charge component in this tariff does not vary according to the amount of electricity consumed
 - (b) the LFC Regulations consistently refer to amounts of electricity consumed and charges "per year" and "in total per year" (for example, regulations 9(2), 10(3), 15(1) and 16(2)). This suggests that "the amount of electricity consumed" in the definition of "variable charge" in regulation 4(1) refers to the entire amount of electricity a consumer consumes in a year. The variable charge in TLC's LFC tariff is inconsistent with this definition because it is based on kW demand derived from peak usage, rather than the entire amount of electricity consumed in a year in kWh.
25. Because TLC therefore does not have a valid variable charge, it has breached regulation 14(1)(c) by recovering charges that are not provided for under that regulation.

Relevant provisions

26. Regulation 4 of the LFC Regulations provides:

4 Interpretation

- (1) In these regulations, unless the context otherwise requires,—
average consumer means,—

- (a) in relation to a consumer whose home is in the Lower South region, a person who purchases or uses 9 000 kWh of electricity per year in respect of that home; or
- (b) in relation to a consumer whose home is elsewhere in New Zealand, a person who purchases or uses 8 000 kWh of electricity per year in respect of that home

variable charge means a charge that varies according to the amount of electricity consumed (for example, cents per kilowatt hour).

27. Regulation 14(1) of the LFC Regulations provides:

14 Regulated distributor tariff option

- (1) An electricity distributor must ensure that any arrangement it has with an electricity retailer in respect of a home that is on a bundled low fixed charge tariff option, and that any arrangement it has with a domestic consumer in respect of a home that is on a split-charging low fixed charge tariff option, complies with the following minimum requirements:
- (a) the electricity distributor must not charge more than 1 fixed charge for the line function services supplied to the home; and
 - (b) that fixed charge must be not more than 15 cents per day, excluding goods and services tax; and
 - (c) the electricity distributor may not recover any charges associated with the delivered electricity supplied to the home other than by all or any of the following:
 - (i) the fixed charge referred to in paragraph (b); and
 - (ii) a variable charge or charges; and
 - (iii) any fees for special services; and
 - (iv) any fee payable for providing or reading any meter that is owned by the electricity distributor; and
 - (v) any fee payable for providing any relay that is owned by the electricity distributor.

Impact

28. If the variable charge in TLC's LFC tariff is inconsistent with the requirements for a variable charge under the definition in regulation 4(1), this means that:
- (a) the variable charge in TLC's LFC tariff is invalid
 - (b) TLC has recovered charges that are not permitted under regulation 14(1)(c)
 - (c) TLC's LFC tariff itself is invalid.
29. A further consequence of the breach is that TLC has denied some low-use consumers, such as [REDACTED] the benefits of an LFC tariff.

30. Because TLC automatically puts consumers on the LFC tariff, it has significantly more consumers on the LFC tariff compared with the retailers on TLC's network. Retailers on TLC's network only place consumers on the LFC tariff at the consumer's request. TLC has advised it has 5,131 consumers on its LFC tariff as at 1 April 2014, while retailers on the TLC network collectively had 2,780 consumers on an LFC tariff as at 31 December 2013.

Actions taken to prevent recurrence

31. TLC has taken no steps to prevent recurrence.

Options for the Committee

32. The Committee has the following options with respect to the complaint covered in this report:
- (a) decline to take any action on the breach of the LFC Regulations if:
 - (i) there is no prima facie case (i.e. the alleged breach is not established); or
 - (ii) the alleged breach is minor and no further enforcement action is necessary;
 - (b) direct Compliance to issue a Compliance advice letter for a possible or likely, but not serious, breach of the LFC Regulations;
 - (c) issue a warning letter from the Committee Chair to inform and stop the behaviour in question and deter repeat or new breaches of the Regulations;
 - (d) appoint an investigator to investigate the breach of the LFC Regulations if the breach:
 - (i) has significant, actual or potential impact (market/operational/security, and/or has affected a number of participants);
 - (ii) is likely to recur (for example, if there have been previous breaches, no reasonable steps are in place to decrease the likelihood of future breaches, or if the alleged breach is denied);
 - (iii) would best be resolved through the investigation process, for example, where the circumstances surrounding the alleged breach are complex; or
 - (e) require further information to be provided so that the Committee may make a more informed decision.

From: Peter Wakefield
To: [REDACTED]
Subject: Notice of Investigation of The Lines Company Limited
Date: Friday, 4 July 2014 3:59:00 p.m.
Attachments: [image001.jpg](#)
[Notice of investigation 2014-07-04.PDF](#)
[Report to Compliance Committee 2014-06-27.PDF](#)
[Strata Report on TLC compliance with LFC Regs 2014-03-24.PDF](#)
[Buddle opinion TLC LFC compliance 2014-05-05.PDF](#)

Dear [REDACTED]

As discussed please find attached a notice of investigation of an alleged breach of the Low Fixed Charge Regulations. Also attached is the report considered by the Compliance Committee, the report from Strata Consulting and the legal opinion received from Buddle Findlay.

Regards

Peter Wakefield

Senior Investigator

DDI: +64 4 460 8864

Mob: +64 21 392 715

Fax: +64 4 460 8879

Email: peter.wakefield@ea.govt.nz

Electricity Authority - Te Mana Hiko

Level 7, ASB Bank Tower, 2 Hunter Street

PO Box 10041

Wellington 6143

New Zealand

www.ea.govt.nz

Notice of Investigation of an alleged breach of regulation 14(1)(c) of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 by The Lines Company Limited

On 27 June 2014, the Compliance Committee considered the report of an alleged breach of regulation 14(1)(c) of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 (LFC Regulations) by The Lines Company Limited (TLC).

The breach is alleged to have occurred from 1 April 2007, when TLC began to invoice domestic consumers based on peak kW demand, and is ongoing.

The Authority alleged the breach of regulation 14(1)(c) of the LFC Regulations after receiving a complaint. The complaint concerned TLC's use of 2.2 kW peak demand as the equivalent of the average consumer who purchases or uses 8,000 kWh of electricity per year, for the purposes of the LFC Regulations. In considering the complaint the Authority received external legal advice that TLC's low fixed charge tariff is in breach of regulation 14(1)(c).

On 27 June 2014, under regulation 12 of the Electricity Industry (Enforcement) Regulations 2010, the Authority appointed Peter Wakefield as investigator to investigate the alleged breach. The investigator will follow the process set out in the Authority's Prosecution Policy available at <http://www.ea.govt.nz/code-and-compliance/compliance/prosecution-policy/>

Attached is the memorandum the Compliance Committee considered at its meeting on 27 June 2014. Also attached is a report from Strata Energy Consulting referred to in the memorandum and the external legal opinion the Authority received from Buddle Findlay.

You are requested to respond to this allegation, in writing, to the investigator within 10 working days of receipt of this notice.

Your response should include:

- Whether you believe you have breached the LFC Regulations
- Identification of any information provided in your response that you consider confidential.

Please provide your response by return e-mail to the Investigator.

Dated 4 July 2014.

The investigator's contact details are:

Peter Wakefield
Senior Investigator
Electricity Authority
Phone: 04 460 8864
Mobile: 021 392 715
peter.wakefield@ea.govt.nz

Level 7
ASB Tower
2 Hunter Street
PO Box 10041
Wellington
Fax: 04 460 8879

From: [REDACTED]
To: [Peter Wakefield](#)
Subject: email as discussed - maybe helpful?
Date: Tuesday, 22 July 2014 12:50:22 p.m.
Attachments: [Scan-to-Me from pm-wna-0901.wd.govt.nz 2014-07-22 122929.pdf](#)

Hi Peter

The attached email sets out the reasoning for moving away from the variable charge definition of “a cents per kilowatt hour charge” (as per the regulation making power in 172B(3)(b) of the Electricity Act at the time) in the LFC regulations. There are subsequent emails regarding the definition, but they are between legal and PCO so legally privileged. This email contains the substantive information anyway.

Regards

[REDACTED]

From: [REDACTED]
Sent: Tuesday, 22 July 2014 12:30 p.m.
To: [REDACTED]
Subject: Scan-to-Me from pm-wna-0901.wd.govt.nz 2014-07-22 122929

[newzealand.govt.nz](#) - connecting you to New Zealand central & local government services

Any opinions expressed in this message are not necessarily those of the Ministry of Business, Innovation and Employment. This message and any files transmitted with it are confidential and solely for the use of the intended recipient. If you are not the intended recipient or the person responsible for delivery to the intended recipient, be advised that you have received this message in error and that any use is strictly prohibited. Please contact the sender and delete the message and any attachment from your computer.

[REDACTED]

From: [REDACTED]
Sent: Tuesday, 29 June 2004 1:02 p.m.
To: [REDACTED]
Cc: [REDACTED]
Subject: Low Fixed Charge Regulation Definitions

[REDACTED]

As per our discussion this morning, I think we need some careful crafting around the definitions of variable and fixed charges in the regulations.

The principle reason for refinement relates to the appropriate treatment of Powerco "Demand Charges". In schedules of tariffs, these are defined as \$/kW/month charges for which the allocation between the various retailers is done on a volume consumption basis i.e. per kWh. For this reason, we treat this charge as a variable charge in our assessment of compliance, and Powerco has described it as a variable charge. Looking at the construction of retail tariffs in Powerco areas, the various retailers are inconsistent in whether they regard the charges as fixed or variable.

In our discussions this morning, we all agreed that the Demand Charge should logically be treated as a variable charge, but I do not see that the current wording readily allows this.

Currently the draft regulations have the following definitions:

Fixed charge means a charge levied for each customer connection in currency per time period (for example, cents per day).

Variable charge means a cents per kilowatt hour charge.

Because the Powerco Demand Charge is not a cents/kWh charge (even though it is assigned on a per kWh basis) and it is a charge levied in terms of currency per time period, the current definitions would place it as a fixed charge. This is inconsistent with our present compliance practice.

I suggest the following definition of Variable charge:

Variable charge means a charge levied on a currency per kilowatt hour basis (for example, cents per kilowatt hour).

This opens up an opportunity to assign the Demand Charge as we have been doing. To me, it appears to be not inconsistent with the legislation which referred to a "variable charge (cents per kilowatt hour)", which you are concerned about. It also gives a greater degree of consistency between respective definitions of fixed and variable charges.

[REDACTED]

Senior Advisor, Electricity Group
Ministry of Economic Development
33 Bowen Street
Wellington

[REDACTED]

From: [REDACTED]
To: [Peter Wakefield](#); [Jude Murdoch](#)
Cc: [Brent Norriss](#)
Subject: The Lines Company Response to Notice of Investigation 4 July 2014
Date: Friday, 29 August 2014 4:52:32 p.m.
Attachments: [image001.png](#)
[TLC Response to Notice of Investigation.pdf](#)

Hello Peter,

Please find attached our response to your notice of investigation as received 4 July 2014.

1. We do not believe that LFC Regulations have been breached.
2. The response does not include any confidential information.

Regards,

[REDACTED]

[REDACTED]



The Lines Company Limited
PO Box 281
Te Kuiti 3941

[REDACTED]

[REDACTED]

Response to Notice of Investigation

29 August 2014

Alleged Breach of LFC Regulations

The Lines Company Limited

The logo for The Lines Company Limited. It features a large black semi-circle on the right side. The text "thelines" is written in a bold, lowercase, sans-serif font across the middle of the semi-circle. Below "thelines", the word "company" is written in a smaller, lowercase, sans-serif font.

thelines
company

The Lines Company Limited CEO Response

James Farmer QC Opinion

Russell McVeagh Opinion

Sapere Research Group Opinion

The Lines Company Limited CEO Response



29 August 2014

Confidential and legally privileged

Peter Wakefield
Senior Investigator
Electricity Authority
WELLINGTON

By email

Dear Peter

Notice of Investigation

1. We refer to the Notice of Investigation of an alleged breach of regulation 14(1)(c) of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 ("**Regulations**") by The Lines Company ("**TLC**"), dated 4 July 2014.

Executive summary of TLC's response

2. We understand from the Memorandum to the Compliance Committee dated 18 June 2014 that the Compliance Committee currently believes there are two reasons why the variable charge in TLC's Low Fixed Charge ("**LFC**") tariff may not meet the definition of "variable charge" provided in regulation 4(1) of the Regulations. Those reasons, as set out in paragraph 24(a) and (b) of the Memorandum, are:
 - (a) The variable charge component in this tariff does not vary according to the amount of electricity consumed; and
 - (b) The variable charge is based on kW demand derived from peak usage, rather than the entire amount of electricity consumed in a year in kWh.
3. TLC's position, supported by the legal opinion and economic report accompanying this letter, is that its variable charge **does** vary according to the amount of electricity consumed, and that the Regulations **do not** require the variable charge to be based on total annual consumption. Accordingly, TLC believes that the variable charge in its LFC tariff clearly complies with regulation 14(1)(c).
4. Essentially, TLC believes that the Regulations allow it to select a period or periods for measuring customer electricity consumption, and then set a charge based on the level of electricity consumption in that period.
5. Further, the Regulations **do not** require that a particular relationship is maintained between the annual level of consumption and annual level of lines charges.
6. Under TLC's pricing methodology, variability in the level of the lines charges depends on the level of consumption in six measured control periods. By implication, the level of total annual consumption is not a predictor of the level of lines charges. For example, a consumer with annual consumption of 6,000 kWh but with heavy load in the measured periods would face a

higher lines charge than a consumer with annual consumption of 9,000 kWh but lower load in the measured periods.

7. From a network perspective, TLC considers that its pricing methodology is more consistent with the Authority's Pricing Principles for electricity distributors, and with its statutory objective, than pricing which applies a single charge to all consumption regardless of when it is consumed. It would in our view be a poor outcome for the industry if the Authority sought to apply a contentious interpretation of the Regulations that would preclude TLC's more efficient form of charging.

Background

8. Most electricity network businesses in New Zealand charge residential customers for lines services by way of a fixed daily fee and a single variable charge per kWh consumed. This practice has resulted in a widespread expectation amongst consumers and some commentators that the level of a consumer's lines charges will directly follow the level of their consumption. It is in this context that some question the outcome in TLC's case that the level of the variable charges does not necessarily follow the level of total annual electricity consumption.
9. TLC's concern is to ensure that such expectations do not contribute to a (contentious) interpretation of the Regulations that would prevent TLC from using its efficient pricing methodology.

TLC's variable charges comply with the Regulations

10. TLC believes that its variable charges fully comply with Regulation 14(1)(c). The legal and economic reasoning in support of this position is set out in the attached opinions from Russell McVeagh and Sapere Research Group. In summary:
 - (a) TLC's variable charge **does** vary according to the amount of electricity consumed. The quantity (kW) is based on consumption during the qualifying six, two hour load control periods. The amount of electricity consumed during these periods (whether established by TOU meter or by applying a profile) is what determines the quantity (kW) that is charged to the customer.
 - (b) The Regulations **do not** require the variable charge to be based on total annual consumption, contrary to the view expressed by Buddle Findlay. In fact, regulations 10(3) and 16(2) expressly contemplate that variable charges may differ according to consumption at different times of the day or year, as TLC's charges do.
11. TLC also sought an opinion from James Farmer QC (attached), who agrees that TLC's charge is within the definition of variable charge. TLC sought further independent advice on its pricing methodology from a senior lawyer of Mr Farmer's standing because of how seriously it takes the allegations of breach set out in the Notice, and the importance to TLC of ensuring that its approach is compliant with the Regulations.
12. Essentially, TLC believes that the Regulations fully allow it to select a period or periods for measuring customer electricity consumption, and then set a charge for quantity based on the level of electricity consumption in that period.
13. Further, the Regulations do not require that a particular relationship is maintained between the annual level of consumption and annual level of lines charges. Rather the Regulations explicitly allow for different variable charges across annual consumption and such flexibility may (and is likely to) result in a wide array of relationships between the annual level of consumption and

the annual level of lines charges (see discussion of this on page 2 & 3 of the attached Sapere report). In practice, this means a consumer using, for example, 6,000 kWh and with a heavy consumption in the six measured periods may face a higher lines charge than a consumer using 9,000 kWh, but consuming very little in the six measured periods.

14. Although such outcomes may feel counterintuitive, we think they are entirely understandable and acceptable when considered from the perspective of efficiently pricing lines function services.
15. The Regulations do require that variable charges in a regulated distributor tariff option be set such that the average consumer would pay no more in total per year for the fixed charge and variable charges charged in accordance with regulation 14(c)(i) and (ii) than the average consumer would pay in total per year for those same matters on any alternative distributor tariff option. TLC has carefully assessed its tariffs against the above test in accordance with regulation 23(c), and has received an independent analysis (which was forwarded to the Authority) that found them to be compliant.
16. TLC is also concerned that the Compliance Committee's interpretation of the Regulations would require a distributor to only implement kWh charging. Not only would this restrict the interpretation of the definition of "variable charge" to an unacceptable extent (as explained in the Russell McVeagh opinion), it would mean that TLC would have to change its entire tariff structure. Such an outcome would be inconsistent with the Authority's statutory objective and its Pricing Principles. In his opinion, Mr Farmer QC found this point to be of particular relevance (see page 4).
17. We would be very concerned if, due to a contentious interpretation of the Regulations, the Authority sought to require TLC to implement a new pricing methodology that is less consistent with its own statutory objective and Pricing Principles.

Pricing efficiency

18. TLC's pricing methodology charges customers for the load they place on the network in periods of load control. This is achieved by the variable charge being expressed as a measure of the capacity demanded by the consumer (using kW), rather than the throughput consumed (using kWh), and applying this charge to the amount of load the consumer places (or is estimated to place) on the network in the defined periods.
19. Accordingly, the amount consumers pay for TLC's distribution service is largely determined by the extent to which they load the network in the defined periods, rather than the total amount of electricity they consume over the whole year.
20. The Regulations allow distributors and retailers to set variable charges for consumption in specific periods.

Conclusion

21. It has always been TLC's practice to work constructively and transparently with the Authority to find a solution that is consistent with the regulatory framework we operate under. In this instance we strongly consider that, while we differ to other distributors in our approach to pricing, this difference in itself does not breach the Regulations. We believe we are compliant and our customers are only charged as allowed by the Regulations.

22. TLC appreciates the opportunity to engage with the Authority in this matter and would be happy to provide any further information that would aid the Compliance Committee in its decision-making. Please do not hesitate to contact me if TLC can assist further in this regard.

Yours sincerely

A handwritten signature in black ink, appearing to read "B. Norriss".

Brent Norriss
Chief Executive

James Farmer QC Opinion

JAMES A FARMER QC

Georgia House
19 Emily Place
P O Box 1800
Auckland
NEW ZEALAND

Tel: 64 9 358 7090

Fax: 64 9 358 7091

jamesfarmer@queenscounsel.co.nz

www.jamesfarmerqc.co.nz

25 August 2014

Russell McVeagh
Solicitors
Auckland

For 

The Lines Company and Electricity Authority

I refer to the brief sent to me for advice and to my subsequent meeting with Mr Shrive.

Instructions

I have been asked to advise on the lawfulness of the methodology used by The Lines Company [TLC] for determining the variable charges in respect of its low fixed charge tariff option under regulation 14(1)(c)(ii) of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004.

That regulation provides, so far as relevant:

An electricity distributor must ensure that ... any arrangement it has with a domestic consumer in respect of a home that is on a split-charging low fixed charge tariff option, complies with the following minimum requirements:

- (a) the electricity distributor must not charge more than 1 fixed charge for the line function services supplied to that home; and
- (b) the fixed charge must be not more than 15 cents per day, excluding goods and services tax; and
- (c) the electricity distributor may not recover any charges associated with the delivered electricity supplied to the home other than by all or any of the following:
 - ...
 - (ii) a variable charge or charges;

There is no question of TLC not complying with the fixed charge requirements in (a) and (b) above. The concern that has been expressed to The Electricity Authority is that TLC does not comply with (c).

The Regulations define “variable charge” as meaning “a charge that varies according to the amount of electricity consumed (for example, cents per kilowatt hour)”.

TLC bills domestic consumers in its area directly for its lines services separately from the charges made by electricity retailers for the supply of electricity along those lines. The variable charge is determined by reference to a customer’s level of consumption measured in kWh (kilowatts per hour) but re-calculated in terms of kW demand. The measurement (and the charge) is confined to a consumer’s 6 highest loads in 2 hour control periods in a year. Those periods represent periods of expected high demand (i.e. during the winter season). For the balance of the year, no variable charge is made.¹ In the case of consumers who have a time of use meter, the consumption is the amount measured by the meter for the defined periods. In the case of all other consumers, the consumption is calculated statistically on an averaging basis.

Two questions arise:

- (1) Does the fact that TLC’s charges are based on kW rather than kWh mean that the charge is not a variable charge as defined?
- (2) Does the fact that TLC’s charge is based on the average amount of electricity consumed over 6 two hour periods, rather than the entire amount of electricity consumed over the full year, mean that the charge is not a variable charge as defined?

I have read the following documents or advices that relate to these questions:

- (i) Memorandum dated 18 June 2014 by Peter Wakefield, Senior Investigator;
- (ii) “Review of TLC Compliance with Low Fixed Charge Regulations” (March 2014) prepared by Strata Energy Consulting;
- (iii) Opinion by Buddle Findlay dated 5 May 2014;
- (iv) Memorandum dated 21 August 2014 by Sapere Research Group;
- (v) Draft Advice from Russell McVeagh.

Advice

The first question above is answered by both Buddle Findlay and Russell McVeagh to the same effect. Both firms are of the opinion that the fact that TLC’s variable charge is based on kW and not kWh does not mean that the charge is not a variable charge. To the contrary, as put by Buddle Findlay:

The measure of kW that The Lines Company uses to charge its consumers is derived from the amount of electricity a consumer has consumed, measured in kWh. A formula is applied to the amount of electricity a

¹ Though the charge is spread over the full year.

consumer consumes to convert a measure of kWh to kW. We therefore consider that the variable charge in The Line Company's LFC tariff is based on an "amount of electricity consumed" [the phrase used in the definition of "variable charge"].

Russell McVeagh make the following points relevant to that issue:

[The regulation] simply requires a variable charge to be a charge that varies according to the amount of electricity consumed. This can be contrasted to the definition of a "fixed charge", which is a charge levied "in currency per time period" (such as cents per day).

Cents per kilo-watt hour is given [in the definition of "variable charge"] as an example of a variable charge, which clearly implies that there is more than one basis on which a variable charge may vary...

I agree with Buddle Findlay and Russell McVeagh that the charge is one that "varies according to the amount of electricity consumed" (within the definition) and therefore qualifies as a variable charge on that basis. The answer to question 1 therefore is no.

Turning to question 2, there is disagreement between Buddle Findlay and Russell McVeagh. Buddle Findlay expresses the view that the TLC charges are not variable charges because they are not based on the total electricity used by a consumer over the full year but are based on the average of electricity used during the limited 6 two hour periods of peak demand. In their view, the statutory definition of "variable charge" can only be satisfied if the charge is based on the entire annual amount of electricity. In this respect, they rely on various references in the Regulations (rr. 9(2), 10(3), 15(1) and 16(2)) to the consumption of electricity on an annual basis. I do not myself think that those references are conclusive and agree with Russell McVeagh that these provisions can be interpreted as permitting differing variable charges at different times.²

Russell McVeagh, unlike Buddle Findlay, analyse the issue by reference to the objectives of the statute under which the Regulations were promulgated. The relevant statute was the Electricity Act 1992 (as amended) which has been replaced, and in effect re-stated with the Regulations continued, under the Electricity Industry Act 2010. By section 15 of the current Act, the Electricity Authority's statutory objective is "to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers".

² This has led Buddle Findlay to raise a question of whether the fact that TLC charges nothing for its lines services outside the defined 2 hour periods can be said to indicate the charging of different variable charges over the full year, one of which is no charge. Buddle Findlay says that "no charge" cannot be regarded as a charge and therefore its position that the charge must be based on the electricity that is consumed over the full year remains intact. I am not so sure myself that "no charge" cannot be regarded as a charge but I think question 2 can be answered without deliberating on that point.

Russell McVeagh make the point that “TLC’s methodology has been developed to allow it to price in an efficient manner which reflects the costs it faces in maintaining a reliable network at times of peak demand”. Sapere makes a similar point:

TLC’s pricing methodology is designed to reflect to consumers the way in which their consumption patterns drive TLC’s costs. This is intentional, in order for consumers to bear some of the costs of their consumption patterns and to have economic incentives to, where possible, shift their load. Such pricing is widely considered to lead to more economically efficient outcomes than pricing that does not signal the cost of peak usage.

Put another way, it seems to me that a lines company necessarily is required to cover the costs that it incurs to meet peak demand and that therefore there is a rational economically efficient justification for TLC adopting a pricing methodology that meets that requirement. That conforms with the statutory objective, as stated above, and the definition of “variable charge” is appropriately interpreted consistently with that objective.

I would therefore agree with Russell McVeagh that TLC’s charges meet the regulatory definition of “variable charges” and answer question 2 no.



J A Farmer QC

Russell McVeagh Opinion

TO: [REDACTED] The Lines Company Ltd

FROM: Russell McVeagh [REDACTED]

DATE: 27 August 2014

SUBJECT: Issues Regarding The Lines Company's Variable Charge under the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004

Introduction and summary

1. You have asked us to provide our opinion on the legal issues raised under the Electricity Authority's ("**Authority**") notice that it is investigating TLC for alleged breaches of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 ("**Regulations**").
2. The Authority alleges that TLC's kW load charge is not a variable charge, and therefore breaches regulation 14(1)(c) of the Regulations, because it:
 - (a) does not vary according to the amount of electricity consumed;
 - (b) is based on kW demand derived from peak usage, rather than the entire amount of electricity consumed in a year in kWh.¹
3. The Authority investigation team has confirmed that these are the only issues subject to investigation.
4. Our view is that TLC's kW variable charge clearly complies with regulation 14(1)(c) of the Regulations.
5. The legal analysis relied on by the Authority to commence the investigation is incorrect. It relies on interpreting the definition of variable charge more restrictively than the plain words used. The normal statutory interpretation principles that could support such an approach do not apply in this case. To the contrary, the Authority's current interpretation would appear to make key provisions in the Regulations unworkable.
6. Specifically, we believe the Regulations allow TLC to:
 - (a) Determine a tariff structure, including the composition of variable charges, for recovering the costs of providing lines functions services. Among other things, that may mean that customers with different annual kWh consumption pay the same variable charges (and vice versa);
 - (b) Select a period or periods of consumption (whether days, months, seasons or other periods) which is used to determine one or more variable charges; and

¹ These issues are set out in paragraph 24 of the "Memorandum on an alleged breach of regulation 14(1)(c) of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 by The Lines Company Limited, 18 June 2014 ("**Memorandum**"). This was prepared by Senior Investigator Peter Wakefield for the Compliance Committee meeting of 27 June 2014.

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- (c) Use those variable charges in its low fixed tariff option (provided that they comply with the requirement to ensure an average consumer pays no more for the fixed and variable charges under a low fixed option than he or she would pay under an alternative option, and that the variable charges are not tiered or stepped according to the amount of electricity consumed).
7. Such a position appears entirely consistent with the policy objectives when the definition of "variable charge" was formulated, as evidenced by officials' correspondence at the time.

Relevant Background

8. The following key facts have informed our opinion:
- (a) TLC has a direct contractual and billing arrangement with its customers for the provision of lines function services. TLC does not sell electricity (customers must have a separate agreement with a retailer for the provision of electricity);
- (b) In general terms, TLC sets its charges to recover the costs of providing lines function services capable of meeting peak demand. TLC has received expert economic advice, and we understand that the Authority agrees, that this is an efficient and entirely appropriate way to charge for lines function services;
- (c) For customers on the low fixed charge option under the Regulations, the tariff includes:
- (i) A fixed charge capped at 15 cents per day in accordance with regulations 14(1)(a) and (b) of the Regulations;
- (ii) A charge that varies according to a customer's level of consumption in defined periods.
- (d) TLC determines a customer's variable charge quantity by:
- (i) Calculating the average of a consumer's six highest loads as measured (or estimated) in qualifying, two-hour control periods (**kW Load**). The quantity (kW) is determined by the customer's level of electricity consumption (kWh) in the defined periods.
- (ii) The customer's electricity consumption in the defined periods is either measured using time of use meters, or estimated using statistical analysis. Either way, it is a customer's electricity consumption that determines the variable charge quantity.
- (e) In effect, TLC's variable charges are based on consumption in the six defined periods, with no charge on consumption at other times (albeit TLC invoices the consumer for the variable charge (and other charges) in twelve instalments over the year).

Definition of variable charge

9. Under regulation 4 of the Regulations:

Variable charge means a charge that varies according to the amount of electricity consumed (for example, cents per kilo-watt hour).

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10. Our view is that the definition of variable charge is clear on its face. It simply requires a variable charge to be a charge that varies according to the amount of electricity consumed. This can be contrasted to the definition of "fixed charge", which is a charge levied "in currency per time period" (such as cents per day).
11. The phrase "according to", when given its natural and ordinary meaning, clearly requires a relationship between electricity consumed and the charge. However it does not prescribe a specific relationship. At most it could be said the charge should somehow correspond to or be proportionate to the amount of electricity consumed.²
12. Cents per kilo-watt hour is given as an example of a variable charge, which clearly implies that there is more than one basis on which a variable charge may vary.³ The definition does not go further to state or require that the charge must vary *strictly*, *directly*, or *uniformly* with the amount of electricity consumed (eg a narrow or restrictive view of the relationship between charge and consumption).
13. As set out in the preceding section, a customer's electricity consumption during measured periods will determine that customer's variable charge quantity. It is the *only* factor that determines the charge (putting aside the selection of measurement period, which we return to below).
14. We therefore agree with Buddle Findlay's view that:⁴

The measure of kW that The Lines Company uses to charge its consumers is derived from the amount of electricity a consumer has consumed, measured in kWh. A formula is applied to the amount of electricity a consumer consumes to convert a measure of kWh to kW. We therefore consider that the variable charge in The Lines Company's LFC tariff is based on an "amount of electricity consumed".
15. To find that TLC's variable charge as measured in kW is nevertheless not within the definition of "variable charge" requires the definition to be interpreted more restrictively than established by the plain words used. It requires some implied terms to be read into the definition.
16. The starting point for interpreting statutes is that the meaning of an enactment should be taken from its text (the plain words) and in light of its purpose.⁵
17. It is a generally accepted principle that one cannot read words into an Act or provision that are not there.⁶ The mechanism of "reading in" is permissible only where this is

² See for example the following dictionary definitions of "according to":

Oxford English Dictionary (Online): as stated or formulated by; corresponding to something; agreeing; matching; suitable; fitting; appropriate; in accordance with something previously stated; in accord or agreement; concordant; harmonious; with respect or reference to; in a manner corresponding to conforming to; in proportion or relation to; in accordance with.

Oxford English Dictionary (6th ed): in a manner consistent with or a degree proportioned to; as formulated by; as stated by.

Collins English Dictionary (2nd ed): in proportion; in relation; in conformity with; in accordance with.

³ We note that regulation 4(4) expressly provides that examples given in the regulations are only illustrative of the provision to which they relate and do not limit the provision.

⁴ Buddle Findlay advice to Authority, 5 May 2014, at paragraph 5.

⁵ Interpretation Act 1999, section 5(1).

⁶ JF Burrows and RI Carter *Statute Law in New Zealand* (4th ed, LexisNexis, Wellington, 2009) at 305.

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required to avoid absurd or clearly unintended outcomes,⁷ or where, on a sensible reading of the provision and the legislation as a whole, it is clear that the express words of the provision themselves contain certain implications.⁸ Accordingly, such a restrictive or implied interpretation as is adopted by the Authority (where implied terms are read into the definition) must be required in order to give effect to the scheme and purpose and to avoid unworkable outcomes.⁹

18. Our view is that the definition of "variable charge", when cross-checked against the immediate and general legislative context, requires that the natural reading of the words be applied. The interpretation adopted by the Authority is not only inconsistent with the plain words, but is contrary to the wider statutory scheme, and accordingly is an erroneous interpretation of the regulation. The following explains why.

The statutory scheme

19. As the title of the Regulations suggest, their focus is on requiring a low fixed tariff option to be made available by retailers and/or distributors, and on setting a limit on the level of the fixed charge.
20. The direct regulation of variable charges is limited to ensuring that they are not used as a mechanism to make an average customer worse off under the low fixed charge option (see regulations 9(1) and 15(1)), and to prohibiting tiered or stepped charges (see regulation 16(1)(a), which is not relevant for this investigation). The regulatory scheme fully allows for a customer's variable charge to be higher on a low fixed option than on an alternative option (given that the fixed charge will be usually be lower).
21. It is also relevant that regulation 23 does not require the electricity distributor to provide information demonstrating that a charge is a variable charge. Instead the focus is on requiring the distributor to demonstrate compliance with regulation 15(1) (and other matters not relevant to the current issue).
22. Further, the drafting history of the definition of variable charge demonstrates that it was intended to allow flexibility in the way variable charges are set. We have been provided with information from the Ministry of Business, Innovation and Employment ("MBIE") regarding the development of the definition of "variable charge". A table summarising the contents of relevant documents is attached in the Appendix. In brief, the documents show that the wording of regulation 4 was changed to its current form by officials during the drafting process, in order to ensure charges other than cents/kWh charges could be levied. In particular, the intent was to ensure the definition of variable charge was flexible enough to accommodate Powerco's demand based variable charge at that time, which is comparable to TLC's variable charge now.
23. Finally, the definition of variable charge should also be interpreted consistently with the scheme of the empowering Act. The Authority's statutory objective is:
- to promote competition in, reliable supply by, and the efficient operation of, the New Zealand electricity industry for the long-term benefit of consumers.¹⁰
24. Accordingly, in our view there is nothing in the scheme of the Regulations that supports or requires an interpretation of the definition of "variable charge" that in some way

⁷ See for example *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 at [22] (Tipping J).

⁸ *Ibid*, at 306.

⁹ *Ibid*, at 310.

¹⁰ Electricity Industry Act 2010, section 15.

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restricts the way variable charges are set beyond the plain requirement that the charge varies according to electricity consumed. On the other hand, as we explain below, the plain wording of the definition of "variable charge", which enables a degree of flexibility, makes the regulatory scheme workable. Further, the drafting history suggests that the definition was intended to provide flexibility.

The specific allegations

25. Considered in light of the statutory scheme discussed above, our view is that the Authority's specific allegations of breach are not sustainable as a matter of law. We consider each in turn.

Argument that the variable charge does not truly vary according to consumption

26. The Authority's allegation is that it is possible for two consumers with different annual kWh consumption to have the same variable charge quantity (kW Load) and therefore the same variable charge. Accordingly, in its view, the charge does not vary according to the amount of electricity consumed.

27. However, this amounts to narrowly interpreting the definition of variable charge as requiring a different total charge if there is a different kWh consumption between consumers, even if kWh is not the basis on which the charge is set. In our view (and as above, it also appears to be Buddle Findlay's view), this is incorrect:

- (a) There is no orthodox statutory interpretation principle that supports restrictively interpreting the definition of "variable charge" in this way. As set out above, it is not the purpose of the regulations to regulate how variable charges are set - the purpose is simply to distinguish variable charges from fixed charges, and to ensure that the average customer is not worse off under the low fixed option due to the rate for variable charges;
- (b) It is clear that the quantity (kW Load) is derived from electricity usage or consumption. Higher/lower consumption in the measured periods will lead to higher/lower quantity. The charge therefore varies according to electricity consumption;
- (c) Put another way, the *only* factor that can cause a customer to have a different quantity is different electricity consumption (as measured in relevant periods). This is sufficient to make the charge vary according to electricity consumed - as discussed above, it is not necessary under the definition for the charge to vary **directly** or **uniformly** according to annual consumption.

28. More fundamentally, the proposed restrictive approach would effectively require a distributor to set its variable charges on the basis of electricity consumed (on a kWh basis). This would contradict the definition itself, which provides charging by cents/kWh as just one example of a variable charge.

29. In our view, it would not be consistent with the scheme of the Act (as evidenced by the objective to promote efficiency) for the Authority to construe the Regulations as requiring TLC to ensure its variable charge is for kWh consumption. TLC's methodology has been developed to allow it to price in an efficient manner which reflects the costs it faces in maintaining a reliable network at times of peak demand. This approach clearly aligns with the Authority's objective for the electricity industry.

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Argument that charge must vary according to annual consumption

30. The allegation is that the variable charge does not comply with clause 14(1) of the Regulations because TLC charges consumers based on electricity consumed in six two-hour peak periods, rather than per year.¹¹ Essentially, Buddle Findlay's view is that the scheme of the Regulations requires the definition of variable charge to be read as requiring the charge to vary according to the entire amount of electricity consumed in a year, even though such a requirement does not appear in the definition itself.
31. In our view, applying the statutory interpretation principles set out above, there is no basis for implying such a requirement into the definition. Indeed, such an approach would directly contradict the scheme of the Regulations:
- (a) The Buddle Findlay opinion cites regulations 9(2), 10(3), 15(1) and 16(2) as supporting its view that the regulations "consistently refer to amounts of electricity consumed and charges "per year and "in total per year"". We do not understand this position, given that our reading of those regulations is that they expressly support the opposite conclusion:
 - (i) Regulations 9(2) and 15(1) give effect to the purpose of ensuring the average consumer pays no more per year on a low fixed tariff option than on the alternative option. It makes sense to use an annual measure for that purpose. However it does not logically follow that an implied restriction should be read into the definition of variable charge such that it must be calculated on total annual consumption also; and
 - (ii) Regulations 10(3) and 16(2) expressly allow variable charges to be set according to consumption at different times of the day or year (among other things). Accordingly, they in no way support the theory that the definition of variable charge should be interpreted as based on total annual consumption. They actually support the opposite interpretation.
 - (b) Regulation 14(c)(ii) expressly allows for multiple variable charges within a low fixed charge tariff option. Further, Regulation 16(2)(a) anticipates the setting of variable charges for controlled and uncontrolled loads, or for electricity consumption at different times of the day or year (provided that the different variable charges are not otherwise tiered or stepped according to the amount of electricity consumed). However we cannot see how multiple variable charges could be set in accordance with regulations 14(c)(ii) and 16(2)(a) if the definition of variable charge requires each variable charge to be set according to consumption for the entire year. That is, interpreting the definition of variable charge in such a way directly contradicts the scheme of the Regulation and would render some of its operative provisions unworkable.
32. TLC has chosen to set a charge for certain measured periods (and no charge for other periods), which is clearly allowed under the Regulations. Accordingly, our view is that TLC's kW charge is clearly within the definition of "variable charge", and the way it is set is entirely consistent with the scheme of the Regulations. In addition, we consider the interpretation put forward by Buddle Findlay, and adopted by the Authority, is erroneous and a misapplication of the Regulations.

¹¹ Buddle Findlay opinion at para. 3 and 7(a); Memorandum to Compliance Committee, at para. 24(a) and (b).

APPENDIX

Document	Date	Comment
Internal MBIE email, from [redacted] (attached).	29 June 2004	<p>This email indicates that, in the regulations as drafted at this date, variable charge was defined as "means a cent per kilowatt hour charge".</p> <p>[redacted] suggests the definition be changed to "means a charge levied on a currency per kilowatt hour basis (for example, cents per kilowatt hour)".</p> <p>The rationale for the change was to enable Powerco Demand Charges to be treated as variable charges, and therefore enable consistency with current compliance practice.</p> <p>Under the original drafting, Powerco's demand charge could not be a variable charge, as it was not a cents/kWh charge (even though it is assigned on a per kWh basis) and was a charge levied in terms of currency per time period - therefore falling within the definition of 'fixed charge'.</p>
Exposure draft of regulations (incorrect version sent out) PCO 5864/7	2 July 2004	variable charge means a charge that varies on the basis of electricity consumption (for example, cents per kilowatt hour).
Exposure draft of regulations (corrected/final) PCO 5864/8a	7 July 2004	variable charge means a charge that varies according to the amount of electricity consumed (for example, cents per kilowatt hour).
'Near final' regulations PCO 5864/12	31 August 2004	variable charge means a charge that varies according to the amount of electricity consumed (for example, cents per kilowatt hour).
Final Regulations	Came into force on 1 October 2004	variable charge means a charge that varies according to the amount of electricity consumed (for example, cents per kilowatt hour).

[REDACTED]

From: [REDACTED]
Sent: Tuesday, 29 June 2004 1:02 p.m.
To: [REDACTED]
Cc: [REDACTED]
Subject: Low Fixed Charge Regulation Definitions

[REDACTED]

As per our discussion this morning, I think we need some careful crafting around the definitions of variable and fixed charges in the regulations.

The principle reason for refinement relates to the appropriate treatment of Powerco "Demand Charges". In schedules of tariffs, these are defined as \$/kW/month charges for which the allocation between the various retailers is done on a volume consumption basis i.e. per kWh. For this reason, we treat this charge as a variable charge in our assessment of compliance, and Powerco has described it as a variable charge. Looking at the construction of retail tariffs in Powerco areas, the various retailers are inconsistent in whether they regard the charges as fixed or variable.

In our discussions this morning, we all agreed that the Demand Charge should logically be treated as a variable charge, but I do not see that the current wording readily allows this.

Currently the draft regulations have the following definitions:

Fixed charge means a charge levied for each customer connection in currency per time period (for example, cents per day).

Variable charge means a cents per kilowatt hour charge.

Because the Powerco Demand Charge is not a cents/kWh charge (even though it is assigned on a per kWh basis) and it is a charge levied in terms of currency per time period, the current definitions would place it as a fixed charge. This is inconsistent with our present compliance practice.

I suggest the following definition of Variable charge:

Variable charge means a charge levied on a currency per kilowatt hour basis (for example, cents per kilowatt hour).

This opens up an opportunity to assign the Demand Charge as we have been doing. To me, it appears to be not inconsistent with the legislation which referred to a "variable charge (cents per kilowatt hour)", which you are concerned about. It also gives a greater degree of consistency between respective definitions of fixed and variable charges.

[REDACTED]

Senior Advisor, Electricity Group
Ministry of Economic Development
33 Bowen Street
Wellington

[REDACTED]

Sapere Research Group Opinion

Memorandum

22 August 2014

To: [REDACTED] The Lines Company Ltd
From: [REDACTED]
Re: **Comment on Electricity Authority's investigation issues**

The Electricity Authority (Authority) is investigating the compliance of The Lines Company's (TLC) charges with the low fixed charge (LFC) regulations. The Authority has confirmed that the investigation is focused on the two issues set out in paragraph 24 of the 18 June 2014 memo to the Compliance Committee, and these two issues can be summarised as follows:

1. the variable charge component in the TLC tariff does not vary according to the amount of electricity consumed; and
2. the variable charge is based on kW demand derived from peak usage, rather than the entire amount of electricity consumed in a year in kWh.

In addition to these two points it appears there is an underlying concern for the Authority and some complainants that the level of the LFC variable charges does not follow the level of the consumer's annual electricity consumption. For example, a consumer using 6,000 kWh per annum (with heavy demand in the defined pricing periods) may face a TLC lines charge greater than another consumer who uses 9,000 kWh per annum (with little usage in the defined pricing periods).

I address each of these three inter-related issues from an economic perspective, plus comment on the context that the Authority's statutory objective and its Pricing Principles provide for these issues.

Do TLC's variable charges vary with respect to the amount of electricity consumed?

The TLC variable charges are expressed as dollars per kW and are applied to the average of a consumer's six highest loads as measured (or estimated) in qualifying two-hour control periods (see page 27 of TLC's Pricing Methodology). The quantity (kW) is determined by the measured (or estimated) level of electricity consumption in the defined pricing periods. Thus although the charging metric is kW, the measured (or estimated) level of this metric in the defined pricing periods is determined by the level of consumption in those periods. Thus the variable charge varies with the level of electricity consumption in those periods.

In my view such a variable charge is consistent with:

- the LFC regulation's definition of "*variable charge means a charge that varies according to the amount of electricity consumed (for example, cents per kilo-watt hour)*"; and
- clause 16 (2) which states, in reference to variable charges

"Subclause (1)(a) does not prevent an electricity distributor from doing any of the following things:

(a) setting different variable charges for controlled and uncontrolled load, or for electricity consumption at different times of the day or year, provided that the different variable charges are not tiered or stepped according to the amount of electricity consumed." (underlining added)

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TLC's practice of applying its variable charge to measured (or estimated) electricity consumption in the qualifying two-hour control periods is in my view an example of the application of the underlined phrase from clause 16 (2) above. It is an example of setting different variable charges for electricity consumption consumed at different times of the day or year. In TLC's case the variable charges apply to consumption in the qualifying control periods, with no charge (or a zero charge) on consumption at other times. The resulting lines charge is determined for an annual period and payable monthly.

The Authority has clarified that it is not investigating whether TLC's LFC charges are tiered or stepped so I understand there is no need to address that aspect of clause 16 (2).

I conclude TLC's LFC variable charges do vary with the amount of electricity consumed, and in a manner that is specifically allowed for under clause 16 (2). Thus I consider these variable charges are consistent with the "variable charge" definition in the regulations and its description in clause 16 (2).

Do the LFC regulations require LFC variable charges to be based on a consumer's entire annual electricity consumption?

The second of the Authority's concerns is that TLC's LFC variable charges are not based on the consumer's entire annual consumption of electricity.

I agree that TLC's LFC variable charges are not based on the consumer's entire annual electricity consumption, but rather only on the consumer's electricity consumption in the qualifying two hour control periods. However, from an economic perspective I do not consider the LFC regulations require LFC variable charges to be based on a consumer's entire annual electricity consumption. The reason for this view is as follows.

Clause 16 (2) of the regulations allows for "*different variable charges for controlled and uncontrolled load, or for electricity consumption at different times of the day or year ...*". This clause (and the balance of the regulations) neither prohibits a zero variable charge nor requires that all consumption must be subject to a LFC variable charge. It follows that it is possible under the regulations for some electricity consumption to not be subject to a LFC variable charge.

I therefore conclude from an economic perspective that the LFC regulations do not require that a LFC variable charge must be based on a consumer's entire annual electricity consumption. It follows that I consider the Authority's second concern does not reflect a requirement of the LFC regulations and therefore this concern is not a valid test for identifying non-compliance with the LFC regulations.

Why does the level of TLC's variable charge not follow the level of the consumer's annual consumption and is this outcome non-compliant with the LFC regulations?

Most electricity network businesses in New Zealand charge residential customers for the lines service by way of a fixed daily fee and a single variable charge per kWh consumed. This practice has resulted in a widespread expectation amongst consumers and some commentators that the level of a consumer's lines charges will follow the level of their consumption. It is in this context that some consumers and commentators question the outcome in TLC's case that the level of the variable charges does not necessarily follow the level of electricity consumption.

As mentioned above, clause 16 (2) of the regulations allows for "*different variable charges for controlled and uncontrolled load, or for electricity consumption at different times of the day or year ...*". Where an electricity network business employs different rates across annual consumption (e.g. differing with respect to controlled versus uncontrolled, or consumption at particular times), the relationship between the annual level of

consumption and the annual level of lines charges will not be a simple positive function. Rather, this relationship will vary according to the mix of the consumer’s consumption relative to the differing rates.

The table below provides numerical examples to illustrate the potential variability in the relationship between the annual level of consumption and the annual level of lines charges. In these examples it is assumed that the annual line charge is calculated on the consumer’s electricity consumption in six, two hour pricing periods. Each kWh consumed in these pricing periods is charged at \$25, and all kWhs consumed in other periods attract no charge. The dollar values in the table are the resulting annual lines charges. It is assumed that any fixed charge is constant over all consumption patterns and therefore is not included in this analysis.

		kWhs consumed in 6 peak pricing periods		
		10	20	30
kWhs consumed annually	6,000	\$250	\$500	\$750
	8,000	\$250	\$500	\$750
	10,000	\$250	\$500	\$750

It can be seen from the above table that the variability in the level of the lines charges depends entirely on the level of consumption in the six pricing periods. By implication the level of total annual consumption is not a predictor of the level of lines charges.

The key point from this example is that where different variable charges apply across consumption, there will generally be no particular relationship between the annual level of consumption and annual level of lines charges. The regulations explicitly allow for different variable charges across annual consumption and such flexibility may (and is likely to) result in a wide array of relationships between the annual level of consumption and the annual level of lines charges.

Using the examples in the above table , the observation that the total lines charge for a consumer using 6,000 kWh is \$750 (when using 30 kWhs in the six pricing periods) while a consumer using 10,000 kWh pays only \$250 ((when using 10 kWhs in the six pricing periods) is not an indication that the LFC regulations have been breached. Rather the observation simply indicates the former consumer consumed more electricity in the peak pricing periods than the latter consumer.

The practical implication of this ability under the LFC regulations to have different variable charges across annual consumption is that a complaint from consumers that the level of their line charges does not follow the level of their annual consumption is not evidence that the LFC regulations have been breached.

I note in TLC’s case this outcome of the level of lines charges not following the level of annual consumption arises from TLC’s general pricing methodology and is not unique to its LFC variable charges.

The wider regulatory context

It is instructive to consider the wider regulatory context within which these claims of non-compliance are being made.

TLC's pricing methodology is designed to reflect to consumers the way in which their consumption patterns drive TLC's costs. This is intentional, in order for consumers to bear some of the costs of their consumption patterns and to have economic incentives to, where possible, shift their load. Such pricing is widely considered to lead to more economically efficient outcomes than pricing that does not signal the cost of peak usage.

The Authority's statutory objective focuses on economic efficiency, that is "*The objective of the Authority is to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers.*"¹

In addition the Authority has issued Pricing Principles for electricity network businesses that directly support cost reflective pricing (the Pricing Principles are appended, see in particular (a) (iii)). TLC's pricing methodology is more consistent with these Principles than other tariff structures used by electricity network businesses that employ a constant variable charge for all annual consumption regardless of whether it is consumed at peak or off-peak periods.

Thus a finding by the Authority that TLC's cost reflective variable charges are non-compliant with the LFC regulations would be inconsistent, from an economic perspective, with its statutory objective and its own Pricing Principles.

¹ Section 15 of the Electricity Industry Act 2010

Appendix – Electricity Authority Pricing Principles

Electricity Authority Pricing Principles

- (a) Prices are to signal the economic costs of service provision, by:
 - (i) being subsidy free (equal to or greater than incremental costs, and less than or equal to standalone costs), except where subsidies arise from compliance with legislation and/or other regulation;
 - (ii) having regard, to the extent practicable, to the level of available service capacity; and
 - (iii) signalling, to the extent practicable, the impact of additional usage on future investment costs.
- (b) Where prices based on 'efficient' incremental costs would under-recover allowed revenues, the shortfall should be made up by setting prices in a manner that has regard to consumers' demand responsiveness, to the extent practicable.
- (c) Provided that prices satisfy (a) above, prices should be responsive to the requirements and circumstances of stakeholders in order to:
 - (i) discourage uneconomic bypass;
 - (ii) allow for negotiation to better reflect the economic value of services and enable stakeholders to make price/quality trade-offs or non-standard arrangements for services; and
 - (iii) where network economics warrant, and to the extent practicable, encourage investment in transmission and distribution alternatives (e.g. distributed generation or demand response) and technology innovation.
- (d) Development of prices should be transparent, promote price stability and certainty for stakeholders, and changes to prices should have regard to the impact on stakeholders.
- (e) Development of prices should have regard to the impact of transaction costs on retailers, consumers and other stakeholders and should be economically equivalent across retailers.

12 November 2014

To

Jude Murdoch
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Copy to

Andrew Springett
Peter Wakefield

From

Dipti Manchanda
Tony Dellow

By Email

jude.murdoch@ea.govt.nz

Dear Jude

The Lines Company's compliance with the Low Fixed Charge Regulations: legal opinions obtained by The Lines Company and the Authority's next steps

1. The Lines Company has provided the Authority with two legal opinions that take the view that the Low Fixed Charge (LFC) tariff set by The Lines Company complies with the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 (regulations). You have asked us to review those legal opinions. This letter outlines our views on the legality of The Lines Company's LFC tariff and how the Authority could proceed.

Background

2. In February 2014, the Authority received a complaint from a consumer regarding the methodology The Lines Company uses in its LFC tariff. That complaint prompted the Authority to consider whether or not The Lines Company's LFC tariff complies with the regulations.
3. In March 2014, the Authority obtained a report from Strata Energy Consulting Limited, which took the view that The Lines Company's LFC tariff does not comply with the regulations. The Strata report came to that conclusion because the LFC tariff set by The Lines Company is based on average peak kW demand, and not electricity consumption in kWh.
4. In April 2014, you asked us to review the Strata report and provide our opinion on the legality of The Lines Company's LFC tariff. In our opinion dated 5 May 2014, we advised that in our view, The Lines Company's LFC tariff does not comply with the regulations. We disagreed with the reasoning in the Strata report. We considered that the variable charge was based on the amount of

electricity a consumer consumes, because The Lines Company calculates a consumer's electricity demand based on the amount of electricity consumed by that consumer.

5. However, we considered that The Lines Company's LFC tariff does not comply with the regulations in two respects:
 - (a) The variable charge in the LFC tariff only takes into account a consumer's electricity consumption at certain peak periods, and does not take into account a consumer's electricity consumption over the rest of the year. The variable charge therefore does not fall within the definition of "*variable charge*" in the regulations, and as a result, the LFC tariff breaches regulation 14(1).
 - (b) The variable charge is tiered or stepped according to the amount of electricity consumed. As a result, the LFC tariff breaches regulation 16(1)(a).
6. Based on our advice, Peter Wakefield recommended to the Compliance Committee at its meeting on 26 June 2014 that it appoint an investigator to investigate an alleged breach of the regulations by The Lines Company of regulation 14(1). The Compliance Committee then appointed Peter to investigate an alleged breach of regulation 14(1). The Lines Company was informed of the investigation on 4 July 2014.
7. On 29 August 2014, The Lines Company wrote to the Authority, explaining why it believes that the variable charge in its LFC tariff complies with regulation 14(1). In that letter, The Lines Company included legal opinions that it had obtained from James Farmer QC and Russell McVeagh supporting its position.

Summary of advice

8. For the reasons outlined in this letter and in our meeting with you on 7 October 2014, we consider our advice of 5 May 2014 to be correct, and that The Lines Company's LFC tariff breaches the regulations.
9. However, the Compliance Committee has a discretion to decide not to take further action against The Lines Company. Under the Authority's Prosecution Policy, the Compliance Committee may decide that no further action is warranted. However, if the Compliance Committee does recommend to the Board that prosecution action be taken, the prosecution is only appropriate if the Board is satisfied that there is sufficient evidence to provide a reasonable prospect of conviction and that prosecution is required in the public interest.
10. We consider the real issue to be the regulations themselves, which appear to be highly unsatisfactory and in need of review.

The variable charge in The Lines Company's LFC tariff

11. The Lines Company charges consumers based on an assessment of their peak kW load, or, for consumers with time of use meters, on their actual kW demand. A consumer's kW demand is derived from the amount of electricity the consumer consumes, measured in kWh, as follows:

- (a) The Lines Company develops a profile for an average consumer, based on all consumers whose annual consumption of electricity is between 7,000 kWh and 9,000 kWh. The Lines Company then uses this profile for an average consumer to derive a formula that converts consumption in kWh to a kW load.
- (b) The Lines Company obtains a measure of the amount of electricity a consumer has consumed, in kWh. For a consumer that has a time of use meter, this measure is the average of six readings taken over peak consumption times in a 92-day winter period. For a consumer that does not have a time of use meter, this measure is based on the consumer's total kWh consumption over the same 92-day period.
- (c) For a consumer that does not have a time of use meter, The Lines Company then applies the formula derived in step (a) to that consumer's kWh measure, as determined in step (b), to give The Lines Company a value that is used as the consumer's kW load. For a consumer that has a time of use meter, the consumer's kWh measure, as determined in step (b), is converted to a kW load. The consumer is then charged based on \$/kW.

The regulations

12. Regulation 14(1)(c) limits the components of a distributor's LFC tariff to a fixed charge, a variable charge or variable charges, fees for special services, a fee for providing or reading a meter owned by the distributor, and/or a fee for providing a relay owned by the distributor.
13. We, Russell McVeagh, and James Farmer QC, all agree that the issue raised by regulation 14(1)(c) is whether The Lines Company's kW based charge is a "*variable charge*" as defined by the regulations.
14. Regulation 4(1) defines "*variable charge*" as "*a charge that varies according to the amount of electricity consumed*".

Legal opinions obtained by The Lines Company

15. James Farmer QC and Russell McVeagh are of the opinion that The Lines Company's kW based charge is a variable charge as defined in the regulations. They consider that:
 - (a) The regulations envisage distributors setting variable charges that do not vary according to the amount of electricity consumed over a whole year, but that vary according to consumption over a much shorter period.
 - (b) The variable charge or charges that form part of an LFC tariff are not required to have a direct relationship with the amount of electricity a consumer consumes over a whole year.
 - (c) The Authority's statutory objective "*to promote competition in, reliable supply by, and the efficient operation of, the New Zealand electricity industry for the long-term benefit of consumers*" bears on the meaning of "*variable charge*". The Lines Company's LFC tariff is efficient, consistent with the Authority's statutory objective. The Authority's statutory objective does not support reading in a requirement that a variable charge varies according to the amount of electricity consumed over a year.

The relevance of annual electricity consumption to the variable components of an LFC tariff and The Lines Company's compliance with the regulations

16. In our advice of 5 May 2014, we did not suggest that any individual variable charge must vary according to the amount of electricity consumed over a year. As referred to in section 6 of our 5 May 2014 advice, the regulations allow a distributor to include different variable charges in an LFC tariff for electricity consumed at different times of the year.
17. Rather, we consider that:
 - (a) The regulations do not limit the number of variable charges that a distributor can include in an LFC tariff.
 - (b) An individual variable charge must vary according to electricity consumption in the period covered by that variable charge.
 - (c) The references to electricity consumed and charges "*per year*" and "*in total per year*" in regulations 9(2), 10(3), 15(1) and 16(2) indicate that together, the periods covered by all variable charges in an LFC tariff must cumulatively account for an entire year.
18. We consider that when interpreting the regulations, while the statutory objective of the Authority in the Electricity Industry Act 2010 may be of assistance in resolving the ambiguities in the regulations, the wording of the regulations is the primary determinant of their effect. The empowering provision in the Act, section 113, allows for regulations that "*require low fixed charge tariff options to be made available to consumers who use less than a prescribed amount of electricity*". Regulation 3(a) states that one of the objectives of the regulations is to "*ensure that electricity retailers offer a low fixed charge tariff option or options ... that will assist low-use consumers*". "*Low-use consumer*" is defined in regulation 4(1) with reference to annual electricity consumption. We therefore consider that our interpretation of "*variable charge*" is consistent with the purpose of the regulations.
19. Applying our interpretation, if an LFC tariff only contains one variable charge and not multiple variable charges, that single variable charge must vary according to the amount of electricity that a consumer consumes over a whole year. The Lines Company's LFC tariff contains just one variable charge, but that variable charge only varies according to electricity consumption in certain periods. A consumer's electricity consumption over the rest of the year has no bearing on any variable charge in The Lines Company's LFC tariff at all. We therefore remain of the view that The Lines Company's LFC tariff does not comply with the regulations.

How the Authority could proceed

20. We understand that The Lines Company is concerned that our interpretation of "*variable charge*" will result in The Lines Company having to substantially change its tariff methodology for all customers, in order to comply with the regulations.
21. Whether there has been a breach of the regulations is not the end of the matter. When deciding on the appropriate course of action to respond to a breach, the Authority's Prosecution Policy allows or

requires (depending on the action being considered) the Compliance Committee and the Board to take other considerations into account.

22. Paragraph 10.1 of the Prosecution Policy allows the Compliance Committee to decide to take no further action regarding an alleged breach if the alleged breach is minor. An alleged breach may be considered minor if, for example, the alleged breach is inadvertent or not part of a deliberate intention to breach.
23. If the Compliance Committee considers that the seriousness and overall impact of an alleged breach is high, the Compliance Committee may decide to recommend to the Board that prosecution action be taken. Paragraph 14.3 of the Prosecution Policy requires the Compliance Committee to take into account the Solicitor General's Prosecution Guidelines when deciding whether to make such a recommendation. Applying paragraph 5.1 of the Prosecution Guidelines, the Compliance Committee should only recommend commencing a prosecution against The Lines Company if the Compliance Committee is satisfied that there is sufficient evidence to provide a reasonable prospect of conviction, and that prosecution is required in the public interest.
24. If the Compliance Committee does recommend to the Board that the Board prosecute The Lines Company for breaching the regulations, paragraphs 14.5 and 14.6 of the Prosecution Policy require the Board to make its own assessment on whether to commence a prosecution, applying the same test. Before commencing a prosecution against The Lines Company, the Board must therefore also be satisfied that there is sufficient evidence to provide a reasonable prospect of conviction and that the public interest requires that the prosecution be commenced.
25. In summary, if either the Compliance Committee or the Board is not satisfied that the Authority has a reasonable prospect of securing a conviction for a breach of the regulations, or is of the view that a prosecution is either not required by or in the public interest, the Authority should not commence a prosecution against The Lines Company for breaching the regulations.
26. We consider that the Authority should avoid adopting an untenable interpretation of the regulations. Instead, the differing interpretations of the regulations here highlight that the regulations themselves are unsatisfactory. That should, in our view, be addressed by the Authority approaching the Ministry of Business, Innovation and Employment to seek a review of the regulations.
27. Please contact us if you have any further questions.

Yours sincerely



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