27 June 2024

Tamara Linnhoff
Manager, Electricity Markets Policy
Ministry of Business, Innovation & Employment

Via email to electricitymarkets@mbie.govt.nz.

Dear Tamara,

Thank you for your letter on the mid-point review of the phase-out of the Low Fixed Charge (LFC) Regulations.

ENA is firmly of the view that the LFC phase-out should continue as it is in the long-term interest of all New Zealanders. The LFC regulations are an inefficient cross-subsidy that negatively impacts many New Zealanders. Especially those with large families and/or living in poorly insulated homes.

EDBs are progressing with distribution price reform as expected and promoted by the Electricity Authority (Authority). EDBs progress is evidenced by the Authority's distribution pricing scorecard in which the average EDB score rose from 3.0 in 2021 to 3.9 in 2024.

A key pillar of the Authority's guidance on efficient distribution pricing is that EDBs should set variable (price signalling) prices at long-run marginal cost with all remaining revenues to be recovered from fixed or fixed-like charges. In response to this guidance, EDBs have been increasing fixed prices for those customers on standard pricing plans.

However, during the phase-out, the LFC regulations continue to be a barrier to the implementation of the reform expected by the Authority. Because for the 50% of residential customers (by number) who are on the LFC pricing plans, the LFC regulations strictly limit the level of fixed charges making the complete implementation of the Authority's guidance impossible.

Pricing innovation is occurring in the retail electricity marketplace with both incumbent and challenger retailers offering a variety of innovative pricing options to customers. These innovative prices include plans tailored to customers with home batteries and EVs and plans offering free power at off-peak times. These innovative retail offerings are only enabled by EDB's deployment of time-of-use prices.

EDBs now offer time-of-use distribution prices to more than 94% of residential consumers up from 84% in 2022-23. EDBs continue to work with retailers and the Authority to ensure that, where possible, consumers are allocated to the more efficient distribution prices, enabled (but still constrained) by the phase-out of the LFC.

The attached MS Excel spreadsheet contains ENA's response to your specific questions.

Yours sincerely

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MBIE Mid-point Review of LFC Phase-out 2024 - Data and Information Request – to ENA - 21MAY2024.xlsx

Please provide (here, or in an separate word document)

Information on distribution pricing

Question EN1: In general, what percentage of distributor's costs of serving residential consumers are fixed?	**Response:** ENA holds no specific EDB data on the percentages of fixed versus variable cost to serve residential customers. However, our understanding is that the vast majority of EDB's costs are asset-based costs which do not vary by throughput including depreciation and return on capital.

Question EN2: Do you expect the proportion of distributor's fixed costs to change in future, as a result of DPP4 and wider electrification?	**Response:** Electrification will have an impact on EDBs' fixed costs, as far as it will require EDBs to invest in assets (including data) and infrastructure to enable the greater use of electricity. These investments will grow EDB's assets bases and subsequently their depreciation and return on capital expenses. However, while electrification will increase EDB asset bases, it is not likely to have a material impact on the share of fixed versus variable costs within DPP4 or beyond.

Question EN3: How have variable charges changed on low-use tariffs in response to higher fixed charges as a result of the phase-out?	**Response:** As the LFC cap has increased, EDBs have rebalanced their variable price for LFC customers to comply with the equivalence tests set out in the LFC regulations. This has largely resulted in decreases in volumetric tariffs. In some cases, the decline in volumetric prices facilitated by the LFC phase-out has been mitigated by general price increases tied to historically high inflation.

Question EN4: How have fixed charges changed on equivalent standard tariffs in response to higher fixed charges on low-use tariffs as a result of the phase-out?	**Response:** Many factors have influenced the fixed prices for customers on standard pricing plans during the LFC phase-out. Primary amongst these is EDBs' responses to the Authority's expectation that they increase the use of fixed or fixed-like charges to recover revenues. Its expectations set out in their open letter on distribution pricing and issues papers on targeted reform of distribution pricing is that EDBs recovery a greater proportion of their revenues from fixed and fixed-like changes that do not influence demand.

Question EN5: How have variable charges changed on equivalent standard tariffs in response to higher fixed charges on low-use tariffs as a result of the phase-out?	**Response:** EDBs have continued to reform their variable prices for customers on standard pricing plans in line with the Authority's guidance of efficient distribution pricing. This has included an increased focus on the use of time-varying prices (including time of use tariffs) and setting peak prices with reference to their long-run marginal cost. The most common change to variable charges in response to this guidance has been a significant lowering of off-peak tariffs. Many EDBs (including Vector) have set their off-peak kWh charges for standard users at or near 0c/kWh. For many EDBs, this process has lowered the overall share of revenue recovered from volumetric tariffs on standard users.

Question EN6: To what extent have wider factors (outside of a rebalancing of charges between fixed and variable) impacted pricing of low-use tariffs?	**Response:** The historically high inflation rates and changes to the TPM since the commencement of the LFC phase out, have mitigated the downward movement of variable prices made possible by the rebalancing of LFC tariffs.

Question EN7: To what extent have wider factors (outside of a rebalancing of charges between fixed and variable) impacted pricing of standard tariffs?	**Response:** As noted above, higher-than-usual inflation and the Authority's guidance of efficient distribution pricing have been critical factors in the movement of standard tariffs during the phase-out to date.

Question EN8: What percentage of your costs of serving residential consumers are fixed?	**Response**: Not applicable

Information on whether the phase-out is enabling more efficient distribution pricing

Question EN9: How has the phase-out directly impacted your members ability to introduce more efficient distribution pricing?	**Response:** The LFC phase-out has allowed EDBs to gradually improve the alignment of their prices with the Authority's more efficient distribution prices. A core plank of which is the greater use of fixed or fixed-like prices to recover revenues not recovered by price signalling prices. This has only occurred to the extent possible by the LFC phase-out. The cancellation of the phase-out would curtail any further progress towards more efficient distribution prices. In addition, the LFC phase-out has enabled off-peak volumetric prices to be reduced and in several cases to zero or near zero facilitating a variety of attractive retail price offering including power at off peak times.

Question EN10: If more efficient price signals have been introduced, has this resulted in less peak demand or less constraints on the network? If not, why not?	**Response:** If more efficient price signals have been introduced, has this resulted in less peak demand or less constraints on the network? If not, why not? Distribution prices are just one part of consumer electricity bills, accounting approximately 27% of a consumers total electricity bill. Retailers bundle distribution prices along with other costs to offer pricing plans that are attractive to customers. For example, a recent EECA study found that 91% of customers were aware of the availability of time-of use retail prices but only 30% chose to be on these pricing plans. In this instance, the EDB price signal is not being received by 70% of customers. With less than 30% of customers receiving price signals from efficient TOU distribution prices it is near impossible for EDB to

Question EN11: What additional innovation could be expected when the LFC regulations are removed completely?	**Response:** EDBs are committed to the continued reform of their distribution prices. The complete removal of the LFC regulations would allow EDBs to fully implement the Authority's guidance on efficient distribution tariffs. Innovation made possible by the removal could include all-you-can-eat fixed prices (where networks are not constrained) that will incentivise the electrification of NZ homes. The removal will also enable the development of prices that reward the provision of flexibility services.

Question EN12 : Whether the phase-out resulted in lower forecast expenditure in DPP4 (and so less cost for consumers) than would have been the case had the LFC regulations been retained?	**Response:** No, the LFC does not impact total revenues only the balance between residential customer groups. The cross-subsidies are not borne by EDB through lower revenues but rather by other customers, often larger families, and those in poorly insulated homes.