Q & A: Why the Low Fixed Charge Regulations are being phased out

What was the problem?
Some households were paying more for their connection to the electricity network than other households. Households that use more power were, in effect, cross-subsidising households that use less power. Those paying higher charges included families and vulnerable consumers living in uninsulated homes and unable to afford energy efficient appliances or technologies.

As a consequence, this:

- Created an undesirable incentive for income-constrained households to under-heat their homes to save money, which had knock-on health and education issues, especially for children;

- Increasingly favoured wealthier consumers over the longer-term as they could afford the capital investment in solar, efficient lights, insulation and the like. This increased the cost-shifting from wealthy consumers to less-wealthy consumers;

- Would have frustrated the uptake of the electric vehicles (which is arguably the best opportunity to de-carbonise our economy) by penalising greater electricity consumption;

- Increased the complexity of tariffs and double the number of tariffs on offer, increasing costs for retailers and ultimately consumers as well as making it more difficult to understand electricity pricing.

These problems were caused by a regulation called Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004. Commonly known as the *low fixed charge*.

What did the LFC regulations do?
The regulations required retailers to offer domestic consumers low daily fixed charge tariff options of no more than 30c per day (excluding GST). Fifteen cents went to the lines company and 15 cents to the retailer.

The flip-side of the low fixed charge requirement was that networks and retailers had to significantly increase the variable charges (the price charged per unit of electricity) for consumers who chose a low-fixed tariff. Under-recovery of costs from low-fixed charge customers meant they also needed to increase prices for those customers who weren't on low-fixed charges.
The actual cost of a connection to the grid varies from place to place, but a typical actual amount is $2.50 a day for the lines component alone.

Prior to the phase out beginning in 2022, about 60 percent of households were on the low fixed charge plan.

The 15 cents per day of the fixed charge that went to the lines company contributed less than five percent to the cost of providing and maintaining the local lines network.

What are daily fixed charges, and what are they for?
Fixed daily charges are used by networks and retailers to recover those costs which do not vary with the amount of electricity consumed.
In total, the actual fixed costs can be around $2.00 - $2.50 per day for typical residential users – the low fixed charge regulations meant that users who qualified could be charged no more than 30 cents per day to cover these fixed costs.

Who was paying more than they should?
In general, above-average consumers of electricity paid more than the actual cost of their connection to the electricity network. In contrast, homes which used less electricity contributed less than the actual cost of their connection.
In effect, the regulations created a cross-subsidy. Those paying the higher prices were subsidising those paying the lower prices.

But shouldn't higher users have been paying more?
For electricity, yes. But they shouldn't also have had to stump up more for their lines charge. Lines costs are largely fixed, meaning they do not vary depending on how much electricity is flowing through lines. All things being equal, a customer in any single town or city should be paying the same amount for their lines connection as their neighbour, regardless of energy consumption (measured in kilowatt hours).

Didn't the LFC regulations help people on lower incomes?
Not necessarily. Some low-income households are low users. However, there are many low-income households that use more than 8,000 kWh a year. These include larger families living in homes with no other energy source (eg, gas, solar, wood-burners) and which are poorly insulated. These households were worse off, as these higher-use households were subsidising the electricity supply costs of smaller households living in well-insulated modern homes with energy-efficient modern appliances.

Why should I pay around $2 per day in fixed charges if I don't use much electricity?
Many of the costs of running the electricity network and managing your account are fixed and are not related to how much electricity you consume. Similar to the cost of having access to landline telephone connection, you pay a fixed monthly charge for access to the network, irrespective of how many calls you make or receive.

The average cost throughout the country per consumer of maintaining a local distribution network is $750 per household. With around $1.00 per day of fixed charges going to the lines company, this charge covers around half of the actual annual cost. (The other $1.00 per day of the fixed charge goes to the retailer.)

Who will be paying more and who will be paying less after the LFC is removed?
At the end of the five-year phase out, most consumers who are currently on standard plans will pay less with the removal of the cross-subsidy that the LFC created. Their costs of electricity consumed will drop nearly 40 percent from an average 27 cents per kWh to 16 cents per kWh at today's pricing.

The majority of users currently on the low fixed charge plan will either see a reduction or no significant increase in their overall electricity charge when the low fixed charge is phased out.

Extremely low users (those using less than 4000 kWh of electricity per year who are currently on the low fixed charge plan) could see a modest to significant increase in their total electricity charge when the cross-subsidy created by the low fixed charge is removed.

Is there support for those consumers in hardship who may be most adversely impacted by the phase out of the low fixed charge?

Low users who are in considered to be in energy hardship may qualify for a rebate to mitigate the impact of the phase out over the course of the five-year transition period.

Was this just a way for lines companies and retailers to make more money?
No. Lines companies are natural monopolies and as such the total revenues they can earn are curbed by the Commerce Commission. Lines companies will not make more money from the regulations being removed.

Retailers face fierce competition on pricing from their competitors. Retailers are legally prevented from collectively setting price levels, and if they charge more, they risk losing customers to their competitors – effectively preventing them from charging more than necessary. The removal of the low fixed charge will therefore not see retailers making any more money.

What did the electricity pricing review say about the regulations?
Quoting from the Electricity Price Review's final report of 21 May 2019:

> "The Government should phase out low fixed charge tariff regulations by allowing the maximum fixed charge component of low-user plans (currently 30 cents) to rise gradually over five years, at which point the cap would be removed.
>
> Retailers and distributors would no longer have to offer consumers the option of a low-user tariff, although they might choose to do so.
>
> The Government would make this change by amending regulations made under the Electricity Industry Act 2010.
>
> A five-year phase-out, co-ordinated with help for households in energy hardship and the distribution pricing changes mentioned above, should moderate the impact of removing the cap on most low-use households.
>
> Some distributors suggested a shorter phasing-out period, but this, in our view, could result in unacceptable price increases for low-use households.
>
> The regulations should be removed because they exacerbate already inefficient price signals to residential consumers and also unintentionally shift costs to households with low incomes and high electricity consumption."

Does removal of LFC disadvantage those who have put solar on their roof, or are planning to?
The economics of solar panels could change with owners no longer being able to rely on artificially low fixed daily charges and an associated reduction in consumption charges.

How will the five-year phase out work?
From 1 April 2022, the maximum low fixed charge, currently at 30 cents a day, will increase by 30 cents each year until 1 April 2027.

This means the maximum low fixed charge will rise to 60 cents a day on 1 April 2022, 90 cents a day on 1 April 2023, $1.20 a day on 1 April 2024, $1.50 a day on 1 April 2025 and $1.80 per day on 1 April 2026.

On 1 April 2027, the regulations will be removed, and power companies will no longer be required to offer customers a low fixed charge.

Maximum low fixed charge	
Current price	$0.30 a day
1 April, 2022	$0.60 a day
1 April, 2023	$0.90 a day
1 April, 2024	$1.20 a day
1 April, 2025	$1.50 a day
1 April, 2026	$1.80 a day
1 April, 2027	Regulations removed. Power companies are no longer required to offer customers a low fixed charge.