

ENVIRONMENT FOOD AND AGRICULTURE

1.7. Manx Gas – Tariff reductions and adjustments

The Hon. Member for Onchan (Mr Callister) to ask the Minister for Environment Food and Agriculture:

To what extent the announcements by Manx Gas in December 2015, April and August 2016 were genuine reductions in tariffs or simply an adjustment in order for Manx Gas to meet certain terms of its Regulatory Agreement?

The Speaker: Question 7. I call on the Hon. Member for Onchan, Mr Callister.

Mr Callister: Thank you, Mr Speaker.

Could I ask the Minister for Environment, Food and Agriculture to what extent the announcements by Manx Gas in December 2015, April and August 2016 were genuine reductions in tariffs or simply an adjustment in order for Manx Gas to meet certain terms of its Regulatory Agreement?

The Speaker: I call on the Minister for Environment, Food and Agriculture to reply.

The Minister for Environment, Food and Agriculture (Mr Boot): Good morning. Thank you, Mr Speaker.

In answering this Question, I would firstly explain that, while the Department of Environment, Food and Agriculture is a sponsoring Department for the Office of Fair Trading, the OFT is a separate legal entity. Under normal circumstances, this Question would probably be addressed to the OFT Chairman; however, the current OFT Chairman is no longer a Member of this House and the new Chair will most likely not be appointed until November Tynwald. Therefore, it is appropriate that I should respond at this stage.

As Hon. Members will be aware, with effect from 1st January 2015, the Government, through the OFT, the Department of Economic Development and the Treasury, entered into an agreement with Manx Gas Ltd to provide a light touch regulation of the gas supply market.

The agreement, which is published on the OFT website, provides for the fixing of profits of Manx Gas Ltd, linking those profits to the capital employed in the business. The agreement is using profitability as a proxy for prices, thus ensuring indirectly that the consumer is getting a fair deal. This also leaves the company free to run its business without interference.

The lead role in monitoring the performance of Manx Gas Ltd in order to ensure compliance with the agreement is vested in the OFT, although they are very ably assisted by professional accountants from the Treasury. There have been three tariff cut reductions during 2016 so far and these were introduced by Manx Gas Ltd after consultation with the OFT, in order to reflect changes in the feedstock prices and ensure that the company continued to target its fixed level of profitability.

In addition, there is currently a regulatory rebate in place because, despite endeavours to achieve the fixed profit level, the company actually exceeded that level last year and under the agreement it now has to pay back the excess over three years to the customer base.

In summary, I understand these reductions represent genuine savings for Manx Gas customers.

The Speaker: The Hon. Member for Onchan, Mr Callister.

Mr Callister: Thank you, Mr Speaker; and I thank the Minister for his response as the sponsoring entity.

I would still like to ask my question and that would be: would the Minister agree with me that any regulatory adjustment applied by Manx Gas in accordance with the regulatory agreement is nothing more than a simple refund back to Manx Gas customers, who have been overcharged in one or more periods?

The Speaker: The Minister to reply.

The Minister: Thank you.

That is a subjective judgement. If you look at the market in the UK, where there is competition, prices move up and down and there is a lot of criticism in the UK about the way prices move there. On Island there have been three reductions – 3.5% in January, 3.5% in April and 3.6% in September – and they are reflected by the agreement that we have with Manx Gas Ltd, which is a private company. One could argue that they have reduced their prices because they have to, but that is the way a regulatory agreement works.

So that is where we are and I think the customers have benefited accordingly.

The Speaker: The Hon. Member for Onchan, Mr Callister.

Mr Callister: Thank you, Mr Speaker; and I note the Minister's response, although he does not give a clear definition of what the difference is.

Could I ask the Minister: does he agree with me that the Office of Fair Trading should write to Manx Gas in the strongest terms in order to ensure that all future press releases make it very clear as to what is a regulatory adjustment, a refund or overcharge, and what is a genuine reduction in the kWh unit prices or standing charges, in order that Manx Gas customers feel that they are actually getting a reduction in service and not just a refund?

The Speaker: The Minister to reply.

The Minister: I think it is fair to say that the Office of Fair Trading, with the Treasury accountants, scrutinise the company accounts on a quarterly basis to ascertain and calculate returns on investment. That is how the agreement works and I believe that accounts for a genuine decrease in prices when there are decreases in feedstock prices.

The Speaker: Mr Callister.

Mr Callister: Mr Speaker, could I ask the Minister, because he did not answer my question there: will he be writing to the Office of Fair Trading and asking them to write to Manx Gas in order to ensure the press releases are very clear on what is a refund and what is a regulatory adjustment? I think it is very important.

They have a monopoly on this Island; they have thousands and thousands of customers. And customers on the Island are given the impression that they are getting a price reduction or a price cut, and actually it is a regulatory adjustment because the Manx Gas customers have overpaid. I think this organisation – Manx Gas – and the Department and the Office of Fair Trading should be very clear with the Manx Gas customers.

The Speaker: The Minister for Environment, Food and Agriculture to reply.

The Minister: I am very happy to talk to the Office of Fair Trading to see whether they can determine a way forward which is more open and reflects the situation with regard to any adjustments, whether regulatory or not, that are made.

The Speaker: The Hon. Member for Ramsey, Dr Allinson.

Dr Allinson: Thank you, Mr Speaker.

Could I ask the Minister, further to that: the OFT has declined to undertake any investigations into gas prices between 2015 to 2018, as I understand, which waives its statutory regulatory powers – and this was part of the agreement with Manx Gas, who have now gone through a change of ownership in terms of the overall responsibility.

Unfortunately the introduction of tariff charges and standing charges has meant that many people, particularly those who use small amounts of gas and who live on their own, are paying disproportionately more prices. Whilst the regulation at the moment looks at the overall profit of Manx Gas, it does not look at the individual costs of that gas supply, and I would like the OFT to look again at their statutory powers and perhaps investigate and audit how the introduction of standing charges has skewed the costs to individual customers for gas through a monopoly provider.

Mr Callister: Hear, hear.

The Speaker: The Minister for Environment, Food and Agriculture to reply.

The Minister: If we go back a little in history: in 2007 following a series of OFT investigations into energy prices, the Council of Ministers directed the OFT to undertake an investigation under section 19A of the Fair Trading Act 1996 into gas prices. This investigation covered a specific reference period and sought to answer the question of whether prices charged were excessive or not. The OFT commissioned external auditors, or consultants, to undertake that work on their behalf and the report was laid before Tynwald and published.

It concluded that the most appropriate method of assessing whether the prices for gas were excessive was by using the ratio of profits to capital employed as a proxy, referred to by economists as the 'return on capital employed', or ROCE; they provided the formula for the acceptable range of profitability, the ROCE method showing a range between 8.8% and 12.4%. And during that period, the reference period that the gas profits by proxy, the prices were deemed not to be excessive.

We are now running into subjective territory as to whether profits are excessive or not. At present they are within the range as agreed by the OFT and in 2018 the agreement comes up, unless there are substantive breaches in the meantime, and it can be renegotiated or terminated by both parties. So I would suggest that is the appropriate time to revisit the agreement as it stands at present.

The Speaker: Dr Allinson.

Dr Allinson: I completely understand the way that the profits are calculated. What I am looking at, though, is rather the overall profits of a company, the individual charges to a person. And by changing the charging structure, what Manx Gas has done is to preserve their profits but, it could be said, at the expense of individual charges.

Since the documents you quote, the charging structure of Manx Gas has changed quite radically and what I would like the OFT to perhaps look at again is whether that charging structure actually brings fairness to the consumer, rather than just preserve profit and cash flow to the company.

The Speaker: The Minister to reply.

The Minister: I fully understand what you are getting at and I understand that, not only in this jurisdiction but in other jurisdictions, companies have adjusted the tariffs to reflect more on the standing charge and less on the unit charge, and that does have a disproportionate effect on some consumers, particularly those who use very little.

I am quite happy to commit to talk to the OFT about that charging structure and see whether that can be revisited, although I understand that some changes have been made of late.

The Speaker: The Hon. Member for Ayre and Michael, Mr Baker.

Mr Baker: Thank you, Mr Speaker.

In the Minister's earlier answer he referred to Manx Gas paying back any excess profits over a three-year period. Does the Minister feel it is equitable that hard-pressed, hard-working Manx families are effectively subsidising Manx Gas for a three-year period before they get their credit back for having overpaid?

The Speaker: The Minister to reply.

The Minister: The agreement is that they will pay it back over three years, and the agreement is an agreement unless he wishes to break it, and I do not think that would be a substantive break, or a failure on part of the agreement. In essence, yes, I do agree with you, but we are where we are.

The Speaker: I call on the Hon, Member for Onchan, Mr Callister.

Mr Callister: Thank you, Mr Speaker.

Would the Minister agree with me that the Manx Gas return on capital is 9.9%, which is a significant amount in the current market, and their profits are based on an infrastructure put in place by the Manx taxpayer at twenty three and a half million pounds; and we should actually ensure that Manx Gas puts the customer first, and not their profits?

The Speaker: The Minister to reply.

The Minister: Well, 9.9% does sound a good return based on present interest rates, but we should remember that things do change and times change and when the investigation was taking place the acceptable range was 8.8% to 12.4%, and by agreement they settled on 9.99%.

When it comes to maintaining the infrastructure, if they maintain the infrastructure and they look at capital deployed, then that will have an effect on their profitability – so there are two sides to the coin.

The Speaker: Hon. Member for Douglas Central, Mr Thomas.

Mr Thomas: Thank you, Mr Speaker.

Does the Minister agree with me that, in actual fact, over the three years when the customer has the regulatory adjustment refund they are actually earning 9.99% on their money, so at least that issue has been addressed in the regulatory agreement?

And secondly, does the Minister agree with me that in fact some of the excellent points made today are actually the sorts of issues that are being investigated quite properly by Government in the run-up to 2018, when the regulatory agreement is reviewed?

The Speaker: Minister to reply.

The Minister: I agree with the Hon. Member. That is in fact the case.