

GD 2020/0042



**Isle of Man**  
**Government**

*Reiltys Ellan Vannin*

## **Overview of Proposed Gas Regulatory Agreement**

**July 2020**

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**To the Hon Stephen Rodan OBE MLC, President of Tynwald, and the Hon Council and Keys in Tynwald assembled**

**Foreword by the Minister of Policy and Reform**

This document has been prepared on a strictly “subject to contract” basis, to be presented to the July 2020 sitting of Tynwald, to enable a debate around the terms of a negotiated voluntary agreement with Manx Gas Limited.

I commend the work of the Department in progressing this project apace during an unprecedentedly busy time, and acknowledge the support of the Council of Ministers in this process.

The document sets out the main terms of the proposal negotiated with Manx Gas Limited. These terms have not been agreed by the relevant Departments of Government and all negotiations with Manx Gas Limited to date have been on a strictly subject to contract basis.

The provision of this document does not preclude the relevant Departments of Government from seeking to amend the proposal and continuing to negotiate with Manx Gas, subject to any necessary approvals or from proceeding by means of legislative regulation if necessary. This document does not form any part of the legislative process.

The final Heads of Terms will require to be agreed by Council of Ministers and then Tynwald.

Tynwald is asked to approve, in principle, the proposal negotiated with Manx Gas Limited.

**Hon R K Harmer Esq MHK  
Minister for Policy and Reform**

## 1. Introduction

- 1.1 The Chief Minister's Gas Regulatory Review Committee was established on 30 October 2017 as a Committee by the invitation of the Chief Minister.
- 1.2 The Committee considered submissions, both through meetings and in writing, from a wide range of relevant stakeholders on gas prices and regulation on the Island.
- 1.3 The Committee published their report in February 2019.
- 1.4 Negotiations have been ongoing and have been affected by a number of factors including climate change and the COVID-19 pandemic.
- 1.5 The Motion below was approved in Tynwald in June 2020.
- 1.6 *"That Tynwald is of the opinion that the Isle of Man Government should a) give notice to Manx Gas Limited terminating the Agreement for the Regulation of the Gas Market in the Isle of Man dated 24th April 2015; and b) propose at the July 2020 sitting of Tynwald either (i) Heads of Terms of a voluntary agreement for approval or (ii) a timetable regarding the introduction of regulation to cover the public supply of gas for customers which conforms to UK regulatory best practice and is in line with the other proposals and conclusions of the Gas Regulatory Review Committee's report published in February 2019."*
- 1.7 Notice was given to Manx Gas Limited terminating the Agreement for the Regulation of the Gas Market in the Isle of Man dated 24 April 2015 on 30 June 2020.
- 1.8 Work has continued with Manx Gas Limited to move forward negotiations in relation to a new voluntary agreement.
- 1.9 Heads of Terms to be signed by both parties are currently being drafted, however due to the timescale involved been June and July 2020 Tynwald sittings, it has not been possible to have the fully agreed Heads of Terms available.
- 1.10 However, a summary of the main terms are outlined below for approval by Tynwald.

## 2. Effect on Customers

- 2.1 The effect of the proposal negotiated with Manx Gas will reduce gas costs for regulated natural gas customers by 7.4%.
- 2.2 The charges between the Isle of Man Government and Manx Gas Limited in relation to the gas extension project are being reviewed, the company will pass on any reduction in charges received from the Isle of Man Government to customers,

it is expected that this could reduce tariffs for regulated natural gas customers by up to 5.2%, giving a total bill reduction of up to 12.6%.

- 2.3 The detail in relation to the charging going forward will be agreed before Heads of Terms are finalised.
- 2.4 If the WACC of 6.99% for regulated customers had been in place during 2019, Manx Gas Limited have indicated that their operating profit for that year would have been reduced by 25%.
- 2.5 The agreement will be back dated to 1 January 2020 resulting in a credit for regulated natural gas customers for the period from 1 January 2020 until the agreement is signed.
- 2.4 The relevant Departments of Government and Manx Gas Limited will undertake a review of the all Island tariff in relation to LPG to consider the options available.
- 2.5 Unless agreed otherwise between the parties to this agreement LPG tariffs will not rise at a faster rate, subject to commodity prices than regulated natural gas tariffs.

### **3. Headline Terms**

- 3.1 There will be a split of the business into regulated and non-regulated.
- 3.2 The relevant Departments will be able to bring in enabling primary legislation to provide for a structure that will enable the relevant Departments of Government to regulate gas pricing by means of secondary legislation. The relevant Departments will not seek to bring into force any secondary legislation to regulate or control natural gas prices within the regulated gas market whilst this agreement is in place and not under notice.
- 3.3 Regulated customers will include all domestic customers and all business customers using 12,000 or less kilowatt-hour (kWh) per annum.
- 3.4 Non-regulated customers will be those business customers using 12,001 kWh or more per annum.
- 3.5 The price reduction will apply to Natural Gas customers only.
- 3.6 The assets and costs of the business will be split between the regulated and unregulated parts of the business.
- 3.7 The Weighted Average Cost of Capital (WACC) for the regulated business will be 6.99%.
- 3.8 To encourage efficiency in the business a base level of regulated operational costs will be agreed with Manx Gas Limited based on 2019 actuals and these will increase annually by Consumer Price Index (CPI) until there is reset point.

- 3.9 The level of CPI used will be that used by the Manx Utilities Authority (MUA) for increasing electricity prices.
- 3.10 Gas commodity costs and the related MUA costs for the regulated part of the business will be passed through to regulated customers.
- 3.11 Depreciation for the regulated part will be included on an actual basis adjusted for any changes in depreciation policy and any depreciation on revalued amounts.
- 3.12 An amount apportioned to the regulated business will be allowed as a reduction from profit for the actual pension deficit payment.
- 3.13 The Modified Asset Value (MAV) will be the assets and liabilities directly related to the regulated part of the business, assets and liabilities not directly related to the gas supply business or not related to the regulated part of the business will be excluded.
- 3.14 The MAV of the regulated part of the business will be agreed between Manx Gas Limited and the Department.
- 3.15 The fixed assets of the business will be valued at the balance sheet value, this is the FRS 102 (Financial Reporting Standard 102) value rather than the historic cost value.
- 3.16 The revaluation reserve will be excluded and no upward revaluations may be included in the asset valuation.
- 3.17 The MAV will include an amount for the working capital of the regulated part of the business, this will exclude intercompany, financing asset/liabilities or other amounts not directly related to the regulated part of the business.
- 3.18 Capital expenditure will be on an actual basis, split between the two parts of the business.
- 3.19 Manx Gas Limited will provide the Department with a copy of the budgeted capital expenditure before the commencement of each financial year and consider feedback from the Department.
- 3.20 There will be a review process of the capital expenditure by the Department to ensure it relates directly to the regulated part, is reasonable in the circumstances and is compliant with the company's historical policies.
- 3.21 To the extent that there is over or under recovery of return against the MAV this will be repaid or charged within 12 months of the agreement of the calculation.
- 3.22 Manx Gas Limited, subject to any billing system constraints, will make changes to make the over/under recovery more transparent.
- 3.23 Manx Gas Limited will work with the Isle of Man Government including other Government related bodies to look for opportunities to develop "test" cases to bring new energy solutions to the Island.

- 3.24 Manx Gas Limited will continue with their customer services and support for vulnerable customers. It is acknowledged that the company had made significant progress in this area.
- 3.25 The agreement will be for 10 years with a notice clause, exercisable by either party, included.
- 3.26 The agreement will have a reopener to enable the operational costs to be rebased, this enables efficiencies to be passed onto customers.
- 3.27 There will be a review clause to enable the terms of the agreement to be assessed.
- 3.28 There will be reopener clauses relating to climate change and anti-competitive matters which could significantly impact the company's business.
- 3.29 Non-regulated customers will continue to negotiate their tariffs with the company.
- 3.30 There will be a force majeure events clause within the contract.
- 3.31 Changes to regulated tariffs and/or regulated tariff structure will be submitted to the Department for comment, Manx Gas Limited will consider the comments and provide a response to the Department detailing their consideration.

#### **4. Difference from Previous Agreement**

- 4.1 WACC reduced from 9.99% to 6.99%.
- 4.2 Operating costs fixed at an agreed starting point based on the 2019 actuals and increased by CPI to encourage efficiency.
- 4.3 Current assets and liabilities not directly related to the business will be excluded from working capital.
- 4.4 The business is split into two parts regulated and non-regulated.
- 4.5 Non-regulated business is all the other activities carried out by Manx Gas Limited.
- 4.6 Agreement to work with the Isle of Man Government on trials to assist with climate change.

#### **5. What Happens Next?**

- 5.1 If Tynwald approve, in principle, the offer from Manx Gas Limited, Heads of Terms and an Agreement will be finalised.
- 5.2 Heads of Terms/Agreement will be brought back to Tynwald in October 2020 for final approval.

- 5.3 If Heads of Terms or an Agreement cannot be completed before October 2020 without reasonable excuse or are not approved by Tynwald at that sitting, a legislative route will be followed.
- 5.4 If Tynwald at the July 2020 sitting does not approve the offer from Manx Gas Limited in principle the legislative route will be followed.
- 5.5 The legislation is being drafted to ensure it is ready for introduction into the branches if required and may be introduced into the Branches anyway to ensure the necessary framework exists should imposing statutory regulation become necessary in the future.
- 5.6 If there is a requirement to introduce legislation urgently it will require co-ordination with Mr President and Mr Speaker.