GD 2020/0066

Isle of Man Government

Reiltys Ellan Vannin

Voluntary Gas Regulation Agreement

Heads of Terms

Cabinet Office

October 2020

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

I thank this Honourable Court for their patience that these are brought, one month overdue, to the November sitting. As I advised in my statement at the October sitting, agreement on the wording for these Heads of Terms was only agreed just before 4pm on the Thursday preceding the October sitting.

Once again I would like to thank the Department and colleagues from the Attorney General's Chambers and wider Government for their assistance during these protracted, extensive and complex discussions with Manx Gas Limited.

Whilst the Heads of Terms Agreement is not necessarily legally binding, they formalise the agreements reached between the parties to date and will shape the form of the final binding agreement, if these Heads of Terms are approved by Tynwald.

The regulation of gas on the Isle of Man is important for our people, our businesses and our environment. The direction for the next iteration of regulation is now in the hands of Tynwald. A voluntary agreement has been progressed and will be finalised by the end of the year, if it is the will of Tynwald.

Concurrently I will also be bringing the Gas Regulation (Amendment) Bill 2020 to the Branches so that there is a framework for statutory regulation, should that be the preferred option.

The choice is now in the hands of Honourable Members.

Hon R K Harmer MHK
Minister for Policy and Reform

1. Introduction

1.1 The 'regulation' of Manx Gas Limited has been an issue that has taken up much time in this Honourable Court. Over recent years the form of this regulation has evolved; from investigations under the Fair Trading Act 1996 in the 2000s, through to a voluntary regulatory agreement in 2015.

1.2 In 2017, the Chief Minister instigated a review of the 2015 agreement and formed a Committee to do so. 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. The Committee published its report in February 2019 with the following recommendations:

i. "This report is published immediately;

ii. Council of Ministers mandates Cabinet Office, Treasury and HM Attorney General's Chambers, supported by external technical regulatory expertise, to take forward negotiations with Manx Gas to establish a new voluntary regulatory agreement that conforms to UK regulatory best practice and includes:

- *A flat rate standing charge for domestic customers with more control over standing charges and gas tariffs. Consideration should be given to offering more than one pricing package,*
- *A rate of return in any future regulatory agreement should be significantly lower than the current rate. This rate of return should be open to review in line with changing economic circumstances and business risks;*
- *A revised reimbursement mechanism in order to repay customers sooner and more fairly; and*
- *Regulation of 'non-price factors', including customer service and measures to mitigate fuel poverty.*

iii. The new gas pricing and regulatory arrangements should include the evolving policy response to decarbonisation, and should be integrated into any new regulatory approach."

1.3 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.

1.4 At the July 2020 sitting of Tynwald, Council of Ministers presented An Overview of the Proposed Regulatory Agreement[1] and Tynwald resolved:

"That Tynwald approves:
1. in principle the proposal negotiated with Manx Gas outlined in the Overview of Proposed Gas Regulatory Agreement [GD No 2020/0042];
2. that the Heads of Terms will be brought for Tynwald approval in October 2020;
3. the bringing forward of enabling legislation in relation to gas regulation concurrently with continued negotiation on the Heads of Terms."

[1] GD 2020/042

2. Heads of Terms

2.1 The Department has worked extensively with Manx Gas Limited to agree these Heads of Terms for a possible new voluntary regulatory agreement ("the Proposed Agreement"). A copy of the full Heads of Terms is included as Appendix 1.

2.2 In order to provide Tynwald Members with the maximum amount of time to consider the Heads of Terms prior to the November sitting, a copy of the Heads of Terms was circulated to Members, by email, on 22 October 2020.

2.3 The Heads of Terms have been built upon the proposal negotiated with Manx Gas Limited and approved by Tynwald, in principle in July 2020.

2.4 A summary of the main points of the Heads of Terms is given below.

a) Scope

As advised in July, the Heads of Terms covers residential and small business customers (Domestic Customers) consuming less than 12,000 KW per annum. Both natural gas and LPG customers are covered.

Manx Gas will continue to negotiate their tariffs and prices with its non-Domestic Customers until such time (if ever), and only in the event that Manx Gas has acted unreasonably in these negotiations, that Regulation is introduced by the Departments or other parts of the Isle of Man Government which would impact upon the setting of these tariffs and price.

The Proposed Agreement (if made) will be between the Department, the Department of Infrastructure ("DOI"), Manx Gas and the Communications Commission. The Communication Commissions role is to act as an independent arbiter in the Agreement in relation to calculation to turnover allowed under the Proposed Agreement and in relation to future capital expenditure by Manx Gas.

b) Timescale

The proposed legally binding Proposed Agreement is required to be signed by all parties prior to 31st December 2020.

All parties are required to reach agreement on the description of the Domestic Assets and the original value of the Base Operating Costs prior to signature as these valuations will be included in the Proposed Agreement.

c) Term

A proposed Agreement would be for a term of 6 years from the 1st January 2020. The agreement may be terminated in certain circumstances by either the Company or by the Department or by the DOI, with 30 days notice.

d) Agreeing the Tariff

There is an oversight role for the Communications Commission ("the Commission"), as an independent body, to determine that tariffs are set in line with the Target Allowed Turnover.

Every year the Company will submit to the Commission its Calculation of its Target Allowed Turnover for the forthcoming Financial Year together with details of any Tariff that results from the Calculation for the Commission's review. The exact timelines and information required would be set out in the Proposed Agreement.

e) Calculation of the Target Allowed Turnover

The Return on Capital Employed (ROCE) for Manx Gas would be permitted to achieve is 6.99%. Any amount of turnover which is over or under recovery against this percentage is either repayable to or collectable from Domestic Customers.

The Heads of Terms Agreement permits Manx Gas a Target Allowed Turnover which is calculated as (6.99%) x Modified Asset Value (MAV) minus Eligible Financial Costs, this excludes inter-company loans, cash, and inter-company payments.

The MAV relates only to assets which are used to supply gas to Domestic Customers. The detail of what will be included/allowable as Domestic Assets is to be agreed between the Departments and Manx Gas and will be included in the final agreement. Similarly, the MAV only includes the liabilities that relate to the Domestic Customer business, these liabilities also exclude operational cash balances over £1.5m and intercompany borrowing which is not directly related to the Domestic Customer gas business.

There is also provision in the Heads of Terms to put controls in place to ensure any capital expenditure made by Manx Gas is appropriate and warranted (and thus the amounts to be taken into account when calculating the MAV). The HOTs include a provision which means that the Communications Commission must approve capital expenditure if the amount to be expended exceeds 110% of what has been spent by Manx Gas on capital on average over the preceding 3 years. The primary purpose of this clause is to ensure that only necessary expenditure occurs given the main method of control is a cap on return on capital rather than a price control.

The Eligible Costs that are to be included in the calculation of the allowed ROCE include, that part of the Depreciation Costs (as shown on the company accounts) as is attributable to assets which serve the Domestic Customer Business, the cost of Gas from its supplier, and its Base Operating Costs. The Departments will agree an amount for the Base Operating Costs (based upon what costs are reasonable for the operation of the Domestic Customer Business) and this amount will be included in the final agreement and will then be increased adjusted annually by in line with CPI during the Term.

As Manx Gas would effectively be operating under partial regulation there is a need to ensure that issues such as cross-subsidisation do not occur in order to protect consumers. The Commission would be required to develop and maintain cost models for assessing compliance with the Proposed Agreement based on the agreed values assets and costs outlined above. As much of the infrastructure that is used to deliver gas to Domestic Consumers is shared with markets that do not fall within the scope of the Proposed Agreement it is important that the cost models are developed in a way that ensures costs are appropriately allocated to consumers.

f) Obligations on Manx Gas Limited

The Proposed Agreement places a number of obligations on Manx Gas Limited, including supply of information, but also covers

- That should the Manx Utilities Authority (MUA) reduce the amount currently charged to Manx Gas for the loan made to it at the time of the extension to the Gas Network, the amount of this reduction is to be paid directly to its Domestic Customers who are supplied with natural gas in a fair and proportional manner.
- purchase gas in a manner which provides a balance between best price and the need for stable prices over an annual buying cycle
- reviewing the Company's billing arrangements and moving to adopt a billing process that clearly shows any charges or credits made in accordance with clause 3.2.7.3 in customer invoices;
- compilation and maintenance of a vulnerable customer database to ensure that vulnerable Domestic Customers receive priority service in appropriate circumstances, subject to the Company's ability to implement appropriate safeguards under applicable data protection legislation; and
- publication of an agreed customer service charter and customer service metrics.

5. What Happens Next?

5.1 If Tynwald approve the Heads of Term, a final binding legal agreement with Manx Gas will be drawn up, to be signed prior to 31 December 2020.

5.2 As the Proposed Agreement will be deemed to have come into force on the 1st January 2020, it is likely that Manx Gas will have achieved a ROCE of more than 6.99% for the year to the 31st December 2020. It is therefore likely that Domestic Customers will receive a rebate of charges paid. This rebate will be increased further if the MUA reduce the loan charges to Manx Gas (as this reduction will be passed on to natural gas customers). The exact value of any rebate would be directly related to the agreed asset values and costs and as such it is not possible to put any values on this at this point in time.

5.3 As a consequence of the Agreement, if approved, the DOI and the Department are required to agree that they will not seek to introduce legislation to regulate or control gas charges to Domestic Customers during the Term. This does not prevent them from:

(i) introducing legislation to regulate or control gas charges to Commercial Customers if Manx Gas act unreasonably and increase charges disproportionately to Commercial Customers; and

(ii) introduce primary legislation which allows the making of secondary legislation which would regulate or control charges provided that they do not bring into force the secondary legislation.

5.4 Should Tynwald not accept the Heads of Terms and opt to reject the Proposed Agreement legislation is to be brought through the branches to establish a statutory regulatory regime. It should be noted that this would not likely occur by the end of December 2020 but is nevertheless an option for ensuring adequate protection of consumers.

Appendix 1

DRAFT FOR DISCUSSION

SUBJECT TO CONTRACT AND POLITICAL INPUT AND APPROVALS

HEADS OF TERMS

DATED 2020

BETWEEN

(1) The **Department of Infrastructure** (a Department of the Isle of Man Government) of Sea Terminal Buildings, Douglas, Isle of Man, IM1 2RF ("**DOI**"); and

(2) The **Cabinet Office** (a Department of the Isle of Man Government) of Government Office, Bucks Road, Douglas, Isle of Man, IM1 3PN; and

(3) **Manx Gas Limited** (a company registered in the Isle of Man with company registration number 000721V) whose registered office is situate at Murdoch House, South Quay, Douglas, Isle of Man, IM1 5PA (the "**Company**");

(4) **The Communications Commission** (a Statutory Board of Tynwald) of Murray House, Mount Havelock, Douglas Isle of Man IM1 2SF ("the Commission")

(the DOI, the Cabinet Office and the Company together referred to as the "**Parties**").

WHEREAS:

(A) The Company is currently a public gas supplier for the purposes of the Gas Regulation Act 1995.

(B) By way of an Agreement for the Regulation of the Gas Market in the Isle of Man dated 24 April 2015 (the "**2015 Agreement**"), the Company, OFT, Treasury and the Department of Economic Development (which is now the DFE), agreed to a framework of voluntary regulation of the activities of the Company. DFE's responsibilities under the agreement passed to the Department of Environment, Fisheries and Agriculture in 2017.

(C) The 2015 Agreement was reviewed by the Chief Minister's Gas Regulatory Review Committee (the "**Committee**"). The Committee produced a report dated February 2019 (the "**Report**") with a variety of conclusions on the 2015 Agreement, one of which was that a new regulatory agreement was required that conforms to UK regulatory best practice.

(D) The Council of Ministers has authorised the Departments to negotiate with the Company a voluntary agreement for the regulation of certain gas supplies (the

"Proposed Agreement") and these Heads of Terms set out the main terms that will be included within the Proposed Agreement.

(E) Whereas the 2015 Agreement imposed a regulation regime for the whole of the business of the Company, these Heads of Terms set out the basis of agreement reached between the Parties with a view to regulating the Domestic Business of the Company (as hereinafter defined) only. The Company will continue to negotiate their tariffs and prices with its remaining Customers until such time (if ever), and only in the event that Manx Gas has acted unreasonably in these negotiations, that Regulation is introduced by the Departments or other parts of the Isle of Man Government which would impact upon the setting of these tariffs and price

1. STATUS OF THE HEADS OF TERMS

The terms of these Heads of Terms are not exhaustive and are expressly subject to contract until the Proposed Agreement is entered into. The terms are not intended to be legally binding between the Parties except where specifically stated.

1.1. Timescale and Notice to Terminate

1.1.1. The Parties agree to negotiate in good faith with a view to signing the Proposed Agreement on or before 1st January 2021

1.1.2. Any Party may at any time until the Proposed Agreement is entered into, by giving notice to the other, terminate negotiations for the Proposed Agreement without having to give any reasons for doing so.

1.1.3. The Party giving notice will not incur any financial liability to any other Party, unless it has breached a legally binding of obligation of these Heads of Terms as set out below.

2. ESSENTIAL PRE-CONDITIONS TO AN AGREEMENT

The entering into of the Proposed Agreement is conditional upon:

2.1. the Parties negotiating, drafting and agreeing the satisfactory terms of the Proposed Agreement governed by the laws of the Isle of Man;

2.2. the approval of and consent to the Proposed Agreement being given by the Parties (including any necessary internal, shareholder, board of directors, Departmental, Treasury, Council of Ministers, Tynwald or Ministerial approval as required); and

2.3. the Parties reaching agreement as to the original value of the Domestic Assets as referred to in clause 3.2.5.1 and the Base Operating Costs as referred to in clause 3.2.5.2, which valuations will be appended to the Proposed Agreement

3. AGREED TERMS

3.1. Definitions

Definitions of terms are set out in Schedule 1 to these Heads of Terms.

3.2. Agreement

3.2.1. Commencement and Term

3.2.1.1. The 2015 Agreement shall be deemed to have terminated on the Commencement Date, provided that such termination shall be without prejudice to the Company's right to recover from, or its obligation to credit to, its customers any Variance (as that term is defined in Schedule 4 to the 2015 Agreement) that was outstanding at such date, including interest calculated in accordance with Schedule 4 to the 2015 Agreement, to the extent that such amounts have not already been so recovered/credited in accordance with the 2015 Agreement on or before the date of the Proposed Agreement. The timing of any such recovery from/credit to the Company's customers shall be consistent with Schedule 4 to the 2015 Agreement.

3.2.1.2. Subject to the provisions of clause 3.2.1.3, the Proposed Agreement shall be deemed to have come into effect on the Commencement Date and shall continue until the sixth (6^{th}) anniversary of the Commencement Date (the "**Term**").

3.2.1.3. The Proposed Agreement may be terminated as follows:

(a) by the Company by giving not less than thirty (30) days' notice to the Departments in the event of a Government Event of Default;

(b) by either the DOI or the Cabinet Office by giving not less than thirty (30) days' notice to the Company in the event of a Company Event of Default; or

(c) by either Party by giving not less than thirty (30) days' notice to the other Party in the event of a Change in the Law PROVIDED ALWAYS that the Departments will act reasonably and in good faith in the exercise of its option to terminate as set out in this clause 3.2.1.3 (c).

3.2.1.4. The Proposed Agreement shall include customary provisions to the effect that termination pursuant to clause 3.2.1.3 shall be without prejudice to any rights, remedies, obligations or liabilities of the Parties that have accrued before such termination.

3.2.1.5. The Proposed Agreement will provide for any Variance that remains outstanding at the end of the Term or the earlier termination of the Proposed Agreement in accordance with its terms to be charged or credited (as the case may be) to the Domestic Customers in accordance with clause 3.2.7 notwithstanding such termination.

3.2.2. **Agreeing the Tariff**

3.2.2.1. The Parties will agree the Variance for the Agreement Year ending the 31st December 2020 ("the Initial Variance"). The Parties will use their reasonable endeavours to ensure that the Initial Variance is agreed by the 1st January 2021.The Parties will use the Calculation as a basis for agreement of the Initial Variation.

3.2.2.2. Not less than sixty (60) days before 1 January in each Agreement Year, commencing on 1 January 2021, the Company will submit to the Commission its Calculation of its Target Allowed Turnover for the forthcoming Financial Year together with details of any Tariff that results from the Calculation.

3.2.2.3. The Company will use its reasonable endeavours to ensure that any proposed Tariff is calculated so as to ensure that the Company achieves no more than the Target Allowed Turnover for the forthcoming Financial Year.

3.2.2.4. The Commission may request from the Company any additional financial or other information it may reasonably require in order to assess whether the proposed Calculation is likely to ensure that the Company achieves the Target Allowed Turnover.

3.2.2.5. The Commission can object to the proposed Calculation within thirty (30) days of the date on which it receives details of the proposed Calculation from the Company.

3.2.2.6. If the Commission objects to the proposed Calculation, it will inform the Company of its reasons within the period stated in clause 3.2.2.4 and will require the Company to submit a revised Calculation for consideration.

3.2.2.7. The Company will submit a revised Calculation within fourteen (14) days after the date on which it receives the Commission's reasons pursuant to clause 3.2.2.6.

3.2.2.8. Upon receipt of the revised Calculation from the Company pursuant to clause 3.2.2.7, The Commission will confirm the Calculation to be applied (which may be the original Calculation, the revised Calculation or another Calculation), having regard to such reasons and any other representations made by the Company and this Calculation shall be final in the absence of manifest error.

3.2.3. **Calculation of the Target Allowed Turnover**

3.2.3.1. The Target Allowed Turnover for any Financial Year shall be the Target Allowed Return Percentage multiplied by the MAV as at the end of the immediately preceding Financial Year plus the Eligible Costs for such Financial Year.

3.2.3.2. The Eligible Costs for any Financial Year will be the sum of:

(a) the Relevant Proportion of the Depreciation Cost in the immediately preceding Financial Year;

(b) the Gas Commodity Cost in the immediately preceding Financial Year;

(c) the Base Operating Costs for such Financial Year (reflecting any prior adjustments in accordance with clause 3.2.5.3, meaning the original Base Operating Costs as increased in accordance with clause 3.2.4.3);

(d) the Pension Cost in the immediately preceding Financial Year; and

3.2.3.3. The Eligible Costs will exclude:

(a) financing costs both of a profit and loss and balance sheet nature, such as interest and source of finances (regardless of whether they are short or long term), including costs relating to inter-company loans and non-operational cash and bank balances; and

(b) taxation on income and any associated corporation tax or deferred tax (all of which must be construed in accordance with the provisions of the Income Tax Act 1970); and

(c) inter–company payments that do not reflect the provision of goods or services but that serve to transfer funds between entities.

3.2.4. **Domestic Assets and Base Operating Costs**

3.2.4.1. The Parties will work together to agree the original value of the Domestic Assets (all acting reasonably) with a view to reaching agreement prior to the 31st December 2020.

3.2.4.2. The Parties will work together to agree the original value of the Base Operating Costs (all acting reasonably) with a view to reaching agreement prior to 31st December 2020

3.2.4.3. The Base Operating Costs will be reset on each anniversary of the Commencement Date in line with CPI.

3.2.4.4. The assets and liabilities that are included in the calculation of the MAV will for the avoidance of doubt exclude:

(a) intercompany loans ;

(b) non-operational cash and bank balances; and

(c) any other amounts not directly related to the operation of the Domestic Business.

3.2.5. **Company Obligations**

The Company will:

3.2.5.1. Apply:

(a) the Initial Reduction (including any reduction from MUA Service Costs), proportionately across the Company's Domestic Customers, excluding its LPG Customers; and

(b) Apply any subsequent reduction or increase in the Gas Commodity Cost (including any reduction or increase in the MUA Service Costs) proportionately across the Company's Domestic Customers (including its LPG Customers). The Gas Commodity Cost changes will be applied separately to LPG Customers and other Domestic Customer groups

3.2.5.2. not less than sixty (60) days before 1 January in each Agreement Year, commencing on 1 January 2022, submit details of all planned annual capital expenditure for the following Financial Year to the Commission for approval. If the total forecast amount of capital expenditure does not exceed one hundred and ten percent (110%) of the Company's average capital expenditure incurred in the three preceding Financial Years, the capital expenditure plan as submitted to the Commission shall be deemed to be approved.

3.2.5.3. use its reasonable endeavours to purchase gas in a manner which provides a balance between best price and the need for stable prices over an annual buying cycle; and

3.2.5.4. operate its business with appropriate standards of customer service and use its reasonable endeavours to undertake the following measures:

(a) a review of the Company's billing arrangements and use its reasonable endeavours to adopt a billing process that clearly shows any charges or credits made in accordance with clause 3.2.7.3 in customer invoices;

(b) compilation and maintenance of a vulnerable customer database to ensure that vulnerable Domestic Customers receive priority service in appropriate circumstances, subject to the Company's ability to implement appropriate safeguards under applicable data protection legislation; and

(c) publication of an agreed customer service charter and customer service metrics.

3.2.6. **Variance**

The Company will:

3.2.6.1. calculate the Initial Variance in accordance with clause 3.2.2.1

3.2.6.2. agree any subsequent Variance on an annual basis and will provide details of the Variance to the Departments within 120 days of each anniversary of the Commencement Date (the "**Anniversary Date**");

3.2.6.3. subject to the provisions of clause 3.2.8 ensure that all Variance is charged to or credited to its Domestic Customers in the Financial Year commencing on the relevant Anniversary Date; and

3.2.6.4. subject to the provisions of clause 3.2.2.1 and clause 3.2.6.1, ensure that the Variance is allocated proportionately across all of the Company's Domestic Customers.

3.2.7. **Non Qualifying Domestic Customers**

3.2.7.1. Any Domestic Customer that would otherwise be entitled to be credited with any amount of Initial Variance shall forego such entitlement if it is not a Qualifying Customer on 31 March 2021.

3.2.7.2. Any amounts that are forfeited by Domestic Customers pursuant to clause 3.2.9.1 shall be retained by the Company.

4. DOI AND CABINET OFFICE OBLIGATIONS

4.1 The Departments agree that during the Term (but excluding any period of notice given by any Party pursuant to clause 3.2.1.3) neither the DOI nor the Cabinet Office will seek to bring into force any legislation to regulate or control charges to Domestic Customers PROVIDED ALWAYS that this will not prevent either the DOI or the Cabinet Office from introducing primary legislation which will enable secondary legislation to be made to regulate or control charges to Domestic Customers but not the making of that secondary legislation or the making of primary legislation which in itself imposes such regulations or control.

4.2 The Departments agree to delegate such statutory functions as are reasonably necessary to enable the Commission to undertake its obligations under these Heads of Terms.

5. COSTS

5.1. This paragraph is legally binding.

5.2. Each Party is responsible for its own costs in connection with these Heads of Terms and the Proposed Agreement, whether or not the transactions anticipated by these Heads of Terms proceed.

6. OTHER AGREEMENTS

6.1. This paragraph is legally binding.

6.2. Where they exist, any agreements between the Parties will continue to apply and shall remain in full force and effect and are not affected by anything in these Heads of Terms.

7. RIGHTS AND REMEDIES

7.1. This paragraph is legally binding.

7.2. These Heads of Terms are for the benefit of the Parties and are not intended to benefit, or be enforceable by, anyone else.

8. GOVERNING LAW AND JURISDICTION

8.1. This paragraph is legally binding.

8.2. The agreement constituted by the provisions of these Heads of Terms that are expressed to be legally binding shall be governed by the laws of the Isle of Man and the Manx courts shall have exclusive jurisdiction for all matters arising under it.

9. COMMENCEMENT AND SIGNATURE

The agreement constituted by the provisions of these Heads of Terms that are expressed to be legally binding will come into effect on the date above and will remain in effect until superseded by the Proposed Agreement.

AS WITNESS the hands of the Parties or their duly authorised representatives on the date first stated above.

SCHEDULE 1

DEFINITIONS

"2015 Agreement"

has the meaning set out in Recital (B) to these Heads of Terms;

"Actual Revenues"

the actual amount of revenue generated by the Company in any Financial Year.

"Agreement Year"

means each three hundred and sixty five (365) days (or 366 days in any leap year) of the Term calculated from the Commencement Date and each anniversary thereof;

"Base Operating Costs"

means the Company's operational costs attributable to the Domestic Business for the 2019 Financial Year, which will be agreed in accordance with clause 3.2.4.2 and adjusted in accordance with clause 3.2.4.3;

"Calculation"

means the calculation set out in Schedule 2 to these Heads of Terms;

"Change in the Law"

Means: (i) a change to the laws of the Isle of Man; or (ii) the implementation of policy by Government relating to climate change where such change or implementation occurs after the date of the Proposed Agreement and which renders any provision of the Proposed Agreement impossible or which has a material impact upon the supply of gas to consumers in the Isle of Man as anticipated by the Proposed Agreement

"Commencement Date"

means 1st January 2020;

"Commercial Customer"

means a commercial customer of the Company who uses more than 12,000 KW of natural gas or LPG per annum

"Committee"

has the meaning set out in Recital (C) to these Heads of Terms;

"Company Event of Default"

means:

i. any compromise or attempt to compromise the debts owing by the Company to its creditors generally;

ii. an order placing the Company under judicial management or for its final or provisional liquidation is granted or the proposing of any resolution for its voluntary winding up, other than for reasons of a bona fide restructuring;

iii. any material breach of any term of the Proposed Agreement by the Company which is not remedied within ninety (90) days of receipt of written notice from the DOI or the Cabinet Office;

"CPI"

means the 12 month average Isle of Man Consumer Prices Index published by the Economic Affairs Division of the Cabinet Office;

"Departments"

means the DOI and Cabinet Office collectively;

"Depreciation Cost"

means the value in the relevant financial statements less any adjustment to remove the effect of any upward asset revaluation undertaken after the 1st January 2020 or asset within the revaluation reserve at that date;

"DFE"

means the Department for Enterprise, a Department of the Isle of Man Government;

"Domestic Assets"

means the assets of the Company which allocated to the Domestic Business. The Domestic Assets will be agreed in accordance with clause 3.2.4.1;

"Domestic Business"

means the business of the Company which is engaged in the supply of gas to Domestic Customers;

"Domestic Customers"

means all Customers of the Company for the supply of gas to a residential property together with LPG Customers and all commercial/business customers who are not Commercial Customers;

"Eligible Costs"

has the meaning set out in clause 3.2.3.2 of these Heads of Terms;

"Financial Year"

means the Company's financial year, which commences on 1 January in each calendar year and ends on 31 December in each calendar year;

"Gas"

Has the meaning given to it in the Gas Regulation Act 1995

"Gas Commodity Cost"

means, in respect of any Financial Year, the cost incurred by the Company in such Financial Year in the purchase of gas for the Domestic Business (to include all/any MUA charges) as this appears in the Relevant Accounts;

"Gas Distribution Network"

means the system of gas supply developed from time to time by the Company;

"Government Event of Default"

means a material breach of any term of the Proposed Agreement by either Department which is not remedied within thirty (30) days of receipt of written notice from the Company to the DOI and the Cabinet Office;

"Initial Reduction"

means the reduction to the MUA Service Cost agreed by the MUA in the Agreement Year ending 31st December 2020;

"Initial Variance"

Has the meaning set out in clause 3.2.2.1.

"LPG Customers"

means customers who purchase less than 12,000KW of Liquid Petroleum Gas per annum from the Company (and where a Customer purchases both Liquid Petroleum Gas and natural gas, it relates to that part of their account which relates to the supply of Liquid Petroleum Gas);

"MAV"

means the net book value of the Domestic Assets only, calculated as fixed assets plus current asset less current liabilities where:

i. The value of the Domestic Assets in the relevant financial statements less the current revaluation reserve or any other upward Domestic Asset revaluation undertaken after the 1st January 2019. The depreciation policy must be that as at the 31st December 2019;

ii. The current Domestic Assets and current Domestic Liabilities must exclude any amount of any Variance. The maximum allowance for operational cash balances is one million five hundred thousand pounds sterling (£1,500,000);

iii. Intercompany balances, financing amounts and assets not directly related to the operation of the domestic business are to be excluded

iv. The current Domestic Assets will be calculated based on actual values for domestic stock, debtors and unread meter income

"MUA"

means Manx Utilities Authority;

"MUA Service Cost"

means the amount that the Company repay to the MUA as a result of a loan given by the MUA to the Company to facilitate the extension of the gas network as detailed in exchanges of letters in 2009, 2010, 2011 and 2012.

"OFT"

means the Office of Fair Trading, a Statutory Board of Tynwald;

"Pension Costs"

means the Relevant Proportion of the costs incurred by the Company in meeting its pension deficit costs as shown the Relevant Accounts .

"Proposed Agreement"

means the agreement that the Parties propose to into substantially based upon these Heads of Terms;

"Qualifying Customer"

means a Domestic Customer that, as at 31 March 2021, has either (i) paid in full all of its invoices from the Company that have fallen due for payment on or before such date or (ii) entered into a pre-agreed payment plan with the Company and complied in all respects with such payment plan for a period of time that will be agreed and set out in the Proposed Agreement;

"Relevant Accounts"

means, in respect of any Financial Year, the Company's audited financial statements as at and for the year ended 31 December in such Financial Year;

"Relevant Proportion"

means the percentage of a cost or charge that is allocated to the Domestic Business;

"Report"

has the meaning set out in Recital (C) to these Heads of Terms;

"Standing Charge"

means the fixed element of a gas price charged by the Company to Domestic Customers to cover the fixed costs of operating and maintaining the Gas Distribution Network;

"Target Allowed Return Percentage"

means six point nine nine percent (6.99%) of the Modified Asset Value;

"Target Allowed Turnover"

has the meaning set out in clause 3.2.3.1 of these Heads of Terms and is calculated in accordance with the Calculation;

"Tariff"

means the variable element of the price charged to a Domestic Customer being a per unit charge on the volume of gas consumed (for the avoidance of doubt this excludes the Standing Charge);

"Term"

has the meaning set out in clause 3.2.1.2 and includes any period of extension or holding over which is agreed in writing between the Parties;

"Variance"

means the amount by which the Actual Revenues are greater or less than the Target Allowed Turnover and will include reference to the Initial Variance where applicable.

SCHEDULE 2

CALCULATION

To calculate the, Target Allowed Turnover the following calculation will be undertaken:

Target Allowed Return Percentage (6.99 %)	Actual	
Multiplied by MAV		Calculation
Plus the Eligible Costs (taking into account the exclusions in clause 3.2.3.2)		
Gas Commodity Cost		Actual
Base Operating Cost		Calculation
Plus Depreciation Cost		Actual
Pension Deficit Payment		Actual

Less

Depreciation adjustment (see clause 3.2.3.2 (d))	Actual
Variance (may be plus or minus)	Actual
Commercial use of domestic assets	Calculation
Other adjustments	Actual

(as may be required by the Departments acting reasonably)

SIGNED by the Minister or a person duly authorised by the Minister for Infrastructure in the presence of:- : ....

Witness Signature: .... : *Print name:*

Witness Full Name: .... : *Position:*

Witness Address: .... :

.... :

Witness Occupation: .... :

SIGNED by the Minister or a person duly authorised by the Minister for Cabinet Office in the presence of:- : ....

Witness Signature: .... : *Print name:*

Witness Full Name: .... : *Position:*

Witness Address: .... :

.... :

Witness Occupation: .... :

SIGNED by the Company acting by:- : ....

Authorised Signatory

: *Print name:*

Final 15.10.20

Isle of Man Government

Reiltys Ellan Vannin

DATED 2020

Department of Infrastructure

and

Cabinet Office

and

Manx Gas Limited

HEADS OF TERMS

IN COMMERCIAL CONFIDENCE

Attorney General's Chambers
Douglas

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