

Gas Sector Regulation

Roadmap to Regulation

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Lught-reil son Gurneil Çhellinsh as Bun-shirveishyn

**Communications and Utilities
Regulatory Authority**

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1 Background

1.1 Communications & Utilities Regulatory Authority

- 1.1. In December 2020, the Communications and Utilities Regulatory Authority Order 2020 was approved by Tynwald and came into force immediately. This had the effect of establishing the Communications Commission as the Communications and Utilities Regulatory Authority.
- 1.2. The Authority is in the process of consulting on temporary price control Regulations that would have the effect of preventing tariffs from being increased above those currently in place (see [Document 03/21](#)). The proposed Regulations would be made under the Gas Regulation Act 1995 (the Act), as amended by the Gas Regulation (Amendment) Act 2021. It should be noted that the Authority has a limited remit under the Act; it may set parameters which a public gas provider must adhere to when setting tariffs. The Authority is also empowered to set conditions in connection with the parameters set.

1.2 Tynwald Motion – February 2021

- 1.3. The Authority took on formally regulating the Island's gas sector following a motion voted on and passed by Tynwald in February 2021, which stated:

"That Tynwald notes that the requirement for the then proposed legally binding Proposed Agreement to be signed by all parties prior to 31st December 2020 was not met; further notes that all parties have not reached agreement on the description of the Domestic Assets and the original value of the Base Operating Costs; and requests the Communications and Utilities Regulatory Authority to introduce regulation to cover tariffs for the public supply of gas for all customers pursuant to s. 6 of the Gas Regulation (Amendment) Act 2021 by 30th April 2021; and calls for the rebalanced pricing of gas for all customers."

The motion represents public policy on the issue of regulation of the Island's gas distribution sector and requests the Authority exercise its functions under existing legislation. The Authority agrees that the approach requested best meets the public interest in this matter and has commenced introducing regulations.

- 1.4. As outlined in Document 03/21, the Authority was of the view that it would best serve the public interest to introduce controls that would prevent excessive pricing in anticipation of regulation being introduced. It was made clear that there was no suggestion that this would happen, but that the opportunity and incentive to engage in such practices nevertheless exists. To introduce an ex-ante measure, such as the proposed price control, it is sufficient that the potential for anti-competitive behaviour exists. Ex-post measures are more appropriate to address instances where such abuses of a dominant market position have occurred.
- 1.5. It was also noted in the consultation document that "*the Authority will begin the process of putting in place more detailed pricing parameters in line with the Gas Regulation (Amendment) Act 2021. This will also be subject to public consultation and the Authority will seek to engage with all stakeholders in relation to any further measures proposed*". It was also pointed out that the Authority is seeking to commence the process to try and introduce new legislation that would provide a broader and more nuanced framework for the economic regulation of the gas sector.
- 1.6. Given the above, the Authority is of the view that providing a Roadmap to Regulation is timely and will provide certainty to all stakeholders. It is the Authority's intention to build a strong, modern regulatory framework for the Island and is of the view that this is in the interest of gas suppliers and consumers alike.

2 Roadmap to Regulation

- 2.1. The proposed introduction of the Gas (Tariff Fixing) Regulations 2021, as outlined in Document 03/21, is only the first step in introducing regulation to the Island's gas sector. The Authority has been clear that it sees the proposed regulations as a temporary measure to provide a degree of protection to consumers; it is committed to putting in place further Regulations to bring in more detailed price controls. Introducing new legislation to provide a more wide-ranging economic regulatory framework for the gas sector is also an imperative.
- 2.2. The following subsections set out the next steps the Authority intends to take. The following is not intended to be a consultation on the proposed measures, the Authority will run public consultation processes on each of the elements in this document. The only exception to this is the development of cost models where to protect commercially sensitive information the Authority would only deal directly with the public gas supplier.

2.1 Gas (Price Control) Regulations 2021

- 2.3. The Authority is of the view that there needs to be more detailed price controls in place to ensure that the tariffs for gas supplies are fair, reasonable, and cost-orientated. Tariffs must also provide a sufficient level of return for gas suppliers to compensate for existing investment and encourage new investment in networks.
- 2.4. The Authority is also acutely aware that the safe operation of networks is crucial and must be prominent in any consideration of appropriate tariffs.
- 2.5. To put in place more detailed price controls, the Authority will seek to work with Manx Gas, and any other public gas supplier that may enter the market, to establish the cost of providing a gas supply. The development of suitable cost models is one of the core tenets of establishing cost-oriented pricing. The Authority expects that any parties with applicable information would provide it upon request to facilitate the development of cost models in a timely manner.
- 2.6. When developing the cost models the Authority will take account of any submissions it receives including the allocation of costs, but notes that ultimately such decisions rest with the Authority.
- 2.7. The Authority has already commenced work in this space and intends to complete the development of its cost models during Q2 2021.

- 2.8. In conjunction with the development of suitable cost models the issue of determining an appropriate level of return also needs consideration. In regulated sectors the Weighted Average Cost of Capital (WACC) is typically used to set the appropriate return and the Authority sees no reason at this time to deviate from established best practice.
- 2.9. The process of determining the WACC will be subject to public consultation, however in the interest of providing clarity the Authority will:
- Use an established methodology, that is in line with best practice, to calculate the WACC;
 - Take into account the specific circumstances of parties that would be subject to regulation, as appropriate;
 - Benchmark its work against other suitable National Regulatory Authorities to ensure the Island is in line with other jurisdictions; and,
 - Provide mechanisms for the periodic review of the WACC and to take account of changes in external factors.
- 2.10. The Authority intends to complete the process of determining the WACC during Q2 2021, initially publishing a Public Consultation document; the process will conclude with the publication of the Authority's Response to Consultation and Decision, along with all submissions received.
- 2.11. The culmination of this work will be a consultation on proposed Gas (Price Control) Regulations 2021. These Regulations will look to establish the parameters for setting tariffs that ensure they are cost-orientated and that the return is in line with the established WACC. The Authority will also consider the issue of consumer categories and explore any appropriate conditions that may be applied in connection with the set parameters.

2.2 Introduction of New Legislation

- 2.12. While the introduction of the Gas Regulation (Amendment) Act 2021 is welcomed by the Authority, it must also be kept in mind that this legislation has a very specific and narrow focus in relation to economic regulation. The Authority will make use of its provisions to set price controls and associated conditions that are fair for both consumers and providers, however it is of the view that new legislation would be required to put in place a modern, more wide-ranging regulatory framework.

- 2.13. At present the legislation only provides for narrow price controls through setting parameters that a gas supplier must confine itself to when setting tariffs. While there is scope for making conditions in connection with the parameters and defining different categories of consumers, the Authority is of the view that it would inhibit the introduction of more rounded incentive-based regulation and putting in place remedies to potentially allow for competition in the sector. While the Gas Regulation (Amendment) Act 2021 was being progressed through the Legislative Branches it was made clear that it was only ever intended to be one step towards building a robust regulatory regime for the gas sector on the Island.
- 2.14. The Authority will during Q2 2021, liaise with Government to commence the process of introducing new legislation to the Branches of Tynwald. The Authority will run a full Public Consultation on any draft legislation that is produced, but at this time it is not possible to set a firm date for completion given the number of external factors that may impact on the process. The Authority is however committed to the process and will keep stakeholders informed on progress made as it develops.
- 2.15. Table 1 below outlines the key milestones and target dates that the Authority is working towards for introducing regulation to the gas sector. The roadmap to Regulation tries to strike a balance between the timely introduction of regulation, ensuring the regulatory process is respected and maintained, and providing clarity to all interested parties.
- 2.16. It should be kept in mind that regulation is an ongoing process, it is not going to be simply 'done' at any point. Once the milestones set out below are achieved the Authority will consult with interested parties on the next steps to be taken to ensure the Isle of Man gas sector is regulated in line with international best practice.

2.3 Roadmap to Regulation 2021 – Gas Sector

Step	Output	Target Date
Response to Temporary Price Freeze Consultation and Decision on Regulations	Response to Consultation & Decision	Q2 2021
Producing Appropriate Cost Models	Internal Process	Q2 2021
Preparing Draft Legislation	Internal Process	Q2 2021
Review of Gas WACC	Consultation	Q2 2021
Implementation of Price Controls 2021 – Draft Regulations	Consultation	Q2 2021
Final Determination on WACC	Response to Consultation & Decision	Q3 2021
Implementation of Price Controls 2021 – Final Regulations	Response to Consultation & Decision	Q3 2021
Public Consultation on Gas (Economic Regulation) Bill	Consultation	TBD

2.17. Should any further information be required on any of the Authority's work, please see the contact details below for submitting any queries you may have.

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