

Consultation

Licence fee cost recovery principles – Recovery of Heat Network regulation set up and ongoing costs

Publication date:	29 January 2024
-------------------	-----------------

Response deadline:	25 February 2024
--------------------	------------------

Contact:	Richard Bellingham
----------	--------------------

Team:	Heat Networks Team
-------	--------------------

Email:	heatnetworksregulation@ofgem.gov.uk
--------	-------------------------------------

This document sets out our approach to recovering Ofgem’s costs for Heat Networks regulation. Following our August 2023 consultation, we set out our decision that, in the initial year that Heat Networks regulation is in place, Ofgem’s Heat Networks regulatory costs will be recovered from gas and electricity licence fee payers. We are also consulting on extending this approach, to apply from financial year 2024/25, to recover the costs of setting up the new regulatory framework. We set out changes that would be made to the Licence Fee costs recovery principles, to give effect to our decision and the proposal we are consulting on.

We are seeking views from those with an interest in the principles, particularly licence fee payers. We particularly welcome responses from gas transporters and electricity network operators. We would also welcome responses from other stakeholders and the public.

This document outlines the scope and purpose of the consultation and how you can get involved. Once the consultation is closed all responses will be considered. We want to be transparent in our consultation which means we’ll publish the non-confidential responses we receive alongside a decision on next steps on our website at [ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you would like your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

© Crown copyright 2023

The text of this document may be reproduced (excluding logos) under and in accordance with the terms of the [Open Government Licence](#).

Without prejudice to the generality of the terms of the Open Government Licence the material that is reproduced must be acknowledged as Crown copyright and the document title of this document must be specified in that acknowledgement.

Any enquiries related to the text of this publication should be sent to Ofgem at:

10 South Colonnade, Canary Wharf, London, E14 4PU.

This publication is available at www.ofgem.gov.uk. Any enquiries regarding the use and re-use of this information resource should be sent to: psi@nationalarchives.gsi.gov.uk.

Contents

Licence fee cost recovery principles – Recovery of Heat Network regulation costs	1
Executive Summary	4
1. Introduction	5
2. Consultation on recovery of Heat Networks regulation set up and ongoing costs and changes to the licence fee recovery principles.....	7
3. How to respond and provide feedback	10
Annex 1 – Consideration of responses to Q70 of the Heat Networks Consumer Protection consultation	13
Annex 2 – Calculation of impact of proposed change per customer	14
Annex 3 - Privacy notice on consultations.....	16

Executive Summary

Ofgem is set to become the regulator of the Heat Networks industry. [The Energy Act 2023](#) provides Ofgem with the power to recover the regulatory costs associated with this future new role. These costs will be recovered through the licence fees paid by certain gas and electricity licensees, and at a later date, through fees that will apply to authorised Heat Networks. The government decided on this overarching approach to recovering Ofgem's costs of Heat Networks regulation in 2022, following a [consultation in 2021](#).

In August 2023, Ofgem and the Department for Energy Security and Net Zero (DESNZ) issued [a consultation on the Heat Networks regulatory framework](#), including a proposal on how to recover Ofgem's costs, in the initial period when the new regulatory framework is introduced. We proposed in that period, that Heat Networks regulatory costs would be recovered from relevant gas and electricity licensees only, and not from Heat Networks, to minimise the impact on Heat Network customers and support growth of the sector. We have considered responses to this proposal and set out in this document our decision to proceed by recovering Heat Networks regulatory costs from gas and electricity licensees, in the initial period.

This document also sets out a proposal to extend this approach to cost recovery, applying it from financial year 2024/25, to recover the costs of setting up the new regulatory framework. For example, this would include costs associated with developing processes related to authorisation, monitoring, audit, drafting and publication of guidance and development of an IT system. These costs are estimated to amount to around £7.3 million in the financial year 2024-2025.

This consultation sets out proposed amendments to the [principles](#) in relation to the costs recovered from licence fee payers.

1. Introduction

Background

- 1.1 In 2018, the Competition and Markets Authority (CMA) recommended regulation of Heat Networks in a market study¹. The government committed to this in a 2020 public consultation, with the government response published in 2021 setting out the approach to regulation². In July 2022 the government introduced the Energy Bill to Parliament, which appointed Ofgem as Heat Networks regulator and provided for the introduction of an authorisation regime for Heat Networks supported by authorisation conditions.
- 1.2 On 26th October 2023, the Energy Act 2023 achieved Royal Assent and formally appointed Ofgem as the regulator of Heat Networks in Great Britain. Further policy development and secondary legislation is required to establish the detail of the regulatory framework, before Ofgem can take on this new role.
- 1.3 Ofgem welcomes this new role as it offers an opportunity to regulate a sector where there is currently little or no consumer protection. Regulation of the sector should make Heat Networks a more attractive option for customers and aims to encourage development and deployment of Heat Networks across GB. Government's aim is for Heat Networks to provide around 20% of heat in GB by 2050.

Approach to Heat Networks regulatory cost recovery

- 1.4 The Energy Act 2023 provides Ofgem with the power to recover the regulatory costs associated with this new role. These costs will be recovered initially through the licence fees paid by certain gas and electricity licensees, and at a later date, also through fees that will apply to authorised Heat Networks³. The government decided on this approach in 2022, following a consultation in 2021⁴.
- 1.5 In August 2023, Ofgem and DESNZ consulted on how Ofgem's regulatory costs would be recovered in the initial year of Heat Networks regulation. This document sets out our decision to proceed with our proposal, that Heat

¹ <https://www.gov.uk/cma-cases/heat-networks-market-study>

² <https://www.gov.uk/government/consultations/heat-networks-building-a-market-framework>

³ The exact mechanism for long term recovery of Ofgem costs from heat networks has not yet been developed and will be the subject of future consultation.

⁴ [Recovering the costs of heat networks regulation - GOV.UK \(www.gov.uk\)](#)

Networks regulatory costs should be recovered from gas and electricity licensees only in the initial year of regulation, and not Heat Networks.

- 1.6 In this document, we also set out a proposal to extend that approach to cost recovery. We are proposing to apply it from financial year 2024/25, to recover the costs of setting up the new regulatory framework. For example, this would include costs associated with developing processes related to authorisation, monitoring, audit, drafting and publication of guidance and development of an IT system. These costs are estimated to amount to around £7.3 million in the financial year 2024-2025.

The Licence fee cost recovery principles

- 1.7 The licence fee cost recovery principles (the “principles”) set out how the amounts payable to Ofgem under certain gas and electricity licences⁵ are calculated and billed. The principles were last updated in May 2022 after consultation⁶.
- 1.8 This consultation sets out proposed amendments to the principles in relation to the costs recovered from licence fee payers. The amendment would make specific reference, in the list of costs recovered from licence fee payers, to Ofgem costs related to both setting up the regulation of the Heat Networks industry and Ofgem’s ongoing regulatory costs. Alongside these proposed changes we will be making housekeeping updates to reflect new naming conventions throughout the document.

Next steps

- 1.9 Subject to responses to this consultation, the updated principles would apply from the financial year 2024-2025 onwards. The first invoices, credit notes and letters to relevant licensees under the new framework would be issued in June/July 2024.
- 1.10 We welcome your views on the areas for consideration. We are open to all feedback and opinions on the below items and will take account of the costs and benefits of all proposed amendments to the current practice.

⁵ Standard Licence Condition (SLC) entitled ‘Payments by Licensee to the Authority’ (SLC 3 in gas transportation licences and SLC A4 in electricity transmission licences) and SLC 5 ‘Licensee’s payments to the Authority’ in the electricity distribution licences), set out the obligation to pay proportionate amounts to Ofgem annually.

⁶ [Licence Fee Cost Recovery Principles \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/consultation/consultation-on-licence-fee-cost-recovery-principles)

2. Consultation on recovery of Heat Networks regulation set up and ongoing costs and changes to the licence fee recovery principles

Recovery of Ofgem set up costs through the licence fee cost recovery mechanism

Government decision on recovery of ongoing costs of regulation

As set out above, a previous government consultation⁷ has established the principle of recovering Ofgem's costs of Heat Networks regulation through the licence fee cost recovery mechanism. The consultation undertaken by government related to the ongoing costs that Ofgem will incur when we are undertaking this new role. The new regulatory framework and our new role is currently estimated to 'go-live' in Spring 2025.

Decision on approach to cost recovery in the initial period

In August 2023, government and Ofgem issued a consultation on a range of issues related to consumer protections for Heat Network customers⁸. This consultation included a proposal on how Heat Network regulatory costs would be recovered in the first year of the new regulatory regime. We proposed that in the first year of Heat Networks regulation being in place, costs would be recovered from gas and electricity licensees only, and not initially from authorised Heat Networks, which would begin to pay fees after the initial period⁹.

Ofgem and Government have considered responses to this consultation¹⁰. We summarise responses in annex 1 to this document and set out our decision to proceed with that proposal. To implement this decision, the changes to paragraph 2.4 of the cost recovery principles now includes reference to recovery of Ofgem's ongoing costs of regulation¹¹.

⁷ [Recovering the costs of heat networks regulation - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/recovering-the-costs-of-heat-networks-regulation)

⁸ [Heat networks regulation: consumer protection - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/heat-networks-regulation-consumer-protection)

⁹ The 'initial period' is a period of time post go live (likely to be 12 months) of the regulatory regime when existing heat networks are required to register certain details about their heat network on Ofgem's IT system. All existing heat networks will be automatically authorised but Ofgem recognise that the industry will need time to embed processes to become fully compliant.

¹⁰ [Heat network consumer protection consultation \(publishing.service.gov.uk\)](https://publishing.service.gov.uk/government/consultations/heat-network-consumer-protection-consultation) p.83-84

¹¹ Likely total annual regulatory costs are £12.2m – see p.48 [Heat networks regulation: impact assessment \(publishing.service.gov.uk\)](https://publishing.service.gov.uk/government/consultations/heat-networks-regulation-impact-assessment)

Proposed approach to set-up cost recovery from 2024/25

Ahead of go-live, Ofgem is incurring, and will continue to incur, costs associated with its future new role. In the policy development phase of our work, these costs are currently being directly funded by the government. This consultation proposes that, as we move to the 'set up' phase of the new regulatory framework, it is appropriate to recover Heat Networks regulation set up costs through the licence fee cost recovery mechanism. This would mean introducing the approach (of recovering costs from gas and electricity licensees only) from 2024/25, ahead of the regulatory regime 'go-live'.

These set up costs will include but not be limited to

- Development of an IT system
- Hiring and training of an operational team
- Drafting and consulting on Authorisation Conditions and other Statutory Instruments
- Drafting and publishing guidance documentation

The estimated cost of set up in the 2024/25 financial year is around £7.3m although we are still refining these costs (see Annex 2 for an assessment of how this would impact consumer bills).

We think it is reasonable and appropriate to recover the costs from the licence fee recovery mechanism since the Energy Act 2023 has achieved Royal Assent on 26th October 2023, appointing us as the regulator of Heat Networks. We are also moving from higher level policy development, towards the 'set-up' phase of the new regulatory framework. The Act gives us broad powers to recover costs associated with exercising a function relating to Heat Networks¹² and as such we propose to recover the Heat Network regulation set up costs incurred in the 2024/25 financial year and, if go live is delayed, the set-up costs incurred after this.

The alternative to recovering our costs through the licence fee, would be to continue to recover costs from government funding. However, as set out above, the Energy Act has now appointed Ofgem as Heat Network regulator. Government has already decided, following consultation, that Ofgem's ongoing costs will be funded via the licence fee mechanism, and through the Energy Act has given us powers to do so. As the appointed regulator, moving into the 'set up' phase of our new regulatory role, we consider the appropriate mechanism by which to recover our 'set-up' costs is through the licence fee

¹² [Energy Act 2023 \(legislation.gov.uk\)](https://www.legislation.gov.uk/ukpga/2023/5/section/222) Part 8, Chapter 1, section 222(2)(f)

recovery mechanism by which we recovery Ofgem's other regulatory costs, but we welcome respondents' views on this.

Housekeeping changes

In addition to the proposed changes to the licence fee cost recovery principles that would give effect to the proposal relating to Heat Networks costs, we will be making housekeeping updates to reflect new naming conventions throughout the document.

Question 1:

Do you have any views or comments on our proposal to recover heat network regulation set up costs and ongoing costs through the licence fee cost recovery mechanism?

Proposed changes to the licence fee cost recovery principles

The main proposed change is to update the list of costs being recovered through the licence fee to explicitly include Heat Networks regulation.

2.1 The associated document containing our proposed updated principles, also being consulted upon with this consultation, contains the following appendices: Costs; Licence fee calculation template; Definition of gas and electricity customers; and Illustrative allocation of licence fees to licence holders. This chapter of this consultation explains our proposed changes to paragraph 2.4 of the principles. We are not proposing to make any changes to other parts of the document apart from making housekeeping updates to reflect new naming conventions throughout the document.

2.2 The proposed changes do not affect the underlying calculation methodology of the cost. The changes to paragraph 2.4 of the principles are set out below in bold.

Paragraph 2.4

Ofgem's costs, being the net of:

- All Ofgem's own costs, **including Ofgem's set up and ongoing costs related to the regulation of Heat Networks**, less Ofgem's exceptional costs (see paragraph 2.5) and less Ofgem's own costs that will be recovered by means other than through the use of the 'Payments by Licensee to the Authority' or 'Licensee's payments to the Authority' SLCs (see Appendix 1); and

- All Ofgem's own income. For the purposes of these principles Ofgem's own income excludes the income recovered through the 'Payments by Licensee to the Authority' or 'Licensee's payments to the Authority' SLCs;
- The costs of the Secretary of State and Office for Product Safety and Standards within **the Department for Business and Trade (DBT)** which relate to statutory metrology services;

Question 2a:

Do you agree with our proposed changes to the licence fee cost recovery principles?

Question 2b:

Do you have any comments to make about our proposed changes to the licence fee cost recovery principles?

3. How to respond and provide feedback

Consultation stages

- 3.1 The consultation will be open until 29th February 2024. Responses will be reviewed and the consultation decision will be published in April 2024.

How to respond

- 3.2 We want to hear from anyone interested in this consultation. Please send your response to heatnetworksregulation@ofgem.gov.uk.
- 3.3 We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.
- 3.4 We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

- 3.5 You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

- 3.6 If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.
- 3.7 If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations at the end of this document.
- 3.8 If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

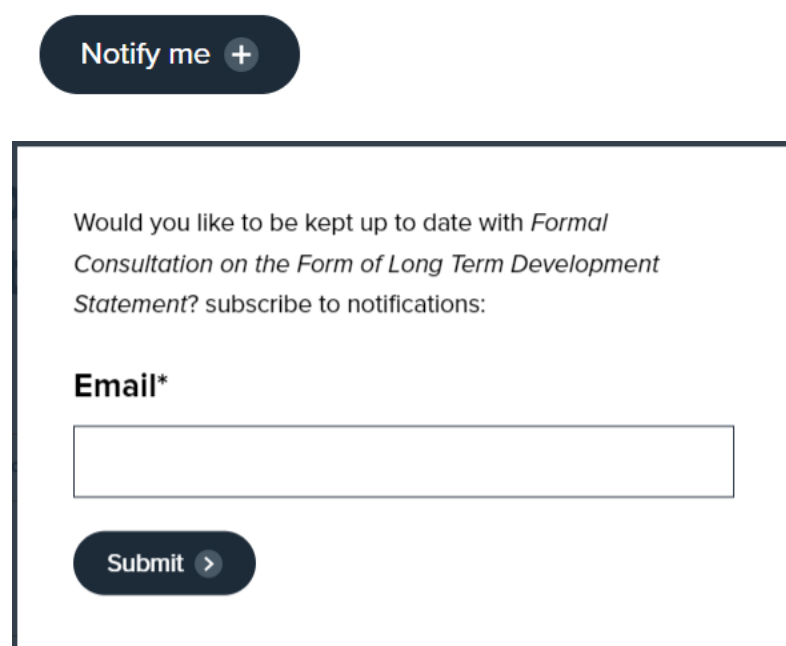
- 3.9 We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:
- (1) Do you have any comments about the overall process of this consultation?
 - (2) Do you have any comments about its tone and content?
 - (3) Was it easy to read and understand? Or could it have been better written?
 - (4) Were its conclusions balanced?
 - (5) Did it make reasoned recommendations for improvement?
 - (6) Any further comments?

Please send any general feedback comments to stakeholders@ofgem.gov.uk.

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website.

[Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations)



The image shows a dark blue button with the text "Notify me" and a plus sign icon. Below it is a white rectangular box containing the text: "Would you like to be kept up to date with *Formal Consultation on the Form of Long Term Development Statement*? subscribe to notifications:". This is followed by the label "Email*" and a text input field. At the bottom of the box is a dark blue button with the text "Submit" and a right-pointing arrow icon.

Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:

Upcoming > **Open** > **Closed** (awaiting decision) > **Closed** (with decision)

Annex 1 – Consideration of responses to Q70 of the Heat Networks Consumer Protection consultation

By way of background:

1. DESNZ previously decided that Ofgem’s Heat Network regulatory costs would be recovered from a mixture of the gas and electricity licence fee recovery mechanism together with fees levied on Heat Networks¹³.
2. However, policy questions remained as to whether the regulation costs of the initial period should be paid back by Heat Network consumers.
3. The Consumer Protection consultation set out a proposal not to implement a payback period as the impact on gas and electricity consumers would be negligible and the payback would put disproportionate costs on Heat Network consumers for little gain for gas and electricity consumers.

Q70 of the Consumer Protection consultation sought views on not implementing a payback period in a situation where the transition period is funded by gas and electricity licensees. The outcome of the consultation is awaited; however, given the links to this consultation, a summary of responses and a decision in relation to this specific question only is set out below.

Government and Ofgem response to Q70 and decision

From 111 responses, we received 56 responses which agreed that the transition period should be funded by gas and electricity licensees (50%), and 2 responses which did not agree (2%). 53 (48%) respondents did not provide an answer to this question. Respondents who agreed with the policy re-iterated that having a transition period and not implementing a payback period would avoid putting large financial burden and deterring heat network operators, and this would also avoid disproportionate costs being passed on to heat network customers. Responses that disagreed with the policy mentioned the issue of fairness, that gas and electricity customers are paying for a service that is not provided to them. However, as stated in the consultation, recovering the additional 2 pence from gas and electricity customers who fund the transition period provides negligible impacts to gas and electricity customers while putting disproportionate burden on HN customers.

¹³ [Recovering the costs of heat networks regulation - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/recovering-the-costs-of-heat-networks-regulation)

The majority of those responding to the question agreed with the policy proposed. While we recognise the points raised by those who do not agree, we continue to consider it is appropriate to recover the transition period costs from gas and electricity licence fee payers and not to implement a payback period for the funding recovered in this period. We will give effect to this decision, through the changes to the licence fee cost recovery principles proposed in this consultation.

Annex 2 – Calculation of impact of proposed change per customer

DESNZ previously consulted on the cost recovery mechanism for Heat Networks regulations in 2021¹⁴ where they asked a question about recovering the costs for Heat Networks regulation. Based on the responses to the consultation, the government decided to proceed with spreading evenly the total ongoing costs of regulating the Heat Networks market across Heat Networks, gas and electricity consumer bills¹⁵.

More recently, DESNZ and Ofgem jointly consulted on Heat Networks regulation: consumer protection, which included questions on cost recovery approaches that built on the policies established in the earlier cost recovery consultation¹⁶. This consultation is accompanied by an Impact Assessment (IA)¹⁷, part of which analysed the impact of the cost recovery methodology proposed in the cost recovery consultation in 2021.

According to the IA, the cost recovery mechanism proposed above would result in annual regulatory cost of £1.78 per customer across GB. This IA analysed the cost recovery mechanism for the period after which Ofgem actively regulates the market. The cost recovery mechanism in the IA does not include the set-up costs that will be incurred by Ofgem before the regulation goes live.

In the consumer protection consultation, we also asked respondents about funding the first year (called “transition year”) of regulation from gas and electricity customers only. Analysis of the responses showed that most respondents agreed with the proposed policy of funding the costs of the transition year from gas and electricity customers only. The respondents also agreed that there should be no payback period due to the limited

¹⁴ [Recovering the costs of heat networks regulation: a consultation \(publishing.service.gov.uk\)](https://publishing.service.gov.uk/government/consultations/recovering-the-costs-of-heat-networks-regulation-a-consultation)

¹⁵ [Recovering the costs of heat networks regulation - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/recovering-the-costs-of-heat-networks-regulation)

¹⁶ [Heat network consumer protection consultation \(publishing.service.gov.uk\)](https://publishing.service.gov.uk/government/consultations/heat-network-consumer-protection-consultation)

¹⁷ [Heat networks regulation: impact assessment \(publishing.service.gov.uk\)](https://publishing.service.gov.uk/government/consultations/heat-networks-regulation-impact-assessment)

benefit for gas and electricity customers and high administrative burden of implementing any payback regime.

Recovering the set-up costs from gas and electricity licence fees (as proposed in this consultation) would lead to an increase of 13 pence per customer in regulatory cost in the year 2024-2025. This figure is calculated by taking the expected set up costs of £7.3 million and dividing it by the number of gas and electricity customers across GB, which is estimated to be 55 million ¹⁸ as below.

$$\text{Increase in regulatory cost per GE customer} = \frac{7,300,000}{55,000,000} = £ 0.133$$

¹⁸ [Recovering the costs of heat networks regulation: a consultation \(publishing.service.gov.uk\)](https://publishing.service.gov.uk/government/consultations/recovering-the-costs-of-heat-networks-regulation-a-consultation)

Annex 3 - Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

4. With whom we will be sharing your personal data

None

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for six months after the review project is completed.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- Know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data

- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

7. Your personal data will not be sent overseas

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.

10. More information

For more information on how Ofgem processes your data, click on the link to our [“Ofgem privacy promise”](#).