



Making a positive difference
for energy consumers

Heat Networks Market Study
Competition and Markets Authority
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Dear Sir/Madam,

Ofgem Response to CMA Heat Networks Market Study – Statement of Scope

We welcome the CMA's market study on heat networks.

Drawing on available evidence, it seems likely that a significant expansion of heat networks will be part of the solution to energy decarbonisation. As such, protecting consumers of heat networks is important.

We have also received complaints from consumers on price increases and the quality of service with heat networks. While the Heat Trust has introduced useful consumer protection standards, it is understandably limited by its voluntary nature. More broadly, we share the CMA's concerns that certain features of heat networks may lead to poor outcomes due to the monopolistic nature and potentially inadequate or inconsistent consumer protection. We consider the three themes identified by the CMA for further investigation – transparency, the monopoly elements of heat networks and outcomes for consumers – are appropriate.

We do not comment in this response on the evidence of poor service for consumers; rather we draw on our experience as the regulator of the gas and electricity markets to outline some key considerations to inform the development of remedies. We are happy to work with the CMA on this.

In addition to considering appropriate remedies, which will take time to develop and implement, we recommend that where the CMA's study uncovers unacceptable conduct, the CMA considers whether enforcement action can be taken under existing consumer law.

In the sections below, we set out our views on the remedies associated with each of the themes in the study.

Transparency

Any regulation to improve the information in bills and on metering should set clear standards for heat suppliers but avoid unnecessary prescription that could inhibit innovation. Ofgem is moving to principles-

based regulation of the retail energy markets, removing prescriptive rules, where appropriate, from the gas and electricity supply licences. A joined-up approach with heat networks would make it easier to read across arrangements from electricity and gas, and help to meet consumer expectations.

Monopoly Supply

Heat networks share characteristics – such as high fixed costs and economies of scale – with other networks. The monopolistic nature of heat networks could lead to poor outcomes in terms of price, the effect of which could be compounded by lock-in to long-term contracts, inability to switch supplier, and insufficient information to understand the basis of charges. The risk of consumers being charged too much may be augmented by the absence of formalised regulation (although the sector is subject to competition law).

In terms of remedies, there may be limitations on the extent to which switching away from a heat network is technically feasible. This could be due to the unavailability of alternatives for some consumers or the economic viability of alternatives. While remedies to amend the contractual provisions may address challenges of exit costs for heat consumers, costs in connecting to alternative sources of supply may augment the full cost of switching. Furthermore, given the small scale of many heat networks, remedies to separate the network from the metering and billing of consumers may have a limited impact on competition.

As such, it may be necessary to consider other remedies. Regulation of prices can be used to prevent the abuse of a monopoly position. Perhaps the closest parallel in the current electricity and gas regulatory framework is with independent gas transporters (IGTs) and independent distribution network operators (IDNOs). These are licensed entities and subject to price caps, which typically involve requirements that they do not charge more than the local incumbent network. For heat networks, one option might be that consumers connected to heat networks are charged no more than if they were using natural gas for heating.

We have participated as an observer in the ADE Task Force to produce recommendations on how industry and Westminster can work together “to create a self-sustaining market for heat networks”¹. We trust this will provide a useful input into the CMA’s work.

Outcomes

Consumers on heat networks expect similar levels of consumer protection and customer service as for energy. In our experience, formal regulation is more likely to ensure that all parties comply with the standards than voluntary requirements. Ofgem has significant experience in setting standards for the conduct of energy suppliers and for service provision. As noted above, we have moved towards a more principles-based approach to regulating supplier conduct, using prescription where necessary to protect consumers. We would be happy to share our experience in setting appropriate standards.

There may also be lessons from the experience in opening the retail energy markets to competition to consider when assessing the risks for heat consumers. For example, we saw cases where sales agents, acting on behalf of energy suppliers, misled consumers over costs or contract provisions; these were particularly damaging to consumers and to the reputation of the sector. Other common issues include infrequent billing, which has led us more recently to introduced a back billing principle which prohibits the supplier – when at fault – from seeking additional payment for unbilled energy used more than 12 months prior to the error being detected and a corrected bill being issued².

It is important to ensure that the required standards are enforceable to deter non-compliance. Energy regulation requires energy suppliers to obtain a licence that contains the regulatory conditions, which if breached, may result in Ofgem imposing financial penalties. Licensing relevant parties is only one option and others, including authorising those engaging in the activity, could be considered. The emergence of new business models bringing new players, who interface with consumers, raises the question as to whether energy suppliers will remain the key interface with all consumers and whether licencing energy suppliers is the

¹ Association of Decentralised Energy statement of task force [scope](#), 13 March 2017.

² <https://www.ofgem.gov.uk/consumers/household-gas-and-electricity-guide/who-contact-if-its-difficult-paying-energy-bills/energy-back-billing-your-rights>

right approach in the future. Therefore, it is important that any heat regulatory regime takes account of potential future developments in the energy sector.

Finally, given that heat is likely to be considered as an essential service, it will be important to put in place a regulatory backstop to mitigate risk of business failure contagion, with special administration for insolvency³. Such arrangements exist in the energy sector.

Thank you for the opportunity to respond to your market study notice. We are happy to discuss any of these points and look forward to engaging with the CMA during the process.

Yours sincerely

Pamela Taylor

Partner, Improving Regulation

³ <https://www.ofgem.gov.uk/publications-and-updates/ofgem-ensures-secure-energy-supplies-gb-energy-supply-customers>