



Making a positive difference  
for energy consumers

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Dear John

### **Ofgem's response to *Heat networks: building a market framework* consultation**

We welcome the opportunity to respond to the consultation setting out policy options for the development of a regulatory framework for heat networks. Ofgem regulates the gas and electricity markets in Great Britain. Our principal objective is to protect the interests of existing and future gas and electricity consumers.

As set out by Ofgem's recently published Decarbonisation Action Plan heat networks have an important role to play in the path towards the decarbonisation of heat, and in helping to achieve net zero by 2050.<sup>1</sup>

Ofgem plays a pivotal role in paving the way for the energy sector to decarbonise and we need to make sure this happens at lowest cost to consumers. We are committed to working with the UK and devolved governments to enable and encourage the decarbonisation of energy to ensure that people – especially those in vulnerable circumstances - will always be able to heat their homes at an affordable price and be protected as we make the transition to net zero.

Subject to a final policy position being taken that Ofgem is the appropriate body to appoint as the regulator for heat networks, we look forward to working with you on the design of a regulatory framework. As with the design of any new framework, there will be a number of important issues to consider in detail throughout this process. It is important that the regulatory regime is practicable and capable of being regulated effectively, so that heat network customers are able to enjoy the expected benefits. If we identify an issue with the framework or regulatory design that we think could negatively impact on consumers, we will bring this to your attention. We have set out below some key issues that need to be considered carefully in the design of the framework.

#### *Proposed role for Ofgem and funding arrangements*

As the economic regulator for gas and electricity markets, Ofgem has significant experience in developing and enforcing consumer protection measures, as well as in designing and setting price controls and encouraging network investment.

We agree with BEIS's proposal that there should be protection for heat network customers.

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<sup>1</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-s-decarbonisation-action-plan>

From a customer perspective, heat networks have similarities to gas, electricity and essential service monopoly infrastructure, and we agree that it is appropriate for them to be subject to a regulatory oversight. The consultation sets out areas such as ensuring access to independent redress, smooth arrangements for market exit, and the fair treatment of vulnerable consumers. We agree that these should be key areas of focus going forwards, although others are likely to arise as proposals develop further.

Ofgem's approaches to these issues in the context of gas and electricity markets are likely to provide helpful guidance both to the design of the framework and the operation of regulation in practice. It will be necessary to take account of the unique characteristics of existing heat networks, particularly that competition among suppliers of heat and switching by consumers is unlikely to be possible for many networks in the immediate term.

Accordingly, careful consideration will need to be given to the identification of an appropriate regulatory objective, as well as guidance as to how to achieve that objective. It is likely to be appropriate to as far as possible align the objective with energy, whilst recognising the differences that exist between the frameworks. For example, there is currently limited scope for competition on heat networks as compared with the gas and electricity sectors.

With 14,000 heat networks currently in the UK serving half a million households, there is significant complexity in the current market. This complexity will impact on the costs of the regulatory regime to be established. We consider that in principle those who benefit from the system of regulation should bear its costs as far as possible. Careful consideration will need to be given to appropriate transitional funding for the regulator's set up.

The Scottish Government is developing its own legislation in relation to heat network regulation. As consumer protection remains a reserved matter to the UK Parliament, we note that the Scottish Bill does not provide for statutory minimum consumer standards for heat network customers, as the Scottish Government would wish. There are benefits and synergies associated with the appropriate alignment between regimes in order to ensure consistent consumer outcomes across boundaries. We encourage both Governments to work towards this outcome.

#### *Proposed scope of framework*

We support the proposals to keep the regulatory approach as simple as possible in order to ensure an appropriate regulatory burden, and to ensure there is clarity for the end consumer and the regulator as to where responsibility sits.

As the consultation notes, we have previously identified with Government that the current energy retail market design, including the 'one size fits all' supply licence, is starting to hold back progress by preventing consumers from benefitting from innovation.<sup>2</sup> We are therefore particularly interested to explore with Government how to ensure sufficient flexibility in the framework to accommodate the diversity of existing structures which exist in the sector and future developments particularly those relating to the energy transition.

At the same time we recognise the importance, for participants and investors, of a clear regime with an appropriate degree of regulatory certainty. As part of this, the regulatory framework should look to support innovative use of data in the sector so that Ofgem and other stakeholders can have clear insights into how heat networks are delivering for their customers.

Our experience in the gas and electricity sectors shows that microbusinesses face many of the same issues as domestic customers.<sup>3</sup> We therefore support proposals to offer domestic and microbusiness customers the same level of protection in many respects. However, we

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<sup>2</sup> <https://www.gov.uk/government/publications/future-energy-retail-market-review>

<sup>3</sup> <https://www.ofgem.gov.uk/publications-and-updates/opening-statement-strategic-review-microbusiness-retail-market>

think further clarification is required on the need to allow for a different approach around bad debt, disconnections and obligation to supply for microbusiness customers. In addition, we would see merit in further consideration of the protections in place for larger heat network businesses as they are unlikely to have the same ability to shop around as large gas and electricity consumers.

#### *Protecting consumers*

It is important that the heat network market can deliver a good deal for all heat network consumers. This means that heat network customers should receive a good level of service with access to an appropriate complaints handling and redress framework to protect consumers.

The consultation reveals some ambition to take action to protect heat network customers against excessive pricing. We support this intention but this is an area where further clarification is required from Government in terms of the proposed ambition of the price protection aspects of the regime.

Finally, it is important that customers of heat networks know their rights – particularly since these will differ from electricity and gas customers, for example not having the right to switch.

#### *Other areas*

The consultation discusses potential additional roles for the regulator across other areas, including issuing licences for statutory rights and powers, monitoring compliance with technical standards, and monitoring decarbonisation targets specific to heat networks. We are keen to explore with government where these roles might best sit in the policy and regulatory landscape to ensure the associated risks are managed effectively.

We hope this provides further clarity on Ofgem's position regarding our potential role in the regulation of heat networks. I look forward to further engagement with you on these matters and in particular on the key areas this letter highlights in relation to our regulatory objectives, funding arrangements and framework design considerations.

Yours sincerely



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