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Dear Heat Networks Policy Unit, DESNZ and Heat Networks Regulation Team, Ofgem

Heat Networks Regulation – Consumer Protection

Sustainability First is an independent charity and think tank focused on promoting practical solutions to deliver fair and sustainable energy and water sectors. We have a long history of engagement on policy, regulatory and market design issues from the consumer and environmental standpoint, and in advocating for strengthened consumer protections and statutory regulation of the heat network sector.

We welcome the opportunity to contribute to this consultation. We recognise that a significant and growing minority of households are on heat networks and it is crucial that they receive excellent service and effective, clear and transparent complaint handling and redress when things go wrong. Arguably the bar needs to be set higher than for competitive energy supply markets given that customers are not able to switch their provider in the same way and, unlike gas and electricity distribution networks have more direct contact with consumers.

Heat networks are expected to play a crucial and growing role in the decarbonisation of heating, as noted consistently by the Climate Change Commission and most recently in the National Infrastructure Commission's second National Infrastructure Assessment.¹ This requires heat networks to also be accepted by consumers, which in turn requires greater awareness, consistent high standards of provision and reasonable pricing, with additional protection for those that need it. Effective regulation can help deliver this, but the approach set out in the consultation will fall short and, in any event, cannot deliver alone, as we explain in the remainder of this response.

While the CMA market study in 2018² found that most heat network consumers received comparable service and prices broadly in line with other forms of heating, some providers were significantly worse. Since then, the energy crisis has seen prices paid for gas soar and heat network consumers have been less protected than electricity and gas consumers, without a price cap and with less timely and complete bill support. Evidence from the Heat Trust³ suggests that consumers on heat networks are without heat, on average, for about 24 hours a year, compared to outages of much less than 1 hour a year on electricity and gas networks. The form of regulation set out in the consultation will not address these fundamental challenges of affordability and reliability, which require a broader policy response including protection from extreme gas prices, a clear and consistent approach for those least able to pay (such as income support or through a targeted tariff), a multi-sector approach to priority services for those with additional needs and funding for upgrades

¹ [National Infrastructure Assessment - NIC](#)

² [Heat networks market study - GOV.UK \(www.gov.uk\)](#)

³ [Heat Trust response to DESNZ/Ofgem consultation on consumer protection](#)

of unreliable or inefficient heat networks. We must ensure that consumers whose heat and hot water is provided by a heat network are not only treated fairly by their supplier but are also treated fairly in comparison to customers with individual electric or gas heating. In particular we support proposals for a stronger consumer voice and consumer engagement in the heat network sector. This should be a win-win for consumers, the heat network sector, government and regulators.

If heat networks are to achieve their potential, we need regulation to fit within a market design that delivers excellent customer experience while also being attractive to entrants and innovators. It must go beyond just protecting the worst outcomes, to bring forward new products and services that inspire and delight consumers. As a minimum, a narrative from DESNZ and Ofgem that highlights the opportunities as well as the challenges would help sow the seeds for growth in the market. Regulation can help by creating upside, championing good practice, recognising the importance of, and responding to consumer views, ensuring data is available and building in space for innovation.

As a first step improving transparency and data on the heat network sector is critical. There has been no published data on the number of heat networks in the UK since 2018 (which was based on data collected in 2015). There is no publicly accessible database of heat networks that consumers can access, except in Scotland where some data is available via Scottish Heat Map. Local authorities also struggle to identify heat networks in their area. Ofgem will not be able regulate effectively without improved data on company practices and the consumer experience. In particular both heat networks and providers need better data on who is on heat networks, including any additional needs, in order to provide effective protection and good quality service.

We acknowledge the challenges that Ofgem faces in regulating such a highly diverse sector with thousands of small heat suppliers, some with a history of poor performance and low levels of compliance with existing regulations. Within the specific approach to regulation set out in the consultation, we welcome much of what is proposed, including the balance of principles and prescriptive rules, improved transparency and the focus on consumers in vulnerable situations. We comment further on some of the specific questions in the annex below. However, while we see that consideration has been given to the different nature of the heat network market from the electricity and gas sectors currently regulated by Ofgem, we are not convinced that this has led to a workable model of compliance and enforcement. We agree that a digital first approach to data and compliance is essential. But we see two main problems:

1. Where investigations show potential issues, the consultation does not make clear how Ofgem will act effectively to ensure compliance. Its traditional approach to electricity and gas cases, where often hundreds of thousands of customers are affected, ultimately relies on the threat of enforcement cases which are highly resource intensive, potentially costing over a hundred thousand pounds for each case. This isn't workable for failings at a heat network that might serve a few dozen consumers.
2. As the consultation notes, many heat networks operate on a cost-recovery (not for profit) basis. So, both guaranteed standard payments and enforcement fines (or compliance payments) risk being passed on to the very consumers that have already suffered.

We welcome the proposal to explore Fixed Penalties but this does not of itself address either of these challenges. We see some scope for Ofgem to learn from other enforcement agencies, such as Trading Standards, but it will be challenging to maintain two distinct approaches to enforcement within one organisation. We think there is also merit in exploring other non-financial approaches to penalties, such as the equivalent to "points on a licence"/"three strikes and you are out", with the potential to accelerate step-in or reassignment, and conversely to remove points for good practice.

As noted above, we provide further comments on selected questions below, and we would be very happy to discuss any aspects of this response and how we could contribute to a successful roll out of regulation if that would be helpful.

Yours,

Zoe McLeod
Associate Director Sustainability First

Cc Martin Crouch, George Day, David Murray.

Answers to selected questions

Q.7. Do you agree with our proposed approach to the authorisation of existing and new networks?

For new entrants, Ofgem should ensure there is a robust approach to entry, learning the lessons from energy supply market failure. As noted, this is an essential service and short and longer-term positive consumer outcomes should be the primary principle driving decision making. It may be that fewer high-quality providers are better for current and future consumers than a plethora of poorer quality networks. This is especially important given these are effectively monopolies and customers cannot switch supplier in the way they can in competitive markets. We welcome the focus on the areas outlined e.g. complaints handling, vulnerability etc. but also suggest requesting information on customer service policies e.g. inclusivity of communications, service response times, given the problems identified by organisations such as Citizens Advice. We query if some consideration could be given to historic performance of existing networks, with a greater level of scrutiny on those networks where there is consistent evidence of customer concerns.

Q9. Do you agree with the proposal to use a mixture of principles and prescriptive rules to protect consumers? Do you agree with our assessment that parts of the sector are likely to want directive rules and supporting guidance to help them comply?

We agree that a mixture of principles and prescriptive rules is likely to be appropriate. As regulation is introduced, clarity of requirements will help those newly regulated to comply, and more prescription will likely be needed especially to establish minimum standards. It will be necessary to recognise the challenges faced by legacy networks, but it would be inappropriate to fix standards based on the lowest common denominator and hence embed sub-optimal standards for new build networks. Given the expected growth in the sector, priority must be given to getting excellent service for new consumers, not held back by a desire to have one size fitting all that requires standards to be achievable by old networks. Further, as noted, however the rules are drafted, they are only useful to consumers if they are complied with, and we see significant challenges in holding network operators to account.

Q11. Do you think we should further consider requirements on consumer engagement and including the consumer voice in heat networks' decision making?

Yes, definitely to improve consumer outcomes, support the transition to lower carbon heating and build confidence in the heat networks sector. We would welcome discussing further with DESNZ and Ofgem how this can best be achieved and at what level in the sector (e.g. requirement on individual networks or at an industry-wide or regulatory level). An effective consumer voice ensures that

services can more effectively meet the needs of end users. It can assist in early warning of problems and faster identification of promising approaches to improve service and efficiency. If done well, it can help develop solutions to problems, build trust and confidence in the sector. It could also arguably be another tool in the regulatory toolbox (especially important given the challenges of regulating such a large number of entities).

For the heat network sector to deliver the contribution it can make to net zero, requires consumers to engage, understand and advocate. The lack of information and awareness that some consumers on heat networks experience is shocking. Regulation can help ensure that better information is available. Better consumer engagement and strengthening the consumer voice can ensure information is communicated in the right way, at the right time to the right people.

However, we must avoid heat network operators seeing consumer engagement as a regulatory box-tick. A company level requirement, dependent on how it is designed, will likely be hard to consistently enforce given the number of entities and some creativity is needed in the design. Alternatives such as reputational regulation and in particular positive incentives and motivation – how can the operators that do this well benefit may be more appropriate. As a minimum, setting and championing good practice and supporting with guidance may help. Government should be clear about what it wants consumer engagement to deliver and design the approach accordingly.

Q12-14 Price transparency

We welcome the focus on price transparency. For individual customers it is important that this information is available prior to moving into a property so they can make an informed choice as to whether this form of heating is right for them, and they can afford the costs. Also, awareness of any rights they have where they believe they are being unfairly charged or treated. We would welcome comparative provider information – this could offer a useful evidence base for the regulator and consumer advocacy groups to improve household outcomes where needed. In particular it will be helpful to identify outliers who may need to be subject to further scrutiny. To maximise its usefulness, information should be published in a timely way. While acknowledging any potential administrative burden, especially on smaller companies, companies should have and be able to articulate this information. Realistically, if this is not required, poor performers will opt out. We therefore support it being a basic requirement.

Q15. What are your views on a general obligation on heat networks to provide fair and transparent prices, accompanied by rules and/or guidance, setting out minimum expectations, principles, and good practice? We are particularly interested to hear from leasehold arrangements, not-for-profit networks and small players.

We agree with setting fair pricing principles, such as expecting suppliers to take steps to increase efficiency and reduce heat losses, reduce costs through competitive fuel procurement, and ensure any charges and fees are fair, but as noted Ofgem will need to find new ways to effectively monitor compliance given the nature of the sector.

As noted above, we welcome requirements for transparent pricing but while these will provide a tool to support more effective regulation and consumer advocacy, we are concerned that they will offer little real protection to individual consumers. DESNZ and Ofgem's description of fair pricing, is cost reflectivity but there is of course often a gap between cost reflective pricing and affordable heat. The predominant drivers of higher prices appear to be high fuel prices (perhaps partly driven by inefficient purchasing), poor thermal efficiency, high initial construction cost and developer

contributions. While the approach proposed may root out excessive profits, it is not clear how, if at all, it will deal with any of these predominant drivers. In the past there has been a significant gap between what regulators define as “fair pricing” and what consumers and the public see as ‘fair’ when working households are unable to keep their homes warm or lower income households end up paying more for their energy despite the costs being efficient. Much has happened since the CMA’s review and government and Ofgem should reflect shifting expectations and greater affordability challenges in its decisions. Failure to do so risks being out of step with customer expectations and needs.

Q27. What information and evidence should Ofgem be seeking as part of our monitoring activity to identify where there is a case of disproportionate pricing?

See our answer to Q15. Information collection will need to enable Ofgem to disaggregate the drivers of prices. DESNZ and Ofgem need to consider how the consumer protection framework as a whole will address each of these drivers, particularly if Ofgem’s regulatory powers can only practically address excessive profitability. The proportionality of heat network pricing as a sector also needs to be compared to other forms of heating, given the overall policy intent for heat networks to contribute to the decarbonisation of heating.

Q28. Do you agree that price regulation, such as a price cap or profit regulation, should not be introduced in the near term but that this should be kept under review?

It is critical that government does more to ensure that those on heat networks are protected from high and volatile energy prices and unfair charges. Heat Trust reports examples of heat network consumers facing tariff increases of up to 700% and unit rates for heat as high as 50-60p/kWh, in some cases even after the government’s Energy Bill Relief Scheme was applied. Also, that some low-income social housing tenants are paying £50-60 a week for heating and hot water (£3,500 a year).

We agree however that a price cap or profit regulation akin to electricity and gas network regulation would not be appropriate at this stage. As noted above, the predominant drivers of higher prices appear to be high fuel prices (perhaps partly driven by inefficient purchasing), poor thermal efficiency, high initial construction cost and developer contributions. While the approach proposed may root out any excessive profits, it is not clear how, if at all, a price cap applied to heat networks would address any of these factors.

As noted, the energy crisis has seen prices paid for gas soar and heat network consumers have been less protected than electricity and gas customers, without a price cap and with less timely and complete bill support. The form of regulation set out in the consultation will not address these fundamental challenges, which require a broader policy response including protection from extreme gas prices, a clear and consistent approach to income support (or tariff support) for those least able to pay, and funding for upgrades of unreliable or inefficient heat networks. We must ensure that consumers whose heat is provided by a heat network are not only treated fairly by their supplier but are also treated fairly in comparison to customers with individual electric or gas heating.

It is anomalous that consumers with individual gas-fired heating or individual electric heat pumps benefit from significant price protection, for example through the retail price caps, whereas consumers on heat networks don’t have an equivalent. At this level, if heat networks are to contribute to the decarbonisation of heating, then further thought is needed to create a level playing field. Similarly, the clear and increasing policy support for heat pumps (including significant and growing grants) contrasts with the relatively muted public policy support for heat networks. For example, would it help level the playing field if heat network grants were channelled through, or at

least publicised to, consumers on heat networks and set at similar levels (on an annual equivalent cost) to heat pump support?

Q29. Do you agree with this approach to regulations to complaints handling?

Yes. We welcome the standardisation of complaints handling processes and the promotion of good practice. We also support a role for the Extra Help Unit to assist those with additional needs and in vulnerable situations. Longer-term it would be useful to publish performance data and reporting would ideally enable comparisons across different sectors.

Q32. How should guaranteed standards of performance work for heat networks operating on a cost recovery model? How can we avoid consumers paying for their own compensation through higher prices in the future? How can we further incentivise reliability for these networks?

Reliability of supply is a top consumer priority, and any approach should incentivise and support a reliable safe supply of hot water and heat for all. We recognise the importance of improving reliability for heat networks and the benefits of payments to consumers who are affected by long outages. However, the guaranteed standards model from electricity and gas clearly cannot just be copied across to a cost recovery model with relatively few consumers on a particular heat network. While there may be ways round the cost recovery issue such as through contracting out operations, this is unlikely to be suitable for all cases. So rather than asking “how should guaranteed standards work”, the better question is how can we design a system (including for cost-recovery networks) that incentivises better reliability, protects consumers and supports customer satisfaction? This is likely to involve technical support and non-financial penalties, potentially alongside a mutual insurance scheme to compensate worst affected consumers. This is an area where there may be value in developing a scheme in collaboration with end consumers as well as providers.

Q36. What are your views on heat networks being contractually required to have a contingency plan in place to ensure the continuity of heat supply? Should this obligation apply to all heat networks, including small networks?

We would expect the authorisation regime (rather than contracts) to require a contingency plan, given the risks to consumers from failure. There appears to be a strong practical case for small networks to share one or more common arrangements, which DESNZ or Ofgem could potentially help to arrange.

Q40. Do you agree with the proposal to require heat suppliers to operate a Priority Services Register and provide specific services for consumers who need them? As previously stated, we would really welcome views from networks that would find it particularly challenging to deliver this.

We support the proposal for heat networks to operate a Priority Services Register and urge that lessons from the registers in other sectors are taken on board at the outset rather than attempting to retrofit them later. These include designing the register on a multi-sector basis (so consumers only need share information once for multiple sectors if they so choose), prioritising the quality as well as quantity of information, and putting significant effort into consumer engagement, in this case on a sector-wide or multi-sector basis as well as through individual heat network operators. We would welcome a review of the PSR services outlined to reflect recent innovations and technological capabilities. In particular, that government should ensure there is a clear package of support available to customers, during any interruption to supply. With both energy supply and networks there is often a disconnect between the number of customers on a company's PSR and the number

that in practice receive services (or receive them in a timely way) with poor communication also a key complaint. This may be for a range of reasons, including poor company delivery processes or services being offered not meeting customer needs. The services outlined while a starting point will need updating. It will be important for Ofgem and the providers to monitor not just the numbers on the PSR, but the uptake of services, and satisfaction of those on the PSR. DESNZ and Ofgem should also encourage inclusive design. Many customers with additional needs are not on existing electricity and gas PSRs according to energy network and water company PSR vulnerability gap analysis. It is therefore essential, especially given our increasingly aging and disabled population, that general communications and engagement channels are designed with those in vulnerable situations in mind. This also helps to improve the customer experience for all customers (many of them who don't see themselves as vulnerable) and reduce costs and reliance on bespoke services.

Q46. Do you agree with our approach for ensuring that consumers in vulnerable circumstances do not resort to self-disconnection or self-rationing and that PPMs are only used where appropriate for the consumer?

We support a strong focus on ensuring customers in debt are treated fairly and the promotion of at least comparable protections as in energy retail but ideally good practice. We agree with the concern in the consultation to support consumers in vulnerable circumstances in avoiding disconnection and self-rationing and the need to better understand current disconnection processes and the consumer experience. It is imperative to learn the lessons from recent experience in the regulated energy sector and to apply the highest standards to use of prepayment.

Q47. Should we include financial vulnerability as a required consideration for whether a PPM is 'safe and reasonably practicable'?

Yes.

Q57. Do you agree with the proposed rules on billing information, frequency, and method?

DESNZ and Ofgem should require companies to offer a choice of payment options including cash and cheque and budgeting options for those who need it. Longer-term the heat network companies should be encouraged to provide payment flexibility to support affordability and at least monthly billing. This is especially important given the high cost of energy and the current cost of living crisis but it should be required regardless. Protections should at least be consistent with energy retail suppliers and are especially important as customers cannot switch. A 'wait and see' approach is not appropriate here.

Q.50-56 – Approach to metering

We support enhancing the accuracy and number of meters on heat networks to improve consumer access to consumption information and costs and help identify inefficiencies and heat losses. Such information must be available to both operators and their consumers to empower them to engage. We also strongly support the proposal to re-introduce heat meter accuracy standards into UK law. These should match the EU standards that were previously in UK law before EU exit. We support the intention to require more legacy heat networks to install individual meters. Meters are a fairer way of billing consumers for energy use, give consumers more control over costs and are an essential tool to monitor and improve heat network efficiency. Regulations must ensure that consumers do not face additional upfront costs for meter installation as is the case with energy retail customers.

Q58. Do you agree with the proposed rules on back-billing, price change notifications, and heat supply contracts?

We support the improvements to billing proposed in principle, particularly to limit back-billing and to improve information provision. However, 12 months back billing is too long when it is not the fault of the consumer, especially given the cost of bills. We would welcome further discussions with DESNZ and Ofgem on this issue. We would also encourage Ofgem to test detailed requirements with consumers before finalising them. Further, we note that the cost recovery model potentially implies adjustments to pricing where costs diverge from revenues so further clarity is needed about how this should work, in particular to avoid undue back billing. We support the principle that consumers should be able to know in advance of consumption how much they will be charged for that consumption, based on accurate metering.

Q68. Do you consider that the proposed compliance and enforcement framework is appropriate for ensuring that non-compliance is addressed?

We support the layered approach of investigation, compliance and enforcement. However, ultimately any enforcement regime is based around the credibility of enforcement to provide deterrence against non-compliance. As explained in the main body of this response, the consultation does not appear to provide for credible enforcement given the disproportionate cost of Ofgem's enforcement (or compliance) activity compared to the scale of harm for relatively small networks and, for many such networks which operate on cost recovery principles, the lack of credible penalties. Given the level of poor practice we have seen in the market it is crucial for Ofgem to have the appetite and resources to monitor and enforce appropriately. Heat Trust reports there has been almost no enforcement of the current metering and billing regulations despite evidence of widespread non-compliance.

Q69. Do you consider that our penalties policy should include Fixed Penalties as an efficient way of addressing certain non-compliance? If so, what are the main benefits and risks that need to be considered when implementing this approach, including how they would apply to different segments of the market?

We support investigation of alternative approaches to addressing non-compliance, such as Fixed Penalties which could be scaled based on numbers of consumers affected. We consider that more creative solutions are needed, which could include an approach based on penalty points analogous to a driving licence and with a range of consequences which could ultimately include appointing a new operator. For this to provide an efficient approach, a different model of enforcement from that used by Ofgem to date would be needed, which could draw on approaches in other sectors (e.g. retail). As noted, it will be important that the cost of any penalties is not passed on to the consumers who have already experienced the detriment.

Ends.