

## Consumer Futures Unit Response: CMA: Heat Networks Market Study

### About Us

The Consumer Futures Unit (CFU), part of Citizens Advice Scotland, uses research and evidence to put consumers at the heart of policy and regulation in the energy, post and water sectors in Scotland. We work with government, regulators and business to put consumers first, designing policy and practice around their needs and aspirations.

We welcome the Heat Networks Market Study, and having undertaken significant work into the consumer issues in the heat market in Scotland we are keen to work with the CMA to support this ongoing investigation.

### Transparency

#### 1. Are consumers given sufficient information on heat networks before their decision to buy or rent a property that has a heat network?

Information is one of the seven key CFU consumer principles and it is crucial that prospective homeowners or tenants are provided with timely, comprehensive, and accurate information prior to the decision to buy or rent.<sup>1</sup>

CFU research found that there are mixed approaches to the provision of information to new customers. Some suppliers reported that they provide information via face-to-face home inductions, others provided written information via a home information pack, and some organisations also have their own energy advisors.<sup>2</sup> A case in Which?'s research demonstrated that expected low energy costs based on information provided when purchasing a property are not always realised.<sup>3</sup>

Recent CFU research has also found that consumers may require additional information on how to use newly installed heating systems beyond initial written or verbal instruction, through follow-up advice and guidance.<sup>4</sup> While this refers to the replacement of heating systems, it is possible that similar issues may arise when beginning a new tenancy or buying a new property.

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<sup>1</sup> Consumer Futures Unit, *Consumer Principles*, [link](#).

<sup>2</sup> Consumer Futures Unit, *Different Rules for Different Fuels*, [link](#), p.40.

<sup>3</sup> Which? *Turning Up the Heat*, [link](#), p. 13.

<sup>4</sup> Consumer Futures Unit, *Hot off the Grid*, [link](#), p. 71.

## **2. To what extent are consumers able to assess and act upon information regarding heat networks prior to purchasing a property?**

Which?'s report provides some evidence that in fast moving property markets, a buyer may feel compelled to sign up to a district heating supply to secure a property before addressing any concerns.<sup>5</sup> The Heat Trust's Annual Report notes that the gap in informing a customer that a heat network supplies their property appears to be more prevalent in the private rented sector.<sup>6</sup> Consumers can only make informed decisions if they have access to the relevant information. This is particularly critical given lower levels of consumer awareness about what heat networks are and how they function.

## **3. To what extent is information on the costs of heat networks made clear to customers in bills?**

Some regulations exist around billing, namely through the Heat Network (Metering and Billing) Regulations 2014, which require suppliers to provide separate heat bills. The Heat Trust also provides guidance around billing to its members.<sup>7</sup>

However, consumer experience of billing is not consistent across heat network schemes, with a range of approaches to billing residents. Our research suggests issues with:

- how price rises are communicated;
- payment options;
- price comparison and knowledge of prices;
- information provision;
- regularity of billing;
- backbilling.<sup>8</sup>

In Citizens Advice's 2016 information request to local authorities in England, Wales and Scotland, it was found that only 38% of schemes shared with customers how their bill was calculated, reinforcing the need to explore billing transparency.<sup>9</sup> While legislation exists, without a regulator to ensure that suppliers adhere to legal requirements consumers can have limited access to redress.

In the regulated gas and electricity markets prices are published, so consumers should, comparatively speaking, be able to see if their price is 'fair' before entering a contract. Furthermore, gas and electricity suppliers must also give 30 days' notice before a price increase.<sup>10</sup> In contrast, district heating schemes are not mandated to provide similar levels of information. While many schemes will provide full pricing data, this is not guaranteed, so

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<sup>5</sup> Which? *Turning Up the Heat*, [link](#), p. 13.

<sup>6</sup> Heat Trust, *Annual Report*, [link](#), p.16.

<sup>7</sup> UK Government, *Heat Network (Metering and Billing) Regulations 2014*, [link](#).

<sup>8</sup> Consumer Futures Unit, *Different Rules for Different Fuels*, [link](#), p.21.

<sup>9</sup> Citizens Advice, *District Heating Networks: Analysis of Information Request*, January 2016, p.10.

<sup>10</sup> Citizens Advice, [link](#).

some consumers may not be able to discover whether prices are reasonable before entering into a contract. For those who do know their annual heat bill, the Heat Trust's Heat Cost Calculator helps to provide some indicative comparison between district heating and modern gas boiler costs.

Our research suggests that changes to tariffs are not always well communicated. For example, in one case local authority tenants were informed of a tariff increase but a private resident was not advised.<sup>11</sup> While some consumers appreciate the predictability of fixed fees, others feel standing charges subsidise high users and disincentivise energy saving.<sup>12</sup> Prepayment meters appear to be a factor in making it harder to understand costs, including unit price, whether tariffs include standing charges, where to get information and how charges are broken down.<sup>13</sup> Overall, the lack of accessible information adds to challenges for district heating consumers.

#### **4. Do you have views on our proposed approach to data collection and analysis?**

It is welcome that the statement of scope noted the devolved nature of district heating. The CMA's evidence gathering should reflect the distinct experiences of Scottish consumers. It would be useful to build on BEIS' consumer attitudes survey from England and Wales, and draw out parallels in Scotland.<sup>14</sup> We would welcome ambition to explore whether vulnerable consumers are able to make informed decisions about their heating system, and to extend the scope of research to information provision after a tenant or homeowner moves into a property. We know that only 58% of district heating users surveyed felt heating control advice was useful and such issues could be investigated further.<sup>15</sup> Additionally, any further work that maps where schemes are sited would aid the evaluation of schemes.

#### **5. Do you think that the potential remedies we are considering are appropriate? What are the potential benefits / risks in implementing such remedies and how should they be designed to maximise benefits? Are there other remedies that we should be considering?**

Our research called for the Scottish Government to put in place a statutory licence which should include Fair Heat Contracts, providing clear information on a range of consumer protections including joining and leaving rights.<sup>16</sup> If pre-transaction transparency is improved, it will be important to monitor consumer experience of whether they have received sufficient information. The effectiveness and extent of additional 'follow up' information should also be

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<sup>11</sup> Consumer Futures Unit, *Different Rules for Different Fuels*, [link](#), p. 21.

<sup>12</sup> Ibid., [link](#), p. 18.

<sup>13</sup> Consumer Futures Unit, *Different Rules for Different Fuels*, [link](#), p.21.

<sup>14</sup> BEIS, *Heat Network Consumer Survey: Executive Summary*, [link](#).

<sup>15</sup> Consumer Futures Unit, *Different Rules for Different Fuels*, [link](#), p.18.

<sup>16</sup> Consumer Futures Unit, *Different Rules for Different Fuels: Insight Report*, [link](#), p. 16.

assessed. Further research could test the consistency of approach and the effectiveness of regulations.

Any new billing proposals should build on the work of groups such as the Heat Trust to strengthen consumer protections and ensure that standards are at least on a par with electricity or gas sectors. Our research provided more detail on the protections we would like to see around billing and pricing in Scotland. These included:

- **Publishing prices** – including benchmarking against other schemes – which could encourage pressure from consumers on their supplier for improvements, and allow them to raise concerns about high prices, through allowing consumers and operators the chance to compare performance. This may also allow consumers to understand prices. As mentioned earlier, the Heat Trust currently has a price comparison tool that would help to enable this.
- **Minimum standards of regularity and accuracy for billing** – This may reduce risk of build-up of large bills or confusion around billing. This may also help to prevent consumers falling into debt.
- **Breakdown of prices to consumer** – This would give the consumer the opportunity to see what contributes to cost (and what savings could be available by reducing use etc.).<sup>17</sup>

## **Theme 2: Monopoly supply**

### **1. Do heat networks exhibit natural monopoly characteristics (high fixed costs; economies of scale; barriers to further local entry to compete for existing customers)?**

In a district heating scheme, supply, distribution and generation are all often owned by the same organisation, meaning that once built, a scheme operates as an effective monopoly. Even where a third party supplier is involved, the end consumer has only one supplier to choose from. Alternative suppliers can take over struggling schemes, but it is rarely the individual consumer who makes the decision to switch. For example the Wick District Heating Scheme was taken over by Ignis Energy in 2012, but this was only after the scheme had failed and high costs had been incurred.<sup>18</sup> The district heating supplier may collectively change for consumers when difficulties arise, but individual switching to get a better price or improved service remains problematic.

### **2. To what extent are consumers able to switch from their current heat network providers to alternative heat network operators or to alternative heat sources?**

The legal opinion obtained as part of our research stated that district heating consumers technically have a legal right to switch, but this right is not reflected in reality. John Campbell QC wrote:

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<sup>17</sup> Ibid, [link](#).

<sup>18</sup> BioPAD, *Wick District Heating Scheme: Rising from the Ashes*, [link](#).

*'However, the "right to switch" supplier will be problematic, because by its nature a DHS means that there is a monopoly supplier, whatever the scale – a few houses, or an entire village or town. The option in the licence would have to be a right to discontinue/terminate and to provide an alternative supply for oneself.'*<sup>19</sup>

Consumers who bring complaints to Citizens Advice Bureaux regarding negative experience of district heating schemes can be surprised that they cannot switch supplier. For example, one adviser noted:

*'[The] Client is frustrated as no clear options to stop the landlord charging unfair rates seem to be available.'*

This was echoed by one social housing tenant interviewed by Changeworks who said:

*'I don't understand how in this day and age with consumer laws I don't understand how you can be tied into one supplier and for them to be able to set their rates at whatever they want, there should be something in place that forces them to set their rates competitively, there should be a limit to what they can set it at... if they are meant to be delivering better value then there should be some sort of body that says there should be a maximum rate that they can charge.'*<sup>20</sup>

While some of the remedies from the CMA's Energy Market Review look to encourage switching by gas and electricity consumers, district heating consumers face a lack of choice. If a consumer does choose to disconnect from district heating, alternative heating is likely to be expensive, particularly for tenants who can make fewer infrastructure changes and may even become reliant on plug-in electric heaters.

### **3. What are the key factors (contractual and / or technological) impeding consumers from switching?**

The need to cover the capital costs of building a district heating scheme means that contracts tend to be long – up to 20 years – prohibiting switching.<sup>21</sup> The CFU has been made aware of cases where a consumer has to pay a standing charge, even though they have effectively self-disconnected and are not using the heat generated in a scheme. Similarly, paying heat with rent can make it harder to switch. District heating schemes may be used in areas without mains gas, where alternative options are limited, often being seen as a more affordable means to tackle fuel poverty than electric heating. Building regulations in some high-rise blocks mean it is not possible to install mains gas to individual households, again limiting consumer alternatives if they are not happy with their district heating scheme.

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<sup>19</sup> Consumer Futures Unit, *Different Rules for Different Fuels: John Campbell QC, Legal Opinion*, p. 7, [link](#).

<sup>20</sup> Changeworks et al., *Identifying the Fair Share*, [link](#), p.67 cited in *Changeworks et al., Different Rules for Different Fuels*, [link](#), p. 22.

<sup>21</sup> Citizens Advice, *District Heat Networks 2: Analysis of responses from private heat suppliers*, [link](#), p.5.

### **3. How do commercial and financial incentives at different levels in the value chain affect the decisions of builders, operators and residents?**

With the exception of community-owned district heating schemes, such as that at St Bride's Community Centre in Douglas, South Lanarkshire, the decision to build a district heating scheme is not normally directly taken by the consumers who will use the scheme. Similarly, investors, local authorities, housing associations, private developers, or operators tend to dictate investment in, building and operation of a scheme. The way schemes are incentivised should therefore be clearly linked to improved consumer outcomes from their inception, such as alleviating fuel poverty and meeting high technical standards. Improving consumer engagement and advocacy at all stages of development and operation would help to ensure schemes are designed around the users of district heat. This would help to meet the Scottish Government's Energy Strategy aim to prioritise consumer engagement and protection.<sup>22</sup>

### **4. Do you have views on our proposed approach to data collection and analysis?**

Assessing how costs compare between district heat tariffs and alternative fuel tariffs will be insightful as we know even well-informed consumers can find it hard to make such comparisons. Investigating transparency at different stages through investment, planning, construction, operation, and supply will help to gain a clearer insight into how costs, ultimately borne by the end consumer, can be kept down. This is particularly important as BEIS concluded that 'there is relatively poor transparency in the heat network sector.'<sup>23</sup>

### **5. Do you think that the potential remedies we are considering are appropriate? What are the potential benefits / risks in implementing such remedies and how should they be designed to maximise benefits? Are there other remedies that we should be considering?**

Our research in Scotland recommended that because of the practical difficulties of switching, a rigorous licensing regime should be implemented to protect consumers.

While we would welcome measures to ensure excessive costs are not imposed on consumers for leaving a DHS, it can be hard to do so for practical reasons. However, we do not have enough evidence to comment on whether separating network deployment and provision through a tendering process would be practical, improve accountability, or have unintended consequences.

## **Theme 3: Outcomes**

### **1. Are heat network prices reasonable, and is quality of service and reliability adequate, when compared with alternative heat sources and/or operating costs?**

We don't have systematic data on prices paid by district heating consumers, but prices can vary quite dramatically from scheme to scheme. BEIS' survey in England and Wales found

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<sup>22</sup> Scottish Government, *Energy Strategy*, [link](#).

<sup>23</sup> BEIS, *Consumer Survey*, [link](#).

some consumers pay more than £1,000 or even £2,000 a year under district heating schemes, although it found median prices to be lower than this. The average annual gas bill was £569 in 2016, although direct comparisons with district heating schemes are complicated.<sup>24</sup> Whereas gas and electricity standing charges are always detailed, comparing the running costs of district heating schemes is more complex. For example, social housing organisations may absorb standing charges making the running costs of the scheme seem artificially low.

Smaller schemes may lack economies of scale leading to a variation in price. For example, a Citizens Advice Bureau case showed a rural Scottish tenant paying £150 per month with little consultation before a small scheme was installed.

Even where prices are low, Changeworks' research suggested some fixed fee schemes were not sourcing sufficient income from residents, keeping prices artificially low, and storing up potential future increases.<sup>25</sup>

There is a varied experience in how faults, interruption of supply and compensation payments are dealt with. Our report showed some consumers receiving swift repairs and compensation, while others had to use expensive alternatives while their district heating scheme was repaired.<sup>26</sup> Apart from members of the Heat Trust, there are not consistent standards for engaging with and supporting vulnerable consumers. Both underheating and overheating due to poor insulation or control issues are also problems in some schemes. Without sufficient regulation pricing, quality of service and reliability are varied across district heating schemes.

## **2. Do you have views on our proposed approach to data collection and analysis?**

Fuller data on prices across the district heating sector would be very welcome, including how prices compare to other heat sources. It would also be insightful to expand the scope beyond price to explore the overall customer experience of district heating e.g. how faults are dealt with, quality of service, compensation, and warmth and comfort.

## **3. Do you think that the potential remedies to control outcomes directly are appropriate? What are the potential benefits / risks in implementing such remedies and how should they be designed to maximise benefits? Are there other remedies that we should be considering?**

Exploring rules around pricing and quality of service were key recommendations of our research. It would be beneficial for any remedies around price or quality of service to consider the experience of other European countries which have more numerous district heating schemes, as drawn out in our research. For example, in Denmark, the Netherlands and Sweden there are requirements to publish prices. Price caps exist in Norway and the Netherlands. In Denmark, Norway, the Netherlands and Germany regulations specify how the price for district heating must be calculated. In Sweden, consumers always have the right to request a negotiation with regard to price and capacity that has been agreed upon.

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<sup>24</sup> Ofgem, *Prices and Profits*, [link](#).

<sup>25</sup> Changeworks et al, *Identifying the Fair Share*, [link](#), p. 85.

<sup>26</sup> Consumer Futures Unit, *Different Rules for Different Fuels*, [link](#), p.10.

The University of Edinburgh's Report to the Scottish Government Working Group on District Heating drew out more examples of European consumer protections. For example, in the Netherlands companies must demonstrate financial capacity to continue supply of heat (through submission of financial statements etc.) as well as forecasting how heat demand will be met.<sup>27</sup> Evidently, not all of these measures may be practical in Scotland, but they give examples of some regulatory options.

Our report found that it is not clear whether or how price controls could be implemented at a Scottish level under existing legislation. However, our research identified this as an important area of consumer protection and provided examples of options that should be explored. As district heating networks generally operate as supply monopolies, we believe that it is reasonable to exercise some control over pricing to protect consumers from detriment, as they are generally not able to switch tariff or supplier. We would therefore welcome exploration of the viability of the following measures:

- **Price cap** – where prices would be capped at no more than the equivalent cost of the cheapest alternative system in the area.
- **Price-setting criteria** – To make clear the basis on which prices should be determined based on cost base. This may help to prevent overcharging by ensuring prices for heat supply reflect given criteria such as running costs – comparable to a rate of return approach rather than a price cap. This would have to be combined with technical standards to promote the efficiency of schemes so that prices are not overly inflated by high running costs. This could also give consumers an opportunity to raise concerns about high running costs, and help the regulator to identify inefficient schemes, enabling support to be directed at those schemes where appropriate.<sup>28</sup>

**Marcus Wilson, Energy Policy Officer**

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<sup>27</sup> R. Bush, D. Hawkey and J. Webb, *Regulatory options for district heating in Scotland: Report to Scottish Government Working Group on District Heating*, [link](#).

<sup>28</sup> CFU, *Different Rules for Different Fuels*, [link](#), p.15.