



Heat Networks Market Study
Competition and Markets Authority
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Invitation to comment on market study notice – Statement of Scope

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, storage, and energy and heating supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

EDF Energy Services is a joint venture between EDF Energy and Dalkia which combines the energy experience and technical expertise of these two EDF Group companies. This is an emerging part of our business in the UK that supports the integration and growth of city-wide low carbon district heating and cooling networks with a wide range of technologies. We also provide billing and customer services to administer these networks. The joint venture draws on the experience that Dalkia has in developing and managing heating networks within France and across Europe.

We welcome the opportunity to respond to the CMA's Statement of Scope as part of the Market Study into heating networks. EDF Energy would support a move to broader, proportionate mandated regulation across the market and this Study is a step toward that approach. District heating consumers should receive comparable protection as consumers who use other heating technologies. We support the Each Home Counts recommendations to raise quality standards and strengthen the accreditation in the energy efficiency, heat and renewable industries, and believe this could be extended to district heating. The outcomes of this Study should look to align with the principles of the Each Home Counts review, and build on the existing voluntary Heat Trust Scheme, in a way that is both technology neutral and comprehensive across all heating technologies.

However, the introduction of regulation needs to be balanced to ensure it does not unduly restrict the small but growing heat network market. There are substantial challenges inherent in providing any price protection for consumers, given the diverse range of costs and recovery mechanisms. Overly restrictive regulation risks damaging growth and innovation in this market.

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We have provided our detailed views in the attachment to this letter. In summary, the key issues to consider are:

- There is a need for a formal minimum standard of consumer protection that all network providers would be obligated to meet to build consumer confidence.
- Any minimum standard should be through a regulatory framework that builds on the standards developed in the Heat Trust Scheme Rules, as this has proved a good foundation for a framework of consumer protection and the standards are widely adhered to.
- However, not all developers sign up and adhere to the rules, allowing a minority to compete without the cost of robust consumer protection in place. This requires addressing to ensure a good standard of mandated consumer protection across the industry.
- Any such standards should cover transparency on consumer costs, pricing and levels of service (including consumer redress), and be provided to the consumer both before moving into a property connected to a heat network and reiterated at regular intervals during residence.
- There needs to be recognition in the standards of the distinction between new developments and retrofits, ensuring that standards are appropriate to the level of performance that is achievable.
- It should be recognised that ‘switching’ in terms of heat networks is different to that for retail electricity and gas. A heat network is most comparable with the network operator’s role in the retail market, and therefore this is the type of regulatory approach that is most suitable.
- A key aspect of ensuring greater competition across networks would be to ensure, where practical, open protocol systems (e.g. for metering and data collection) are used to avoid networks being locked into costly long-term contracts for Operation and Maintenance (O&M), customers service and billing, and asset replacement.
- Existing contract structures tend to include Key Performance Indicators (KPIs) on value for money, service quality and reliability, which can lead to providers losing contracts where they fail to deliver. However, an obligated minimum standard would ensure this occurred throughout the market and build consumer confidence.
- The nature of heating networks requires long term investment, and therefore any regulatory framework or intervention needs to be appropriate and proportionate, affording investors and developers the opportunity to make a reasonable return, provided they can guarantee, at a minimum, the appropriate standards of consumer protection.



Should you wish to discuss any of the issues raised in our response or have any queries, please contact Martin Pearce on 07875 112 299, or myself.

I confirm that this letter may be published on the CMA website.

Yours sincerely,

Paul Delamare
Head of Customers Policy and Regulation

Theme 1

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

The Heat Trust Scheme Rules include provisions for transparency before consumers buy a property connected to a heat network. Under the Heat Trust, Customer Information Packs must be provided to prospective heat customers, estate agents, letting companies, and other interested parties on request. This also outlines the minimum level of information required on scheme principles, charges, key terms within contracts, and complaints handling. The Heat Trust Scheme Rules also require participants to provide clear instructions to prospective heat customers on procedures for connecting to a heat network.

The Heat Trust Rules have proved a good foundation for a framework of consumer protection and the standards are widely adhered to, even where providers choose not to sign up to the Scheme itself. Equally, we are aware of many examples where networks have provided protection beyond the standards set out by the Heat Trust. However, not all developers sign up and adhere to the Rules, allowing a minority to compete without the cost of robust consumer protection in place. This requires addressing to ensure a good standard of consumer protection across the industry.

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

Under a typical Energy Services Contract (ESCo) arrangement the Developer is expected to notify customers of any obligations included within the lease agreement, before entering into a supply agreement with the ESCo. The supply agreement includes details relating to conditions of supply, including heat charges and guaranteed standards which the ESCo is expected to abide by over the contract term. Developers should be required to provide all the necessary pre-transaction information for customers to understand the terms of the heat supply, and the ongoing cost and duration of the contract.

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

The Heat Trust Scheme Rules require participants to provide billing to customers, stating information on any consumer charges, how they are calculated, and the consumption of the property. Any changes to charges should be notified within a minimum of 31 days to the customer. The Scheme Rules for billing are based on, and aim to achieve compliance with, The Heat Network (Metering and Billing) Regulations 2014.

The Heat Trust also provides a Heat Cost Calculator, via its website. This enables customers to gain an indication of the annual heating and hot water cost for a similar-sized property if it had a modern gas boiler.

However, as noted in our response to Question 1, not all developers sign up and adhere to the Rules, allowing a minority to compete without the cost of adequate and robust consumer protection in place. There is a need for regulated minimum standards that all network providers would be obligated to meet to build consumer confidence. Failure to adhere to such should result in providers losing contracts.

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

The methods proposed present a comprehensive approach. We will support the CMA study by providing any evidence or data that may be of use, based on our experience as a heat network provider and supplier both in the UK and across Europe.

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?

We agree that the potential remedies discussed in relation to Theme 1 are appropriate. There is a need for a minimum standard of consumer protection that all network providers are obliged to adhere to, as this will help build consumer confidence. Without a formal requirement to meet such standards, a minority of developers and providers within the market have an unfair advantage as they do not incur the costs of ensuring consumer protection. Furthermore, their approach could negatively impact consumer confidence and trust in the industry.

Any minimum standard should be through a regulatory framework that builds on the standards developed in the Heat Trust Scheme, as this has proved a good foundation for a framework of consumer protection and the standards are widely adhered to. Therefore, in most cases there would be little additional cost to the introduction of a formal regulatory framework where providers already meet these Rules. Additionally, there should be recognition in the standards of the distinction between new developments and retrofits, ensuring that standards are appropriate to the level of performance that is achievable.

Whatever mechanism is used to administer these standards, they should include transparency on consumer costs and pricing, and levels of service (including consumer redress). This should then be provided to the consumer: during consideration of purchase of a property connected to a heat network; before moving into the property; before

consideration of connection of a property to an existing heat network; and at regular intervals during residence.

A regulatory framework would need to ensure that consumers had a route to redress or compensation where reliability or value for money is not being achieved. To some extent this is addressed through Key Performance Indicators (KPIs) within existing contracts. However, a regulated requirement is necessary, encompassing all developers and providers to ensure that this always the case. A minimum standard should set a requirement to have a recognised route for adjudication of consumer complaints through Alternative Dispute Resolution (ADR).

Theme 2

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

Heat Networks make up a relatively small part of the heat market in the UK, but it is a growing market with both some established players and new entrants emerging. Whilst there are characteristics of natural monopolies in the market as identified in the question, there needs to be a clear recognition of the areas where competition can be, and often is, achieved.

Heat network contracts are often through an ESCo in which the network owner contracts with a partner organisation to develop, and operate and maintain the network on the owner's behalf. ESCOs tend to require long term contracts (anywhere between 15 and 25 years) to ensure the investment partner can gain a reasonable return. Alternatively, where a developer has already established a heat network they may seek to separate service contracts out across different delivery partners for O&M, customer services and billing, with contracts of a shorter length, typically 12 months or more.

In most cases KPIs are included in the contracts to ensure that value for money and reliability is achieved, with associated termination clauses and compensation mechanisms where KPIs are not met. This reflects the Guaranteed Performance Standards, set out in the Heat Trust Scheme Rules, which include compensation for interruptions to service.

The development of heating networks requires long term investment, and therefore any regulatory framework needs to be appropriate and proportionate. It should enable investors and developers to make a reasonable return on any investment, where they are delivering on the appropriate standards of consumer protection. A regulatory framework that covers all network developers and providers, requiring a minimum standard of consumer protection would then be reflected within contracts for services. This should in turn drive value for money and reliability, and increase consumer confidence.

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

It should be recognised that 'switching' in terms of heat networks is different to that for retail electricity and gas. A heat network is most comparable with the network operator's role in the retail market, and therefore this is the type of regulatory approach that is most suitable

A key aspect of ensuring greater competition across networks would be to ensure, where practical, open protocol systems are used (e.g. for metering and data collection) to avoid networks being locked into costly long-term contracts for Operation and Maintenance (O&M), customers service and billing, and asset replacement.

As we outlined in our response to Question 1 of this section, any regulatory framework needs to be appropriate and proportionate. It should enable investors and developers the opportunity to make a reasonable return on any investment, where they are delivering on the minimum standard of consumer protection. Any restrictions on the ability to connect sufficient demand across a network would severely hamper the commercial case and, therefore, the market in the UK. Regulation should ensure consumer protection is incorporated in all contracts, and that transparency of information enables individual consumers to make informed choices prior to moving into a property or at the point of connecting to a network.

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

EDF Energy does not have any comment to make in relation to this question.

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

The methods proposed represent a comprehensive approach. We will support the CMA study by providing any evidence or data that may be of use, based on our experience as a heat network provider and supplier both in the UK and across Europe.

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?

We agree that the potential remedies in relation to Theme 2 may be appropriate. The key aspect to be addressed in the Heat Networks market in the UK is the need for a minimum

standard of consumer protection to be required of all developers and providers. This will ensure value for money and reliability, and increase consumer confidence.

However, there should be flexibility for developers and providers to deliver these standards through contracts that best reflect the investment made in the network. Any restrictions on the ability to connect sufficient demand across a network would severely hamper the commercial case and, therefore, the market in the UK.

Proportionate regulation should ensure continuity and consistency in consumer protection is maintained during and after handovers of responsibility. Equally, it must also recognise the need for a variation of contractual arrangements and service structures in the market, to ensure flexibility remains for innovation. Additionally, it should remain technology neutral as far as possible to acknowledge the various routes to decarbonisation of heat in the UK.

Theme 3

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

In many cases KPIs are included in the contracts to ensure that value for money and reliability is achieved, with associated termination clauses and compensation mechanisms where KPIs are not met. However, the key issue is that there is no requirement across all developers and providers to ensure that this on a consistent basis, which would then provide consumer confidence.

This can lead to a variability of prices across networks with examples of new developments in areas that are next to one another where heat charges vary considerably. This sometimes reflects the difference in levels of investment and/or technologies used. However, other factors arise from the lack of minimum standards as discussed. For instance, different networks use differing methods of indexation, with some schemes referencing Consumer Price Index (CPI), others Retail Price Index (RPI), RPIX or RPIY. In the case of RPI indexation this can lead to Heat Network's being more expensive than the equivalent counterfactual over the long-term. A minimum requirement to ensure transparency of both price and how it is calculated would ensure property buyers, landlords or consumers considering linking to heat networks could do so properly informed of the relevant costs.

A further issue arises, due to a shortage of skill sets and a lack of maturity in the supply chain. This can lead to work not being completed to good standard, with some contractors and developers seeking to meet their contractual requirements for the minimal capital outlay. There is also limited regard to lifecycle costs which leads to a lack of operational efficiencies. Ultimately, customers end up paying higher heat charges to cover

the additional O&M and asset replacement costs. We would support an approach that aligns with the principles set out in the Each Home Counts recommendations. This aims to raise quality standards and strengthen the accreditation in the energy efficiency, heat and renewable industries, and believe this could be extended to district heating.

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

The methods proposed present a comprehensive approach. We will support the CMA study by providing any evidence or data that may be of use, based on our experience as a heat network provider and supplier both in the UK and across Europe.

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?

We agree that the potential remedies in relation to Theme 3 are appropriate. However, the introduction of regulation needs to be balanced to ensure it does not unduly restrict the small but growing heat network market. There are substantial challenges regarding providing any price protection for consumers, given the wide range of costs and recovery mechanisms. Inappropriate regulation risks damaging growth and innovation in this market.

Therefore, any regulatory intervention on pricing must ensure sufficient balance is achieved between consumer protection and enabling developers and investors to make a reasonable return on investment, if the UK is to attract interest in the heat networks market. In many cases KPIs are negotiated within the contracts to ensure that value for money and reliability is achieved, with associated termination clauses and compensation mechanisms where KPIs are not met. However, the key issue is that there is no requirement across all developers and providers to ensure that this always the case.

**EDF Energy
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