Response to the CMA Heat Networks Market Study- 2017

ENGIE UK

ENGIE is a global company that aims to lead the world's energy transition by developing integrated and innovative solutions for its customers. This includes the provision of affordable green and low carbon solutions across the energy and services sectors.

In the UK, ENGIE employs 20,000 people in a number of activities across the energy value chain, as well as through its extensive services business. In generation, ENGIE is one of the country's largest independent power producers, with a mixed portfolio of generation assets that include gas, CHP, onshore wind, solar and the UK's foremost pumped storage facilities at First Hydro. ENGIE also has a 23.3 % stake in the £3 billion Moray East offshore wind farm which is expected to be commissioned in 2022.

ENGIE operates an Industrial and Commercial (I&C) and Small and Medium Enterprise (SME) B2B electricity and gas supply business in the UK, and has recently entered the domestic retail market through its Home Energy business.

It is also one of the top five service companies in the UK, subsequent to the acquisitions of Balfour Beatty Workplace and Lend Lease FM. ENGIE is a major provider of services and energy services to customers, in particular in education, healthcare and local authorities. Services include energy efficiency expertise in buildings, grounds and building maintenance, and soft services.

In March 2017, ENGIE signed an agreement to acquire the regeneration business of Keepmoat for £330 million from TDR and Sun Capital. Keepmoat is the UK's leading provider of regeneration services specialising in the design, refurbishment and upgrade of buildings and places, helping to transform communities and strengthen local economies. This transaction will enable ENGIE to offer a complementary range of services to local governments, cities and businesses across the UK and strengthen its existing network of local authority partnerships.

ENGIE is also the UK's leading district energy company. We design, build, finance and operate district heating and cooling schemes in partnership with the public and private sectors. ENGIE's district heating schemes include; the Queen Elizabeth II Olympic Park, Southampton District Energy scheme, Whitehall District Heating scheme, Leicester District Energy scheme and Birmingham District Energy scheme. ENGIE also has over 200 district energy schemes across Europe and is a major service provider across a range of related sectors including schools and hospitals.

Summary of consultation response

ENGIE welcomes this opportunity to respond to the CMA's Heat Networks Market Study and is happy to engage with the CMA as well as provide any information relevant to the CMA's study. Whilst we welcome the study, we believe that many of the issues raised by the study are in the process of being considered by the ADE's Task Force on district heating which is set to report shortly. These issues include:

- The development of a regulatory framework for district heating.
- Improved transparency for heat customers.
- Improved heat metering and billing for customers.
- Improved heat network design and technical standards.
- Improved consumer protection for domestic heat customers.

We however would like to make the following points in relation to some of the potential remedies proposed by the CMA in its statement of scope:

- **The proposal to introduce competition**. When considering the issue of competition, we believe it is important for the CMA to recognise the key differences that exist between the district heating market and that of statutory utilities such as electricity and gas. Unlike the electricity and gas

markets, the district heating market structure and consumer offer is intrinsically bundled and is comprised of heat production, heat network assets and supply. The proposal to introduce a similar competitive environment to that of the statutory utilities (electricity and gas) could result in a significant disruption of the current market structure and supply chain. Whilst this is not something that we advocate, we urge the CMA to consider the likely impact such a measure could have on future investor confidence given the Government's anticipated role for heat networks in a future energy system.

- **The proposal to encourage collective consumer switching**. Whilst we understand the rationale behind the proposal, we believe that it will be equally important for the CMA to consider the likely impact such measures could have on future investor confidence.

- **The proposal to compare the cost data associated with the different technologies and fuels**. We believe that any comparison of cost data should be done on a like for like basis and should include the whole lifecycle and avoided costs associated with each of the technologies being investigated.

- **The proposal to introduce rules around how heat prices are set**. We believe that this should take into account the mechanisms by which heat prices change and are adjusted over time.

- **The proposal to develop a regulatory regime to provide customers with sufficient transparency over metering and billing**. We believe that aspects of a regulatory regime may already exist through provisions in the Heat Metering and Billing Regulations 2014.

- **The proposal to examine how heat network construction is tendered and whether this could be separated from heat network operation**. We believe that any such proposal should fully acknowledge the different stakeholder interests and incentives involved as well as the different procurement processes.

We have provided responses to each of the questions raised under the three themes within the CMA's market study below:

Theme 1: Transparency

Question1.
Are consumers given sufficient information on heat networks before their decision to buy or rent a property that has a heat network?

Response Q 1: Whist we provide comprehensive information on heat networks via our web portals[1] and customer welcome packs, we believe that it is incumbent upon property developers and landlords to pass on this information to prospective property buyers/tenants prior to the latter making a decision to buy or rent a property.

This is important because district heating scheme operators such as ourselves have limited interaction with prospective property buyers and tenants at this early stage prior to them making the decision to purchase or rent a property.

However, it is important to point out that some property developers do ensure that their customers receive information on heat networks prior to property purchase. This may be as a result of hosting an open evening or event to which heat network operators are invited to meet with prospective property buyers. From our experience though, this is limited to a small proportion of property developers. We believe that more such interaction should be encouraged and should form part of future best practice alongside other wider efforts to educate property buyers and tenants.

[1] East London Energy. Available at: http://www.eastlondonenergy.co.uk/
ENGIE Community Energy. Available at: https://business.engie.co.uk/community-energy/

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

Response Q 2: We believe that customers face significant difficulty in assessing and acting upon information regarding heat networks prior to purchasing a property. This is largely due to the reasons outlined in our response to question 1 above namely:

- the failure of some property developers to sufficiently pass on information on heat networks to their prospective customers and,
- a general lack of customer awareness of heat networks.

In addition, we believe that the information(on heat networks) currently out in the public domain is of variable quality and standard. This further impacts the ability of customers to adequately assess and act upon information prior to purchasing or renting a property.

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

Response Q 3: From an ENGIE perspective, we believe that information on the costs of heat networks is made clear in bills.

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

Response Q 4: Yes, these are as follows:

- In instances where the heat supplier only provides bulk supplies to a third party (such as a housing association or Local Authority) for onward sale to the final customer, we believe that the CMA's approach should allow for data collection from the third party supplier. This would help ensure that the CMA gathers more comprehensive data on aspects such as heat pricing and billing which the bulk heat supplier has no access to.

- We believe that the CMA should seek to gather data from key stakeholders such as property developers as this could help provide more information and answers to important questions such as the extent to which customers are able to assess and act upon information regarding heat networks prior to choosing and purchasing a property.

Question 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?

Response Q 5: Whilst we agree that there is a need to ensure greater transparency around the metering and billing of heat, we do not necessarily agree with CMA's proposed remedy to develop an additional regulatory regime in this area by extending existing gas and energy regulations to the heat sector. We believe that a regulatory regime is potentially already in place through the provisions of the Heat Metering and Billing Regulations2014 which state that:

"the heat supplier must ensure that bills and billing information for
the consumption of heating, cooling or hot water by a final customer are—
(a) accurate;
(b) based on actual consumption;

(c)and that the heat supplier must provide a clear explanation of the information contained in a bill, including how the bill was calculated and specifying fixed and variable charges[2]"

We do however agree with the CMA's proposed remedy in relation to addressing pre-transaction transparency including the requirement that property developers provide all the pre-transaction information necessary for consumers to understand the existence of a heat network and the ongoing cost and duration of the contract.

Theme 2: Monopoly supply

Question1.
Do heat networks exhibit natural monopoly characteristics (high fixed costs; economies of scale; barriers to further local entry to compete for existing customers)?

Response Q 1: Most heat networks exhibit natural monopoly characteristics due to their high fixed costs which make it economically inefficient for there to be more than one heat network within a given area or for alternative forms of heating to be provided.

Question 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?

Response Q 2: Customers are often unable to switch from their current heat network providers to alternative heat network operators or heat sources due to technological and contractual barriers such as:

- the costs of installing alternative heating sources,,
- the lack of proximity to the gas grid which could offer an alternative source of heating,
- commercial arrangements relating to the recovery of capital investments.

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

Response Q 3: The diverse commercial and financial incentives at the different points in the value chain can have a significant impact on the decisions taken by the different stakeholders along the value chain and on consumer costs.

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

Response Q 4: Yes. We believe that any proposal to collect, analyse and compare the cost data associated with the different heating technologies and fuels should be done on a like for like basis and should include the whole lifecycle and avoided costs associated with each of the heating technologies under consideration.

Question 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?

[2] Heat Network (Metering & Billing) Regulations 2014. Section 9, paragraph 7 (Billing). Available: http://www.legislation.gov.uk/uksi/2014/3120/pdfs/uksi_20143120_en.pdf

Response Q 5: Whilst we understand the broader principles and reasons behind some of the CMA's proposed remedies, we believe that it will be important to consider the likely impact of these measures on the development of heat networks and on investor confidence.

Theme 3: Outcomes

Question1.
Are heat network prices reasonable, and is quality of service and reliability adequate, when compared with alternative heat sources and/or operating costs?

Response Q 1: From an ENGIE perspective, we believe that residential heat network prices are reasonable when compared to alternative heat sources taking whole life costs into consideration. In addition, we believe that the quality of service and reliability is adequate and compares well with alternative heat sources.

This view is supported by a recent BEIS Heat network Consumer Survey[3] which reported that heat network consumers paid on average around £100 less for their heating compared to non-heat network consumers. This provides evidence that heat networks can offer a competitive alternative heat source.

With regard to reliability and quality of service, the same survey reported that the level of satisfaction for consumers on heat networks was similar to that of non- heat network consumers with 75% of consumers reporting that they were either 'satisfied' or 'very satisfied' with their heat network. Heat network operators often have engineers available locally to attend to customer issues and emergencies unlike other utilities. This ensures greater reliability for customers.

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

Response Q 2: Yes, these are as follows:

- Firstly, that any representative sample (of schemes) taken for analysis should reflect the different delivery models and be representative of all the commercial solutions on the market -particularly as such variables are key determinants of the final heat tariff paid by the consumer.

- Secondly, that any comparison of the cost data associated with each of the different heating technologies and fuels should be done on a like for like basis and should include the whole lifecycle and avoided costs associated with each of the technologies under consideration.

- Thirdly, that any efficiency assumptions in relation to an alternative heating technology should be made on an actual whole life basis and not on the basis of nameplate efficiency.

Question 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?

Response Q 3: With regard to the CMA's proposed remedies to improve outcomes for consumers, we believe that:

- The proposal to introduce rules around how heat prices are set should take into account the mechanisms by which heat prices change and are adjusted over time. ENGIE advocates a balanced indexation portfolio, reflecting changes in the counterfactual. This approach offers a

[3] BEIS Heat Networks Consumer Survey- December 2017. Available at:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/665444/HNCS_Executive_Summary_-_FINAL.pdf

non-discretionary price adjustment mechanism and ensures that any cost savings are passed onto consumers.

- The CMA will need to consider the likely impact of some of its proposals on non -domestic consumers within district heating schemes as schemes often have mixed use customers. This is important as the proposals may result in unintended consequences for commercial customers within the same scheme.

- Some of the CMA's proposals, such as those around introducing rules on how heat prices are set may discourage and impede future private sector investors.

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