Heat Trust's response to the CMA heat networks market study

January 2018

Introduction

Heat Trust is pleased to respond to the Competition and Markets Authority's Statement of Scope for its heat networks market study.

We welcome the market study and support the scope of the study as set out. A number of the key issues set out in the Statement of Scope reflect the issues identified in our first annual report[1].

Heat Trust is a not-for-profit, stakeholder-led customer protection scheme for the heat network sector. Our vision is that all heat network customers have access to dependable heat supplies and excellent customer service. Heat Trust delivers heat network customer protection by:

- applying robust customer service standards to heat suppliers;
- providing access to an independent dispute resolution service; and
- promoting best practice, continuous improvement, and innovation in customer service.

The Heat Trust Scheme was developed through a collaborative process between the heat network industry, government and consumer stakeholders. Both BEIS (then DECC) and the Scottish Government participated on the Steering Committee which developed Heat Trust Scheme Rules and remain part of the Stakeholder Committee.

It is the Stakeholder Committee's role to review and service standards set out in our Scheme Rules[2] document and propose updates and amendments. This means that the Scheme Rules will change to reflect developments in the market and drive forward better standards in Heat Trust registered networks.

Importantly, we use independent panels and organisations to assess a heat network's compliance:

- The Energy Ombudsman provides the independent dispute handling service;
- Each heat network will be required to undergo an independent audit at least once every five years. Audits will be conducted by independent auditors ; and
- Where disciplinary action is required, separate independent non-compliance and appeal panels will be used.

Customer satisfaction must be at the heart of plans to grow the heat network sector. In a market where customers cannot actively chose their heat supplier, heat network operators should adopt consistent and measurable industry-wide standards on technical performance, customer service and customer protection.

[1] http://heattrust.org/index.php/annual-reports
[2] http://heattrust.org/index.php/the-scheme-rules

We believe that all heat networks should be required to meet the standards set by Heat Trust and this should be a requirement for heat networks in receipt of public funding. We would welcome further engagement with the CMA on the role Heat Trust can provide in raising standards in the heat network sector.

Before setting out responses to the specific questions to the Statement of Scope, we have included an update on Heat Trust since its launch in 2015.

Heat Trust's progress to date

Heat Trust is having a positive impact on the market. The BEIS consumer survey[3] evidences this, finding that customers receive more comprehensive information about their heat network compared to heat networks that are not registered with Heat Trust.

For the first time, customers have access to an Ombudsman. Seventy-three customers made use of the Energy Ombudsman service in our first year. Our annual report published performance data on heat networks registered with Heat Trust and details on complaint types and resolutions.

In 2017, Heat Trust launched a publically available Heat Cost Calculator, with the aim of helping to improve access to annual heat cost information to consumers. We are now looking to develop the Heat Cost Calculator further (please see our responses to Theme 3).

Since its launch in 2015, Heat Trust has grown to cover over 33,000 domestic and micro-business customers across 51 heat networks nationwide. The six largest ESCO providers have registered heat networks with Heat Trust with new applications from three new ESCOs suppliers under assessment.

We are now consulting on expanding our coverage to heat networks which do not have a heat supply agreement in place. These are more likely to be local authority and housing association heat networks which tend not to use heat supply agreements. Increasingly, Heat Trust is being specified as a requirement in new heat network contracts and tenders. In response, we are developing plans to support heat networks still in the construction phase to be Heat Trust ready and registered from the operational 'go live' date.

We are encouraged with the progress of the scheme in the short time since it was launched. The developments in-train will increase the reach and value that Heat Trust can provide. We would welcome further engagement with the CMA to build on Heat Trust and support the adoption of the standards set by Heat Trust, across the heat network sector.

Answers to specific questions

Theme 1: Transparency

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

In October 2017, Heat Trust published its first annual report. Three overarching themes emerged from customer complaints and feedback received over the first year of Heat Trust. These were:

[3] https://www.gov.uk/government/publications/heat-networks-consumer-survey-consumer-experiences-on-heat-networks-and-other-heating-systems

clear customer communications, transparency of heat charges and an industry wide performance framework.

The customer communications theme focused on the need for all customers to be provided with clear information about a heat network prior to moving into a property. This should include an example heat supply agreement, the proposed tariff and a customer information pack. It is encouraging that the BEIS survey found that customers served by heat networks registered with Heat Trust, were more likely to receive information about their heat network compared to non-Heat Trust registered sites.

We are encouraged by the BEIS survey results, but customer feedback has indicated that information about a heat network is not consistently provided to prospective buyers or tenants in advance. Our annual report indentified a particular gap in the private rented sector, where by private tenants are not informed by the letting agent or the landlord (property owner) that the property is served by a heat networks and what this means in terms of service provision. This has implications on the apportionment of costs – please see our answer to question three below.

We recommended in our annual report that a consistent approach to informing customers needs to be developed, including a means of evidencing that a customer had been provided with the information in advance. Options to consider could include a signed declaration that the buyer understands that the property is on a heat network and they have seen and understood the heat supply agreement and indicative annual costs. Further consideration is needed for heat networks where heat supply agreements are not provided.

As well as investigating the type of pre-transaction information available in the market, it would be helpful for the CMA to consider where responsibility for ensuring information is provided should lie.

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

As mentioned above, there does not appear to be a consistent approach to ensure consumers are provided with sufficient information prior to purchasing a property. In our annual report, we recommended developers with suppliers, estate and letting agents should adopt a consistent approach in how potential buyers can access information on heat networks, including estimated costs.

The Statement of Scope notes that even when prices are transparent, the extent to which it influences a consumer's decision is likely to vary. Using focus groups to assess the motivations that influence a consumer's decision to purchase a property would be helpful to understand.

There is an additional issue with Energy Performance Certificates (EPCs). As identified in our annual report, EPCs do not include repair and maintenance costs. It would be helpful if EPCs for properties on a heat networks include an explanation that additional costs, which may form part of a standing charge, are not captured by EPCs. More broadly, the input data used by the Standard Assessment Procedure (SAP) on heat networks to prepare EPCs, would benefit from a review to ensure it is market representative.

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

The BEIS consumer survey found that customers on heat networks registered with Heat Trust received more comprehensive billing information compared to non-Heat Trust registered heat networks.

Heat Trust requires registered heat networks to be compliant with the Heat Network (Metering and Billing) Regulations 2014. This includes the provision of a separate heat bill (or annual statement for prepayment meters) which sets out the fixed and variable charge and specific billing information as required by Schedule 2 of the Regulations.

The Heat Network (Metering and Billing) Regulations should help drive forward better transparency in the market. However, the majority complaints received by the Energy Ombudsman were related to billing, specifically standing charges and clarity around the costs recovered from standing charges. This indicates that further steps maybe required to improved transparency.

Options to consider and investigate further could include: setting out how costs are apportioned between the variable and fixed components of a heat bill, publishing tariffs, requiring a standardised format that bills should take, the inclusion of graphics to help breakdown heat charges and consumption pictorially and including a link to the Heat Cost Calculator, so that customers can compare against an alternative heating technology.

Further research is needed to determine whether the new Heat Network (Metering and Billing) Regulations are being correctly implemented. For example, there are heat networks where the heat charge forms part of a consumer's rent or service charge. It is not clear if a consistent approach is used to ensure a consumer is:

- made aware that their heat charge is included in their rent or service charge;
- provided a breakdown of what proportion of their rent / service charge is for heat and hot water;
- details on how charges are set, with fixed and variable charges separated out; and
- payment options for customers experiencing difficulty paying their heat charge.

We would encourage the CMA to consider the private rented sector. In our annual report we highlighted that guidance is needed regarding a private landlord's responsibility towards repair costs on heat networks. In England and Wales, under the Landlord and Tenant Act, certain repair costs are the responsibility of the landlord under section 11 of the Act. The legislation is clear that this is a responsibility for social landlords, but is ambiguous on private landlords. Clarity is needed to ensure a consistent approach across the market.

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

Following findings from our annual report, we would encourage the CMA to look at the transparency of standing charges.

As part of gathering pre-sale information provided to customers, it would be helpful to understand whether a sample heat supply agreements are provided in advance. Where heat supply agreements are not provided, it would be helpful to understand what information is provided to inform the customer that a heat network is present and the indicative costs.

With focus groups, it will be important to get feedback from both owner occupiers and those that rent from a private landlord or social landlord.

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?***

With regards to pre-transaction information, a requirement to ensure that this is provided by the developer would support the recommendation in our annual report. We believe a consistent approach should be adopted across the market. It will be important to be clear on how developers evidence that the required information was provided pre-transaction.

On billing transparency, we would encourage building on the existing Heat Network Metering and Billing Regulations, ensuring that they are being implemented and enforced.

Consideration should be given to stipulating what costs can be recovered from the fixed charge (standing charge) and requiring all heat suppliers to publish heat tariffs. Coupled with enforcement of the existing metering and billing regulations, this would be a significant step forward in providing more transparency in the market.

Last year the Association for Decentralised Energy (ADE) established a Heat Network Taskforce[4] which has looked at whether additional regulatory action is needed on heat charges. The taskforce, which Heat Trust has participated in, will publish its emerging findings on 31st January.

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)?

Yes. Heat networks are high capital cost infrastructure projects. As the Statement of Scope acknowledges, a key risk when designing heat networks is securing heat demand. This is a risk that is being examined by the ADE Heat Network Taskforce.

The ADE Heat Networks Taskforce has also considered what additional steps are required on top of Heat Trust to ensure consumers are adequately protected. As part of this work, the taskforce has discussed how competition for services could be introduced. For example, while the distribution pipework and generation assets may be owned by one company, the customer service elements could be competitively tendered for on a rolling basis, ensuring poorly performing suppliers can be replaced.

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?

With long-term contracts associated with heat networks, customers cannot generally switch. We understand that some heat networks allow customers to disconnect, but there is no industry consistency on whether the customer is required to continue to pay the standing charge.

[4] https://www.theade.co.uk/news/ade-news/industry-launches-new-district-heating-task-force-welcomed-by-governme

If a customer disconnected from a heat network, the likely alternative would be electric heating, particularly for high-rise developments where there are restrictions on how high gas-flues can be installed.

We welcome the CMA's consideration on the options and impacts for disconnection. For example, should a large proportion of customers disconnect and move to electric heating, the impact on the local electricity network would need to be considered, in addition to any further building / health and safety refurbishment that may be required for electric heating. There would also be an impact on the reduced heat demand for the heat network, and potential cost increases for customers that remained connected to the heat network.

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

The heat network sector is diverse, with a variety of different schemes run by different types of operators, from local authorities and housing associations to energy service companies and private housing developers.

The table below sets out three examples in how the structure of heat networks can vary. It does not include every type of permutation on different heat network set-ups, but provides a high-level overview. Please note that the freeholder of a development can be a local authority, housing association or private developer. It is also possible that a freeholder may hold a portfolio of developments with different types of heat network delivery structures, e.g. a concession model on one network and owner / operator model on another.

	Typical concession model	**Typical owner / operator model**	**Typical owner / operated model with in-house services**
Owner of heat network	Freeholder of development	Freeholder of development	Freeholder of development
Operator of heat network (the company that should have the heat supply agreement with the customer)	ESCo	Freeholder of development	Freeholder of development
Metering and Billing	ESCo	Outsourced	Freeholder of development
Operation and Maintenance	ESCo	Outsourced	Outsourced

Heat networks with different operating structures will have their own standards of service quality and reliability targets. The length of time a particular company is involved in a development can vary and it is possible that a freeholder may chose to sell a development on with next freeholder requiring different operating standards.

This gives rise to a lack of consistency in customer protection and technical standards across the heat network market. We agree that the CMA should investigate misaligned incentives such as where an organisation has no long-term interest in a heat network, there may be little incentive to ensure the needs of customers are prioritised.

We strongly believe that customer experience and satisfaction needs to be considered from the start and should be a key criterion in all contracts. There is a role for leadership here by ensuring

projects with public funding embed the needs of customers from the outset. A clear means of demonstrating this is by requiring heat networks to meet the service standards set by Heat Trust.

We also noted in our annual report that there is a need for industry-wide performance metrics that are adopted by all heat networks. We understand that ADE is developing a technical compliance scheme to address this gap.

Requiring all heat suppliers to meet mandatory standards ensures a level playing field and assures consumers a consistent level of service regardless of which heat network they are served by. This does not prevent heat suppliers from going above minimum standards to differentiate themselves within in the market.

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

We agree that a key part of analysis will be to understand the different types of cost structures. Given that different types of operating models, a key factor in ensuring the CMA can fully assess the market is to ensure cost data and costs structure are gathered from a range of different heat networks.

We would support the CMA assessing the practice of developer payments, the extent to which this happens and the impact on consumers.

We also think it will be important for the CMA to understand the requirements that different types of developers and project sponsors specify in tenders and contracts for heat networks.

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 welcome the CMA investigating competition for the market. As noted above, the ADE Heat Network Taskforce has discussed how competition can be introduced in parts of the heat market, specifically for the customer services elements of a heat network. Options to allow a customer to switch service providers should be investigated as part of this.

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 strongly agree that better transparency is required and welcome the CMA investigating pricing, cost structures and how tariffs are set.

Heat Trust does not have the legal authority to provide consumers with advice on pricing, contract length, end-user charging, or tariff structure.

To help increase access to information, Heat Trust has created its Heat Cost Calculator[5] which allows a customer to obtain an indication of what the annual heating and hot water costs could be for a similar sized property using a gas boiler. It is important to be clear that with so many different operating models and associated costs structures, the Heat Cost Calculator cannot provide a bespoke assessment.

[5] http://heattrust.org/index.php/test-the-comparato

The assumptions which are used in the Heat Cost Calculator as derived from public sources and published on the Heat Trust website[6]. The element that is not published in the gas unit rate which is postcode driven and provided by Energylinx.

Recognising that for a number of new build developments the alternative heating technology would be electricity, Heat Trust is now looking to expand the Heat Cost Calculator to allow a comparison with electric heating. We believe that this will increase the value of the Heat Cost Calculator, providing consumers with the option to compare against the most appropriate heating alternative to their situation.

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

We agree with the proposed approach to data collection. It will be important to look at costs from as many different types of suppliers as possible (local authorities, housing associations, ESCOs and private developers) and to see whether the structure of how the scheme was financed affect tariffs structures

Heat Trust would be happy to discuss the development of the Heat Cost Calculator in further detail if helpful. We believe that as we develop the Heat Cost Calculator, it can be a useful and pro-competitive customer tool.

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?

The Statement of Scope acknowledged that the potential remedies are challenging given the wide variety of heat networks and number of heat suppliers. The CMA is right to identify potential remedies in this area. Should price control be considered, we agree this would be best focused on the natural monopoly elements of a heat network.

As noted throughout this response, there is a need for standardisation in the heat network market. In addition to the remedies identified in the Statement of Scope, the CMA could consider whether heat tariffs would benefit from a standard structure and stipulating which costs can be recouped through the fixed element of a heat charge. In addition, we would support a requirement for all heat suppliers to be required to publish their tariffs. Our view is that this would be in the best interest of the consumer and pro-competitive for the market.

[6] http://heattrust.org/index.php/assumptions-data