



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

May 2018

Introduction

Heat Trust is pleased to respond to the Competition and Markets Authority's (CMA) Interim Report to its heat networks market study.

We welcome the interim report and are pleased that the report has considered the work of Heat Trust and findings from our first annual report¹. We are also pleased and encouraged to see the CMA take account of Heat Trust as part of a future regulatory framework.

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

Since 2015, Heat Trust has been working to improve service standards for customers served by heat networks by:

- applying robust customer service standards to heat suppliers;
- providing access to the Energy Ombudsman; and
- promoting best practice, continuous improvement, and innovation in customer service.

In recognition of the expected market growth in heat networks, we welcome the CMA's recommendation to government to introduce a regulatory framework. We are keen to engage further with the CMA, BEIS and others on how Heat Trust can be utilised within a regulatory framework as a route to demonstrate compliance that is compatible with a licencing and authorisation regime.

Indeed a number of the recommendations in the interim report point to work that Heat Trust has undertaken or is underway. Heat Trust provides a scalable framework and we are keen to share our experience and learning, and where we see support is most needed to equip and prepare the market to make the transition to regulation.

¹ <http://heattrust.org/index.php/annual-reports>

Recognising that it will take legislative time to design and implement a regulatory framework we support the call in the interim report that, as a requirement for public funding and planning consent, heat networks should be required to meet standards set by Heat Trust.

Response to consultation themes

Assessment of the issues

The report has taken a wide-reaching review of the heat network market. We welcome the proposed high-level recommendations which provide a good forward trajectory for the sector.

Further detailed consideration is now needed on what form a robust and proportionate regulatory framework for the sector would entail. We are pleased that the report notes the work of Heat Trust.

Since 2015, Heat Trust has operated a recognised Code of Conduct scheme. In developing the scheme, Heat Trust has specifically looked at the standards set in the gas and electricity market to ensure that standards set by Heat Trust are comparable, as far as possible, to those that other energy consumers receive.

This includes access to the Energy Ombudsman, guaranteed service payments, restrictions on back-billing where the supplier is at fault, and support for vulnerable customers, including holding a priority services register.

We are keen to engage further with the CMA, BEIS and others on how Heat Trust can be utilised within a regulatory framework as a route to demonstrate compliance.

Benchmarks

As the report notes, there is large variation in how heat networks are structured and managed. It is inherently difficult to create a benchmark that is able to cater for all scheme types. No comparator is able to provide a true counterfactual.

To help increase access to information, Heat Trust has created its Heat Cost Calculator² 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 as comparison.

The report notes that 85% of customers used main gas for their heating needs. From a customer perspective, it is more likely that a customer living in, or moving into, a property served by a heat network will have lived in gas-connected property previously. Their experience of heating and hot water, including the costs incurred are more likely, therefore, to be based on their experience of a gas boiler.

² <http://heattrust.org/index.php/test-the-comparato>

For new-build homes, particularly high-rise developments, the most likely alternative would be electric heating. Heat Trust is looking to expand the Heat Cost Calculator to allow a comparison with electric heating. It is worth highlighting that there is a range of different electric heating technologies. For example, the type of electric heating could range from direct panel heaters, storage heaters and heat pumps. The suitability of one electric heating technology over another would be challenging for a high-level tool to account for.

Operating models

The report focuses on two broad categories of ESCO operated, and landlord operated, models. The report appears to view ESCOs as entities primarily owned and managed by private energy company.

Local authority, housing associations and private developers can all set up a separate ESCO company to run a heat network on a development on which they are the freeholder or have a stake in the freehold. In this respect, it is not always correct to assume that all local authority or housing association heat networks are operated on a not-for-profit basis.

There are ESCOs that are owned by local authorities and housing associations operating in the market that are profit making. This type of model may grow as these organisations increasingly take on the role of a utility provider. Tenure adds a further complexity as the party that is responsible for repair and maintenance costs associated with a heat network varies according to tenure (owner occupier, leaseholder, private renter or social renter).

When considering a regulatory framework, it will be important that responsibilities between different parties involved in the on-going management of heat networks are clearly set out, so that customers are not adversely impacted with poor service as a result of poorly defined contractual responsibilities.

Recommendations

1. Regulation of heat networks

With expected growth in the market that could see heat networks serving up to 8million customers, we support and welcome the recommendation to introduce a statutory regulatory framework.

All customers, regardless of what type of heat network or the type of operator managing the heat network, should be afforded the same protections as other gas and electricity customers in the market. The principle that a customer is no worse off should be a starting point.

With support from BEIS, Heat Trust has already established a recognised Code of Conduct scheme that sets consistent customer service standards, designed to be comparable to those in the rest of the energy market, and provides access to the independent Energy Ombudsman.

The interim report acknowledges that the heat network sector is diverse in terms of the scale of individual heat networks, the type of heat network operators and operating structures. This creates a challenge in delivering a regulatory framework that can work for all heat networks and deliver robust consumer protections.

A future regulatory framework will need to be flexible and able to adapt to a growing and maturing sector. This is important as a significant proportion of market participants as within the heat network sector will have little experience of what is required by being a regulated utility provider delivering an essential service – heating and hot water.

From our experience of operating Heat Trust, consideration needs to be given on what standards are deemed to be proportionate and achievable across the market, including small suppliers where resource and capabilities may be more limited. This is something that Heat Trust has already started to develop thinking on and we would be pleased to share our initial thoughts with the CMA.

The interim report notes different approaches to regulation that could be used for heat networks, such as a licencing regime, or authorisation regime which is overseen by a regulator. Heat Trust is compatible with both of these approaches and can be utilised as an effective means of demonstrating compliance. For example, to operate in the market under an authorisation regime, heat suppliers would be required to register with Heat Trust and meet minimum technical compliance standards. We would envisage that reporting requirement would be agreed with a regulator alongside reporting requirements for technical performance.

A number of the recommendations that the interim report envisages as part of a regulatory framework are already in place within Heat Trust:

- We provide access to the Energy Ombudsman;
- We require pre-transaction information to be made available to customers;
- We require heat supply agreements to be in place³ ;
- We require a priority services register and vulnerable customer strategy to be place; and
- We have standards on back billing and guaranteed service payments.

Considerable effort has already been invested in the creation of Heat Trust. We would strongly encourage future discussions to build on the work that Heat Trust has started, especially given that there are clear opportunities to utilise Heat Trust as part of regulatory regime.

Recognising that it will take legislative time to design and implement a regulatory framework we support the call in the interim report that, as a requirement for public funding and planning consent, heat networks should be required to meet standards set by Heat Trust.

³ We recently closed a consultation seeking views on admitting heat networks that do not use a heat supply agreement

Pricing

The report highlights the difficulty in price regulation for nearly 17,000 heat networks which could all have very different cost structures. Following its assessment and evidence gathered, the conclusion to use a principle based approach with the ability to review, seems sensible. Clarity on how rules will be set and guidance on compliance with the rules will be important to ensure consistency across the market.

2. Planning and technical standards

The planning regime

The interim report examined how misaligned incentives could result in poor outcomes for customers. We agree with the interim report's findings that customer experience and satisfaction should be considered from the start of a designing a development.

The planning regime and supplementary planning guidance offers an opportunity to ensure new and retrofit heat networks meet industry standards on customer service, and technical performance, by linking them to planning consent. It also gives a clear signal to the market that due consideration must be given to the long-term needs of customers and system reliability from the outset. Applicants should be required to evidence as part of the planning approval process how their schemes will deliver customer protection and deliver reliable heating supplies.

Stipulating industry-wide standards ensures consistency across the market, and avoids standards varying between planning authorities. In turn, customers can be assured that a heat network has been required to demonstrate that it will meet recognised industry standards on service and performance as part of planning approval.

Technical standards

Heat Trust sets standards focused on customer service. For a proportion of customer complaints, customer satisfaction is affected due to poor technical performance. We are, therefore, fully supportive of technical standards being developed to improve the efficiency and performance of heat networks.

The ADE / CIBSE Code of Practice provides guidance on how to design and build schemes. The next step is on-going monitoring by setting industry-wide performance metrics. The ADE is developing a heat network technical compliance scheme to address this gap.

Similarly to requiring a heat network to meet customer service standards set by Heat Trust, we envisage that in order to be eligible to operate in the market, a heat network would also be required to meet the Code of Practice, and register with a technical compliance scheme. Reporting would be shared with the regulator that would have the ability to enforce against non-compliance and poor performance.

3. Pre- transaction transparency

Awareness and understanding of heat network pre-transaction

Further information is required to improve consumer understanding of the significance of living in a home with a heat network. Findings from our annual report show that not all customers are consistently provided with clear information about a heat network prior to moving into a property.

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. This is because Heat Trust requires heat suppliers to make their customer information pack available to customers, which includes information on what is a heat network, a sample heat supply agreement, and details on the proposed tariff.

We also recommended in our annual report that a consistent approach to informing customers that a property is on a heat network needs to be developed; this often falls to sales and letting agents who are separate from the heat operator. An area Heat Trust is keen to explore further is linking with other relevant industry Code of Conducts, such as the Consumer Code for New Homes which is a conduct scheme for the marketing and selling of new homes.

Heat supply agreements

It is standard practice in the utility sector to set out terms and conditions in a contract.

Heat networks registered with Heat Trust are required to have a contract - which Heat Trust refers to as a Heat Energy Supply Agreement - in place with each customer served by a heat network. We believe all heat network customers should be provided with a Heat Energy Supply Agreement, and this should be standard practice for all new heat networks going forward.

Heat Energy Supply Agreements are one way of presenting clear terms and conditions. For a significant proportion of existing heat networks separate Heat Energy Supply Agreements are not used. The provision of heating and hot water is more often captured as a clause(s) within the tenancy or leasehold agreement.

Additional information on the standards of service which would form part of a Heat Energy Supply Agreement does not typically form part of a tenancy or leasehold agreement. In these circumstances where developing a new contract could be prohibitive, clear terms of service could be provided in a separate customer charter. Heat Trust recently issued a consultation seeking views on opening Heat Trust to heat networks that do not use Heat Energy Supply Agreements, provided terms of service are set out in a customer charter. This would be for existing heat networks only. The expectation is that the market should be adopting heat supply agreements going forward.

One point to note is that we expect industry service standards to change overtime. For example, the standards set by Heat Trust will develop over time and we expect to set higher standards as

the market evolves. It may be more sensible for contracts to refer to the standard that the heat operator commits to meeting, but exact details to be set out in an accompanying service standards document. This document can then be revised to reflect standards set by industry codes of conduct / practice.

Energy performance certificates (EPCs)

Energy Performance Certificates (EPCs) do not include repair and maintenance costs associated with heat networks. To improve transparency, it would be helpful if EPCs for properties on a heat network included an explanation that additional costs, which may form part of a standing charge or separate service 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. For example, the standing charge for heat networks currently used by SAP is exactly the same as the standing charge used for properties with individual gas boilers.

4. Transparency during residency

Improving billing information

The Heat Network (Metering and Billing) Regulations should help drive forward better transparency in the market. However, the majority of 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 may be required to improved transparency of bills and information provided.

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.

For landlord operated schemes, a heat network may not be captured as part of a single heat bill. A proportion of costs associated with a heat network may be recovered through separate service charge and or rent bills. For these customers, it will be important to be transparent that costs are recovered in multiple bills and what share of each bill in relation to heat network costs.

We would encourage the CMA to consider transparency of costs in 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.

Performance metrics

Yes, we agree that industry wide performance metrics should be produced and we understand this will form part of the forthcoming ADE Heat Network Technical Compliance Scheme.

Heat networks that register with Heat Trust are required to report back the total volume of planned and unplanned outages and faults. Heat Trust already publishes this data in its annual reports. Heat Trust is already engaging with the ADE on its technical compliance scheme and we envisage that the monitoring that both schemes undertake will be complementary.

Setting industry-wide performance metrics will ensure heat suppliers are all collecting the same types of data allowing for performance between schemes to be assessed. It will also help to identify whether there are strategic issues affecting heat network performance that industry need to address collectively.

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