



Department for  
Business, Energy  
& Industrial Strategy

# Heat Networks: Cost recovery proposals

Government Response

June 2022



© Crown copyright 2022

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit [nationalarchives.gov.uk/doc/open-government-licence/version/3](https://nationalarchives.gov.uk/doc/open-government-licence/version/3) or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: [psi@nationalarchives.gsi.gov.uk](mailto:psi@nationalarchives.gsi.gov.uk).

Where we have identified any third-party copyright information you will need to obtain permission from the copyright holders concerned.

Any enquiries regarding this publication should be sent to us at: [heatnetworks@beis.gov.uk](mailto:heatnetworks@beis.gov.uk)

---

# Contents

General Information	3
Introduction	4
Background	4
Cost recovery consultation response	5
Consultation questions analysis	6
Question 1	6
Question 2	8
Question 3	9
Question 4	10
Next Steps	12

## General Information

This document sets out the Government’s response to the [Recovering the costs of heat network regulation](#) consultation, which was published on 29 December 2021 and closed on 16 February 2022. It provides a summary of the responses to each question in the consultation and a brief overview of government’s intention following the consultation.

We received 25 responses to the consultation. A diverse range of stakeholders provided their views, with respondents consisting of representatives from local authorities, trade associations, energy service companies (ESCOs), energy network companies, consultancies, consumer advocacy organisations, small, medium and large businesses and individuals, among others.

### Contact details

For questions related to policy decisions or this document please contact: [heatnetworks@beis.gov.uk](mailto:heatnetworks@beis.gov.uk)

---

# Introduction

Heat networks play an important role in decarbonising heat and support delivery of our net zero commitments. They are uniquely able to unlock otherwise inaccessible large-scale renewable and recovered heat sources such as waste heat and heat from rivers and mines.

In our consultation [Heat Networks: Building A Market Framework](#) we outlined how there are currently no sector specific protections for heat network consumers, unlike for consumers of other utilities such as gas, electricity, and water. Regulation would increase consumer protections, for instance via improved technological and reliability standards as well as price regulation.

Funding for a regulator must be recovered in a sustainable and fair manner. In December 2021, we [published](#) proposals for how heat network regulation costs could be recovered. This consultation response document summarises the responses we received to those proposals and gives an overview of government's next steps for implementing the cost recovery regime.

We are committed to regulating this sector within this parliament, for the benefit of consumers, investors, and the wider economy and environment. This follows recommendations by independent experts, such as the Competition and Markets Authority and the Climate Change Committee, as well as calls by industry bodies and consumer advocacy groups.

In December 2021 we announced that Ofgem will take on the role of regulator for heat networks which will give it new powers to regulate standards and prices in this sector as a matter of priority. This will raise protections for heat network consumers as well as ensuring heat network operators are securing good purchasing deals for their consumers. In summary, we need heat network consumers to receive a fair price and a reliable supply of heating and hot water whilst ensuring future market growth.

## Background

There are currently over 14,000 heat networks in the UK, providing heating and hot water to approximately 480,000 consumers. Around 2% of UK heat demand is provided by heat networks and the Climate Change Committee estimates that with government support this could rise to 18% by 2050.

There is significant potential for the number and scale of heat networks to increase dramatically. We estimate that up to £16 billion of capital investment could be needed for heat networks to deliver their full contribution to net zero. There is a growing heat network market in this country on which to build. Market growth is already supported by strong government commitments through our Heat Networks Investment Project (HNIP) of up to £320m and the work of the Heat Networks

---

Delivery Unit (HNDU) supporting local authorities and project developers in the early phases of scheme development. In addition, in the Heat and Buildings Strategy we announced that we will be investing £338 million over 2022/23 to 2024/25 into a broader Heat Network Transformation Programme to scale up low-carbon heat network deployment and to enable local areas to deploy heat network zoning, which will create a step-change in low-carbon heat network market growth. This includes funding for the [Green Heat Network Fund \(GHNF\)](#) which launched in March 2022 and which aims to stimulate the growth of low-carbon heat networks by supporting low-carbon thermal generation.

Reaching the required growth rate for net-zero will also require ambitious policy action. The December 2020 Energy White Paper committed to introducing heat network zoning by 2025 at the latest. We have worked and will continue to work with local government, industry, experts, and other stakeholders to establish a heat network zoning approach that is consistent with wider government policy on local government and heat decarbonisation. Our proposals for heat network zoning can be found [here](#). In addition, the Government's commitment to low-carbon heating in new homes, as provided in the Future Homes Standard, and commitment to low carbon heating in new non-domestic buildings, as set out in the recent Future Buildings Standard consultation, creates a further significant opportunity for faster roll-out of low-carbon heat networks. To ensure this expansion is built on sound foundations, we need to make sure that the market is supported by minimum regulations on consumer protections, technical standards, and regulatory requirements on decarbonisation.

## Cost recovery consultation response

In our original consultation we estimated that the total annual cost of regulating the heat network market will be approximately £6.5m per year.<sup>1</sup> If these costs solely fell on heat networks, then assuming costs would then be recovered through heating bills, it would lead to an additional £10 or more per heat network consumer bill per year. An additional £10 or more to each heat network consumer bill per year would create risks to the competitiveness of the market, create issues of affordability for heat network consumers and have impacts on suppliers.

We therefore [consulted](#) on a proposal for Ofgem's and Citizens Advice's total ongoing costs of regulating and performing consumer advocacy functions in the heat networks, gas, and electricity markets being spread evenly across heat network, gas, and electricity consumers. We estimate that this approach would result in heat network, gas and electricity consumers paying £1.40 per year towards the costs of heat network, gas, and electricity regulation. This amounts to an additional £0.10 per gas and electricity consumer per year compared to what they currently pay for Ofgem's gas and electricity regulation and Citizens Advice's consumer advocacy

---

<sup>1</sup> Average over the 10-year appraisal period.

---

functions. If applied to our estimate of the average gas bill, this represents a 0.02% increase.<sup>2</sup>

We received 25 responses from various industry stakeholders and consumer groups from the heat network and wider energy sectors, with 84% of respondents agreeing with our proposed approach. Nearly 70% of respondents agreed that our proposal would ensure that the costs of regulation are affordable for heat network consumers and businesses. This document summarises responses to the consultation in more detail.

## Consultation questions analysis

### Question 1

**Question 1: Do you agree with the approach of introducing a cost recovery regime which ensures that Ofgem and Citizens Advice’s total ongoing costs of regulating the heat networks, gas and electricity markets are spread evenly across heat network, gas, and electricity consumers (Option C)?**

Question 1	Response	Percentage of responses
Agree	21	84%
Disagree	4	16%

*Table 1: Responses to Question 1.*

We received 25 responses to this question. Table 1 above shows that 84% of respondents agreed with the preferred approach (Option C). This majority of respondents agreed that this approach would ensure fairness in that heat network, gas, and electricity consumers would pay the same amount for the same levels of regulation. Respondents also cited the limited estimated increases of £0.10 to gas and electricity consumers and agreed that this option would mean that Ofgem does not have to implement a ringfenced heat network specific cost recovery regime, which would require set up costs and therefore increase the cost of regulation, as would be required for option B.

The 4 respondents who disagreed with option C were companies associated with the power sector and broadly supported the alternative option of the costs of heat networks regulation being spread across heat network and gas consumer bills (i.e. not electricity bills). Respondents justified this by saying that the costs of meeting our net-zero ambition should be levied on higher polluting fuel sources. Concerns were

---

<sup>2</sup> The 2020 QEP estimates that the average annual gas bill is £510 <https://www.gov.uk/government/statistical-data-sets/annual-domestic-energy-price-statistics>; Tables QEP 2.3.5 and 2.2.5.

also raised that government is looking to pursue Option C as it is easier to implement (policy cost) rather than the incentives it creates (policy benefits).

For ease of reference, the 4 options proposed in the consultation and the estimated impact on individual consumer bills are noted below.

**Option A (counterfactual):** Ofgem’s and Citizens Advice’s total ongoing costs of regulating the heat networks market spread across heat network consumer bills only.

**Option B:** Ofgem’s and Citizens Advice’s total ongoing costs of regulating the heat networks market to be spread across heat network and gas consumer bills (i.e. not electricity bills).

**Option C:** Ofgem’s and Citizens Advice’s total ongoing costs of regulating the heat networks, gas, and electricity markets to be spread evenly across heat network, gas, and electricity consumer bills.

**Option D:** Government part-funding heat networks regulation to bring the cost per heat network consumer down to an affordable level.

		<b>Options proposed in consultation (either market used for cost recovery or source of funding)</b>			
		<i>A) Heat networks</i>	<i>B) Heat networks &amp; Gas</i>	<i>C) Heat networks, Gas &amp; Electricity</i>	<i>D) Exchequer funding</i>
<b>Estimated impact on consumer bill by market</b>	<i>Heat network</i>	<b>£10.30</b> (+£10.30)	<b>£1.50</b> (+£1.50)	<b>£1.40</b> (+£1.40)	<b>£1.30</b> (+£1.30)
	<i>Gas</i>	<b>£1.30</b> (£0)	<b>£1.50</b> (+£0.20)	<b>£1.40</b> (+£0.10)	<b>£1.30</b> (+£0)
	<i>Electricity</i>	<b>£1.30</b> (£0)	<b>£1.30</b> (£0)	<b>£1.40</b> (+£0.10)	<b>£1.30</b> (+£0)

*Table 2: Estimated impact on consumer bills of each option considered. The numbers in bold show the estimated cost of regulation per consumer per year, with the numbers in bracket showing the level of increase from the status quo. Option C is the option we proposed in the consultation.*

### **Government Response – Question 1**

We were encouraged that a large majority of respondents to the consultation agreed with our proposal (option C) that the costs of regulating the heat network, domestic gas and domestic electricity markets should be spread equally across heat network, domestic gas and domestic electricity consumers.

Two respondents argued that the cost recovery of heat network regulation could be used as a carbon signal under the polluter pays principle. They argued for Option B. The Government is committed to cutting the cost for consumers who want to make improvements by ‘rebalancing’, in short shifting

away from fossil fuel usage towards electrification. A key aim of this would be enabling heat pumps to be cheaper to run over time than a gas-fired boiler. This will reduce consumer and the wider economy's exposure to volatile global commodity markets. We will publish our proposals on how to do so in 2022, considering overall system impacts and limiting the impact on bills, particularly for low-income consumers.

However, in the case of the forecast increases in electricity and gas bills as a result of Option C, we believe these are not significant enough to be used to rebalance fuel prices to be more sustainable. Further, to achieve this rebalancing, there would be a cost due to the higher administrative burden of option B compared with C, as the latter requires far smaller changes to Ofgem's existing cost recovery mechanism.

We will progress with Option C in forthcoming heat network legislation.

## Question 2

**Question 2: Having considered our estimates in the analytical annex (of the consultation), do you agree that our approach would ensure that the costs of regulation are affordable for heat network consumers and businesses?**

Question 2	Response	Percentage of responses
Agree	17	68%
Partial Agree	1	4%
Neither	2	8%
Disagree	2	8%
N/A	3	12%

*Table 3: Responses to Question 2.*

Table 2 above shows that the majority of respondents (68%) agreed that the preferred approach (option C) would provide an affordable cost of regulation to both heat network consumers and businesses. Some respondents felt that the cost of regulation should be weighted dependent on the size of the network, using the example of a one-bedroom flat paying the same amount towards regulation as a leisure centre. Respondents who disagreed reiterated arguments from Question 1 that costs should be incurred by the sectors that create them and other companies were concerned that costs would increase and that careful budgeting would be necessary.

Our response to this question is outlined below.



## Government Response – Question 2

The majority of respondents to this question agreed that the proposals would be affordable for consumers and businesses. This has reaffirmed our view that the proposal is an affordable approach for the heat network and wider energy sectors.

Government welcomes the support for these proposals and will proceed on the basis laid out in the consultation. We recognise that some respondents voiced concerns about inflating costs of regulation. However, Ofgem always works to achieve good value for money, with budgets agreed by HM Treasury. Ofgem's activities and spending are also subject to parliamentary scrutiny and can be investigated by the National Audit Office. In addition, as part of the development of regulation we intend to create a stakeholder scrutiny board which will be able to feedback directly to government and Ofgem with views on design, implementation, and cost effectiveness of the regulatory framework.

## Question 3

**Question 3: Do you agree that the regulatory fee which a heat network regulated entity paid should be based on the number of heat network consumers it supplies? Do you agree that this should be calculated and collected at the entity level?**

Question 3	Response	Percentage of responses
Agree	15	60%
Partially agree	3	12%
Neither	1	4%
Disagree	1	4%
N/A	5	20%

*Table 4: Responses to Question 3.*

Twenty stakeholders provided responses to this question, excluding those responding *N/A*.

Fifteen stakeholders, including 3 trade associations and one local authority agreed with the recommended approach. Seven of them pointed out that this consumer-based approach is aligned with the existing regimes for gas and electricity companies, while 3 further stakeholders pointed out it would reduce administrative costs. However, 6 stakeholders underlined the need to consider distinguishing between domestic and non-domestic consumers to avoid discrepancies in rates. One stakeholder specifically pointed out the caveat that the definition of 'consumer'

may vary between providers/operators/companies and needs to be fleshed out carefully.

The risk of disproportionate charges was also underlined by 4 stakeholders. Only one of these 4 explicitly disagreed with our approach, stating that the regulatory fee should be calculated on the basis of energy consumption rather than number of consumers connected to the heat network. This would mitigate both disproportionate charges between domestic and non-domestic consumers, whilst also ensuring the protection of disenfranchised domestic consumers who choose to use less energy in their households than other domestic consumers. The other 3 responses advocated for distinguishing between domestic, microbusiness and commercial users, with the need for the latter to face higher fees. Finally, one of these stakeholders suggested that it would be important to obtain more data that will allow deeper insight into the different consumer groups connected to every heat network, thus enabling the implementation of a more targeted and accurate calculation and collection methodology.

Our response to this question is outlined below.

### **Government Response – Question 3**

As described in the consultation, we envisage regulatory fees to be calculated and collected at an entity level. This is likely to happen based on number of consumers served by a heat network rather than number of heat networks operated by the authorised entity.

Given the mixed response to the idea of a de minimis threshold, we recognise that this will require further consideration and engagement with industry. We will work with Ofgem to continue assessing the merits and drawbacks of a threshold. For this purpose, we continue to consider the definition of the term ‘consumer’, as well as ways to efficiently obtain the necessary data to help us secure fuller understanding of the different consumer groups served by each heat network.

The responses to this question will help inform the direction of policy development in this area but we expect that more detailed consideration will be necessary in relation to the Licence fee cost recovery principles to be amended and consulted on by Ofgem.

### **Question 4**

**Question: Do you think we should introduce a de minimis threshold to reduce the administrative complexity of Ofgem collecting fees from heat networks, with the cost per consumer remaining affordable for entities which do have to pay?**

<b>Question 4</b>	<b>Response</b>	<b>Percentage of responses</b>
Agree	8	32%

Partially agree	3	12%
N/A	4	16%
Partially disagree	1	4%
Disagree	9	36%

*Table 4: Responses to Question 3.*

There were 21 replies to this question, excluding N/A responses, with a wide variety of viewpoints stated. There was widespread agreement that the system of charging needs to be fair yet also cost-effective, but respondents were split almost evenly on the best way to achieve this.

There were nuanced views expressed by some respondents that a threshold might not be appropriate for now because the market is currently made up of many smaller networks, but that it might become more appropriate as the sector consolidates.

Those who disagreed with the proposals thought that a de minimis threshold would increase costs for everyone else to unsustainable levels and also pointed to gas and electricity markets where there is no de minimis threshold. One respondent pointed out that the de minimis threshold could incentivise some schemes to stay small to avoid paying for regulation.

Those who supported the proposal thought that setting a de minimis threshold for very small networks would make the system more practical and reduce costs in the long run.

#### **Government Response – Question 4**

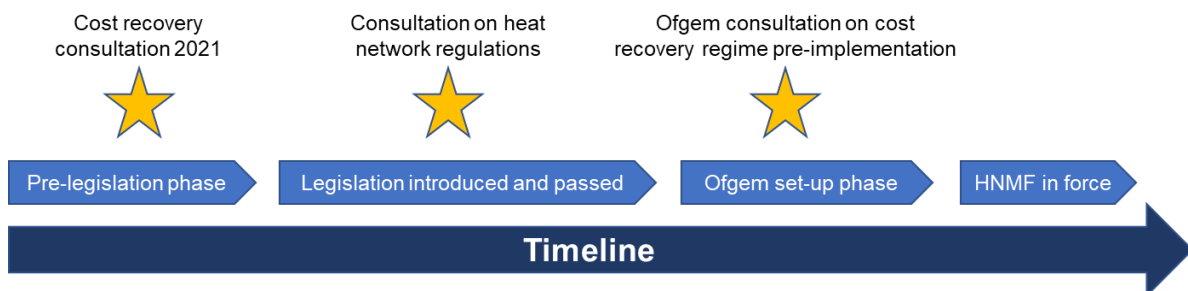
Given the mixed response to the idea of a de minimis threshold, we recognise that this will require further consideration and engagement with industry. We will work with Ofgem to continue assessing the merits and drawbacks of a threshold. Ofgem will explore methods which could standardise or simplify the regulatory fee payment process to reduce the administrative burden on Ofgem and minimise the number of outstanding payments from regulated entities. For example, further consideration is needed as to whether smaller heat networks are charged the same amount to introduce standardisation, following the precedent of the £500 flat fee for the smallest licensees in the gas and electricity markets. Alternative payments methods to reduce transaction costs could also be investigated. We can then assess whether such measures negate the need for a threshold. We will also work with Ofgem to estimate the cost of recovering regulatory fees. This will help us establish whether, for the smallest heat networks, the administrative cost of Ofgem collecting the fee is larger than the fee those networks would pay.

Although our approach requires further consideration, we can provide assurances that a threshold would only be introduced if the cost of regulation for larger heat networks and their consumers remained affordable. We will work

with Ofgem to produce modelling on how different thresholds would impact on the cost of regulation for the sector, as well as for gas and electricity consumers. There will be further opportunities for consultation on this issue.

## Next Steps

There will be opportunities for stakeholders to engage with more developed thinking on cost recovery in future, including when Ofgem consults on its cost recovery principles at the set-up phase (see Figure 1 below).



We will continue our engagement with stakeholders as we advance our policy and prepare to introduce legislation in this Parliament. As set out in the consultation document in February 2020, we anticipate that there may be grounds for transition arrangements for some aspects of the Market Framework. We will inform industry of the nature and duration of transition arrangements once we have a proposal ready, and there will be an opportunity for key stakeholders to provide views.

We continue to encourage parties to follow existing good practice ahead of the introduction of statutory regulation, such as that set out by the Heat Trust and the ADE-CIBSE Code of Practice.