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Ofgem
10 South Colonnade,
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Dear Lewis Togwell,

Thank you for the opportunity to respond to the Heat networks regulation: enforcement guidelines and penalty policy consultation.

The additional clarity provided in these documents is helpful for industry to prepare for the commencement of regulations.

Maintaining a principles-based approach to regulation

Throughout this process, Energy UK has consistently supported and welcomed the adoption by Ofgem of a principles-based approach to the regulation of heat networks. Energy UK would caution against Ofgem adopting an enforcement-led approach to compliance, and would instead encourage a culture of early engagement with industry to support raising standards and getting the best outcomes for customers. The 'Initial enquiry phase' section in the consultation provides helpful detail in this respect, however this section only explains how Ofgem will request additional information from companies potentially in breach. This phase should be an opportunity for early engagement and dialogue with industry over the nature of any non-compliance, instead of a one-way flow of information to Ofgem.

Furthermore, there may be an instance where a heat network operator or supplier has identified a breach, and requires support on the application of the authorisation condition or interpretation of the guidance, and is requesting support from Ofgem to resolve this. However, in raising this issue, as set out in the draft guidelines, the company is at risk of enforcement or compliance action. It would be helpful to discuss how companies that require clarity on the application of the regulations can be encouraged to ask these questions, especially in the context of heat networks being a newly-regulated sector where a pragmatic approach is required to raising standards and getting the best outcomes for customers.

Ultimately, the outcome of an enforcement-led approach to compliance is that this skews communication about the activities of heat network companies in the public domain to be almost exclusively about breaches and penalties. This damages the

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reputation of the industry and damages the relationship between the customer and the utility. This would have a negative impact on the potential to draw greater investment into the development of new networks.

Finally, maintaining a principles-based approach means that the guidelines that Ofgem is producing to support the implementation of the regulations should be treated as such. There is a risk that the guidelines will be used as de facto prescriptive regulation, and the basis for enforcement, but it is important that the industry retains the flexibility to innovate in the service it provides to its customers through the implementation of a principles-based approach.

Ofgem should adopt a risk-based approach to enforcement

The reference to Ofgem's internal monitoring functions being informed by particular industry risks is welcome. However, there is little additional explanation as to how Ofgem will adopt a risk-based and data-led approach to monitoring and enforcement. Previous consultations have sought to segment the heat networks market according to different characteristics to aid Ofgem in its application of the regulations to what is a very diverse sector. Ofgem should ensure that it adopts a risk-based approach to enforcement, led by data that identifies likelihood of consumer detriment within the sector.

Providing greater clarity on the approach to financial penalties

The Penalty Policy document and guidelines share a very similar approach with the gas and electricity regulations. Ofgem could consider consolidating these into a single source setting out the approach across the energy sector. This would help ensure fairness and consistency across all energy customers.

Energy UK has concerns relating to the approach to fixed penalties, especially as there is a divergence between the approach suggested in this consultation and the rest of the regulated energy sector. For example, minor compliance breaches are typically not subject to fixed penalties, so introducing them for heat networks could risk over-regulation, impacting negatively on competition and undermining a credible framework.

Fixed penalties risk unintended consequences by diverting a heat network's compliance resource to focus on activities that are subject to these kinds of penalties, rather than the activities that deliver the best outcomes for customers. Fixed penalties could discourage productive and cooperative relationships between the regulator and operator when constructive relationships need to be maintained.

If they are deemed to be appropriate, then fixed penalties may be most suitable in instances of objective administrative failure, but not appropriate where subjective interpretation is needed. It is more likely that a nuanced approach is needed in determining the size of the penalty to be levied on the network, as there could be a range of factors that determine non-compliance given the diversity of the sector.

Energy UK has further concerns relating to the maximum financial penalty under the regulations, and the timetable for issue. With regards to the provision within the regulations of a maximum financial penalty of £1 million or 10% of the authorised person's turnover, whichever is higher, it is not clear at what company level the 10% will be levied at, and this should be clarified as soon as possible. With regards to the timetable for imposition of a financial penalty or consumer redress order, the rationale is not clear as to why Ofgem will have up to five years to impose this after the provisional order, whereas within the gas and electricity framework, this is six months. Ofgem should consider reducing this time period.

Greater clarity on the Enforcement Action

There is a lack of clarity regarding the practicality of the divergence from Gas and Electricity Enforcement Guidelines when it comes to decision making powers. While giving decision making powers to the Director for Enforcement can help produce a timely and proportionate response, the 'director only' model creates a lack of consistency with the Gas and Electricity framework, and could therefore cause confusion and reduce confidence in the sector.

Ofgem should ensure sector specific expertise is drawn upon when handling enforcement cases within the heat network industry. This will be essential to ensuring efficient enforcement and avoid cases becoming misinformed in technical and commercially challenging cases.

The guidelines could also be improved to support heat network operators that are inexperienced with regulation by including more information about the approach that will be taken to operators or suppliers that are also landlords.

Thank you again for the opportunity to respond to this consultation.

Yours sincerely,

Louise Shooter
Head of Heat Decarbonisation

Anna Simms
Policy Executive