EXPLANATORY MEMORANDUM TO

THE HEAT NETWORKS (MARKET FRAMEWORK) (GREAT BRITAIN) REGULATIONS 2025

2025 No. XXXX

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Energy Security and Net Zero and is laid before Parliament by command of His Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Declaration

2.1 Dr. Miatta Fahnbulleh, the Minister for Energy Consumers at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

2.2 Ludo Tolu, Deputy Director for Heat Networks Policy at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Thomas Kavanagh-Rose at the Department for Energy Security and Net Zero (DESNZ), Telephone: 07843 825963 or email: heatnetworks@energysecurity.gov.uk can be contacted with any queries regarding the Instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This Instrument establishes a structure of regulation for the heat networks market. It defines "regulated activities" in relation to heat networks and provides that anyone carrying out those activities (subject to narrow exceptions) needs an authorisation. Authorisations will be granted by the Gas and Electricity Markets Authority (GEMA), in practice Ofgem, as the Regulator for Heat Networks. Ofgem will also enforce the majority of the provisions of the Instrument and authorisation conditions made under it and the Instrument contains appropriate enforcement powers.

4.2 Other key organisations are given specific roles within the regulatory framework. These are: the Secretary of State, expected to act through the Office for Product Safety and Standards, in relation to meter accuracy standards; The Energy Ombudsman, in relation to establishing a heat network Alternative Dispute Resolution Scheme (ADR); Citizens Advice, as Consumer Advocacy Body (CAB) for England and Wales; Consumer Scotland, as principal CAB for Scotland, and Citizens Advice Scotland.

Where does the legislation extend to, and apply?

4.3 The extent of this Instrument (that is, the jurisdiction(s) which the Instrument forms part of the law of) is England, Scotland and Wales, except for regulation 68 which extends to Scotland only.

4.4 The territorial application of this Instrument (that is, where the Instrument produces a practical effect) is England, Scotland and Wales, except for regulation 68 which only affects Scotland.

5. Policy Context

What is being done and why?

5.1 Heat networks are a form of decentralised energy distribution, where heating, cooling or hot water are circulated from central sources of generation to multiple points of use. This can include domestic dwellings, public and commercial buildings.

5.2 Heat networks have to date been largely unregulated, despite being an essential utility. The only current legislation that applies specifically to heat networks is the Heat Network (Metering and Billing) Regulations 2014 (as amended in 2015 and 2020), a piece of assimilated law (it originally implemented elements of an EU Directive) that relates solely to meter installation and consumption-based billing.

5.3 This means that heat network customers have significantly fewer rights and protections compared to other utility services. A report carried out by the Competition and Markets Authority in 2018 found that the existing market was an effective monopoly. Although it did not find evidence of widespread consumer detriment, it identified a high risk of consumer exploitation as the market grows.

5.4 Chapter 1 of Part 8 of the Energy Act 2023 (together with Schedule 18) and this Instrument represent a response to that. They are the foundation of a regulatory framework for heat networks similar to what exists for gas and electricity. The Instrument sets out the core features of the role of GEMA, in practice Ofgem, as the Regulator of the heat networks sector under section 217 of the Energy Act 2023. It gives them the necessary powers to carry out this role, including investigative powers to collect information and issue different types of compliance notices, consumer redress orders, and variable penalties (these are similar to powers available to Ofgem in relation to gas and electricity regulation). Investigatory powers allow the Regulator to enter a regulated entity's premises to review and seize information relevant to an investigation of a potential regulatory breach (the Instrument, of course, includes safeguards around this – the powers of entry cannot be used in respect of private dwellings and must be exercised at a reasonable time). The Secretary of State is also given limited Regulator functions in relation to heat meter accuracy.

5.5 The Instrument sets the Regulator's principal objective as protecting consumers. Like many aspects of the Instrument, this is modelled on similar provisions in respect of gas and electricity. So certain matters considered to be in the interests of heat network consumers are named specifically, notably their interest in compliance with the net zero target under the Climate Change Act 2008 and carbon budgets. Then the Instrument sets out matters to which the Regulator is to have regard when exercising its functions under the Regulations, notably the interests of heat network consumers in vulnerable circumstances.

Creating the authorisation regime

5.6 The Instrument introduces an authorisation regime, which subject to narrow exceptions prohibits carrying out a regulated activity (in the first instance, the operation of a relevant heat network as defined in section 216 of the Energy Act 2023 or supplying heating, cooling or hot water through such a network) without holding an active authorisation. Exemptions cover, for example, houses in multiple occupation and some converted buildings. The Regulator may prescribe how an authorisation can be applied for, the information and supporting documents that must be provided, and associated fees ("prescribed requirements"). The Regulator may on occasion confer a temporary authorisation e.g. where more time is required to establish suitability for authorisation.

5.7 The Regulator may confer a heat network authorisation provided the prescribed requirements are met. They may set general authorisation conditions, which apply to all heat networks, or conditions that only apply to specific entities. The Instrument also sets out the process and procedure for setting both types of authorisation condition, and for modifying those conditions once set.

5.8 The Instrument establishes the subject matter that authorisation conditions are expected to cover. Much of the substance of heat networks regulation is expected to be set out in authorisation conditions which may, for example, include rules on pricing and requirements to meet technical standards.

5.9 These conditions can be different or applied differently to specific sectors of the market.

5.10 The authorisation regime will come fully into force on 27 January 2026. But the provisions about consumer advocacy and the redress scheme to be operated by the Energy Ombudsman (see below) will come into force on 1 April 2025. There will be provisions under which an entity that is carrying out a regulated activity on 1 April 2025 is considered to hold an authorisation. Entities that start carrying out a regulated activity before 27 January 2027 will also benefit from such a deemed authorisation until 27 January 2028 (with these dates able to be extended by Ofgem with the Secretary of State's consent).

Standards of performance

5.11 The Instrument allows the Regulator to prescribe standards of performance for regulated activities that affect heat network consumers, or potential heat network consumers, that is standards that heat networks are supposed to meet in individual cases (as well as overall standards for their activities as a whole).

5.12 Regulations made by the Regulator may specify circumstances in which authorised persons must inform consumers of their rights, and require the provision of information to demonstrate compliance with the individual standards. Where the Regulator believes that it would be appropriate to do so, they may set different standards for different types of authorised persons.

5.13 If an authorised person fails to meet an individual standard, the authorised person must pay compensation to any person affected by the failure; the nature of that compensation will be set out in the regulations made by the Regulator. The payment of compensation does not prejudice other remedies that may be available relating to the failure.

Consumer advocacy, advice and complaints

5.14 This Instrument applies Part 1 and Part 2 of the Consumers, Estate Agents and Redress Act 2007 (CEARA), in order to achieve two things. First, to create a framework for consumer advocacy similar to that which exists in the gas and electricity markets, replicating the roles of Citizens Advice, Citizens Advice Scotland and Consumer Scotland as consumer advocacy bodies in relation to those markets. Second, to apply legislation to create a complaints handling and redress scheme for heat network consumers, to be administered by the Energy Ombudsman scheme.

5.15 Where relevant the Instrument modifies the interpretation of terms in CEARA to align with definitions used in the Instrument.

5.16 This Instrument creates six new offences relevant to heat networks: carrying on a regulated activity without an authorisation; failure to provide information requested by a lawfully issued notice; provision of deliberately misleading or inaccurate information; intentionally suppressing or altering documents required to be provided to the Regulator; obstruction of a person exercising a legal power of entry; impersonation of a person entitled to entry.

Amendments to the Heat Networks (Scotland) Act 2021

5.17 The Instrument makes amendments to the Heat Networks (Scotland) Act 2021. These changes align the Scottish licensing regime with the Market Framework, in particular, designating GEMA (in practice, Ofgem) as the licensing authority and ensuring that it has enforcement powers similar to those in Part 4 of the Instrument.

Assimilated law

5.18 This Instrument does not have any interactions with legislation deriving from the EU, now called "assimilated law". Although the Energy Act 2023 does enable the Government to amend or revoke the Heat Network (Metering and Billing) Regulations 2014, this will be implemented through later legislation.

6. Legislative and Legal Context

How has the law changed?

6.1 The Instrument introduces a new area of regulation. It needs to be read in the context of Part 8 of the Energy Act 2023, which as well as setting out the powers under which the Instrument is made, establishes key definitions (including of "relevant heat network"), makes GEMA the initial Regulator of heat networks and gives GEMA powers in relation to recovery of costs. Amendments of the Utilities Act (GEMA's constitutional legislation) connected with GEMA's role as heat networks Regulator have been made by the Energy Act 2023 (Consequential Amendments) Regulations 2024 (S.I. 2024/706).

6.2 Heat networks are currently subject to some limited regulation in the form of the Heat Network (Metering and Billing) Regulations 2014 (HNMBR), a piece of assimilated law implementing rules about initial meter installation and consumption-based billing requirements. This legislation has definitions and terms which differ with those set out in this Instrument, or with interpretations in the Energy Act 2023 that this Instrument refers to.

6.3 Paragraph 57 of Schedule 18 of the Energy Act allows regulations made under the Act to amend or revoke HNMBR. We intend for subsequent Regulations introduced to

implement other elements of market regulation to use those powers to resolve these legislative differences before this Instrument commences.

Why was this approach taken to change the law?

6.4 This Instrument implements Part 8 of the Energy Act 2023. The approach taken is driven by the structure of that Act and the policy considerations set out above.

7. Consultation

Summary of consultation outcome and methodology

7.1 BEIS published a consultation on the Market Framework, entitled "Heat Networks; Building a Market Framework", on 6 February 2020. Our response was published on 29 December 2021.

7.2 A summary of the "Heat Networks; Building a Market Framework", consultation is available at www.gov.uk/government/consultations/heat-networks-building-a-market-framework.

7.3 Additionally, DESNZ launched a follow-up consultation on 4 August 2023 through a formal consultation, entitled "Heat networks regulation: consumer protection", which has informed the design of authorisation conditions and definitions of regulated activity.

7.4 The "Heat networks regulation: consumer protection" consultation sought views from consumer groups, heat network industry bodies (such as developers) and local government. Our response was published on 4 December 2023.

7.5 The consultation summary is available at www.gov.uk/government/consultations/heat-networks-regulation-consumer-protection.

7.6 Stakeholders expressed support for market regulation, both to improve consumer outcomes and prevent exploitation of an essential utility and to provide market and investment confidence in growth initiatives.

7.7 Stakeholders voiced concerns about the cost of regulations. The cost of Ofgem's regulatory activity is typically paid for by the entities being regulated. Concern was expressed that the comparative size of heat networks could lead to disproportionately high prices, when compared to gas and electricity, when regulatory costs were passed on to consumers. The Department responded to these concerns by securing agreement for the cost of heat network regulation to be socialised across gas, electricity and heat network customers (this is provided for by section 222 of the Energy Act 2023). This ensures that heat network customers will not face disproportionate costs arising from regulation of the market, while adding very little to gas and electricity bills.

7.8 In accordance with section 220 of the Energy Act 2023, the previous Secretary of State gave notice to the Scottish Government of the intention to make this Instrument, describing the provision within Scottish devolved competence and giving 28 days to make representations. The response raised no substantive issues with the Instrument and mainly related to policy in future legislation. Statutory consultation requirements in relation to the Welsh Government were not engaged because the Instrument does not include provision within Welsh devolved competence.

8. Applicable Guidance

8.1 Guidance on regulating heat networks will be published before the Instrument comes into force.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has been completed and assessed by the Regulatory Policy Committee and is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

9.2 There will be benefits associated with introducing this Instrument as it is necessary to implement an operable regulatory system in GB. It will provide assurance to the public that the transition to net zero heating will occur in a way that provides positive outcomes and gives certainty for the market to expand.

Impact on businesses, charities and voluntary bodies

9.3 The impact on business, charities or voluntary bodies operating or supplying heat networks is that businesses will need to submit information as part of provisions establishing the authorisation regime, and comply with notices and orders when they are issued. Similarly regulated entities will be required to accept and act on findings from complaints made by customers. Those entitled may incur financial penalties from failure to comply with these requirements.

9.4 The regulation places two main costs on business, charities or voluntary bodies operating or supplying heat networks. The additional resource required to submit information as part of provisions establishing and complying with the authorisation regime, and potential compensation payments or penalties from a failure to comply with these requirements.

9.5 These costs are likely to impact on small and micro businesses.

9.6 To minimise the impact of the requirements on small or micro businesses (employing up to 50 people), the approach taken is to ensure that a proportionate, outcomes-based approach to regulation can be taken. Businesses, including small and micro, connected to a heat network will benefit from the protection and standards that the regulation enforces.

9.7 The legislation impacts the public sector as local authorities operating heat networks for public services and social housing will likely be subject to these additional costs. Also, the Government will need to establish and maintain the operational capacity to implement, enforce, monitor, and adapt requirements that are implemented through the regulatory regime.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation is Ofgem and the Department will use data collected through the authorisations regime to develop understanding of the market and monitor the effectiveness of regulation..

10.2 A statutory review clause is included in the instrument.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 The initial coming into force date of the Instrument is the day after it is made. However, the Department has had regard to what Statutory Instrument Practice says in relation to coming into force dates, notably in paragraph 3.12.10, about the need for a reasonable interval between the making of an affirmative instrument and its coming into force. The initial date is only to give Ofgem the necessary powers to put in place regulations, general authorisation conditions and so on that will have effect from 27 January 2026. No provisions directly affecting operators of heat networks or heat suppliers will have effect before 1 April 2025.

12. European Convention on Human Rights

12.1 The Minister for Energy Consumers has made the following statement regarding Human Rights:

"In my view the provisions of the Heat Networks (Market Framework) (Great Britain) Regulations 2025 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This Instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").