

Heat networks regulation: fair pricing protections

1Energy Group Response

9/7/2025

Q1. Have we identified the right set of fair pricing consumer objective, principles and outcomes and are these properly defined? If you disagree with this proposal, please specify what changes you would like to see and provide a justification.

Yes

Q2. Do you agree with our proposals to develop the fair pricing guidance in relation to the principles (please note that questions on cost allocation proposals, including guidance, are asked separately under Chapter 3: Cost allocation). In particular:

a) have we identified the right areas to be covered by the guidance implementing the fair pricing principles (see paragraph 2.53 for a summary of the areas we are proposing to develop in guidance under each principle)? If you disagree with this proposal or think other areas should also be included, please specify what changes you would like to see and provide a justification.

b) Do you agree with the specific proposals to develop each of these areas in guidance? If you disagree, please specify what changes you would like to see and provide a justification.

a) Yes

b) Yes

Q3. Do you agree with the proposed 'fairness test'? In particular:

a) Do you agree with the high-level features of the fairness test (principle based, reasonableness, case-by-case basis, and objectivity)?

b) Do you agree with our proposals to implement the fairness test discussed in Appendix 1: Fairness test?

a) Yes, we agree.

b) Metrics such as profits and rates of return are of limited relevance, given the diverse sources of financing across networks, ranging from private investment to public funding, including varying proportions of support from schemes like the GHNF.

Additionally, we do not believe that non-domestic customers should be included in the 'fairness test', as their connection and pricing is typically the result of individual negotiations. These bespoke arrangements reflect the specific needs and

circumstances of each customer, making standardised comparisons or fairness assessments inappropriate. It could also discourage future investment from private investors in the development of the UK's DHN sector.

Given the recent cancellation of Public Sector Decarbonisation Scheme (PSDS) support for public sector customers, we anticipate that the upfront building works costs may need to be recovered through fixed fees. As a result, including non-domestic customers in price comparisons may no longer be appropriate, as their pricing structures could be significantly affected by these changes.

Q4. Does the revised authorisation condition, 'fair pricing', reflect the policy intent?

Only if the targeted customer groups are correctly identified, e.g. domestic vulnerable customers, should the fairness test be applied.

Q5. In relation to market segmentation (please note that we are asking in relation to the considerations discussed in paragraphs 2.58-2.61, segmentation considerations in relation to price benchmarking are considered under Chapter 4: Price comparison and benchmarking methods):

a) Have we identified the right characteristics for market segmentation, and are these correctly defined?

b) Do you agree with the segmentation approach discussed for each of these characteristics?

a) We welcome the idea of creating segmentation to recognise the variety of heat networks. However, we believe a few fundamental characteristics are missing from the current proposal: the 'type of fuel' used by the network, the 'carbon intensity of the heat', the 'temperature of the network', and the 'availability of the heat'.

b) Size: For a city-wide heat network, given its scale, we believe that volume of supply is a more appropriate metric than the number of customers.

Regarding the distinction between domestic and non-domestic consumers, we understand the original intent was to safeguard vulnerable groups, such as residential and microbusiness customers, who may lack the resources to effectively represent their own interests. Extending this regulation to the entire non-domestic sector appears inappropriate, as these consumers typically engage in bespoke negotiations tailored to their specific needs.

Moreover, it's important to consider the relative size and capacity of some non-domestic customers. In many cases, these entities may be larger and more resourceful than the authorised heat network supplier itself. As such, they are often better equipped to advocate for their own interests, making a blanket application of the regulation potentially misaligned with its original purpose.

Additionally, if fair pricing requirements are extended to all non-domestic customers, it could unduly restrict our ability to enter into commercially flexible arrangements. These often involve a range of counterfactual pricing models. Such

restrictions would also hinder the implementation of tiered pricing structures, which are designed to incentivise improvements in building energy efficiency.

Q6. Of the information listed in Table 3 below, what do heat networks already regularly collect and can be easily reported?

N/A

Q7. Of the information listed in Table 3 below, which items would be more challenging for heat networks to report?

N/A

Q8. Of the cost drivers listed in Table 7 (in Appendix 3), which items would be more challenging for heat networks to report?

We can envisage that assessing the 'age and type of properties supplied' would be challenging, particularly given the large number of buildings served by a city-wide heat network.

Q9. Should certain types of heat networks have more limited data reporting requirements? If so, which heat networks should these reduced requirements apply to, and what data should they be exempt from reporting?

N/A

Q10. Do you agree with our proposed prescriptive rule that GSOP payments, compensations, fines, penalties and other redress provided to consumers should not be passed through to customers?

Yes

Q11. Do you agree with the draft best practice guidance provided? Is there anything that should be added? Should any of the best practice guidance be strengthened to prescriptive rules?

We understand that best practices in cost allocation and tariff structures can bring greater clarity and transparency to the regulation of customer costs. However, a cost structure that works well for one network may not necessarily be suitable for another. Imposing a standardised approach could also constrain innovation in tariff design.

For example, 1Energy applies a volume-based charge that incentivises customers to reduce their return temperatures, thereby improving the overall efficiency of the

network. Moreover, some networks may implement tiered tariffs to encourage building energy efficiency and promote energy conservation. A one-size-fits-all model risks overlooking these benefits and the unique characteristics of individual networks.

Q12. Do you think that the best practice approach to cost allocation should differ for different types of heat networks, or different types of suppliers? If so, for which types and how?

As Q11

Q13. Does the authorisation condition, 'cost allocation', reflect the policy intent?

Yes.

Q14. What other feedback do you have on the proposed approach to cost allocation?

N/A

Q15. Do you agree with our proposed approach for defining heat network prices in a comparable way? Are there any other ways to define price that we should consider?

We have concerns regarding the comparability and fairness of the two proposed definitions for heat charges. Both approaches appear to overlook the substantial diversity and complexity inherent in heat networks.

The first proposal, calculating average charges by dividing the total charges recovered by the number of customers, fails to account for the wide variation in building efficiency across networks. For example, a network serving a newly developed site with highly energy-efficient buildings will naturally report lower average charges than a similarly sized network supplying older, less efficient buildings. This discrepancy could lead to misleading comparisons and unintended consequences for network operators and customers alike.

The alternative proposal, which categorises user levels as 'low', 'medium', or 'high', also presents fundamental challenges. In dense urban areas such as central London, it is common to find buildings with mixed uses, offices, retail units, restaurants, and hotels, within a single structure. Applying a single usage classification to such diverse buildings is impractical and risks oversimplifying complex usage patterns, potentially leading to inaccurate or unfair assessments.

Q16. Do you agree with our proposal to use gas boilers and heat pumps as external reference benchmarks?

Gas boilers should be used as external reference benchmarks for networks that use gas boilers or CHPs as their heat source. Heat pumps should be used as benchmarks for low-to-zero carbon heat networks.

Furthermore, for networks that provide both heating and cooling, it is essential that the benchmarking methodology accounts for the full scope of services delivered. In these cases, reference benchmarks should incorporate the performance and energy use of chillers or other cooling technologies to ensure a fair and accurate comparison.

Q17. Do you agree with the proposed method for calculating a heat pump benchmark, including the key input parameters outlined? Are there any additional factors that should be considered to ensure a robust heat pump benchmark?

Yes

Q18. Do you agree with the proposed approach to comparator benchmarking, and our list of potential cost drivers set out below and in Appendix 3: Cost driver? Are there any relevant cost drivers that we haven't considered?

'Communal heating or district heating' should also be included as a variable in the cost drivers. This is because communal heating systems are sometimes managed by a variety of organisations that may not have the same level of expertise as professional district heating operators, making it difficult to provide all the necessary data and information.

Q19. What is your view on the ease with which data could be reported on the four 'High Importance' cost drivers set out in paragraph 4.33? What information do heat network operators and suppliers already collect, and what would be challenging to provide?

We believe that 'operating temperature' should be added to the list of 'high-importance' cost drivers. At 1Energy, we have incorporated a volume tariff into our total variable charge. This tariff is based on the volume of flow through the Building Heat Substation and is designed to incentivise customers to improve their return temperatures. By doing so, they enhance the overall efficiency of the network. The volume tariff also serves to recover the additional costs associated with reduced system efficiency when return temperatures are too high. We actively work with our customers to identify solutions that improve return temperatures and, in turn, reduce their volume charges.

Q20. What is your view on the ease with which data could be reported on the remaining 'Medium Importance' cost drivers set out in paragraph 4.33? What information do heat network operators and suppliers already collect, and what would be challenging to provide?

1Energy does not yet have a network in operation, but we do not anticipate any issues in collecting the listed information once our first network in Bradford becomes operational next year (2026).

Q21. What is your view on our proposal to publish a high-level methodology for each benchmark (once data is collected and methods have been tested), to provide an accessible overview of the approach?

We welcome the publication of the benchmarking methodology, as it will enhance transparency in how each benchmark is established.

Q22. Do you have any other feedback on the proposed approach to price comparison and benchmarking?

We believe that making direct cost comparisons between heat networks presents a significant challenge for Ofgem. Such comparisons often fail to reflect the inherent diversity of heat networks, each of which has a unique cost structure shaped by its design, customer base, building stock, and operational context. Attempting to standardise or compare these costs risks oversimplifying complex systems and may lead to misleading conclusions.

However, we recognise the importance of benchmarking and the need to identify outliers. We believe that more appropriate metrics should be developed to ensure that benchmarking exercises are meaningful and reflect the diversity of network archetypes – for example, by incorporating carbon intensity as a differentiating factor.

Q23. Do you agree with the proposal for ongoing monitoring of profitability through data collection on EBIT margins for all heat networks?

We don't consider EBIT to be an appropriate methodology to establish a profit baseline across all heat networks as currently proposed. Moreover, the benchmarking methodologies proposed by Ofgem in Section 4 of this consultation are already aiming to compare prices paid by consumers to reference points and to identify outliers, so introducing ongoing monitoring of profitability would duplicate the benchmarking exercise.

Specifically on EBIT, the reason why we do not consider it to be an appropriate methodology for assessing profitability and benchmarking across all heat networks is because while it is a straightforward metric to calculate as pointed out by Ofgem, it has key and fundamental limitations when applied to infrastructure assets like heat networks:

- Ignores capital intensity and long-asset lives. EBIT margin focuses on operational revenues, ignoring the capital employed to generate earnings. This means that 2 networks with identical EBIT could have vastly different capital bases, leading to flawed benchmarking or regulatory comparisons.

- Skews comparability across lifecycle phases. Heat networks vary significantly in their lifecycle stages: Early-stage projects may incur design, commissioning, and optimisation costs, whilst mature assets benefit from operational efficiencies and customer growth. As a result later-stage/operational networks might appear more profitable purely due to lifecycle timing, not inefficiency or overpricing.
- Doesn't capture timing of revenue recognition. In infrastructure like heat networks revenue can be subject to connection timing and commercial arrangements with customers, regulatory constraints, delays in metering and billing. This creates revenue-recognition lags that can make EBIT volatile or misleading, especially when timing differences skew annual earnings.
- Data allocation and attribution challenges. Portfolios often share overheads, services, or procurement contracts across multiple networks. Accurately allocating costs and EBIT to each network is therefore complex and risks inconsistency, e.g. creating a risk of double-counting or under-attribution, especially in vertically integrated platforms. This challenges the comparability and interpretability of EBIT margins on a standalone network basis.

We consider that any in-depth profitability analysis should only happen in extreme instances where outliers have been identified (having clear guidelines and criteria), and as part of the price investigation process, as outlined by Ofgem in Section 7 of this consultation. In those cases a more appropriate metric could EBIT averaged over a period of time (e.g. 5yrs) or ROCE, as already identified by Ofgem.

We suggest that Ofgem consider alternative light-touch monitoring methods to determine whether excessive profits are being made.

Q24. How challenging would it be for heat network operators and suppliers to provide the data outlined for calculating EBIT margins? What barriers, if any, might affect the accuracy and completeness of the data?

There are several practical challenges that may affect the completeness and consistency of reported EBIT data. Many heat networks operate within broader entities or as part of portfolio in which costs are shared (as explained in our answer to Question 23), making it difficult to accurately allocate costs and risking inconsistency. Accounting practices (e.g. different depreciation schedules for heat assets) can also easily lead to inconsistencies in EBIT reporting. In addition, certain costs that might be incurred in a cyclical schedule (e.g. major network maintenance) can have a significant impact on EBIT.

We welcome Ofgem's acknowledgement that EBIT can fluctuate considerably from year to year, and that a single period of high EBIT does not necessarily indicate excessive profitability. However, the consultation does not provide further clarity on how such fluctuations will be assessed. Specifically, it remains unclear what metric or timeframe (e.g. how many consecutive years of high EBIT) would be used to determine whether profits are considered excessive and to pursue further investigations.

Q25. As data collection improves, do you agree that more in-depth profitability assessments, for example using Return on Capital Employed (ROCE), should be conducted for networks identified as outliers through benchmarking?

Please see our response to question 24. We consider that any in-depth profitability assessments should only happen in extreme instances where the price benchmarking has identified clear outliers (having clear guidelines and criteria), and as part of the price investigation process, rather than as an additional benchmarking exercise. This is irrespective of the metric used (i.e. EBIT, ROCE, other), and of the data collection process.

We believe that this is a balanced approach that should allow to get into a more detailed analysis of networks by exception, and would also help to manage the resourcing demands on Ofgem as pointed in the consultation.

Q26. Do you have any other feedback on the proposed approach to profitability assessment?

We support the principle of fair pricing regulation as a means to protect customers. However, we believe that the mechanisms already proposed in this consultation, such as cost allocation rules and external benchmarking, are sufficient to assess whether customers are receiving fair value.

Introducing profitability assessments as a standalone regulatory tool risks misrepresenting the financial realities of heat network operations. Each network operates under unique conditions, including varying capital structures, customer profiles, and infrastructure constraints. Profitability alone does not provide a reliable indicator of fairness or efficiency.

As we mentioned in our response to Question 24, we recommend that profitability assessments be reserved for exceptional cases, specifically, where benchmarking suggest that a network is charging significantly higher prices than comparable low-carbon alternatives, having clear criteria to identify those outliers. In such instances, a targeted review and price investigations may be appropriate. Otherwise, profitability should not be used as an independent criterion for regulatory intervention. Finally, alignment of any benchmarking and profitability assessment (as part of price investigations) with zoning policy (e.g. community benefits, revenue-sharing mechanisms) is essential to avoid regulatory double-counting that could negatively impact growth of the sector and investment appetite and confidence.

Q27. What are your views on the three options? Please comment on each option in terms of the price information to be centrally published, how the price information is presented and what prices are compared to.

We believe that Option 1, the 'Grouped Comparison' approach, presents significant challenges due to the diverse characteristics of heat networks. For instance, a single network may incorporate a mix of technologies, such as combined CHP systems alongside heat pumps. Even among heat pumps, the heat source can vary widely, ranging from free heat like a TfL ventilation shaft to paid sources such as EfW plants. Grouping such uniquely configured networks into meaningful comparison categories is inherently difficult. This could result in some groups containing a large number of networks, while others may include only a few, potentially undermining the robustness and fairness of the comparison. Therefore, we believe that more appropriate metrics should be developed to ensure that the exercises are meaningful and reflect the diversity of network archetypes – for example, by incorporating carbon intensity as a differentiating factor.

We believe that Option 2, the 'Pooled Market Average Comparison', is a reasonable approach. It effectively balances the need for price transparency with the ability to provide meaningful comparisons against counterfactual technologies. Additionally, the way the comparison information is presented is clear and user-friendly, which supports its practical application.

We also consider Option 3 to be preferable to Option 1. However, as it is currently proposed, the way the information is communicated appears unclear and may lead to confusion.

Q28. Do you think the options have the right balance between providing a good level of transparency, burden on consumers to interpret the information, risks of misinterpretation by consumers, disclosure of commercially sensitive information, and risk of price convergence?

Among the three options presented in the consultation, we believe Option 2 offers the most reasonable and balanced approach.

Q29. Do you support focusing on one option or a combination of options in paragraph 6.69?

While each of the three options has its merits, none offers a complete solution. Therefore, we believe further investigation and refinement are necessary to develop a more robust and balanced approach.

Q30. Do you support the phasing in of the options described in paragraph 6.70?

Yes

Q31. Do you support the adoption of different options for different heat network groups described in paragraph 6.71?

As previously noted, grouping diverse heat networks is a complex and challenging task that may lead to inaccurate or misleading results. Given this, adopting different regulatory or benchmarking options for different networks appears unviable unless more suitable metrics are developed.

Additionally, communal heating networks, when compared to large district heating networks, may present further difficulties. They are often managed by organisations with less expertise in data collection and reporting, which can hinder accurate assessment. Therefore, communal heating networks should be treated differently from large district heating networks to reflect these operational differences.

Q32. Do you agree that central price transparency measures are unlikely to put additional administrative burden on heat networks in addition to data reporting for benchmarking? Do you have concerns on the administrative burden from any options?

Yes we agree.

Q33. Do you think it is appropriate to link central price transparency with benchmarking?

Yes

Q34. Do you agree with the approach to price investigations set out so far? Please provide reasons and views to support your response.

We broadly support the approach to price investigations, particularly the intention to focus on clear outliers and cases of significant consumer detriment, following fair pricing principles. However the current proposed approach is not clear about the criteria that will be used to define the circumstances that would trigger a price investigation as it is only defined as “cases where there is the greatest consumer detriment”. We recommend clear criteria is defined to clarify this, and that the criteria is linked to the benchmark analysis and fair pricing principles.

We also recommend that guidance is developed to provide clear principles for how the price investigation process will work, including information requirements and timescales. We welcome Ofgem’s proposal to further consult on price investigations, and we recommend that stakeholder engagement should include inputs into the development of benchmarks and fairness thresholds, and clear guidance on how qualitative and quantitative evidence will be weighed.

Regarding data requirements, we anticipate that some of the data required, such as network performance information, may take considerable time to collect, particularly given the seasonal nature of heat network operations. Furthermore, network performance is likely to improve over time as systems mature, utilisation of the generation and heat network assets increases, and systems are optimised. Consequently, any decision to initiate a price investigation should consider the full context of the network's performance, including lifecycle stage, cost drivers, capital

recovery model, and efficiency efforts. And any investigations may need to span several years to ensure that assessments are both accurate and fair.