

## Heat Networks Regulation: Fair Pricing Protections



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### Consultation questions

**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.**

We are largely in agreement with the principles of the proposed heat network consumer protections and system regulation. However we have struggled in our response to this consultation because it seems to lack the level of detail to adequately define the metrics that Ofgem proposes to regulate. In the water industry in England, the gas and electricity markets we have witnessed how poorly the customers are served by regulation which has added costs, fines and responsibilities but been largely ineffective in protecting the customers or the environment. We, therefore, have concerns on how those principles will be manifest as regulation and note that our overall impression of this consultation is to express concern on the lack of detail which compromises our ability to give well informed responses to the questions.

**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.**

The principles have been identified and they are hard to disagree with but as with most things the devil is in the detail and it is the detail that is lacking in this consultation. We sincerely hope that this is the first consultation in a series as Ofgem honours the exact nature of the regulation it intends to apply.

- 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.**

Yes. In principle yes, but as noted initially we require a lot more clarification before we can support how those principles are manifest in guidance.

The term 'cost efficiency' is not clear. We look for clarification on whether this applies to the efficiency of the administration of networks, the operation of those networks, their performance against an appropriate benchmark or their maintenance. Without clarity we can not endorse this becoming guidance.

In our view domestic customers have been failed by the regulation of the electricity and gas markets. A blind faith on market abilities to deliver value for money while being heavily regulated and further constrained by government policy has seen a collapse of that market and bills that an increasing portion of our population can not afford. Informed by that we are concerned of how Ofgem's understanding of affordability will translate into guidance. This requires clarification which is lacking in this consultation. The energy price cap for domestic electricity places a limited level of constraint on prices and is focused on the wholesale costs of energy rather than the affordability of the energy for customers. Since affordability is dependent on household incomes, outwith the control of DHS operators, we also question whether this can be brought into regulations. We also note that the definitions of fuel poverty exist in current legislation, for example, [Fuel Poverty \(Targets, Definition and Strategy\) \(Scotland\) Act 2019](#) , and ask how the proposed guidance will consider these to ensure that there are no clashes between existing legislation and the new regulations.

**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)?**

Yes.

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

Yes. Again we agree in principle but question the details or lack of them. We generally agree with the proposals but note that there is no explicit reference to heat networks operated by RSLs to ensure the unique role of these organisations as not-for-profit, social purpose businesses is taken into account in the fairness test questions.

We have concerns in respect of the proposals that the identification of disproportionate pricing will make benchmark comparisons in A1.2 inappropriate. The detail of that benchmarking methodology and its application through regulation is not described in this consultation, however we note that this is likely to require the normalisation of multiple variables and could lead to misguided and inappropriate comparison. We note that the small scale community heating systems which may be operated in accommodation for elderly residents and in care homes would not compare well to large scale 5<sup>th</sup> generation DHS. We therefore ask for clarity on the proposed benchmarking and ask that it gives due consideration to widely different systems.

On A1.3, the question of ‘who’ would be affected by disproportionate pricing gives no detail on the level of information sought. Is this aiming to establish the demographic profile or whether vulnerable households are being affected, or simply the number of customers impacted? Further clarity on how this question will be used to determine level of concern would be welcome.

**Q4. Does the revised authorisation condition, ‘fair pricing’, reflect the policy intent?**

Yes

**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?**

We are in broad agreement with the list of characteristics identified. We particularly support the inclusion of profit vs not-for-profit, size, metered vs non-metered, housing tenure, and district vs communal heat networks. We would like to emphasise the importance of non-metered communal systems that can give residents stability in charges and cause much less stress than regular billing.

We have concerns about how vulnerability would be defined, whether it aligns with the vulnerability definitions in [Fuel Poverty \(Targets, Definition and Strategy\) \(Scotland\) Act 2019](#) and/or the priority register. We note that vulnerability is not necessarily a static characteristic of householders who may fall in and out of the precise definitions. Again, as previously noted about household incomes, this data is outwith the control of DSL operators which brings into question any affordability metric proposed in regulation.

- b. **Do you agree with the segmentation approach discussed for each of these characteristics?**

We note the importance of network size but would like to highlight that this is also closely tied to network function, for example care homes. We therefore have concerns about the impact of over onerous regulation and reporting on un-metered communal systems. We would also flag that forcing these systems to becoming metered, while being highly detrimental to tenants will also add significant administration, capital investment and maintenance costs. We therefore urge careful consideration of the data submission required. As previously stated we require more detailed definitions of what Ofgem are proposing and would welcome further discussion around these.

On profit vs not-for-profit, we agree this is an important distinction although a clearer definition of not-for-profit would be helpful. We agree on the data submission requirements being less onerous for not-for-profit schemes and it is also sensible to exclude the profitability assessments for this group. We note the intention to still collect key financial metrics and would call for this to be reconsidered in line with our response to Q9.

On function (or regulatory role), we note that responsibility for compliance with price regulation sits with either the heat network owner or a long-term concession holder (e.g. ESCo). We would

welcome further guidance on overall responsibilities, particularly on data reporting, given the diversity of different ownership models and need to align data/reporting requirements.

We are uncertain on the inclusion of consideration of tenure. This risks making assumptions about the households that is at least classist. Where tenure is relevant is when considering the roles and responsibilities of the DHS operator when they are also the landlord. However it can not be used to define the affordability of a DHS.

We are uncertain on the value of the length of pipe work as a metric. A meter of poor pipe work can lose as much heat, or more than 100m of high specified pipework. It is also an irrelevance in smaller DHS where the delta T is a paramount metric on the performance of the system.

As above we note that both size, function and customers all add to the defining characteristics of a network. On the type of network, we agree on the need to distinguish between district and communal heat networks and expect this would overlap with the size comparisons depending on the segmentation approach.

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

In terms of existing reporting requirements, information on location, capacity and supply figures are already reported to the UK Government as part of the Heat Network (Metering and Billing) Regulations. With Ofgem now becoming the regulator for the sector, we would question the need for these parallel reporting systems and call for a more streamlined process whereby Ofgem acts as the central repository for data which could then be accessed by other relevant bodies.

Social landlords in Scotland also report to the Scottish Housing Regulator on their financial performance including provision of an Annual Assurance Statement, audited financial statements and five-year financial projections. They also submit an Annual Return on the Charter which covers various aspects of performance including customer satisfaction and compliance with the Scottish Housing Quality Standard. While these don't offer direct comparisons with the items in Table 3, they do offer assurances of the overall financial health and robust governance processes of RSLs.

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

Our concerns over the data that might be requested is that the resources required to collect and report this additional data may be onerous. As an operator of multiple communal systems the amount of work involved will be significant even on an annual basis.

Reporting on the operational expenditure associated with maintenance, including maintenance of the consumer facing units and plant, and factoring in the amortisation of the equipment will be challenging and we question the value of this data to the regulator. As previously stated the detail of what is being asked is important but missing in this consultation.

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

We note that many of the data points listed would remain consistent (e.g. fuel/technology type, location) so the challenge for these would be in the initial data collection exercise.

**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?**

Yes. We would like to see reduced reporting requirements for not-for-profit heat networks which are managed by social landlords.

While we agree that heat network operators should be held to account on treating their customers fairly, our members are already regulated by the Scottish Housing Regulator (SHR) and must comply with its regulatory framework, including Standards of Governance and Financial Management. RSLs also must comply with the Scottish Government's Social Housing Charter, with the SHR measuring compliance through the Annual Return on the Charter. The SHR monitors compliance and will engage with any landlord directly regarding any issues. It can also use its statutory powers to require action from a landlord where it is failing to provide services or manage its affairs to an appropriate standard.

So while the data collection proposed in this consultation is primarily for facilitating cost comparisons, where information is being gathered for assurance purposes, we believe that sufficient protections already exist where the heat network entity is covered by the social housing regulatory framework. On this basis, there could be a case for excluding the social landlords from the financial data collection although we note that Table 2 suggests this information would still be beneficial for transparency and benchmarking.

The current proposals also suggest that both charges and prices would be collected on a quarterly basis. As acknowledged in the consultation, this would be a considerable administrative burden and not aligned with the annual reporting cycles for the social housing sector. Within the wider sector we question the rationale behind requiring quarterly reporting. We consider this to be a potentially onerous administrative burden that reeks of micro management in the absence of effective management. We would therefore support this quarterly reporting being reduced to annual reporting for all heat networks.

**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?**

We support this principle when applied to for profit heat networks. However, the current consultation does not specify how this is expected to work for not-for-profit heat networks. The 2023 consultation made explicit reference to this and acknowledged that customers served by a not-for-profit heat network would essentially be paying for their own compensation through future price rises. This approach would therefore be unworkable for our members and could result in some social landlords shifting to alternative ownership models or being reluctant to be involved in future heat network project.

**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?**

Yes. As per Q10 we would like to see further guidance on the approach to GSOP obligations for not-for-profit providers.

**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?**

Yes. See Q10.

**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?**

Yes

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

For external benchmarks, we believe electric heaters could also be a valid counterfactual. While the consultation mentions that this has been considered but is not currently being progressed, we would like this to be reviewed. It is already the case that 7% homes in Scotland make use of electric storage heating and with the forthcoming Heat in Buildings Bill and Social Housing Net Zero Standard requiring a shift to clean heating by 2045, the gas comparator will become less relevant over the coming decades. Furthermore, where individual heat pumps are unsuitable for a property, the most likely options for meeting net zero requirements will be high retention heat storage heaters.

We question the rationale behind the comparison with heat pumps. There are too many badly designed, badly installed and badly operated heat pumps. Is the proposal to compare against manufacturers' projected COP or actual measured COP. If it is the later how will this data be collected and kept up to date? In 5<sup>th</sup> generation DHS there is a potential to use both large scale heat pumps and small scale domestic level heat pumps in a cost effective manner however this is not a universal truth. In smaller scale DHS an ambient loop with small scale heat pumps can be a very expensive heat pump installation to operate. It is essential that we have regulation that is not bound to assumptions but relies on fact otherwise we have the potential of encouraging poor, expensive DHS. In respect to assumptions associated with DHS we would note that DHS can offer affordable low carbon heating but do not do so universally and the length of pipe work (Q18) is not a meaningful metric for network heat loss. We ask that any detailed regulation is mindful of the pitfalls.

**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?**

As stated in our response to Q16 we have too many outstanding questions to be able to comment on this question.

**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?**

We have concerns about the use of 'network pipe length' which may, on its own, not be a good indicator of costs although we note that this has been identified through modelling and will be subject to review following the increased availability of real-world data. We suggest that temperature loss per metre of network pipe may be a more useful indicator given this would also take the quality and specification of the pipework into account. However we note that it would be very challenging to calculate the length of the pipe work in an operating communal system and provide a meaningful metric. Smaller systems operate on delta Ts which is more akin to the design parameters of a domestic heating system. The delta Ts are optimised for each development and a direct comparison between these may not be useful at all.

The number of customers is a metric of limited value. Small scale community systems that feed care homes will have a 100% uptake. The portion of potential vs actual customers may be relevant but this is a complex aspect that may be defined by local geography or land and home ownership. Again there is a lack of detail in this consultation to confidently critique the proposed regulation.

There appears to be a strong tendency towards metering supplies that does not acknowledge the value of heat with rent nor the costs of metering and billing. We are concerned that neither planned maintenance costs or metering and billing costs (including service fees where this function is outsourced) are included in the list.

**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?**

See Q8.

**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?**

See Q8.

**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?**

Agree

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

N/A

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

See Q9

**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?**

**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?**

N/A

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

N/A

**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.**

Option 1 (segmented approach) – This is potentially the most appropriate in offering transparency but depends on the validity of the comparisons being made to ensure these are ‘like for like’.

Option 2 (pooled market average) – We have concerns on the validity of the comparisons given averages would not reflect the diversity of the sector. For example, this would likely result in more favourable results for newer developments compared to older schemes and could therefore disadvantage many of the heat networks our members are involved in.

Option 3 (RAG rating) – We have concerns about this approach as while it is more simplistic, it could still be subject to misinterpretation. As noted in the consultation, there is a risk of a ‘red’ rating being interpreted as a ‘fail’ and could create alarm and more confusion for consumers.



**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?**

We recognise the need and importance of regulation of the sector and for adequate customer protections to be built into what will be mostly monopolies. As previously stated we have concerns over the focus on financial quantification without the consideration of the specific needs of vulnerable residents. Therefore, while comparisons can be helpful, there are risks of overcomplicating and providing consumers with an overwhelming amount of information. There are risks that confusion and misinterpretation could lead to increased complaints around costs and billing, even where these aren't justified.

More broadly, it is important to recognise that unlike the gas and electricity market, heat network customers don't have a choice in their supplier. So, while these options may offer increased price transparency, it doesn't allow customers to switch to a more affordable alternative.

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

Option 1 preferred.

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

Yes. It seems sensible to evolve this process as more data becomes available.

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

Yes. It could be helpful to treat not-for-profit heat networks differently if there are to be fewer reporting requirements. We understand that there would be a trade off in the validity of central price comparisons if this is based on more limited data inputs, but this should be explored further.

**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?**

We agree that the proposed options won't require further information than that already proposed through the price comparison proposals, but as discussed elsewhere in the response, this is still a considerable increase in data collection and reporting compared to current practice.

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

N/A

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

Broadley, yes, given this will be done on a case by case rather than a prescriptive basis. However, the proposed guidance for Authorised Entities will be of critical importance and we would welcome further engagement with the social housing sector as this is developed.

It would be particular useful to understand how the different benchmarking methods discussed in Chapter 4 will be used in the case of a price investigation. We note that while it is proposed that all three methods may be used, there needs to be some consistency to avoid a heat network basing its pricing on one method but then being assessed against another.