

## **Coventry City Council Response to:**

### **Consultation - Heat networks regulation: fair pricing protections 2025**

#### **Fair pricing framework**

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.

CCC Response: We are in general agreement with the objectives, principles and outcomes set out for the Fair Pricing Framework.

We do however believe significant education of customers to understand the nuances of cost-reflective pricing for heat. Many customers do not tend to factor in existing heating system maintenance and replacement costs into their utility budgeting currently, therefore are not accustomed to the concept of “Heat as a Service” pricing which is effectively what the “Cost-Reflective pricing” principle is moving the industry towards.

In terms of the “Cost Efficiency” principle, the ability for Heat Network operators to take a long-term view will be significantly impacted by the length of tenancies, Heat Supply Agreements, Concession Arrangements and other contractual arrangements that relate to the connection. Whilst some of these can be addressed through introducing transferable sinking funds or other such mechanisms this still requires the buy-in from customers to also take a long-term view on pricing which is not commonplace amongst UK leasehold property owners or renters.

Fuel Procurement principles also need to consider the non-financial aspects for fuels source. Using a low carbon heat source such as reclaimed heat of ASHP sources can be more expensive per unit than a gas equivalent. This principle needs to be considered in the context of Net Zero requirements and needs to be careful not to delay the transition of heat networks to lower carbon fuel sources. The definitions in the consultation seem to be focused on heat networks that use grid connected fuel sources such as grid electricity or natural gas where open market opportunities exist. This is not possible for networks linked to Energy from Waste centres or other bipartite supply heat sources. Considerations around restrictions on transfer pricing rules for example need to be considered as waste heat use becomes more prevalent.

The one principle that is potentially unclear is the one of Affordability. Whilst it is clearly a desirable outcome, the significant subjectivity and variation in economic circumstances of customers that sits behind perceived affordability means that it would be a difficult principle to evaluate and enforce. As set out in the consultation you are not intended on requiring customer economic circumstances in the setting of pricing and

therefore it might be better to avoid the calling the principle “affordability”. Based on the aspects looking to be addressed by the principle (eg. Bill shock) perhaps a better term would be “Predictability”. The main aim seems to be to ensure that pricing is developed that gives the customers the best opportunity to understand and budget for their heat use.

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.

CCC Response: We are generally supportive of the proposed guidance areas. Some of the areas will need to be developed once clarity has been given from other parts of the regulations such as HNTAS. For example, Data Accuracy and Metering guidance will only be able to be developed once the requirements of HNTAS are confirmed.

An area of guidance that we think would be beneficial is how the guidance aligns with other obligations that exist via other regulations such as the Landlord Tenant Act or the Social Housing Act. This will be the first time that many landlords will be exposed to Ofgem utility regulations and it is unclear how obligations will impact on current practices in place to comply with the Landlord Tenant Act. The biggest difference between Heat Network Regulation and other utility regulation is that the key stakeholders are largely not utility specialists but have heat supply as an ancillary function as a result of being a property landlord. Particularly best practice on whether heat network sinking funds need to be diverged from other building related sinking funds or whether it is more transparent to keep all property related sinking funds centralised.

There might also need to be specific guidance about how fair pricing principles sit within the context of publicly owned and operated networks.

- 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.

CCC Response: Yes we agree with the proposal to develop these areas initially as guidance. As information about heat networks builds over time there may be specific areas that get further developed into specific obligations rather than simply guidance as the industry continues to mature.

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)?

CCC Response: Yes we broadly agree with the high-level features of the fairness test as it allows for the significant variability that exists in the type, scale and commercial arrangements related to heat networks.

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

CCC Response: We agree the questions that Ofgem seeks to understand are appropriate for determining whether pricing of a network meet a fairness test. However, the majority of the questions posed would not be possible for individual heat network operators to answer until significantly more information is publicly available about heat networks. It is not clear if heat network operators will be expected to develop their pricing independently from this process.

It is also not clear what would happen if Ofgem determines that the pricing for an existing network is deemed “not fair” compared to external benchmarking but customers are in existing long term heat supply contracts? We believe in earlier consultations there was an overarching principle that the new Heat Network Regulations would not impact existing commercial investments that had been made prior to the regulations coming into effect. Whilst overriding existing contractual terms due to a Change in Law, if the provision exists within existing contracts, may be of benefit to customers, it is not clear what the implications would be on the incumbent operators and whether this could lead to Operators or Suppliers failing and triggering issues elsewhere.

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

CCC Response: We agree that the authorisation condition text presented in the consultation reflects the policy intent for supporting fair pricing in the heat network industry.

### **Market segmentation**

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?

CCC Response: In general, we feel the characteristics are broadly identified and correctly defined although we have some comments relating to some of them as set out below.

We are not clear on the rationale as to why heat networks in a “Heat Zone” should be treated differently to those outside a Heat Zone from a Fair Pricing perspective. We would like Ofgem to clarify what aspects they believe would be different relative to Heat Zoning. It is not clear if Ofgem is referring specifically to customers mandated to join district heat networks within Heat Zones as opposed to voluntary heat network customers that would exist both inside and outside zones.

A characteristic that we are not sure has been clearly captured is whether the Heat Network Operator has control over the heat source or is primarily operated as a “Heat Shipper” with others controlling the actual heat source. For these types of networks the fair pricing principles might need to be lighter touch if the input price of heat is not within their control.

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

CCC Response: In general, we agree that the segmentation approach is appropriate for each characteristic, however, we have the following comments related to a few of them that we have a difference of opinion.

The “profit vs not-for profit” segmentation needs more clarity. For many heat network operators (particularly communal heat networks), the heat sales itself will be on a non-profit basis but as an organisation they will be profit making as a commercial landlord. Ofgem will need to provide greater clarity on exactly what EBIT reporting organisations will need to provide and how it proposes to separate heat related and non-heat related earnings in the EBIT reporting.

We believe the “Function” does have relevance to the market segmentation. Where obligations are split between both an Operator and a Supplier there will be a need to consider these differently potentially. For example, a Supplier has no responsibility for the maintenance and operation of the network and heat source and therefore would not be responsible for setting these elements under fair pricing tests as this would be for the Operator to demonstrate. It will depend on the contractual arrangements for the network as to whether the Operator directly bills customers or if costs are passed through to the Supplier to bill to customers in a similar fashion as other utility network costs.

The energy needs for large commercial customers can be very different compared to domestic customers. They can also have very different requirements in terms of ability to contribute to initial capital costs and desire for pricing arrangements that suit their

business. As mentioned in the consultation some commercial customers will want greater price certainty whilst others will more of a market driven price. This variability is clear to see in other utility markets where I&C suppliers offer everything from fixed price contracts to day-ahead pricing or even long-term PPAs. Similarly, the consumer protections required for domestic and micro businesses may impact considerations in relation to the application of fair pricing principles. For example, a network reliant on a commercial input energy contracts may have to factor in the additional risk associated with the difference between back billing rules between commercial energy contracts and domestic heat customer contracts.

### **Data requirements**

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

CCC Response: We currently operate a range of communal heating systems, some that have their own heat generating equipment and others that rely on 3<sup>rd</sup> party bulk heat supply from a district heat network. A general clarification is needed as to whether this data is on an “aggregate basis” by organisation or on a “per network basis”. In terms of this consultation response we have presumed that it is on a “per network basis”. Our responses are also based on the fact that we do not operate any standalone heat networks and therefore our customers receive a range of services from us not just heat supply.

We currently measure and record the amount of heat apportioned to our tenants in order to account for them in our annual emissions reporting. Some of these are measured and other are based on floor area however it means it would be easy to report annual consumption information as its already collected. Most tenants are currently on quarterly energy recharge schedules so this information could be provided quarterly. Similarly the total number of customers and cost of tenant consumption and Revenue from tenants would be easy to report.

For heat networks where there is a heat output meter fitted on the heat source, providing generation data is easy. Similarly those with full BMS the collection of flow and return temperatures are generally already reported.

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

CCC Response: Currently the tenants are only charged for a proportion of the input energy costs depending on either metered consumption or floor area. Therefore currently reporting unit rate and standing charges associated with each tenant will be more challenging.

The O&M costs and communal area heating costs associated with the communal heat networks are currently incorporated into general standing charges for the buildings and not separated out for other O&M costs for the building. Therefore reporting specific heat network related costs would be challenging to report.

The length of communal networks is not something routinely provided in construction information pack and for old systems that have been modified many times in the past this is likely to be very hard to determine retrospectively.

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

CCC Response: The length of communal networks is not something routinely provided in construction information pack and for old systems that have been modified many times in the past this is likely to be very hard to determine retrospectively. Estimates based on building height would likely have to be used, In some old buildings the exact route of pipe work can be not as straight forward to determine.

In some cases, the commercial terms for different tenants may vary in the same communal heat network due to things like the length of contract tenant requirements or other commercial benefits offered to secure a tenancy. This is also the case for district heat networks so it is not clear how a network would be able to report this concisely and meaningfully without potentially being in conflict with commercial confidentiality that is contained in some existing contracts.

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?

CCC Response: Yes the amount and frequency of data reporting should be tailored to be appropriate to the Heat Network and the organisation operating it. For large district networks operated by dedicated heat network operators, much of this reporting should be fairly easy to do as it is part of their core business, For landlords of communal buildings the reporting depth needs to be set at a level that does not introduce excessive burden that they are not currently resourced to or skilled to deliver. The contemplation of the new Heat network regulations is already making some developers and landlords look to avoid these implications and burdens by switching to less efficient non-communal systems.

Where heat network operating costs are contained within general building service charges it would be onerous to separate out the heat network costs as it will require the landlord to have to manage 2 service charges and potentially 2 sinking funds. This would

see a rolling back in administrative efficiencies that exist from bundling all O&M costs into a single Service Charge arrangement.

If the heat network forms part of a single building asset by an organisation it may not be possible to separately account for depreciation of the Heat Network on its own.

### **Cost allocation**

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?

CCC Response: The principle is a fair one that clearly makes sense in the sector when considering commercial heat network operators. However, the implications of this with other types of heat network ownership needs to be considered carefully. There are some heat networks that might be operated on a non-commercial basis by for instance a Residents Association. In this scenario the costs of the O&M and compliance would be split amongst the residents and there would be no option but for any penalties incurred to be shouldered by the residents.

It also needs to be clear that this does not prohibit heat network operators from appropriately recovering any additional costs incurred in order to make improvements to rectify the route cause leading to the GSOP. For instance, higher service charges to cover increased costs associated with purchasing additional equipment or employing additional staff.

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?

CCC Response: The greatest challenge with allocating capital cost is largely down to the fact a district heat network has little control over the number or timescales at which new customers join. This does therefore mean that early adopters are typically bearing a larger proportion of the initial build costs. Introducing a requirement or recommendation to limit the capital cost recovery rate could jeopardise the business case for new heat networks by introducing too much risk for developers and investors in the early stages. Whilst we are aware that Zoning is intended to mitigate this risk, it is not looking like that legislation is shaping up to provide the level of certainty that would make a marked difference on this. Perhaps the guidance should instead be moving towards a requirement for Standing Charges to move away from a fixed cost linked to inflation metrics to one that is to be evaluated on an annual basis reflecting on any growth of a network. This would stop heat supply agreements with high fixed costs remaining for the

full duration of the term and offer early adopters the opportunity to also benefit from additional growth of a network they helped to initiate.

**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?

CCC Response: Yes. We believe best practice needs to be different for district heat networks and communal heat networks. This is largely due to district heat network operators being less likely to be providing other services to customers whereas communal heat network operators are likely providing other property services to customers.

We also believe the guidance should be aligned with the different types of Building Class within the HNMBR. We agree that metered and unmetered heat networks would need different guidance, however there may need to be different guidance for existing networks and post-regulation built networks. The guidance for new builds should provide best practice that can be incorporated into the design stage of new heat network installations whereas existing networks may not be able to be retrofit to the same degree. Similarly, it is easier to forecast the likely lifecycle costs for a new heat network and plan accordingly compared to one that has been in operation for many years and will therefore have an unknown condition.

**Q13.** Does the authorisation condition, ‘cost allocation’, reflect the policy intent?

CCC Response: This authorisation condition reflects the aim of the policy and allows for additional guidance to be introduced separately to cover off the issues raised previously about the GSOP payment recovery for customer owned/operated heat networks.

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

CCC Response: It is important to enable a flexible approach to cost allocation due to the significant diversity in the nature of Heat Networks and their operators. The proposed approach appears to have considered this. One observation and concern is that adopting the guidance may introduce additional operational costs that will ultimately increase the administrative costs shouldered by some customers compared to the pre-regulation scenario. For example, currently our tenants are not charged any uplift on input energy costs for administration purposes because of the light touch and simple approach we use for cost allocation. If cost allocation needs to be made more robust, better documented, recorded and audited this will likely require additional admin costs meaning we would have to start charging tenants extra to cover these extra costs.



## **Price comparison and benchmarking methods**

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?

CCC Response: The biggest challenge we see with heat network price benchmarking is probably the wide range of variance in how capital costs are treated. Some customers will prefer to invest capital if they have it available at the start to reduce the ongoing revenue costs of the heat supply but others without available capital will look to the heat network developer to recover it via higher revenue charges. This then means that the total heat sales from one connection could cover a different scope of costs than another and skew any benchmarking exercise. Requiring heat developers to disclose the cost of capital included in their capital recovery pricing would greatly help the transparency of the industry in terms of policing fair returns are being achieved.

We believe that Ofgem should work with heat network operators to understand how network investment costs could be separated from heat generation and supply costs. If the capital investment recovery was excluded from the benchmarking approach it might enable a simpler benchmark of comparing Total Heat Sales against Total Energy Delivered (p/kWh) and Total Input Energy Costs (% uplift). This would be potentially easier to compare to other utility pricing or for networks that have no control of the input cost of heat.

If capital costs are not to be excluded from the benchmarking then there will need to be some prescriptive methodologies for providing the cost benchmarking figure so that the range of variations are limited.

The 4 categories of heat network are probably appropriate however consideration is needed in relation to the definition of “district networks” who have a blend of heat sources, some of which they own and operate and others that are owned and operated by others.

The carbon intensity of a heat network probably also needs to be factored into the benchmarking process in some way. It is presumed that this is being considered in the “Archotyping” stage however we noticed earlier that nothing in relation to carbon intensity was mentioned in the data items that were being proposed to be collected.

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

CCC Response: We consider the two proposed counterfactual benchmarks are appropriate for heat networks however we have significant reservations on the ability to develop them in a robust and cost effective manner based on previous experience of different situations where either Gas or ASHP counterfactuals have tried to be developed. We note that your proposal is to base your gas benchmark on the Heat Trust calculator.

This is aimed at domestic properties only and therefore doesn't cater for the significant variance you have in the non-domestic sector. It has not been made clear in the consultation if these benchmarking requirements are going to be limited to domestic heat network connections only.

We have attempted to develop a number of gas boiler and heat pump counterfactuals in the past and have really struggled to find a robust methodology for doing so as there are many interdependencies on both gas or heat pump costs. Even just the variance in the input cost of gas causes significant challenge. Using the latest data from the Council's own broad range of gas supplies we are responsible for shows that whilst the average levelised cost of gas (standing charges and unit charges divided by consumption) was 9p/kWh this varied significantly with some sites being as low as 5.4p/kWh and another being as high as 39p/kWh due to technical specifics about the nature of gas demands on the sites.

Similarly the recent changes to TUOS residual costs on electricity supply have had significant impacts on sites with heat pumps particularly for medium sized buildings. A significantly impacted sector has been schools. They often have large capacity electricity supplies however historically paid very little Triad costs as they are rarely occupied during triad events but are now captured by the fixed banding approach. This means that the impact of ASHP deployment is dependent on whether it triggers a school to go up a Capacity Banding or not despite the capacity rarely being needed at the peak of the network demands. As with gas supply costs, electricity costs also vary significantly. Again, using the Council's latest data, levelised costs of electricity varied by as much as 33p/kWh. This makes determining the costs of an ASHP counterfactual difficult to standardise.

Another example of the difficulty of this approach is the PSDS grant funding scheme. It has attempted to calculate "like for like" cost counterfactuals for grant allocation purposes. It was found that this approach was too varied to work with and therefore they moved to a set 12% contribution requirement. This was because the gas replacement counterfactual presented unnecessary burdens on the supply chain to work up site specific costs for a project that there is no intention to deliver.

We are often asked to provide a comparison of our current heat network operating cost compared to what it would have cost on gas. This is something we frequently struggle with particularly for buildings that never had gas as the systems that are designed specifically with a heat network in mind. We end up having to use the building's EAC/AQ data and the average levelised costs of gas or electricity but as mentioned above it has its limitations.

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?

CCC Response: We assume that the intention is that it will be a benchmark against an air source heat pump not any other type of heat pump. For the ASHP benchmark you would also need to factor in the grid upgrade cost to enable its installation and the potential increase in standing charges associated due to changes to the capacity and consumption levels. As mentioned above this can be impacted significantly by the existing building connection and other technical specifics for the site.

In terms of including for capital grant support you would need to consider how competition-based funding is applied. The existing grant schemes are insufficient to support every property and the eligibility for funding is also often dependent on the nature of the occupant.

We have seen significant variance in the cost of maintaining heat pumps depending on the manufacturer's requirements and the type of heat pump deployed. (eg. Refrigerant used, cascade vs larger packaged unit). Similarly, as mentioned above, the cost of electricity is also significantly variable so Ofgem would have to stipulate what these are for all organisations to use for benchmarking purposes even if the rates are not reflective of what could be achieved for a specific property. The proposed use of the price cap value is not transferable to the non-domestic sector.

The heat demand proposition again seems to only consider the domestic scenario. Given DESNZ is working on the NZM if this tool was made available to everyone then it could be the standard methodology that the benchmarking is done against. We think this what is intended in this proposal. It is worth noting that as part of the zoning pilot work, our appointed consultants have had to spend significant time verifying and correcting anomalies in the NZM outputs and adjusting the DESNZ heat pump assumptions for each specific feasibility study as there has been significant differences between NZM and reality. We believe there is scope to better incorporate real world consumption data into the heat demand modelling to reduce the burden of manual adjustments of the NZM. This however requires better coordination of various national agendas and more open routes for relevant data sharing via RECCo. The designation of energy data as personal data has created significant unnecessary challenges with developing universal solutions that address the challenges that we are now coming up against. The new consents portal from RECCo may present a solution for the specific needs of this benchmarking for heat network operators as consent could be relatively easily obtained as part of potential customer engagements. It would however require Heat Network Operators to be recognised as User Category on the Data Access Matrix. This is not a quick process. It took over 2 years to add Local Authorities to the DAM and a further 2+ years trying to set up the new service provisions via REC to facilitate the data provision.

An alternative would be to use existing methodologies for reference energy demands that are used for Energy Certification (eg, DEC and EPCs) so there is consistency between heat network benchmarking and wider building energy efficiency benchmarking. These methodologies and data is already in the public domain.

Again with COP, this is an area that is significantly impacted by assumptions made in the heat pump counterfactual. If Ofgem wishes to develop a counterfactual then it is recommended that Ofgem specifies what COP is to be used to enable consistency.

**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?**

CCC Response: We were not clear whether the investor type and source of capital was considered within the recovery of cost driver. Whether the network has been invested in using public, private or grant finance could have a significant impact on the pricing achieved as the cost of capital plays a significant part for high capex projects like heat networks.

Given that cost of network build-out and maintenance is such a significant part of the price calculation for a heat network has Ofgem considered applying knowledge from the cost regulation of gas and electricity to do similar in the heat network regulations? This relates back to previous comments about attempts to separate network investment costs from heat generation and supply costs. We appreciate that there may be network operators that wish to blend high returns on capital investments with low returns on heat supply (or vice versa), however, ensuring fair pricing in the capital costs associated with network buildout will be critical to ensuring a fair price for heat is achieved from the outset particularly with district heat networks where the number of connected customers is likely to vary over time. Communal Networks are different as the operators will tend to be in control of the number of connections served.

**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?**

CCC Response: The input fuel cost, annual demand and heat source type is easy to report and is most likely held already. However, consideration of how networks with multiple heat source types will report this information will be needed. The likelihood is that district heat networks will have increasingly diverse heat sources so it might be more relevant to consider a blended Carbon Intensity instead.

As mentioned earlier, network length may be more difficult for communal heating networks as this is probably unlikely to have been a consideration to date. This may have

to be estimated from building plans particularly where multiple adaptations to building internal networks have happened over time. This could be particularly difficult for heating systems that we not originally intended as multi-tenant communal heating systems.

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?

CCC Response: The majority of drivers listed would be easy to report as will be information already held by most heat network operators. The challenge could be in reporting on the cost recovery approach as there could be such significant variance in this it might make segmentation difficult. Is the intention of Ofgem to provide a defined list of responses for these drivers as operators may use different terminology for the same thing.

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?

CCC Response: We agree it makes sense to publish the methodologies that are used for each benchmark so that there is transparency on what they do and dont account for. This is a new process and will require customer and industry engagement to build understanding as to what the benchmarking is, and just as importantly, what it isnt. Experience of other sectors has shown that introduction of benchmarking can be easily misinterpreted (eg. EPCs, Nutrition Labelling, Appliance energy declarations).

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

CCC Response: It would be good to get further clarity on what happens if disproportionate pricing methodologies are identified during this benchmarking process in relation to existing contracts. Many heat customers with have existing contracts that set out the pricing methodology. Will these new regulations have the power to override existing contracts and require alternative pricing methodologies and customer charges to be applied retrospectively? Many of these contracts were entered into in good faith many years ago although without fully considering all of the potential implications of indexations and formula-based adjustments included in them. The recent energy crisis has significantly changed the picture of what was perceived as the maximum variance in commonly used indices. There is the potential you end up with the benchmarking process not really becoming effective for decades as these long-term pre-regulation contracts work through their term.

We are presuming the intention is that how each network performs against this benchmarks will be published eventually or that operators will be required to include the benchmark comparators alongside any pricing offers they issue to customers?

The outcomes demonstrated in Appendix 4 are largely consistent with outcomes identified in previous district heat network feasibility and masterplanning work. However it is noted that this model testing appears to only focus on district energy networks. How this translates into to modelling you plan to use for communal heat networks is not clear. More detail on the benchmarking of communal heat networks is needed. It is anticipated similar correlations are expected in that communal heat networks with higher overall consumption would work out cheaper. However the number of customers on the number and type of customer on the network may play more of a factor than linear density. (eg, A block of flats vs a block of offices)

### **Profitability analysis**

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

CCC Response: We agree that the profitability analysis needs to be as light touch as possible and therefore a simple metric like EBIT is probably appropriate in the main. However consideration needs to be given to how profitability will account for the varied ways Heat Network Operators will be making their profits. Some will be making profit from financing the network, others will be through the heat sales, some will be making profit through rents and will be either non-profit making or (even loss making) on their heat network.

Something that really needs to be considered is how this might be able to prevent poor practices from the water industry being repeated. How will ofgem prevent heat networks being loaded with significant debts that effectively mean profits are stripped out by investor owners.

We welcome Ofgem's recognition of the need for a cautious use of this metric as a heat network with a low EBIT could still be unfair to consumers if the operator is poorly managing their input costs. Conversely, a high EBIT operator may be still offering fair low prices but generating higher profits through acting efficiently.

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?

CCC Response: For district heat networks where the primary function of the operator is the supply of heat this should be a fairly easy metric as is most likely already calculated by those organisations. However the treatment of intercompany loans needs to be

considered as many operators invest capital from a parent company and therefore the profitability of the heat network operator is underestimated as a result as the repayment of the loan and interest on it would be captured as costs for the operator. Two identical networks charging the same prices and having the same costs could be generating significantly different profits for an entity depending on whether it was self-financed or 3<sup>rd</sup> party financed and the associated cost of capital for each. How do you prevent operators from reporting a low EBIT as a result of an excessively high cost of capital from an intercompany loan.

Applying this to communal heat network operators could be significantly more challenging as you would need to separate out the costs and assets associated with the heat network from all of the other costs and revenue the operator has from other aspects related to operating a tenanted property. Many landlords probably do not segregate the O&M costs of communal heat networks from other costs associated with operating and maintaining a building. It may often be the case that the heat network will not even be considered an asset in its own right with the accounted asset being the overall building. Therefore things like depreciation may not be calculated for the heat network specifically. Separating out heat network costs directly to enable accounting for them separately to all other M&E assets in a building would not be a straightforward task and will add significant additional administrative burden. This would likely result in an increase in costs being passed through to tenants for little benefit.

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?

CCC Response: We support the regulator having the powers to investigate potential poor practice and excessive profit making by operators through more in-depth profitability assessments. However, this needs to be done via exception to avoid unnecessary cost being applied throughout the heat network sector. Perhaps segmentation done to separate those organisations whose primary function is heat network operation from those who are only heat network operators as an ancillary activity to their core function.

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

CCC Response: Whilst it is understood that this won't begin immediately January 2026 but phased in, it is presumed that the provision of the information required will be aligned with an organisations normal reporting cycles to avoid operators from having to potentially make multiple calculations of similar information. It is presumed Ofgem will allow reasonable time following the end of the relevant reporting period for this information to be provided.



## **Central price transparency**

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.

CCC Response: Given the fact that consumers will not be able to actually chose their heat supplier, we are not convinced that the price transparency information will actually be that beneficial to the vast majority of consumers that have no control over the heating system in thier property. The main beneficiary for this pricing transparency will be those who have to make procurement decisions around the heating systems deployed. Being able to compare connection offers, standing charges and unit rates with national benchmarks for similar solutions will help them make informed decisions about whether or not they are getting fair value. Alongside the cost allocation principles this would likely increase the confidence in heat networks and help to alleviate concerns prospective developers and building owners have.

Perhaps more important that the transparency on price, it is the transparency on methods of price change and therefore potential volatility of price that is crucial. Many heat networks start off seeming like a good price but then years down the line are unfair due to links to inflation metrics that are disproportionate to the actual operating cost inflation.

Option 1 – We are not really clear how this is different from the Benchmarking process discussed previously. We are broadly supportive of this approach to price transparency that provides some degree of comparative pricing for different types of heat network. This does however rely on consumers understanding which benchmark group they should be comparing. The examples given of similar price transparency data is a testament to this. How many consumers actually use, or even view, the Market indicators. We feel it is important to be realistic about who this information is for and therefore how best to publish it. The proposed publishing options would really only be beneficial for Heat Operators to help market their services much like broadband companies do (eg. You could save x% by switching to us).

If this really is for consumers, perhaps the way to publish this is for Ofgem to pass it to Heat Network Operators and require Heat Network operators to present the appropriate group pricing information alongside any communications to consumers in relation to their heat supply rates. (eg. On heat supply contracts, price change notifications, or on invoices)

Option 2 - This option as described is probably better suited to the aim of providing consumers with pricing transparency information than the option 1 presented. It is



simpler to understand however there are still significant opportunities for misunderstanding given it will likely tend to use national assumptions around demands for certain types of buildings. Much like the gas and electricity price cap causes confusion amongst consumers in its use of stating it in an “Annual Spend” value, the heat cost calculator tools such as the Heat Trust one can also cause confusion. This approach is also probably limited to domestic customers as it becomes more prone to assumptions when non-domestic customers start to be considered. This consultation does not make it clear if the intent is for pricing transparency to only be required for domestic customers of heat networks or for all customers of heat networks.

Option 3 – whilst we are supporting of a RAG rating being applied to show the overall performance of a Heat Network we are not clear that this is appropriate specifically for the topic of price transparency. The addition of a RAG rating as part of the overall regulatory oversight KPIs of heat networks would enable broader comparison of heat operator performance. The variability of heat networks means it would be unfair for a network to have a Red rating simply for being more expensive if it happens to also be more environmentally friendly, offer better customer service and have less compliance and reliability issues. (much like the Citizen Advice utility supplier rankings).

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?

CCC Response: We believe option 1 would be the best overall option as long as there was additional support from Ofgem to ensure the information is presented to consumers in a more digestible way than proposed. This could be done through requiring Heat Operators to supply this information as part of contracts and billing processes (in a similar way as electricity suppliers have to tell you how your annual spend on your existing tariff compares to their cheapest tariff) rather than relying on consumers working out which group to compare against. Option 2 is a middle ground but could be difficult to make work for non-domestic customers. Option 3 is the simplest but could be easily misunderstood and doesn't meet the intent of pricing transparency. As with all price transparency options there is a risk of price convergence however the cost allocation principles should help to mitigate this as it would potentially flag heat operators who are artificially increasing prices towards any higher benchmark pricing published.

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

CCC Response: Given that there are existing tools that enable early adoption of Option 2 for some consumers but the broader applicability of option 1, we feel that it would be appropriate for Ofgem to develop both of these in parallel.

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

CCC Response: Yes we support the idea of phasing in the two options so that some degree of pricing transparency can be made available early on with the more detailed comparisons and transparency developing over time.

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

CCC Response: Yes we can foresee scenarios where certain market segments will need an alternative approach to pricing transparency due to the nature of the networks and therefore it would be appropriate for Ofgem to allow for Pricing Transparency options to be varied across market segments. (much like exemptions for Electricity Resellers)

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?

CCC Response: As long as the data requested is the same as the data requested for Benchmarking there should be little additional administrative burden for pricing transparency activity over and above the additional burdens that benchmarking will create. The concern would be if the pricing transparency option begins to deviate from the benchmarking data requests or is requested at a higher frequency compared to the requests for benchmarking. For many heat networks prices are adjusted annually and therefore an annual price transparency data request should not be overly burdensome to action.

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

CCC Response: We think that it is a requirement for price transparency approaches are linked with benchmarking approaches otherwise you would end up in a confusing scenario where heat network pricing is being compared on multiple different metrics. This would undermine the intent of the regulations to provide consumers with greater confidence in the prices charged by heat network operators.

### **Price investigations**

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

CCC Response: We believe the approach set out for price investigations is a fair and appropriate one as the variety of heat networks under these regulations would not lend itself to a formulaic approach and a case by case approach will be needed. Over time it

maybe that certain market segments are appropriate for a formulaic or standardised approach to be considered. This would need to be based on evidence gathered through the early years of the regulations being in effect.

## General Feedback

The format of this consultation was not the easiest to engage with and develop a response for. Having the questions for each section set out at the start of the section meant and with some information attached in appendices at the end meant that respondents had to flick back and forth across a very large document.

It would have also been useful for Ofgem to have provided a downloadable editable response template with all the questions in it. It took a fair amount of time just to capture all of the questions being asked in the consultation in order to develop our response. This time was probably spent by every respondent which cumulatively would be a very inefficient use of people's time. Making consultations easier to digest and respond to would likely improve the number and range of responses. Ofgem needs to appreciate that the organisations it is having to engage with on Heat Network Regulations are very different to the utility focused organisations that they are used to dealing with for gas and electricity market regulation. The vast majority of heat network operators will be property landlords with little to know experience of utility regulation practices or terminology.