



Fair pricing consultation

By John Tang Jensen, Chief Advisor, Danish Energy Agency

Questions 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.

In general, the objectives and principles are fine. A cost reflecting tariff structure is easy to implement if all heat demand relates to outdoor temperature and hot tap water demand.

A comment on cost-reflective tariff structure: Then all consumers have same demand profile and fixed costs related to capacity can easily be charged by £/kWh or £/m² heated area and variable costs to demand profile £/kWh. If the district heating company, though, has other customers like industrial heat demand not relating to outdoor temperature and perhaps more constant demand during the year then this consumer does not reflect the same fixed costs due to relatively less demand for capacity in winter and relatively more demand for cheap heat sources in summertime. It can be recommended to allow cost-reflective pricing for each consumer groups – different pricing for different demand profile. Consumer groups, though, must be transparent.

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.

Cross-subsidisation: Cross subsidisation is not only when some consumers are financing costs related to other consumers. It is also when early consumers are financing costs benefitting consumers connecting on a later stage. Regulation of depreciation may be important in this context but regulation of depreciation may also be a tool that can be used for avoiding shock-bills (allowing varying depreciation from year to year).

Danish Energy Agency

Carsten Niebuhrs Gade 43
1577 København V

T: +45 3392 6700
E: ens@ens.dk

www.ens.dk



Restricted Cost passthrough: Instead of defining which costs cannot be passed through to consumers another approach could be defining which costs can be passed through to consumers (Easier).

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?

If prices differ between groups the company must be able to explain the rationale behind and make calculations that show benefit for the whole district heating system shared with the group having lowest prices.

In principle, the key consideration for fairness should be that network operators are providing consumers with the lowest cost that they can within the policy and technology framework that the network is operating in, while understanding that this can and will vary significantly between networks.

Q4. Does the revised authorisation condition, 'fair pricing', reflect the policy intent? Market segmentation Consultation - Heat networks regulation: fair pricing protections 18

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? Data requirements

The more segments the more the complexity increases. There should not be any unmetered consumers. In Denmark vulnerability is a Government issue – not regulator. Industry – see comments Q1 regarding Industry.

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

- Heated area m² if fixed price relates to heated area or capacity kW if fixed price relates to metered capacity demand.
- Number of customers? – is this number the same as the number of meters used for billing?
- Network length by type (Transmission, distribution and branch pipes)
- Annual economic reports could be reported.

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



“Other efficiency measures” needs to be defined if possible for companies to report. In Denmark all data on each production line (per technology) is collected annually by the Energy Agency (Not by regulator). These data are used for calculating technology efficiency and are publicly available also for regulator.

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

In Denmark the difference between DH companies having low prices and companies having high prices often is very dependent on how many different technologies (Heat sources) are implemented including heat storage and how management use the different fuel and electricity markets in combination with purchased heat. This is a management risk not reflected in the cost drivers and very often benchmarking investments does not look good but at same time benchmarking operational costs will be excellent due to management using market opportunities.

If management has many sources and on an hourly base optimises production the risks are low and prices normally likewise. If management make fixed pricing contracts on some fuel sources and not on other like electricity dependent sources the risks increase and heat price likewise. If management make fixed contract on all sources the price may be stable and competitive with individual competitors, but not as low as it could be.

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?

It can be recommended to start in a simple way and not add complexity from beginning. The very small communal networks may be exempted. In Denmark networks with production capacity (Supply to network) below 250 kW are exempted from regulation. They are not regarded district heating networks, though, they have to connect to the larger local district heating network if the heat source is fossil.

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?
companies

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. Best practice guidance should include standard accountant principles. Otherwise costs can be allocated differently and regulator cannot compare/benchmark companies.

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?

No. Pricing system should be similar for all companies. Approach should only differ for consumers having a different profile than outdoor temperature profile

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



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

Heat network losses are a fixed cost. They do not change with supply. Heat supply costs – if heat is purchased from supplier it should be possible to split costs between fixed and variable costs because there are fixed costs included in the price even if it is paid by a variable price.

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?

Comparator benchmark may be difficult, but a starting point is to make a ranking list of all companies by the use of “standard dwelling” or “Standard house” definitions.

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

OK

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?

Ok

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?

In practice this is very difficult. Regulator tried to establish this in Denmark but never succeeded. I do not believe the prediction method has been considered.

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?

As mentioned before data should be collected per production line. Fuel and electricity input price may be different for each line in same company.

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?

Network generation (3rd, 4th ...): There is no clear definition on this and same network may in summertime be 4th generation but 3rd generation in winter due to capacity issues in bottlenecks. Probably easy to provide data, but difficult to find a robust model.

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

It is worth to try.

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?

Regulator may probably meet all kind of excuses and companies will make efforts to hide profit.

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?

No comments.

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

No – this is something we do not have experiences with in Denmark and then it is difficult to imagine how it will work and the resistance from companies.

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.

From a consumer point of view all three options would be fine. The more ways to compare the better.

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?

The discussion of sensitive information is not relevant. DH companies have a monopoly and do not compete with each other for the same customers. The comparison to contrafactual technologies will anyway lead to price convergence. This risk relates to ownership models and not transparency.

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

Anonymised prices do not give sufficient transparency. Both the actual price for each company and statistics showing average etc. should be published.

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

Yes. Publish results when methodology and data make it possible.

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

No. A non-profit company can also have high prices and bad management

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?

The additional burden is very small. In Denmark prices are reported to regulator together with budget showing how the price is calculated in reference to budget. The price to consumers is not valid before reported to regulator.



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

I do not believe it will be possible to make a benchmark showing the true picture of the situation. Low prices come from long-term strategies and management using all opportunities on markets which is difficult to meter. It requires skills, right incentives, professional board and professional management which is more important than the proposed indicators.

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

Yes – of course regulator should be able to investigate prices and require companies to change if it is disproportionate. In Denmark the regulator often requires district heating companies to pay consumers back if disallowed payments are charged.