

Heat Network Regulations Fair Pricing Protections

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1. About Servus

Servus is a metering and billing agent operating in both residential and commercial sectors. We also have experience of management of heat network billing arrangements in Germany.

Servus is responsible for the metering and billing at some of the UK's largest single residential developments. We provide a high level of customer service with bespoke billing systems providing online access to customers.

We are experienced at integration of our services with a variety of heat network schemes, district and communal, and provide consultation services on cost recovery and tariff production.

Servus take on the management of new heat network billing arrangements as well as being appointed to take over many networks that have historically been mismanaged. We work with property managers to coordinate cost recovery with service charge provisioning.

We also manage the procurement of primary utilities used to service heat network installations.

2. Overview

The OFGEM consultation is titled 'fair pricing protections' (FPP) and is clearly seeking to put in place a framework to protect end customers from over charging on heat networks that most often hold a monopoly on supply.

There is a distinct difference between residential and commercial users of utilities. This has been accepted by OFGEM for a number of years with the Maximum Resale Price provisions on gas and electricity only applying to residential customers. The resale by commercial landlord of electricity under the relevant Electricity Act class exemption does not place any limitation on the resale rate. The relationship is regarded as a commercial arrangement, most often governed by a commercial lease arrangement. Both parties to a commercial lease (the landlord and tenant) are able to agree whatever terms they wish for the resale of electricity. The residential market is different whereby the end customer is not considered a commercial operator and does require some level of protection. For the provision of electricity and gas there is a simple maximum resale price provision. The landlord is not permitted to profit but only recover reasonable costs. The FPP are being prepared to have a different provision whereby landlords or owners of the heat network (heat network operators) are entitled to profit (unlike landlords or building network operators in the case of private electricity networks). We feel that OFGEM should clearly appreciate the shift in position being developed for heat networks.

It is notable that the FPP proposals are all aimed at ensuring end customers are not over charged for energy. There appears to be no consideration for undercharging or back billing. From our experience residential communal networks (the place where the most vulnerable class of end customer reside) are generally billed to only recover the cost of supply, with no profit provisioning. In theory the introduction of profit may increase costs as it becomes a justified provision.

A significant part of heat network management is meter management. Heat meters often have limited life or require battery replacements. The cost of meter replacements (and original install) can be significant. The

ability to charge for the cost of metering supply (funding meter installations) is something that should be considered. Furthermore, end customers will dispute meter data that can result in a requirement for the meter operator to attend and inspect. This involves costs that should be recoverable from the customer in some circumstances (for example when nothing is found to be wrong with a meter).

3. Respondent Observations

Cost reflective pricing

Fair pricing is clearly the overarching principle of the regulations. This seems to be focused on preventing heat network operators from overcharging customers. We believe that the regulations should consider the issues that arise from undercharging customers and how such arrangements are corrected. Undercharging leads to positions where landlords and network operators are unable to sustain network operation costs and are required to either seek alternative methods of cost recovery or undertake back billing. We have seen properties where less diligent metering and billing operators have purposefully undercharged for energy in order to make collection simpler, then leaving the network operator with a financial hole.

The regulations should consider corrective action for undercharging and allow for back billing (not limited to the same time period as licenced electricity providers as heat networks operate on annual efficiency curves meaning true costs and performance may not be known until 12 month have passed and for new developments until occupancy is at a saturation level).

Property management of residential property generally places a restriction on contract placement to 12 months (unless a leaseholder consultation process is followed). Has OFGEM considered the impact of this restriction?

As noted in Section 1, OFGEM should be clear on the difference being established between electricity and gas resale to residential customers and heat with the latter not being affected by the Maximum Resale Price provisions but specifically having a profit provision included.

The Heat Network Metering and Billing Regulations is the only place that an assessment of a reasonable amount for metering and billing service costs is made. The amount is currently set at £92 per annum. Will the new regulations more clearly define the amount?

The management of VAT on heat networks can often be a contentious area. Residential properties may be charged VAT on main supplies and suppliers can be obstructive in changing to zero rating. Where heat networks are operated as part of an estate service charge the VAT costs may not be recoverable and so heat network tariff rates may be constructed from gross cost amounts. Does OFGEM intend to clearly define the expected method for management of VAT on heat network primary supplies and recharges?

Cost Recovery

Fines are to be defined in the regulations. For a residential communal heat network that is effectively owned by the residents as a group, any fine would ultimately be met by themselves. Will the process of fines consider the ownership of the network (not for profit or commercial)?

The tariff definitions anticipate fixed costs to be defined in the standing charge and variable energy costs included in the unit rate. Often the most significant element of cost is heat losses. Losses can be accounted for either in the unit rate or as a fixed element payable by each end customer irrespective of whether they use heat. This is often a contentious area for customers in low occupation. Will the regulations make clear the preferred method of managing the value of system loss costs?

Will the regulations define notice periods for tariff changes and back billing?

Benchmarking

The benchmarking discussion appears to focus on identifying pricing that is too high. Will the process also seek to identify pricing that is too low to avoid stockpiling problems for end customers?

We also would ask for consideration where published data may be used in a way that charges are manipulated. For example heat network costs are lowered artificially to represent below benchmark performance with additional costs recovered through other means (such as service charge provisions).

Profitability Assessment

On residential communal networks the principle is currently generally just to recover the cost of providing the service. How will the regulations facilitate this arrangement and make provisions to ensure the networks are not required to run at a loss?

Energy procurement is a complex area. Networks often limit procurement contracts to 12 months and hedging is not a risk taken on residential communal networks. Will the assessment of pricing just accept the raw energy costs or will network operators be in some way penalised for making poor decisions on procurement or allowing supplies to fall into default rates.

The use of EBIT would be difficult for all networks as their costs may be embedded in other parts of an estate operational budgets. Will it be necessary for heat network operators to produce bespoke accounts for their heat networks?

Price Transparency

It would seem more practical to have compartmented price benchmarking. This would separate key elements: maintenance, energy, losses etc and allow for more reasonable assessment. For example an older network may have higher maintenance costs and this would help end customers understand the construction of their pricing.

Main points summary

- Heat network performance can only be assessed on an annual profile with network use saturated. Ensure this is considered in any regulation provisions.
- Consider distinction between residential and commercial customers.
- Consider maximum resale price provisions on electricity and gas.
- Consider back billing provisions.
- Consider undercharging management.
- Consider meter replacement and costs.

- Consider metering and billing costs (eg £92 under HNMBR).
- Consider that fines on residential communal networks will fall to end customers.
- Consider recommendations for attributing network heat losses in tariffs.
- Consider notice periods for tariff changes and back billing.
- Benchmarking to be on tariff price components (not overall cost).
- Consider if raw energy costs will be accepted and networks not penalised for expensive source energy.
- Consider whether heat networks be required to produce annual accounts for EBIT.

