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By email – heatnetworksregulation@ofgem.gov.uk

9 July 2025

Dear Sir/Madam,

Heat Networks Regulations: Fair Pricing Protections

Thank you for providing the opportunity to respond to your recent consultation regarding Fair Pricing Protections. We have detailed below our responses to the questions raised in the consultation:

Fair pricing framework

- 1. 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 support the intent to define the fair pricing customer objective, principles and outcomes however would request that the final approach to this is proportionate to the sector taking into account smaller operators whereby the requirements could become a burden.

We believe that the total annual price should be comparable to, or less than, a counterfactual linked to alternative heat sources and would largely suffice to meet the principles and outcomes you want to achieve. We also note that the energy price cap limits the cost of gas and electricity so a counterfactual linked to these would effectively apply the same price cap to the heat network sector.

- 2. 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: 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.

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.

We agree that it seems sensible to develop guidance in relation to fair pricing however, aligned to our response to question 1, we would encourage proportionality that considers the requirements from the perspective of smaller operators/suppliers to ensure that any requirements are not overly burdensome.

Objective

Whilst we agree with the Objective it must be remembered that “fair” should include being “fair” to the supplier and must be reflective of the investment, often secured from the private sector, to deliver such schemes. Without ‘fair’ returns to investors, it may become increasingly difficult to secure investment to deliver future schemes aligned to the Governments net zero challenge.

Principles

Cost reflective pricing: We agree that this principle as it applies to those networks using a ‘cost recovery’ model but it completely fails to address those networks that employ a ‘cost avoidance’ or ‘price promise’ model. For the avoidance of doubt this is the method that is and will be used by all major ESCo’s in the UK and will be prevalent across heat network zones. We further understand that in securing a heat network zone a heat network developer will only need to set out their pricing methodology which will be based on setting prices against a range of counterfactuals, not cost reflective pricing. Therefore there appears to be a disconnect between this consultation and heat network zoning.

It could be argued that the cost avoidance model would negate the need for most of this consultation and adherence to being equal to or below an agreed benchmark would be sufficient. Any efficiency and operational improvements would be the responsibility of the network to achieve as they have a known finite income. To be clear, we are not advocating such a wholesale change but use this argument to identify that cost avoidance has a strong place in this discussion.

Cost efficiency: We are not confident that delivery of greater efficiencies will automatically result in lower costs to consumers. Delivering certain efficiencies may well require a significant capital cost – a large part or all of which would need to be recovered from residents. A drive to drive down costs will, most likely, result in poor customer experiences as operators cut the level of service which would conflict with the quality improvements elsewhere in the wider proposals.

Fuel procurement, Given the size of our heat portfolio, we have no power to negotiate terms and prices offered by suppliers. We would welcome some form of centralised/Ofgem sponsored pricing framework similar to the service provided by Laser to local authorities that would undertake the fuel procurement and hedging etc on behalf of the wider industry and provide a standard PIA price.

We would also welcome discussions between Ofgem and the gas and electricity providers about some form of cap to prices for gas and electricity used in networks supplying residential consumers to avoid the risk of huge price ranges.

Capital cost recovery. All capital costs associated with the construction must be recoverable in the form of connection charges and heat costs to consumers. Ofgem should also consider capital costs from subsequent works and upgrades (e.g. for efficiency improvements to ultimately in the fullness of time once capital costs have been recovered to drive down costs); these can only be recovered from heat charges.

Fair and reasonable returns. Investors in heat networks require a known return on their investments; any uncertainty in returns or threats of possible future Ofgem price investigation will simply make this sector uninvestable.

Furthermore, if a network has invested time and money to develop buildings that are highly efficient and not just compliant to minimum standards then they should not be penalised by being forced to make a similar margin to a similar network that simply complies with minimum standards. There must be an incentive for excellent networks to be built.

We understand that Ofgem allows gas and electricity network operators to earn a profit on their investments, generally around 5%. For domestic energy suppliers, the price cap sets a maximum unit rate and caps profits

at a 1.9% EBIT (Earnings Before Interest and Tax) margin. Our concern is that similar levels of profit may be considered by Ofgem to decide what is 'fair and reasonable' but this is completely inappropriate for a sector which is trying to attract significant capital investment to deliver the growth required by the government.

Affordability. If all other principles are met then the price charged by the heat network will be fair and we are concerned that this is a further requirement that puts additional burden on the sector and in some cases may drive unhealthy practices such as cross subsidisation. To be clear the Heat Network sector is not a social care provider, our primary purpose is to provide high quality fairly priced low carbon heat to decarbonise buildings.

Shock Bills: The proposal seems to suggest that heat networks should have a sinking fund to cover shock bills and we assume then that these costs would not be passed on? If so, this is not acceptable. Sinking funds are traditionally used to fund major plant replacements they are not used to deal with investments to increase efficiency improvements nor energy price hikes. We agree with the concerns regarding Temporal mismatch.

Debt repayment. Please confirm that the heat network sector will have the ability to reclaim debt through third party deductions from benefit payments. We are also concerned that Ofgem appears to be taking the position that where a repayment plan is agreed but the customer then struggles to make agreed repayments the heat supplier should then accept further reductions. This almost appears to be a charter for non payment of heat supply charges. Whilst we recognise that it is important to work with customers, if a service has been provided then ultimately the supplier has a right to expect payments. It is also important to note that each scheme has to operate within its own financial resources and for small schemes high levels of bad debt will make them unviable to operate and for cost recovery schemes will simply increase charges to other customers. This direct link does NOT exist in the gas and electricity sector. Underlining the need to heat network specific regulation.

Outcomes

It is not clear how some of the stated customer outcomes will be achieved with this framework.

Increased efficiency does not result necessarily in reduced prices, when considering capital investment required. Investments in efficiency improvements will, also need to be recouped from consumers, at the very least maintaining existing prices or in some cases increasing prices.

There is little in the framework that addresses service quality – in fact with pressure on costs then this could drive an unintended consequence resulting in poorer standards of customer service.

The framework as proposed currently does not give guidance on how capital investment can be recouped over time in a fair manner.

The Industry Outcome that “the framework does not discourage growth of the heat network sector” is weak and does not appear to support sector growth. We suggest Industry Outcomes could include:

- An overarching outcome and framework that regulation supports investment to deliver growth
- Certainty about allowable margins which deliver an investable return
- Through regulation benchmarks are published which demonstrate fair pricing using a whole life cycle costs methodology to address the many current pricing complaints where customers do not understand that heat is a delivered service and not a primary fuel.

3. 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)?**

Some of the principles are flawed as can be seen from our responses above. Without predefined and easily understandable definitions of 'fair' and a definition of 'disproportionate' that don't have to rely on multiple, complicated economic cost model driven counterfactuals then the sector and its customers are in no better place than they are in currently.

While the framework strives for objectivity through specific analytical methods and defined steps, the overall determination of fairness and whether prices are disproportionate involves applying principles and exercising judgment based on the specifics of each case. The questions for the fairness test listed in Appendix 1 include both objective comparisons (benchmarking, profitability) and considerations that involve qualitative assessment (e.g., who is affected, tariff design rationale, presence of cross-subsidisation

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

The proposals do not specify a test but just a non-exhaustive range of topics to be considered. On a case by case basis this will lead to subjectivity, variation and challenge.

We do not consider comparator benchmarking to add any value as there will always be reasons why the model does not fit, or the specific network can argue why it is not relevant to their specific case.

Some of the questions that may be asked to prioritise actions should be used to assess concerns e.g. 'structure of cost and capital recovery'. We suggest that the priorities are

- The consultations first bullet point in A1.4
- the level of overall customer detriment as defined by the average amount the annual bill is above the benchmark
- The impact of any price ruling on heat network viability

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

Partially

Clause 4.4 of the draft Authorisation Conditions refers to guidance which is still to be consulted upon. If the guidance that comes out as a result of this consultation is weak, unclear, open to dispute or unfairly treats the industry then the policy intent will fail.

Market segmentation

5. 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):

This question is confused as it refers to market segmentation as opposed to price benchmarking, but the table refers to price benchmarking.

We challenge the application of market segmentation as described in the consultation to fair pricing. We believe this is overly complex and unmanageable and a much simpler system needs to be developed to assess whether prices are fair for consumers which uses a simple set of counterfactual benchmarks.

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

If Ofgem does proceed as proposed, in Table 2 of the consultation there are many segments, many of which are specifically excluded from price requirements and some, where this is implied. It is not clear which segments will be applied to 'price requirements'.

The segments that specifically are mentioned for price are;

- Network Size
- Metered v non metered
- Profit v non-profit
- Tenure

Other measure that may be included appear to be

- Type of network
- Zoning location

We believe this produces a confusing matrix of benchmarks which Ofgem will struggle to operate and heat suppliers and customers will struggle to understand.

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

- Network Size – whilst we agree that theoretically larger networks should see lower heat prices driven by economies of scale, in practice larger schemes will often have to secure much more complex and spatially challenging low carbon heat sources and therefore this may not be the case. As long as the scheme delivers a fair price against the generic counterfactual then size should not be an issue.
- Metered v non metered – we agree that the costs on unmetered schemes should be allocated to consumers on some proxy such as no of bedrooms.
- Profit v non-profit – we disagree the analysis of profit and under/over cost recovery is essential regardless of status of supplier.
- Tenure – we agree; standing charges for rental tenants should reflect that the landlord should be maintaining and replacing the infrastructure and this should not be included in heat charges.

- Type of network – we do not agree as ultimately all residential customers are connected to a heat network
- Zoning location – whilst we can see this is data that should be gathered, building outside of a zone should not mean that that prices should be unfair.

Data requirements

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

Data requirements could be quite extensive based on the information listed throughout the consultation. Whilst we have access to some of this data, further development may be needed to be able to share some of the broader list. We would encourage Ofgem to finalise data requirements and work with heat operators / suppliers to better understand what is currently available and the impact or costs associated with the further development of systems to be able to provide any wider data requirements.

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

We may require additional time to review the requirements surrounding Cost Drivers and Cost Allocation which may be more difficult to extract.

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

We are concerned that Ofgem are considering 30 cost drivers, and believe this will create an unmanageable framework which is complex for Ofgem to operate and difficult for the customers/heat suppliers to understand.

The cost drivers listed as high importance should be straightforward to report on.

The other metrics may all be difficult to accurately report on especially for mixed age/technology networks and for those networks that have changed in the reporting period.

9. 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?

We believe that the majority of the problems with unfair pricing may arise from smaller operators and single block communal schemes and schemes which are accidental ESCo's and have been created to meet a planning requirement. For these smaller schemes there is little room to negotiate prices and every link in the chain will be making margin, possibly resulting in higher prices to consumers

We suggest that the private, for-profit sector is the one area that has a best understanding of its cost base and also has the most cost effective and technically efficient operation; to penalise them with huge dataset requirements is not appropriate. In fact, those operators on a cost avoidance model could be largely exempted from this process.

Cost allocation

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

Yes.

11. 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?

Tariffs should not reward or encourage high energy use by having a very small unit charge or, similarly penalise low users by having a high standing charge. Therefore it is not always correct to have a rigid adherence to fixed costs = standing charges and variable costs = unit charges.

There is no correct answer but a balance is needed that;

- Generally, tariffs reflect the cost base of the organisation
- Does not significantly disadvantage one group of consumers
- Encourage high consumption
- Penalise low users

Best practice should be developed to deliver these principles.

Cost reflectivity.

We repeat our point that cost reflectivity or cost recovery is not the only pricing model. Price promise networks provide 100% fair prices as they are benchmarked against a standard counterfactual and any cost or operational inefficiencies are borne by the network – not the consumer.

12. 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

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

Yes

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

None

Price comparison and benchmarking methods

15. 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?

A fair price is something a consumer pays. The consultation has missed this point when it focuses on operator and supplier costs. The whole Approach is disproportionate to the problem that presents itself to Ofgem. We understand that, as a regulator, Ofgem needs to have a pricing policy in place but it needs to be consumer focussed

Clause 4.1 of the consultation says “the motivation for benchmarking is.... To identify... disproportionate pricing”. We do not understand why Ofgem simply does not define disproportionate pricing as being an amount above a counterfactual. The market would also then have a clear idea of what their allowed parameters are and can work within a known and defined envelope.

Therefore, we strongly support the external benchmarking as, assuming it is based on a regulated price of gas and/or electricity then you will have a maximum fair price.

Consumer transparency has also been forgotten in this consultation. As an industry we are trying to understand how fair prices will be assessed, but how will consumers be expected to understand and have confidence that their prices are fair and not disproportionate when such a complicated model as the diagram on Page 51 of the consultation shows? Counterfactual pricing is hard enough to explain to residents even when using a simple tool, such as the Heat Trust Heat Cost Calculator but to add in a multitude of complexity will make explanations and transparency impossible. This whole proposal by Ofgem needs to be simplified down to external benchmarking.

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

Yes if they are used in a fair manner which reflects the scheme that the occupier is connected to, i.e. a gas boiler counterfactual should not be applied to a low carbon heat network.

A sophisticated but easy to use counterfactual should be developed that can be easily communicated with residents but that takes account of different energy types and resident tenure.

Any external benchmark should have a clear and complete explanation as the point above.

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

Yes we broadly agree but this benchmarking needs to take into account all elements of a heat pump as set out in the DESNZ funded work undertaken by WSP as sponsored by the UKDEA. Please refer to that body of work which we understand DESNZ plan to use in setting fair prices in HNZ.

18. 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 do not believe this delivers the correct outcomes for consumers and is overly complex difficult to understand and open to challenge

19. 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?

The 'high importance' cost drivers should be easy to collect.

20. 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?

The 'medium importance' cost drivers could present some challenges to report sensibly especially in a large mixed technology/type/metering/age scenario.

21. 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?

If these benchmarks are to be used, then publishing the methodologies is essential for transparency.

Price complaints from consumers are common and often it is because the consumers do not understand the benchmarks and/or cost models. Therefore, alongside the benchmarks must be a consumer facing explanation and ability to benchmark their own consumption and allied costs.

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

Whilst the existing Heat Trust Heat Cost Calculator is useful it does need updating and adapting to account for the rental market who typically pay for repairs, insurance and plant replacement in their rent

Any charge comparison must take account of Landlord & Tenant Act Section 11. Consumers should not be charged twice for maintenance and replacement of heating infrastructure. The fact that this consultation does not mention this is concerning.

Profitability analysis

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

Partially.

The analysis of profit is very limited and suggests that not for profit sector is excluded, and this is just another burden of the 'for profit' sector. To avoid cross subsidisation from heat charges into other areas it is important that all owner types are included.

If margin is to be monitored then the best option would be EBIT as it imposes no extra data reporting than is necessary for statutory accounts.

24. 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?

For many networks the costs of operating a heat network would be 'lost' in the wider operational costs of the organisation.

We are also concerned that in early years schemes which are developing will likely suffer from very low or even negative EBIT as they build out but then as the operations stabilize and connected consumers grow the EBIT will rise and therefore taking a snapshot one year EBIT is not a fair approach. A longer term approach to measuring EBIT would be a fairer solution.

25. 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, this should be considered and adapted on a case by case basis and as needed.

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

This approach risks damaging investments in heat networks as it introduces a doubt on possible returns.

We accept that profits in a regulated sector need monitoring and have some level of control but if a price can be demonstrated to be 'fair' then the level of profit particularly on a single year basis is immaterial.

Any analysis of 'profits' must include all types of providers – including the not-for-profit sector. Costs and income related to being an 'operator' and/or 'supplier' only should be considered.

Central price transparency

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

We support Option 2 as we do not believe that the other options are fair or make sense. It is important to understand that the heat network sector has spent many years trying to convey prices to customers and what is a fair price and the overwhelming outcome of this process is that it is essential to keep things very simple to ensure customers are not confused. Therefore an expansion of the Heat Trust Cost Calculator is one we fully support, and we firmly believe is the only solution which makes sense.

28. 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?

Please see our response above.

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

We fully support Option 2 alongside a clear definition of 'fair' pricing to be at or lower than a benchmark price

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

No, this would provide a very confusing landscape for customers.

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

No.

32. 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?

This could lead to a large burden on networks to deliver the level of data required. Small networks may also need to procure consultancy support to assist with this, at a cost which has to be recovered from consumers.

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

No these are completely separate topics and should not be conflated.

Price investigations

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

This must be a process which the organisation against which action is being taken can understand the process. The consultation does not set out the process which follows a price review where it is found prices are unfair.

We remain very concerned as to what happens to a network where it is determined that unfair pricing is taking place and in practice the only way of resolving this is to put the network owner into a situation where they have to reduce prices so that they make a recurring loss due to the underlying characteristics of the network (i.e. excessive heat loss which cannot be remedied) or will Ofgem determine that the operator can continue with unfair pricing. What is the long term future for such a network if it does operate at a loss, and the connected customers and no other party will take over a network which has to operate at a loss to deliver a fair prices.

Should you require any further detail to support our current position, please contact me on 07391 866484.

Yours sincerely

A handwritten signature in dark ink that reads 'V Bell'.

Vicky Bell

Head of Regulation and Compliance

For Utilities Services MediaCity