

2. Fair pricing framework

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.

To a degree, yes. The key to fair pricing is transparency, rational breakdown of how the cost is made up (so each element can be understood by the user, especially maintenance, service and customer service costs) and benchmarking of costs. We think the outcome is properly defined, in terms of protecting users from unfair high prices that might originate from a monopolistic provision of a heat network service. The two areas in our view that require further definition in the documentation is benchmarking and around maintenance, service and customer service costs.

The benchmark should include comparison with other ‘similar’ heat networks (recognising that similar needs further clarity) and also comparison with other low carbon heat solutions in the area. The latter is a really important point so that consumers are able to understand that what they are paying is more cost effective than other solutions (and also presumably less carbon intensive). If the benchmark shows this is not the case the question should then be asked as to why, and what improvements can be made, otherwise consumers will lose faith in the market.

The maintenance, service and customer service costs requires further clarification to help consumers understand that being on a heat network still incurs costs akin to serving a private boiler. The reason we raise this is that residents may not think of costs related to maintenance in relation to a heat network so further information on these costs and what they are comprised of may help in terms of defining fairness.

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.**

Yes though we think an additional category or sub-category under the costs sections or price transparency section is around levelised cost of heating. This is really important as a comparator for residents to help the heat network operator demonstrate that what they are providing is the most cost effective.

- b) **Do you agree with the specific proposals to develop each of these areas in guidance? If you disagree, please specify what changes you would like to see and provide a justification.**

Yes, the provision of guidance is critical. One point to note however is that the guidance should be prepared for a number of audiences, one for operators and one (much more simplistic, consumer focused) for users of the network so they understand that the costs they are incurring are fair and are built based on rational elements.

Q3. Do you agree with the proposed 'fairness test'? In particular:

a) Do you agree with the high-level features of the fairness test (principle based, reasonableness, case-by-case basis, and objectivity)?

Yes, these seem sensible, though each operator will need to define how their pricing aligns with these tests so that if they are challenged on fairness they can show how they have considered and evidenced against each principle. As stated in earlier questions the benchmarking aspect around levelised cost of heat is important in this instance and guidance should definitely be provided.

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

These seem logical, however, it definitely feels like a comprehensive test spreadsheet, process flow or form should be developed to complete the test. Also perhaps an additional question is 'what is the proportion of the price made up of wholesale prices.' As this in theory is the main fluctuating factor this should help highlight when a price is not fair.

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

Providing the policy intent is the objective 'Consumers pay fair and not disproportionate prices' then yes, the revision would appear to do this, though it should be noted that as we did not comment on the pre-revision authorisation condition it is difficult for us to talk about the comparison.

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?

Yes, when looking at Table 2. Though an additional characteristic might also be source of heat. This is important as a network heated geothermally or via mine water (for example) will function differently to gas powered. This will filter down into different factors including pricing for example. Type of owner might also be a characteristic (so local authority vs private sector for example – the ownership will result in the heat network operating differently).

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

To a degree, yes, though further clarity is definitely required around 'Network built pre-regulation versus post-regulation'. This is relevant to Newcastle with historic networks like Byker.

One segmentation that might not be needed is zoning location. Its irrelevant to the functioning of a heat network. Level of vulnerability may need to be further defined

based on recognised ways of classification – perhaps social housing vs non-social housing tenants, and then further subsets of each.

Data requirements

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

All of these factors can be reported on, though the type and age of the network will usually impact this. For example older communal networks would need to gather further information to report on these (especially features relating to cost drivers/financial data which may not have been recorded in the same way). For a newer more commercially focused network this data will exist.

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

For an older communal network cost drivers may prove more challenging, simply because certain aspects may not have been recorded accurately when the network was established (for example network length). Older communal networks may not also be able to predict demand and supply as accurately as modern networks.

What should also be noted is an additional data item could be ‘carbon intensity’ of network.

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

For older networks the features that may prove more difficult to report on, due to the factor that the older network mechanisms are out of date, include:

- Annual network demand
- Network length
- Other efficiency measures

For newer networks like that at the Helix Energy Centre, Newcastle the cost drivers are not challenging to report on

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?

Historic networks (maybe pre 1980s?) should have more limited requirements, unless they have been upgraded with modern equipment (including sensors and meters). Reporting on certain features may place a significant burden on local authorities who are operating these networks.

Potential data that should be exempt, or considerably amended include:

- Fuel input price (not exempt but amended as this might prove difficult where a communal network is part of a broader complex).
- Annual network demand (not exempt but amended as the accuracy of this area may prove challenging)
- Network length (not exempt but amended as the accuracy of this area may prove challenging)

- Annual network generation (not exempt but amended as the accuracy of this area may prove challenging)
- Other efficiency measures (not exempt but amended as the accuracy of this area may prove challenging)
- Installed primary heat capacity (not exempt but amended as the accuracy of this area may prove challenging)

3. 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?

Yes, though this can only be effectively achieved through transparent pricing so that if the cost to the consumer rises alongside GSOP payments its clear that the increase is independent of these payments. Our assumption is that where these are payments are levied the cost comes out of the heat network profit margin.

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, though we think the benchmarking part should be more prescriptive. From our perspective, especially when consumers compare their costs to heat to other energy sources, it is important that the information is available for them to make a fair comparison. Benchmarking should include comparison with other similar types of heat networks, a comparison of levelised cost of heat verses other low carbon heating solutions (in addition to heat networks) and also a comparison of standing charges or equivalent (including the composition of this that relates to maintenance of the network). Where there have been discussions with residents in Newcastle around what they believe are unfair prices there are some cases where the residents forget that if the heat network wasn't there, they'd have to be covering maintenance costs of their own gas boiler or other solution. Transparency around how the heat network standing charges including maintenance costs verses if they were paying for standing charges and maintenance for other low carbon heating solutions would help in demonstrating fairness

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?

We think the broad structure of cost allocation is the same across all types of heat network (**standing charges** covering capital costs for the initial heat network, operations and maintenance, **unit costs for cost** the provide heat including wholesale energy costs, possible **one off connection charges** to connect and 'switch on' the connection). That being said cost allocation guidance should be developed for different types of heat network to structure how costs are allocated in each of the categories. For example a mine water or geothermal heat network will have slightly different allocation to a heat pump powered or CHP heat network. Further guidance may also be needed for those heat networks which also provide power.

Q13. Does the authorisation condition, 'cost allocation', reflect the policy intent?

Yes. Our understanding of the policy intent is to charge customers a fair and transparent price for them to be connected to and use the heat/energy provided by the heat network. The crux is that the provider follows the cost allocation guidance.

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

We query the reference to authorised person. Surely the authorisation condition should apply to the provider (and this be made clear), and be executed through the authorised person.

One point around cost allocation which we would recommend is the provision of some form of alert flagging if a price is rising beyond an expected increase (for example due to a blip in wholesale costs) with a description of why this is happening and its impact on the price to the consumer. This should be provided in anticipation of the price rise. Something similar to that provided around anticipated electricity price increased could be a good starting point. Providing this alert enables customers to interrogate an increased price and prepare for it.

4. 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?

Yes, the three methods look robust. Each has its strengths in terms of being able to compare multiple different heat networks types, especially across a market where there is a wide range of variations in type. An additional way to consider price is the cost to heat a square metre. Of course this would need the size of the buildings being heated, however it is a useful indicator for the efficiency of heating via a heat network vs a boiler.

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

Yes, though as battery prices fall and it is increasingly possible to store cheap overnight energy to electrically heat properties (and in some cases combined with solar) this should also be considered though this might not apply in all instances. We recognise this is partly referred to in 4.24 but this doesn't specifically mention a battery.

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?

Yes, though it should be stressed for the counterfactual that the calculations are estimations. And for these estimations the information given must include a margin of error. A robust heat pump benchmark not mentioned is the Coefficient of Performance (CoP - [Heat pumps: how they work, costs and savings - Energy Saving Trust](#)). CoP is an indication of efficiency. It can also be used as a comparator against other methods of heating and would be a useful benchmark, which, when combined with price, would indicate where the heat network is offering value for money vs other heating methods.

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?

Yes, we recognise that developing a benchmark for archetypes will be challenging as even within the same archetype there will be a range of factors contributing to price. However, it is

important to consumers that for similar heat networks they can understand that they are paying a fair price. Predicted prices is also an important measure. But as noted in Q17 there needs to be a margin of error especially when related to predicted pricing, and the calculations for both archetype comparisons and pricing must be transparent. We anticipate that archetype comparison will improve over time as more heat networks are analysed. A shared record of all archetypes and price comparisons would be useful for heat network operators (and those commissioning heat networks – for example local authorities).

Regarding cost drivers the list looks well structured. As stated in Q17 an additional cost driver could be heat network efficiency (measured as CoP). Even if a measure doesn't exist one could be developed using the data provided.

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?

The first two key factors (technology and fuel type & fuel input) should be easily reported. The final two high importance factors (network pipe length and annual heat demand) may prove more difficult to report for older networks, especially where records of pipe metreage and accuracy of network demand are somewhat out of date. Heat network operators and suppliers collect most if not all of this data for larger district heat networks. The challenge will likely relate to gathering this data for smaller communal heat networks (in high rise tower blocks for example) and especially where these are older. In these settings basic information (fuel input price, annual demand) might only be available, and other information may prove challenging to provide. It should also be noted that a margin of error should be factored in.

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?

Similar to the response for Q19, all of these factors should be easily reportable for a modern heat network operator/supplier but may prove more difficult for an operator of an older network (for example a communal heat network). All (bar the two listed below) are reportable and the data already exists, though may not be regularly reported on. The factors which may prove more difficult include:

- annual network generation (kWh) – A high level estimate is possible but may need flexibility on accuracy.
- network generation (for example, 3rd, 4th, 5th generation) – clarity needs to be provided regarding this especially where a network is quite old – what generation will this fit into?

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?

I think this is critical – the methodology needs to be transparent so that suppliers and operators understand the methodology and can also flag where they may have issues with steps in the process. This would allow clarifications to be provided if a benchmarked figure is considerably outside an expected range as the operator/supplier has followed the methodology but that analysis of a certain cost factor relevant and unique to that heat network is pushing costs up.

One point to note though is that as more data comes the methodology may need to evolve so it should be version controlled.

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

Yes, although the consultation specifically excludes benchmarking of connection. Although it makes sense to avoid an additional degree of complexity this is an important cost which a customer is expected to pay, and might happen throughout the life of the asset as customers connect. A fair and sensible connection cost could be determined by benchmarking these across similar archetypes etc.

5. Profitability analysis

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

Yes, the approach seems logical, especially as the consultation is clear that it is one measure as part of a range of measures and that there is flexibility in terms of how the collected data is used, and whether action is taken based on this data. The approach (that EBIT data alone will not be used to scrutinise the operator/supplier) is sensible as is the proposal not to look at EBIT for one year. One point of clarity however is how EBIT will be calculated for not for profit/council run heat networks.

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?

As the consultation document states, data relating to EBIT is already reported in annual company accounts (for commercial suppliers and operators) so there shouldn't be any major challenges. Any challenges related to provision of the data will primarily be accountancy related and could be overcome, assuming the data provided is caveated.

The main barrier around accuracy and completeness will relate to the fact there is always a 1 year delay regarding EBIT data meaning that any identification of a challenge or issue will be after the event. This is why the EBIT data should only be one mechanism alongside other benchmarks (e.g. price benchmarks) to assess the fairness of pricing to customers.

A further barrier as stated in Q23 is whether this type of data is recorded by not for profit/ local authority run heat networks.

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?

Yes, providing it doesn't place excessive burden on operators and suppliers, and that it enables the regulator to understand better what is driving higher pricing.

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

No, beyond clarity on whether EBIT (and ROCE etc.) will apply to not for profits/ local authority operated heat networks.

6. 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.

The first point to note across all three options is that an informed customer is critical regardless of the one selected. Guidance will need to be provided so that the customer understands the price comparisons and what the data available to them is showing (as stated in para 6.63). A key part of this should state that unlike other energy comparisons, the consumer has no option but to use the heat network (unless they disconnect) so the purpose of the comparison is to help them fight unfair or irrational charges,

Our views on each option are as follows:

- **Option 1: Grouped comparison:** The grouping aspect (as shown clearly in Table 5) is a key strength of this approach, though consumers would need to understand the logic behind the grouping. The interactive tool to communicate the comparison is important.
- **Option 2: Pooled market average comparison:** This is a powerful way to help consumers understand if the price they are paying deviates significantly from the average. The interactive tool to communicate the comparison is
- **Option 3: RAG ratings indicating comparison with benchmarks:** We think this is more confusing to the consumer. The consultation flags the point around pass or fail which might be interpreted based on the RAG, and therefore confuse the consumer.

Across all of the options some form of upper and lower pricing banding should be developed so that consumers can understand whether what they are being charged sits alongside.

Our view is that a blend of Option 1 & 2 are the most suitable to consumers as both have their merits. If one option is only possible option 2 is the most suitable,

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?

Yes, though as stated above Option 3 should be discounted. If we focus purely on Options 1 & 2 and providing the information is updated more than once per year (see final point in Q33) the options should provide the right balance. The key point, however is that communication and guidance is critical in ensuring the consumer is well informed to make an opinion on the information. For example consumers are informed enough to challenge their gas and electricity bills because it is clear what makes up the price. The same should be said for heat networks.

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

A combination of Options 1 and 2 is a powerful approach. This is because Option 1 enables consumers to understand similar pricing in their group of similar heat networks (e.g. of a certain size or type) whereas Option 2 helps enables comparison to a specific average, showing consumers how close they are to the average. The use of the heat trust calculator is also an important tool. However, if a combination approach is adopted this shouldn't be shown as two separate options to the consumer but rather by entering their address and postcode they can

see how their heat network compares to the average and other similar types. The relevant support information for both must be provided.

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

Yes (excluding Option 3). This is a practical approach as not all the data relevant to price transparency will be available once the regulation goes live and it is likely that data will need to be available for one year before comparisons can be made.

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

Yes, this is really important. The example of a not for profit heat network is a good one, though Option 1, where a grouped comparison of similar types of heat network should enable this. We imagine that a consumer, in entering their address will be presented with the central pricing transparency comparators relevant to their location and type of heat network.

One key point which strengthens this being really important is that we need to ensure not for profits/ local authority networks are grouped similarly from a pricing perspective so to prevent comparisons which aren't like for like. For example a not for profit will likely have a cheaper energy price so it wouldn't make sense to compare them to a profit making heat network.

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?

As stated in our response to 2. Fair pricing framework there is a greater risk of an additional administrative burden on local authority/not for profit run heat networks because they may not have the data collection mechanisms in place required to report the data which feeds in to the central pricing transparency mechanisms. This burden will apply to Options 1 and 2 (we are excluding 3). Most commercial networks will already collect the data so the question for them will be the burden of ensuring data is shared which isn't commercially sensitive. Again the burden relates to Options 1 and 2.

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

Yes – benchmarking is key to ensuring price comparison which enables transparency.

As an aside under 6.67/ 6.68 the data requirement favours annual collection, however there is a risk that the data provided is not closely associated with the time when the consumer needs it – for example if there is an example of unfair pricing and the data against which this is compared to is only updated annually the consumer may have to wait a year or more to be able to demonstrate that their price is unfair. A six monthly period might be better. Quarterly is probably too great a burden, though it should be noted that this might highlight the seasonality of pricing (otherwise lost under longer reporting periods).

7. Price investigations

Q27. Do you agree with the approach to price investigations set out so far? Please provide reasons and views to support your response.

Yes, this seems logical but further work is required to provide additional detail which, we expect, will need to be consulted on. We would therefore expect a more detailed consultation on this area. An example of where further detail could help is establishing a customer complaints

process which involves the customer challenging the unfair price before involving the regulator. This would mean that investigations only take place once all normal routes have been exhausted.

It would also be useful in any future consultation on this part to provide an example of a price investigation.

Under 7.22 regarding data to be provided under a pricing investigation one additional form of information should be existing engagement with the customer, including frequency and how their query has tried to be resolved prior to investigation.

One point noted earlier in the consultation is that any fine that is issued as a result of unfair pricing by an operator/ supplier must not be recovered through heat network operations. Further clarity must be provided as to how this should be avoided (for example, does the fine come out of the heat network's profits?) What happens if a not for profit is fined?

Other points

The information required for submission is likely to have a significant impact on resources for existing networks. It will necessitate investment in monitoring equipment and the development of reporting processes. Additionally, the wide variation between district heating systems will make meaningful benchmarking difficult in the short term, as it will take several years to gather sufficient data for reliable comparisons.

We would recommend a phased approach to the transition, including the introduction of potential price caps, similar to those in the current gas and electricity markets. This would provide the flexibility needed for organisations to manage delivery costs, while upholding the principle that customers should not pay more for heating and hot water than they would with a standard utility provider. These caps could then be refined over time as more data becomes available to support benchmarking across different system types.