

Ofgem Consultation: Heat Networks Regulation - Fair Pricing Protections

Section 1: Introduction

The Energy Act 2023 has appointed Ofgem as the regulator for heat networks in Great Britain. This consultation sets out Ofgem's proposed framework for fair pricing protections for heat network consumers. Proposals cover a fair pricing framework, cost allocation, price benchmarking, profitability analysis, price transparency, and price investigations. These regulations aim to ensure fair pricing, protect consumers from monopoly power, and support the sector's growth.

Section 2: Fair Pricing Framework

Ofgem proposes a high-level fair pricing framework for heat networks, underpinned by a consumer objective and six principles:

- Cost-reflective pricing
- Cost efficiency
- Fair and reasonable returns
- Affordability
- Regulatory control
- Price transparency

The aim is to ensure that consumers pay fair, proportionate prices. A 'fairness test' will assess whether heat network prices comply. The proposed Authorisation Condition 04 would require suppliers to ensure that charges are not disproportionate, with enforcement to follow guidance issued by Ofgem.

Key components include:

- A fairness test that is principle-based, case-by-case, and relies on reasonableness.
- Market segmentation considerations (e.g., network size, metered vs non-metered, profit status, etc.)
- Specific data requirements to support future monitoring and benchmarking.

Consultation Questions

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.**

As operators of heat networks, members of The Residential Freehold Association (RFA) like RTM companies, Resident Management Companies, and Commonhold Associations, have no direct control over the pricing of energy nor what suppliers charge. Our members can only charge leaseholders based on the prices set by energy suppliers as available for purchase via the open market.

RFA members support fair pricing for leaseholders. To ensure fair pricing is delivered to residents, the primary obligation should be on the heat supplier to offer fair prices for the supply of energy which RFA members as the operator then pass to leaseholders.

The most effective way to protect consumers, the end user, and ensure fair pricing is to regulate the energy suppliers and monitor that prices are not excessive within the market.

As noted in paragraph 1.14 of the consultation paper, the Competition and Markets Authority (CMA) 2018 market study found no evidence of widespread high prices across the market. This suggests that the existing system is, on the whole, already functioning properly.

As the RFA has stated in previous consultation responses, the leasehold system already provides protections for leaseholders, in relation to costs. Please see our previous responses to Ofgem's '*Heat networks regulation: authorisation and regulatory oversight*' consultation, as well as Ofgem and DESNZ's '*Heat networks regulation: implementing consumer protections*' consultation.

We have therefore not commented in detail on the fair pricing framework.

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:

- 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.**

Services charges within leases operate on a not-for-profit basis. Please note therefore, the application of the majority of the proposals outlined in the Consultation is not relevant nor proportionate for the leasehold sector.

Not-for-profit communal heating systems within a single block, where individual metering of flats is either not present or uneconomical/impractical to retrofit, should be excluded from many of these proposals given the associated costs involved in complying with the reporting requirements.

The provisions in paragraphs 2.46 and 2.47 of the consultation paper, in respect of flexible payment plans and back billing would also contradict the service charge provision in leases, and existing legislation, and the existing regulatory system and framework.

- 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.**

Please see the response to question 2a above.

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)?**

Please see the response to question 1 above.

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

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

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):

- 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?**

The RFA agrees that the segmentation approach needs to be fit for purpose.

As mentioned above, service charges within leases operate on a not-for-profit basis and any proposals need to be considered in light of this.

In addition, our members are not in a position to provide details on all of the proposed segmentation criteria, such as "level of vulnerability". Where RFA members are aware of vulnerable consumers they do already routinely provide consumers with vulnerabilities additional support and are professional and sensitive.

Data requirements

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

RFA members are not in a position to provide the vast majority of information, which should be the responsibility of the energy supplier to provide. We'd be happy to discuss what data, if any, our members are able to provide. The ability of resident managed buildings to provide data also needs to be taken into account. A disproportionate data provision requirement risks disrupting the smooth management of a building and increasing costs.

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

Please see the response to question 6 above.

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

Please see the response to question 6 above.

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?

Yes, certain types of heat networks should have more limited data reporting requirements, such as those operated by RFA members, especially for not-for-profit networks and communal networks in a block that have no individual meters. Different types of networks, particularly modern and older systems, may not be able to support the same reporting standards. For instance, data from older equipment may be harder to collect or incompatible with newer systems, making it unfeasible to apply uniform reporting requirements across all heat networks.

The administrative burden associated with gathering and reporting this data would be disproportionately high, with costs likely outweighing any potential benefits. Any data recording requirements should be the responsibility of the heat supplier. It is important to consider who bears this responsibility; it should not, for example, fall on building managing agents, who may lack the resources or capacity to comply with these extensive requirements. Any additional data reporting requirements will also impact the costs of the management of a building.

If reduced data reporting is to be considered, these exemptions should apply to smaller or older networks where the infrastructure does not support detailed data collection, or where the costs of collecting such data are unreasonable. Specifically, data on complex or less accessible cost drivers could be exempt, as these may be too difficult or costly to obtain without significant investment in infrastructure.

Section 3: Cost Allocation

This section covers Ofgem's proposals for how heat suppliers allocate costs to the various charges levied on consumers. Heat suppliers currently use a wide range of pricing structures, making price benchmarking and regulatory oversight challenging. To address this, Ofgem proposes a single prescriptive rule: Guaranteed Standards of Performance (GSOP) payments, fines, penalties, and other redress provided to consumers must not be passed on to them through charges.

Additionally, Ofgem will issue best practice guidance for allocating costs between standing charges, unit rates, connection charges, and other fees. This guidance is intended to promote consistency,

transparency, and fairness across the market, while allowing flexibility given the diversity of heat networks.

Ofgem recognises that a one-size-fits-all approach may not be suitable due to differences in network size, ownership model, and commercial arrangements. Hence, the guidance may vary by network type, and segmentation will be used to tailor expectations. This section also discusses the challenges and trade-offs in moving towards more standardised cost allocation practices, particularly how this impacts benchmarking and price comparison methodologies.

Ofgem is consulting on whether additional cost allocation guidance should be made mandatory in the future and whether differentiated rules should apply to different types of networks or suppliers.

Consultation Questions

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?

RFA members do not profit from energy costs and only pass through the actual costs incurred in providing services to a building. Building owners should be treated similarly to not-for-profit providers, much like social housing providers, as they do not make a profit from these charges. Applying fines would also be incompatible with the not-for-profit system, and for dormant companies such as RTMs, Resident management Companies and Commonhold Associations. In practice, applying compensation or fines to leaseholders would be problematic. These payments cannot be passed through the service charge, making it unworkable in the leasehold system.

As mentioned in our previous consultations, lease agreements require landlords to comply with specific obligations including in relation to the provision of energy, and poor performance or unreasonable costs can be challenged through the First-Tier Tribunal or the courts.

Additionally, RFA members are already part of Ombudsman Schemes, which assess compensation where there has been a service failure. Given these existing mechanisms, it is not appropriate to apply additional compensation proposals within the leasehold sector.

Energy suppliers are responsible for the supply of energy, and therefore for any disruption to service or poor quality service. If compensation is payable to customers it should therefore be paid by the energy suppliers.

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?

It is not clear who is responsible for paying, and how these payments would work, however not-for-profit companies should remain exempt. As mentioned in the RFA's previous consultation response, and in question 1 above, as operators of heat networks, RFA members have no direct control over the pricing of energy or what suppliers charge to our members and leaseholders.

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, which types and how?

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

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

Section 4: Price Comparison and Benchmarking Methods

This section outlines Ofgem's proposals for benchmarking methods to assess heat network pricing and detect disproportionate charges. Benchmarking will play a crucial role in monitoring prices, supporting investigations, and providing evidence for potential regulatory interventions.

Ofgem proposes three main benchmarking approaches:

1. ****External benchmarking**** – Comparing heat network prices to those of alternative heat sources, such as gas and electricity.
2. ****Comparator benchmarking**** – Comparing prices across different heat networks with similar characteristics.
3. ****Own past price benchmarking**** – Comparing a heat network's current prices to its historical prices.

Each method has its own strengths and limitations. External benchmarking provides a consumer-relevant point of comparison but may not account for the unique costs of heat networks. Comparator benchmarking requires granular segmentation to ensure like-for-like comparisons, while own-price benchmarking helps identify pricing anomalies over time within a network.

The consultation explores the methodologies for each approach, including how to define a 'reference price' for benchmarking purposes and how to handle complex tariff structures. It also discusses the use of statistical models and archetypes to support robust analysis. Cost drivers, such as network size, demand, technology, and customer mix, will inform segmentation and price predictions.

Stakeholders are invited to comment on the proposed benchmarking approaches, suggest improvements, and identify challenges, especially around data availability and the feasibility of accurate segmentation.

Consultation Questions

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?

Please see the response to question 1 above.

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

Please see the response to question 1 above. We cannot meaningfully respond as we don't have control over the price of energy, nor experience of how pricing is set and the various components involved in the pricing.

- 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?**

Please see the response to question 16 above.

- 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?**

Please see the response to question 16 above.

- 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?**

- 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?**

- 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?**

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

Section 5: Profitability Analysis

This section outlines Ofgem's proposals for assessing the profitability of heat networks to identify instances where providers may be earning excessive profits. Ofgem views profitability analysis as a complementary tool to benchmarking for ensuring fair consumer pricing.

Ofgem proposes starting with a light-touch approach to profitability monitoring using basic financial metrics like Earnings Before Interest and Tax (EBIT) margins. Over time, and as more data becomes available, more sophisticated tools may be deployed. These could include full return-on-capital analysis, comparisons to industry benchmarks, and detailed financial ratio assessments.

This section discusses what profit metrics may be suitable and how data will be collected, including annual revenue, operational costs, and investment recovery. Ofgem also proposes comparing profit levels against market expectations, such as the Weighted Average Cost of Capital (WACC).

The objective is to ensure that profits earned by heat network operators reflect reasonable returns on investment, without leveraging monopolistic advantages to exploit consumers. Input is sought on appropriate metrics, methodologies, and challenges that might arise in implementation.

Consultation Questions

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

Not-for-profit heat networks should be exempted from the profitability monitoring requirements, as well as the EBIT reporting requirements.

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?

See response to question 23 above.

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?

See response to question 23 above.

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

Please see the response to question 1 above.

Section 6: Central Price Transparency

This section considers how Ofgem can enhance transparency in the heat networks market by making pricing information publicly available. The lack of price visibility currently hampers consumer choice, prevents effective scrutiny, and inhibits competitive pressure.

Ofgem outlines three potential models for central price transparency:

1. ****Grouped comparison**** – Publishing prices by defined segments (e.g., by network size or region).
2. ****Pooled market average**** – Publishing market-wide average prices with segment comparisons.
3. ****RAG (Red-Amber-Green) ratings**** – Comparing individual network prices to defined benchmarks.

Each model aims to inform consumers, stimulate provider accountability, and support benchmarking. However, they vary in complexity, clarity, and implementation effort. Ofgem is also exploring how to present data in accessible formats that empower users without oversimplifying pricing dynamics.

Stakeholder feedback is requested on which option best balances transparency, practicality, and accuracy, as well as what price data should be published, how frequently, and in what format.

Consultation Questions

- 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.**

The RFA can see the benefit in energy suppliers being transparent about pricing for all parties involved in the purchase and consumption of energy.

- 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?**

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

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

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

Please see the response to question 2a above.

In respect of the leasehold model, service charge is operated on a not-for-profit basis, and therefore any reporting requirements need to be relevant and proportionate.

- 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?**

The administrative burden associated with gathering and reporting this data would be disproportionately high, with costs likely outweighing any potential benefits. Any data recording requirements should be the responsibility of the heat supplier. It is important to consider who bears this responsibility; it should not, for example, fall on building managing agents, who may lack the resources or capacity to comply with these extensive requirements.

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

Section 7: Price Investigations

This section outlines Ofgem's proposed approach to investigating individual heat networks where prices appear to be disproportionate. Price investigations will be a regulatory tool used in cases where there is evidence of consumer detriment or outlier pricing behavior.

Investigations will follow a structured process, beginning no earlier than 2027 due to the complexity of developing tools and gathering robust data. Ofgem plans to use benchmarking and profitability indicators to identify high-priority cases. Investigations may include data requests, audits, and analysis of operational costs.

This section details the data requirements, procedures, and timelines that would govern investigations, as well as criteria for launching and escalating inquiries. Ofgem will focus on the greatest consumer harms and where regulatory intervention is most warranted.

Input is sought on the appropriateness of this approach, how to ensure proportionality and fairness in investigations, and what improvements could strengthen the framework.

Consultation Question

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

As mentioned above, there are already significant protections in place within the leasehold system. Adding additional layers of regulation on those responsible for managing buildings would only serve to increase costs for leaseholders.

As mentioned in the RFA's previous consultation response, and in question 1 above, as operators of heat networks, RFA members have no direct control over the pricing of energy or what suppliers charge to our members and leaseholders. However, RFA members ensure that any service charge costs are reasonable. To deliver fair pricing, the primary responsibility lies with the heat supplier to set fair prices for energy, which RFA members, as operators, then pass on to leaseholders. Further engagement should therefore be completed with energy providers.