

Shetland Heat Energy and Power (SHEAP)

Consultation Response to Ofgem's Heat Networks Regulation: Fair Pricing Protections

Executive Summary SHEAP supports the principle of fair pricing for heat network customers. However, the current Ofgem proposals are unworkable and inequitable for community-owned, rural, and island-based networks such as ours. The regulatory framework risks penalising efficient, socially responsible operators by applying inappropriate benchmarks, excessive reporting burdens, and insufficient recognition of ownership structures or geographic challenges.

SHEAP is a private limited company, wholly owned by a local charitable trust. Surpluses are donated annually to that charity via Gift Aid. While Ofgem has yet to clarify whether such arrangements constitute "not-for-profit" status, they should, and a formal position is urgently needed. We are also concerned that Ofgem is pressing ahead without clarity on the Heat Network Technical Assurance Scheme (HNTAS), which may itself impose onerous requirements. These overlapping obligations risk becoming unmanageable.

The Scottish Government's 2018 Islands (Scotland) Act mandates that new legislation take into account the unique needs of island communities. Ofgem has failed to heed this, and has made no explicit allowance for the operational realities of remote locations such as Shetland, where logistics, weather, and access constraints result in materially higher costs. This failure risks exacerbating inequality and disadvantaging already marginalised customers.

This submission is structured thematically but addresses all 34 consultation questions. Cross-reference can be provided if required.

Grouped Consultation Responses (SHEAP Perspective)

Q1–4: Fair Pricing Principles, Guidance & Fairness Test - SHEAP rejects the proposed framework unless it is revised to recognise rural and island-specific cost drivers. - The fairness test is inapplicable to operators that reinvest all surplus income into community benefit. - Ofgem must define and recognise not-for-profit structures such as ours—private limited companies wholly owned by charities, with all surpluses gifted to those charities. - Cost efficiency obligations should not duplicate those that may emerge from HNTAS. These schemes must be published and assessed first.

Q5–6: Market Segmentation & Data Reporting - Ofgem's segmentation ignores geography. Island and rural networks should form a distinct category with their own benchmarks.

- The proposed data requirements are excessive for smaller operators and duplicative of what may be required under HNTAS. - SHEAP cannot feasibly provide pipe length, property age, and other granular data without significant cost and systems upgrades. The value of this data does not justify the burden. - These micro-reporting requirements risk undermining efficient, low-cost operations. SHEAP operates with a light staffing model to keep customer tariffs as low as possible. If new administrative burdens force us to increase staffing or invest in new systems, this will directly increase costs to customers. Ofgem's proposals therefore contradict the cost-efficient, community-serving model they should be aiming to support.

Q7–11: Cost Allocation & GSOP - We support transparency in cost allocation but reject any requirement that imposes rigid pricing models unworkable for integrated community systems. - Ofgem should exempt operators from duplicating cost allocation if they are already fully

recovering costs on a whole-network basis. - GSOP penalties must not be passed back to customers. However, in a cost recovery model like SHEAP's—where revenue is solely derived from customer charges—Ofgem must clarify how such penalties are to be absorbed. Unless additional funding streams are introduced, these costs will inevitably reduce funds available for reinvestment or require higher future tariffs, which contradicts the goal of fair pricing.

Q12–22: Benchmarking & External Comparators - Heat network tariffs in non-gas areas should not be compared to gas heating costs. - Shetland has no gas grid. This renders the current benchmark comparisons misleading. - SHEAP uses waste heat and oil-fired backup, with ambitions to integrate renewable heat sources such as sea water heat pumps in future. Regulatory benchmarking must recognise different technology stages. - Heat networks are a key tool in the transition to net zero, providing low or zero-emission energy in urban and rural settings alike. The use of fossil fuel-based counterfactuals—such as gas heating—for price comparisons risks undermining the very policy objective these networks are intended to support. Fairness assessments should reflect carbon reduction benefits, not penalise them through inappropriate fossil-fuel benchmarks.

Q23–26: Profitability Analysis - Ofgem must clarify what qualifies as a not-for-profit network. - Applying ROCE or EBIT benchmarking to SHEAP, which transfers surpluses to a charity, is both misleading and potentially damaging. - EBIT-based profitability analysis fails to recognise capital reinvestment into networks. This is a critical omission, especially for operators like SHEAP that invest significantly in maintaining and upgrading infrastructure. Profitability assessments should be based on surplus after capital expenditure, not before. - SHEAP does not aim to make profits. Surpluses are allocated transparently and reinvested or transferred to charitable causes. This is a model Ofgem should protect, not penalise.

Q27–33: Central Price Transparency - Raw price comparisons without geographic and operational context will mislead consumers and regulators alike. - Option 3 (RAG) may be useful, but only if contextualised and caveated to avoid damaging misinterpretation. - No comparison should be made until sufficient segmentation and recognition of network diversity is implemented.

Q34: Price Investigations - If island networks are subject to price investigations purely on the basis of cost, they will be unfairly targeted due to factors outside their control. - Price investigations must be rare, evidence-led, and take into account ownership models, geography, and historical reinvestment.

Additional Comments - SHEAP calls for a moratorium on enforcement of any price fairness measures until HNTAS is published and operators can reasonably assess how technical and pricing obligations interact. - Ofgem must consult on a joint implementation timeline that reflects the true capacity of smaller networks. - SHEAP also urges Ofgem to liaise with the Scottish Government to align regulation with the intent and protections under the Islands (Scotland) Act 2018.

Conclusion The heat networks regulatory framework must serve all customers fairly—not just those in urban areas. Without meaningful revisions, the current proposals will undermine community operators like SHEAP that have delivered decarbonisation, social benefit, and customer value for decades. We urge Ofgem to recognise and protect models like ours that exemplify place-based transition and public interest energy delivery.

Prepared by: Shetland Heat Energy and Power Ltd June 2025