

Ofgem

Via email

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Dear Sirs,

Heat network regulations: RBKC's response to fair pricing protections consultation

The below is the Royal Borough of Kensington and Chelsea's (RBKC) response to the Heat networks regulation: Fair pricing protections consultation.

Questions for Section 2:

Fair pricing framework

Q1: Have we identified the right set of fair pricing consumer objectives, 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.

In principle, we are supportive of the fair pricing objectives, principles and outcomes. Also, as a not-for-profit organisation we are supportive of Ofgem's proposals for lower data reporting requirements for non-profits networks. The ability for us to collate some data sources will be challenging as we have over 50 legacy networks that are unmetered. Also, we have serious concerns over Ofgem's proposal regarding restricted cost passthrough regarding a restriction on passing on fines and other penalties to consumers. If fines were imposed on us as a Local Authority (LA) these would have to be re-charged to the Housing Revenue Account (HRA) and so would ultimately be passed on to our tenants as the main sources of funding to the HRA is from tenants' rents and service charges. As we have previously stated on our previous responses to Ofgem's 2014 consultation, we strongly believe that LAs should be exempt from fines generally and use an agreed Heat Network Improvement plan with Ofgem instead.

Q2: Do you agree our proposals to develop the fair pricing guidance in relation 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, please specify your changes and provide a justification.***

(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.

We are generally supportive of the principles cited for fair pricing guidance. However, as cited above as we are a not-for-profit organisation with a significant portfolio of legacy heat networks. Our ability to collate the high levels and granularity of data required will be challenging. Specifically in relation to some of the older legacy heat networks that are unmetered and also require substantial capital works to either replace or upgrade metering assets. So, we would stress the need to have a suitable transitional phase for us to be able to secure all the required data to comply with Ofgem's fair pricing proposals and suggest that this should be a minimum of 24 months.

RBKC also has serious concerns regarding Ofgem's proposal (section 2.47) to limit back-billing to a maximum period of 12 months. Owing to legacy billing processes and the fact we cannot unbundle heat charges from the lease/rent charges, RBKC needs to back-bill heat network customer 18 months in arrears and the enforcement of a 12-month limit will have potential significant negative financial implications for the council. We therefore suggest to Ofgem that we will need to keep to our existing 18-month timeframe as allowed for by the Landlord and Tenants Act (Section 20B) until heat charges can be unbundled from our lease and this requires legislative changes.

The Landlord and Tenant Act and the leases are prescriptive about how and when charges can be made to leaseholders and not complying with these provisions will place all the charges we make for heating and hot water to leaseholders at risk. Should we not be able to recover the cost from leaseholders it will place the HRA at risk where effectively the tenants' rent would have to cover this cost. A situation which is not viable given that tenants are usually our most vulnerable residents.

RBKC's leases with leaseholders does not allow for sinking funds to be adopted and the Housing Revenue Account will not be able to sustain a sinking fund for all the tenanted properties. Sinking funds are therefore not an option when thinking about protecting customers from shock bills. We do however have the ability to offer payment options to assist customers spreading payments over a period of time.

Heating and hot water is not covered by Housing Benefits.

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-bases, reasonableness, case-by-case, and objectivity)?***
- (b) Do you agree with our proposals to implement the fairness test discussed in Appendix 1: Fairness test?***

Yes, but subject to the practical ability for us to collect the data requirements as cited in our answers above, in particular from legacy networks with a variety of different billing infrastructure and billing agents/processes. We also have concerns that owing to our diverse legacy networks using site by site cost reflective pricing will mean a wide variance of charges to end users owing to different distribution losses and standing charges. This has the risk of causing consumer confusion as to why costs vary for otherwise similar properties. Consumer awareness of how heat network charging methodologies operate is low and so we would welcome more detailed guidance from Ofgem on this matter. Also, the importance of improving network efficiency is critical but given the serious financial constraints of the public sector, this will be very challenging for RBKC as a not-for-profit organisation to undertake without additional government support for capital investment.

Q4: Does the revised authorisation condition, "fair pricing" reflects the policy intent?

Yes.

Market Segmentation

Q5: In relation to market segmentation (paragraphs 2.58-2.61), segmentation considerations in relation to price benchmarking:

- (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?**

We are supportive of taking a proportionate approach to regulation and so welcome Ofgem's proposal to segment the market. In particular, we welcome consideration of metered versus non-metered and profit versus non-profit market characteristics. RBKC, as a non-profit heat network owner with a significant portfolio of over 50 legacy heat networks we believe heat network regulation needs to take into account of our ability to comply with new requirements without having existing resources or internal expertise in place and the financial implications of providing such. Hence, we believe non-for-profit networks need to be treated differently than for profit regulated entities.

Where "Housing tenure" (Table 2) refers to "social housing" it needs to be considered that it may include social housing tenants and leaseholders.

Although it may be sensible to distinguish domestic versus non-domestic supplies, some level of flexibility needs to be maintained for those commercial properties which may be located within residential buildings and supplied by heat from the same source.

Data requirements

Q6: Of the information listed in table 3 below, what do heat networks collect and can be easily reported?

We have concerns over the ability to provide the level of data granularity proposed in table 3. We have a diverse range of network assets ranging from new build developments to older legacy systems with price and other critical data held across multiple departments and external provider and billing systems. Hence, it would need to be collated and centralised and this would take considerable time and resource to achieve. We therefore believe that Ofgem should consider allowing a suitable transitional phase for non-profit networks to collect and verify the accuracy of data. We also believe that quarterly reporting is an excessive requirement and should be done on an annual basis instead.

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

We believe reporting cost-drivers, revenue and operating/maintenance costs for each specific network would be challenging as these are generally grouped together in our non-profit cost model. So, it would be a challenging exercise to disaggregate these and allocate cost-drivers accurately on a network-by-network basis, particularly for older legacy networks.

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

The longlist of potential cost drivers for price comparison and benchmarking cited in Appendix 3 is extremely detailed. As cited above the ability for RBKC to collect and verify such granularity over such a wide range of variables will be a challenging exercise to deliver. This is particularly true for older legacy heat networks where some of the technical and performance data is limited and would require additional monitoring to obtain. Also, given that leaseholders are not required by their lease to provide any personal information and some of our leaseholders rent out their flats, RBKC will not have any data on the end-users in the flats so we will not be able to report on issues like levels of consumers vulnerability, age etc.

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?

We believe older legacy networks for not-for-profit organisations will find it challenging to obtain the high levels of data granularity as cited in Table 7. This is because either the data is not available or is held currently in different council departments or with suppliers. This will require additional

resources to deliver, collate and verify, and so we believe that such heat networks should be exempt from reporting or at the least have a suitable transitional phase adopted for non-profit organisations.

Questions for Section 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 consumers?

RBKC as a local authority has some concerns over Ofgem's proposal not to recover fines and other compensations from consumers. The only source of funding for such fines will be RBKC's Housing Revenue Account (HRA). The HRA is funded by rents and service charges paid by customers and as a ring-fenced account all payments relating to the delivery of services to estates are covered by this fund and any payment of fines and compensation will ultimately be passed on to residents. Hence, as we cited in our response to Ofgem's 2023 consultation, RBKC strongly believes that social landlord heat networks should be exempt from any fines and have an agreed heat network improvement plan process instead.

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?

RBKC supports Ofgem's proposal for more specific guidance on best practice in relation to cost allocation and tariff structures. This should allow different approaches for older legacy non-metered heat networks. We are concerned over the potential for consumer confusion for different tariff rates for otherwise similar properties.

Regarding cost reflectivity and the comments that maintenance charges may be included as a standing charge we would welcome clarity as to whether this element of cost is not covered by the rent charge.

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 are supportive of Ofgem's proposal to treat metered and un-metered block differently.

Q13: Does the authorisation condition, "cost allocation", reflect the policy intent?

As cited above, RBKC as a local authority, has concerns over the ability to meet this policy intent as any compensation payments will ultimately be borne by residents by being charged to the Housing Revenue Account.

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

As RBKC currently provides heat as a service under leases with leaseholders and charge the cost of such service as a service charge at a large number of legacy networks, it will not be possible to "unbundle" these costs easily. We note that Ofgem is investigating the option of unbundling in such situations, and that this will require changes to the Housing law, such as the Landlord and Tenant Act.

Questions for Section 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 prices that we should consider?

Yes.

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

We are generally supportive of using heat pumps as a counterfactual but have concerns using gas boilers potentially as these will not be compatible with RBKCs and government's net-zero policy agenda.

Q17: Do you agree with the proposed method for calculating a heat pump benchmark, including the key input parameters outline? Are there any additional factors that should be considered to ensure a robust heat pump benchmark?

No comment

Q18: Do you agree with proposed approach to comparator benchmarking and our list of potential cost drivers set out below and in Appendix 3: Cost driver? Are there any cost drivers that we haven't considered?

No comment

Q19: What is your view on the ease with which data could be reported on the "high importance" cost drivers set out in 4.33? What information do heat network operators and suppliers already collect and what would be challenging to provide?

RBKC would be able to collect data for its heat network portfolio for the "high importance" variables as cited in 4.33, apart from network pipe length in some older legacy networks as these might have to be estimated (depending on if as built drawing exist).

Q20: What is your view on the ease with which data could be reported on the remaining "medium importance" cost driver set out in paragraph 4.33? What information do heat network operators and suppliers already collect and what would be challenging to provide?

Collection of all the "medium importance" data would be more challenging to collect as the data would have to be collected from a variety of sources internally as this is not currently held centrally. Specifically, the high levels of data granularity as cited in Appendix 3 would be challenging to collect and verify for all our heat network assets. This would require additional internal resources to collect and submit to Ofgem.

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?

We are generally supportive.

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

The ability to collect market data of sufficient quality to allow Ofgem to undertake the various benchmarking methods as cited in Table 4 p.61 is likely to take some time given the very diverse nature of the UK heat network market. Also, smaller and not-for-profit organisations are likely to find this challenging as such data is not currently routinely collected and so will have a practical resource implication to gather and submit to Ofgem.

Questions for Section 5: Profitability analysis

Q23-26 – No response as RBKC is a not-for-profit Local Authority.

Questions for Section 6: Central price transparency

Q27: What are your views on the three options? Please comment on each option in terms of price information to be centrally published, how the price information is presented and what prices are compared to.

All of the three options will require market data to be submitted and as cited in our response to Question 22 we believe this will be challenging for Ofgem to collect given the wide diversity of networks in the UK market. Also, for option 1 as cited by Ofgem will not be possible until HNTAS is adopted. The critical objective is for consumers to better understand their costs. We are concerned that there is a real risk for consumer confusion over cost reflectively in that there will ultimately be different tariffs charged for otherwise similar properties, and this will be challenging to explain given the low existing customer knowledge of heat networks e.g. distribution losses. Given this it might be sensible for Ofgem to test all three models on a consumer panel before going live in the market.

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?

We think these should be tested by Ofgem on a consumer panel first so that consumer feedback is given for each option.

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

At this stage we believe that Ofgem should test out each option before going live and so all options should be developed further. Some options will be easier to develop as these will be data dependent.

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

Yes.

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

RBKC supports Ofgem's proposal in paragraph 6.71 that not-for-profit heat networks should face fewer reporting requirements like average price ranges.

Q32: Do you agree that the 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 RBKC has cited in a number of responses above, the ability to collect the high levels of data granularity on the range of criteria for benchmarking will be challenging to collect without new dedicated responses. So, we do not agree that it is unlikely to put additional administrative burden on heat networks, especially for not-for-profit Local Authorities.

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

We are generally supportive of this.

Questions for Section 7: Price investigations

Q34: Do you agree with the approach to price investigations set out so far? Please provide reasons and views to support your response.

The challenge for Ofgem to intervene on disproportionate pricing to consumers is predicated on having sufficient and accurate data to undertake benchmarking, cost-reflectivity and profitability analysis of a diverse range of market actors. RBKC has concerns over the ability for Ofgem in the short-term to gather this data accurately to reflect the market properly. We are particularly concerned over smaller and/or not-for-profit networks' ability to collect meaningful data at the required granularity. We would therefore suggest Ofgem needs to consider these networks to have less data reporting requirements and/or allow for a suitable transitional phase to mitigate these risks.

We trust that the above would be helpful. Please do not hesitate to contact me if you have any further queries.

Yours faithfully,

Jana du Preez

Jana Du Preez
Head of Home Ownership