

Heat networks regulation: fair pricing protections

Veolia Response

N°	Theme	QUESTIONS	Response
1	Fair Pricing framework	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.	<p>We generally agree with the consumer objectives, principles and outcomes as defined, although stronger guidance and clearer definition of roles and responsibilities is needed.</p> <p>We would however like to highlight concerns that the interactions between this policy framework and the other drivers in HN authorisation and regulation have not been considered adequately. For example, the previous zoning consultation indicated that DESNZ were considering a hard cap on connection costs. If this cap value is below the amount it would cost an operator to actually connect a building to a network, proposals such as those outlined in this consultation would make it impossible for a network to recoup any of those outstanding costs back, including via an addition to the standing charge as would be expected. This disincentives networks from seeking to connect buildings, businesses or domestic customers that may have more challenging access.</p>
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. 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.	<p>We understand the intent of Ofgem to ensure pricing is fair for customers on a heat network. However, we have several significant concerns about the application of the proposals.</p> <p>Firstly, these proposals must not apply to non-domestic customers. The Authority appears to have lost sight of the original intention of fair pricing, which was specifically to protect households from excessive charges. Extending these controls to non-domestic customers risks severely hampering investment in the sector, as restricting returns from commercial customers could make many schemes unviable. Additionally, we note that the proposals lack specific guidance on what constitutes fair and reasonable returns, particularly in relation to heat network zoning where local price controls may already exist.</p> <p>The consultation also fails to acknowledge that many existing networks do not currently employ cost-reflective pricing models, but instead use a fair price benchmarking and consideration of the heat trusts pricing calculator. Of particular concern is how the framework will account for different risk profiles across projects. For example, older networks often require significant capital investment identified during due diligence - if these costs cannot be recovered from end users, such essential investment simply won't happen, making the market less attractive for improvements to existing schemes.</p> <p>Furthermore, the Authority needs to provide much more detail on what constitutes 'disproportionate' corporate risk. Whilst supporting the principles in general, we believe these aspects require substantial clarification and refinement before implementation.</p>
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)? b) Do you agree with our proposals to implement the fairness test discussed in Appendix 1: Fairness test?	<p>We broadly agree with the proposed 'fairness test' features and their implementation, particularly the principle-based approach and case-by-case assessment.</p> <p>However, several crucial considerations need addressing. Firstly, debt levels for projects vary significantly over time, and many mid-term contracts operate under fixed financing arrangements where asset owners may be unwilling to accept recalculations. We must account for whole-life costs, including future replacement costs, which can restrict our ability to modify financing structures for compliance. Operating costs fluctuate yearly due to network investments, HNTAS requirements, and upgrades needed to meet regulatory standards. This cost-driven pricing model could lead to significant year-on-year variations in consumer bills, potentially undermining sector confidence. Additionally, the Authority must carefully consider standing charge calculations. Current approaches vary significantly between operators - our typical standing charge is £375/year, though this may be higher for smaller networks. Any standardisation could result in substantial increases for some operators. Furthermore, the framework must account for different payment arrangements, where standing charges might be paid entirely by landlords or split between landlords and tenants. These complex realities of heat network operations need to be fully reflected in the fairness test implementation.</p>
4		Does the revised authorisation condition, 'fair pricing', reflect the policy intent?	Yes, although more clarification is required. We would expect further consultation and a longer/staged implementation period before redress/enforcement actions are available.
5	Market segmentation	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?	N/A
6	Data requirements	Of the information listed in Table 3 below, what do heat networks already regularly collect and can be easily reported?	<p>Veolia collects the majority of information outlined in the table.</p> <p>It should be noted however that this information changes rapidly and often, which would need to be considered in any reporting requirements. The dataset is extensive and complex, requiring significant resources to maintain and update accurately. Managing such a large volume of constantly changing data presents operational challenges, particularly when considering the frequency of reporting and the need to ensure data accuracy. The Authority should consider these practical implications when determining reporting requirements and frequencies, ensuring that the administrative burden remains proportionate while maintaining the effectiveness of oversight.</p>
7		Of the information listed in Table 3 below, which items would be more challenging for heat networks to report?	<p>The most challenging information to report would be related to fuel costs, particularly for networks connected to Energy from Waste (EfW) facilities. In these scenarios, calculating the actual 'fuel cost' is extremely complex as it involves multiple variables. For instance, where we own and operate the heat generating asset, determining the true cost of fuel is problematic - should it be based on gate fees, the weight of waste burned, or another metric? Furthermore, in some cases where we self-supply heat from our own assets, we don't actually charge ourselves for the heat, making it particularly challenging to reflect this accurately in fair pricing data submissions. This creates a significant complexity in providing standardised cost information that aligns with the reporting requirements while accurately representing the true operational model.</p> <p>Different networks and operators also have varying responsibilities for Heat Interface Units (HIUs), which means operational costs included within charges can vary significantly between schemes. This creates a significant complexity in providing standardised cost information that aligns with the reporting requirements while accurately representing the true operational model.</p>

8		Of the cost drivers listed in Table 7 (in Appendix 3), which items would be more challenging for heat networks to report?	N/A
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?	N/A
10	Cost Allocation	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?	We agree with this proposal, as it aligns with existing requirements in the gas and electricity markets. It is appropriate that GSOP payments, compensations, fines, penalties and other forms of consumer redress should not be passed through to customers.
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?	N/A
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?	N/A
13		Does the authorisation condition, 'cost allocation', reflect the policy intent?	While we understand the policy intent of the 'cost allocation' authorisation condition, we have concerns about its practical implications. Specifically, if we are required to include all the costs laid out in the Authorisation Condition under the standing charge, this will inevitably lead to significant increases in standing charges for customers. This could have unintended consequences for affordability and customer acceptance, particularly given that standing charges are already a sensitive issue for consumers.
14		What other feedback do you have on the proposed approach to cost allocation?	The heat network market by its very nature is diverse, with varying business models, technologies, and operational arrangements. A uniform cost allocation approach would not be possible or desirable given this diversity. It's crucial to note that the true cost of operating heat networks is significantly higher than Ofgem appears to appreciate, particularly when compared to traditional gas networks. This fundamental difference in operational costs and structures must be acknowledged. Instead of prescriptive rules, we recommend developing flexible guidance that can accommodate different market structures while achieving the intended outcomes. Prescriptive rules risk creating unintended consequences and may not effectively serve the varied nature of heat network operations.
15	Price comparison and benchmarking methods	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?	<p>No, we disagree with the proposed method for calculating a price benchmark. The approach fails to account for several crucial factors.</p> <p>Firstly, the profitability calculations for new networks may be distorted due to initially low maintenance requirements. While new installations might require minimal attendance in early years, significant issues often emerge from year 5 onwards, leading to substantially higher attendance costs. These delayed operational costs are not adequately reflected in the proposed benchmark. Secondly, the methodology does not properly account for risk management across multiple stakeholders. As operators, we assume risks from various parties, from asset owners to end users. The current pricing structure allows us to manage these risks through flexible arrangements, such as deferring substantial investments. This means costs may be lower in one accounting year but appear significantly higher in later years. The proposed benchmark methodology does not accommodate this necessary flexibility in pricing arrangements.</p> <p>Own price benchmarking is unnecessary and potentially counterproductive. Many of our networks have maintained stable prices for years or incorporate heat network costs within broader cost pools. Forcing a review of these arrangements will likely result in significant price increases. If prices remain within a fair price envelope relative to external benchmarks, internal price variations should not be of concern. Secondly, we oppose comparator benchmarking as it creates an unnecessarily complex and confusing system, imposing a substantial and constantly shifting data burden on the sector without demonstrable benefits. While comparator benchmarking might be referenced in price investigations, we believe its practical value in decision-making will be minimal, making the extensive effort required for data collection and analysis unwarranted. This is particularly true when considering that high prices can be justified through cost analysis during investigations.</p> <p>Many heat networks operate under long-term fixed heat offtake contracts, which provide essential stability and certainty for both suppliers and customers. The proposed benchmarking approach fails to adequately account for these existing established contractual arrangements, which are fundamental to the sector's business model and investment decisions.</p> <p>Profitability of new networks may be distorted because there is less attendance required e.g minimal issues. Though these savings are not immediately realised in practice because the site may have a high rate of issues at year 5 onwards of operation which require high attendance costs.</p> <p>This approach would not reflect risk management. We take the risks from multiple parties, ranging from the asset owner to the end user. For example in the pricing structure, sometimes we may defer an investment of substantial sums. This improves finances in one accounting year, but that cost will show in a later year. Pricing needs to be flexible for this arrangement.</p>
16		Do you agree with our proposal to use gas boilers and heat pumps as external reference benchmarks?	N/A
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?	N/A
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?	N/A
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 proposed reporting requirements for 'Medium Importance' cost drivers cannot be considered light touch - they will impose significant costs on operators. The administrative burden of collecting, processing, and reporting this data will require additional resources and potentially new systems, leading to considerable operational expenses. These costs would ultimately need to be recovered, potentially impacting consumer prices. The Authority needs to carefully consider whether the benefits of such extensive reporting requirements justify the additional cost burden placed on heat network operators.

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?	N/A
22		Do you have any other feedback on the proposed approach to price comparison and benchmarking?	No, we do not agree with the proposed approach. Instead, we recommend using a version of the Heat Trust Cost Calculator, but with two distinct calculators: one for CHP/Gas and another for electrified systems. This would better reflect the fundamental differences in cost structures and operational characteristics between these technologies. The current approach to like-for-like comparisons fails to reflect actual differences between technologies and their associated costs. We would strongly encourage more consideration of how price comparison and benchmarking methodologies could better support and align with wider sector development work. The benchmarking system must be sophisticated enough to account for the diverse range of technologies and business models in the heat network sector, rather than attempting to force all networks into a single comparative framework.
23	Profitability analysis	Do you agree with the proposal for ongoing monitoring of profitability through data collection on EBIT margins for all heat networks?	We partially agree. Given the differential investment requirements between networks and the uneven profile of typical investments in replacements and upgrades to systems, any short-term analysis of profitability could be misleading or misinterpreted. Heat networks require significant capital investment at different points in their lifecycle, creating natural fluctuations in profitability that may not reflect the true long-term financial health of the network. A snapshot view through EBIT margins could provide a distorted picture of network performance and potentially lead to incorrect conclusions about pricing fairness.
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?	N/A
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?	N/A
26		Do you have any other feedback on the proposed approach to profitability assessment?	The proposed approach to profitability assessment fails to recognise several crucial operational realities. Firstly, heat networks are treated as a portfolio, where well-performing networks effectively subsidise poorly performing or loss-making networks, whilst maintaining similar pricing points across the entire portfolio. This balance shifts year to year, making individual network assessment potentially misleading. Secondly, we often employ different pricing mechanisms within the same network and between different networks, simply because customers joined at different times under different arrangements. This complexity makes standardised profitability assessment challenging. Additionally, there are significant questions about how this assessment will be administered in practice. The Authority needs to provide much more detail on the practical implementation of these proposals, considering the complex nature of heat network operations and the varying commercial arrangements that exist across portfolios. We understand the need for profit oversight in regulated sectors. However, we firmly believe that profitability monitoring should be secondary to price fairness. If a heat network can demonstrate that its prices are fair and reasonable for consumers, then the actual profit levels, especially when viewed in isolation for a single year, should not be the primary concern. This is particularly relevant given the long-term investment cycles and varying operational costs inherent in heat network operations. The regulatory focus should remain on ensuring fair pricing rather than imposing arbitrary restrictions on profit levels that naturally fluctuate throughout a network's lifecycle.
27	Central price transparency	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 disagree with the notion that operators should be obliged to provide price comparisons to customers, especially considering the additional information requirements in term of billing, outlined in the previous consumer protections consultation. We fundamentally question the value and logic of publishing pricing data in this manner. If fair pricing regulation is effective, there appears to be limited benefit in this level of transparency. In fact, it could be counterproductive for several reasons. Firstly, comparing costs against market averages makes little sense when customers have no ability to switch providers. This could simply generate frustration and complaints without offering any practical benefit to consumers. Secondly, the expectation to immediately achieve 'gold standard' reporting (as in other regulated utilities) seems unrealistic and unnecessarily burdensome, and should be something considered in the future once the initial phasing of regulation is complete. Inally, there appears to be a contradiction in mandating connection through zoning while simultaneously highlighting price differences between networks. This could undermine consumer confidence in heat networks and potentially conflict with the government's broader heat network expansion objectives.
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?	We have significant concerns about the proposed balance of transparency. While we support including some information on bills to strengthen trust in the industry, we strongly oppose publishing detailed cost calculations. The information requirements already outlined in the billing consultation are sufficient. We are particularly concerned about the unintended consequences of central price transparency. Given the widespread issue of under-pricing, especially in inefficient networks within the social housing sector (particularly supported housing), publishing detailed price comparisons could exacerbate existing problems. Operators who identify their tariffs through such comparisons may face increased complaints or potential regulatory action from Ofgem, even when their prices accurately reflect their costs. This could create a perverse incentive to maintain unsustainably low prices, ultimately harming the long-term viability of networks and the sector as a whole.
29		Do you support focusing on one option or a combination of options in paragraph 6.69?	N/A
30		Do you support the phasing in of the options described in paragraph 6.70?	N/A
31		Do you support the adoption of different options for different heat network groups described in paragraph 6.71?	N/A
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?	We strongly disagree with the assertion that central price transparency measures won't create additional administrative burden beyond benchmarking requirements. This assumption particularly disadvantages smaller operators. While larger operators may have the internal resources to manage this, many smaller networks will struggle to understand and comply with these requirements. This approach creates an unfair advantage for larger operators and risks further incentivising monopolisation of the sector.

33		Do you think it is appropriate to link central price transparency with benchmarking?	N/A
34	Price investigation	Do you agree with the approach to price investigations set out so far? Please provide reasons and views to support your response.	<p>While we are minded to agree with the broad approach to price investigations, several important caveats must be considered. We support the principle that investigations should be scaled over time and that multiple factors and information sources should be used to determine pricing proportionality. However, significant concerns exist about implementation.</p> <p>There is high risk of market disruption, especially considering that Supplier of Last Resort (SAR) measures are not yet in place. Many existing contracts contain change in law provisions, which could lead to contract terminations due to these fundamental regulatory changes. Most critically, there is a substantial risk that smaller operators and housing associations may exit the market entirely if they find the regulatory burden excessive. This could lead to market consolidation and reduced competition, ultimately harming consumers. The investigation framework must be carefully balanced to avoid triggering these unintended consequences while still maintaining effective oversight.</p>