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Office of Gas and Electricity Markets
9 Millbank
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24 June 2004

**Theft of electricity and gas
Discussion document 85/04**

Dear Andrew

Central Networks is pleased to respond to Ofgem's discussion document, Theft of electricity and gas, 85/04. Whilst recognising that the paper considers the theft of both electricity and gas, our comments and responses are mainly related to electricity supply.

We agree with the stated principle that the honest customer should not have to pay for those that seek to steal gas and electricity. Further, we would agree with Ofgem that the current electricity industry framework does not encourage suppliers to fulfil their licence obligations in relation to theft. Any incentives introduced should therefore actively encourage the detection of theft, which would act as a deterrent to further illegal abstraction.

Our responses to the specific questions raised in the discussion document and further detailed comments are attached as an appendix to this letter.

In summary, Central Networks believe that there is a role for an effective revenue protection service for both electricity and gas supply. However, significant issues need to be addressed to ensure that the correct drivers are put into place for all market participants to deliver such a service. It should be recognised that whatever solution is adopted it must act to reduce the incidence of theft to ensure that honest customers do not continue to bear the costs.

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Central Networks would be concerned if the mismatches between benefits and obligations were to remain the same. Suppliers clearly do not currently have the incentives to be proactive in Revenue Protection and there would need to be positive incentives, compliance monitoring, or a strengthening of current obligations on them to stimulate a more proactive approach.

Distributors do have some commercial incentive, through losses and volume growth drivers, to deter the abstraction of electricity. If it is decided that they should provide revenue protection services in the future, a clear way would need to be found for them to recover their full costs, and this would need to be considered as part of the current DPCR.

Central networks will be pleased to support the formation of, and actively participate in, workshops to facilitate a way forward.

Yours sincerely

Paul Eveleigh
Regulation Manager

CENTRAL NETWORKS

APPENDIX TO LETTER DATED 24 June 2004

Theft of electricity and gas - Discussion document 85/04

Current Arrangements in the Market for the Prevention and Detection of Theft

We believe that the current industry arrangements are inadequate to ensure a consistent and effective revenue protection service. There are significant mismatches which exist in the obligations, ability to provide the services and incentives to do so between the interested parties.

Supplier Obligations and Incentives

As demonstrated in the discussion document, electricity suppliers are the market participants who should be instigating investigations into theft, as they have:

- obligations to inspect meters for tampering, damage or interference;
- links with all agents and market participants through the supplier hub;
- the relationship with end consumers, and long term stewardship of the customer base; and
- responsibility for the metering system.

In addition suppliers / shippers may have a broader view, where they supply both electricity and gas to consumers.

Suppliers are therefore the party best placed to drive the RP activity, but the current arrangements offer them little incentive to do so, as:

- the current supplier incurs the costs of any investigation regardless of when the actual interference took place;
- there may be limited opportunity to recover the costs of illegally abstracted energy, especially where there has been a change of customer and/or supplier; and
- the cost of unidentified theft is currently borne by all suppliers. Individual suppliers who actively investigate theft are therefore unfairly discriminated against.

Distributor Obligations and Incentives

Distributors are not required to actively seek and remedy theft and have no obligation to investigate theft other than report incidents that they identify to the appropriate supplier. Furthermore, distributors are increasingly becoming isolated from contact with individual consumers due to:

- no longer having data collection obligations;
- the opening of competition in meter operations and suppliers starting to de-appoint distributors as meter operators; and
- loss of internal expertise and technical competency in Revenue Protection in most DNOs.

However, distributors have the advantage of geographic presence and do have incentives to minimise theft as identified in the discussion document. These include:

- the drivers to reduce losses and maximise use of system income;
- safety of the network, which is a distributor issue;
- interference may not be limited to the meter and may include distributor equipment.

Other Issues

Other points to consider in the current arrangements are that:

- whilst distributors may not have the technical competency in RP it is also recognised that most suppliers are in a similar position; and
- the impact of supplier competition has meant that no one industry party has a complete overview of the issues, for instance in the cases where a customer has multiple sites with different suppliers.

Principles for Arrangements to Detect, Investigate and Prevent Theft

We welcome the concept of the draft principles outlined by Ofgem in Chapter 8 of the discussion document and, in the main, we agree with the specific principles as drafted.

Under principle 2, it should be noted that in other industries, retailers see the cost effective prevention of theft as sufficient incentive to take preventative or detective actions. In electricity there is the added issue that the suppliers not only have an obligation to their shareholders but also to the other industry parties who are currently affected by the theft.

Whilst, under principle 3, we would concur with the view that monitoring should be minimised, we believe that without some form of active assessment of the performance of parties, a consistent and effective deterrent will not be achieved.

Specific Questions Raised in Chapter 7

7.5 Comments are invited on whether the responsibilities and incentives on electricity suppliers and DNO's are correct or should be amended. If respondents consider that the responsibilities and incentives should be amended then views are requested on what changes should be made.

The responsibilities and incentives of both suppliers and DNOs are discussed in this appendix. This clearly demonstrates the mismatch between obligations and ability to perform the function on the one hand and the incentives on the other.

Clearly, if a consistent level of revenue protection activity is to be maintained, a mechanism needs to be in place which aligns the responsibilities, access to data and customers and costs / benefits. Under the current arrangements there are a number of areas of action that could be strengthened to ensure that costs and benefits are more equitably aligned, for example for incentives to be realised, assessed stolen units must go through the settlement process. However, the lack of obligations (or incentives) to undertake a consistent level of service would still lead to inequities. The only real incentive to suppliers is to reduce theft in its entirety and unless a consistent approach is adopted, this will not be achieved.

A number of mechanisms could be adopted, either jointly or individually, to achieve a more consistent approach.

- Standard service levels should be set for all suppliers to meet their licence obligations. This could be achieved by the RP Code of Practice being modified and updated to become an agreement in its own right, with governance determined by the industry, in the same way as other industry agreements such as the MRA or MOCOPA.

- The RP service could be provided through a central fund managed by an organisation on behalf of RP service providers could fund the activity. Any monies recovered by suppliers could be paid to the fund.
- If the RP service was provided by the DNOs, financial consideration for the cost of running a fully staffed RP unit should be made in adjusting revenue accordingly. This would need to be done within the current DPCR, and would therefore limit the time available to reach a decision on which mechanism was most appropriate.

It should be recognised that whatever solution is adopted must reduce the incidence of theft to ensure that honest customers do not continue to bear the costs

7.18 Comments are requested as to whether respondents consider that there should be a requirement on GT's and/or DNO's to provide RP Services for use by suppliers on their networks or whether this should be a supplier responsibility. In particular, it would be useful to understand the differences between the gas and electricity markets and in how the provision of RP Services and IGT's IDNO's and DNO's operating outside of their distribution service areas should be treated.

The obligations and responsibilities for providing a Revenue Protection service coupled with the customer and service provider relationships make it more appropriate for the service to be supplier driven. This is in line with the provision of all other end-user related services and the move to competition. That being said, there would be some advantages if the DNOs were to provide the service these include:

- geographically based;
- advantage of local knowledge;
- technical competency to deal with issues relating to network;
- DNOs are less impacted by customers who change suppliers;
- Distributors already have a commercial relationship with all suppliers through the Use of System Agreements offering non-discriminatory services; and
- the ability to recover Use of Systems income should be an incentive.

The issues that using the DNO to provide the services would not be addressed include:

- there is no established method of entering abstracted units in to settlement;
- the DNO is not the data collector;
- the DNO is not necessarily the meter operator;
- distribution areas no longer have the traditional boundaries. Therefore, the IDNO's and DNO's acting outside their distribution areas, may need to procure RP services ; and
- the DNO is not authorised to work on an embedded network, unless contracted to so by the network owner.

7.23 Comments are requested here on whether there is value in having a RP Code of Practice in the electricity market and, if so, whether and how it should be reviewed and updated. Views are also requested on whether it is sufficient or appropriate to maintain compliance with the Code through the DUoS Agreements or whether, for example, compliance should be voluntary or mandated by licence.

When there is a service provided to and for the public, there needs to be a Code of Practice to ensure that no parties involved with actions taken against or with customers is contrary to their rights. The current Code of Practice needs updating and revising in some areas, but companies still

refer to it when discussing or debating issues relating to RP. All suppliers refer to the Code when requesting categories and expecting work to be done. Service providers use it as a means of setting key performance indicators and charging for work carried out.

As mentioned earlier, the RP Code of Practice could become an agreement in its own right, with governance determined by the industry, in the same way as other industry agreements such as the MRA or MOCOPA. If this were to be the case, the code would then need to be revised to reflect its function as an agreement between industry participants and signatory would need to be mandated by licence.

7.36 Ofgem believes that an appropriate and effective regime for the detection and prevention of theft should not require regulatory action as a matter of course to ensure its success. However, action may be required where it can be demonstrated that a particular party has not met its regulatory obligations. Comments are requested here on this approach, in particular, whether respondents consider that the current arrangements are sustainable or would require ongoing compliance enforcement by Ofgem to ensure that parties meet their obligations.

The level of monitoring by Ofgem will be dependent on the final solution adopted.

It is unrealistic to expect there will not be any compliance monitoring. This is the current position and the fact there is now a debate, suggests that having no monitoring has been ineffective. However, if there was a mandatory agreement as previously described, then the level of Ofgem monitoring could be reduced as regular independent audits of compliance monitoring could be incorporated within the agreement (as it is in the case of MOCOPA).

Cost and Prevalence of Theft of Gas and Electricity

As the discussion document identifies, the cost of theft is not easy to quantify. However, even at the lowest estimate of £44 million, it is clear that some action needs to be taken.

Whilst the cost of discovered theft is relatively straightforward to identify, the proportion unidentified abstraction is much more difficult to estimate. Historic levels of identified theft have been reported by some DNO's as significantly below 0.1% of units distributed.

The impact of these costs is spread across a number of persons (suppliers, distributors and customers) depending on the circumstances. However, in the long term the ultimate costs are borne by the consumers. The initial impact of the costs depends on a number of factors namely:

- whether the illegal abstraction has been identified or not;
- the costs of the investigation (and where the costs are borne);
- any transactional charges for the investigation;
- whether identified units are included in the settlement process; and whether the supplier recovers any costs from the customer.

Other Issues

Scope of service

In formulating any future options, the activities that any Revenue Protection Service would be required to carry out must be very clear.

Currently, some Revenue Protection units focus only on theft; others have broadened their remit to include any metering point that is not being recorded accurately, such as faulty CT or inaccurate ratios, errors in billing or faulty meters. Some providers limit activity to non half-hourly metering points; whilst others include half-hourly.

The scope of activity therefore needs to be agreed upon (without limiting a suppliers choice to have further activity undertaken) to provide a consistent base level service.

Alignment between gas and electricity

Given the increasing propensity for consumers to move to dual fuel arrangements with suppliers/ shippers, we believe that any future arrangement should be consistent across both utilities. The supplier will have substantial advantages in assessing likelihood of theft in having data from both gas and electricity.

Action and remedies on discovery of theft – prevention of re-occurrence

As discussed, the cost of theft can only be reduced if action and remedies on detection are seen as a deterrent. Currently, the view is that in most cases there are insufficient penalties applied to guilty parties on detection. This is mainly due to the reluctance of industry parties to take legal action and, in many cases, the reluctance of the Police and/or Crown Prosecution Service to act.

We believe that for revenue protection services to act as an effective deterrent, a nationally agreed process for dealing with offenders needs to be put in place.

Role of meter operator / data collector

Whilst the Supply Licences place obligations on the suppliers, there are no specific requirements on supplier agents. We are of the opinion that, in order to have a consistent and effective revenue protection service, all supplier agents must be required to operate to a minimum standard in the detection of theft. This can only be achieved through the strengthening of the Supply Licence conditions.