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Dear Andrew

### **Theft of Electricity and Gas**

Thank you for the opportunity to comment on the above consultation document and for holding the industry seminar on 7 June 2004.

EDF Energy has important interests in energy supply and electricity distribution and metering, and is responsible for revenue protection services in four distribution areas. We therefore have a strong interest in the subject of the theft of electricity and gas, and wish to work closely with Ofgem and the rest of the industry to address any adverse issues concerning the current commercial, organisational, and regulatory arrangements.

It was evident at the seminar that:

- All parties present could identify with the benefits of the operation of an effective revenue protection service, and
- There was considerable interest in the setting up of an appropriate working/expert group to develop further, suitable proposals and an incentives framework, prior to full consultation and the formalisation of licensee's obligations through appropriate licence modifications.

It is also essential that the work progressed following this consultation is fully co-ordinated with Ofgem's thinking on distribution losses and the distribution price control review process to ensure a consistent and complementary set of solutions. In particular, we understand that the current work progressing in Ofgem to set the baseline distribution losses assumes that the current form and operation of revenue protection and related services continue. Should this consultation in any way lessen the opportunity or incentive for those distributors

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who currently provide this service to continue to provide at least the same level of service, then it may be necessary to re-open that debate.

Ofgem has requested comments on particular questions as follows. Following each question I have set out our current views, which I hope will be fully considered in subsequent work.

## **Responsibilities and incentives**

### **Electricity**

**Comments are invited on whether the responsibilities and incentives on electricity suppliers and DNOs 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.**

Currently, suppliers bear the cost if illegal extraction is identified but they find it difficult to recover money from offenders. Part of the problem is that those accused of theft are quick to complain to energywatch, protesting their innocence, even when culpable. Therefore some suppliers may not pursue all cases of theft.

It should be expected that, given supply licence obligations, all contracts for meter operation and data collection should have a general obligation on agents to at least identify that theft of electricity may have occurred and has been duly reported to the relevant supplier and the distributor. Suppliers should consequently ensure that they have adequate management reporting in place. Incentives may be needed to encourage agents to report suspected cases of theft. Such incentives may also ensure that safety issues associated with theft are picked up early and dealt with by the supplier and/or distributor.

In order that all cases of suspected theft are thoroughly investigated, we believe that suppliers and distributors need to work together. Both parties are, after all, impacted by any loss of energy. Licence obligations are currently mainly on suppliers, with distributors responsible for the safety and security of networks, and therefore incentives for suppliers and distributors should balance the risks and benefits.

At present, the supply licence places an obligation on the licensee to inspect all non-half-hourly metered premises for metering equipment tampering and other interference every two years where they have continuously supplied the premises during that period. The first weakness with this obligation is that it does not take account of customer churn. The second problem is that, where a supplier identifies fraudulent extraction of electricity, he is not adequately incentivised to take action.

Further points that can be made concerning the present arrangements include the following:

- Revenue protection services are at their most efficient when provided within a defined geographic area. Operation of multiple services in the same geographic area would not be cost effective.
- When theft is identified, the supplier should declare the fact to the settlements process. This can effectively be achieved only through changing the meter and providing a deemed closing meter reading equivalent to the actual meter reading plus a reasonable estimate of the stolen units. This information would normally be provided through the supplier's appointed meter operator. If this process is completed, the supplier will incur the full settlements energy cost, rather than simply a share of the "spill" units plus the due distribution charges. However there is some debate as to whether units falling prior to the open settlement window, should be "forced in". Our view is that this practice would not be appropriate, as it could otherwise affect the legitimate ongoing calculation of the customer's EAC. As a distributor we would wish to consider separately whether to recover any prior period units, if material, by raising a separate invoice, normally in respect of the relevant supplier. In addition, the supplier would incur the costs of setting up the revenue protection service and the specific costs of that case, together with the possible costs of raising warrants and potential court appearances, and, as we have said above, may not be able to recover the outstanding debt from the customer. But we should not forget that if the customer had used the electricity correctly in the first place, it would only be the revenue protection costs that could otherwise be avoidable. So we have a perverse relationship here. It could be argued that each supplier gains an advantage if theft is identified for customers that he does not supply, while in practice he is only likely to incur more costs where his customer has stolen electricity compared with the situation where he is minded to ignore the whole incident. Further complexities occur if an MPAN cannot be linked to the relevant customer or a supplier has failed to register its liability. In those cases a distributor would have little choice but to levy a charge for use of its distribution system plus RPS fees directly on the customer. Where a risk of customer non-payment occurs, it may be necessary to consider de-energisation until full payment is made. Each of these scenarios needs some further debate to agree this model nationally and we agree with the formation of a working group to explore all aspects of revenue protection processes.
- It is also of concern that if suppliers choose not to pass on the costs of the identification of theft to those customers who have caused them, the deterrent message is weakened and the scale of undetected theft will only increase.
- There is a financial disincentive on non-incumbent suppliers to deal with theft. The playing field needs to be levelled so that suppliers who are proactive in revenue protection benefit and those that are not are penalised, perhaps through a grant scheme of some sort.
- Distributors will often not have a contractual relationship with particularly the meter reading agency and to a lesser degree the meter operator, from which a useful source of leads could be developed. However, as such services are often outsourced and operatives are incentivised only to complete more meter reads or meter changes, the additional time required to complete the

collation of evidence and reporting is not warranted and therefore little advantage is gained by either the supplier or the distributor operating the revenue protection service. As these contracts are always held with the supplier, it is therefore essential, as we have said above, that clauses are included in the metering agreements, to ensure that service providers are also required to proactively identify such cases and pass them on to the supplier and distributor, and, where separate, to the revenue protection service

- Distributors, though able to charge on a transactional basis for the specific work involved once theft has been identified, may not be financially funded through price control allowances to provide the infrastructure necessary for such a revenue protection service. Net infrastructure costs clearly need to be recovered in order to facilitate the operation of an effective service by distributors.
- Distributors do, however, have incentives to detect theft of electricity. In particular, if the missing consumption is passed into settlements, they will be entitled to the otherwise lost income from use of system and are also incentivised to manage distribution non-technical losses. So, provided that, as a minimum, the difference between set up costs and income recovered from use of system and losses and the transactional costs is recoverable, plus an appropriate return, a valid incentive model can be envisaged. In addition, while a distributor operated service can proactively generate leads, through the development of contacts with police and other agencies, and can offer financial or other incentives for the provision of positive leads, there is also a need to require the supplier, through its metering agents, to continue to remain diligent in identifying theft from their own site visits and reporting it accordingly.
- Effectiveness of services will continue to further tail off over time, without adequate incentives being placed on parties, particularly recognising the reducing numbers of leads being passed through by metering operators as these services are further unbundled

The previous section identified that distributors have greater incentives to facilitate the effective operation of a revenue protection service, provided that the recovered units are generally introduced back where they should have been in the first instance, i.e. in settlements.

Safety to the public, the customer, and the operative visiting the premises is clearly of paramount importance. Fraudulent extraction of electricity can often include tampering with distribution network assets. We would be concerned if the conclusion of this consultation process had the effect of increasing the opportunity for unauthorised access to distribution equipment, having the consequence of putting the above persons at greater risk of exposure to live apparatus.

## Gas

**Comments are requested as to whether the responsibilities and incentives on gas suppliers, shippers and DNOs 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 gas market differs from the electricity market in that suppliers pick up a smear of “lost” energy as part of normal industry billing processes. In addition, suppliers incur costs when investigating and pursuing theft cases, the proceeds of which are not always recovered. In order to keep industry costs down and deter further cases, suppliers need to increase detection rates. As with electricity, suppliers need to ensure that all contracts for both metering and meter reading have a general obligation on agents to at least identify and report theft of gas. Suppliers should ensure that they have adequate management reporting and audit in place. All available incentives similar to the electricity model mentioned above should be considered to encourage agents to report suspected cases of theft. Suppliers and the GT need to work together to ensure all cases of suspected theft are thoroughly investigated as both parties are impacted by any loss of gas

**Specific comments are requested on the effectiveness of the reasonable endeavours and allowances schemes in place and the role of IGT s in providing a mechanism for suppliers to recoup costs from failed attempts to recover charges from customers**

The current Transco cap of £250 does not reflect actual costs incurred by the supplier. If it is agreed that this scheme is effective, then a more realistic range would be between £400 and £1,000.

### **Provision of Revenue Protection Services**

**Comments are requested as to whether respondents consider that there should be a requirement on GTs and/or DNOs to provide Revenue Protection Services for use by suppliers on their networks or whether this should be a supplier responsibility. In particular, it would be useful to understand any differences between the gas and electricity markets and how the provision of Revenue Protection on IGTs, IDNOs and DNOs operating outside their distribution services areas should be treated**

As suppliers maintain customer contact, they should take some responsibility for identification of theft since they are responsible for the actions of their customers and for ensuring that their customers adequately contribute to the costs they have caused by their behaviour. Suppliers would also require a close relationship with the distributors via a contractual arrangement.

It can be appreciated that the most effective solution is clearly where a single service is offered into each geographically defined area, provided that there are adequate incentives to set up the service in a cost efficient and value added manner. This tends to suggest, as was understood in 1998, that distributors, if properly incentivised, should be obliged by their licence to offer to provide such services (through internal provision or outsourcing) on terms that can be challengeable through determination to ensure the right quality and value of service and that suppliers should be obliged to take that service. However, it may be possible for other parties to provide the service, provided it is efficient and proactive, under contract to the relevant distributor.

Costs for the provision of a revenue protection service fall into two categories: those associated with the set up of the service, provision of skilled resources, the development of IT systems and data management techniques, and the establishment of contacts with police and other agencies; and those associated with the specific cases of identified theft.

Initially the ongoing set-up and infrastructure costs should be recovered as a simple charge per MPAN to suppliers based upon the number of customers supplied. As units are recovered and proven to pass into settlements, that will provide its own income stream to distributors. By returning some of that value to suppliers, in terms of a lower overall service charge, both parties benefit. For the transactional related costs, plus an appropriate margin, these should clearly be levied specifically on the supplier of the affected customer, who may choose to recover those costs in addition to the normal energy costs that he would be entitled to recover from any customer using electricity. Through this model, incentives are better placed, all suppliers are treated equally, the perverse incentives associated with the settlements system are overcome, and a fair sharing of costs and benefits results. The form of this incentive model should also enable the enduring development over time of an efficient size of operation in each distributor's area relative to the number of proven leads that can be identified and managed, so that financial self-sustainability is achieved.

## **Codes of Practice**

### **Electricity**

**Comments are requested on whether there is value in having a Revenue Protection 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.**

We would support a common approach for both fuels. By having a common Code of Practice in place, suppliers would have the comfort of knowing the minimum standards of service being provided by distributors. A common Code of Practice should set out the rules and governance arrangements, and must also ensure that all safety issues are immediately addressed.

The electricity Code of Practice in any case needs to be updated to take into account industry changes that have taken place since it was written, with particular regard to the following:

- Revenue protection services are not necessarily currently being provided directly by distributors, though we have found no difficulty in the South West of England with one supplier (EDF Energy) offering revenue protection services to others.
- The extent and standards of service provided by revenue protection agents and the circumstances under which charges for these services are applied.
- A mechanism for maintenance of the code needs to be put into place and the arrangements, existing and future, need to be effectively regulated and policed.

Compliance with the Code should be through the use of system agreements, as was intended in 1998 on the assumption that the distributor holds the obligation to provide these services.

## **Gas**

**Comments are requested on whether there is a continued need for the Theft of Gas Code of Practice and, if so, whether it should be reviewed and updated and if so, who should carry out this review. Comments are also requested on whether adherence to the Theft of Gas Code of Practice should be voluntary or mandated, for example under the standard conditions of the licences.**

In order to ensure a consistent approach for both fuels, by having a Code of Practice in place, suppliers would have the comfort of knowing the minimum standards of service being provided. Governance should be through a supplier forum

## **Compliance**

**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**

There should be a regulatory obligation on suppliers as well as distributors and GTs to ensure the timely identification of all instances of theft and appropriate performance reporting to Ofgem. If suppliers have an effective meter reading policy, this should ensure an inspection is carried out every two years when the customer has been continuously supplied. Early detection of theft would result and safety issues would be identified quickly.

Following the Utilities Act amendments to the principal legislation, access rights to meters are now held by suppliers and access rights to service equipment by distributors. As the nature of tampering is seldom known in advance, and in lieu of any further legislative changes, it would make sense for any revenue protection service provider who is not aligned to a distributor to be a de-facto agent of the distributor for the area and for suppliers to grant access to the metering equipment in order that RPS activities can be effected.

### **Principles for arrangements to detect, investigate and prevent theft**

We support the draft principles proposed in Chapter 8. While Principle 2 would be the preferable way forward to encourage detection and prevention of theft of gas and electricity, it is likely that this will need to be supplemented by some changes to the current regulatory framework.

I hope that you will find these comments helpful.

Please do not hesitate to contact me if you have any queries on our response.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D. Linford', with a stylized flourish extending to the right.

**Denis Linford**  
**Head of Regulation**