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Dear Andrew

Theft of Electricity and Gas

I am pleased to have the opportunity to respond to your recent discussion document on the theft of electricity and gas. This is an important area where all stakeholders in our industry have a shared responsibility to discourage illegal activity and to protect the safety of public and staff. We have had previous discussions and correspondence in which I have explained the historical background to the current arrangements in electricity. I have found it helpful to set that experience alongside the evidence from the gas market described in your paper and discussed at the forum on 7 June.

Our focus now should be on the future. It is clear that the current situation is not acceptable. At the least there needs to be a clarification and alignment of the responsibility of parties, so that the same obligations are faced by all holders of any class of licence, and that suppliers and their customers can expect to see consistency in all regions of Great Britain. There is a danger that the period of uncertainty since 2000 has already weakened the previous deterrent against theft, and new initiatives are needed to restore the confidence of honest customers in the workings of the energy markets.

I will structure our comments against the chapter headings used in your discussion document.

Introduction

As you are aware, I have had an interest and involvement in discussions about revenue protection for many years. Whilst your discussion paper is a welcome sign that Ofgem now intend to tackle the uncertainty that exists among industry players, it is disappointing that progress has been so slow since your commitments in August 2001. In the meantime, there has been a lack of clarity as to where responsibility/obligation for the detection and investigation of theft reside, particularly as some parties have ceased to provide services which were once offered consistently by all Public Electricity Suppliers. We are therefore pleased by the publication of this paper and we hope this signifies a determination by Ofgem to clarify the obligations and incentives that should encourage distributors and suppliers to understand their respective roles. We acknowledge the difficulty of some of the issues that arise, but believe that all parties should be willing and able to act in the wider interests of the energy market, so long as there is an appropriately supportive regulatory framework.

Summary Impact Analysis

Your summary rightly identifies the two main issues related to illegal abstraction: the safety risks for the public and industry staff; and the impact on the retail market, with honest customers and suppliers bearing costs that should be recovered elsewhere. We support the objectives you identify and agree that an ideal solution would not involve regulatory intervention, but we do not believe it will be possible for Ofgem to step back entirely from this area.

You point out the difficulty of assessing the scale of the problem. Whilst we have recently indicated in our data submission that the occurrence of theft is increasing, it is not easy to accurately quantify the actual number of incidents that occur. However, all the available evidence from related crime statistics shows an increase, and there is no reason to suppose that the theft of electricity has somehow escaped this trend. We therefore support the view that there is a growing problem, even if it is not possible to be specific about the absolute levels of theft.

In our view it is right to retain the basic split of responsibilities established in the electricity market in 1998. Suppliers should have the primary responsibility to identify evidence of illegal abstraction and Distributors should provide an independent investigation service, which also provides an assessment of the levels of unrecorded consumption.

Overview of Current arrangements

As you are aware, UU has continued to provide a Revenue Protection service for all suppliers operating in our Distribution Services Area and we believe it is in customers' interests for us to continue to do so. We hope that Ofgem's review will ensure that this service remains financially viable.

In paragraph 3.14, you refer to the lack of any DNO scheme under Schedule 6 of the Electricity Act. At the time of the drafting of the Act, the industry advised the DTI that no DNO would be able to publish a scheme, as DNOs do not trade energy. Our advice has proved correct.

You also state in para 3.15 that it is unclear whether newly licensed IDNOs will provide RP services. We have always argued that all distributors should operate on a level playing field. This should also apply for the provision of RP services. It is a weakness of the arrangements put in place in 1998 that the obligations on distributors were put in the standard (Ofgem approved) Use of System Agreement rather than in the licence. This has created an area of uncertainty that is best remedied by clarifying obligations in the licence.

Industry Performance and Cost of Theft

We hope the updated statistics provided by companies will enable Ofgem to gain a clearer view on this issue. However, lack of consistency in the industry in the provision of statistics should not be a bar to making progress in the future.

Incentives in the Electricity Industry

The effectiveness of incentives is at the crux of the debate. It is essential that these encourage the right behaviour for all parties and there are reasons to doubt whether this is currently the case.

<u>Incentives for Suppliers</u>

This is the main area of concern. Suppliers face conflicting incentives. If a customer is illegally abstracting electricity, the supplier does lose revenue, but their loss of profit is

limited to the margin they expect to earn on kWh sales (as they will also avoid the costs associated with kWh purchases and volume related network charges). The impact of less recorded 'sales' is smeared across the market as additional losses and eventually also in higher network related prices for all suppliers. Arguably the worst effect for suppliers is if they identify 'theft' but are unable to recover the costs of stolen kWh from any customer. In this case they bear the costs but do not gain any extra revenue.

The challenge is therefore to find ways to encourage suppliers to identify theft, given the risk that they may worsen their commercial position by doing so. The combined body of suppliers has an interest in theft being minimised, since this will reduce the costs that they must pass on to customers, and they will all be aware of the deterrent effect arising from effective detection and redress.

We agree that the current arrangements for settlement, DUoS charges and transactional charges do not appear to provide sufficient commercial incentives on suppliers to detect theft. The critical activity is site visits to inspect meter installations. This should be undertaken regularly by suppliers' data collection agents, who should be sufficiently trained to identify evidence of interference. However there are reasons to doubt that this obligation, which is specified in the multi-party settlement agreements, is given sufficient consideration. This is where incentives may need to take the form of a stick rather than a carrot.

The current obligation is to read meters at least once every two years, but it could be argued that this should be tightened to fit in with the time lags involved in settlement, so that every meter was read during the period between consumption and final reconciliation. Such an approach would not only improve the procedures for settlement, but would also align with Ofgem and energywatch desires for a greater proportion of supply invoices to be based on real meter readings. We believe this is an area where effective monitoring of supplier performance could achieve a range of benefits for customers, including the reduction in the level of losses that contribute to energy prices.

On 22 April 2004, Ofgem announced an investigation into Npower's gas meter reading performance. John Nielson stated that "Regular meter readings are important to enable customers to be charged fairly". He could also have added that they help to detect and prevent theft. We would also urge suppliers and Ofgem to actively lobby the Crown Prosecution Service to prosecute theft more regularly as a greater deterrent to theft.

We were concerned by the energywatch suggestion at the recent Ofgem seminar that a supplier's redress should be limited to charges for stolen energy for a three-month period. This would significantly reduce the opportunity for a supplier to recover its costs and would therefore accentuate the disincentive to report any suspicions. What is needed are mechanisms that increase the prospect for a diligent supplier to recover all due revenue, and therefore to increase the likelihood that a supplier will pursue suspicions of theft with renewed vigour.

Incentives for DNOs

We believe the existing incentives for DNOs to investigate and determine the extent of any theft are adequate. As UU has shown over the last few years, it is possible to provide a viable RP service under the current regime. It is surprising that you claim in paragraph 5.21 that some DNOs do not provide a RP Service as 'there was not a commercial driver'. Neither can we see the relevance of different characteristics of DNOs' networks as a reasonable explanation. We strongly believe that all Distribution licence holders should be required to offer an investigation and independent assessment service to all suppliers using their network.

This should be backed up by continuing incentives that mean an efficient operator can earn a reasonable return on its activities.

In our view, the new obligations within the ESQCR for distributors to inspect meters for safety reasons should also assist in the revenue protection process. It provides a further reason for site visits to inspect metering and therefore offers another opportunity to seek evidence of illegal abstraction.

Incentives in the gas industry

It was clear from the contributions of representatives of Transco and gas suppliers at the Ofgem seminar on 7 June that the existing 'Reasonable endeavours' scheme is not working and many claims were being rejected. It does not appear to offer an industry solution to this issue based on the contributions of those currently operating the scheme. However, we would support a more rigorous review of the gas market scheme by any working group that is seeking to identify the best approach for the future.

Effectiveness of current arrangements

The current consultation is not making formal proposals at this stage and states that the outcome could be a fundamental change to the current arrangements or the status quo. We do not believe that status quo is an acceptable way forward and would simply leave the existing lack of clarity in the system. There must be a greater level of consistency across the market, although this could be based on more stringent application of the approach covered in most existing Use of System Agreements.

Code of Practice

We agree that the Code of Practice needs to be updated and did support the Electricity Association's attempts to revise the document to reflect Utilities Act changes. However, it proved impossible at that stage to agree who should contribute to the work, largely because of the uncertainty that had been created in respect of where RP responsibilities lay. We hope that within Ofgem's project, clarity will be restored and the appropriate parties can then work to bring the Code of Practice up to date.

Compliance

We agree that compliance with licence and contractual obligations is essential for the effective operation of revenue protection. We suspect that this will inevitably involve a degree of monitoring, which can most practicably be carried out by Ofgem. In previous discussions, it has been suggested that it should be a last resort for Ofgem to take on this role, but we believe it is now clear that other industry parties cannot be expected to do so effectively. The role of independent monitoring must fall within the jurisdiction of Ofgem.

Next steps

At the seminar, BGT representatives stated that they had a number of proposals that they would like to put forward and that the establishment of some working groups as on the Connections issue may be the best way forward. However, we would prefer only one working group to be established that would examine the end-to-end process with clear terms of reference. We would wish to participate in any working group established.

It is common ground within both the electricity and gas industries that theft is a problem and that Ofgem must take the lead in establishing clarity for future arrangements. It will be necessary for Ofgem to clarify and if necessary impose obligations that will provide for regular site visits by suitably qualified staff. The process of investigating and remedied instances of illegal abstraction needs to be standardised. We hope that Ofgem will develop

their thinking on these areas and have some progress to report in the September 2004 document.

I hope you find these comments helpful. Although this is not an ideal time to engage distributors in discussions on non-price control issues, I would be happy to spend some time explaining the points covered by this letter if you wish.

Yours sincerely

Mike Boxall
25th June 2004

Mike Boxall
Head of Electricity Regulation