

Mr Cesar Coelho
Ofgem
9 Millbank
London
SW1P 3GE

31st January 2011

Dear Cesar

RE: Ofgem Consultation on “Reducing supplier disincentives to detect and investigate gas theft – uniform network code proposal UNC231V and other changes”

1. British Gas supports Ofgem’s consultation on Modification Proposal 0231V and welcomes the statement that they are minded to implement Modification Proposal 0231V¹. We believe that such a decision would be an important step forward in removing some of the disincentives which currently exist for Suppliers to invest in the detection of theft within the gas market. Detecting gas theft is expensive and without a regime which effectively incentivises Suppliers to take part the evidence is that most Suppliers will not take adequate steps to address it².
2. We consider that the Reasonable Endeavours Scheme (RES) now in place is rendered ineffective by the low levels of compensation paid to Suppliers for the given theft detection activities. These values, set back in 1997, bear no relation to the actual costs associated with these activities and therefore widen the gap between the costs and benefits associated with theft detection activity for Suppliers.
3. This creates a disincentive to detect theft which in turn puts customer safety at risk and increases the costs associated with gas theft to the law abiding general customer population. British Gas believe that disincentives like these on the detection of theft need to be removed, and therefore support the provisions in the Network Owners’ licence which provide for both a RES and for the volumes of energy stolen to be kept out of settlement³.

¹ Ofgem Consultation on “Reducing supplier disincentives to detect and investigate gas theft – uniform network code proposal 0231V and other changes”, paragraph 4.1.

² In 2009, British Gas reported 83% of all theft detections. The next best performing Shipper reported only 4%.

³ Licence Condition 7.

4. As the RES allows compensation only for specific activities relating to theft detection we consider that it will never in isolation provide a holistic incentive regime for the detection of theft, and consider that this can only be achieved by introducing a scheme such as the Supplier Energy Theft Scheme (SETS). Notwithstanding this, we believe a RES has an important role to play before a more complete incentive regime is in place. This point is explored more in paragraphs 28 to 34 within Appendix One.
5. We welcome the fact that Ofgem agree with us⁴ that Modification Proposal 0231V will improve the transparency and change control management of the RES by moving it from the Network Owners Licence and in the Uniform Network Code (UNC) where all industry parties can access, discuss and modify it. We believe in addressing this, Modification Proposal 0231V will enable more Shippers to understand and access the scheme, in itself giving overall theft detection levels a boost.
6. We note Ofgem's concerns⁵ about the adequacy of the current RES audit provisions and whilst we agree with the premise that the level of oversight must be proportionate to the degree of impact any misuse of the process would create, we think that the existing implied obligation on the Network Owners to ensure only genuine claims are paid is sufficient. British Gas, for example, is able to substantiate all of its actual costs and is ready to provide the necessary evidence to the Network Owners for this purpose. We consider this should be sufficient to mitigate any risk of Shipper abuse, and caution against overly strict requirements which would have the effect of preventing any claims to be submitted.
7. Finally, we call on Ofgem to take steps now to enforce the obligation on independent Gas Transporters (iGTs) to have in place a RES. iGT networks now represent a significant portion of the UK market and as such any disincentive to detect theft that the absence of a RES creates will pose a significant threat to customer safety.
8. These points are explored further within Appendix One. If you have any queries relating to this representation however, please do not hesitate to telephone me on (07789) 570501.

Yours sincerely

David Watson
Regulatory Manager, British Gas

⁴ Ofgem Consultation on "Reducing supplier disincentives to detect and investigate gas theft – uniform network code proposal 0231V and other changes", paragraph 4.21

⁵ Ofgem Consultation on "Reducing supplier disincentives to detect and investigate gas theft – uniform network code proposal 0231V and other changes", paragraph 4.25 onwards.

Appendix One – Detailed Answers

Chapter 2, Question 1: What factors have led to the limited number of suppliers using the current compensation arrangements?

9. British Gas consider there are a number of factors which, when combined, have led to only ourselves using the Reasonable Endeavours Scheme (RES)⁶. We consider the primary cause to be the general lack of investment in theft detection activities from other Suppliers, although also believe that the difference between the costs of submitting a claim and the potential benefits recovered and the often unacceptable customer treatments Suppliers must take before having some claims paid to be material factors.
10. The claims under the RES are only payable for confirmed theft detections, and as such the number of RES claims the Supplier community make is directly linked to the amount of effort that Suppliers put in to detecting theft. Statistics published by the Network Owners agent, xoserve show that British Gas detect over 83% of all theft in the market, despite supplying approximately 40% of the market and receiving less than 33% of all the leads sent out from the Network Owners. This means that the other 60% of the market receive 66% of the leads and yet make just 17% of the theft detections in the market. We are not therefore surprised that these same statistics show that British Gas is the only party to use the RES.
11. We also consider that the general lack of investment in theft detection activities will also mean that these Suppliers will lack the resource or process capabilities to manage claims made under the RES. This too will lead to a reduction in the volume of claims which are made in the industry.
12. We note the findings of the ERA and ENA Theft of Energy Working Group on this matter and agree with their conclusion that “*the Reasonable Endeavours Scheme was too complicated and inadequately repaid suppliers for the costs they incurred*”⁷. We consider the potential revenue recovered through the RES does little to cover either the costs associated with Revenue Protection activity, and from experience know that even the cost of managing claims under the RES itself can outweigh the total amount of compensation ultimately received. These values, which generally allow for a Supplier to recover £125 against a claim were devised over thirteen years ago and bear no relation to the actual costs which a Supplier incurs. This is considered in more detail below, but we believe Modification Proposal 0231V remedies both

⁶ The Monthly Theft of Gas statistics from xoserve show that only British Gas made use of the scheme last year.

⁷ Report of the Theft of Energy Working Groups report (April 2006), para 11.1, p27.

issues identified by the ERA and ENA Working Group by firstly increasing the amounts payable and secondly improving the transparency of the RES.

13. Furthermore, the actions the RES requires Suppliers to take before submitting a claim are in some cases so unacceptable from a customer treatment point of view that Suppliers such as us often choose to absorb the costs associated Revenue Protection activity. For example, where a payment arrangement for the repayment of stolen gas is made and then subsequently broken by the customer, the RES requires us to first disconnect the supply at the customer's premises for twenty-eight days before submitting a claim, even where that payment arrangement is made through a prepayment meter by a vulnerable customer. Whilst the Network Owners recognise this and provide flexibility around their approach such that we do not need to take this action, we are concerned that the fact that the documentation remains out of date may create future problems which may in turn incentivise poor treatment of customers. We believe that steps should be taken now to amend the RES so that issues like this are resolved.
14. This can also be seen in the requirement of the RES to recover the costs associated with theft from a customer on a payment arrangement not exceeding twenty-four months. Our licence obligation to assess each customer's ability to pay means that we often enter in to payment arrangements that last beyond this timescale, a fact which then prevents us from submitting a claim under the RES. We believe that Suppliers should not be penalised for taking actions which are in the customers' interests and that the RES should be updated to reflect this.
15. Finally, we consider there are specific issues on iGT networks which impact the number of RES claims which Suppliers can make. Primarily, there are very few iGT networks that have a RES for Suppliers to claim against, in contravention of their licence obligations. Additionally, it is our experience that theft is harder to detect theft on iGT networks due to the poor quality of industry held data on these sites, thus limiting our ability to proactively find theft. The issues with the accuracy and availability of AQ and meter detail related to iGT sites affect a number of our processes but in particular limit the amount of theft we find on iGT networks and therefore reduce the volume of RES claims we make against those iGTs with a RES.

Chapter 4, Question 1: Do you agree that the £1,000 cap per allowance (apart from Allowance (vii)) is reasonable? Please provide supporting arguments.

16. British Gas believe that the £1000 limit proposed by Modification Proposal 0231V is justified, and wish to stress that as this amount is a limit and not a fixed fee the Proposal is not that the maximum is paid out for each claim, but simply that Suppliers are allowed to claim recover exactly the costs incurred against each relevant claim type. As no single action we take in the course of detecting theft costs more than £1000, we consequentially consider the limit to be appropriate.

17. The current allowances with the Reasonable Endeavours Allowances Scheme (REAS) were set in 1997 when the costs associated with Revenue Protection activity were very different, and thus no longer bear any relation to the actual costs a Supplier may incur. As a result, the REAS currently acts as a disincentive on Suppliers to go out and detect theft, placing customer safety at risk and increasing costs to law abiding customers.
18. Ofgem themselves recognised this point in April 2004 on arrangements covering theft of electricity and gas, Ofgem published a “Next Steps” document in January 2005 which recognised a number of concerns with the RES, including that *“the amount of money that could be recovered under the scheme did not reflect the actual costs incurred by carrying out an investigation⁸”*. The subsequent recommendation from Ofgem was that *“in conjunction with the ERA/ENA workgroups’ consideration of incentives, the Reasonable Endeavours Scheme be reviewed to ensure that it meets the requirements of the gas industry⁹”*
19. As Ofgem themselves note¹⁰, the £1000 limit is more than a Supplier could expect to incur during the course of a theft detection for any of the activities provided for under the RES, and as such will allow Suppliers to claim for their actual costs thus removing an important disincentive to detect theft with the consequential impact that more Suppliers are likely to invest in theft detection. We consider this in turn will improve customer safety and reducing the costs associated with theft to law abiding customers. Indeed, the £1000 is such that the scheme will allow Suppliers to claim their actual costs for the foreseeable future, negating the need for further short term reform.
20. We consider the danger in setting a flat fee (as is currently the case) is that, as the costs associated with detecting theft vary on a case by case basis, payments made under the RES will inevitably be inefficient; more money than necessary will be paid out in some cases and less in others. By moving to an upper limit, set deliberately above the current levels of cost incurred, Suppliers will be able to recover precisely the amount of cost incurred. The degree to which actual costs incurred by Suppliers are greater than the current £125 provision, but less than the £1000 limit in Modification Proposal 0231V is discussed below.

Chapter 4, Question 2: (For suppliers only) Do you have further supporting information on your actual costs associated with each of the activities set out in Table 1? Information on average costs and the range and distribution of costs would be particularly helpful.

21. We provided some indicative costs associated with the detection of theft as part of the original consultation process, and for completeness have reattached them to this response as Appendix Two. Please note that this

⁸ Ofgem Theft of Electricity and Gas - Next Steps document (January 2005), para 6.18, p32.

⁹ Ofgem Theft of Electricity and Gas - Next Steps document (January 2005), para 6.29, p33.

¹⁰ Ofgem Consultation on “Reducing supplier disincentives to detect and investigate gas theft – uniform network code proposal 0231V and other changes”, paragraph 4.24

Appendix has been provided in confidence and is not intended for publication by Ofgem.

Chapter 4, Question 2: Views are invited on whether the audit and compliance arrangements for the payment of allowances to suppliers are appropriate. In particular, are they sufficient to meet the implied requirement under SLC7 of the gas transporters licence to only make payments when the relevant criteria are met?

22. We agree with Ofgem that the Network Owners have an implicit duty within their Licence to only make payments under the RES where sufficient evidence has been presented to demonstrate that a claim is valid. We therefore believe that an important benefit of Modification Proposal 0231V is that it does not seek to duplicate this requirement with a separate oversight regime, instead leaving it to the Network Owners to decide on the level of audit and compliance they believe is necessary to continue to maintain compliance with their Licence obligations in this area.
23. It is our experience that the Network Owners take these obligations very seriously and require documentary evidence in support of all claims before they are paid. Whilst this creates a certain administrative burden on Suppliers using the process we accept that this is necessary to ensure customers receive full value for money. We support a continuation of these measures and note that in the move from fixed to capped claim levels, Suppliers have to account for every £1 of expenditure rather just confirm a particular act took place, enabling the Network Owners to better scrutinise claims made under the RES. This will improve the value for money offered to customers.
24. Whilst we appreciate the difficulties which Network Owners face in determining the appropriateness of any claim under the RES, we consider that the information Suppliers already have available, whether that be documentary evidence of actions being taken or cost breakdowns for aspects of their Revenue Protection activity, will enable Network Owners to establish the appropriateness of any claim. We can, for example, evidence what actions we have taken, and then break down the costs associated with each of these activities. Such cost breakdowns have previously been provided to Ofgem, and an example is reattached as Appendix Two.
25. Thus, whilst we agree that audit and compliance measures must be proportionate to the potential risk that customers face from abuse of the system, we believe that Network Owners and Suppliers already have the means with which to achieve this and that further, more onerous, measures may not be required.

Chapter 4, Question 2: Do you agree that an equivalent modification should be raised to the iGT UNC?

26. We would support similar arrangements being brought forward in the iGT UNC and consider that theft is an issue on iGT networks and that measures designed to incentivise its detection are warranted. This includes

enforcement of the existing obligations for iGTs to have a RES, and wider improvements to the availability and accuracy of iGT held data used to proactively detect theft.

27. On this first point, we are concerned that despite there being a licence requirement on iGTs to have a RES in place, the majority do not. We understand a number of iGTs may have submitted draft schemes to Ofgem, and we therefore call on Ofgem to approve these schemes as soon as possible, and investigate why the remaining iGTs have not brought forward a RES for approval.

Chapter 4, Question 2: Views are requested on the compatibility of UNC231V with the proposed NRPS, SETS or any other industry developments (see paragraph 4.36).

28. We consider that incentives are a crucial and necessary element in encouraging theft detection. The nature of gas theft, unlike electricity theft, is that evidence is rarely left behind meaning that theft detection is more than simply visiting a property unannounced in order to check the meter. Given that meter tamperers such as substitute meters can be remedied within thirty seconds, a simple obligation to detect theft will never suffice. Extra effort, and thus expense, is needed to catch the thief in the act.
29. For this reason, only a results-based incentive scheme such as the Supplier Energy Theft Scheme (SETS)¹¹ will ensure a step change reduction in the amount of theft. Because the value of the SETS fund is calculated from our experience of the investment required in order to detect theft across a customer portfolio, we believe that a decision to implement SETS would go furthest to remove disincentives from theft detection. In particular we believe that Modification Proposal 0346 provides the most complete solution as it properly incentivises non-domestic Shippers where both the risks presented by theft, and the costs associated with resolving theft, are greatest.
30. For clarity, we believe that were a SETS to be implemented, any Shipper caught by the Windfall Avoidance measures within the scheme, and therefore not subject to the same incentive payments for the first two years, should retain access to a RES. Were this not to happen then we believe that these parties would be disadvantaged.
31. Conversely we believe that the National Revenue Protection Service (NRPS) currently being considered by the Gas Forum is merely a delivery mechanism for the detection of theft, and therefore still allows for disincentives exist. As the mere existence of the NRPS will sufficient for a Supplier to comply with their obligations, regardless of whether any theft was detected, there will be a disincentive on Suppliers to maintain an appropriate level of funding for the NRPS to make the extra effort required to find gas theft as no extra level of expenditure will increase the degree to which that Supplier is compliant. This is one of the reasons why we oppose the NRPS in its current form.

¹¹ www.gasgovernance.co.uk/0277 and www.gasgovernance.co.uk/0346.

32. We also consider that the current lack of clarity about how the NRPS will be funded could mean that they themselves are not adequately focussed on results. Were this to be the case, there would be no incentive on them to do anything other than the bare minimum required in order to follow up leads they have generated, thus avoiding the extra expense that detecting gas theft requires (as above), therefore maximising margins.
33. The existence of these disincentives leads us to conclude that a results based incentive scheme is needed for the NRPS model to operate successfully. A RES certainly meets the definitions of such a scheme, but do not believe that it would address the disincentives described above. For example, the ability for the NRPS, or Suppliers who have opted out of field activities, to reclaim the cost for some of their activities under the RES will still leave a requirement for significant operational and capital expenditure to be made without the opportunity to recover that. Furthermore, a RES would not remove the incentive on Suppliers to continually drive down the cost of the NRPS itself, nor would it incentivise the NRPS to do anything other than the bare minimum required to meet its charter. We therefore consider that whilst the RES could compliment the NRPS proposal as it currently stands, its inclusion would add only marginal value.
34. It is for this reason that we are bringing forward our own NRPS proposals, designed to correct the deficiencies of the current model by ensuring that even those Suppliers using the NRPS delivery mechanism are subject to a SETS, incentivising all parties to get the best possible results by focusing them on results. Were this NRPS and SETS “hybrid” model to be approved by Ofgem, we consider that the existence of the SETS would again negate the need for a separate RES.

Chapter 5, Question 1. Views are requested on our proposals to amend SLC7 and each large gas transporter REAS and RES.

35. We accept that, without change to Standard Licence Condition 7, Modification Proposal 0231V may create the undesirable situation of dual-governance for the Network Owners, and leave them potentially exposed by future amendment to the UNC provisions in this area. We therefore support Ofgem’s indication that, were they to direct the implementation of Modification Proposal 0231V, they would move to amend Standard Licence Condition 7 so that the Network Owners could fulfil their obligations through the UNC.

Chapter 5, Question 2. Views are requested on our proposed timetable to amend SLC7 and each large gas transporter REAS and RES.

36. We have consistently argued for urgent reform of the theft of gas arrangements, and this includes reform of the provisions within the RES. We therefore welcome the indication that, were Ofgem to approve Modification

Proposal 231V, that they would seek to amend Standard Licence Condition 7 within the first quarter of 2011¹².

Chapter 5, Question 3. Do any of the proposed changes have potential detrimental consequences for the arrangements on IGT networks?

37. We believe that the current lack of RES' for iGT networks actively disincentivises theft detection in a significant area of the country, and that any moves to update or reinforce iGT licence obligations in this area will be welcome. In particular, we note that any increase in theft detections on across iGT networks will bring consequential benefits to the iGTs themselves, through an increase in consequential upstream theft detected, by reduced damage to their network caused by undetected theft and by improving the accuracy of information available to them about where and how much gas is being used on their network.

Chapter 6, Question 1. Do you agree with our further proposals to improve the drafting of SLC7?

38. Yes. British Gas believes that Ofgem's proposals will lead to a fairer and more efficient operation of the RES. In particular, we believe that the clarification to Licence Condition 7(4) and 7 (5) so that claims can only be made where the customer has not already paid for the gas and that any compensation received is only against the portion of unpaid gas left to be both fair and equitable and likely to lead to unnecessary socialisation of gas costs in the market.

¹² Ofgem Consultation on "Reducing supplier disincentives to detect and investigate gas theft – uniform network code proposal 0231V and other changes", paragraph 5.3.