Appendix One – Detailed Response to the Ofgem Consultation on Tackling Gas Theft and accompanying Theft Impact Assessment document[1]

1. This document provides British Gas' detailed response to Ofgem's Theft Impact Assessment. It assesses each of the three options for reform in turn before going on to give answers to the specific consultation questions Ofgem have asked. Links to the relevant sections of this response are provided below in paragraph 8..

2. Please note that all parts of this response are to be considered part of our consultation response, and that the specific answers to the consultation questions should not simply be taken in isolation.

Introduction

3. We welcome Ofgem's Theft Impact Assessment and believe this is a clear opportunity to deliver a step change reduction in the volume of theft. We have been concerned for some years now that Suppliers are not investing sufficient resource in to the detection and prevention of theft, and that this has created a material risk to overall customer safety.

4. We are also mindful that several years of inaction by the industry have unnecessarily left the wider, law-abiding, public liable for the costs of theft. Whilst we welcome the current industry initiatives to more accurately reallocate these costs between market sectors, it is important to note that this work will not directly reduce the overall cost to consumers in itself. Any reform which increases the amount of theft detection will therefore have an important role to play in ensuring customer's energy costs are as low as possible.

5. Ofgem's acceptance that "*the incentives for suppliers to detect theft proactively are, in some cases, weak*"[2] is also welcome, and reinforces the message we have been delivering for some time now. The qualification within the statement is unnecessary however; action must be taken in order to ensure that Suppliers are not commercially disincentivised from wanting to detect theft. Failure to address this will lead to theft reform failing to achieve the justifiably high expectations Ofgem and the industry have.

6. Without financial incentives forming part of the overall solution Suppliers will continue to face a net cost whenever they choose to detect theft, even before they consider making the considerable capital expenditure associated with this activity. This point contradicts Ofgem's initial findings that there is a marginal benefit to detecting theft today, and is expanded on below. Our conclusion is that if detecting theft continues to make no commercial sense, Suppliers will never truly be proactive in detecting it.

[1] Throughout this document, these documents are collectively referred to as the "Ofgem Theft Impact Assessment".
[2] Tackling Gas Theft, page 1.

7. This Impact Assessment has provided us with the opportunity of assessing the impacts of our initial proposals, and as such we have also taken the opportunity to set out our latest thinking on how the structure of a Supplier Energy Theft Scheme (SETS) could be improved upon, either as a standalone proposal or as part of the wider Enhanced SETS or NRPS proposals. These thoughts are set out below in paragraphs 26 to 48.

8. Links to sections within this document are provided below.

Assessment of the Supplier Energy Theft Scheme (SETS) Proposals[3]

General

9. Our view on the benefits of SETS was provided in response to the UNC consultation on MOD0277 and MOD0346[4] and this response should be read in conjunction with that document.

10. We continue to estimate that approximately £220m of gas is stolen each year, but believe from our work in assessing the scale of unidentified gas that the true figure could as high as £400m. Whilst we accept that estimates on the scale of theft vary, the Allocation of Unidentified Gas Expert's (AUGE) latest view on the scale of gas theft is material[5]. Whilst we will be presenting evidence which shows how this under-estimates the scale of the problem, it demonstrates that a significant amount of gas is stolen each year, and that the present regulatory framework is not driving sufficient action by Suppliers to tackle theft.

11. British Gas has chosen to make theft detection a priority, and during 2010 detected 1814 cases of gas theft, representing 78% of all theft found within that year. The next best performing Shipper found only 151 cases of theft, or 6% of the total. This comparative success in detecting theft is because we have invested more effectively than our competitors, not because a British Gas customer is 12 times more likely to steal gas.

[3] Unless explicitly stated, the Supplier Energy Theft Scheme (SETS) refers to both Uniform Network Code (UNC) Modification 0277 and 0346.
[4] UNC Modification 0277 papers can be found here. UNC Modification 0346 papers can be found here.
[5] In the second draft of their methodology, the AUGE estimates theft is as much as 4123 GWh, which we estimate to be roughly £70m per annum.

12. There are a number of barriers which currently dissuade Suppliers from starting to detect theft. In addition to the initial capital and operational expenditure required in order to create or procure a Revenue Protection Unit, gas theft is difficult to detect and returns are therefore difficult to guarantee. This means obligations in isolation will not be enough to drive the right behaviour. For example, gas can be stolen in ways which leave no trace of the theft. This means Suppliers need to spend time, effort and money in catching the customer in the act. This cannot be done by simply visiting a site and asking to inspect the meter.

13. As a result, and regardless of the theft reform option decided upon by Ofgem, it is imperative that an appropriately structured incentive regime forms part of the solution. Failure to do this will risk encouraging Suppliers to continue to make the commercial decision to make insufficient efforts to tackle the theft on their portfolio.

Precedents

14. In the electricity market, the arrangements for detecting theft were historically structured in a very similar way to those proposed under the National Revenue Protection Service (NRPS) model. Suppliers would contract with a central Revenue Protection service[6] for the provision of revenue protection services and that central service provider would use centrally held data relating to, for example, consumption and energisation status in order to determine where theft may be occurring.

15. Ofgem subsequently dropped this model in 2005 over concerns that it was not driving sufficient focus on losses prevention, and implemented an incentive based approach (the Losses incentive). This resulted in significant investment in theft detection processes from a number of Network Owners.

16. It is our view that this change did not go far enough, and that it should have equally placed corresponding incentives on Suppliers. This resulted in disengaged Suppliers allowing Network Owners to take full accountability for theft detection instead of remaining at the table as an active player. Following the change at least one Network Owner[7] flagged the lack of co-operation in resolving electricity abstraction and there was even a suggestion that Network Owners may seek to share any gains made from the Losses Incentive. Our conclusion is that all parties involved in theft detection, whether they are Suppliers or service providers, need to have a commercial interest in the result else the approach will be unbalanced and fragmented.

17. We also note that Ofgem have long supported a similar principle of financial incentives as a tool to ensure gas Network Owners manage theft in the

[6] In each of the fourteen geographic electricity areas.
[7] United Utilities letter to Suppliers dated 4th February 2007 stated "*The number of leads passed to our Revenue Protection team for investigation has declined dramatically in recent years and we now receive only about 5% of that figure in a year. We continue to be proactive in seeking evidence of illegal abstraction, but are greatly hampered by the poor contribution from suppliers and their agents*" and called for an incentive scheme to address the issue.

course of conveyance[8]. If Ofgem were to now depart from this view in favour of a model which excluded financial incentives we would need to see evidence to suggest why either Suppliers take different commercial decisions to Network Owners in respect of theft, or why the decision to introduce upstream incentive mechanisms was flawed.

Theft Impact Assessment: Costs and Benefits of Detecting Theft

18. Ofgem conclude in the Theft Impact Assessment that "*if a theft is detected … a supplier will have a net benefit from detecting a theft when compared to not detecting a theft*". They go on to find that "*The benefit is observed across all market shares that we have considered*".[9]

19. This is derived from a model[10] which assesses the impacts of a typical case of theft, known as the "base case". This base case considers the potential costs and benefits a Supplier may incur in theft detection, by either doing nothing or by detecting theft, and reaches the conclusion that, on average, SSP Suppliers can mitigate £23 of cost for each theft they detect[11].

20. Our own analysis however suggests this is based on an incorrect assumption that the net investigation costs associated with theft detection are £343, derived by taking a weighted average of the differing costs of unsuccessful and successful theft investigations, assuming a 35% conversion rate from 17000 investigations. In reality however the costs associated with a single successful theft investigation include the (unrecoverable) costs incurred during any unsuccessful investigations along the way. Assuming the same conversion ratio of 35% Ofgem have used, Suppliers can expect to make 1.857 unsuccessful theft investigations for every 1 successful investigation. This gives a total cost of £971.40 per successful investigation[12].

21. This means, in the base case set out by Ofgem in the Theft Impact Assessment, a Supplier doing nothing today will incur £729.67 in cost, whereas a Supplier deciding to take action will incur £1270.90 in cost; a net cost of taking action in the base case of £541.23 per theft detected. This is shown in the table below.

Do nothing	Lost Revenue	-£	1,120.67	as per Ofgem Model
	Avoided Cost	£	710.92	as per Ofgem Model
	RbD	-£	319.92	as per Ofgem Model
	Investigation	£	-	as per Ofgem Model
	Recovered Revenue	£	-	as per Ofgem Model

[8] Theft in the course of conveyance is typically theft which occurs before the Emergency Control Valve, i.e. theft from the Network itself.
[9] Impact Assessment, paragraph 3.7.
[10] Appendix Two, Theft Impact Assessment
[11] Impact Assessment, paragraph 3.7. Conclusion appears to be derived from Table 11, page 57, which shows that a Supplier with 45% market share will lose £730 by doing nothing whereas if that same Supplier detected that theft, they would lose £707, assuming a 25% revenue recovery rate.
[12] Full calculation as follows: A 35% conversion rate means that for 1 successful investigation there will be 1.857 unsuccessful investigations. Assuming £600 cost for a successful investigation and £200 for an unsuccessful investigation the total investigation costs for detecting one theft will be {£600+(1.857*£200) = £971.40}

	Do nothing	**-£**	**729.67**	Subtotal of the above
Detect	Lost Revenue	-£	1,120.67	as per Ofgem Model
	Avoided Cost	£	710.92	as per Ofgem Model
	RbD	-£	319.92	as per Ofgem Model
	Investigation	-£	971.40	£600+(1.857*£200) = £971.40
	Recovered Revenue	£	430.17	(£1120.67*0.25)+(£600.00*0.25). Assumes same 25% recovery rate as Ofgem base case.
	Detect theft	**-£**	**1,270.90**	Subtotal of the above
	Cost / Benefit of detecting theft	**-£**	**541.23**	**Extra cost incurred as a result of detecting theft**

Table 1

22. The theft impact assessment modelling shows therefore that even before a Supplier takes the decision to invest £millions in creating the processes and procedures necessary to detect theft, they do so in knowledge this investment will only serve to increase their exposure. It is for this reason that incentives which offset this impact must be part of the overall theft reform solution.

23. We recognise the importance of setting the value of the incentive scheme at the right level and have set out ways in which our initial proposals could be amended in this respect below in paragraphs 33 to 46. Importantly, we believe there is also scope for the level of incentive to be changed periodically so as to maintain the right incentive level as the variables in the calculation, and level of remaining theft, change. To this extent, SETS can be a truly flexible lever which the industry can use to adapt to the changing needs of the industry over time.

24. An incentive mechanism such as SETS (and Enhanced SETS) which retain the principle of Suppliers managing theft on their own portfolio is also the only option which uses the competitive market to address the problem. The existing revenue protection market has a large number of service providers willing to offer their expertise, but faces a lack of demand from Suppliers. The introduction of SETS would resolve this issue, increasing the level of demand and thus use the existing competitive market to solve the problem in line with Ofgem's Primary Duty.

25. We continue to prefer a SETS model where the input and output costs are calculated based on a share of volume and not supply points, as in UNC Modification Proposal 0346. This targets the incentive according to where the risk presented by theft is greatest and therefore achieves a more accurate distribution of costs.

Potential amendments to SETS

The scope of SETS should deliver proportionate remedies

26. British Gas has always maintained that the treatment of Suppliers in any future reform needs to be proportionate to the risk that they pose, and to that

extent SETS may not be appropriate for the smallest Suppliers. As highlighted by Ofgem in the Theft IA[13], our original proposals were that a Supplier with less than 110 Supply Points should be excluded from the scheme.

27. We recognise now that this may not go far enough however and that there is scope to increase this threshold to exclude more small Suppliers. This could be achieved by setting a threshold which accounts for the size of portfolio in terms of Supply Point numbers and throughput. For example, Suppliers with both less than 50k Non-Daily Metered (NDM) customers and an aggregate NDM Annual Quantity (AQ) on their portfolio of less than 10TWh[14]could be defined as small and thus excluded from the scope of SETS. This would ensure that even if a small Supplier had a portfolio where the risk from any theft was material due to the level of throughput on their portfolio, they would also be captured.

28. For the avoidance of doubt, we continue to propose that the scope of SETS would only be the NDM market.

Controls on over-zealous behaviour need to be strong

29. Although incentives are a fundamental requirement of the overall theft reform package, we recognise the concern expressed by Ofgem that if the value of the incentive scheme is too much it may lead to over-zealous behaviour from Suppliers to the detriment of customers.

30. This can be addressed in two key ways, firstly by setting the value of the incentive mechanism at an appropriate level and secondly by ensuring the scheme has robust controls to ensure that customer treatment is fair. It is for this latter reason that SETS explicitly provides for an independent audit of Supplier's theft detection activities to ensure they are compliant with both the statutory provisions and the proposed Theft Code of Practice.

31. We believe this is an important check and balance on the effect of the incentive which is not properly recognised in the Impact Assessment, particularly as any failure identified by the Auditor will have direct financial implications for Suppliers. To this extent, SETS also creates a financial incentive to comply with the statutory and regulatory provisions on customer treatment.

32. Notwithstanding this however, we recognise that we could do more to improve the methodology which under-pins the calculation of the incentive scheme, and ensure this is based on as robust data as possible to avoid any unnecessary over-incentive. To this end we have re-modelled the value of the incentive scheme using the data within the Ofgem Theft Impact Assessment.

Calculating the correct level of incentive required

[13] Tackling Gas Theft, paragraph 3.23, page 25.
[14] Roughly 2% of NDM throughput p/a.

33. The current incentive level proposed under SETS and Enhanced SETS is either £10.062m[15] or £12.062m[16] per annum. This is based on the assumption that a Revenue Protection function will cost Suppliers a specific amount per annum and that the aggregate amount of investment required across all Suppliers is either £10.062m or £12.062m depending on how you calculate Supplier market share. This was determined by our own experience of investing resources in order to manage theft on 43% of the market.

34. Whilst we do not accept this is "*arbitrary*"[17] as Ofgem have suggested we recognise that the publication of the Impact Assessment provides Suppliers with the opportunity of calculating an incentive scheme value with a more accurate understanding of how the costs and benefits fall under the current framework. To that end we have developed our thinking on how the incentive framework outlined in SETS and Enhanced SETS could be modified in order to avoid the "*over-zealous*"[18] behaviour that Ofgem fear could arise from too large an incentive on Suppliers.

35. For example, the value of the incentive scheme may also be calculated by aggregating the net costs and benefits which a Supplier currently not detecting theft today will face if they move to detecting theft tomorrow. This should include consideration of:

    – Any initial capital or operational investment required to build or procure revenue protection capabilities from today's baseline,
    – Any lost revenue the Supplier may incur during the period a theft has occurred over,
    – Any industry costs the Supplier may have avoided as a result of an artificially low AQ,
    – Any costs the Supplier may incur from cost reallocation processes such as Reconciliation by Difference,
    – Any investigation costs a Supplier may reasonably incur in the course of making one successful theft detection, and
    – A realistic estimate of the revenue a Supplier may recover from the customer following the theft detection.

36. The model within the Impact Assessment document[19] provides analysis which supports a calculation of all but the first of these elements, based on an Ofgem survey of Suppliers in January 2011. The resulting conclusions on net costs or benefits from moving from doing nothing to detecting theft vary considerably depending on the nature of the assumptions made on a variety of inputs such as length of time a theft may remain undetected for and the degree to which the AQ drops during the period of time the theft occurs over.

37. This highlights that even if Ofgem's assumptions on investigation costs were accurate, there is considerable risk associated with the marginal net benefit

[15] UNC Modification Proposal 0277, page 4.
[16] UNC Modification Proposal 0346, page 7.
[17] Tackling Gas Theft, paragraph 4.12, page 32.
[18] Tackling Gas Theft, paragraph 4.9, page 31.
[19] Impact Assessment, Appendix Two.

Suppliers may face from starting to detect theft. We also note that if the marginal net benefit to Suppliers of starting to detect theft was £23 per detection as Ofgem suggest, the break-even point for repaying the initial capital and operational expenditure would be 76 years. This highlights why most Suppliers have taken commercial decisions so far to not invest in theft detection.

38. Using the assumptions within the base case, with the corrected investigation costs discussed above, this provides the following[20]

What	Do nothing	Detect theft	Rationale
Lost Revenue	-£1120.67	-£1120.67	Taken from base case.
Avoided industry costs	£710.92	£710.92	Taken from base case, assuming 45% market share.
RbD	-£319.92	-£319.92	Taken from base case, assuming 45% market share.
Investigation costs	£0.00	-£971.40	Assumes a conversion rate of 33%, and therefore one successful investigation at £600 cost and two unsuccessful investigations at £200 each.
Recovered revenue	£0.00	£430.17	25% recovery of lost revenue and successful investigation costs.
TOTAL	-£729.67	-£1270.90	Net cost of detecting theft of **£541.23**.

Table 2

39. Assuming all Suppliers have already made the capital and operational expenditure necessary to provide adequate theft detection processes and procedures, an incentive scheme should at least ensure that the disincentive this net cost represents is removed. To achieve 6000 theft detections per annum therefore it follows that the correct incentive level to achieve this is a minimum of £3.250m per annum.

40. The reality however is that all Suppliers have not made sufficient capital and operational investment to provide adequate theft detection processes and procedures, and that this cost also provides a disincentive to act. To this extent, we consider there is also scope to provide for an initial uplift in the value of the incentive scheme in the initial Scheme years.

41. Establishing the value of capital and operational investment remaining in the market is not an easy task, but we can provide a view on how it may be estimated. For example, if you assumed that no investment had been made by *any* Supplier, and that the £10.062m value of capital expenditure calculated in Modification Proposal 0277 was accurate, it follows that an uplift in the value of the incentive scheme value of £10.062m is required in the initial years of the Scheme before it returns to £3.250m in subsequent years. More realistically, it could be argued that this initial capital and operational

[20] Assumes an SSP Supplier with 45% market share detecting an SSP theft which has lasted 2.5 years with a 25% revenue recovery rate.

expenditure would be spread over at least a two year period, meaning the necessary uplift in incentive value would also be spread over the first two Scheme years, i.e. an additional £5.031m per annum (total of £8.281m) for two years before returning to £3.250m.

42. The industry is not starting from a position where no investment has been made, however. British Gas for example has already made significant investment in this area, and we do not discount that other Suppliers have made some investment, albeit to a comparatively small degree.

43. An estimate of the remaining capital and operation expenditure required can be made by using share of theft detections to determine who has invested what to date. For example, British Gas has invested £4.4m per annum and achieves 78% of detected thefts. It is therefore reasonable to assume that our investment represents 78% of the total. On this basis £5.640m has been invested across the industry, leaving a further £4.422m remaining.

44. Were this to be spread over a two year period as proposed above therefore, the value of the incentive scheme would increase in the first two years from £3.250m to £5.461m, before returning to £3.250m in subsequent years.

45. Importantly we conclude that were SETS to be combined with the NRPS proposal, this initial uplift would not be required as the NRPS has separately provided for this expenditure to be made. We are also clear that if Ofgem believed that more substantive analysis was required on the level of remaining initial investment before agreeing a value for the initial uplift, SETS could start at a value of £3.250m whilst an independent assessment of the matter was completed, with the uplift following thereafter...

46. We also recognise that such an independent review of the value of the SETS incentive scheme could play an integral role in reviewing the mechanism and ensuring that the level of incentive was not too strong or too weak. This would allow the value of the Scheme to flex over time, responding to changes to either the underlying variables or the estimated size of remaining theft. SETS would in effect become a flexible lever to manage Supplier's performance. Indeed, this could be an option which Ofgem may consider is appropriate to take as a pre-cursor to implementing SETS. This could be achieved by directing the industry to procure such an assessment ahead of a deferred implementation of SETS.

Other

47. Although an explicit feature of the Enhanced SETS proposal, neither Modification Proposal 0277 nor 0346 considers that Suppliers should use the BTU process to immediately correct the AQ value following theft detection. This is an oversight and we are happy to propose an amendment to both proposals so that this can be corrected, bringing the proposal into line with the accepted industry position on this point.

48. Finally, we consider that in specific relation to Modification Proposal 0346, it may be beneficial for the payments out of the Scheme to be calculated by a Suppliers' share of aggregate invoiced value rather than aggregated assessed theft value. This would reduce the risk of Suppliers "gaming" the system as evidence would be readily available, and provide an additional incentive on Suppliers to ensure that the offender bore the full cost of the amount stolen.

Implications for the break-even point for SETS

49. Ofgem have calculated the in time point that the difference between the costs and benefits of SETS reaches zero, known as the break even point. This is based on our original thinking that between £10.062m and £12.062m of investment in the market was required. The conclusion is that SETS will break even after approximately 24 months[21].

50. As we acknowledge above however, our initial estimates of the remaining capital and operational expenditure left remaining are incorrect, and do not account for investment which has already been made by Suppliers, including ourselves. Indeed, our latest estimates, suggest that although a total investment of between £10.062m and £12.062m is required, approximately £5.640m of that investment may already have been made.

51. As we have noted above therefore, the implication is that the value of the SETS could be significantly reduced from the value originally proposed and still achieve the stated aim. Therefore, assuming £5.640m has already been invested, there is between an additional £4.422m and £6.422m of investment required in the market.

52. The implications for the break-even point are material. If a revised SETS is implemented, using the corrected values taken from the Ofgem Impact Assessment, the cost to the industry would be a mid-point of £5.422m[22], and thus break even in approximately 12 months[23].

Amending Modification Proposals 0277 and 0346

53. We are aware that it may not be possible to make any of the potential amendments identified above to the SETS proposal without a new UNC Modification Proposal. If Ofgem felt that any of the proposed amendments added value, we would welcome any suggestion of how they could be incorporated in to the regulatory framework without having to proceed through the Code Modification process, for expediencies sake. As a worst case scenario however, these amendments could be made to the Scheme and

[21] Impact Assessment, table 1, page 8.
[22] We note this is less than the £5.800m investigation costs Ofgem have assumed as it also takes in to consideration the benefits that a Supplier has accrued during the period of time the theft has occurred e.g. avoid industry costs and recovered revenue. The consideration of this point, and it's implications for the break-even point of a Scheme underlines the benefits which an independent annual assessment could deliver.
[23] We have not been able to replicate he way in which Ofgem have calculated the benefits accrued through the increase in theft detections and so have not been able to calculate this precisely. As a result this assumes the benefits are linear and that a relative reduction in costs of 49.2% will have a consequential reduction in repayment time of 49.2%.

then re-proposed under a new urgent modification. This would extend the implementation timeline currently considered in the Proposals by two or three months at most.

Assessment of the Enhanced SETS Proposal

54. It is important to note that as the Enhanced SETS proposal seeks to build on the SETS, any amendments to the operation and calculation of the incentive scheme above applies equally to the Enhanced SETS proposal.

55. Although we believe that a theft solution which has competition at its heart is crucial for success, we recognise the market will not resolve all the current market issues in isolation. It is for this reason why we favour the Enhanced SETS proposal over the SETS proposal.

56. Whilst an incentive mechanism is required to drive investment and innovation, we recognise there is also an opportunity to improve information within the industry on where theft is occurring, how it is occurring and how much of it (in volume) is occurring. In addition, value could be added by the central creation of a Stolen Meters register, the creation and funding of a dedicated theft hotline, co-ordination and hand-over of theft detection information during a change of supply event, and the sharing of best practice between Suppliers for the benefit of all. We also see a role for an industry representative to co-ordinate efforts with bodies outside of the industry. These are all good examples of benefits which the competitive market could not deliver in isolation. It is for that reason that we support the creation of a Revenue Protection Activity Co-ordination Agency (RPACA).

57. We also recognise some smaller or niche Suppliers' fear that they may be unable to access bespoke revenue protection services on a commercially viable basis. Whilst we do not necessarily accept this given the current proliferation of service providers in the market, we consider that the proposal for a Central Revenue Protection Unit (CRPU) would act as a correction to the market were it felt that there was insufficient depth to the supply side.

58. As Ofgem point out in the Impact Assessment[24] the underlying assumption within the SETS is that all qualifying Suppliers have an equal opportunity to detect sufficient theft in order to compete fairly. We are also aware that some have raised concerns that this assumption is flawed because:

- Suppliers with access to more data may have a better ability to identify where theft is occurring,
- Larger Suppliers may have access to economies of scale which allow more cost effective theft detection,
- The prevalence of theft may vary between portfolios, and
- There may be scope for Suppliers to "game" the incentive scheme at the expense of others.

[24] Impact Assessment, paragraph 3.29.

59. We argue that the RPACA function mitigates the first of these concerns directly by ensuring that all Suppliers have access to the data items which, when aggregated, add value to the theft detection process. This includes the who, where, what and how of theft detections, but could also easily include other available data such as average consumption information or property values by geographic area.

60. Importantly, this is distinct from data items which has no value to the industry when aggregated, for example payment history. No additional thefts will be detected by pooling data such as this in one place as it only has value when used on the specific account you are concerned with assessing, not at the macro level. There is therefore no advantage by having a large database full of data items such as aggregate payment histories.

61. The same is also true of other data items proposed in the NRPS model, such as email address, bank account information, payment type, prepayment meter customer payment "performance", refused access reports, Meter Asset Manager and non-purchase reports to name but a few. Each has value on an individual account level, but not when aggregated.

62. We are aware of a large number of external service providers who offer bespoke services in to the market, allowing smaller Suppliers to purchase a service which meets their specific needs without having to make the entire capital and operational expenditure an in-house service would entail. G4S for example, will consider commercial contracts which utilise their existing national infrastructure, allowing any Supplier to benefit from their economies of scale. Identical offerings are also available from a number of other providers such as Richburns, PDP, Face to Face, Chase, Power 2 Contact, ABM, Marston Group and UMS.

63. We do not therefore accept that larger Suppliers have an advantage when it comes to detecting theft. Were Ofgem to consider that the market did not have sufficient depth to guarantee this however, the commitment to create a CRPU with obligations to offer bespoke services at commercial rates mitigates the issue.

64. Furthermore, we do not accept that the prevalence of theft differs between Supplier portfolios. No evidence has been presented to demonstrate this is the case. Indeed we believe that if different Suppliers had a material per capita difference in the relative prevalence of theft on their portfolio, theft of energy would be perhaps the only crime where this phenomenon occurred. There is for example no evidence to suggest that the instance of telecommunications or insurance fraud differ materially from portfolio to portfolio. For clarity, British Gas finds theft across all sectors, in all geographies and across all social-economic groups.

65. Finally, we consider that the alternative methodology for calculating the value of the SETS incentive scheme within this response, combined with the

existing controls within the original Modification Proposal itself, mitigate any concerns that the scheme may be "gamed" by Suppliers.

66. Our conclusion is that either the factors which our competitors claim prevent them from competing fairly for the incentive scheme funds are either false or that any issues which do prevent fair competition can be adequately mitigated by the Enhanced SETS proposal. Again, although British Gas supports both SETS and Enhanced SETS, we favour the Enhanced SETS proposal.

Assessment of the National Revenue Protection Service (NRPS) Proposal

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General

67. We share Ofgem's concern that the lack of commercial incentives within the NRPS proposal will mean "*suppliers may not make sufficient efforts to robustly investigate a suspected theft*"[25]. As we have shown above, there is a net cost to a Supplier of detecting a theft which means that there is an incentive to ensure that any investigation is not successful. This perverse incentive will only lead to Suppliers at best withholding proactive support for the NRPS, and at worst lead to the NRPS' ability to deliver results being inhibited. A key test of this would be whether under the NRPS proposal Suppliers would be willing to increase the NRPS funding if a new an innovative approach to detecting theft was identified. Currently we conclude that they would not on the basis that an increase in theft detections would simply generate more cost.

68. Given the lack of incentive for Suppliers to detect theft, and the option for Suppliers to provide their own field services instead of relying on the NRPS, we have deep concerns with the lack of substance behind the proposed assurance framework. Our expectation is that in any model where disincentivised parties are able to control the site visit and therefore the assessment of whether theft is or is not happening, theft detection performance will simply not improve from today's rates. Under this model a very robust assurance process indeed is required, but this is not set out.

69. Indeed, in some recent NRPS Working Group meetings the view has been put forward that Licence obligations to detect theft will suffice as a control, or that apparent differences in annual performance will lead to sufficiently challenging questions being asked of the Parties concerned. We consider these controls simply ineffective and do not guarantee any action.

70. For example, we note that the industry has for many years published statistics on the theft detection performance of all Shippers. This has highlighted wide variations in Shipper performance, and yet when questioned those Shippers implausibly claim, for example, that the numbers reflect the lower rates of

[25] Theft Impact Assessment, paragraph 2.28

theft on their portfolio. We question what would be different in a post-NRPS world.

71. We also maintain that an important consideration in this theft reform consultation process is the extent to which each proposal will deliver year on year improvements to both detection rates and the marginal cost to customers. An environment where a service provider has some (weak) incentives to improve performance which is then undermined by disincentivised Suppliers either opting-out of the provision of field services or by refusing any additional expenditure for future innovations will deliver neither innovation nor improvement. By contrast, a model where service provider and Supplier share in the benefits of theft detection would see co-operation in a drive to innovate and reduce costs.

72. Finally, it is not clear to us how effective the proposed incentive framework on the NRPS service provider themselves will be. For example, if the performance in the first two years is significantly below that envisaged, it is not clear to us that they would be forced to improve or whether the contract would simply be renegotiated.

Costs and implications for the "break-even" point

73. The cost estimates provided in the NRPS proposal are flawed, and we are disappointed Ofgem has not subjected them to any form of scrutiny. They are based on the responses to a Request for Information (RFI) at a time when the proposal was quite different to the current proposal. Indeed, having spoken to some potential NRPS service providers, we believe that a number of unresolved issues such as the extent to which Suppliers will be incentivised partners in the proposed venture, the adequacy of any assurance process and the extent to which the Supplier led Smart Meter installation program may find out a large volume of pre-existing theft are all material factors with regard to the cost of this proposal. The fact that none of these issues are fully addressed in the proposal leads us to conclude that the costs are subject to a very high degree of risk.

74. Notwithstanding this, for the purposes of this response we have taken them at face value and have found them to be overly optimistic in places and inaccurate in others.

– The costs associated with investigating theft are given as between £325 and £726 for a successful investigation (total cost of between £1.3m and £2.75m) and £125 and £250 (total cost of £1.95m and £4.355m). By extension, this shows the proposal is costed on between 3788 and 4000 successful theft detections per annum, and between 15600 and 17420 unsuccessful theft detections per annum depending on whether you take the higher or lower cost estimate[26]. The benefits case for the NRPS however is based on making 6000 theft detections per annum[27]. In effect,

[26] NRPS Final Proposal, page 37.
[27] NRPS Final Proposal, page 28.

the NRPS proposal claims costs based on 4000 theft detections and benefits based on 6000.

– It follows that the cost estimates of the NRPS proposal are based on the assumption that a total of between 19388 and 21420 investigations will take place (ignoring the additional 2000 investigations required to achieve the stated benefits). This implies a maximum conversion rate of 25.64% and a minimum conversion rate of 22.96%. This is below the aspirational conversion rate of 35.00%[28]. Again, the NRPS proposal is based on cost estimates for low performance, but claim benefits based on high performance. If their aspirational conversion rate of 35.00% was to be achieved, it can be assumed there would be a substantial increase in investigation costs as the quality of each investigation would need to consequentially rise.

– Making reasonable assumptions about the rolled up cost of employees[29], i.e. including National Insurance, tax and other costs, it is clear that the "Admin and Management" costs claimed in the proposal seriously under-estimate the number of staff required to operate the NRPS. For example, we calculate that the proposal is currently costed on an assumed headcount of 23 full time employees. Using a like for like comparison, we have 25 full time employees for the same "Admin and Management" purpose, and only provide a service for 43% of the market. Conservatively, we estimate therefore the true cost will be more than double that quoted, i.e. £1.85m per annum.

75. Ofgem's analysis of the NRPS proposal "break-even" point uses assumed common values for the costs of a theft investigation of £600 for a successful investigation and £200 for an unsuccessful investigation. However they also assume that the benefits claimed of 17000 investigations and 6000 detections per annum are accurate, and ignore the fact that the proposal is costed based on 21420 investigations and a 22.96% conversion rate.

76. If this was corrected, the investigation costs of the NRPS would rise from the assumed £5.800m per annum[30] to £6.251m per annum. If the costs from the NRPS proposal itself are used instead of Ofgem's assumed costs the total figure could be even higher still, possibly as much as £7.696m per annum[31].

77. When we factor in the extra cost anticipated for Administration and Management services the total cost of the NRPS becomes £9.602m per annum[32] using Ofgem's assumed investigation costs and as much as £11.047m, up to £2.387m more than claimed. By our calculations this would extend the break-even point for the NRPS proposal from 17 months to

[28] NRPS Final Proposal, page 28.
[29] We have assumed rolled up costs of £50k p/a for management FTE and £30k p/a for administration staff. Applied to the Admin and Management costs quoted of £800k p/a, NRPS Final Proposal, page 37.
[30] Impact Assessment, Table 8, page 53.
[31] Based on the maximum investigation costs quoted in the NRPS Proposal, page 37.
[32] This uses the numbers in Impact Assessment, Table 8, page 53, but with amended values as above for investigation and Administration and Management costs.

between 20 and 24 months. This compares to the 12 month break-even point of the potential SETS model proposed above[33].

78. This analysis ignores both our view that the initial outlay for the NRPS is also optimistic, and the fact that the costs within the proposal have a higher degree of risk associated with them than the SETS scheme. Our conclusion is that there is significant scope for these costs to increase in the final solution, extending the "break-even" point out still further.

79. This analysis also ignores the apparent confusion in the NRPS proposal itself over the benefits it will deliver. Clearly if the costs do not increase to fund the claimed benefits then the break-even point will extend nonetheless, as less theft detections are made.

80. The NRPS costs are subject to a subsequent RFI and tender process after any Ofgem decision. The proposal is also subject to revisions as the detail of it is worked through. Having now flagged our concerns that there is a significant risk that the costs will exceed those currently stated, we are calling for an indemnity for British Gas against any eventual increases. We should not be exposed to an increase in costs which we have highlighted throughout the process, and which could have been avoided had a more realistic estimate of costs been put forward by the proposer in the first place. Our expectation is that the Proposer's themselves should provide this indemnity.

81. Of further concern is the fact that the current proposal explicitly allows Suppliers to submit data of any quality to the service provider and have that "cleaned". This conveys a benefit on Suppliers with poor quality data which is funded by all other Suppliers through the costs of the Data Solution. This presents a risk of distorting competition between Suppliers, transferring cost from those who have displayed poor behaviour to those who have invested resource in to cleaning their data.

82. This could be mitigated by amending the proposal so that on submitting data to the Data Solution, Suppliers had to pay for the data to be cleaned to an agreed standard. This would ensure that a Supplier's costs reflected the actual costs they had generated. We will propose this at the next available NRPS Working Group.

83. Finally, we are conscious that the NRPS proposal duplicates to a large degree the cost the industry is already committed to making for the creation of the Data Communications Company (DCC) in Smart Metering. At a time when Suppliers and Ofgem are striving to ensure customers receive value for money, we are strongly opposed to any proposal which unnecessary duplicates cost.

Timeline

[33] See paragraph 52.

84. The NRPS proposal claims that it can be delivered within 12 months[34] of an Ofgem decision. Assuming an Ofgem decision in February 2012 therefore, it is claimed the NRPS would be operational by February 2013. This is entirely unrealistic given the tasks which still require completion:

- Develop detailed working instructions for the NRPS to operate by,
- Reach agreement on areas of disagreement at the moment (e.g. settlement processes and the detail of the assurance framework),
- Complete a second RFI process,
- Complete a tender exercise under EU OJEU rules,
- Extract the data from Supplier's billing systems and build feeds in to the Data Solution (we note this is contemplated at the same time as a number of Suppliers are introducing new billing systems)
- Build the systems required to support the NRPS (we are aware service providers have quoted that they need approximately nine months to develop a data solution from the point in time that they are appointed and Supplier feeds are built and ready).
- All of this in the context of Suppliers controlling the delivery of a solution which will force them to invest new money in to processes and procedures on activities which will in turn increase their cost exposure, and are disincentivised from doing anyway.

85. It is claimed that these tasks will all be completed within 12 months in a climate where the proponents of the NRPS cannot agree on anything other than the high level details within the proposal, and all outside of a code governance framework which would provide a route to reaching a final decision. Simply placing an obligation on Suppliers to achieve these tasks within 12 months will not make it any more realistic.

86. We recognise that a programme of works of this size is a major IS project impacting all Suppliers; the scale which needs significant resource from across the industry. We note Ofgem's request for the NRPS Working Group to commit to resourcing a project management support function to ensure delivery of this on time has been ignored.

87. We continue to argue that given the scale of work required, the level of disagreement between the Proposer's, lack of clear way to resolve those disagreements and the clear incentive on them to continue to delay the proposal further, the NRPS will not be operational before 2014. It is entirely relevant to highlight the fact that it has taken the proposer 25 months to take the proposal from the initial concept discussed in Review Group 0245 to the proposal we have today[35]. Even if we took the raising of Modification [36]Proposal 0274 as the starting point, it has taken 23 months, yet the Proposer considers it plausible to claim that they will now undertake the bulk of the work in half the time it has taken them to draft the high level proposal.

[34] NRPS Final Proposal, page 35.
[35] The NRPS was proposed as an alternative solution to SETS on 14th September 2009.
[36] Modification Proposal 0274 was raised on 11th November 2009.

88. Finally, we are aware that Ofgem may seek to mitigate the risk of slippage by introducing a licence obligation on Suppliers to put in place the NRPS by a fixed date in the future. We are concerned that if this date was to be set at February 2013 for example, British Gas may be held in breach of our Supply Licence when the proposal is not operational at this date, despite having consistently highlighted the overly optimistic claims about delivery timescales. We would welcome a commitment from Ofgem now that were this situation to arise, we would not be held in breach of licence.

Legal issues

89. We welcome the moves of the Gas Forum to conduct a Privacy Impact Assessment on the NRPS proposal, although our own view is that in order to be compliant with the Data Protection Act (1989) Suppliers will need to make a unilateral variation to their terms and conditions which allow the release of such a wide range of data. This indeed was the solution for the insurance industry during the creation of the Insurance Fraud Bureau.

90. The key difference between our industries however is that the insurance industry operates with annual contracts where the terms can be unilaterally changed on renewal. The evergreen contracts many gas customers are on do not allow for this possibility, meaning a specific change will be required. Given this could be a material change in data usage to an existing contract, this is likely to require “opt-in” consent from customers; something which will make the proposal unworkable.

91. Legal advice we have obtained also highlights that there may also be obstacles to Ofgem implementing the NRPS solution given the existence of other less intrusive market based solutions. This advice has already been provided to Ofgem under separate cover.

Next Steps

92. Although we have now provided a number of different ways of calculating the value of an incentive scheme, we believe there is also scope for Ofgem to provide guidance on the most appropriate way forward as part of their final decision letter. For example, it may be appropriate to involve an independent expert in assessing the various proposals for the value of an incentive scheme, or even to propose a version of their own.

93. Ofgem could for example use their final decision letter to implement either SETS or Enhanced SETS, with an accompanying direction for independent review of the incentive scheme value to take place either immediately or annually from the end of the first Scheme year.

94. Alternatively, if Ofgem believe that the methodologies contained within UNC Modification Proposal 0277, 0346, or the alternative suggested in this response, is fit for purpose then it could simply direct the implementation of the Scheme as proposed.

Answers to Specific Consultation Questions

Question 1: Do you agree with our proposals to introduce new gas supply licence obligations in relation to theft?

95. We agree that a new Supply Licence obligation is an appropriate part of the overall theft reform solution. We strongly believe however that the obligations contained in the proposed licence conditions (which place stringent measures on Suppliers) must be reinforced with a financial incentive scheme for Suppliers.

96. The nature of theft detection is such that it remains easy *not* to detect theft through poor practice in the field. Such activity would achieve compliance with the proposed Licence drafting, but would not achieve the stated goals of reform. For the industry to achieve a step change reduction in theft, Suppliers both have to need and want to detect theft.

Question 2: Do you agree that our drafting proposals set out in Appendix 3 meet the policy intent described in this chapter?

97. As we state above, the drafting proposals in themselves cannot achieve the objectives set out, and must be combined with a financial incentive regime in order to be effective. Suppliers currently face a net cost when they detect theft and an obligation in itself will not be sufficient to ensure the detection, investigation and prevention of theft.

98. More specifically, in addition to our more general comments in paragraphs 99 to 106 below, we have the following comments on specific sections of the drafting proposals:

– We consider that the new "Objective" places a very high standard on Suppliers. In particular the obligation in clause 1.1 (a)(iv) to prevent Theft of Gas through the physical security of the supply. We welcome Ofgem's clarification of the intention behind their drafting here. There also appears to be some duplication of obligations throughout draft SLC 1.1, 1.2, 1.4 and 1.6.

– We are concerned that Ofgem has, through it's drafting of draft SLC 1.12((c), applied the Winter Moratorium to a wider customer base than that applied to customers in debt under Supply Licence Condition 27.10. Our view is that draft SLC 1.12 (c) should reflect the same wording as in Supply Licence Condition 27.10.

– Draft SLC 1.12 (d) – the obligation to offer to repay charges through a prepayment meter should only apply to the customer on their first offence.

Question 3: Do you consider that our proposal for gas suppliers to make reasonable efforts not to disconnect vulnerable customers should apply throughout the year or be restricted to the winter months?

99. We agree that the disconnection of vulnerable customer's premises following a theft detection should be avoided wherever possible on the first offence. However it is imperative that disconnection during the Winter months, even for vulnerable customers, remains an option where the theft is a repeat offence.

100. The alternative would be to continually replace the meter and face the risk that the customer will attempt to steal gas again. This is equivalent to knowingly leaving an unsafe situation on site, endangering the safety of the customer and those living around them.

101. Such an obligation would also create a climate where there is no deterrent to stealing gas throughout the winter months. Such offenders would be able to continually re-offend with Suppliers powerless to stop them until the following spring. In addition to the serious safety issues this presents, we also believe this could mean a significant debt is built up as lost revenue and investigation costs are levied, with little or no hope of ever recovering it.

102. This could be avoided by ensuring the proposed obligation in draft SLC 1.12(c) applies to all offences other than repeat offences, or where it is unsafe for another reason to reconnect the supply. We also recommend that the proposed licence condition could be supplemented with an obligation, perhaps in the Theft Code of Practice, to ensure that where a vulnerable customer is disconnected in the Winter months, the Supplier should alert the relevant Local Authority to that fact so that their welfare may be maintained.

Question 4: Do you consider that gas suppliers should be required to offer vulnerable customers and customers that would have genuine difficulty paying, a wide range of methods for the repayment of charges associated with gas theft as an alternative to disconnection?

103. We do not agree with this. Where any customer steals gas from a Supplier, that Supplier should be able to refuse to offer them a line of credit until the charges are repaid in full. We maintain that it is important to distinguish customers who steal from customers who do not and, as a matter of public policy customers who seek to benefit from crime should not receive the same level of protection as those customers who need genuine help to manage their debt responsibly. We are concerned that the levels of consumer protection that Ofgem is seeking to impose through its draft licence conditions may operate as a perverse incentive to steal.

104. We also consider that an important outcome of theft reform is to better enable the industry to allocate the costs of theft to those that steal through repayment of all charges. Whilst this is best achieved when the supply is disconnected, we recognise that for some customers, including the vulnerable, this is not appropriate and that a prepayment meter should be used, on the first offence, to allow continuance of supply whilst the balance is repaid. If this recovery

tool was lost by obligating the Supplier to offer customers alternative payment methods such as a regular payment scheme, we believe that the bad debt charge associated with theft would increase still further[37], increasing the degree to which the costs of theft are socialised across the wider customer population in the form of higher charges. This may negatively affect Ofgem's assumption that increased theft detection activity will decrease the cost to customers.

Question 5: Do you consider that Ofgem should include a licence requirement on all suppliers to establish a code of practice on, among other things, theft investigations and the detailed arrangements for compliance with our proposed consumer protection measures?

105. We do agree with this. British Gas has been a long supporter of the principle of a Code of Practice and raised the initial change proposal to the Supply Point Administration Agreement (SPAA) in September 2009.[38] We consider a Code of Practice has a fundamental role in theft reform and in particular will standardise the treatment of customers across the market regardless of which Supplier they are registered to. We will continue to support the existing work to develop of a Code of Practice in both gas and electricity codes.

Question 6: Do you agree that our proposed new gas supply licence should be introduced as soon as reasonably practical?

106. Yes. Assuming the concerns highlighted above are addressed beforehand, we believe that there is no reason why these Licence obligations should not be implemented immediately.

Question 7: Have we correctly assessed the main impacts in the accompanying IA? Are there additional, material impacts that we should also consider?

107. As we have highlighted above, we broadly support the impact assessment Ofgem have provided alongside this consultation, with the exception of the assumptions made regarding the investigation costs within the base case. Please see paragraph 20 of this response for more detail on this.

108. Once this error is corrected, the conclusion which is drawn is that the negligible benefit Ofgem originally found in the Impact Assessment becomes a large net cost. This highlights the need for financial incentives.

Question 8: Do you agree with the assumptions that we have made and the outcome of our analysis in Appendix 2 of the accompanying IA?

109. With the exception of the assumed aggregate investigation costs associated with making a single theft detection (as above) we broadly agree with the assumptions Ofgem have made in Appendix Two of the Impact Assessment. We believe that the assumed assessed value for a typical SSP and LSP theft

[37] We estimate that it is currently ~75% for domestic customers.
[38] SPAA CP 09/142

is incorrect however, with a typical SSP assessment value of £1100 and a typical LSP assessment value of £3950; both significantly above Ofgem's assumed values.

Question 9: Which, if any, of the three proposals to increase theft detection should be implemented and why?

110. Our detailed assessment of each proposal is contained above, however for clarity we believe that Enhanced SETS will deliver the largest number of theft detections as it combines the benefits of a financial incentive mechanism with centralised organisation(s)[39] which can provide benefits which the market cannot, for example co-ordination and facilitation.

111. SETS in isolation will deliver significant benefits over today's baseline given it will remove the financial disincentives that are present today for the detection of theft. We continue to support this proposal on its own, although express a preference for Enhanced SETS.

112. We believe that the NRPS proposal in its current format is unworkable as it fails to ensure that the disincentives Suppliers face in detecting theft are addressed. This will create a large central monopoly organisation with a remit to detect theft, controlled by an industry which continues to benefit from a failure to detect theft. We also believe as the NRPS will remain reliant on Suppliers to assist it detecting theft, through data provision, funding and potentially field services, a failure to ensure the benefits of success are shared will lead to the failure of this model.

Question 10: Do you consider that there are any alternative proposals, or variations on existing proposals to improve theft detection that should be considered?

113. Yes. As above we have proposed a number of potential improvements to the mechanism of SETS. More detail on these improvements can be found in paragraphs 26 to 48 of this response.

114. In summary however, the potential changes to the SETS (and thus impacting both SETS and Enhanced SETS proposals) are:

- Amend the value of the incentive scheme so that it is calculated from an assessment of the net cost a Supplier will face if they choose to move from doing nothing to detecting theft.
- An independent annual review of the value of the incentive scheme to ensure it is set at the appropriate level to deliver the desired results.
- Amendments to the scope so that small Suppliers are excluded.
- Amendments to the way a share of incentive payments are calculated under Modification 0346 so that they are paid out based on invoiced amounts rather than on the initial assessed amount.

[39] It should be noted that the Enhanced SETS proposal includes the RPACA element as standard with the CRPU function as a further, optional, policy option.

Theft of Gas – Impact Assessment Document

IA Question 1: What do you consider to be the scale of theft in the GB gas market? Do you consider that there is a material difference in the prevalence of gas theft between suppliers' customer portfolios? What factors drive any considered difference in theft distribution?

115. We estimate that at least £220m of gas per annum is stolen in the UK, but that it could be as high as £400m per annum. We do not believe there is any evidence to suggest that the prevalence of theft differs between Suppliers' portfolios and want to make clear that we detect theft across a wide variety of customer types, sectors and geographies.

116. Indeed we see no reason why theft of gas should be different to any other comparable crime such as telecommunications and insurance fraud which are an issue for all Suppliers.

117. By way of more direct precedent, we note that the current network incentives to detect theft do not differ in their application by geographic area, suggesting Ofgem believe it is reasonable to expect a common incidence of theft across the country, or at least that there is sufficient theft in the market to ensure that any variations do not materially effect parties ability to compete for the incentive. We argue the same is true of Suppliers.

IA Question 2: Where theft has been detected, how long on average would you expect future revenues from a customer to fully reflect their consumption, i.e. what is the expected re-offending rate over time. Do you expect there to be a material difference under each of the three proposals?

118. British Gas sees a repeat offender rate of approximately 3% across all customer types and sectors.

119. Re-offending is invariably identified by a Supplier making the additional expenditure to re-visit a site some time after a theft has been identified. We consider therefore that re-offenders are only likely to be caught where a Supplier is incentivised to make that extra investment in re-visiting sites. For the reasons given above, we believe this is only possible under a scheme which utilises a SETS mechanism.

120. The lack of incentives within the NRPS proposal mean that Suppliers will actually be disincentivised from looking for re-offenders, as any detection will leave them further exposed to cost.

IA Question 3: For each industry proposal, are the proposed compliance measures sufficient to ensure suppliers conduct investigations to satisfactory standards and thereby protect customer interests? Are there any further measures that should be introduced to help address any perceived weakness?

121. SETS and Enhanced SETS are committed to providing for an independent annual audit, where all Suppliers actions are assessed against the provisions of both the Gas Act (1986) and the Theft Code of Practice. These are the only proposals which guarantee this. In addition there is an explicit financial liability associated with any failure. We therefore consider that the proposed compliance measures in both proposals are both significant and robust.

122. Furthermore, we have now made proposals which reduce the overall value of the incentive scheme to a level which is calculated on the net cost a Supplier faces when they choose to move from doing nothing to detecting theft. To this extent, we consider that this, combined with the proposal for an independent annual review of the incentive scheme value, mitigates the risk of any over-zealous Supplier behaviour.

123. We note that the NRPS scheme in contrast however has no defined assurance regime, other than a broad commitment to having an audit on those parties who opt-out of centrally provided field services. No detail is provided on the nature or scope of this audit, and no audit is proposed on the NRPS themselves. We are aware from discussions in the NRPS Working Group that this audit may even take the form of a desk-based assessment of processes and procedures; something which would be wholly inadequate under the circumstances. For this reason we believe it is impossible to conclude that the compliance measures under the NRPS proposal are fit for purpose at this time.

IA Question 4: Are there any material differences between suppliers‟ ability to compete for incentive payments between UNC277 and UNC346? Would Enhanced SETS address any potential concerns raised about suppliers‟ ability to compete?

124. As we have said above, we do not necessarily accept that Supplier's ability to compete for an incentive payment under SETS is materially different. We recognise that Enhanced SETS introduces other benefits however which may mitigate the risk of Suppliers being unable to access the revenue protection market, or access aggregated data which genuinely adds value to theft detection processes. This is explored more in paragraphs 54 to 66.

IA Question 5: Do you consider that the current NRPS proposal is likely to establish and realise targets for theft detection that are proportionate to the potential customer benefits? If not, what additional measures do you think are needed to meet this aim?

125. We consider that the existing 6000 theft detection target set in the NRPS proposal is entirely arbitrary and has simply been included so as to meet Ofgem's expectations. We note there is nothing in the proposal which explains precisely how this target will be achieved under the mechanism proposed.

126. As we have said above, this is especially important considering that Suppliers will be actively disincentivised from assisting the NRPS from detecting theft.

Under these circumstances we cannot agree that theft detection performance will improve from today's baseline.

IA Question 6: Would the NRPS prevent some suppliers from realising additional commercial benefits from theft detection that may be available to them, e.g. by going further that the NRPS mandated investigation requirements? Would the focus of the NRPS proposals on data analysis reduce the overall efficiency of the market in theft detection by excluding investment in other sources of detection?

127. Although we have received verbal assurances that Suppliers will be able to act over and above the requirements set upon them by the NRPS, we remain concerned that the investment we are required to make on an annual basis effectively precludes us from making additional expenditure to innovate in isolation, and instead forces us to rely on securing agreement of the industry on how to innovate.

128. As we believe Suppliers will continue to face a disincentive to detect theft under an NRPS scheme, we do not believe that gaining industry agreement t invest further funds to explore innovative ways of detecting theft will be possible. This will reduce the efficiency of investment over time and prevent the year on year improvements other proposals promise.

129. We also note that, even if Ofgem's analysis on costs and benefits is correct (which we do not accept), the most a Supplier will consider investing on finding one extra case of theft is £23. It follows therefore that an NRPS initiative which will deliver an additional 1000 theft detections is only likely to be approved by Suppliers if it costs less than £23k. This clearly illustrates the innovation issues the NRPS proposal presents, and again highlights the need for incentives.

IA Question 7: For each of the three industry proposals, is a scheme necessary to compensate a supplier when it is not able to recover its costs from theft?

130. We consider that as SETS and Enhanced SETS remove all disincentives to detect theft, additional compensation schemes will not be necessary.

131. Under the NRPS however, the disincentives will continue, meaning additional compensation schemes will be required. We believe from experience however that this is an inefficient and difficult way to remove a disincentive, requiring significant resource commitments from Suppliers in order to manage it, and should be avoided wherever possible. Any compensation scheme would need to fully compensate Suppliers for the costs they incur to avoid any continued disincentive. This is not the case with the existing Reasonable Endeavours process which, for example does not allow the recovery of unsuccessful investigation costs.

132. Again, we believe it would be more efficient to remove the disincentives at the start of the process rather than asking Suppliers to invest now on the possibility that they will receive some compensation later.

IA Question 8: Do you consider that cost and availability of services to support theft detection and investigation is a material issue for small suppliers?

133. Cost and availability of revenue protection services is an issue for all Suppliers. There are however a large number of providers already in the market who offer competitive revenue protection services to anyone who needs it on commercial basis. This removes the need for a potentially costly and inefficient capital expenditure for those small Supplies with bespoke needs, or specific geographic concentrations of customers.

134. The Enhanced SETS proposal goes some way to enhancing this market, and we note that the effect of SETS will also be to stimulate demand for these services, and therefore encourage yet more supply.

IA Question 9: What percentage reduction in consumption would you expect customers to make when an illegal gas supply is detected? To what extent do you consider that this would result from a response to increased costs and/or an increased propensity to invest in energy efficiency measures?

135. When customers steal gas, they typically do not respond to the normal price signals and energy efficiency information other customers do. As a result, we believe that their average daily consumption is higher than it would be under legitimate circumstances. Anecdotally, we find a significant proportion of customers who steal have their heating on constantly and use a combination of thermostats, windows and doors to regulate the temperature.

136. Following a theft detection, this behaviour changes as they once again become subject to price sensitivity. We have no firm evidence to quantify this reduction but it is logical this will happen.

IA Question 10: Do you have any further information on safety incidents where harm has directly resulted from theft of gas.

137. We have no further information to share at this time. Safety incidents such as those detailed in the Impact Assessment are usually recorded by the Network Owners, and not Suppliers. We do not therefore have recorded information on them.

IA Question 11: Do you consider that any of the proposals are likely to reduce the health and safety of any particular individuals?

138. The health and safety of individuals will improve as theft detections increase. To that extent, and for the reasons given above, we consider that the NRPS proposal will lead to a lower standard of individuals' health and safety when compared to SETS and Enhanced SETS. It therefore follows that we

consider that SETS and Enhanced SETS will have the greatest benefit to the health and safety of individuals.

IA Question 12: Which proposal do you consider will have the greatest overall benefit on health and safety?

139. See the answer to IA Question 11, above.

IA Question 13: Do you consider that the proposed implementation timescales for each proposal are realistic and achievable. If not, what do you consider to be a realistic timeframe? What additional measures, if any, do you consider should be undertaken to secure implementation within a reasonable timeframe?

140. It has already been confirmed that SETS can be implemented immediately following an Ofgem direction to so. Although potential improvements have been suggested to the operation of SETS, we consider that an urgent Code Modification could see the scheme operational in two to three months.

141. As we have said above, we do not consider the implementation timeline for the NRPS is reasonable and believe 2014 is a workable assumption. Enhanced SETS also considers setting up an industry body, but avoids many of the key implementation steps NRPS has, for example building data feeds from Suppliers and completing a European tender under OJEU rules. To that extent we consider the timeline quoted in the proposal remains realistic.

IA Question 14: Do you consider that gas transporters should be required to adhere to a code of practice on the conduct of theft investigations?

142. Yes. Theft upstream of the meter is also a serious issue as well, and we see no reason why a customer should face different treatment from a Transporter than they would by a Supplier.

IA Question 15: What impact will either of the three industry proposals have on the annual number of investigations of theft in conveyance that gas transporters undertake and the total cost of undertaking these?

143. Suppliers find theft in the course of conveyance as a natural consequence of detecting downstream theft. From the data analysis Suppliers and their service providers complete it is not possible to assess where on the pipe work a theft may be occurring, only that it may be occurring somewhere. To this extent, the proposal which delivers the most number of downstream theft detections will also find the most number of upstream theft detections. For the reasons given above this will be SETS and Enhanced SETS.

IA Question 16: What, if any, changes to the regulatory arrangements need to be made to enable gas transporters to adhere fully to their requirements to conduct theft investigations?

144. As we say above, theft in the course of conveyance is a serious issue and we welcome Ofgem's focus on this issue. We recognise that Transporters have existing obligations to detect theft and recover the revenue associated with that theft, however we have no visibility of their performance and therefore no assurances that the matter is being properly managed.

145. Given Transporters do not have customer billing functions, we have serious doubts as to how they are currently complying with their obligations. It is for this reason we have raised UNC Modification 0399 which seeks to improve the transparency of Transporter performance. We believe this proposal should be implemented as soon as possible so the industry can assess whether further regulation is necessary, for example by reform of the Shrinkage incentive mechanism.