

Margaret Coaster
Smarter Markets
Ofgem
9 Millbank
London
SW1P 3GE

26 October 2011

Dear Margaret

Tackling Gas Theft

EDF Energy is one of the UK's largest energy companies. We provide 50% of the UK's low carbon generation. Our interests include nuclear, coal and gas-fired electricity generation, renewables, combined heat and power plants, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including both residential and business users.

We welcome the opportunity to respond to this consultation and to comment on the three industry proposals described. The key points we are making are set out in this letter, and the Attachment contains our detailed responses to the questions raised in Ofgem's paper.

I can confirm that we are happy for this letter and its attachment to be published on Ofgem's website.

We share Ofgem's view that theft of gas has serious cost implications for honest customers who bear the cost of theft. Gas theft also impacts suppliers who lose revenues, incur costs in tackling theft incidents, and have to manage the associated safety risk to their employees and agents. Theft of gas can also have serious safety consequences for customers that commit or commission the offence as well as other individuals in close proximity.

We agree that improved arrangements to detect and prevent theft are likely to have consequential benefits for customers and the market more widely, but it is imperative that any measures implemented are proportionate and effective.

One of the issues faced by suppliers when dealing with gas theft is that they are seldom able to recover the value of energy stolen, or indeed the costs associated with its identification. Even where we are able to identify the culprit and bill them accordingly, recovery is generally over an extended period through prepayment metering or direct benefit deductions. Consequently, these costs (which increase as more theft is identified) fall mostly on honest customers.

EDF Energy considers that Ofgem's proposal to introduce new licence obligations to detect and prevent theft will lead to improved performance in the industry.

Further, the development of the common Code of Practice for tackling theft that is currently being undertaken by SPAA should ensure that suppliers investigate suspected theft in a consistent manner, and do so in accordance with minimum standards.

In addition to the measures proposed, the Smart Metering programme will ensure that suppliers visit every domestic premises in Great Britain in the period up to 2019. These visits are likely to lead to a significant increase in the number of theft incidents identified. The roll out of Smart Metering is also likely to act as a deterrent to theft once the relevant customers (i.e. those who would otherwise steal gas) become more aware of suppliers' obligations to visit their premises.

Meter tampering detection facilities on smart meters are also more likely to prevent theft than the majority of tools available to any of the three proposed industry schemes described in Ofgem's paper. Tamper alerts will act as a preventative measure, whereas most of the tools at the disposal of SETS, Enhanced SETS and the NRPS are largely reactive (data analysis, third party referrals etc).

Having given careful consideration to each of the three proposals, we do not believe that any of them should be implemented at the present time. In particular, we do not believe that the industry currently has a clear view of how much theft is occurring, nor do we believe that there is sufficient evidence to demonstrate that implementation of any of the schemes would offer a significant increase in the identification of theft above and beyond that likely to be delivered by the revised licence obligations, the common Code of Practice, and the roll out of smart metering.

EDF Energy remains committed to working with Ofgem to introduce a framework that will increase the industry's theft detection performance, and we look forward to Ofgem's decision on an appropriate arrangement.

Should you wish to discuss any of the issues raised in our response or have any further questions, please do not hesitate to contact my colleague Dan Simons on 0787 511 3701, or myself.

Yours Sincerely,

A handwritten signature in blue ink that reads 'Paul Delamare'.

Paul Delamare
Head of Corporate Regulation

Attachment

Theft of Gas

EDF Energy's response to Ofgem's questions

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

Yes. While we believe that there is already sufficient commercial incentive for suppliers to proactively detect and prevent theft, we do accept that the proposed licence obligations will help to ensure that all suppliers are incentivised to proactively identify theft and tackle offenders in a consistent manner.

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

Yes, we agree that the draft licence conditions set out in Appendix 3 accurately reflect the policy intent.

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?

All large suppliers have already committed to never knowingly disconnect a vulnerable customer at any time of year, under the ERA Safety Net. This goes further than the current Licence obligations (SLC 27.10/ 27.11). The provisions of the Safety Net already provide sufficient protection for vulnerable customers and it is not clear why a licence obligation is required in addition to this.

Any changes should, of course, retain a supplier's ability to disconnect on the grounds of safety where appropriate.

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?

Suppliers already have an obligation under SLC 27.6 to offer a wide range of payment methods to customers struggling to pay. This includes prepayment metering, regular cash payments, Fuel Direct. In addition we would also offer Direct Debit. Customers who had accrued a debt due to abstraction or tampering would be offered a payment arrangement to repay any debt in accordance with the existing legislation and the customer's ability to pay would be taken into account when agreeing an appropriate repayment plan.

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?

No. We do not consider that a licence requirement to establish a code of practice is necessary.

A draft code of practice has already been developed as part of the combined SPAA and DCUSA DCP054 working group. This work has now been picked up and further progressed by the SPAA Expert Group, with the intention of introducing a formal change before the end of the year to incorporate the code of practice as a mandatory schedule to the SPAA.

Meetings have been well supported by suppliers, transporters and Ofgem, and work is ongoing to ensure the code of practice is fit for purpose.

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

No. Ofgem have stated that they aim to bring forward proposals for reform in the electricity market, where necessary, in spring 2012. Assuming that these reforms are likely to include similar licence obligations in the electricity market as those proposed in gas, we believe it would make sense to align any changes between the two in order to minimise the cost of any consequential system changes that may be required.

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

While we are broadly satisfied that the main impacts have been assessed, the fact is that the total value of gas theft remains largely unknown, with vastly differing estimates of the amount of theft currently taking place.

In addition, many of the figures quoted in the IA are taken from the response to the Ofgem questionnaire issued in December 2010. Ofgem notes that "responses were not received from all suppliers and suppliers did not provide data for all questions asked. This limits the potential conclusions that can be drawn from the data". In fact response rates were as low as 50% in some categories.

Finally, the assessment has been made purely against the "as is" process and does not take into account likely improvements that could be achieved as a result of the proposed licence conditions, implementation of the Code of Practice, or the roll out of smart metering.

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?

We would question some of the assumptions made in the "Base Case".

In section 2.10, Ofgem state that no setup costs have not been included for any of the proposals in the static break-even analysis. However, some of the setup costs quoted in

the proposals are significant and are likely to add a considerable length of time to the break-even period.

There is also an assumption made that a customer's consumption rate will not alter once theft has been detected. We do not believe that this assumption is correct. Our expectation is that consumption would be likely to reduce given that the customer would now be paying for their energy usage. Therefore, we would expect these customers to reduce consumption by the same factors as other customers with similar energy requirements, i.e. price, energy efficiency, etc.

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

While we support the reduction of theft and believe that this is a matter of high priority for the GB gas industry, we do not consider that there is sufficient evidence to suggest that implementation of any of the three schemes proposed would offer the consequential benefits for customers, or would be the most effective and proportionate for tackling gas theft at the present time.

The costs associated with developing the arrangements under any of the proposed schemes are significant and will add a sizeable sum to the overall costs to suppliers of detecting and investigating theft. Consequently, there is a strong likelihood that these costs will be passed on to honest customers in the event that increased levels of theft are not detected. We consider this to be counter-productive given that there is absolutely no guarantee that additional theft of gas will be found.

Of the three industry schemes proposed, we support the principal of NRPS but are concerned that the cost of providing the service could outweigh the benefits received and monies that can be recovered from offenders. There are also a number of additional issues that would need to be resolved in relation to governance arrangements and data privacy before NRPS could be implemented.

We do not support SETS or Enhanced SETS, as we do not feel that either proposal would address the issue of gas theft in an appropriate manner.

The basic premise of SETS and Enhanced SETS is that suppliers should contribute equally towards a common incentive fund as they have an equal ability to recover these costs. We do not believe that this is the case.

Both proposals make the assumption that theft occurs evenly across all shipper portfolios. We do not consider that there is sufficient evidence to validate this assumption and are concerned that implementation of an incentive scheme that rewards those that detect theft and penalises those that do not, could result in an unfair distribution of funds.

We remain unconvinced that suppliers that do not identify high volumes of gas theft have "performed badly". Under the SETS scheme, it is entirely possible that a supplier could incur significant costs for having a cleaner portfolio with less instance of gas theft than other suppliers.

Also, the introduction of either competitive solution contemplated by the SETS proposals will result in detection becoming more rewarding than prevention. This is not a desirable

result, will not lead to the industry working together to prevent theft, and is not in the best interest of consumers.

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

Yes. We consider that placing new licence obligations on suppliers to detect, investigate and prevent theft coupled with the common Code of Practice currently being developed by the SPAA Expert Group should lead to an increase in the amount of theft being detected as well as a reduction in the amount of gas theft occurring.

It is anticipated that the Code of Practice will also place increased reporting obligations on parties in relation to theft detection and prevention. The statistics generated as a result of this work should provide a far more accurate picture of the amount of gas theft taking place.

Collating these statistics over the course of a year and then carrying out a further review of theft arrangements would allow parties to better assess whether or not implementation of the NRPS solution is proportionate to the level of theft occurring. This approach would be consistent with other SPAA products delivered in the past, whereby a further review is carried out once the process has had time to “bed in”.

Adopting this approach would also allow additional time to resolve some of the current issues with the NRPS proposal such as governance arrangements and data privacy concerns.

Draft Impact Assessment

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?

It is difficult to quantify the scale of theft currently taking place in the GB gas market as there is little in the way of publically available data or analysis. Also, the lack of a code of practice has meant that suppliers are likely to have different definitions of what actually constitutes theft.

In many cases we have discovered through our own investigations, what may initially look like gas theft, has in fact been caused unintentionally or by a previous tenant and so should not be treated as dishonest practice. It is important that customers are only treated as stealing gas on the basis of a substantial body of evidence as any allegation of dishonesty can have serious implications for a customer’s credit history and ease of switching supplier.

EDF Energy does not believe that theft is evenly distributed across suppliers’ customer portfolios. Our belief is that where theft has occurred, customers do not tend to switch supplier while the theft remains unidentified and might only do so once the theft has been detected and revenue recovery work has commenced. Our expectation would be

that gas suppliers with a high proportion of static customers would be more likely to have a higher incidence of theft on their portfolios.

Based on our experience in the electricity market, we would also expect customer type and geographical split to be factors in theft distribution, with a higher proportion of theft occurring in cities where customers tend to be more transient.

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 reoffending rate over time. Do you expect there to be a material difference under each of the three proposals?

We would estimate reoffending rates to be around 5% within 12 months. We don't believe that there would be a material difference under the three proposals.

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?

No. We are concerned that both SETS and Advanced SETS will create a commercial "bounty" for finding theft, which could lead to inappropriate and disproportional behaviour by revenue protection agents. Both schemes may incentivise suppliers to treat any site where gas is not being correctly registered as theft. This would not protect customer interests and could lead to customers being unfairly alleged to have been stealing gas.

While a code of practice may in some way militate against inappropriate practices, we believe the nature of SETS and Advanced SETS will still lead to far more aggressive behaviour by suppliers and their agents in order to meet the targets set. This could lead to a very varied approach being taken by individual companies, with customers receiving a very different experience dependant on who they are supplied by.

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?

We do not consider that there are any material differences between suppliers ability to compete for incentive payments between UNC277 and UNC346 as the issues are likely to be similar for the majority of suppliers under either proposal.

However, there may be differences in the type of customers targeted, with UNC346 potentially leading suppliers to focus investigations on commercial users with higher consumption levels.

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?

While we support the principal of NRPS, we remain concerned that the cost of procuring and providing the service may outweigh the benefits received and monies that can be recovered from offenders.

The industry does not yet know exactly how much theft occurs and until such a time as detailed statistics are available, it will be extremely difficult for the NRPS to establish and realise targets for theft detection.

It is imperative that any solution delivered to tackle gas theft is proportionate to the issue. We consider that placing new licence obligations on suppliers to detect, investigate and prevent theft coupled with the common Code of Practice currently being developed by the SPAA Expert Group should lead to an increase in the amount of theft being detected as well as a reduction in the amount of gas theft occurring.

As set out in our response to Question 10 of the theft consultation, we anticipate that the Code of Practice being developed under SPAA is likely to place increased reporting obligations on parties in relation to theft detection and prevention. The statistics generated as a result of this work should provide a far more accurate picture of the amount of gas theft taking place.

Collating these statistics over the course of a year and then carrying out a further review of theft arrangements would allow parties to better assess whether or not implementation of the NRPS solution is proportionate to the level of theft occurring.

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 than 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?

No, suppliers could still opt to go further than the NRPS mandated investigation requirements should they consider that additional commercial benefits are available. However, any additional theft identified would still need to be notified to the NRPS.

While the NRPS is primarily focussed on data analysis, it is recognised it would need to be flexible enough to be able to utilise other methods of theft detection if required.

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?

In principle, yes. Suppliers are rarely able to recover all gas charges from customers who have taken an illegal supply. Consequently, supplier revenues are lowered while charges increase for other customers as suppliers seek to recover their costs. A scheme to compensate suppliers could go some way to mitigating the impact on honest customers.

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?

We consider that cost and availability of services to support theft detection and investigation is a material issue for the majority of suppliers, rather than being limited to small suppliers. While small suppliers do not benefit from the same economies of scale as larger suppliers when contracting with an RPS, this is also an issue experienced by larger suppliers outside of areas of customer density.

One of the main benefits of the NRPS proposal is that it allows suppliers to operate on a level playing field while providing an industry wide approach to tackling gas theft.

However, smaller suppliers will likely have the same obligations to rollout Smart and AMR metering as larger suppliers and so should see a similar increase in the amount of theft identified as larger suppliers.

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?

Once an illegal gas supply has been identified and rectified we would expect future consumption to be reduced to a level consistent with any other customer with similar energy usage requirements. Where gas is taken illegally, customers are less likely to be price sensitive and motivated to moderate consumption and therefore consumption would be higher.

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

No. However, we share Ofgem's view that theft of gas can have serious safety consequences for customers that commit or commission the offence as well as other individuals in close proximity, including industry staff that work with gas infrastructure as well as the emergency services.

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

There is a risk that SETS and Advanced SETS could lead to increased pressure on suppliers and their agents to find higher levels of theft which could lead to a higher number of investigations and less quality. This could potentially lead to increased health and safety risks.

The two SETS proposals may also result in a disincentive for suppliers to work together to resolve theft for the benefit of the industry and customers alike. If suppliers are competing against each other to identify the highest volume of theft, there is no incentive to alert another supplier to potential theft on one or many of their sites. Again, this could lead to increased health and safety risk.

EDF Energy believes that it is absolutely imperative that any proposal implemented does not, in any way, compromise the safety of any particular individual.

Adoption of a common code of practice when carrying out investigations should help to further militate against health and safety risks.

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

We consider that a common code of practice detailing, among other matters, a common approach for the conduct of investigations and the measures that suppliers should take concerning health and safety would have the greatest overall benefit on health and safety.

Of the three industry proposals, we consider that NRPS would have the greatest overall benefit on health and safety.

Unlike the two SETS schemes, the NRPS would place an emphasis on preventing and detecting theft across the industry as a whole rather than focussing on any particular supplier's portfolio, while ensuring that each case is dealt with in a consistent manner.

We also note that meter tampering devices on smart meters might be more effective than the majority of tools available to the three proposed schemes as tamper alerts would be preventative whereas most of the tools at the disposal of both SETS and NRPS are reactive (data analysis, third party referrals etc).

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?

While the proposed implementation timescales detailed in all three of the proposals would be possible, all would be challenging.

There are a number of potential issues, notably in relation to governance arrangements, that would need to be resolved in a very short time period in order for NRPS to be implemented 12 months after a decision to proceed.

Introducing the NRPS into SPAA would require a change to the licence obligations to require non-domestic suppliers to be a party to this agreement and comply with the relevant sections. Amendments would also be required to the SPAA governance arrangements to facilitate non-domestic supplier members.

The time and resource required to establish new governance arrangements for the NRPS could be significant and is unlikely to be achievable within the timescale.

The view from the proposer is that SETS could be implemented shortly after an Ofgem decision. We do not believe this to be the case. Xoserve have already stated that they would require between 35 and 51 weeks to make the required system changes to deliver the System Administrator role and an auditor would also have to be appointed. In addition to Xoserve changes, suppliers would also need time to implement any required system changes.

It is also unclear how the "windfall avoidance measures" would work in practice, with British Gas not participating in the scheme for the first two years. For example, would other suppliers also have the option of not participating?

Furthermore, the timescales detailed in the Enhanced SETS modification for delivery of the RPACA and CRPU have not been subject to any validation and are based purely on the estimates of the proposer.

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?

Yes. All gas transporters including IGT's should be required to adhere to a common code of practice on the conduct of theft investigations.

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?

We would anticipate that all of the industry proposals would lead to an increase in the annual number of investigations of theft in conveyance as a result of increased site visits.

However, it is also likely that the roll out of smart metering will lead to an even higher number of theft in conveyance investigations in the event that upstream theft is identified.

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?

The code of practice is currently being developed as part of the SPAA as a mandatory schedule for both suppliers and gas transporters. As all gas transporters are signatories to the SPAA, we do not believe that any further changes to regulatory arrangements would be required.

**EDF Energy
October 2011**