



26th October 2011
Ms Margaret Coaster
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Dear Ms Coaster

Tackling Gas Theft

We welcome the consultation by Ofgem on the work that industry is doing to tackle gas theft. We hope that Ofgem feel encouraged that suppliers have taken the initiative to bring forward solutions that will improve the detection and investigation of gas theft, and we hope that the outcome of this consultation will lead to the establishment of new arrangements that will reduce the amount of theft, lighten the financial burden on customers (both in terms of the energy stolen and the costs to discover it) and improves the reconciliation of unallocated energy.

Please note that we have included a confidential response (see Chapter 7 responses)

CHAPTER: Two

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

Yes, although we have substantial reservations (see Q2) about some of the additional requirements which go beyond those in the Electricity Licence.

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We strongly support the enhanced focus on preventing energy theft, and we agree that the best solution to improve the detection and investigation of the theft of gas is a solution in which the whole market is required to participate. Discussions of various incentives arrangements over the past 7 years have failed to stimulate the market to adopt an incentive-based approach. However, the Gas Forum has been developing proposals that will offer a whole market solution that requires the participation of all suppliers to work in a more proactive and focused way. Whether this needs to be via a new licence condition depends on where you sit in terms of the industry arrangements. Both the proposals for the NRPS and the SETs schemes can be delivered via the existing industry codes, but the requirement to comply with those codes would necessitate an additional change in the Supply Licence to those proposed, for certain parties.

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

No. The proposed licence condition goes beyond the policy intent. It is overly prescriptive as to the actions suppliers must take, with some risk of being a "cheat's charter," increasing the costs on all customers. The details would be better in a Code of Practice or a service level agreement for the NRPS.

We also have a number of specific comments as follows:

1.1(a) (iv) Delete. It is unclear what is intended by this condition. For instance the strongest deterrence would be immediate resort to disconnection, whilst physical security would seem to be already covered by MAP/MAM obligations and Annex 1 of the EU Measuring Instruments Directive.

1.1(b) Delete. Already covered by SLC13

1.5 We would appreciate confirmation from Ofgem that 'all reasonable steps' does not require enhanced

meter standards, for instance to fit tamper warning capability on I&C meters (and equivalent in electricity)

1.12 These requirements should be in a Code of Practice (which could also apply to electricity theft) referred to in Para 2.25.

1.12(c) All reasonable steps is a far reaching test and Ofgem's comments in Para 2.26 ("repeatedly tampering" "and puts others in danger" "disconnection may be appropriate") would seem to indicate a quite different attitude to theft from us or, we believe, consumer groups. Moreover this obligation could contradict that of 1.5 "to take all reasonable steps to prevent Theft of Gas." We fully agree with the principle of recognising vulnerability and indeed in the Energy Safety Net go further than required by SLC27 and therefore propose Ofgem place this requirement, and the others of 1.12, in a Code of Practice.

1.12(e) (f) Delete. The Gas Act 1986 is sufficient to establish whether disconnection is allowed or that theft has occurred. The argument as to how much responsibility the current occupant has and hence whether to disconnect, because of repeat offending, or and what charges to recover is quite different and is best covered in the Code of Practice proposed in Para 2.25.

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?

As noted in response to Q2, we have substantial concerns over this aspect of the proposed licence condition given that there is no clarity on what steps to avoid disconnection may be considered reasonable. We do not believe it would ever be acceptable to tolerate an unsafe connection or to allow vulnerability to become a shield which gives licence to repeat offenders. Nor does it seem reasonable that there should be an ability to avoid payment for ongoing consumption as would occur if a customer repeatedly

bypassed a prepayment meter.

The proposed licence condition could therefore have some quite unintended consequences and we therefore recommend that if it is introduced it is limited to winter.

We agree that vulnerability should be a criteria in how suppliers treat customers who steal energy and propose that the Energy Safety Net is expanded so that there is confidence in a consistent level of support to help vulnerable customers who do resort to desperate measures and tamper with their meters to stay on supply, get back on to a proper financial footing with their supplier and not repeat their crime.

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?

Yes, but the question seems to be based on a misapprehension that disconnection is the normal response to gas theft.

This is quite wrong. Our primary action is of course to return the supply to a safe situation. Having made an assessment of the value of energy stolen we discuss and agree with the customer how those costs will be met. We would offer the fullest range of options to the customer to return their supply to normal payment terms, including the option of pre-payment metering or various non-metering based payment arrangements.

We would also be willing to change payment method if customer believes that a different option would be more suitable. However, if a customer is persistently unwilling to pay and repeats the theft we should be able to disconnect. Disconnection is a last resort option which terminates the customer relationship and limits the options for repayment, therefore it isn't done lightly.

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?

Yes, we support the introduction of a Code of Practice that will standardise the conduct of theft investigations, give transparency to consumers on what they can expect in such circumstances. It will provide safeguards for consumers from aggressive detection and investigation strategies and will support the development of competitive services in revenue protection. It will also align the activities with those of the electricity market.

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

The introduction of improved governance around theft detection and investigation is very welcome; however we have concerns with the proposed drafting and could not support its introduction in its current form.

CHAPTER: Four

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

Ofgem recognises the difficulty in assessing the true value of energy stolen and have relied on the assessments provided by suppliers in coming to their conclusions. However, we have expressed our concern during this assessment that not all suppliers would reach a determination of theft in the same circumstances which may lead to an overstatement of the value of theft when extrapolated to the whole market. There are certain beliefs that will affect supplier's portfolios differently that should also be considered in determining whether the assessment is correct:

- Theft of gas is most common from credit meters which is in contrast to the electricity market,

therefore, it could also be said that the larger the credit meter portfolio the greater risk there is of gas theft.

- The level of gas theft on supplier portfolios does not align with market share. Customers do not discriminate about which supplier to steal from.
- Incidents of theft in rural areas are much lower than in urban areas, so portfolios with a higher urban penetration will have a higher level of theft.
- Customer behaviour has shown that to prevent investigations or action by a supplier a customer who is alerted to an active theft investigation will change suppliers to avoid remedial action, therefore customers who have been stealing and evading detection over a long-term period of time are unlikely to have changed supplier at all and we believe there will be a higher level of theft relative to the age of the portfolio.

What can be certain of is that there is no accurate determination of the level of gas theft in the market currently; however, the introduction of solutions to measure unidentified gas under the Uniform Network Code will hopefully give us more reliable assessments, as will improvements in the detection of theft should the National Revenue Protection Service be introduced.

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?

Yes, we have contributed data to the modelling and have worked through the outputs established during the Gas Forum's NRPS working Group.

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

Our preference is the introduction of the National Revenue Protection Service..

It is our belief that the industry will only really get to grips with tackling gas theft effectively by working together and the NRPS provides this opportunity. The establishment of the NRPS is a real commitment by suppliers to invest in the detection and

investigation of the theft of gas by establishing a new body, funded by the suppliers, to deliver a co-ordinated effort to tackle gas theft.

Based on a similar solution introduced into the insurance market, it is a solution which enables suppliers to better identify those who may be stealing by improving our understanding of the supply point on an iterative basis. We will be able to recognise the risk indicators which are likely to lead to a finding of theft, and deal with it much earlier. Effectively it changes the industry's approach to detection from one of reaction to pro-action.

It will deliver a consistent approach to investigation and the determining of theft and will act as a deterrent to those who may be considering interfering with their meter, since the NRPS will publicise its activities and its successes.

The NRPS will provide services to all suppliers, therefore companies who may not have invested in revenue protection services will benefit from access to a service provider at a reasonable cost and who is committed to performance across the market not individual portfolios.

The alternative proposals by British Gas rely on incentive mechanisms to improve detection rates. We don't believe that anyone, not even the supplier, should be rewarded for the criminal behaviour of customers which burdens the whole market. Unfortunately for these incentive proposals xoserve have provided evidence to the modification group (UNC0245) developing SETS that theft does not track market share and that it has more of a geographical feature relative to population density, so to make the scheme conditional upon a market share performance target is seriously flawed .

The value of the SETS scheme is not insignificant, nor is it capped, and the scheme's value can be amended in the future by a modification to the UNC. Suppliers will have to fund the SETS scheme in proportion to their market share but cannot guarantee irrespective of

the level of effort invested that they will find the proportion of theft required to either come out with a balanced position or even to gain a benefit.

Since market share of theft found will be a constantly moving target and could vary proportionally to the activity of the different suppliers, a supplier may choose to do nothing and pay into the fund without the expectation of reward on the basis that this is a quantified risk which can be managed through tariffs, whereas the additional investment in revenue protection activities is more of a leap of faith with no guarantee of success. Ultimately this could lead to the upward spiralling of revenue protection cost across the industry, which taken together with the need to fund the incentive mechanism will further burden customers with higher costs with no guarantee that theft can be reduced.

The well intentioned proposal then becomes the opposite of what it started out to be - it becomes a disincentive to act.

SETS with elements of the NRPS has problem; we disagree that the SETS scheme will act as an incentive for the reasons previously stated. While we welcome the recognition by British Gas that the NRPS has merits as a future solution, some elements of the proposal give us real cause for concern.

The effectiveness of the data analysis is compromised if parties choose not to provide data. Only by analysing all the data will we see the full benefit of this activity. It was interesting to see at the UKRPA conference in 2010 British Gas demonstrating how they have deployed this data mining approach on their own portfolio and the successes they were seeing. It is not unreasonable to expect that the same approach applied across all supply points will deliver even better results than analysing individual portfolios.

In developing the SETS proposal xoserve held a workshop on theft reporting and it became clear that the industry differed in how it treated reports of theft. BG claim that they found 83% of theft in 2009

and 77% in 2010, this is based on self reporting on their own determination that theft has occurred. Many suppliers differed in their assessment of whether a finding of theft on the report was recorded as theft or not. This difference in approach may give a distorted view of both the amount of theft taking place and the effectiveness of suppliers in finding theft.

The proposal also includes a suggested approach for sharing of information on active theft investigations during the COS process. This proposal will require suppliers to pass on information about active investigations which haven't been concluded with a determination that theft has occurred. Our experience has shown that not all investigations for theft lead to the determination of theft and this may open up both the gaining and losing supplier to action by a customer for any incorrect allegations.

The proposals put forward by British Gas have not had the benefit of the same legal review that the NRPS has been through, and questions around the legality of the proposals and the data protection issues still need to be reviewed in greater detail, particularly around the sharing of sensitive information between suppliers.

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

No, the industry has been debating for many years how to improve theft detection and investigation. Our preference for the introduction of the NRPS has come about as it is the output of the industry working together to solve the problem, which is the way the best solutions are usually identified. The majority of suppliers - serving both the domestic and I & C markets worked together to provide a solution which doesn't introduce unnecessary cost burdens on customers, which seeks to fairly adjust instances of misallocation where mechanisms exist, and removes any disincentive to carry out the activity.

CHAPTER: Two

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?

We do not have a view on the scale of theft in the GB market. Claims that it is as much as £220m are estimates based on extrapolations of one supplier's view of the level of theft. We believe that the AUGE will help identify the true level of theft and that the introduction of the NRPS will give us the best opportunity to quantify theft since it will have a whole market view of consumption and theft.

We have seen evidence from xoserve that theft is different across portfolios, they provided a report which demonstrates that theft is not relative to market share and a number of things account for the difference:

- The demographics of the individual portfolios. Higher concentrations of theft instances occur in urban areas, the grapevine has a greater effect in high population density areas.
- It is believed that theft of gas is most common from credit meters; this is in contrast to the electricity market.
- Customers who have been getting away with theft for many years are under no incentive to change supplier, therefore it is likely that portfolios which have higher levels of customers who haven't switched are likely to have more customers who steal. In methods used to interfere with the meter that are dependent on known factors such as the meter reading cycles, change introduces risk, and if you are evading paying for something the price you would be charged for the product you are stealing is not a determining factor in decided which supplier to steal from.

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, ie what is the expected reoffending rate over time. Do you expect

there to be a material difference under each of the three proposals?

Broadly speaking, usage of gas tends to be seasonal. Therefore, a true reflection of a customer's consumption will have a time lag. Re-offending is unusual once a customer has been identified as stealing gas. Detection should be coupled with monitoring to prevent re-offending and the NRPS includes this within the scope of services it will provide.

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?

Voluntary codes have led to inconsistency in the treatment of customers under investigation, we would therefore support the introduction of obligations into codes which will introduce standards and provide an assurance regime which gives customers protection from aggressive actions.

CHAPTER: Three

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?

Effectively the SETS between 277 and 346 are really about how you carve the pot, is it by supply point or by volume. Since we would argue that customers don't steal in proportion to market share, any market share incentive mechanism is biased in favour of the larger parties. Enhanced SETS doesn't address the market share issue but provides some additional services which are still relevant market positions.

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?

Yes, the cost to detect and investigate theft would be relative to the whole market and since the NRPS doesn't seek to reward anyone, the costs facing customers will reduce over time. The aim would be for the NRPS to move toward a self-funding structure that will remove the cost from honest customers, we also feel that it has more chance of success in finding long-standing currently undetected theft which will improve energy reconciliation and it will put in processes to address unregistered sites who are using energy without a supply contract - again costs borne by the whole market.

IA Question 6: Would the NRPS prevent some suppliers from realising additional commercial benefits from theft detection that may be available to them, eg 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?

We don't believe that theft detection and investigation is a commercial activity for reasons previously stated. The NRPS proposal does not seek to stop a supplier from acting on its own information and carrying out investigations, but it can't act in isolation of the NRPS. In order for the data to be refined and improve its effectiveness over time it is important that the findings of theft are reported back to the NRPS even if generated from the supplier's own activity. It is also essential that any activity undertaken by the supplier adheres to the same standards of investigation that the NRPS work under.

The data analysis is only one tool that we expect the NRPS to develop. We would expect the NRPS to be abreast of new technology and types of meter interference and to be thinking to the future and the new world of smart meters and how detection may need to evolve to include this new technology. Additionally, the NRPS will publicise its efforts and effectiveness

and we may find increased use of tip-off facilities.

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?

Discussions during the development of the NRPS have looked at the future of the Reasonable Endeavours Scheme and whether it will need to exist. REDs is a mechanism to socialise the cost of unsuccessful investigations which will help smaller parties. However we believe the scheme needs to be reviewed as it is administratively complex to operate and isn't routinely used by all suppliers.

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?

Yes - access to competitive revenue protection services can be a challenge for smaller parties who don't have the volume business that attracts the most competitive of prices. Similarly the specialism that is need for I & C suppliers mean their access to RP services can also be limited depending on the expertise and cost to provide the service.

CHAPTER: Four

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?

We do not routinely monitor the consumption of customers after theft detection; therefore we don't have any evidence to base an answer on. Depending on the reasons behind the customer's decision to steal, increased costs could be a factor in reducing consumption in the future, however there is also a customer type which is "won't pay" rather than "can't

pay" who make the decision to steal and their decisions are driven by affordability.

CHAPTER: Five

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

No.

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

No.

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

The Gas Forum in developing the NRPS has given a commitment to Ofgem about the level of activity that suppliers are guaranteeing to undertake. The SETS proposals have no such commitment to levels of activity and could actually cause in-activity. By committing to this level of detection and investigation we expect to resolve issues of theft, but also we may find metering faults that are currently going undetected which may be unsafe, therefore we believe the NRPS will deliver greater Health & Safety benefits.

CHAPTER: Seven

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?

The timelines for delivery of the NPRS are achievable in line with our understanding of how a similar solution was developed in the insurance industry.

SETS can be implemented relatively quickly in line with

UNC requirements, however the impact on supplier's resourcing ability shouldn't be underestimated and it may take longer to achieve the required resourcing levels to deliver the appropriate conversion levels.

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 - this will ensure a consistent approach to investigations and will give

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 believe the NRPS would deliver greater support for the transporter in terms of investigation capability. The NRPS services providers could undertake this activity on behalf of the transporters who could benefit from competitive prices achieved as a result of the scale factor.

The SETS schemes don't introduce any benefits in terms of gas transporter investigations nor will it have any impact on the costs of investigations.

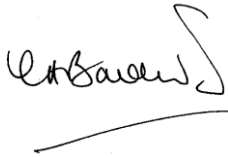
IA Question 16: What, if any, changes to the regulatory arrangements need to be made to enable gas transporters to adhere fully to their requirements to conduct theft investigations?

We foresee the NRPS being able to deliver more certainty for transporters in the areas of shipperless and unregistered sites which will allow the transporters to deal with the ongoing consumption of these sites where no supplier is taking responsibility. This will reduce the error in reconciliation by addressing the on-going consumption on these sites more quickly, and will give the transporter more confidence that the supply is theft in conveyance so enabling them to remedy the theft. This could be achieved if the NRPS was a SPAA requirement on both suppliers and

transporters.

If we can provide any additional information or clarity on any point, please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read "Colette Baldwin". The signature is written in a cursive style and is positioned above a horizontal line that serves as a separator.

Colette Baldwin
Senior Regulatory Analyst