

Gas distribution networks, gas suppliers, consumers, and other interested parties

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Date: 20 February 2014

Dear Stakeholder,

Consultation on our proposed incentive arrangements for Gas Distribution Networks on theft in the course of conveyance and unregistered sites.

Gas and electricity theft increases the costs paid by consumers and can have serious safety consequences. Existing regulatory arrangements may not sufficiently encourage distribution network operators to detect, prevent and investigate theft. We consider that this is a key area where changes could be made to protect the interests of existing and future consumers.

Supplier arrangements

In 2012 we published a document on "Tackling Gas Theft: New Requirements for gas suppliers"¹ which set out our decision to introduce new supply licence obligations on gas suppliers to proactively investigate and reduce gas theft. We decided to introduce an objective based supply licence condition, which includes an overarching objective; detailed requirements on suppliers to detect, prevent and investigate theft; and specific measures on the standards for theft investigations. We also decided to introduce, pursuant to the new licence obligations, a Direction to require gas suppliers to introduce a central service to profile the risk of gas theft at consumer premises (Theft Risk Assessment Service (TRAS)).

Theft in the course of conveyance and unregistered sites

Now that we have set out arrangements for the supply side, this consultation sets out our proposal to introduce new funding arrangements for Gas Distribution Networks (GDNs) in relation to theft. This relates to gas taken either:

- upstream of the emergency control valve (ECV) in the course of conveyance; or
- from sites not currently or previously registered to any supplier.

Although we recognise that gas taken from an unregistered site may not always be considered as theft, for the purposes of this consultation when we refer to theft we are including both of these scenarios (gas taken upstream of the ECV or from unregistered sites).

It is our intention that the counter-theft arrangements for gas and electricity are broadly comparable given the similar nature of the problem across both networks. Therefore our

¹ [Tackling Gas Theft: New Requirements for gas suppliers](#)

proposal in respect of GDNs is aligned with proposed new conditions (SLC 49 and CRC 5F) within the Electricity Distribution licence. These conditions should be introduced with licence conditions implementing the RIIO-ED1 price control, which commences on 1 April 2015².

Within the current price control for GDNs (RIIO-GD1), counter-theft activity was not directly funded. However, the GDNs accepted the price control and the licence conditions and therefore agreed to comply with the licence condition to investigate theft within the allowed revenue for RIIO-GD1. We acknowledge that, going forward, this may not be adequate to encourage GDNs to be proactive in tackling theft and therefore propose to introduce an additional incentive.

We propose to amend Gas Transporters Standard Licence Condition 7 (SLC7) to allow all money recovered from successful investigation cases to be shared between GDNs and customers. We propose to use the existing Totex Incentive Mechanism to share costs and recovered money between GDNs and customers.

As part of our proposal we would still expect GDNs to comply with the investigation procedures set out in the Supply Point Administration Agreement (SPAA) Gas Theft Code of Practice³. This includes best practice procedures for the conduct of investigations, collection and retention of evidence, and treatment of vulnerable customers.

As there are consumer protection procedures detailed in the SPAA Theft Code of Practice we do not consider it necessary to include additional procedures within SLC7. Any views on this would be welcome with responses to our consultation questions.

The type of theft this proposal covers

There are different forms of gas theft and the responsibility for investigating an incidence of theft can depend on where it occurred.

The SPAA Theft of Gas Code of Practice sets out whose responsibility it is to investigate the different forms of theft. The code of practice states that where a supplier has a contract or deemed contract with the customer it is responsible for investigating incidences of theft and arranging to recover the value of gas taken, unless the theft occurs upstream of the ECV.

Therefore as in the SPAA Theft Code of Practice, the gas transporter is responsible for investigating and pursuing recovery of the value of the gas taken:

- in conveyance, where the incident occurred upstream of the ECV; or
- from unregistered sites, where no contract or deemed contract exists or has previously existed between a supplier and customer.

The obligation on GDNs (and the proposed incentive arrangements) applies to these two types of theft⁴.

Current arrangements for the investigation of theft

Currently the Gas Act gives permission for GDNs to recover the value of gas taken and under the Gas Transporter licence GDNs have an obligation to investigate incidences of suspected theft.

² <https://www.ofgem.gov.uk/ofgem-publications/85843/crc2supannex1.pdf>

³ An agreement to which all domestic gas suppliers and all transporters are required to accede. It sets out the inter-operational arrangements between gas suppliers and transporters in the GB retail market. The SPAA Theft Code of Practice is available to registered users of the SPAA website.

⁴ This is also reflected in paragraph 12 of SLC7.

Gas Act

The Gas Act Schedule 2B Paragraph 9⁵ states that:

- (1) *When any person takes a supply of gas which is in the course of being conveyed by a gas transporter, the transporter shall be entitled to recover from that person the value of the gas so taken.*
- (2) *Where -*
- a) *Any persons at premises which have been reconnected in contravention of paragraph 11 (1) below takes a supply of gas which has been conveyed to those premises by the gas transporter; and*
 - b) *The supply is taken otherwise than in pursuance of a contract made with a gas supplier, or deemed to have been made with such a supplier by virtue of paragraph 8 above or paragraph 19 of Schedule 5 to the gas Act 1995.*
- the transporter shall be entitled to recover from that person the value of the gas so taken.*

Gas Transporters Standard Licence Condition 7

The current licence obligation on gas transporters in relation to gas theft is set out in SLC7⁶. The obligation states that gas transporters must investigate cases of theft and, subject to the outcome of the investigation, use reasonable endeavours to recover the value of gas taken. On a case by case basis, the GDN can retain its investigation and recovery costs from any money successfully recovered as a result of their investigation. The licence states that gas transporters must remain revenue neutral in this activity and therefore any overall surplus that results from investigations must be returned to consumers. There is currently no specific mechanism for GDNs to return these sums to consumers.

The current interpretation of the legal framework means that GDNs can only cover their costs when they are successful in recovering money for gas stolen as a result of their investigations. Evidence from GDNs' current theft investigation activity suggests that they are only successfully able to recover money in the minority of cases.

Under the current arrangements there is an obligation to meet the licence condition but there is little financial incentive for GDNs to proactively investigate theft. Pursuing their licence condition could result in a loss which is wholly borne by the GDN.

Our proposal

We want GDNs to actively investigate cases of theft where it is their responsibility to investigate and pursue the value of any gas taken. The current licence condition may not adequately incentivise GDNs to proactively investigate theft. We propose to amend SLC7 to encourage transporters to proactively investigate theft and pursue the recovery of the value of any gas taken. We propose that these arrangements align with the intention of the proposed new licence conditions covering electricity theft (SLC49 and CRC 5F) within the RII0-ED1 licence.

Our proposal would remove and replace the current funding arrangements in SLC7 for theft. Rather than the current requirement for GDNs to remain revenue neutral we propose that all costs and all money recovered from successful investigations would be treated as

⁵ [Gas Act 1986, Supplies of gas taken illegally, Section 9.](#)

⁶ Gas Transporters [Standard Licence Condition 7](#)

part of totex and be shared between GDNs and customers using the existing 'Totex Incentive Mechanism'⁷ (TIM).

Totex Incentive mechanism

For RIIO-GD1, Final Proposals Opening Base Revenue Allowances will have been modelled on the basis that actual Totex expenditure levels are expected to equal allowed Totex expenditure levels (allowances). The TIM provides for an appropriate sharing of any overspend or underspend between licensees and their customers. The incentive strength rates (ie the proportions retained or borne by Licensees) for the eight Licensees are set out in Special condition 3B of the Gas Transporter licence⁸ and range from 63.04 to 63.73 per cent.

We propose that the total income recovered from theft investigations is subtracted from each GDNs actual expenditure (which would include investigation and recovery costs). Therefore if, before theft investigation costs and revenue is taken into account, the GDNs' actual expenditure matched the allowed expenditure then our proposal would effectively result in (all other things being equal) either:

- a) an apparent Totex underspend - meaning that a share of positive income is shared with all customers; or
- b) an apparent Totex overspend – meaning that a deficit position is shared with all customers.

To achieve these outcomes, each GDN would include total income recovered as a negative component⁹ of its Actual Controllable Opex expenditure (ACO) value¹⁰ for the regulatory year in which the income is received.

It should be noted that our proposal would not alter each distribution networks allowed expenditure as agreed in the RIIO-GD1 price control.

The aim of our proposal is to incentivise investigation and allow for the recovery of money in the simplest way. We propose that these arrangements will be effective for the remainder of the RIIO-GD1 price control and could then be reviewed for the RIIO-GD2 price control.

We acknowledge that there is a risk with this proposal that GDNs' costs may not be fully recovered if total investigation costs outweigh the total amount of money recovered in a given year. However, as the TIM is symmetrical these arrangements will also work in favour of the GDNs if the amount recovered is more than the GDNs' costs.

Question 1:

Do you think that our proposal better incentivises GDNs to investigate theft than the existing arrangements?

Question 2:

Do you have an alternative suggestion for incentive arrangements?

Need for more information and data

As part of the proposed new arrangements we would require GDNs to submit information on their investigations annually. Information will be reported as part of the Regulatory Instructions and Guidance (RIGs) process. To monitor the operation of our proposed

⁷ Description of the Totex Incentive Mechanism can be found in the [GD1 Financial Handbook \(Chapter 6\)](#)

⁸ <https://epr.ofgem.gov.uk//document/Download/36479>

⁹ So that a deficit outcome is reported as a positive value.

¹⁰ ACO having the meaning given in chapter 6 of the [GD1 Price Control Financial Handbook](#)

incentive we will require GDNs to provide the following information in the Regulatory Reporting Packs:

- the number of suspected/reported incidences of theft
- the number of investigations carried out by GDNs
- the cost of each investigation
- the amount of money recovered from successful cases
- the proportion of successful cases in relation to unsuccessful cases

Going forwards, gathering more data from GDNs on theft related activities will help us review whether we should introduce different arrangements for RIIO-GD2. The new arrangements and the data provided by GDNs will be reviewed as part of the RIIO-GD2 process. Depending on the outcome of the review, the incentive could be amended for the following price control period.

As part of this consultation we would also welcome any further data from GDNs on costs and money recovered from theft cases.

Question 3:

Are GDNs able to provide any historical information on costs and recoveries in relation to theft investigations?

Question 4:

Would the information we have set out above be sufficient to monitor the operation of the proposed new arrangements?

Summary of Questions

For this consultation we are looking for responses to the following questions:

Question 1:

- Do you think that our proposal better incentivises GDNs to investigate theft than the existing arrangements?

Question 2:

- Do you have an alternative suggestion for incentive arrangements?

Question 3:

- Are GDNs able to provide any historical information on your costs and recoveries in relation to theft investigations?

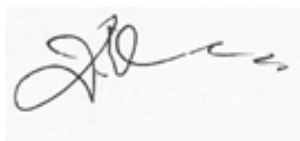
Question 4:

- Would the information we have set out above be sufficient to monitor the operation of the proposed new arrangements?

Next steps

We have summarised the questions for stakeholders in the section above. Please send responses to Jacob Kane (jacob.kane@ofgem.gov.uk) by 18 April 2014. Please note that, unless clearly marked confidential, your response will be published on our website.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Dora Guzeleva', on a light-colored background.

Dora Guzeleva,
Head of Networks Policy, Local Grids.