



Making a positive difference  
for energy consumers

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

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Dear Stakeholder,

### **Decision on incentive arrangements for Gas Distribution Networks on gas theft during conveyance and for unregistered sites**

We have decided that the current gas theft arrangements for Gas Distribution Network operators (GDNs) should stay in place for the remainder of the current price control period (RIIO-GD1 until 2021). This follows consultation. We will enhance the current reporting requirements to gather more information on GDNs' investigation costs and the money that they can recover.

We will also encourage GDNs and other industry parties to keep developing interim ideas that could improve the current arrangements. We will review and consider any developed ideas.

#### Background

On 20 February 2014, we proposed incentive arrangements for GDNs on gas theft during conveyance and for unregistered sites. This was consulted on.

We want GDNs to investigate theft if it is their responsibility to do so, and to pursue the value of any gas taken. The current licence obligation on gas transporters regarding gas theft is set out in SLC7<sup>1</sup>. 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. But the licence says that gas transporters must remain revenue-neutral in doing this and any surplus that results from investigations must be returned to consumers.

We proposed to amend SLC7 to encourage transporters to proactively investigate theft. This would have removed and replaced the current funding arrangements in SLC7 for theft. Rather than the current requirement for GDNs to remain revenue-neutral, all costs and all money recovered from successful investigations would be treated as part of total expenditure (totex) and be shared between GDNs and customers using the existing 'Totex Incentive Mechanism'<sup>2</sup> (TIM). This means that when any overspend or underspend is shared between licensees and their customers, it is done so fairly.

We proposed that the total income recovered from theft investigations would be subtracted from each GDN's actual expenditure (which would already include theft investigation and

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<sup>1</sup> Gas Transporters [Standard Licence Condition 7](#)

<sup>2</sup> Description of the Totex Incentive Mechanism can be found in the [GD1 Financial Handbook \(Chapter 6\)](#)

recovery costs). If, with all other things being equal, the GDNs' actual expenditure matched the allowed expenditure, then taking account of theft investigation costs and revenue through our proposal would result in either:

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

To achieve this, each GDN would include total income recovered as a negative component<sup>3</sup> of its Actual Controllable Opex (ACO) expenditure value<sup>4</sup> for the regulatory year in which the income is received.

### Responses to our consultation

We received six responses to our consultation<sup>5</sup>. Although all respondents welcomed our work on a gas theft incentive, the majority disagreed with our proposal. The main reason they gave was that the money recovered as a result of theft investigations rarely outweighs the investigation costs. In this situation, there is a risk that the GDNs' costs would not be fully recovered. Although the TIM is symmetrical, and would work in favour of the GDNs if more money was recovered than was spent on investigations, the GDNs predicted this would rarely be the case. One respondent said that, for this reason, the existing arrangements better incentivise network activity to tackle theft compared to the proposal.

Respondents also suggested that a risk of our proposal is that it could incentivise the pursuit of larger commercial theft cases, at the expense of other cases which may be complex or where the value of recoverable gas is small.

As part of the consultation, we asked GDNs to share more information on recovered money and investigation costs. Two respondents were able to provide more information. The information from National Grid shows that in both 2013/13 and 2013/14, theft investigations have resulted in recovering money which outweighs the total investigation costs. So in both years, National Grid has passed through recovered money from theft back to consumers. But information from other GDNs suggests that they have been unable to recover any money. Northern Gas Networks said that in 2013 it identified 17 cases of theft of gas (theft in conveyance cases) and nine consumers were billed for theft of gas, but no money was recovered. Theft data is currently limited and conflicting, so we want to gather more evidence on the cost of investigations and GDNs' ability to recover money.

We also asked whether the information reporting requirements we suggested would be sufficient to monitor the operation of the proposed arrangements. The majority of respondents were supportive of introducing this reporting and agreed that the proposed information was appropriate. One respondent said that it was not practical or economic to provide the cost of each investigation. Another respondent agreed that the information was appropriate but that it would be useful to allow commentary to support any statistics submitted as part of the reporting.

### Incentive arrangement options

After reviewing the responses to our consultation, we have reconsidered the options for new incentive arrangements for the GDNs. These are:

- *Implement our proposal.* We could progress with implementing our proposal. Although we do believe the proposed arrangements have merit, we do not want to progress with this option because the majority of consultation respondents disagreed with it.

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<sup>3</sup> So that a deficit outcome is reported as a positive value.

<sup>4</sup> ACO having the meaning given in chapter 6 of the [GD1 Price Control Financial Handbook](#)

<sup>5</sup> The consultation responses are [here](#).

- *Allow cost recovery for theft investigations.* We asked respondents to suggest alternative theft arrangements. The main one was to allow cost recovery for efficient investigations. GDNs said that this would ensure their costs can be recovered irrespective of whether they were successful in recovering revenue from a case. We do not consider that this will give GDNs a strong incentive to pursue recovering revenues. In addition, to introduce a full cost recovery provision subject to efficiency measures to SLC7 would require an audit of all investigation costs to determine if they were efficient.
- *Use a shrinkage-based incentive framework.* National Grid suggested that an incentive framework based on the existing shrinkage model would be a more effective mechanism than our proposal. If National Grid, with the help of any other GDNs, further developed this suggestion and presented it to us, we could review and consider whether it is indeed a better alternative option to the current theft of gas arrangements.
- *Maintain current arrangements.* We acknowledge that the current arrangements for theft of gas may not provide a strong incentive for GDNs, maintaining them for the remainder of RIIO-GD1 will allow us to gather more information and develop a more appropriate incentive for the next price control. In the meantime, we expect GDNs to comply with the obligation in SLC7 to investigate cases of theft and try to recover the value of gas taken.

#### Our decision

Following our consultation we have decided that the current gas theft arrangements for GDNs under SLC 7 should stay in place for the remainder of the current price control period (RIIO-GD1 until 2021). We will still expect GDNs to be proactive in tackling gas theft in order to meet their licence requirement in SLC7.

We will enhance the current reporting requirements to gather more information on GDNs' investigations and the money that they are able to recover. Following the responses to our consultation we think that GDNs should provide the following information in the Regulatory Reporting Information and Guidance Packs (RIGs):

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

#### Next steps

We will amend the gas theft reporting requirements for GDNs in an update of the Gas RIGs. We will be consulting on the updates to the RIGs early in 2015. GDNs will have to submit the first set of data in July 2015 for reporting on 2014/15.

We encourage GDNs and other industry parties to keep developing any interim ideas that they believe could improve the current gas theft arrangements. We will review and consider any developed ideas.

We are still keen to make a gas theft incentive consistent with the new electricity theft arrangements at RIIO-GD2. By RIIO-GD2 we will have gathered information on how the new electricity arrangements operate.

Yours sincerely,



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Head of networks policy, local grids