

Modification proposal:	Supply Point Administration Agreement (SPAA) Change Proposals 14/268 (CP14/268): Introduction of the gas theft detection incentive scheme		
Decision:	The Authority ¹ has decided to approve ² this modification ³		
Target audience:	SPAA Parties, SPAA Panel and other interested parties		
Date of publication:	26 October 2015	Implementation date:	To be confirmed

Background

Theft of gas increases the costs paid by consumers and can have serious safety consequences. It also leads to a misallocation of costs among suppliers, which can distort competition and hamper the efficient functioning of the market. Estimates of the scale of gas and electricity theft vary, but even lower estimates suggest that the scale is significant, being in excess of £100 million per year.

Following a series of consultations, supported by the publication of an Impact Assessment⁴ (IA), in October 2012 we set out new arrangements for tackling gas theft.⁵ These included:

- strengthened licence obligations on gas suppliers to detect, investigate and prevent theft of gas – standard licence condition 12A (SLC12A);⁶
- the introduction of a Theft Risk Assessment Service (TRAS);⁷
- supporting measures including a code of practice on theft investigations; and,
- principles for a theft detection incentive scheme.

The first three components of the theft arrangements have now been put into effect. In particular, pursuant to the requirement to put in place theft arrangements referred to as the TRAS, we accepted SPAA Change Proposal CP12/226: 'Provisions for the Theft Risk Assessment Service'⁸. In consenting to the implementation of CP12/226, which set out the TRAS arrangements as a part of SPAA Schedule 34⁹, we agreed that the SPAA provides an efficient and robust means for gas suppliers to collectively discharge these new obligations.

Although we set out the principles for a theft detection incentive scheme as part of our final proposals, we considered that they should be implemented through industry code governance.

The modification proposal

CP14/268 proposes to introduce a theft detection incentive scheme within the SPAA, in line with the principles set out in our final proposals. The mechanics of the incentive

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority. This decision is made by or on behalf of GEMA.

² This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ 'Change' and 'modification' are used interchangeably in this document.

⁴ See: www.ofgem.gov.uk/sites/default/files/docs/2012/03/gas-theft-ia%282%29_1.pdf

⁵ Tackling Gas Theft: New requirements for gas suppliers – Decision Document. Ofgem Ref 137/12. See: www.ofgem.gov.uk/Markets/RetMkts/Compl/Theft/Documents1/Tackling%20Gas%20Theft%20-%20New%20requirements%20for%20gas%20suppliers%20-%20Final.pdf

⁶ Standard Licence Condition 12A: 'Matters relating to Theft of Gas'

⁷ www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=149&refer=Markets/RetMkts/Compl/Theft

⁸ www.ofgem.gov.uk/ofgem-publications/63491/cp12-226d-2.pdf

⁹ Subsequently amended by SPAA CP15/292: '[Theft Risk Assessment Service Implementation](#)'

scheme are set out in full in the legal text accompanying CP14/268 and are therefore only summarised below.

Theft target and incentive pot

It is proposed the theft incentive applies to all licenced Gas Suppliers, regardless of whether they have acceded to SPAA. For the first two years of the scheme, the target would be 6,000 theft detections per year.¹⁰ This overall target would be broken down into 4,500 theft detections for Smaller Supply Point (SSP) sector and 1,500 theft detections for the Larger Supply Point (LSP) sectors¹¹, each with a ring-fenced incentive pot (see below). It is proposed that in future years, the TRAS would be responsible for establishing the overall and sectoral theft targets.

The intent of the scheme is to establish a value, to be referred to as the 'Marginal Detection Disincentive Value' (MDDV) per detected theft in each sector, to offset the costs which may otherwise deter suppliers from pursuing investigations. Under CP14/268, the initial values are consistent with those set out in the Ofgem IA. Therefore, for the initial year of the scheme, the MDDV will be set at £1,515 for each theft found in the SSP sector and £934 for each theft found in the LSP sector¹².

The proposed incentive pot for year 1 of the scheme would therefore be:

SSP Pot: £6.817m (4,500 x £1,515)
LSP Pot: £1.401m (1,500 x £934)

For future Scheme Years, there will be a requirement to establish a process to review the MDDV with an appropriate methodology developed. It is also noted that the costs associated with any audit requirements are not included.

Performing against the incentive

An offence under Schedule 2B of the Gas Act 1986 would be considered to be a detected theft under the scheme. This is also consistent with Standard Condition 7 (Provision of Information Relating to Gas Illegally Taken) of the Gas Transporters Licence. In order to qualify for the scheme, the supplier would have to show that they have clear evidence to prove (on the balance of probabilities) that a meter tampering offence has been committed, which meets this definition of an offence. Suppliers must additionally ensure that they have complied with the Gas Theft Code of Practice when handling any investigation.

The scheme administrator will log each reported and qualifying offence against the reporting Supplier. The scheme administrator will report monthly to each supplier, together with the SPAA Executive Committee (EC) and Ofgem, detailing progress towards meeting the theft target(s).

Credits and debits from the incentives scheme will be calculated at the end of the reporting year according to a formula.

It is intended that the scheme administrator will audit, on an ongoing basis, a sample of submitted theft detection claims. This may include a requirement that the supplier submit the supporting evidence to demonstrate that (on the balance of probabilities) a relevant offence has taken place. The scheme administrator may exclude individual

¹⁰ Based upon Ofgem views within their 'Tackling Gas Theft: the way forward' document Page 18

¹¹ SSP sector applies to sites with an AQ of <73,200kWh, LSP sector applies to sites with an AQ >73,200kWh – all definitions as per the Uniform Network Code

¹² Ofgem Final IA – Page 80 – section 1.81

claims, and if they have doubt about the scale of detection may recalculate the supplier's incentive entitlement accordingly.

The Change Board's¹³ recommendation

On 18 December 2014 CP14/268 was voted upon by SPAA Parties at the SPAA Change Board.¹⁴ It failed to secure the necessary 65% support in each voting category¹⁵, as required in order for it to be accepted:

CP14/268	WEIGHTED VOTING (%)					
	Domestic Supplier		I&C Supplier		Gas Transporter	
	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	41.8	58.2	69	31	100	0
IMPLEMENTATION DATE	41.8	58.2	69	31	100	0
IMPLEMENTATION TECHNIQUE	41.8	58.2	69	31	100	0

SPAA Forum

British Gas (BG) appealed the Change Board decision to the SPAA Forum in accordance with Clause 9.20 of the SPAA. The SPAA Forum subsequently met on 23 January 2015 and determined not to overturn the result of the Change Board vote.

BG then appealed under Clause 7.26 of the SPAA, requesting that Ofgem overturn the decision of the SPAA Forum. BG argued that the initial rejection of CP14/268 (and subsequent failure of the SPAA Forum to overturn that rejection) was wrong, as its acceptance would have better facilitated the SPAA relevant objectives. In particular, BG argues that reducing theft and correcting the apportionment of misallocated energy costs would improve competition between suppliers.

We agreed that BG had sufficient grounds to appeal the rejection of CP14/268 and on 15 May 2015 requested that the SPAA Administrator submit to us a copy of the Change Report and associated documents.

Our decision

We have considered the views of the Change Board and the SPAA Forum, together with the CP14/268 change report and have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the SPAA;¹⁶ and
- consenting to the modification being made is consistent with our principal objective and statutory duties.¹⁷

Reasons for our decision

We note that BG intended for its proposals to meet the principles set out in our final proposals, and agree that it does so.¹⁸ Our consideration has therefore focused on the

¹³ The Change Board is established and constituted pursuant and in accordance with the SPAA.

¹⁴ All documents relating to CP14/268, including minutes of the Change Board, the SPAA Forum and the SPAA document itself are available online at: www.spaa.co.uk

¹⁵ The threshold for a change proposal being accepted by relevant SPAA parties is 65%, as set out in clause 9 of the SPAA.

¹⁶ As set out in Standard Licence Condition (SLC) 30.5 of the Gas Supplier Licence.

¹⁷ The Authority's statutory duties are wider than matters which the Change Board must take into consideration and are detailed mainly in the Gas Act 1986.

¹⁸ Tackling Gas Theft: New requirements for gas suppliers – Decision Document. Ofgem Ref 137/12. See: www.ofgem.gov.uk/Markets/RetMkts/Comp/Theft/Documents1/Tackling%20Gas%20Theft%20-%20New%20requirements%20for%20gas%20suppliers%20-%20Final.pdf

new issues arising from consultation and whether the implementation of such a scheme better facilitates the particular objectives of the SPAA.

Although CP14/268 failed to reach the required 65% of the weighted vote at the SPAA Change Board, we note that the majority of parties were actually in favour of it. Opinion was evenly split between the six voting suppliers, each of them being one of the largest energy suppliers and there was a further vote in support of the proposal from one of the independent Gas Transporters. We deal with each of the reasons given for voting preference at the Change Board and/or the subsequent SPAA Forum below.

We agree with the proposer and the Change Board that CP14/268 should be assessed against SPAA objective (c). Although the proposal stems directly from our final proposals on gas theft arrangements, there is no obligation under SLC12A to establish a theft detection incentive scheme. We therefore consider that CP14/268 will have a neutral impact against relevant objective (f): *securing compliance with SLC12A*. We consider that CP14/268 will have a neutral impact upon the other SPAA objectives.

(c) Furtherance of effective competition between Gas Suppliers and between relevant agents

Proportionality

Some respondents suggested that an incentive scheme is unnecessary, as suppliers are already subject to a licence condition to detect, investigate and prevent theft. However we remain concerned that there is still a disincentive to proactively and robustly investigate theft. In particular, while much of the cost of theft is a negative externality, being a key contributor to unidentified gas¹⁹ which is socialised across the market as a whole²⁰, the costs of dealing with instances of theft fall directly upon the individual supplier.

The aim of the proposed incentive scheme is therefore to deliver sufficient theft detections to meet the theft target, and associated social benefit. In future, this will be determined by a methodology to be developed by the TRAS. In the interim, we proposed that the theft target be set at 6,000 detections per year, which we would expect to be achieved from around 17,000 investigations. This target was proposed having assessed the results of the best performing gas suppliers in the market.

However, one respondent suggested that the existence of the scheme may create a perverse incentive for suppliers to focus on detecting theft, rather than seeking to prevent it. We recognise that for suppliers with a relatively small market share, the rewards for detecting an individual instance of theft may outweigh the proportion of socialised cost that they would otherwise be allocated. However, prevention is an integral part of the theft strategy and we may in future ask suppliers to demonstrate what they are doing to discharge their obligations in this area. That said, we also consider that the one of the factors which may influence an individual's propensity for theft is the risk of being caught. Enhanced investigation and detection, combined with increased public awareness of these measures, should therefore act as a powerful deterrent and complement other preventative measures.

BG selected the size of the individual incentive pot based on the conclusions of our published IA; the analysis is therefore not repeated here. We note that debits and credits against the scheme will only be made after reporting is available for the first full

¹⁹ The Allocation of Unidentified Gas Expert (AUGE) considers that the majority of the £119m unidentified gas (UG) cost to be allocated in 2015/16 is undetected theft: ['2014 Allocation of Unidentified Gas Final Table for 2015/16'](#).

²⁰ Daily Metered supply points are not exempt from the allocation of UG costs, though to date none has been allocated to them through the AUGE process.

year of operation, requiring no up-front funding from suppliers. We consider that as supplier debits will be based on market share, any additional costs will be proportionate. In the worst case scenario – i.e. where a supplier fails to achieve any detections and therefore receives no credits to net off against debits – the costs of the scheme would be around 38 pence per supply point. In order to gain a net reward from the scheme, a supplier would be required to make one or more detections of theft for every 3,600 registered supply points. We consider this to be a modest and achievable target.

We also note that CP14/268 does not clarify the costs of administering the scheme, including those associated with any audit. However, we are comfortable that relevant suppliers will be able to manage these effectively through the governance of the SPAA.

Non-acceded parties

Some respondents noted that only domestic suppliers were obligated to accede to the SPAA, and that whilst some non-domestic suppliers had also acceded, many others (at the time) had not. Respondents were therefore concerned that, non-acceded parties would not participate in the theft incentive scheme, contrary to the proposer's intention that it also apply to non-SPAA parties. We agree that in the absence of large numbers of non-domestic suppliers, it was unclear how the scheme could be effective in that sector.

SLC12A(8), which is applicable to both domestic and non-domestic suppliers, requires the licensee to be a party to, comply with, and maintain the TRAS. Although SLC12A does not directly require the licensee to accede to the SPAA, in practice this is the means by which the gas industry is contracting with the TRAS. We consider that it would have been impracticable and inappropriate for non-domestic suppliers to enter into bilateral arrangements with the TRAS. On 21 July 2015 we accepted CP15/297²¹, which allowed Industrial and Commercial (I&C) suppliers to accede to the SPAA for the purposes of the TRAS arrangements only. Only the necessary and existing SPAA provisions relating to theft were included within the scope of CP15/297; it therefore did not extend to a theft detection incentive scheme and the acceptance of CP14/268 would not of itself capture 'I&C TRAS suppliers' within the scheme. We consider that such a scheme, particularly having been part of our final proposals to tackle gas theft, would not be an inappropriate extension of scope, though recognise that it may require a further change to the SPAA legal text.

Audit

Some respondents considered that the change proposal needed further clarity, in particular around the requirements for evidence to demonstrate detection of an offence, and other aspects of the audit arrangements. We agree that further clarity is required on these arrangements. However, we also consider that some of the queries raised by respondents are properly a matter for the SPAA administrator and/or any appointed auditor to consider, rather than needing to be prescribed as part of this proposal.

Exclusions

In our final proposal, we noted that for historical reasons, BG may currently have in place more advanced techniques to allow it to detect theft. We therefore proposed that in order to encourage other suppliers to make efforts in response to, and benefit from, the incentive scheme, BG would be excluded from the scheme for an initial period. However, we went on to state that we would expect BG to participate in the incentive scheme once the other arrangements set out in the final proposals had been implemented. As noted above, the other arrangements have now largely been implemented, and the incentive scheme is intended to come into effect alongside the

²¹ CP15/297: 'Accession of I&C TRAS Suppliers'

TRAS, in Spring 2016. This will be four years from the publication of our final proposals and IA, in which we stated that we expected the incentive scheme to be in place by the end of 2012. We therefore consider that all suppliers have had ample opportunity to develop adequate theft detection techniques, and do not consider that it is necessary or appropriate to exclude BG from the proposed scheme.

Conclusion

Whilst we are sympathetic to many of the concerns raised in relation to CP14/268, on the whole we consider that they are not sufficient to warrant its rejection, particularly as they are capable of resolution in advance of it being implemented. As noted above, the problem of energy theft is significant, in terms of both financial cost and the risk to health and safety. We therefore remain of the view that a theft detection incentive scheme is a proportionate measure to mitigate those risks. However, we also consider that the parameters of the scheme, along with the theft target itself, should be determined on the basis of evidence. Noting that our IA was published in 2012, we would be open to the details of the scheme being further reviewed in light of more recent analysis. In particular, the MDDV should as far as practicable continue to track the actual cost of theft detections.

In the longer term, we consider that it may be preferable that the theft incentive scheme does not operate entirely in isolation of the work on allocated unidentified gas (UG) and performance assurance more generally. Given that theft is considered to be a large component of UG, it may be more efficient to combine the two elements and incorporate the theft incentive principles into a weighted allocation of existing UG cost, alongside other performance assurance measures. However, we consider that 14/268 represents a practicable proposal and would better facilitate effective competition between suppliers than maintaining the status quo.

Although the existence of CP14/268 has been well known and flagged during the development of the TRAS arrangements, we were mindful that in the period since CP14/268 was rejected by the SPAA Change Board, the TRAS contract has been finalised and let to Experian. We consider that the anticipated role of the TRAS within the incentive scheme is limited and consistent with existing requirements, such as the establishment of a theft target. That said, before reaching our decision on CP14/268 we sought assurances that nothing within it would be contrary to the TRAS contract or established SPAA drafting relating to the TRAS. We are grateful to the SPAA EC for procuring independent legal advice which gave such assurance. However, it was also suggested, and we agree, that it would be prudent for SPAA parties to undertake a thorough review of all associated legal text to ensure that there is, for instance, a clear read across of all inputs into the scheme and where appropriate, a consistent use or interpretation of terminology etc, before the scheme is fully implemented.

Decision notice

In accordance with Standard Licence Condition (SLC) 30 of the Gas Supplier licence, the Authority hereby approves modification proposal SPAA CP14/268: *'Introduction of the gas theft detection incentive scheme'*.

Rob Church

Partner, Retail Markets

Signed on behalf of the Authority and authorised for that purpose