

Modification proposal:	Supply Point Administration Agreement (SPAA) Change Proposals (CP): 16/327 (CP16/327): Revision and Implementation of the Gas Theft Detection Incentive Scheme and SPAA Change Proposals 16/337 (CP16/337): Movement to Leads-based theft incentive scheme		
Decision:	The Authority ¹ has decided to approve ² modification ³ CP16/327 and reject modification CP16/337		
Target audience:	SPAA Parties, SPAA Panel and other interested parties		
Date of publication:	7 March 2017	Implementation date:	TBC

Background

The 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. In October 2012, we published new arrangements for tackling gas theft alongside an impact assessment. We set out the principles for a theft detection incentive scheme as part of our final proposals and we considered that they should be implemented through industry code governance.⁴

In October 2015, we approved CP14/268⁵ which proposed to introduce a Gas Theft Detection Incentive Scheme within the SPAA. The scheme was designed in line with the principles set out in our final proposals. It places an incentive on suppliers to find a greater proportion of total industry theft, compared to market share in both the Larger Supply Point (LSP) and Smaller Supply Point (SSP) sectors. Our decision included a recommendation to SPAA parties to undertake a thorough review of all associated legal text prior to the implementation of the scheme. This was primarily to ensure consistency between the scheme as set out in the SPAA and the Theft Risk Assessment Service (TRAS) contract, and to also address concerns about the clarity of the reporting and audit arrangements. A SPAA working group was tasked with the efficient implementation and thorough review of CP14/268 and associated legal documentation.

The modification proposals

CP16/327

CP16/327 was raised by British Gas to give effect to the output of the working group. It seeks to ensure a clear and consistent use of terminology with the SPAA and also comprises outputs with the TRAS. The key amendments are listed in the Change Report, so are not repeated here, but consist of amendments to Schedule 7, and changes to the

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

⁵ https://www.ofgem.gov.uk/sites/default/files/docs/2015/10/cp14-268d_0.pdf

SPAA main body.⁶ The proposer considers that CP16/327 would add greater clarity to the arrangements previously directed to be implemented as change CP14/268 and better facilitates the achievement of the relevant objectives of the SPAA.⁷

CP16/337

The incentive scheme introduced by CP14/268 would reward suppliers only where actual theft is detected. An underlying assumption of the scheme is that gas theft is broadly consistent across the whole market, irrespective of relevant supplier. Therefore, each supplier would have within its portfolio instances of gas theft that are proportionate to its total market share. However, some suppliers have challenged this assumption. They consider that the scheme may unintentionally penalise those suppliers that have already made efforts to minimise theft levels within their own portfolio. Some parties also consider that theft is not consistent across all sectors, and that the incentive scheme would therefore be skewed towards those suppliers who focus on sectors where it may be more prevalent. There is also concern that the proposal under CP14/268 may create a perverse incentive to treat any form of unexplained issue at a site (such as damaged meters) as theft in order to qualify for a payment from the scheme.

The Industrial and Commercial Shippers and Suppliers Group (ICoSS) has proposed CP16/337 that seeks to replace the original scheme with a "Leads-Based Theft Investigation Incentive Scheme". Under this scheme, suppliers would be required only to properly investigate Theft Risk Assessment Service (TRAS) Qualified Outliers in order to benefit from the incentive scheme, irrespective of whether or not actual theft was detected as a result of those investigations. The detail of the scheme is outlined in the supporting documentation to the Change Report.⁸

Whilst CP16/337 was not raised and progressed as a formal alternative to CP16/327, we consider them to be substantively similar and have therefore considered them together.

Change Board⁹ recommendation

At the SPAA Change Board meeting on 21 July 2016, the Change Board voted on CP16/327. The outcome of the weighted vote is set out in the table below:

CP 16/327	WEIGHTED VOTING (%)					
	Domestic Supplier		I&C ¹⁰ Supplier		Gas Transporter	
	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	80	20	80	20	0	0
IMPLEMENTATION DATE	60	40	60	40	0	0
IMPLEMENTATION TECHNIQUE	80	20	80	20	0	0

In accordance with the weighted vote procedure,¹¹ the Change Board considered that CP16/327 would better facilitate the relevant objectives of the SPAA and therefore

⁶<https://www.spaa.co.uk/SitePages/CPDetails.aspx?UID=835&Source=https://www.spaa.co.uk/SitePages/CPCurrent.aspx>

⁷ As set out in Standard Licence Condition (SLC) 30.5 of the Gas Supplier Licence.

⁸ The Change Report and drafting can be found on the SPAA's website

<https://www.spaa.co.uk/SitePages/Home.aspx>

⁹ The Change Board is established and constituted pursuant and in accordance with the SPAA.

¹⁰ Industrial and commercial.

¹¹ The threshold for a change proposal being accepted by relevant SPAA parties is 65%, as set out in clause 9 of the SPAA.

recommended its approval. However, the proposed implementation date¹² was rejected. The implementation date was subsequently referred to the SPAA Executive Committee (EC), which decided to overturn the Change Board vote and uphold the original proposed implementation date.

At the SPAA Change Board meeting on 20 October 2016, the Change Board voted on CP16/337. The outcome of the weighted vote is set out in the table below:

CP 16/337	WEIGHTED VOTING (%)					
	Domestic Supplier		I&C Supplier		Gas Transporter	
	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	40	60	40	60	0	0
IMPLEMENTATION DATE	40	60	40	60	0	0
IMPLEMENTATION TECHNIQUE	40	60	40	60	0	0

CP16/337 failed to attract more than 65% of the vote and was therefore recommended by the Change Board to be rejected.

Our decision

We have considered the views of the Change Board and the Change Report dated 5 October 2016 and have concluded that:

- implementation of the CP16/327 will better facilitate the achievement of the relevant objectives of the SPAA;¹³ and
- consenting to the modification being made is consistent with our principal objective and statutory duties.¹⁴

We have also considered the views of the Change Board and the Change Report dated 14 November 2016 and have concluded that implementation of the CP16/337 will not better facilitate the achievement of the relevant objectives of the SPAA.

Reasons for our decision

We agree with the proposers and the Change Board that CP16/327 and CP16/337 should be assessed against SPAA objective (b) and that each has a neutral impact on the other relevant objectives.

(b) the furtherance of effective competition between Gas Suppliers and between relevant agents

CP16/327

CP16/327 clarifies and improves the arrangements approved under CP14/268; for example, by ensuring consistency between the scheme as set out in the SPAA and the TRAS contract. It, therefore, allows implementation of those existing arrangements; which better facilitates objective (b) by meeting the principles set out in our final proposals.

¹² The scheme has an implementation date of 4 November 2016, with the Scheme Year start date to commence on 1st December 2016, or if the Authority's decision comes after these dates, the Scheme Year shall commence at the start of next calendar month following Authority decision.

¹³ As set out in Standard Licence Condition (SLC) 30.5 of the Gas Supplier Licence.

¹⁴ 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.

As noted above, an appeal was raised by a SPAA party to overturn the SPAA Change Board decision on CP16/327, and to include it in the change pack together with the CP16/337. This was to ensure that the two schemes could be discussed and assessed together so that suppliers would have full visibility of both schemes. It would have meant that CP16/327 would not be sent to us for decision before CP16/337 had been considered.

We understand the decision of the SPAA EC not to delay the implementation of the scheme under CP14/268, given that such scheme and the scheme proposed under CP14/337 are not alternates and provide individual solutions. However, it is good practice that changes of a similar nature should be discussed and assessed together. We have chosen to consider the change proposals together, particularly as it is not possible under the current drafting for both schemes to operate. Looking at the schemes together could have helped identify the relative merits of the two proposals and also where aspects of one could be used to enhance or overcome issues in the other.

Another SPAA party commented that it may not be appropriate to implement CP 16/327 until the TRAS reporting requirements are confirmed as being sufficiently robust. It has been a number of years since the publication of our final proposals and impact assessment, 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. The TRAS has been in place since April 2016; our view is that the fact that these requirements will have been in place for nearly a year before the incentive scheme is implemented is not a reason to delay implementation.

We have reviewed the proposed legal changes under the revised Schedule 37 of the SPAA and are broadly comfortable with the amendments to the legal drafting. However, we consider that there could be clearer provision and the inclusion of timescales for the Secretariat to produce Supplier Monthly and Annual Summary reports based on TRAS data in Schedule 37. We encourage industry to propose appropriate changes to address this.

CP16/337

We consider that CP16/337 will not better facilitate the achievement of SPAA objective (b). The rationale for the scheme proposed under CP16/337 is to replace the original scheme approved under CP14/268 with one that avoids the risk of creating a cross-subsidy between those suppliers with a higher potential for theft on their portfolio than the industry average.

We have some sympathy with the issue CP16/337 is seeking to tackle, as incentives should be targeted at an outcome that is within a party's control. However, a redistribution of cost between suppliers is an inherent feature of the incentive regime under CP14/268 and CP16/327. We acknowledge there is a potential scenario where a supplier follows up its TRAS leads but still incurs debits under the scheme because no actual theft was found. In so far as there are differences in theft trends between the LSP and SSP sectors, this is recognised in the arrangements of CP14/268 with separate incentive pots for each sector. It could also be argued that suppliers that have been actively pursuing theft could be at a disadvantage in so far as having less 'low hanging fruit' on their portfolios to investigate. However, as stated in our October 2015 decision on CP14/268, we estimate that 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 3,600¹⁵ registered supply points. We consider this to be an achievable target.

We see the merits in a leads-based investigation scheme. However, we share some of the concerns raised by the industry about the detail of the scheme set out in CP16/337. We consider that the definitions are imprecise and could leave the scheme open to manipulation, undermining the ability for the industry to deliver the scheme's objectives. For example, it may be an acceptable outcome under the scheme simply for the TRAS lead to be "Under Investigation". We are concerned that the scheme, as currently defined, would allow a supplier to put all its TRAS Qualified Outliers "under investigation" to allow them to achieve their required target. Moreover, the timescales for the closure of an investigation are not entirely clear and could impact the effectiveness of the scheme. The scheme also does not clearly provide an incentive to detect theft at a level that is beneficial for consumers; taking into account the costs and other impacts of the activity.

Conclusion

We remain concerned that, despite the licence condition to detect, investigate, and prevent theft, there is still a disincentive to proactively investigate it. We, therefore, remain of the view that a theft incentive scheme is a proportionate measure to mitigate those risks, and the incentive scheme approved under 14/268 which is enhanced by CP16/327 represents a practicable proposal and would better facilitate effective competition between suppliers than maintaining the *status quo*. 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. Theft is considered to be a large component of UG and incentives on UG may form part of the work under the Performance Assurance Committee, which is looking at the accuracy of gas settlement.¹⁶

Overall, we consider that CP 16/327 better facilitates objective (b) and is aligned with Ofgem's principles set out in our 2012 theft document. Given this is a new scheme, we recommend that it is reviewed after it has been operating for at least a year. This review could be used to refine the design of the scheme, ensure it is operating as intended, and to take into account any wider incentives on UG that have been/will be introduced. The review could be used to consider whether there is merit in revisiting some of the redistributive impacts, for example, if suppliers could be in a neutral position if they followed up all the TRAS leads or, given the Allocation of Unidentified Gas Expert (AUGE) work on UG, whether there is a case for the LSP category to be further disaggregated.¹⁷

Decision notice

In accordance with Standard Licence Condition (SLC) 30 of the Gas Supplier licence, the Authority hereby approves modification proposal SPAA CP16/327: 'Revision and Implementation of the Gas Theft Detection Incentive Scheme and SPAA Change Proposals', and rejects CP16/337: Movement to a Leads-based theft incentive scheme.

Rob Church

Partner, Consumers and Competition

Signed on behalf of the Authority and authorised for that purpose

¹⁵ Estimated based on the total supply points and an initial theft target of 6000.

¹⁶ Information related to the work of the Performance Assurance Committee can be found on the Joint Office's website: <http://www.gasgovernance.co.uk/PAC/>

¹⁷ The AUGE work suggests that the UG smear will apply to all profile classes except Class 1. Further detail can be found at <http://gasgovernance.co.uk/augenex/1718>