

Mr Bob Fletcher
Secretary, Modification Panel
Joint Office of Gas Transporters
51 Homer Road
Solihull
B91 3LT

7th January 2011

Dear Bob

RE: UNC Proposals 0277 & 0346 – “Creation of Incentives for the Detection of Theft of Gas (Supplier Energy Theft Scheme)” and “Alternative to Creation of Incentives for the Detection of Theft of Gas (Supplier Energy Theft Scheme)”

1. British Gas supports the implementation of both Modification Proposals 0277 and 0346, although we have a preference for Modification Proposal 0346 because it more effectively incentivises theft detection in the non-domestic sector. Both of these Modification Proposals better facilitate the relevant objectives of the Uniform Network Code (UNC). In addition, these modifications also help Ofgem meet its Primary Duty to protect the interests of customers by reducing costs and improving safety for consumers. Furthermore, the resultant reduction in theft will deliver an improvement to energy efficiency and therefore reduction in carbon emissions. We have summarised why these Modification Proposals achieve this below and gone on to provide supporting rationale and evidence substantiating these points in Appendix One.
2. It is widely accepted that energy theft takes place, that it is dangerous and that it results in higher costs for those customers that do not steal energy, including the fuel poor. Despite this acceptance the gas industry is not tackling theft consistently; last year British Gas detected 83% of all theft found within that year with the next best performing Shipper detecting only 4% of the total¹. This is because the way that costs of theft are apportioned at best dilutes, and arguably deters, Shippers from investing sufficient resource or management focus in the detection of theft.

¹ xoserve monthly Theft of Gas Statistics for 2009, the last full calendar year of available statistics at the time of writing.

3. Many of the methods used to steal gas can only be proven if the culprit is caught in the act. Because of this investigative action must be carefully targeted and timed if it is to be at all successful. For the same reasons, it is easy for a Shipper to make token, less expensive, investigative actions which fail to prove an offence has occurred. Therefore an obligation to detect theft would be almost impossible to enforce and would, without accompanying incentives, continue to lead to insufficient theft detection efforts taking place where the costs associated with real action outweigh the benefits.
4. An incentive scheme is therefore required, and needs to be set at a level that is sufficient to motivate Shippers to invest sufficiently in the detection of theft. It is precisely because our Modification Proposal will be effective in driving investment by the industry that those Shippers who otherwise would not make such investment object to them. We consider that the resistance to our proposals is therefore not only an inevitable, but a strong indicator of the likely effectiveness of them.
5. The original basis for the incentive scheme that we proposed is consistent with that developed by the Energy Retail Association (ERA) and Energy Networks Association (ENA) Theft of Energy Working Group in 2005, in response to pressure from Ofgem to act. Since 2005 however, only British Gas has been proactive in detecting theft and pushing for reform.
6. We are aware that proposals, as yet not fully developed, for a National Revenue Protection Service (NRPS) scheme are being discussed outside industry governance by those Shippers that collectively detect less than 17% of gas theft whilst being responsible for supplying 64% of gas supplied. It is therefore not surprising that these Shippers oppose an incentive scheme which would force them to do more than they do now to detect theft, and that they have consequentially set out to develop proposals that, apparently, seek to both undermine an incentive scheme and delay reform for several more years.
7. We have proposed an alternative regime which, if the NRPS concept was effective in detecting theft, would have rewarded those Shippers using it with incentive payments and penalised those who opted out it. This proposal has been resisted by proponents of the NRPS model, suggesting either a lack of conviction from those Shippers in the effectiveness of the NRPS model or a lack of real intent to implement it.
8. As currently defined, the NRPS scheme seeks to monopolise an already competitive market, and thus is likely to need ministerial approval. Other important steps yet to start include the creation of a new limited company, delivery of Supply Licence Condition changes, the creation of a new industry "Theft Code", the completion of a tender process under European "OJEU" rules, the recruitment and training of staff, the build or procurement of systems capable of handling data on all 21.6m gas sites and the delivery of IS changes within every Supply business to then extract and populate that system both initially and on an ongoing basis. We consider that this is likely to push the delivery of a solution out until 2015, and given the lack of

incentives involved in the model, still not actually force Suppliers to take more than a token effort. This is in contrast to Modification Proposals 0277 and 0346 which are ready for immediate implementation.

9. The obvious way forward to approve the proposed introduction of incentive schemes as set out in either Modification Proposal 0277 or 0346, and then if the case is subsequently warranted, complement this by centralising any of those Revenue Protection services that form a natural monopoly and would be better served by a single independent service provider.
10. In just the last year we know of a number of incidents where undetected theft led to serious incidents including uncontrolled leaks and explosions. These incidents alone resulted in two deaths, thirty-six casualties, three hospitalisations and at least one serious injury. The Regulator has already approved approximately £6bn of investment to upgrade service pipes and improve safety between 2001 and 2009, and is considering approximately £18bn more of investment between now and 2032. Meanwhile, by our estimates, the gas industry invests less than £5m in theft detection, with the vast majority of that investment resting with us.. The contradiction here is stark, and represents a situation which if allowed to continue will endanger the lives of more members of the public.
11. Both Modification Proposal 0277 and 0346 better facilitate the relevant objectives of the UNC. Although Modification Proposal 0346 will enable more effective targeting of the incentive scheme to the non-domestic sector both modifications also have clear benefits to consumers in terms of lower costs, improvements to public safety by preventing explosions and improving sustainability in terms of reducing inefficient use of gas.
12. No genuine alternatives have been raised to Modification Proposals 0277 or 0346. The NRPS is at best a long way off and in reality is unworkable and ineffective in its present form. Notwithstanding this, the incentive regime proposed by Modification Proposals 0277 and 0346 can be used to support the NRPS rather than undermine it. The approval of either Modification Proposal would clearly be aligned with Ofgem's Primary Duty to protect the interests of consumers by lowering costs and improving safety. These proposals also, unlike the potential creation of an NRPS, promote competition.
13. If you have any queries relating to this representation, please do not hesitate to telephone me on (07789) 570501.

Yours sincerely

David Watson
Regulatory Manager, British Gas

Appendix One – Modification Proposals 0277 and 0346

Why is an incentive scheme required?

14. Although we recognise there are many varying estimates about the cost of gas theft² to the industry, there is an agreement in the industry that theft does take place, that that it poses a risk to both customer safety and the integrity of the network as well as creating higher costs for those honest customers who do not steal. Despite this, there are no direct obligations or incentives on gas Shippers or Suppliers to detect theft.
15. It is perhaps not surprising therefore that the gas industry is not tackling theft consistently. In the last full calendar year for which data is available, British Gas detected 1675 cases of gas theft, representing 83% of all theft found within that year. The next best performing Shipper found only 83 cases of theft, or 4% of the total. This is despite British Gas only receiving only 33% of the leads which the Network Owners issued to the industry in the same period³.
16. The reason British Gas detected almost five times the amount of theft that the rest of the industry did *combined* in this period is because of the way in which unidentified gas costs are smeared across the Small Supply Point (SSP) sector. This process means that British Gas saves more than £0.40 in the £1.00 if it stops one of its customers stealing gas whereas most other Suppliers receive less than £0.10. Conversely British Gas receives a cost of over £0.40 in the £1.00 if another Supplier's customers steals, whereas other Suppliers individually only incur a cost of less than £0.10 if a British Gas customer steals.
17. This dynamic has the effect of significantly diluting any incentive on other Suppliers to detect theft and manifests itself in a lack of resources and management focus committed to theft detection, a fact evidenced by their poor detection rates. Conversely, our good detection rates demonstrate how resourcing and management focus will be dedicated to theft detection if meaningful commercial incentives exist.
18. The second reason why there is a general lack of investment in theft detection is that resolving gas theft is both difficult and expensive. Gas can be stolen in ways which leave no trace of the theft and many types of theft can be made good in a matter of seconds, meaning that Suppliers need to spend both time and money catching the customer in the act. A good example of this, and a situation commonly found, is the use of substitute meters which capture the majority of consumption before being exchanged back out by the culprit before a meter reading visit. This type of theft can be corrected in less than thirty seconds without leaving any markings on the "official" meter. Another notable example is the way in which the gas

² As outlined in Modification Proposal 0228, we believe that the theft of gas costs the UK customer £220m a year,

³ All figures taken from the monthly xoserve Theft of Gas statistics for 2009.

prepayment meter housing can be interfered with a piece of plastic so that it passes unlimited gas. The tamper can be inserted and removed instantaneously without leaving evidence behind. Detecting this type of theft takes more time, effort and costs than simply visiting the site.

19. It also follows, therefore, that simply obligating Suppliers to tackle theft without incentives being placed on the results they generate will not work as it will be very easy for them to make a “token” effort to achieve compliance without actually making progress.
20. The xoserve Theft of Gas statistics bear this out, demonstrating that those Suppliers without strong commercial incentives to take on the scale of work required to tackle gas theft Suppliers simply do not take any action. Whether Ofgem eventually choose to involve a centralised NRPS as part of the theft reform solution or not therefore, it is imperative that supplier output based solutions are agreed now, else we will continue to face a situation where Suppliers are able to make a commercial decision not to genuinely tackle theft on their portfolio.

Why would the Supplier Energy Theft Scheme (SETS) work?

21. The problem of theft reform has been assessed previously by both the ERA and ENA Theft of Energy Working Group in 2006 and UNC Review Group 0245 in 2009. The former found that “*the present arrangements for electricity and gas do not provide economic reasons for optimal behaviour by industry participants*”⁴ whereas the latter found that “*there is merit in the development of Shipper/Supplier incentive schemes to drive an increase in the volume of theft of gas incidents detected*”⁵.
22. The ERA and ENA Theft of Energy Working Group report went on to set detail the Supplier Energy Theft Scheme, or SETS, as an option for reform. It was found that as the scheme redistributed cost to those poor performers in theft detection, and that as “*passing on the costs of poor performance to end consumers leaves participants at a commercial disadvantage*”, SETS would remove “*the disincentives to prevent, detect and investigate theft*”⁶. We concur with these findings, and have expanded on them below, however, the ERA and ENA report specifically found that the SETS⁷
 - a) would change the way in which theft was detected in the industry, increasing theft detection volumes; “*help lead the industry as a whole to become more proactive in preventing, detecting and investigating theft*”,
 - b) did not have complex administration; “*the administration of (SETS) is not onerous*”.

⁴ ERA / ENA Report of Theft of Energy Working Groups (April 2006), page 3

⁵ UNC Review Group 0245 Report, page 5

⁶ ERA / ENA Report of Theft of Energy Working Groups (April 2006), page 67

⁷ All quotes from the ERA / ENA Report of Theft of Energy Working Groups (April 2006), pages 68 and 69.

- c) would improve safety; *“There would be no degradation of the current arrangements and through an increase in ‘seek and find’ activity safety should be improved further”*,
 - d) ensured fairer cost allocation; *“costs and benefits would be directly attributable to the poor and better performers in proportion to that performance. This is transparent and easy to understand”*.
 - e) provided an incentive to detect theft; *“rewards better performance and penalises poor performance”*.
 - f) was low cost; *“is self financing: total credits will equal total debits”* and that *“it is simple to administer with current data”* and *“does not in itself result in price rises in either transportation charges or charges to end-users as in the Reasonable Endeavours Scheme”*,
 - g) was a familiar concept to the industry having been used in other areas; *“Gas suppliers are familiar with the concept (as in EBI and Filter Failure Liabilities)”*, and
 - h) that it would specifically drive proactivity; *“It would produce competition between participants, leading to more proactivity in the pursuit of theft of gas cases”*.
23. This was echoed in UNC Review Group 0245, whose final report recommended that *“Suppliers investigate and implement an incentive scheme that promotes the investigation of theft of gas incidents”*. Whilst this did go on to reference the development of either SETS or the National Revenue Protection Service (NRPS) we note with disappointment that the latter proposal has now been explicitly developed so as to exclude any incentives.
24. By providing commercial Shippers with a financial incentive to detect theft on their portfolio in the manner proposed by Modification Proposals 0277 and 0346, we expect any costs to be directly passed through to their contracted Suppliers. We, like the ERA and ENA, believe an incentive like this effect will deliver an increase in theft detection because *“passing on the costs of poor performance to end consumers leaves participants at a commercial disadvantage”*⁸ thus “nudging” Parties to take a course of action which is beneficial for both customers and the market, and would not ordinarily have been taken were Suppliers left to their own devices. Crucially, as payments under the SETS are only made for confirmed results Suppliers will be driven towards taking genuine steps to tackling theft rather than simply doing what is necessary to comply with a future obligation to either detect theft or facilitate a third party’s detection of theft, as in other alternative proposals.
25. If each Shipper or Supplier followed our lead on theft and found similar levels of theft on their portfolio as we have done, proportionate to their market share of Supply Points, we estimate that over 2100 extras cases of theft per annum would be detected⁹. We consider the benefits of stimulating competition in Revenue Protection, with appropriate safeguards, will lead to an increase in

⁸ ERA / ENA Report of Theft of Energy Working Groups (April 2006), page 67

⁹ Based on British Gas continuing to detect 1675 cases of theft per annum and this level representing over 40% of the total theft detections made in the market. Our conclusion is that if everyone matched our performance, over 3800 cases of theft per annum would be found by the industry. This is more than 2100 more than the current 2017 detections each year.

innovation and invention in approach as participants seek to stay ahead of their competitors. We also consider that competition will drive lower marginal costs associated with theft detection as more Suppliers come to the market, greater discipline on Shippers and Suppliers to keep costs down, improvements in quality of Revenue Protection provision from providers, all of which will have consequential benefits for customers. Each of these are accepted economic benefits associated with the introduction of competition in to a market.

26. In support of the SETS, we can point to examples where incentives have already driven results in areas such as theft. In the electricity market for example, theft was historically managed in much the same way as the current Gas Forum National Revenue Protection Service (NRPS) proposal intends to do, by placing obligations on the regional Revenue Protection monopolies to provide centralised services for all Suppliers in the detection of theft. This model was subsequently dropped in 2005 in favour of an incentive approach to detecting electricity theft (the Losses incentive), which resulted in significant investment in theft detection processes from a number of Network Owners.
27. We also note that in the electricity market that whilst the incentives were placed on the Network Owner, there were no obligations to facilitate this detection placed on the Supplier. The result of this according to at least one Network Owner¹⁰ was a lack of co-operation in resolving electricity abstraction as Suppliers seek to avoid the expense this entails. This has led to these Network Owners calling for these incentives to be shared with Suppliers.
28. Although we fully support both of these Proposals, we have a preference for Modification Proposal 0346 as this places a stronger incentive on commercial Suppliers, whose inaction poses a higher risk to the market in terms of cost than domestic Suppliers due to the volume of gas demand passing through their portfolio.
29. Modification Proposal 0346 is underpinned by a belief that theft is related to the volume of gas passing through a Shipper's portfolio, and that as that volume of gas demand increases so will the volume of theft. This is reinforced by our own experience of detecting theft across both the SSP and LSP sectors. In the period January 2010 to September 2010 for example, 57% of all theft volumes we detected were from the LSP sector, despite it representing less than 21% of our total gas demand. The conclusion we draw is that, even when adjusting the results to take account of the larger demand LSP sites have, LSP theft volumes are over *six times* greater than SSP theft volumes. Our full workings have been provided as part of this consultation response under separate cover to Ofgem.

¹⁰ United Utilities letter to Suppliers dated 4th February 2007 stated "*The number of leads passed to our Revenue Protection team for investigation has declined dramatically in recent years and we now receive only about 5% of that figure in a year. We continue to be proactive in seeking evidence of illegal abstraction, but are greatly hampered by the poor contribution from suppliers and their agents*" and called for an incentive scheme to address the issue.

30. We recognise some may argue that the full evidence required to support our assertions will only come once the Allocation of Unidentified Gas Expert (AUGE) publishes their initial methodology and have therefore also proposed Modification Proposal 0277 which allocates incentive payments and charges on a market share of Supply Point basis; ensuring that Suppliers are incentivised to invest a sufficient amount of money to provide theft detection coverage for their size of portfolio. Although we have a preference for Modification Proposal 0346 for the reasons given above, we believe that both proposals would provide real and lasting reform to the way in which theft is detected in the UK gas market.
31. In addition, we argue that a major benefit of the SETS is that it is comparatively cheap for the industry, and therefore for customers, to implement and run. Aside from the investment in Revenue Protection services which will result from its implementation, the net cost to the consumer will simply be the administration costs of the scheme and the cost of an annual audit, estimated by xoserve to be no more than £80k per annum. In contrast with other proposals, there are no new companies to be created, no new governance structures or layers of regulation to be funded, no new system development and no large extracts of data to be paid for. In short, with the exception of the administration and audit costs, both SETS models are self-financing, presenting a zero net cost to consumers.
32. Furthermore, we also consider that the governance required to operate the SETS is minimal. Rules which obligate Suppliers to notify the GDNs of theft they have found are already in existence, thus ensuring SETS can continue to provide an industry wide view of theft, and the processes and systems needed for the GDNs to receive and track performance are well established.
33. In devising these proposals we also recognise the existence of an already competitive Revenue Protection market, and rather than seek to foreclose it, seek to bolster it by incentivising other parties to enter the market either as Suppliers directly entering the market or as new service providers seeking to meet an increase in demand. Currently this market is not operating effectively due to a lack of demand from Suppliers, a problem which these Proposals would address.
34. We also recognise that in introducing commercial incentives such as SETS, controls must also be introduced so as to provide appropriate protection for consumers from the risk that Suppliers will pursue theft at any cost. In particular we consider that it is vital that some form of independent oversight over the process exist so that Suppliers cannot abuse the system with spurious claims of theft detection. Not only does this protect the consumer from false accusations, but as one of the tests which the auditor will be assessing Suppliers against is the Gas Act itself, it also provides Suppliers with a further incentive to ensure that their actions are legally compliant, and that any theft detection is fully evidenced. Any failures in this regard will, under these Proposals, impact the balance sheets of those Suppliers directly. We consider this to be a marked improvement on the current process where

there is no oversight of Suppliers' activities, other than that provided by the Regulator and Consumer bodies in response to individual complaints.

35. Furthermore, we believe the direct requirement for any submitted Supplier theft detections to be audited against the proposed Theft Code of Practice¹¹ will ensure that Suppliers have not only followed agreed industry practice, but have executed those theft detections in a way which treats customers fairly and appropriately. The effect of this provision is such that financial penalties will apply to those who fail to do this, removing any possible incentive on Suppliers to behave inappropriately. It is notable that the draft Theft Code of Practice contains safeguards to ensure that vulnerable customers are fairly treated, and thus these Proposals will have a consequential benefit on the way in which the vulnerable are treated by Revenue Protection providers.
36. British Gas accepts that the existing controls within the mandatory Daily Metered (DM) market mean that it is unlikely that theft occurs there, and that as such considers it right that the scope of both these Proposals excludes mandatory Daily Metered sites from their scope. The effect of this is that those Suppliers and Shippers who operate exclusively in this market are not affected by it, and those Suppliers and Shippers who act outside this market are only affected to a degree proportionate to their scale of presence.
37. British Gas also accepts that the very smallest Suppliers and Shippers¹² are already able to appropriately manage the sites on their portfolio, and that the impact of the SETS on them may be disproportionate. We have therefore included in each Modification Proposal measure which mean that they will be completely excluded from the SETS. Notwithstanding this however, we are mindful of the existing ability of any party to "buy-in" Revenue Protection services which meet their needs rather than bringing these services in-house themselves. This is of particular benefit to those Suppliers operating nationally but with geographic biases to their portfolio.
38. We understand that some may try and argue that the SETS will force Shippers and Suppliers to pay for Revenue Protection services twice; once in terms of the capital and operational expenditure associated with policing their portfolio and then again through SETS if they detect no theft. As we have argued above however, without proper commercial incentives such as the SETS, a decision to make capital and operational expenditure will not happen. Furthermore, our experience demonstrates that once the commercial incentives are in place and investment has been made, theft will be found meaning the risk identified will not materialise.
39. The only reason a Shipper or Supplier would be penalised under the SETS is that their theft detection performance was comparatively poor and thus had driven cost in to the industry through undetected theft. Under these

¹¹ This is currently being developed by DCUSA Working Group 054. A link to their website can be found [here](#).

¹² Defined as a Shipper whose market share of Supply Points (MOD0277) or market share of aggregate AQ (MOD0346) is zero when calculated to four decimal places.

circumstances, we consider a results based incentive to be entirely appropriate.

40. We are also mindful of the argument some raised in the development of these Proposals that these Proposals would provide a windfall to any Supplier with an already established Revenue Protection business, and in particular British Gas. We would therefore like to take this opportunity to make it absolutely clear that these proposals have not been raised in order to secure a short-term gain from any SETS fund, and that we are purely motivated by incentivising others to follow our lead and tackle theft on their own portfolio.
41. To this end, we have freely volunteered to enter in to a Windfall Avoidance scheme whereby we exclude ourselves from the scheme entirely in the first two years so that we cannot benefit from our existing investment. This will allow all Suppliers a full two year period to either establish or procure the expertise necessary to manage theft on their portfolio such that in the third Scheme Year all Suppliers may compete on a level playing field.
42. We understand that some Suppliers have argued that this is nothing more than a deferral of a windfall for British Gas, but note that this would only be the case were all other Suppliers to make no further investment in the first two Scheme Years. Whilst we believe that it would be entirely fair for us to benefit from the SETS in the third year under this scenario, we believe that this risk in itself is an extra incentive on those Suppliers to invest in theft detection activities post-implementation.
43. We are also aware that some Suppliers argue that gas theft will vary between different geographies and customer types and that some Suppliers will therefore be disadvantaged by the SETS if they possess a “cleaner” portfolio than others. Whilst we accept that the prevalence of theft will not be *precisely* the same across all Shipper portfolios, our experience as a national Revenue Protection service provider however has shown that theft occurs in all parts of the country, in domestic and non-domestic properties, across all customer types and income bands.
44. Whilst an incentive which does not specifically account for the slight variations between theft prevalence across different portfolios is not statistically perfect, we consider the impact of this to be, if not nothing then, marginal and even insignificant when compared to the overall benefit delivered from an increased in theft detections. Above all, we contend that this would be a significant improvement over both the current arrangements and the arrangements considered by the current NRPS proposal.
45. We also note that the monthly xoserve Theft of Gas statistics show that theft of gas leads are provided to all Shippers in a relatively even distribution, despite the fact that not every Shipper responds to them. Finally, we note that the same statistics show that we received approximately 33% of all leads during 2009 yet represented over 40% of the market, demonstrating that our efforts in recent years has meant that it is our portfolio which is “cleaner” than

other Suppliers and that there will be sufficient theft on other portfolios for those Suppliers to detect under a SETS model.

46. We are also aware that some have tried to argue that by creating incentives on Suppliers to detect theft, customers will be disadvantaged as those Suppliers focus on the rewards theft detection may bring rather than on treating the customer fairly. Whilst we point out that Supplier's activities in this area are subject to primary legislation and that compliance with the Gas Act is a matter of the utmost importance. We recognise however that controls need to be put in place to ensure customer treatment is standardised and as such these proposals contain measures to ensure compliance with both the Gas Act and any future Code of Practice.
47. We are also aware that some opponents of these Proposals have tried to argue that these Proposals will disincentivise Suppliers from notifying competitors of theft on their portfolio they may come across. We reject this argument in its entirety and do not accept the assertion that Suppliers would be so negligent as to leave an unsafe and explosive situation unreported. Nevertheless, we welcome the moves to ensure that the draft Theft Code of Practice places obligations on Suppliers to not walk away from situations like these without notifying someone, and note that such inclusions will have the effect of ensuring that those under the SETS will be financially penalised for doing so. We will also be working to ensure that information about active investigations is not lost during the change of supplier process, again ensuring that the SETS, when combined with the Theft Code of Practice, provides a complete solution.
48. We believe that some non-domestic Shippers may try to argue that their ability to refuse to take on customers with poor credit records indemnifies them from the risk of acquiring anyone who will go on to steal. Again, we reject this argument entirely and from our own experience know that there is no link between credit worthiness and propensity to steal. Even if we were to accept such a link existed, the fact that the credit assessment for the customer is only as good as the day they acquire the site, and is then subject to change immediately makes it entirely appropriate that non-domestic Shippers are equally incentivised to manage theft on their portfolio.
49. We also understand that some may try and argue that the SETS will somehow increase the costs to consumers by not capping the amount of investment Suppliers make in theft detection. Such an argument would fail to appreciate the effect of the SETS would be to incentivise Suppliers to invest up to the limit of the Scheme itself. Commercial decisions could be made to invest more than that amount, but that would be a decision for each party to make in their own right.
50. Finally, we are also aware that some have attempted to argue that under our Proposals Suppliers could simply choose to take the cost of the SETS scheme without actually investing in theft detection activities. Again, we reject this argument and point out that, as the ERA and ERA found in their 2006 review that *"passing on the costs of poor performance to end*

consumers leaves participants at a commercial disadvantage” and that in a competitive market, Suppliers will make the choice to invest in theft detection rather than be at a disadvantage.

Why can an alternate in its' own right not work?

51. Gas theft is difficult to detect and, unlike electricity abstraction, it is easy for a thief to steal in such a way so as not to leave evidence. Once installed, a tamper may be removed within seconds. For example, one of the commonest forms of gas theft we encounter involves substituting the real meter for an alternative meter, a method which can be corrected within thirty seconds using techniques which leave no mark upon the equipment on site. This example is by no means unique and thus it is vital to catch thieves in the act. Simply obligating Shippers or Suppliers to engage in theft detection activities or facilitate a third party to do it on their behalf will not deliver results because it is both easier and cheaper not to make the extra expenditure required to really tackle theft, with proper intelligence on where theft may be occurring, on employing experienced and qualified Revenue Protection investigators, working with the courts to get “no-notice warrants” and on completing a full and detailed investigation when on site.
52. We are aware that alternative proposals are being developed outside industry change processes by The Gas Forum which seek to establish a regime which will allow just this eventuality to arise however. The fact that the National Revenue Protection Service (NRPS) being developed by those Shippers who continue to invest little in theft detection activities explicitly does not contain any output based performance incentives demonstrates to us that incentives are the very thing which are required. Indeed, we proposed an alternative version of the NRPS which had a performance based incentive measure within it which, if the NRPS concept was effective in tackling theft, would have benefited those Suppliers who opted in over those who opted out. The fact that this proposal was summarily rejected by these Shippers suggests either a lack of conviction in the effectiveness of the NRPS model or a lack of real intent to implement it.
53. We believe that a centralised Revenue Protection body could add value in providing services which Suppliers individually cannot do, for example, providing industry management information on the what, what, where and how of theft, provision of a national tip off line¹³, a register of stolen meters, passing information about in progress investigations during a change of supply, co-ordinating efforts between other agencies and providing a forum for best practice to be shared. Optional services such as provision of a Revenue Protection service to those Shippers unwilling to invest in their own provision could also be offered.
54. We are disappointed the NRPS proposal currently being developed by the Gas Forum does not include many of these activities within its scope and

¹³ We note the success of the Benefit Fraud hotline managed by the Government and believe that a similar co-ordinated effort in the energy industry could bring similar rewards.

instead focuses on providing activities which Suppliers are able to complete today – assuming they had the will to – in advance of any regulatory reform.

55. Indeed the very inclusion of these extra services considered by the Gas Forum NRPS proposal mean that Supplier action to tackle theft of gas is unlikely before 2015. Before the centralised Revenue Protection body considered by that group could be operational the industry will need to create a new limited company to undertake the activities, obtain ministerial approval to foreclose the existing Revenue Protection market and create a monopoly service provider in its place, implement Supply Licence Condition changes, establish a new industry “Theft Code”, complete a tender process under European “OJEU” rules, recruit and train staff for the NRPS, build or procure systems capable of handling data on all 21.6m sites in the country and deliver IS changes within every Supply business to then extract and populate that system both initially and on an ongoing basis.
56. The conclusion we draw is not only that an incentive regime such as the SETS must be at the heart of any solution, but that in any eventuality the SETS must be implemented as soon as possible if the industry wants to see any immediate action on the part of Suppliers to address gas theft.
57. As we have mentioned above, gas theft is difficult to detect and thus, by definition, quite easy not to detect. Were incentives not to form part of the overall theft reform solution, then the desire to keep minimise exposure to the costs of theft detection which we have seen from other Suppliers would manifest itself in a tick-box compliance exercise where they did just enough to achieve compliance without actually making the extra effort required to actually find theft. Even under a model where a centralised Revenue Protection service provides mandatory detection activities on behalf of all Suppliers, without incentives parties would be incentivised to manage down the operational costs of the service provider, limiting its effectiveness.
58. As we have stated in other fora, we believe a centralised Revenue Protection body can add value in providing services which Suppliers individually cannot do, for example, providing industry management information on the what, what, where and how of theft, provision of a national tip off line¹⁴, a register of stolen meters, passing information about in progress investigations during a change of supply, co-ordinating efforts between other agencies and providing a forum for best practice to be shared.
59. We also believe that the centralisation of services which can be adequately provided by the competitive market is unnecessary. Services such as provision of a Revenue Protection field service, data analysis, debt collection, prosecution, settlement reconciliation and ongoing monitoring should only therefore be provided by a centralised body on an optional basis for those Suppliers unwilling to provide their own.

¹⁴ We note the success of the Benefit Fraud hotline managed by the Government and believe that a similar co-ordinated effort in the energy industry could bring similar rewards.

60. As we detailed in paragraph 8, the very inclusion of the some services in the current Gas Forum NRPS model necessitate a lengthy development meaning that Supplier action to tackle theft of gas is unlikely before 2015. The conclusion we draw is not only that an incentive regime such as the SETS must be at the heart of any solution, but that the SETS must be implemented as soon as possible under any eventuality in order to generate some immediate action on the part of Suppliers to address gas theft.

What does a future solution look like?

61. As we have said above, we believe that incentives are an integral part of the theft reform solution, regardless of Ofgem's view about an NRPS. Without them, Shippers will continue to take steps to achieve the bear minimum to achieve compliance rather than focusing on delivering results. This may mean that the SETS is implemented initially with a centralised National Revenue Protection Service of the form described in paragraph 53 implemented as soon as possible afterwards, once all the necessary steps have been taken to create it.
62. This would have the benefit of driving forward reform on theft immediately, with consequential safety and cost benefits, whilst still allowing the benefits that centralising the services that the competitive Revenue Protection market cannot adequately provide at a later date.
63. Indeed, we believe the SETS proposals could be easily modified in future to take account of such a development, potentially with payments in and out of the incentive fund for those using the NRPS being socialised across all users of the NRPS such that no one party was disadvantaged by the arrangement.
64. British Gas also believes that, for the reasons given above, that these Proposals meet a number of UNC Relevant Objectives, help Ofgem meet their Primary Duty to protect the interests of customers, and have significant environmental benefits, as follows.

(c) so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

65. This modification will provide Shippers with a commercial incentive to detect theft on their portfolio by linking costs and benefits to their performance. As commercial organisations these costs will be passed through to their contracted Suppliers; the parties with the ability and customer relationship necessary to make the detections. In a competitive environment such as the energy supply market the potential costs, being calculated at a sufficient level to provide for an adequate Revenue Protection service (see above), will make it commercially important to detect the theft on their portfolio, with benefits payable for results only.
66. The consequence of this modification therefore will be an increase in the amount of theft detected by Suppliers. By incentivising the detection of theft of gas, and thus increasing the amount of theft detected, there should a more

efficient operation of the pipe-line system through the prevention of unsafe interference in the system that all theft represents.

67. By placing an incentive on Shippers to invest in theft detection, and thus increasing investment in detecting theft, there will be a consequential increase in the amount of upstream theft detected and referred to the Network Owner. There are also significant costs associated with handling the fall out from downstream theft, for example but not limited to, instances where downstream theft is not detected and results in damage to the pipelines system which must be put right. Also, if the networks have more accurate or complete information about where and how much gas is being taken, this may lead to more effective investment decisions. To the extent that downstream theft leads to inaccurate information and is by its very nature inefficient, this modification should increase the amount of theft detection, across the Network, more accurate demand information should be available and the margin of error should be reduced, enabling the Network Owner to better comply with their obligations.
68. In the course of detecting theft, Suppliers should often find instances where theft has occurred upstream of the Emergency Control Valve, and is therefore “in the course of conveyance”, as referred to in paragraph 9(1), Schedule 2B of The Gas Act (1986). As this modification proposal should increase the volume of theft detected, and considering suppliers existing obligations to notify such theft to the Network Owner, it should also create a marginal increase in the volume of upstream theft detected by the networks, improving the efficiency with which they meet their obligations under Standard Licence Condition 7.
69. In particular, we note that as Suppliers will not be able to distinguish between upstream and downstream theft until they are on site resolving the matter, any incentive on detecting downstream theft will have a consequential positive impact on the amount of upstream theft detected and reported to the Network Owner¹⁵ for resolution. This will thus enable the Network Owner to better comply with their obligations.
70. Also, providing incentives for the detection of theft, individual instances of theft will be detected sooner than in a market with no incentives. This earlier detection of theft will avoid the potentially greater damage to the network that long term theft risks, for example through explosions. This modification will therefore also enable the Network Owner to better comply with their obligations.
71. Finally, theft is by its very nature inefficient and results in a lack of information flowing about where gas is being used. As this modification will increase the amount of theft detected, better information will be available and the margin of error will be reduced, increasing the efficient and economic operation of the pipeline system.

¹⁵ As per the Supplier obligation under Supply Licence Condition 16)

(d) so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition between relevant shippers and between relevant suppliers;

72. This modification will provide Shippers with a commercial incentive to detect theft on their portfolio by linking costs and benefits to their performance. As commercial organisations these costs will be passed through to their contracted Suppliers; the parties with the ability and customer relationship necessary to make the detections. In a competitive environment such as the energy supply market the potential costs, being calculated at a sufficient level to provide for an adequate Revenue Protection service (see above), will make it commercially important to detect the theft on their portfolio, with benefits payable for results only. The consequence of this modification therefore will be an increase in the amount of theft detected by Suppliers.
73. By reducing theft and correcting the apportionment of misallocated energy, costs should be correctly apportioned across those who drive costs into the market, therefore improving competition. Currently the costs of theft in the market are borne solely by SSP suppliers based on their market share. This is inequitable and disadvantages those shippers in the SSP market who invest in resolving theft on their portfolio. By ensuring that the costs associated with theft are assigned to those Shippers who perform poorly in terms of theft detection, thus driving costs in to the market, costs will be more fairly assigned, and competition between shippers and Suppliers will be improved.

(e) so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards are satisfied as respects the availability of gas to their domestic customers;

74. This modification will provide Shippers with a commercial incentive to detect theft on their portfolio by linking costs and benefits to their performance. As commercial organisations these costs will be passed through to their contracted Suppliers; the parties with the ability and customer relationship necessary to make the detections. In a competitive environment such as the energy supply market the potential costs, being calculated at a sufficient level to provide for an adequate Revenue Protection service (see above), will make it commercially important to detect the theft on their portfolio, with benefits payable for results only. The consequence of this modification therefore will be an increase in the amount of theft detected by Suppliers.
75. To the extent that theft is one cause of unidentified gas, theft distorts the information Transporters receive on how much gas is used, how much gas is needed and where that gas is needed. Thus theft has implications on Transporters ability to effectively plan for seasonal gas demand. By increasing the incentives associated with theft detection as this modification does, Transporters will gain a better understanding of where gas demand is, and how much it will be, thereby increasing the licensees ability to plan for seasonal gas demand.

Ofgem's Primary Duty

76. Ofgem's Primary Duty is to "*to protect the interests of consumers, where possible by promoting competition*"¹⁶. We consider that as, for the reasons given above, both Modification Proposals 0277 and 0346 will increase theft detection volumes, there will be a consequential benefit to consumers in terms of improved safety and lower costs as less unidentified gas is created.
77. We consider that this is in direct contradiction to the alternate proposals being developed which place no incentive on Suppliers to do more than is necessary to achieve compliance and actually defer reform for another four years. We therefore believe that not to implement either Modification Proposals 0277 or 0346, and to allow the status quo to persist until 2015, would work directly against this duty.
78. We also consider that the fact that both Modification Proposals 0277 and 0346 tackle theft reform by improving the existing competitive Revenue Protection market rather than by foreclosing it as others have called for, aids the second part of the duty, "*by promoting competition*". As above, we consider that these Proposals will lead to an increase in the number of entrants in to the Energy Revenue Protection market by incentivising Suppliers to either enter the market or source services from elsewhere.

Environmental Benefits

79. Finally, British Gas considers there are significant environmental benefits associated with each of these Proposals.
80. This modification will provide Shippers with a commercial incentive to detect theft on their portfolio by linking costs and benefits to their performance. As commercial organisations these costs will be passed through to their contracted Suppliers; the parties with the ability and customer relationship necessary to make the detections. In a competitive environment such as the energy supply market the potential costs, being calculated at a sufficient level to provide for an adequate Revenue Protection service (see above), will make it commercially important to detect the theft on their portfolio, with benefits payable for results only. The consequence of this modification therefore will be an increase in the amount of theft detected by Suppliers.
81. When theft occurs it is not done efficiently. Thieves are not affected by the same drivers as other customers, for example price and carbon reduction. Indeed, we regularly find that thieves will leave their heating on for 24 hours each day, thermostats set at the maximum possible temperature, and kitchen hobs burning to heat kitchens. This modification proposal will deliver an increase in the amount of theft detected, and therefore reduce the amount of inefficient gas usage in the UK, with a consequential reduction in emission levels.

¹⁶ <http://www.dti.gov.uk/files/file32549.pdf> page 2.

82. Furthermore, where theft occurs, industry parties are unlikely to know how much gas is being used or who is using it. They are therefore unable to target carbon reduction communication and measures at those responsible, for example measures available under Carbon Emission Reduction Target (CERT) measures. As this modification will lead to an increase in the amount of theft detected, and therefore an improvement in the quality of information on who is using what, Suppliers will be better able to help reduce the carbon emissions of consumers.