

Modification proposal:	Uniform Network Code (UNC) 231V: Changes to the Reasonable Endeavours Scheme to better incentivise the detection of Theft (UNC231V)		
Decision:	The Authority ¹ has decided to reject this proposal		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	26 March 2012	Implementation Date:	N/A

Background to the modification proposal

Theft of gas² 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 the efficient functioning of the market. Improving the arrangements to detect and prevent theft should improve the safety of the gas networks and reduce the costs to consumers associated with the value of stolen gas and the costs incurred by suppliers to detect and prevent theft.

Suppliers incur costs in detecting theft³. Where a supplier is not able to recover its costs from the customer, this may act as a disincentive to investigate gas theft. Our analysis⁴ suggests that shippers, in particular in the Smaller Supply Point⁵ (SSP) market have commercial disincentives to detect theft.

A scheme is currently in place to compensate a supplier where it identifies an incidence of gas theft, but where the supplier is unable to recover charges to which it is entitled from a customer. The aim of this scheme is to remove this disincentive so that suppliers are not unduly impacted by investigating theft of gas.

This compensation scheme is established under the Gas Transporters' licence⁶. Gas transporters are required to set out the steps that a supplier must undertake before a compensation payment can be made and to send this to the Authority for approval. This is known as the Reasonable Endeavours Scheme (RES). These actions include taking a number of steps such as identifying the relevant customer, requesting payment and offering a range of payment methods, and disconnecting if such payment arrangements are not entered into.

The amounts of compensation that a supplier may receive are determined under the Reasonable Endeavours Allowances Scheme (REAS). This scheme is designed by 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.

² We have used the term "theft" as a simple way to describe a number of offences under schedule 2B (paragraphs 10 and 11) of the Gas Act 1986 where a customer prevents a meter from correctly registering the amount of gas supplied, has damaged equipment or reconnects the supply without the relevant permission.

³ These include the cost of the investigation and any meter replacement. LSP shippers will also incur energy and transportation charges if the Annual Quantity (AQ) value is adjusted once the amount of theft is declared to the gas transporter.

⁴ See our decision document Tackling Gas Theft: Way Forward, March 2012 at <http://www.ofgem.gov.uk/Markets/RetMkts/Compl/Theft/Pages/Theft.aspx>

⁵ A SSP is a supply point with an annual consumption of less than 73,200kWh (2,500 therms).

⁶ Set out in Standard Licence Condition 7 of the Gas Transporters licence available on the Ofgem website: <http://epr.ofgem.gov.uk/index.php?pk=folder132277>

Authority. The REAS allows for two different compensation values to be paid by to the shipper⁷:

- A reduction in any shipper charges that the gas transporter would have levied for the amount of gas illegally taken; and
- A further reduction to a shipper's transportation charges equivalent to the costs associated with the theft investigation.

The modification proposal

UNC231V was raised by British Gas in October 2009. It aims to amend the supplier compensation arrangements that are currently in place for the detection and investigation of theft of gas.

UNC231V proposes to move the RES into a UNC Related Document⁸ and therefore under UNC governance, and to incorporate relevant parts of the REAS into the UNC.

UNC231V specifies that, for the current allowances where the level of compensation available to suppliers is fixed, these should be changed to a capped amount. UNC231V further proposes to increase the current levels of compensation payable to suppliers to improve incentives to detect and investigate theft of gas. This would typically increase the amount payable under each allowance from a fixed value of £125 or £250 to a capped value of £1,000. Suppliers would retain the ability to claim for multiple allowances for a specific theft case.

UNC Panel⁹ recommendation

At the UNC Panel meeting held on 21 January 2010, of the 10 votes cast, five votes were cast in favour of implementing UNC231V. The UNC Panel therefore did not recommend implementation of the proposal.

Ofgem consultations on UNC231V and Tackling Gas Theft

In December 2010 we published a consultation¹⁰ on UNC231V and set out our minded to position to approve UNC231V. We received 11 responses to our consultation.

In August 2011 we published a consultation and draft impact assessment on tackling gas theft¹¹. This consultation considered proposals to put in place an improved framework for theft detection. In this consultation we said that we would consider UNC231V alongside other proposals for reform¹².

⁷ This payment is made by the GT to the supplier. The GT is then permitted to recover these costs by adjusting its transportation charges.

⁸ UNC Related Documents are support documents to specific sections of the UNC, usually complementing and/or providing further details to the relevant section.

⁹ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

¹⁰ Reducing supplier disincentives to detect and investigate and gas theft, Ofgem, December 2010.

¹¹ See our consultation document Tackling Gas Theft: Consultation, August 2011 at <http://www.ofgem.gov.uk/Markets/RetMkts/Compl/Theft/Pages/Theft.aspx>

¹² We set out our concerns that the value of the incentive pots did not appear to be based on a robust methodology (and we note that the proposer set out an alternative approach in its response to our consultation). We also reflected concerns that, without a robust methodology for establishing and maintain the size of the incentive pot then this may lead to unwarranted distribution effects between suppliers and negatively impact on competition.

In March 2012, we set out our views on an alternative package of measures that should be adopted¹³. These measures include an incentive mechanism, a Theft Risk Assessment Service, a code of practice on theft investigations as well as other supporting measures.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 2 March 2010. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR¹⁴ and responses to the October 2010 and August 2011 consultations carried out by Ofgem.

The Authority has concluded that implementation of the modification proposal will not better facilitate the achievement of the relevant objectives of the UNC¹⁵.

Reasons for the Authority's decision

We have considered this modification in the wider context of our consultations on improving the current Theft of Gas arrangements.

We consider that, in isolation, this modification may better facilitate relevant objectives (a) and (d) and is in line with our statutory duty to protect the public from dangers relating to conveyance of gas, although without further complementary modifications, this effect may be marginal. We consider that this modification is neutral with respect to all other relevant objectives. However, when considered in the context of Ofgem's wider proposals for reform, we consider that this modification would not better facilitate relevant objective (f) and, on balance, should be rejected. Given the wider context, we do not believe that short-lived changes to the industry codes would be in keeping with the principles of better regulation.

Standard Special Condition A11.1(a) – 'the efficient and economic operation of the pipe-line system'

The proposer considers that, by removing disincentives on suppliers to detect theft, UNC231V would increase network efficiency by reducing the instances of unsafe interference. It also considers that increased theft detection would reduce the costs of dealing with the damage associated with gas explosions caused by unidentified gas theft.

We consider that increasing the level of compensation under UNC231V will improve suppliers' ability to recover costs associated with investigating theft and reduce financial disincentives. We agree that this is likely to have an effect in increasing theft detection and preventing the theft from continuing to occur. We agree that this is likely to have a positive impact on the safety of the network and the costs of dealing with the damage associated with gas explosions caused by unidentified gas theft.

However, it is our view that the steps that a supplier must undertake before a payment can be made continue to require considerable effort on the part of the supplier. This is

¹³ See Tackling Gas Theft: Way Forward, March 2012 at <http://www.ofgem.gov.uk/Markets/RetMkts/Compl/Theft/Pages/Theft.aspx>

¹⁴ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk.

¹⁵ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: <http://epr.ofgem.gov.uk/index.php?pk=folder590301>.

particularly the case when the identity of the customer is known. It is not clear from the proposal to what extent suppliers intend to make use of the revised compensation arrangement, although we note that limited use is made of the current arrangements. Typically this only occurs when the whereabouts of the consumer is unknown and the steps that a supplier must undertake to demonstrate that they have met the reasonable endeavours requirements are more limited. We therefore consider that it is uncertain whether UNC231V, without complementary changes to the RES, would in practice lead to greater theft detection and prevention.

Standard Special Condition A11.1 (c) - 'the efficient discharge of the licensee's obligations under this licence'

We note that UNC231V may increase the instances where a gas transporter is required to act under its licence requirements in relation to theft. However, this is not expected to improve the efficiency of the discharge of the licensee's obligation. We therefore do not agree with the proposer that UNC231V will allow gas transporters to better meet their obligations on theft in conveyance under SLC7 of their licences, and hence consider that this modification is neutral with respect to relevant objective (c).

Standard Special Condition A11.1 (d) - 'the securing of effective competition between relevant Shippers, between relevant Suppliers, and between Distribution Network operators and relevant shippers'

We consider that, by increasing the value of charges that may be recoverable, UNC231V would reduce supplier disincentives to detect and investigate theft. However, the actions that a supplier must demonstrate, particularly when the identity of the customer is known, are substantial. The extent to which UNC231V is expected to improve theft detection, investigation and prevention is unknown so the effect is potentially marginal.

To the extent that there is an increase in the volume of theft of gas detected and prevented, this is likely to reduce the level of unaccounted for gas. Consequently, we consider that this modification may help support effective competition between shippers and suppliers by leading to an improvement in the allocation of energy and more accurate targeting of costs.

More accurate information on consumption is likely to lead to more accurate AQ values. We consider that this may also help to secure effective competition between shippers and suppliers by improving the accuracy of the allocation of transportation charges.

We also consider that UNC231V may also improve transparency and the change control provisions by moving the arrangements to the UNC. In particular, moving the detail of the scheme into the UNC will provide shippers (and therefore potentially suppliers) with a direct role in any potential further changes to the process.

We note that under UNC231V, the maximum value of a claim has risen from £620 plus unlimited court fees to £4,000 plus unlimited court fees. We consider that the value of the payments made and quality of the audit provisions must be proportionate, as the compensation costs will be borne by customers. We also consider that the level of compensation should be consistent with the aim of the scheme. This aim is to reduce the disincentives that a supplier may have to investigate and recover charges from a customer. The evidence provided to us does not support an increase in the level of compensation under each claim category to the level proposed in UNC231V, although we acknowledge that costs in tackling theft will vary and that in certain circumstances they will be higher than the average figures presented to us.

The increase in available compensation and move from fixed rates to payments based on actual costs increases the focus on the audit provisions to ensure that the payments requested and made are accurate, i.e. based on actual costs, and that those costs are appropriate. The modification proposal does not refer to an audit process for these arrangements. The FMR confirms that xoserve¹⁶ will not be required to undertake any additional audit checks to those currently required. Xoserve has confirmed that, in relation to the current scheme, it requests evidence from suppliers to demonstrate that they have fulfilled the relevant actions in the RES before making a payment¹⁷.

For the reasons stated above, we consider that this modification may better facilitate relevant objective (d), although the impact is uncertain and may require further changes to increase the likelihood of the arrangements leading to an increase in theft detection. We note that such additional changes have not been included as part of this proposal.

Relevant objective (f) - 'so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code'

In our March 2012 Way Forward document, we set out principles for an incentive scheme to encourage theft detection that we consider should be developed through a modification to an industry code. We also set out our expectation that this amended incentive scheme should be in place by the end of 2012.

We have material concerns about the potential unintended consequences of operating the existing supplier compensation scheme in tandem with our proposed new incentive scheme. For example, it may allow a supplier to claim under both sets of arrangements and over-recover costs when theft is detected. In our March 2012 Way Forward document, we are therefore proposing to remove the current supplier compensation scheme by modifying the Gas Transporter's licence. We aim to do this to coincide with the introduction of the new incentive scheme.

We therefore do not consider that it would be efficient, in terms of the administration of the UNC, to accept UNC231V as we expect that it would only be in place for a short period of time. We also note that, for UNC231V to have a material effect over that interim period, it would require complementary additional changes to the RES to address concerns over the steps that suppliers would need to take to demonstrate that reasonable steps had been undertaken.

Summary

In the context of our broader reform package we do not consider that UNC231V should be implemented. We recognise that, by itself, UNC231V may have offered some benefits. However, we consider that only one incentive scheme on theft should be in place so as to reduce the potential for unintended consequences.

Colin Sausman

Partner, Smarter Markets

Signed on behalf of the Authority and authorised for that purpose

¹⁶ Xoserve is the agent of the GTs and carries out services on their behalf.

¹⁷ For example, xoserve may require evidence of Police notification, or a witness statement or report, or detail of Police attendance, or a crime reference number or any other supporting evidence.