ofgem
Making a positive difference
for energy consumers

Modification proposal:	**Supply Point Administration Agreement (SPAA) Change Proposals (SCP) 474: Update to Theft Target Split to Reflect Findings of Independent Review of the Theft Target Apportionment Methodology**		
Decision:	The Authority[1] has decided to reject this this modification[2]		
Target audience:	SPAA Parties, SPAA Panel and other interested parties		
Date of publication:	6 July 2020	Implementation date:	N/A

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.[3] We also set out principles for a theft detection incentive scheme, which subsequently formed the basis of CP14/268, which introduced such a scheme into the SPAA.[4]

Under the scheme, all licenced Gas Suppliers are allocated a proportion of an overall theft target, pro-rata to their share of both the domestic and non-domestic, or 'I&C' sectors of the market. Those suppliers who outperformed their target would be net beneficiaries of the scheme, while those who under-perform are net contributors.

The split between sectors was derived from data from the Allocation of Unidentified Gas Expert (AUGE) reports which attributed much of the prevailing unidentified gas consumption to theft, and further estimated that the sectoral split in such theft was 73:27 between the Larger Supply Point (LSP) and Smaller Supply Point (SSP) sectors, which broadly match the domestic:I&C split of the incentive scheme.

The modification proposal

Gazprom Marketing & Trading Retail Limited (the "Proposer") raised SCP474 on 5 November 2019. It aims to simply to revise the SSP:LSP ration of the theft target from the current 73:27 to 90:10 in line with the conclusion of a (as yet unpublished) report undertaken by BDO International, commissioned by the Theft Steering Group (TSG).[5] All other aspects of the theft incentive would remain unchanged by this proposal.

Change Board[6] recommendation

At its meeting of 14 January 2020, the SPAA Change Board voted to reject SCP474.

[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] 'Change' and 'modification' are used interchangeably in this document.
[3] See: [Tackling Gas Theft - New requirements for gas suppliers]
[4] See: https://www.ofgem.gov.uk/sites/default/files/docs/2015/10/cp14-268d_0.pdf
[5] Independent Review of Theft Target Apportionment Methodology: Data Science Reports for SPAA and DCUSA Ltd, March 2019.
[6] Change Board is established and constituted pursuant and in accordance with the SPAA.

Our decision

We have considered the views of the Change Board and the Change Report dated 14 January 2020 and have concluded that SCP474 will not better facilitate the achievement of the relevant objectives of the SPAA.[7]

Reasons for our decision

We note that although the change board recommend the rejection of SCP474, three of the four responses to the earlier consultation supported its implementation. Whilst neither the respondents to the consultation or the change board made specific reference to any of the SPAA objectives, based on the comments provided they appear to have agreed with the proposer that SCP474 should be considered against SPAA objectives (b) and (f). We agree that these are the relevant objectives, and that SCP474 would have a neutral impact upon the other SPAA objectives.

As the SPAA objectives are not hierarchical, we consider that SCP474 should primarily be considered against objective (f), as below.

(f) securing compliance with standard condition 12A: Matters relating to Theft of Gas

When we directed the implementation of the GTDIS in October 2015,[8] we stated that the parameters of the scheme, including the theft target, should be subject to a future review and determined on the basis of further evidence and analysis. Although the gas scheme was introduced in 2017, much of the underlying rationale is substantially older. As noted above, the AUGE report from which the prevailing 73:27 split is derived dates from 2015, while much of the other data comes from the Impact Assessment Ofgem produced in 2012.[9] We therefore welcome the fact that the TSG commissioned two independent reports. In addition to the March 2019 BDO report on the gas and electricity incentive schemes referenced in the SCP474 Change Report, we have also considered an April 2019 report,[10] also produced by BDO on other aspects of the theft arrangements. The summary findings of both reports which are relevant to the gas incentive scheme are annexed to this letter.

Given the above, we are sympathetic to the intent of the change proposal insofar as it seeks to give effect to one of the recommendations of the BDO reports. As noted by the proposer, the March 2019 BDO report suggested that the current 73:27 is not reflective of the actual likelihood of theft being detected in those sectors, and that a 90:10 split would be closer. However, one of the respondents to the SCP474 noted that the TSG had made no decision to endorse or give effect to the recommendations of the report. They also considered that as the analysis was based on historic levels of confirmed theft, it would contain an inherent bias. Another respondent, whilst supporting the proposal, was concerned at the lack of transparency over the data and methodology to produce the revised split in the theft target between domestic and non-domestic sectors.

Whilst we do not question the veracity of the BDO report from which this split is taken, these were based on the data available at that time, i.e. after only the first two years of

[7] As set out in Standard Licence Condition (SLC) 30.5 of the Gas Supplier Licence.
[8] See: SPAA CP14/268 'Introduction of the gas theft detection incentive scheme'.
[9] See: Tackling Gas Theft – Final Impact Assessment
[10] Independent Value for Money Assessment of the Theft Risk Assessment Service (TRAS) and the Energy Theft Tip-Off Service (ETTOS) - April 2019

the scheme. We note that the April 2019 report found that the relatively recent introduction of the incentive schemes made it hard to draw definitive conclusions as to their effectiveness. Without understanding and incorporating more of the underlying methodology into the theft target allocation, we are unable to conclude that the 90:10 split would produce a more equitable split of theft targets and incentives in future scheme years.

We accept that gas theft is likely to be much more prevalent in the SSP sector than LSP sector, even if solely due to the relative numbers of supply points in those sectors. Whilst we accept that the targets may be relatively harder to achieve for LSP suppliers to meet than SSP suppliers, as contributions to the scheme are also split along those lines, the scheme does not result in a redistribution of money between sectors. We also note that a single case of theft at a LSP could involve many times more gas than theft at a SSP, with commensurate cost being passed through to billing paying consumers. It therefore seems appropriate for Suppliers efforts to detect individual cases of theft to be proportionately greater in respect of LSPs.

We are also concerned that, like earlier proposed changes to the scheme, SCP474 seeks to make a piecemeal approach to redistribute some of the financial impact of the scheme, without providing evidence that this would improve its effectiveness overall. For instance, the BDO report suggested that there was some evidence of adverse distributional effects from the current scheme. Specifically, whilst the scheme appeared to provide effective incentives to larger suppliers, there was little or no incentives for smaller Suppliers. BDO considered that this may be partly due to the relevant capabilities of such suppliers and their revenue protection teams, but also because their theft targets were proportionately harder to meet. Whilst the schemes may therefore be achieving the overall objective of encouraging more theft to be found than would otherwise be the case, they may be leaving smaller Suppliers worse off.

The BDO report also highlighted a concern that had previously been raised by some Suppliers[11], that the schemes were structured in a way that rewarded only positive identification of theft, rather than efforts made on theft prevention and other detection methods associated with best practice.

We do not consider that it would be appropriate to focus solely on the split between SSP and LSP sectors without also considering whether the overall theft target is itself set at the right level to improve upon levels of detection, and whether the relative payments are sufficient to cover the costs of those investigations and reward good performance. Further work is being undertaken on this in conjunction with the TSG. We intend to consult on potential revisions to the incentive schemes building upon the work of the TSG, ahead of the schemes being transitioned to the Retail Energy Code. As part of this, we will undertake further assessment of each of the recommendations contained within the BDO reports and elsewhere. However, at present we share the concern of the respondents who considered that there is not enough evidence to suggest that the proposed 90:10 would either be more fair, or effective in tackling gas theft.

Given the above, we cannot conclude that the implementation of this proposal would better incentivise suppliers to detect and investigate theft, pursuant to SLC 12A of their licence.

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

Two of the respondents who supported the implementation of SCP474 considered that the change to the ratio would lead to the more accurate targeting of cost, but did not

[11] See: SPAA CP16/337 'Movement to a leads-based theft incentive scheme '

elaborate on why they considered this to be the case. The proposer considered that the current target ratio means that one (non-domestic) market sector has an "unrealistic" target, while allowing the other (domestic) sector to lessen theft detection activities without any penalty.

We accept that a ratio of 90:10 would be closer to the proportion of supply points within each sector and may well be indicative of the historic number of cases found in each. However, as noted above, this is not necessarily indicative of the relative value of energy stolen from each sector as the consumption at a non-domestic premise may be several order of magnitude greater than at a typical domestic premise. We therefore consider that it is appropriate for greater weight to be given to theft in the non-domestic sector.

Whilst we would agree that it is important that the theft target is set at an appropriate level to achieve the aims of the scheme, we do not consider that the target or the split of that target between the domestic and non-domestic sectors would have a redistributive effect. The current GTDIS scheme was designed with two distinct incentives pots in order to ensure that non-domestic suppliers were not liable for performance related payments to domestic suppliers and vice versa.

However the proposal does raise an important issue insofar as the relative ease with which suppliers can meet their performance targets. Whilst energy theft is present in the non-domestic sector, we understand that it is much more likely to occur in smaller non-domestic premises, rather than larger commercial and industrial sites. Given that suppliers generally focus on one or other end of the market, we accept that those with a predominantly industrial portfolio may find it proportionately harder to detect and investigate each case of theft, than those with a portfolio of small to medium sized business customers.

We would therefore be open to a further review of the theft targets with a view to further disaggregating them to better reflect the nature of the market. This would appropriately be done as part of the transition to the REC as noted above. We consider that this, together with a review of the individual rewards payable for each scheme may improve the effectiveness of the scheme as a whole.

Given the above, and the fact that the current value of the GTDIS is only £7m in its entirety, we do not consider that moving from a 73:27 ratio to the proposed 90:10 ration would of itself have a material impact on competition. We therefore do not consider that the implementation of SCP474 would further SPAA objective b).

Decision notice

In accordance with Standard Licence Condition (SLC) 30 of the Gas Supplier licence, the Authority has decided that modification proposal SCP474: 'Update to Theft Target Split to Reflect Findings of Independent Review of the Theft Target Apportionment Methodology' should not be made.

Arik Dondi
Head of Switching Arrangements

Signed on behalf of the Authority and authorised for that purpose

Annex 1: Summary of findings and recommendations, theft incentive schemes.

3. KEY FINDINGS

3.1. ISTT

BACKGROUND	
Assess the initial split of the targets between the Domestic Supply and I&C Supply market sectors.	
FINDINGS & IMPLICATIONS	**RECOMMENDATION**
3.1.1. FINDINGS • The initial theft split for Gas is not representative of reality; • the initial theft split for Electricity is not representative of reality; and • the Electricity split is closer to reality than the Gas split. It is therefore more likely that, in the future, we would observe the assumed Electricity split, than that we would observe the assumed Gas split; 3.1.2. IMPLICATIONS • For Gas, more theft is apportioned to Commercial than is found, which means the theft target for Commercial is too high (compared to what is found); and • given the visual evidence of the later months for Electricity, the theoretical split is closer to the observed.	1. A sensible suggestion for the Gas split could approximately be rounded to 90:10 Domestic:Commercial; and 2. leave Electricity as is, pending a further review at a later date. **MANAGEMENT RESPONSE** **Accept/Reject** **Action:** **Action Owner:** **Completion date:** [Or] **N/A**

4.4.4. SUMMARY OF FINDINGS, IMPLICATIONS & RECOMMENDATIONS – INCENTIVES TO DETECT THEFT

FINDINGS & IMPLICATIONS	RECOMMENDATIONS
• The GTDIS and ETDIS do not consistently provide incentives for all Suppliers to identify energy theft. There is evidence that they do provide additional focus for some larger Suppliers. However, they offer little or no incentive for smaller Suppliers, and effectively penalise them by draining financial resources which could otherwise be used directly for theft detection. • The methodology that determines the theft target for individual Suppliers (and therefore the extent to which it either rewards or penalises them based on the number of thefts they actually detect) appears equitable in some respects. Moreover, the methodology for gas is currently being refined. However, there appear to be a number of assumptions in both schemes requiring further refinement in order to reflect the complexities of the market. • The GTDIS and ETDIS are structured in such a way that they only reward outcomes (i.e. thefts identified) rather than theft prevention and detection measures and associated good practice.	14. SPAA and DCUSA should work with Ofgem to explore the possibility of providing segmented Gas and Energy Theft Detection incentive schemes that differentiate between the nature and size of different Suppliers' portfolios. 15. Building on the work carried out by BDO on the theft target apportionment methodology in 2019, SPAA and DCUSA should review more broadly the methodology used to determine theft targets. In particular it should take into account how factors other than the number of supply points – for example regional demographics, profile of customers served - might be correlated with energy theft. 16. SPAA and DCUSA should investigate ways in which the incentive scheme could be made to reward actual theft investigation activity and best practice, rather than narrowly focusing on outcomes in the form of thefts identified.

MANAGEMENT RESPONSE
SPAA / DCUSA management note these recommendations, and will consider all three as part of forthcoming work on the Theft Strategy Project.