Retail Energy Code Company Ltd
27 Old Gloucester Street
London, WC1N 3AX

Grace Royall
Senior Policy Manager
Retail Systems and Processes
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

20 March 2025

Dear Grace,

Re. Authority decision to 'send back' Retail Energy Code (REC) change proposal 0173 'Improvements to the Theft Detection Incentive Scheme (TDIS)'

Thank you for your letter dated 03 March 2025 in which you send back REC Change Proposal 0173 'Improvements to the Theft Detection Incentive Scheme (TDIS)' (R0173) for further work.

Your letter was discussed by the REC Change Panel at its meeting on 18 March 2025 and this letter sets out the formal response from that committee.

Intent of R0173

R0173 seeks to extend the scope of the TDIS such that it not only rewards the successful detection of a Confirmed Energy Theft, but also allows for the recovery of reasonable costs of undertaking qualifying Energy Theft Desktop and Site Visit Investigations, which may not always lead to a Confirmed Theft. It is hoped that this change will provide Energy Suppliers greater certainty of a return on investment in tackling theft, and better incentivise appropriate behaviours. This should increase the overall number of investigations and correlating number of Confirmed Energy Thefts that are found and rectified.

Consideration of Ofgem Feedback

The Change Panel has considered Ofgem's view that allowing payments for Desktop Investigations (DIs) and Site Visits (SVs) will not create the cited incentives or drive the correct behaviours. However, the Change Panel considers these elements to be integral to the success of the TDIS, as set out below:

<u>Incentivisation of Site Visits</u>

Potential changes to improve the efficacy of the scheme were discussed at length at the Theft Issues Group, a workgroup attended by both domestic and non-domestic suppliers (and on occasion consumer representatives and Ofgem). While there were a range of views on the efficacy of the current scheme and therefore the value in any further revisions to it, no credible alternatives to improve upon the scheme were raised.

We consider that the incentivisation of site visits is consistent with the design principles for an incentive scheme originally set out by Ofgem. In particular, we consider that it is necessary to:

1. **Overcome Financial Disincentives**

Suppliers historically faced uncertainty about recovering the costs of theft investigations, particularly site visits, unless they resulted in a Confirmed Energy Theft. This financial risk acted as a disincentive to proactively investigate, particularly in cases where the likelihood of a confirmed theft was uncertain.

2. **Encourage More Investigations and Confirmed Thefts**

By providing payments for both Desktop and Site Visit Investigations, even when they do not result in confirmed thefts, the scheme removes barriers to undertaking investigations. This is expected to increase the volume of investigations, which in turn is likely to increase the number of Confirmed Thefts identified and rectified.

3. **Improve Safety and Reduce Consumer Costs**

Increased site investigations contribute to identifying and resolving unsafe meter tampering and illegal connections, improving health and safety outcomes. More detected and addressed thefts reduce the socialised cost of theft on honest, bill-paying consumers, which in late 2022 we calculated to be in the order of £830m to £1.388bn per year.

4. **Support Data Collection and Continuous Improvement**

Including Site Visits in the incentivised activities encourages comprehensive reporting of investigation outcomes, including those initiated through the Energy Theft Tip-Off Service (ETTOS) leads. This improves the quality of data available for analysis and supports continuous improvement in the theft detection processes.

5. **Align Incentives with Appropriate Behaviours**

The incentive design shifts the focus from only rewarding outcomes (Confirmed Theft) to rewarding effort and appropriate behaviours, such as thorough site investigations. This helps ensure that due diligence is maintained in theft detection activities across all suppliers.

<u>Incentivisation of Desktop Investigations</u>

While suppliers cannot control the number of leads they receive from ETTOS, this is a deliberate and necessary design feature that ensures fairness, impartiality, and integrity in how incentives are allocated. ETTOS is operated by Crimestoppers, an independent and highly trusted charity, and leads are generated from public tip-offs. This independence mitigates the risk of bias or manipulation and ensures investigations are based on credible intelligence.

Allowing suppliers to self-generate and claim payments for their own desktop investigations would introduce a significant risk of gaming. Suppliers could be incentivised to undertake large numbers of low-cost, low-value investigations simply to access payments, regardless of the actual likelihood of theft being confirmed. Ofgem recognised this risk in its 2012 and 2014 final impact assessments on gas[1] and electricity[2] theft, which concluded that an independent lead generation mechanism was essential to the credibility of any incentive scheme.

Restricting payments to desktop investigations arising from ETTOS leads creates a positive feedback loop. It encourages suppliers to act on high-quality intelligence, strengthens the deterrence effect, and supports the continued effectiveness of ETTOS, which industry participants have funded for several years as part of the broader theft reduction arrangements introduced under Ofgem's direction.

This design ensures impartial distribution of leads, mitigates the risk of inconsistent investigation quality, and protects against conflicts of interest. It aligns with Ofgem's objectives to promote fairness, reduce consumer harm, and improve energy theft detection, without introducing unnecessary complexity or opportunities for manipulation. While lead distribution may vary between suppliers, the approach reinforces public trust in the system and focuses efforts on delivering tangible consumer benefits.

Impact on collaboration between suppliers

Ofgem acknowledged, during the development of both the Gas and Electricity Theft Detection Incentive Schemes, that introducing financial incentives could potentially have adverse effects on collaboration between suppliers. Specifically, Ofgem recognised concerns raised by stakeholders that a competitive incentive structure might discourage the sharing of information and intelligence. There was a risk that suppliers, in pursuit of financial rewards for identifying theft, might be less willing to cooperate with each other, undermining collective efforts to tackle theft and diminishing the effectiveness of industry-wide initiatives.

In its 2012 Gas Theft Final Impact Assessment and 2013 Electricity Theft Final Impact Assessment, Ofgem considered these concerns carefully. Respondents to its consultations had expressed apprehension that the incentive schemes could create perverse behaviours, including reduced transparency and an emphasis on individual commercial interests rather than coordinated industry action.

Nonetheless, Ofgem concluded that the introduction of well-designed incentive schemes was appropriate and necessary to address the persistent under-detection of energy theft. At the time, there was a clear recognition that existing arrangements had failed to deliver adequate levels of theft detection, partly due to suppliers having weak or misaligned incentives to undertake investigations, particularly when the financial benefits were uncertain or not directly linked to their own activities.

To balance the risks to collaboration, Ofgem incorporated safeguards into the scheme design. These included the establishment of the ETTOS and the Theft Risk Assessment Service (TRAS), which provided a centralised mechanism for intelligence sharing and minimised opportunities for competitive gaming. TRAS was designed to support collaboration by ensuring all suppliers had access to independent, centrally produced theft detection leads. However, following a review of its performance the service was not re-procured at the end of its contractual term and ceased operation in 2021. This decision reflected concerns about its effectiveness in identifying and reducing energy theft and the desire to explore alternative approaches that better align with industry needs and regulatory objectives.

Ultimately, Ofgem considered that the benefits of improving theft detection through targeted incentives—thereby reducing socialised costs to consumers and improving system integrity—outweighed the potential risks to supplier collaboration. The introduction of the incentive schemes was viewed as a proportionate and justified intervention in support of Ofgem's statutory objectives to protect consumers and promote effective market functioning.

Notwithstanding the above, we agree that fostering collaboration between suppliers and indeed other market participants is crucial to tackling energy theft effectively. We operate a number of initiatives as part of the Theft Reduction Strategy to encourage such collaboration, such as sharing best practice through regular stakeholder meeting and facilitating data sharing through a new theft data portal. There appears to be no evidence that the existence of the TDIS is detrimentally affecting supplier behaviours in this area, as those who perform well under the scheme are also constructively engaged in such fora (and vice versa). We

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also observe from the relative levels of performance against TDIS targets that the larger suppliers enjoy no obvious advantage under the scheme. Indeed, the TDIS targets and subsequent liabilities to the scheme are based upon market share and as such designed to be proportionate.

Next Steps

The Change Panel notes the direction set out in your letter to send the change proposal back to the R0173 working group for further consideration and/or undertake a further consultation. Given the mutual desire to implement a meaningful change to the TDIS ahead of the next scheme year, starting 01 April 2025, we would welcome the opportunity to meet with you on Monday 24 March to discuss the benefits of R0173 as outlined above to see if agreement can be reached before determining any further activities.

Your Sincerely,



Lindsay Biginton

REC Change Panel Chair