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By email only:

15 January 2024

Proposed changes to the Theft Detection Incentive Scheme

The Theft Detection Incentive Scheme(s)[1] (TDIS) applies to all licenced Energy Suppliers, with the aim of driving a greater number of theft investigations and detections than would otherwise be the case. The intent of the schemes is to remove what Ofgem determined to be a disincentive for suppliers to investigate theft. While those Energy Suppliers who *do the right thing* will incur costs in pursuing investigations with no certainty of being able to recover those costs from the consumer, the cost of any undetected theft is mutualised across all Energy Suppliers and ultimately consumers. While the Theft Targets may be subject to evidence-based revisions, the aggregate targets have in practice not been substantively altered since the scheme was introduced, other than to compensate for external events such as COVID-19 restrictions.

Following the implementation of REC change R0091[2], the Theft Target Methodology (TTM), which sets out the level, distribution and value of theft targets and overall size of the incentive pots, has been set out in a Category 3 document managed by the Code Manager. The Code Manager proposal for revisions to the TTM that would apply to the scheme from 1 April 2024 is appended to this letter.

While the Code Manager has followed the evidence-based approach expected of them, including in particular seeking updated data on the current cost of theft investigation, that data has not been sufficiently available for it to provide an informed view on what the revised Theft Detection Values (TDV) for 2024/25 should be. In light of the Ofgem letter of 14 November 2023, raising concern at the current level of theft detection as compared to targets, we are concerned that the TDV values are not providing sufficient incentive. This letter therefore sets out proposals on how the incentives could be strengthened, both immediately through the upcoming change to the TTM, and through changes to Schedule 7 of the REC, which would be subject to approval of a REC Change Proposal.

Theft Detection Value

The TDV is defined in Schedule 7 of the REC as representing the likely net cost to an Energy Supplier of having undertaken activity to detect the theft, as compared with having taken no action. Those values, formerly referred as the 'Marginal Detection Disincentive Value' (MDDV), were initially bench-marked by Ofgem against costs submitted to it as part of the Impact Assessments of its theft proposals consulted upon in 2011 (gas) and 2013 (electricity). Our understanding is that those values were not substantively changed or subject to further market testing prior to the schemes being migrated to the REC on an 'as is' basis in 2021.

As in previous years, the 'MDDV' for the 2021/22 reporting year was significantly higher for each case of domestic gas theft than a non-domestic one, despite there being a greater value of energy at risk in the

[1] For the purposes of this letter we refer to the TDIS as being a single scheme, though in effect the gas and electricity schemes formerly operated under different industry codes and continue to operate independently of each other – i.e. targets and performance are assessed against each specific sectors.
[2] R0091: 'Clarifications to the Theft Detection Incentive Scheme'

latter. In electricity, the values for each sector were the same. This was subsequently considered to contribute to suppliers' efforts being disproportionately focused on domestic cases. In order to rebalance suppliers' efforts, the Code Manager developed an alternative methodology for the 2022/23 scheme year, which included a consumption based weighting factor. However, the theft targets and aggregate incentive scheme values were maintained. The adjustments to the 2022/23 values of what were then referred to as the TDV rather than MDDV are below:

	Gas		Electricity	
	Pre-adjustment	Adjusted	Pre-adjustment	Adjusted
Domestic	£1,248.42	£896.77	£428.27	£343.10
Non-domestic	£600.66	£1,551.41	£428.27	£1,067.05

Although suppliers have licence obligations to prevent, detect and investigate theft, as noted above the TDIS is predicated on being able to offset the financial disincentive that would otherwise exist for suppliers to undertake such investigations. As noted in the Ofgem letter of 14 November 2023, suppliers' overall performance for each of the past two scheme years has been around 40% of target. This suggests that TDIS is not providing sufficient reward to cover the cost of further investigation and subsequently detect more confirmed cases of theft. As part of its analysis to inform the TTM for the 2024/25 scheme year the Code Manager sought additional information on the current cost of theft investigations but was unable to source sufficient data to inform a revised market-based benchmark. However, anecdotal evidence did suggest that in addition to the prevailing benchmarks being out of date, and that they should appropriately factor other industry programmes such as the smart meter roll-out which may be competing for the same skill sets and potentially increasing labour costs.

Given the above and in the absence of an evidenced-based means of revising the TDV, we consider that the results of the scheme may themselves provide a means of discovering an appropriate and effective level of TDV. I.e. if the current level of TDV is not sufficient incentive to undertake further investigations, it could be incrementally increased until there is evidence that it is incentivising a change in supplier behaviour. We therefore propose to introduce an escalator mechanism to the TDIS, increasing the level of the TDV by 20% above inflation. As we remain committed to evidence-based decision wherever practicable, the efficacy of each increment should be assessed before a further one is applied. This would mean that any future increments could be applied to every second reporting period, allowing for the results of the previous reporting period to be assessed and inform whether and to what extent any further increment may be appropriate.

Given the importance of tackling energy theft, which not only places an additional financial burden on consumers, but poses a risk to health and safety, we consider that the escalator should be applied from 1 April 2024. However, we also consider that the efficacy of the revised value must be assessed as soon as practicable and if necessary inform the extent of any further increment. We consider that this determination could suitably be a matter for the Performance Assurance Board.

Reporting Cycle

Both the gas and electricity scheme years have historically run from 1 April to 31 March, apart from a period when the scheme was curtailed owing to COVID-19 restrictions.[3] Any changes to the scheme arrangements have been restricted to apply to future reporting periods only, avoiding the potentially retrospective impact

[3] The desire to avoid mid-year disruption to the schemes, prompted those theft arrangements to be migrated from SPAA and DCUSA to the REC as part of the interim REC version 1.1 release effective 1 April 2021, rather than as part of the Retail Code Consolidation on 1 September 2021.

that a mid-year change could have on theft reports submitted early in the reporting period, which could unduly disadvantage suppliers who had undertaken such work and more generally disrupt suppliers' in-flight plans for the year. However, this annual cycle combined with the fact that the full results of the reporting year can only be undertaken once the subsequent reporting year is already underway suggests that cadence of improvements to the TDIS could be restricted to every two years.

This annual cycle also means that the recovery of costs available through a TDIS credit, or conversely the settlement of liabilities to pay into the scheme, can only occur several months into the financial year following the one in which they were incurred. As these rewards or liabilities are determined by the suppliers' performance relative to their peers rather than against their indicative target, this impact on cash-flow can be hard to forecast.

We consider that moving to a quarterly reporting cycle would mitigate the cash flow issues mentioned above, allowing costs to be at least partially recovered in the financial year in which they were incurred, and more generally allow parties to better monitor their own performance as compared to their peers. Importantly, in the context of future revisions, this would also mean that incremental improvements could be made much sooner whilst avoiding any retrospective impact.

This change would appropriately be progressed as a change to Schedule 7 of the REC, which currently refers to a TDIS Reporting Year, but in anticipation of that change being accepted we will, subsequent to responses to this letter, illustrate the quarterly breakdown of the Theft Target in the forthcoming TTM. At this stage we propose that the Theft Target should be split evenly throughout the year, i.e. simply divide the annual target by four, rather than apply a seasonal profile.

Scheme Segmentation

Schedule 7 states that targeted incentive pots are established for each of the consumer segments identified in the TTM. Since the introduction of the schemes, there has been a split between gas and electricity and domestic consumers and non-domestic consumers. Those incentive pots will be changed for the first time. Based on responses to a call for evidence, the domestic incentive pots will now be split into Smart and non-Smart segments.

Respondents to the call for evidence believed that a Smart meter should of itself be a deterrent for meter tampering, and also that sites with Smart meters would have been visited more recently and any tampered meters would have been replaced. This rationale is consistent with the government impact assessment for the Smart Meter Implementation Programme. More recently, the government issued a call for evidence on the relationship between smart meters and energy theft.[4]

The Code Manager proposes that there will be no overall increase to the theft target for the domestic sector, but that the disaggregated theft targets would be weighted more heavily towards the non-Smart segment, in line with the rationale above. This should better target efforts towards sites at greater risk of theft, and the more granular reporting may help inform future policy decisions such as on the installation of a Smart meter following the discovery of a confirmed theft.

Our ability to accurately target incentives towards the different consumer segments will continue to be influenced by the availability of quality data. The availability of portfolio level data on payment methods which may become available as a result of the levelisation scheme may facilitate future modelling on whether, for instance an incentive pot split between prepayment and credit payment methods may be appropriate. We will also continue to explore whether it would be beneficial and practicable to disaggregate the non-domestic

[4] Department of Energy Security and Net Zero: Call for evidence on energy theft, published July 2023.

incentive pot, potentially weighting non-domestic targets towards the smaller commercial end of the market. We will continue to work with industry parties to identify how such a segmentation can be achieved. We recognise that there may be limitations in the accuracy of industry data-sets that were created for different purposes, so will also seek to establish acceptable tolerances so that improvements to the incentive scheme are not unduly stymied by margin cases that would not materially affect the overall efficacy of those scheme.

Reasonable endeavours

In discussion of the TTM proposals at the December 2023 meeting of the Energy Theft Reduction Expert Group, it was highlighted that the *Reasonable Endeavours Scheme* (RES) scheme referenced in Condition 7 of the Gas Transporters licence is still technically in operation, though seldom used. Like the TDIS which effectively superseded it, the RES was intended to compensate a supplier (via their Gas Shipper) where it identifies an incidence of gas theft, but where the supplier is unable to recover charges to which it is entitled from a consumer, removing the disincentive to undertake investigations. Under the scheme Gas Transporters are required to set out the steps that a supplier must undertake before a compensation payment can be made.

The RES allows for two different compensation values to be paid:

- 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.

In March 2012 Ofgem rejected a modification proposal (UNC231V) to incorporate the scheme into the Uniform Network Code.[5] Ofgem noted that it considered "***by increasing the value of charges that may be recoverable, UNC231V would reduce supplier disincentives to detect and investigate theft***". Ofgem also noted that, consistent with its earlier position of being minded to approve the proposal, UNC231V by itself may have been beneficial. However, Ofgem expected the RES to be superseded by a new incentive scheme, the principles of which were outlined in Ofgem's March 2012 way forward document on tackling Gas Theft.[6] Ofgem was concerned that operating the RES alongside the new incentive scheme could lead to unintended consequences, such as a supplier being able to claim under both sets of arrangements and therefore over-recover costs. Ofgem therefore expected the RES to be closed and reference removed from the Gas Transporters licence. The implementation of UNC231V for only an interim period would therefore be inefficient, and as such the proposal was rejected. The referenced scheme was subsequently implemented and became known as the TDIS, however the references to RES were not removed from the Gas Transporters licence.

Notwithstanding our proposal to increase the value of the TDV, we consider that there is merit in an arrangement that would allow for exceptional costs to be considered and if appropriate, compensated through the REC on a case by case basis, where there are Supplier community or societal benefits of doing so. This could remove the disincentive for a Supplier to pursue a particularly complex investigation where there is both little prospect of costs being recovered directly from the consumer, and those costs materially exceeding the value of the TDV, for instance where there are multiple meter points associated with that consumer, but are currently or previously registered to different suppliers. This should further the aim of incentivising theft investigations and detection, and bring down the forward costs of undiscovered theft that would otherwise be mutualised across all suppliers and passed through to consumers.

[5] UNC231V: '*Change to the Reasonable Endeavours Scheme to better incentivize the detection of theft*' - www.ofgem.gov.uk/sites/default/files/docs/2012/03/unc231v.-d.pdf
[6] 'Tackling Gas Theft: Way Forward', Ofgem March 2012 - www.ofgem.gov.uk/Markets/RetMkts/Compl/Theft/Pages/Theft.aspx

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The consideration of such exceptional costs under the same governance as the TDIS, could avoid those costs unduly skewing the more standard costs that we are seeking to discover and compensate through the TDV. This would also allow the scheme to be extended to electricity for the first time and address Ofgem's original concern over the potential unintended consequences of parallel schemes. In particular, we consider that the consideration of such exceptional costs could be integrated into the TDIS arrangements rather than operate as a separate and mutually exclusive scheme. This work could also inform a future incentive regime the recognises the cost that suppliers incur in making reasonable endeavours to investigate theft, without being necessarily contingent upon the confirmation of theft as an outcome. Any such scheme would be introduced via the REC Change Process, and therefore subject to consultation and approval through the standard change management process.

Next steps

Whilst we would welcome views on any of the issues outlined above, those which require a change to the legal text of the REC will be subject to further consultation as part of future Change Proposals.

In facilitation of change to the TTM coming into effect 1 April 2024, we would specifically welcome views on the setting of the TDV as follows:

Q : Do you support the principle of an escalator to discover an effective TDV?

Q : Do you support the proposal to escalate the TDV by 20% on 1 April 2024?

Q : Do you support changing the TDIS reporting period being changed from being annual to quarterly?

We will host a drop-in session to answer any questions you may have on these proposals at 12-1pm on 22nd January 2024. If you would like to register for this session and (preferably) submit any questions in advance, please contact theft@retailenergycode.co.uk.

Responses to this letter are invited by **5 February 2024**.

Following consideration of responses the Category 3 TTM document will be published by **1 March 2024**, and subject to the degree of support for the proposals outlined in this letter we will raise the Category 2 Change Proposal(s) to give effect to the changes to Schedule 7.

Yours sincerely,

Jon Dixon
Director, Strategy and Development