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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, and for the subsequent discussion to clarify those concerns. From that, we understand that Ofgem would like further analysis to inform its decision, specifically addressing three key concerns as follows:

- The fairness of limiting Desktop Investigation (DI) incentives to Energy Theft Tip-Off Service (ETTOS) leads when Suppliers cannot control the volume of such leads received;
- The risk that incentives on DI and Site Visits (SV) could lead to unintended consequences such as gaming in order to increase revenue or reduce collaboration; and,
- The effectiveness of DI/SV incentives in delivering confirmed thefts.

Your letter was discussed by the REC Change Panel at its meeting on 18 March 2025 and this letter sets out our formal response, together with supporting analysis and evidence where available.

Intent of R0173

R0173 seeks to evolve the TDIS to support a more risk-based and preventative theft reduction strategy. It provides targeted incentives for Suppliers to act upon leads that are considered to be high quality, but nonetheless cannot provide certainty of a confirmed theft and qualification for an incentive payment under the current scheme. This is intended to enable further investment by Suppliers in investigative activities, enabling earlier intervention and reducing the risk to safety arising from illegal meter tampers or bypasses.

We consider that the expansion of the Theft Detection Incentive Scheme to include these investigative activities aligns with Ofgem's original rationale for introducing the scheme, as set out in the final impact assessments for tackling gas[1] and electricity[2] theft in 2012 and 2014 respectively. In particular, it seeks to remove the disincentive to undertake such investigations when cost recovery is uncertain. However, the proposed incentive structure does not seek to offer a profit margin, being designed to allow for a reasonable recovery of costs only, ensuring an efficient and proportionate response to the identified risks.

[1] 'Tackling gas theft: Final impact assessment', Ofgem, March 2012
[2] 'Tackling electricity theft: the way forward' Ofgem, March 2014

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.

Alternative approaches were considered during the development of R0173. However, none on these alternative approaches developed into an alternative proposal to R0173.

The use of an ETTOS-based Incentive

Ofgem queried whether it is fair to tie incentive payments to ETTOS-sourced DIs when Suppliers cannot control their volume. During the development of R0173 the use of non-ETTOS sourced DI was considered but raised similar concerns to those raised by Ofgem in that there could be little control over the volume and quality or leads generated by, for instance, a Supplier's own analysis of their portfolio and meter read history. We consider that tying the DI payment to ETTOS is essential to:

- Prevent Supplier-generated low-value investigations purely to access payments;
- Maintain the integrity and impartiality of the incentive scheme.

ETTOS is a national service operated by Crimestoppers, which enables members of the public to anonymously report suspected instances of gas or electricity theft. It plays a key role in supporting industry-wide efforts to reduce energy theft by providing Suppliers with independent, credible leads that can trigger further investigation. The scheme is jointly funded by industry participants as part of the funding commitment to RECCo, and forms part of a broader theft detection and prevention framework governed under the REC. ETTOS is not an exclusive lead generation source—Suppliers may and do pursue investigations from a range of other channels, including internal analytics, customer referrals, or operational observations, but importantly all Suppliers can receive and act upon such tip-offs.

The reports[3] received through ETTOS have grown from 2,642 in the year 2016/17 when the service launched, to 12,225 in the year to March 2024. Reports in the year-to-date total 13,458, suggesting they may reach around 15,000 by the end of the current financial year. Whilst this increase in the volume of reports may be indicative of the growing prevalence of energy theft, our increased funding of awareness campaigns and other improvements prompted by operational experience will also have an influence. The Crimestoppers reports (shared with Ofgem separately) shows that the distribution of reports amongst Suppliers is broadly reflective of their market share (based on Ofgem Retail Market Indicators, Q3 2024) with the variance between ETTOS lead volumes and market share being within a margin of +/-3% for majority of Suppliers. This demonstrates strong proportionality and that no Suppliers should be disadvantaged by the proposal to incentive restriction.

While analysis shows that the distribution of ETTOS leads is broadly aligned with Suppliers market share, we acknowledge that some variation is to be expected. Factors such as socio-economic differences within customer portfolios, geographic distribution, and recent shifts in market share can all influence the number of leads received. For example, theft is likely to be less prevalent among customers who have recently switched Suppliers, compared to the broader consumer base.

[e] Reports are issued to the relevant suppliers where known, or otherwise to the relevant gas transporter and/or electricity distributor as appropriate.

Given that all Suppliers benefit from the wider impact of theft detection—through reduced socialised costs, improved safety, and a more resilient retail market—it is both fair and efficient to recover the costs of incentivised investigations through a Levelisation process based on market share.

This approach aligns with established principles used in other regulated schemes, such as Payment Method Levelisation and the Warm Home Discount, where costs are shared proportionately in recognition of collective benefit. Applying the same model here ensures a balanced funding mechanism that supports impartiality and avoids penalising Suppliers who receive more leads due to portfolio characteristics.

Risk of Gaming / Misuse of the Proposed Changes

A key consideration in developing this change—and one raised by several respondents during the Party Impact Assessment and Consultation—was how to mitigate the risk of Parties attempting to 'game' the scheme by undertaking unnecessary or low-value investigations purely to claim incentive payments.

Allowing Suppliers to self-generate and claim for their own desktop investigations would present a significant risk, as it could encourage high volumes of low-cost activity with limited investigative merit. This concern was acknowledged by Ofgem in its 2012 and 2014 impact assessments on gas and electricity theft, which concluded that an independent lead generation mechanism was essential to ensure the credibility of any incentive scheme.

The proposed restriction of DI payments to only **ETTOS-sourced leads** directly addresses this risk. ETTOS, operated independently by Crimestoppers, provides a neutral, industry-funded source of intelligence. This design maintains fairness, ensures leads are distributed impartially, and prevents conflicts of interest—supporting public trust and reinforcing the deterrent effect of coordinated theft detection efforts.

By incentivising Suppliers to act only on ETTOS leads, the scheme encourages appropriate targeting, improves investigation quality, and strengthens the overall impact of ETTOS itself. While the volume of leads may vary by Supplier, the structure ensures consistency and focuses efforts on delivering tangible consumer benefits.

To further safeguard against misuse, the proposal includes additional assurance measures, which would be implemented by the Code Manager if the change is approved. These enhancements fall within existing Performance Assurance techniques and do not require changes to the legal text:

- **Limiting DI payments to ETTOS leads** eliminates the risk of Suppliers creating artificial or low-quality referrals for financial gain.
- **Incentive values reflect cost recovery, not profit**: SV incentives are capped at 50% of TDV, despite similar costs between confirmed and unconfirmed cases. The TDV itself is based on average net costs to Suppliers, with no embedded margin—removing the incentive for over-investigation.
- **Performance Assurance activities** include:
    - Risk-based monitoring to flag anomalous investigation patterns.
    - Random and targeted sample testing of Party records (in line with the revised Interpretations and Definitions schedule).
    - Process audits focusing on how Suppliers assess and report theft, especially where outliers are identified.

The incentive values—20% of TDV for DIs and 50% for SVs—are underpinned by the Theft Target Methodology (TTM). This used Supplier-submitted cost data, identifying a weighted average cost of £320 per investigation and £2,400 per confirmed theft with a resulting average TDV of £742.

The proposed incentive levels were set well below this benchmark to ensure they enable cost recovery without creating a financial driver for excessive or unnecessary investigations. This approach reflects the operational reality that multiple investigations may be needed for each confirmed theft, and supports a balanced, system-wide theft detection strategy. Anecdotal feedback suggests that site visits, can act as a deterrent for theft and improve safety even where a theft is not confirmed – whether because other metering and safety issues are identified or where a theft may have occurred, but insufficient evidence can be gathered to meet the incentive scheme criteria. Difference in confirmed theft rates can also be reflective of enforcement policies amongst Suppliers, rather than necessarily investigative practices.

The efficacy of incentivising DI and SV

The assumption the additional incentive payments will result in greater engagement and increased investigations is supported by comments made by Parties during the Impact Assessment phase – with parties providing comments such as:

> "This will improve engagement from Suppliers who have historically had low levels of confirmed theft and incentivise a greater number of theft investigations which may also contribute to an overall increase in the number of confirmed thefts"

and

> "The proposed solution would go some way to encouraging more Suppliers to engage with the Energy theft process".

Feedback from Parties—particularly smaller Suppliers —gathered through Theft Engagement sessions, including the Theft Forum, has highlighted difficulties in securing internal funding or building a business case for investment in theft and revenue protection resources. A key challenge is the current scheme's reliance on payments being made only when theft is confirmed, creating financial uncertainty and disincentivising proactive investigation. Introducing a more predictable incentive structure—one that rewards appropriate investigative action, not just confirmed outcomes—would give Suppliers greater confidence to invest in theft reduction activity and support more consistent engagement across the market. 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.

Analysis conducted by the Code Manager on ETTOS reports submitted to Suppliers in the period 1 Apr to 31 Sept 2023 found that only 37% were investigated. Individual Supplier performance in that period varied significantly, with some Suppliers investigating over 70% of ETTOS reports, while others were at or near 0%.

The analysis also showed that the conversion rate of investigated reports to subsequent confirmed thefts to be around 22% across the market, though again results differed between Suppliers.

The implementation of R0173 would require Suppliers to conduct DI of all ETTOS reports submitted to them. Assuming ETTOS generates 15,000 leads for energy Suppliers in each year, that would require around 9,450 more DI each year that might otherwise have been conducted (63% of 15,000). Assuming the proposed

reward of 20% of TDV for each DI is broadly reflective of costs, that would equate to ((£742 * 20%) * 9,450) **£1,402,380**.

As set out in our Outline Business Case for an Energy Theft Police Partnership[4], and based on figures from the Theft Estimation Methodology, we have assumed a typical case of energy theft to cost the industry £2,281 per year in lost revenues, and to have an average duration of three years.

Assuming the additional volume of DI would continue to provide a conversion rate of 22%, that could save the industry and consumers over £14m in cost, with a return on initial investment of 900%.

A more prudent calculation would be on how many additional cases of theft would need to be found as result of R0173 in order to payback the additional £1.4m of cost, which we calculate the breakeven point to be only 205 additional cases found:

$$\text{Break-even cases} = \frac{£1,400,000}{£6,843} \approx 204.6$$

The improved reporting of investigations that don't lead to confirmed theft would also be of value. While reporting has traditionally focused on confirmed cases, capturing data on unconfirmed activity would give a clearer picture of investigation levels and success rates. This would support more accurate target setting, but also lead to valuable insights more generally.

Impact on collaboration between Suppliers

During the development of both the Gas and Electricity Theft Detection Incentive Schemes, Ofgem acknowledged concerns that financial incentives might discourage Supplier collaboration. Stakeholders warned that competition for rewards could lead to reduced information sharing and undermine collective efforts to tackle energy theft.

These concerns were considered in Ofgem's 2012 (Gas) and 2013 (Electricity) Final Impact Assessments, which noted the risk of perverse behaviours, such as reduced transparency and a shift toward individual commercial interests. Nonetheless, Ofgem concluded that targeted incentives were necessary to address persistent under-detection of energy theft, caused in part by weak or misaligned financial drivers for Suppliers.

To mitigate collaboration risks, Ofgem incorporated safeguards into the scheme's design—such as the Energy Theft Tip-Off Service (ETTOS) and the Theft Risk Assessment Service (TRAS)—to ensure all Suppliers had access to shared, independent leads. Although TRAS was discontinued in 2021 following concerns over its effectiveness, the use of ETTOS and the move towards more targeted schemes have continued to support industry alignment.

Ofgem ultimately judged that the benefits of incentivising theft detection—namely, reducing socialised costs to consumers and strengthening system integrity—outweighed the risks to Supplier cooperation.

We fully agree that collaboration remains essential to tackling energy theft. RECCo's Theft Reduction Strategy includes a range of initiatives to support this goal, such as best practice sharing through stakeholder meetings and the introduction of a new theft data portal. We have seen no evidence that TDIS is

[4] Energy Theft Unit Business Case, RECCo November 2024

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undermining collaboration—Suppliers who perform well under the scheme are also active contributors to industry forums, and vice versa.

Moreover, TDIS performance targets and liabilities are based on market share, ensuring proportionality. Larger Suppliers appear to have no inherent advantage under the scheme.

The proposed Levelisation process for the new DI and SV incentives reinforces collaboration further. Because costs are spread by market share, a Supplier that improves the targeting efficiency of its investigations—achieving more confirmed thefts with fewer actions—will benefit not only through lower operational costs but also through reduced liability under the Levelisation mechanism. Sharing best practices to help other Suppliers improve will, in turn, reduce the total number of investigations required, stabilising confirmed theft levels while lowering overall scheme costs for all parties.

Next Steps

Whilst we recognise that Ofgem must make a determination on R0173 based on its individual merits, the proposal is one of a number of measures being taken to improve the efficacy of the energy industry's efforts to prevent, detect and investigate energy theft. At the same time, we believe it is reasonable to expect the proposed changes will have positive impact on the number of investigations conducted and hence the number of confirmed thefts, as outlined above. If approved it will be possible to assess, using the data collected to operate the modified TDIS arrangements, both the impact of this change as well as to make progress in answering other related questions that could influence further changes in the scheme, for example:

- The direct impact of this change can be assessed to confirm whether an increased level of investigations resulted in an increase in confirmed thefts.
- Insight from the Performance Assurance activities will allow assessment of the extent of any inappropriate activity and development of amendments to mitigate this activity.
- Increased levels of investigation in historically under-investigated segments (e.g. I&C) will provide greater levels of data in respect of hypothesis advanced by some Parties that there is limited theft in these segments and hence can allow targets to be confirmed or modified in future years to better direct theft investigation activity.

The expectation of the Code Manager is that if approved the impact of the change would be assessed after the first year of operation and both the existing Theft Target Methodology review process and, if necessary, the change process utilised to further refine or adjust the change to continue to support the overall objective of reducing the level of energy theft and improving consumer safety in an efficient manner.

Your Sincerely,

Lindsay Biginton

Lindsay Biginton

REC Change Panel Chair