

Mr John Bradley  
Secretary, Modification Panel  
Joint Office of Gas Transporters  
51 Homer Road  
Solihull  
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8<sup>th</sup> January 2010

Dear John

**RE: UNC Modification Proposal 0231 – “*Changes to the Reasonable Endeavours Scheme to better incentivise the detection of Theft*”**

British Gas fully supports this modification proposal and believes that it will reduce theft. This means that customer safety will be improved and that the costs which customers pay as a result of theft will be reduced, making them better off. Furthermore, by reducing theft we will reduce shrinkage, improve the efficiency with which the gas network is used and deliver a reduction in carbon.

**1. The current arrangements are not fit for purpose.**

The present Reasonable Endeavours Scheme allows suppliers to claim for a fixed amount against specific theft detection activities, so as to incentivise supplier investment in the detection of theft.

These fixed values were back set by the Transco (Allowances for Gas Taken Illegally) Scheme 1997 however and bear no relation to the actual costs suppliers incur today. This means that a supplier will be unable to recover all of the costs they make in detecting theft, creating an incentive to do nothing, and allowing theft to remain undetected.

Following an Ofgem consultation in April 2004 on arrangements covering theft of electricity and gas, Ofgem published a “Next Steps” document in January 2005 which recognised a number of concerns with the Reasonable Endeavours Scheme, including that *“the amount of money that could be recovered under the scheme did not reflect the actual costs incurred by carrying out an investigation<sup>1</sup>”*. The subsequent recommendation from Ofgem was that *“in conjunction with the ERA/ENA workgroups’ consideration of incentives, the Reasonable Endeavours Scheme be reviewed to ensure that it meets the requirements of the gas industry<sup>2</sup>”*.

The subsequent ERA and ENA working group considered this point and in its report said that whilst the Reasonable Endeavours Scheme allows Suppliers to recover “some” of the costs associated with theft detection, they are *“still liable to pick up any unrecovered costs of the investigation that cannot be recovered through the Reasonable Endeavours Scheme<sup>3</sup>”*. This report went on to find that a number of parties involved in the group *“considered that the Reasonable Endeavours Scheme was too complicated and inadequately repaid suppliers for the costs they incurred<sup>4</sup>”*.

Notwithstanding Ofgem’s comments and the ERA and ENA findings, the Reasonable Endeavours Scheme has remained unchanged, complete with the same deficiencies which were identified over three years ago. We agree with the ERA and ENA findings and believe that if anything, the rising costs associated with theft detection have made matters even worse.

This inability to recover the costs associated with theft detection provides a perverse incentive on suppliers to detect theft, something evidenced by the low numbers of detections currently reported to Xoserve<sup>5</sup>. We consider that by raising the threshold to a level above the actual costs incurred by Suppliers in the course of detecting theft, this perverse incentive will be removed and the levels of theft detected in the market will consequently rise. Evidence to demonstrate that the proposed £1000 level is above the costs incurred by Suppliers has been provided under separate cover to Ofgem.

## **2. Our Proposal will resolve these deficiencies in the current arrangements.**

Our proposal will amend the limits for each of the existing claimable items to a maximum of £1000. This amount is intended to replace the historic fixed value claim and allow shippers to claim the full value associated with each activity, provided they can substantiate that claim.

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<sup>1</sup> Ofgem Theft of Electricity and Gas - Next Steps document (January 2005), para 6.18, p32.

<sup>2</sup> Ofgem Theft of Electricity and Gas - Next Steps document (January 2005), para 6.29, p33.

<sup>3</sup> Report of the Theft of Energy Working Groups report (April 2006), para 10.8, p26.

<sup>4</sup> Report of the Theft of Energy Working Groups report (April 2006), para 11.1, p27.

<sup>5</sup> Xoserve statistics on reported theft. <http://www.gasgovernance.com/NR/rdonlyres/7E08D5CC-B46B-4507-8D43-511F5976BE5F/36220/RG02450017a100809.xls>

Our proposal will also see the governance of the Reasonable Endeavours Scheme move under the Uniform Network Code (UNC). This will increase both the visibility and transparency of the current arrangements whilst also ensuring the Scheme may be developed in future in accordance with UNC procedures.

These steps will remove all barriers and disincentives that are created by the Reasonable Endeavours Scheme as currently drafted, resolving the issues identified by Ofgem, the ENA and the ERA.

### **3. This modification will reduce theft, improving customer safety and making them better off.**

By allowing suppliers to claim the full cost associated with theft detection in the Reasonable Endeavours Scheme, the current perverse incentive to detect theft will be removed, leading to an increase in supplier investment and a reduction in theft.

Theft is dangerous to those who commit it, and those who live around them. By its very nature, bypassing or tampering with the gas installation and the inherent safety features poses a grave risk to those in the immediate vicinity, and any measure therefore which reduces theft will also improve customer safety.

Costs which a Supplier reasonably incurs during the course of detecting theft of gas, but which cannot be recovered through the Reasonable Endeavours Scheme are currently passed through to customers in the form of higher charges. Thus the deficiencies within the current scheme directly impact the wider, law-abiding, population.

The proposed increases the maximum claim allowable to one that means costs will not outweigh potential claim values. This is only a maximum however, and any claim will need to be substantiated such that it is wholly reflective of actual costs incurred.

Furthermore, we believe that approximately £220m of gas is stolen each year, an amount which will inevitably be passed through to the customer in the form of higher charges. This modification will reduce the amount of theft in the industry and therefore reduce the costs which are passed through to customer, reducing their bills.

Our proposal will not remove the need for suppliers to substantiate their claims. By moving to a variable limit for each item, suppliers will have to explain how their claim is constructed, item by item. This in itself will provide more protection than the current process, preventing “gaming” of the process and ensuring that money is only distributed to those who have incurred cost.

In addition to this, Xoserve have existing and effective controls in place which will ensure that spurious, inaccurate or incomplete claims will not be paid. This will ensure that the existing benefits of the scheme will be retained, whilst providing a remedy for the aspects of the scheme which are failing. By keeping the existing requirement for Suppliers to substantiate their claims, we ensure that the existing audit mechanisms within the Transporter's Agent will be sufficient. Any extra substantiation and validation of claims made under the Reasonable Endeavours Scheme will be funded by those Suppliers who submit claims.

#### **4. This modification will improve the transparency and governance of arrangements.**

As became apparent during the process of developing this Modification Proposal, the existing arrangements for maintaining and publishing the Reasonable Endeavours Scheme are inadequate. The relevant information is split between two different documents<sup>6</sup>, and neither are readily accessible. This fact was also recognised in the responses to Ofgem's paper on theft of electricity and gas by those who said "it was not clear what suppliers were able to claim money for"<sup>7</sup>.

The current situation not only restricts potential new market entrants' ability to access the information they need on gas market arrangements, but it hinders transparency in the market, restricting Supplier's ability to take up the opportunity of recovering reasonable costs associated with theft detection.

This proposal will resolve that issue by combining these two documents and moving them in to the Uniform Network Code. In addition to improving the transparency and availability of Reasonable Endeavours Scheme information, this will also make the scheme subject to normal industry change processes.

This will enable the scheme to develop in future years in order to take account of the ever changing range, and cost, of activities Suppliers complete with regard to theft detection. This modification proposal will also ensure that any future change to the Reasonable Endeavours Scheme is robustly developed assessed and decided upon by virtue of the fact that it will be subject to Uniform Network Code change processes.

#### **5. This modification will deliver a reduction in carbon.**

Those who steal energy rarely do so efficiently. Without restrictions on cost, or by bypassing inherent safety features which regulate the flow of energy, stolen energy is used highly inefficiently, and at a higher cost of carbon than legal use. Our own analysis, for example, has shown that those found to be stealing energy use approximately twice as much gas as similar customers who are using gas legitimately.

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<sup>6</sup> Reference them]

<sup>7</sup> Ofgem Theft of Electricity and Gas - Next Steps document (January 2005), para 6.17, p31.

This modification will deliver a reduction in theft, therefore removing the inefficiencies inherent within it, and thus reducing the amount of carbon released.

## **6. This modification better facilitates the relevant objectives**

In addition to the points made above, we believe this change proposal clearly facilitates a number of the relevant objectives of the Uniform Network Code, specifically:

### **Standard Special Condition A11.1 (a): *the coordinated, efficient and economic operation of the pipe-line system to which this licence relates;***

By removing the perverse incentives associated with theft detection, there will be a corresponding increase in the amount of theft detected. This will lead to a more efficient operation of the pipe-line system by the preventing unsafe interference in the system that all theft represents.

Also, by removing the current disincentives the Reasonable Endeavours Scheme represents, individual instances of theft will be detected sooner than if the disincentives not been removed. This earlier detection of theft will avoid the potentially greater damage to the network that long term theft risks, for example through explosions. This modification will therefore also improve the economic operation of the network.

Finally, theft is by its very nature inefficient and results in a lack of information flowing about where gas is being used. As this modification will increase the amount of theft detected, better information will be available and the margin of error will be reduced, increasing the efficient and economic operation of the pipeline system.

### **Standard Special Condition A11.1 (b): *so far as is consistent with subparagraph (a), the (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;***

As above, this modification will impact theft across all pipeline systems.

### **Standard Special Condition A11.1 (c): *so far as is consistent with subparagraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;***

In the course of detecting theft, suppliers will often find instances where theft has occurred upstream of the Emergency Control Valve, and is therefore “in the course of conveyance”, as defined by paragraph 9(1), Schedule 2B of The Gas Act (1986). As this modification proposal will increase the volume of theft detected, and considering suppliers existing obligations to notify such theft to the Network Owner, it will also create a marginal increase in the volume of upstream theft detected by the networks, improving the efficiency with which they meet their obligations under Licence Condition 7.

Furthermore, the Transporter has an obligation under Licence Condition 5 to ensure that any amount of gas taken illegally after the Emergency Control Valve is removed from that suppliers charges, provided that supplier has made reasonable endeavours to recover their costs. By increasing the incentive on suppliers to submit Reasonable Endeavour claims following theft detection, it follows that Transporters will be able to more efficiently discharge their obligations under Licence Condition 5.

**Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs (a) to (c) the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;**

By improving the ability of parties to claim back the costs associated with detecting theft of gas through the Reasonable Endeavours Scheme, and improving the transparency of that scheme, condition A11.1(d) would be better achieved through more accurate energy allocation between Shippers, thus promoting competition.

**Standard Special Condition A11.1 (e): so far as is consistent with subparagraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers’ licences) are satisfied as respects the availability of gas to their domestic customers;**

Theft distorts the information Transporters receive on how much gas is used, how much gas is needed and where that gas is needed. Thus theft has implications on Transporters ability to effectively plan for seasonal gas demand. By removing perverse incentives associated with theft detection as this modification does, Transporters will gain a better understanding of where gas demand is, and how much it will be, thereby increasing the licensees ability to plan for seasonal gas demand.

I understand that some industry parties may be concerned about the impact this modification may have on the Transporters' Agent's auditing process, and that it may lead to an unmanageable burden on them, but we consider that the burden of proof remains with the Supplier in this process and that it is up to them to provide the Transporter's Agent with sufficient evidence to substantiate their claim. The validation processes will therefore remain as a sense checking of claims rather than a more formal auditor role as some have feared. This is in fact no different to today.

We further recognise that some parties may be concerned that by increasing the values which parties may claim under the Reasonable Endeavours Scheme, it may encourage "gaming" of the system. We consider that by placing the onus on the Supplier to fully substantiate any claim to the degree that the Transporter is comfortable in paying that amount, gaming of the system will be avoided. This modification proposal will actually decrease the opportunities to game as it will enable Transporters to more easily validate claims as better evidence will be submitted, for example receipts for money expended, rather than simple statements that work has been completed.

Finally we understand that Network Owners may be concerned that this proposal introduces a scheme which currently forms part of the Licence in to the Uniform Network Code, that this may present them with regulatory issues in future. We therefore welcome Ofgem's commitment at Distribution Workstream on 27<sup>th</sup> August 2009 to review these Licence obligations alongside any decision to implement this modification proposal such that Network Owners concerns are addressed.

If you have any queries relating to this representation, please do not hesitate to telephone me on (07789) 570501.

Yours sincerely

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