REC Theft Target Methodology Options Paper for 2024/25

22/09/2023

V1.0



RETAIL ENERGY CODE

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CHANGE HISTORY

Version	Status	Issue Date	Author	Comments
0.1	DRAFT		Code Manager	Initial Version for Consultation 2024/25 theft year
1.0	FINAL	22/09/2023	Code Manager	Final Version for Consultation 2024/25 theft year

DOCUMENT CONTROLS

Reviewer	Role	Responsibility	Date
Andrew Waghorn	Performance Assurance Technology & Data Lead	Primary Review	19/09/2023
Walter Carlton	Performance Assurance Lead	Overall Review	20/09/2023
Jon Dixon	Director of Development and Strategy	RECCo Review and Comment	22/09/2023

Purpose

This document supports the initial stage of industry engagement and information gathering in relation to changes to the Theft Target Methodology (TTM) for the Theft Detection Incentive Scheme (TDIS) Scheme Year 2024/25.

Following REC change R0091 – "Clarifications to the Theft Detection Incentive Scheme" responsibility for the TTM – that determines the level, distribution and value of targets and hence the overall size of the incentive pots – moved from the RECCo Board to the Code Manager. Scheme Year 2024/25 is the first year that this change applies to.

The Code Manager is taking a multi-step approach to this exercise; this first engagement lays out a number of options for potential changes to the TTM, the available supporting information and a number of questions on which we are seeking input. The purpose of this is both to gather **feedback** on the proposed options and be a **call for evidence** to support the determination of specific aspects of the potential changes.

The information gathered through this process will be used to develop an updated TTM for the 2024/25 Theft Scheme Year which as a Category 3 document will go through a formal change process including industry consultation later in 2023/early 2024.

The Code Manager seeks views and welcomes feedback on the options and specific questions included in this document. All feedback should be provided by return of the accompanying questions template to performanceassurance@recmanager.co.uk with the email title as "TTM Options Paper 2024/25".

Summary

CONTEXT

The Energy Theft Reduction arrangements specified in Schedule 7 of the Retail Energy Code aim to combat Energy Theft within the Retail Energy Market and support Suppliers with their obligations in Condition 12A of the Energy Supply Licence. This requires that Energy Suppliers detect Energy Theft, investigate suspected Energy Theft, prevent Energy Theft once detected, and prevent Energy Theft by other means such as deterrence. The TDIS forms part of this approach.

Following REC change R0091, the responsibility for the TTM – that determines the level, distribution and value of targets – moved from the RECCo Board to the Code Manager.

To facilitate this, the Code Manager administers the TDIS, assigning all Suppliers in the market a Theft Target, currently split by fuel type and further by Domestic and Non-Domestic customer segments for a total of four distinct incentive pots across the industry.

As per the requirements within the Schedule, the TTM requires consideration of a number of inputs:

- The number and definition of **incentive pots** – i.e. how the supply market is split into consumer segments, each pot then operating independently for the purposes of target setting and subsequent calculation of end of TDIS Scheme Year credits/debits.
- The **Theft Detection Value** – defined in the Schedule as an estimated value based on the likely net cost to an Energy Supplier of having undertaken activity to detect the theft, as compared with having taken no action.
- The specific **Theft Target** for theft identification that is targeted for each incentive pot in the TDIS Scheme Year.
- An **attribution methodology** to allocate the target for each incentive pot to the relevant Energy Suppliers for that pot, which the Schedule identifies should be based on market share.

This results in each customer segment having an overall target number of thefts that are assigned to Suppliers according to their market share and a TDV that should reflect the specific customer segment.

The scheme operates at a net zero sum flow of monies using the debits and credits calculation, where monies move to suppliers who perform better than average from those performing worse than average.

To date the scheme has largely operated on the same basis under REC as the legacy arrangements. Current industry performance under TDIS is below the targeted levels, and RECCo have a number of

wider activities underway as part of wider work on the theft strategy which could include fundamental changes to the Scheme, as set out in its Forward Work Plan for 2023/26[1].

SCHEME PERFORMANCE

The overall performance of the industry against their targets for these two completed Scheme Years has fallen short of the identified targets.

There have been 17,423 thefts confirmed in 2021/2022 against an overall target of 41,000 giving a target achievement of 42%. There have been 16,581 thefts confirmed in 2022/2023 against an overall target of 41,000 giving a target achievement of 40%.

The total confirmed thefts and percentages for each Scheme Year are shown in the below Tables.

Scheme Year	Fuel Type	Customer Segment	Number of Thefts Detected	Percentage of Thefts Detected
2021/2022	Electricity	Domestic	13,573	45%
		Non-Domestic	828	21%
	Gas	Domestic	2,854	56%
		Non-Domestic	168	9%

TABLE 1: Industry performance for Scheme Year 2021/2022

Scheme Year	Fuel Type	Customer Segment	Number of Thefts Detected	Percentage of Thefts Detected
2022/2023	Electricity	Domestic	12,663	42%
		Non-Domestic	1,179	29%
	Gas	Domestic	2,623	51%
		Non-Domestic	116	6%

TABLE 2: Industry performance for Scheme Year 2022/2023

[1] See: https://www.retailenergycode.co.uk/introducing-our-strategy-forward-work-plan-2023-26/

OPTIONS INCLUDED IN THIS PAPER

The Code Manager is proposing to make updates to the TTM for 2024/2025. We have developed a number of options for potential change, set out in this document. We have used theft performance data for the last two scheme years, the results from the TDIS survey provided to REC parties in October 2022 and the results of the Theft Estimation Methodology[2] (TEM) produced for RECCo which can be accessed here to support development of these options. In developing these options we have sought to balance the opportunity to improve the outcomes of the scheme in appropriately incentivising theft investigation whilst seeking to avoid over-complicating the scheme in terms of design, administration and reporting.

In summary the options identified include:

- Disaggregating the current customer segments into a number of additional incentive pots based on customer and meter types. Additional pots allow further focusing of theft targets, where theft occurs differentially between pots targets the incentive mechanism to the relevant suppliers and supports recognition of differential costs of investigation through identifying different TDV by pot.
- Refreshing the evidence base for the determination of TDV and reflecting any change in incentive pots.
- Adjusting the current split of targets based on analysis and modelling from the TEM and prior year TDIS outcomes, as well as introducing a mechanism to allocate targets should additional incentive pots be added.

[2] See: https://www.retailenergycode.co.uk/energy-theft-costs-consumers-up-to-1-4-billion-yearly/

Theft Target Methodology Change Options

INCENTIVE POTS

Schedule 7 states that theft targets are assigned to incentive pots that must be split as a minimum between gas and electricity, and Domestic and Non-Domestic, resulting in four incentive pots.

We have identified several potential options to introduce further splits in incentive pots as illustrated below.

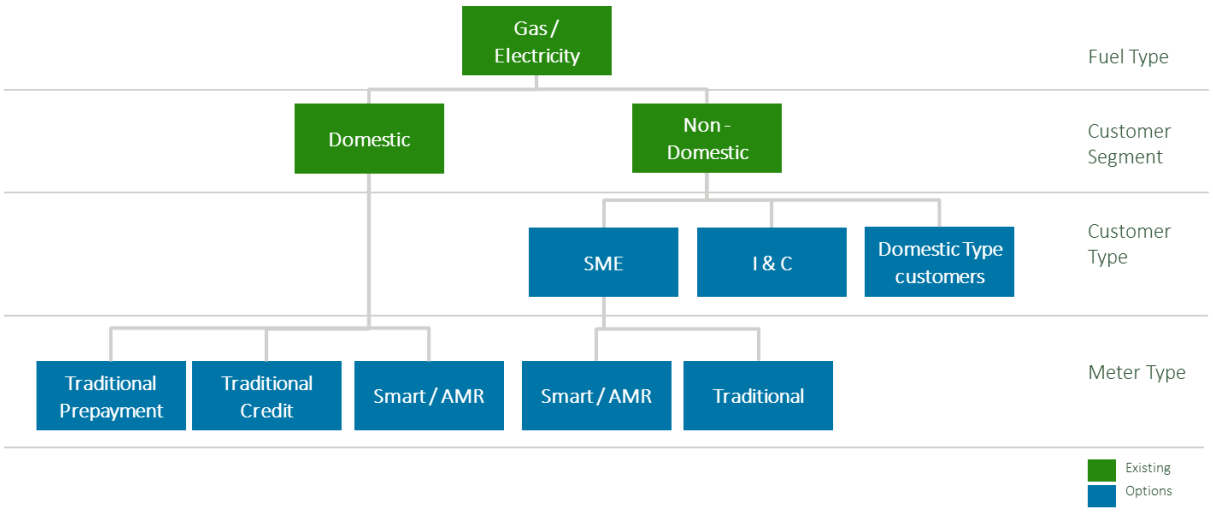


FIGURE 1: Options for changes to pot splits for Scheme Year 2024/2025

Note that each option can be considered individually – e.g., the option to further split the Domestic pot could be taken forward but the Non-Domestic pot retained as is.

The creation of more discrete incentive pots enables:

- TDIS incentives and costs to be more focused on those Suppliers whose portfolios contain specific populations of customer and meter types where a greater level of theft is estimated to occur.
- Differential costs of theft investigation for different customer and meter types to be accommodated via setting different levels of TDV for specific pots.
- Setting of Theft Targets by pot to reflect either the estimated incident of theft or to be adjusted to incentive focus on specific risks aligned to RECCo's wider theft strategy.

However, it is recognised that disaggregating existing pots will lead to additional complexity so a balance needs to be achieved.

Taking each of the potential options in turn:

DOMESTIC POT

The Domestic customer segment could have an additional split by meter type between Traditional Prepayment, Traditional Credit and Smart Meters (irrespective of operating mode). This would be determined based on “Meter Type” and “Smart Meter Indicator” fields taken from EES and GES datasets when setting targets and the equivalent data as at the point of theft confirmation.

This option is supported by responses provided in the TDIS survey and the TEM.

The TEM analysis assessed the hypothesis that there is a bias in investigations towards Prepayment customers. As stated in the TEM Report it was identified that there was both a bias in investigation towards prepayment meters and, when normalising the results to remove the counts of theft detected by payment type, thefts are more likely to be detected by Suppliers in prepaid meters. Combined this supports the option of an incentive pot for Prepayment meters.

Results of the recent TDIS survey identified approximately 57% of respondents thought there should be further split into meter types (for example differentiating between Smart and Traditional meters) and anecdotal feedback is that there is a lower incident of theft in Smart meters.

NON-DOMESTIC POT

The Non-Domestic pot could be split by customer type, i.e.:

- Small and Medium Enterprise (SME) Customers.
- Industrial and Commercial (I&C) Customers.
- Domestic-Type customers – i.e. meters that would otherwise be classified as Domestic but which are considered Non-Domestic within the incentive scheme due to the application of paragraph 3.6 of Annex 3 of Theft Schedule 7.

The SME customer type could be further split between Smart/AMR and Traditional meters.

The Domestic-type customer split is proposed as these meters would be expected to exhibit levels of theft and investigation costs more closely aligned to the wider domestic sector and hence suppliers with a significant number of meters in this population would otherwise have a significant potential advantage in identifying and confirming thefts compared to the wider non-domestic pot. In the current theft year, approximately 40,000 meters across 18 Suppliers would fall into this pot.

The split between SME and I&C customers reflects feedback that there is limited theft in the I&C sector. Within the SME segment it is proposed to include a split by meter type reflecting the TDIS survey feedback with the expectation of a lower level of theft in Smart/AMR meters akin to the lower levels of theft for Smart meters in the Domestic sector. This would use the same data fields from EES / GES as for the domestic sector splits. Note we have not proposed splitting the Domestic Type sub-

population by Customer type to avoid over-complication and reflecting the relatively small proportion of the overall non-domestic segment it represents.

Results of the recent TDIS survey identified approximately 57% of respondents thought there should be further splits of the customer segments. Feedback included splitting by meter types (for example differentiating between Smart and Traditional meters) and a majority of respondents supported further splitting the non-domestic consumer segment by SME and I&C.

The data used to determine meter points as Domestic or Non-Domestic will be based on classification reported from CSS based on the Domestic Premises Indicator.

While Disaggregation of the Non-Domestic customer segment into SME and I&C is suggested, there is no immediately equivalent data available to support this split. There is the potential to use existing industry meter point classification data (for example meter class, measurement class, profile class) to support this although not all of this data is included in the current input data used for applying the TTM. If taking this option, we would propose focusing on defining an inclusive dataset for I&C meters, with the balance of meters classed as SME.

Questions

1. Do you agree with the split of Domestic incentive pot by Meter Type to include Traditional Prepayment, Traditional Credit and Smart/AMR?
    a. What informs your thinking of this? Can you provide any insight or evidence in respect of differential theft risk for these meter types specifically within the domestic segment?
2. Do you agree with the proposed use of EES and GES data to split the data between these meter types?
3. Do you agree with the split of Non-Domestic incentive pot by Customer Type to include Domestic-type customers, SME and I&C?
    a. What informs your thinking of this? Can you provide any insight or evidence in respect of differential theft risk within these segments?
4. What data and rules do you believe should be used to split the Non-Domestic pot between SME and I&C for each fuel type?
    a. Do you agree with the approach of defining I&C criteria and identifying SME by difference?
    b. What informs your thinking of this? What evidence can you provide to demonstrate this thinking?
5. Do you agree with the further split of the Non-Domestic incentive pot SME by Meter Type to include Smart/AMR and Traditional for each fuel type?

a. What informs your thinking of this? Can you provide any insight or evidence in respect of differential theft risk for these meter types specifically within the SME segment?

6. Do you agree with the proposed used of EES and GES data to split the data between Smart/AMR and Traditional meters?

7. Do you have any other comments or suggestions for pot splits?

THEFT DETECTION VALUE

The TDV did not significantly change from 2022/23 to 2023/24, with only an inflation adjustment using the Consumer Price Index (CPI), and our understanding is that there has been limited substantive change since the introduction of the TDIS under the legacy arrangements. In light of the new incentive pot splits, the TDV will be revisited to determine appropriate values.

For the avoidance of doubt, no change is proposed to the underlying definition of the TDV – such as basing it on the value of theft avoided or setting it in a way designed to incentivise specific behaviours (any such amendment would require a Category 2 Change Proposal to update the definition of TDV included within the REC Energy Theft Reduction Schedule). The definition of TDV contained in Annex 3 of Schedule 7 of the Code is:

> "*This value is based on the likely net cost to an Energy Supplier of having undertaken activity to detect the theft, as compared with having taken no action.*"

Results of the recent TDIS Survey indicated a majority agreed that weighting should be applied as part of the TTM in order to incentivise detection activity. We understand the motivation behind this from respondents was to increase the potential value of a detected theft in areas where there was a view that theft was historically under-investigated. However, given the definition of TDV, this incentive is more correctly delivered through modification of the theft target. Notwithstanding, if theft has historically been under-investigated due to higher costs of investigation there is an opportunity to adjust the TDV based on evidence provided as outlined below.

The TDIS survey identified that the vast majority of respondents stated that the TDV should incorporate costs for analytics, desktop reviews and the cost of unsuccessful investigations in the value, stating unsuccessful investigations are still a cost borne by the market, it would enable both an increase in allocated time to investigate theft and account for the site visits where there is use of agents that specialising in meter tampering.

We understand that recent attempts to gather further information on the current cost of theft investigations by the Energy Theft Reduction Expert Group (ETREG) have had limited response from Suppliers.

Notwithstanding, this given the potential change in incentive pots outlined in the previous section and the limited update to TDV over the past scheme years we believe it is important to refresh the evidence base for the setting of the TDV and would request that participants provide as much information as possible in response to the questions below. We recognise that there may be some commercial confidentiality concerns in respect of the costs of investigation – for the avoidance of doubt only aggregate and anonymised data will be shared based on the responses received.

Questions

8. Do you agree there is a need to update the evidence base for the setting of the TDV and update the value itself based on that evidence if appropriate?
9. Is it valid that there is a difference in the TDV value between a gas theft and an electricity theft?
10. Based on the proposed new incentive pots outlined above would you expect each to have a different TDV (based on its definition) – i.e. do you think that the net cost of detecting theft varies for each pot?
    a. What informs your thinking of this? What evidence can you provide to demonstrate this thinking?
11. Do you currently undertake theft investigation / detection activity? If so please provide a breakdown of your best estimate of the annual cost of such activity, the number of thefts investigated and the number of thefts confirmed broken down by:
    - Spend/cost type (e.g. desktop review, analytics, site visits etc). If considered as part of your response please separate any revenue or cost recovery you have included as a result of theft investigation.
    - The potential incentive pots outlined above (based on customer/meter type) as best you can.

    As part of your response please provide a short summary of any key estimates you have made in producing your response and confirm the period you have considered in producing your response.

    Note if you would like us to use the existing TDIS data for number of thefts investigated and confirmed, please indicate in your response. However we understand that it may be easier in some cases to provide data aligned to your financial year rather than the Scheme Year and hence have not assumed we should utilise this data.

    If you would rather provide an anonymous response to this question (i.e. without providing your company name) you can fill in an anonymous online form here.
12. If you do not currently undertake theft investigation / detection activity, do you have an estimate of the likely cost of undertaking theft activity? If so, please provide a breakdown on the same basis as question 12 and include details on the basis of your estimate.

    If you would rather provide an anonymous response to this question (i.e. without providing your company name) you can fill in an anonymous online form here.
13. Do you have any other comments or suggestions for Theft Detection Value?

THEFT TARGETS

The targets for the Scheme Year 2023/2024 year continued to be based on the number of confirmed thefts and operated at the same level as in the prior year. For Scheme Year 2024/25 we would continue to follow a similar approach and incorporate the newly introduced pot splits. The new Theft Targets will be based on the market share of each Supplier in the relevant segment and not industry averages.

This change is supported by the TDIS Survey results that show a very strong preference for the segmentation of the target to be based on the market share of each Supplier in the relevant segment.

Under the current TDIS design, the targets (in combination with the Theft Detection Value) determine the overall pot value and hence any material change to the targets would impact the overall pot available (assuming no change in TDV). Performance against target does not directly impact the calculation of credits/debits positions of Parties – rather this is based on performance of Suppliers relative to others in the same segment but the pot value impacts the scale of the credits/debits.

Results of the recent TDIS survey confirmed a very strong preference for continuing to set targets based on the number detected rather than energy volume or value of theft. There was some support to add a stretch element to the Theft Targets to demonstrate that the industry is trying to improve theft detection levels but little support for a Suppliers Theft Target to go down the following year if they outperformed their target.

Although the theft target has not been met for the past two years we propose retaining the overall target of 41,000 confirmed thefts. Given the TEM indicates theft remains a significant and increasing challenge within the industry and that this target represents approximately 5% of the estimated number of thefts occurring retaining the current target is considered reasonable.

The outcome from previous TDIS Scheme Years and the results of the modelling conducted as part of the TEM analysis however suggest that there may be a need to adjust the allocation of the target within the existing incentive pots and the option of new incentive pots outlined above required further disaggregation of the targets. When setting the targets there is the option of allocating targets based on the best available estimate of where theft is occurring (i.e. seeking to give all targets an equal incentive for detection) or to set targets based on seeking to incentives currently under-investigated theft (e.g. for example reducing the target for traditional prepayment meters given the bias in investigations identified by the TEM analysis).

The TDIS Survey responses include feedback that, if Theft Targets were to be segmented, there was a preference for weighting to be applied for segments where there is evidence of a higher propensity for theft based on historic theft identification levels in each segment rather than being set higher where lower levels of theft have been identified because of potential under detection in some segments.

On the basis of this information there is the option to adjust the current targets for the existing customer segments as follows:

Fuel Type	Customer Segment	Current	Option
Electricity	Domestic	30,000	31,500
	Non-Domestic	4,000	3,000
Gas	Domestic	5,110	5,500
	Non-Domestic	1,890	1,000

TABLE 3: Shows the existing Theft Targets along with options for existing pots

For any of the new incentive pots (as outlined previously) it will be necessary to further split down the targets and hence an option to do so must be identified. To reflect the feedback and approach of setting targets based on the best estimate of where theft is occurring whilst avoiding undue complexity an approach based on market share with a weighting applied could be adopted. This would disaggregate the target based on the market share of the overall customer segments (as per the table above) using the total number of meters for each incentive pot but with a weighting applied to some or all pots.

To provide a starting point for this approach we have developed the following initial set of options for the corresponding weighting factors: These are based on the following rationale:

- As outlined on page on page 9 there is a bias in investigation of theft in prepayment meters and a higher conversion rate of investigations to confirmed thefts. This may indicate there is a disproportionate focus on investigate of theft for such meters and as such a reduced weighting has been applied.
- Smart / AMR meters are expected to exhibit a lower level of theft vs traditional metering and hence a reduced weighting is applied.
- Feedback is that there is limited theft in the I&C market and hence again a reduced weighting is applied.

Customer Segment	Customer Type	Meter Type	Weighting
Domestic	-	Traditional Prepayment	0.8
	-	Traditional Credit	1

Customer Segment	Customer Type	Meter Type	Weighting
	-	Smart	0.6
Non-Domestic	SME	-	1
	SME	Smart / AMR	0.6
	SME	Traditional	1
	I&C	-	0.5
	Domestic Type	-	1

TABLE 4: Shows the new options along with weightings for new option pots

Questions

14. Do you agree with the option of retaining the total theft target at 41,000 confirmed thefts?
    a. Why or why not?
    b. If you do not agree with the option to retaining the theft targets what do you think the overall target should be set at, or what basis for setting the target do you think should be followed?
15. Do you agree with the option of updating the split of targets between the current higher level incentive pots outlined, based on the TEM modelling and previous Scheme Year Outcomes?
    a. Why or why not?
    b. If you do not agree do you think any change is required? If so what, and what evidence do you have to support this?
16. Do you think that targets should be set based on the best available estimate of the relative amounts of theft in each incentive pot or should be adjusted to incentivise currently under-investigated/detected theft?
    a. What informs your thinking of this? What evidence can you provide to demonstrate this thinking?
17. Do you agree with the proposed approach of applying a market share approach to allocating targets, with a weighting factor applied to adjust the target based on the best available estimate of the relative amounts of theft?
    a. Do you agree with the approach of not also applying different weightings by fuel type (given the overall targets are already split on this basis)?
    b. If you do not agree, how do you think the targets should be allocated?
18. Do you agree with the proposed weightings and associated rationale for the weightings for the domestic pot split between traditional prepayment meters, traditional credit meters and smart meters?
    a. What informs your thinking of this? What evidence can you provide to demonstrate this thinking?
    b. If you disagree, please indicate what you believe the weightings should be set at. Please share any supporting evidence/rationale.
19. Do you agree with the proposed weightings and associated rationale for the non-domestic pot split between domestic-type customers, SME and I&C?
    a. What informs your thinking of this? What evidence can you provide to demonstrate this thinking?
    b. If you disagree, please indicate what you believe the weightings should be set at. Please share any supporting evidence/rationale.
20. Do you agree with the proposed weightings and associated rationale for the split of the SME population between traditional meters and Smart/AMR meters?

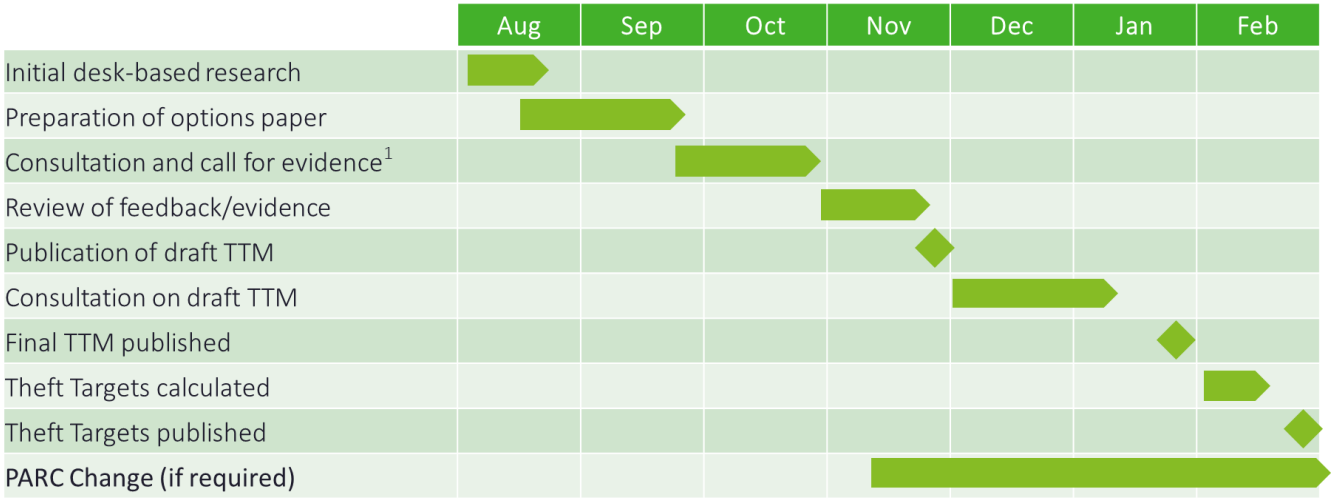
a. What informs your thinking of this? What evidence can you provide to demonstrate this thinking?

b. If you disagree, please indicate what you believe the weightings should be set at. Please share any supporting evidence/rationale.

21. Do you have any other comments or suggestions for Theft Target?

NEXT STEPS AND TIMELINES

We will be seeking industry engagement in both the options paper and through the subsequent consultation on the TTM document itself as per the below timeline. The TTM will be published in line with the Schedule for 1st March 2024.



[1] Includes September PAB and ETREG and bilateral discussions with Ofgem, Citizens Advice and Citizens Advice Scotland

FIGURE 2: The timeline for review of the TTM



To find out more please contact:

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