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25 September 2014

Dear Maxine

### **RIIO-ED1 - SMART GRID SAVINGS - A WAY FORWARD**

The quantification of smart grid savings is clearly a problematic issue. The attempt to introduce this adjustment at a late stage in the process is putting pressure on Ofgem to arrive at a judgement that is supported by the evidence in a very short space of time.

I can see why Ofgem might feel that it was necessary to check that DNOs had captured the savings that will be available from the development of smart grid solutions; this would be the case if there were some reason why the benchmarking of future plans would systematically fail to pick up these savings. In that case we can see that some adjustment to the benchmarked results would be appropriate.

Part of the problem lies in the fact that no one really knows how the smart agenda will play out, what the profile of installation of smart meters will be and how the benefits will offset the extra costs that will arise under the various possible scenarios for LCT uptake.

The normal way to deal with these kinds of uncertainties is to incentivise efficient response and to take account of the revelation of information in due course. Where the uncertainty is pronounced and the timescales are long (as in the case of the RIIO eight year controls) it may be more appropriate to introduce an uncertainty mechanism to deal with the issue.

Since the profile of smart benefits is very likely to be one of relatively little benefit at the start of the period, perhaps growing throughout the later years, this might be an example of where there could be a mid-period review of the available benefits after, say, four years. This could be coupled with an evidence-based *ex ante* assumption of the available savings that would be included in the *Final determination* but that assumption would be much more modest than your present assumption and it would need to take account of all the errors and inconsistencies in the assessment that we have identified - in the profiling of the likely benefits from smart solutions, the proper use of the Transform model and the correct attribution of these savings to DNOs as well as the correct quantification of the benefits already in DNOs' plans. I appreciate that you had intended that the mid-period review envisaged in the *Strategy decision* would be confined to changes in outputs but that treatment might also be more appropriate for smart savings than the alternative that you are now contemplating and that is proving to be so contentious.

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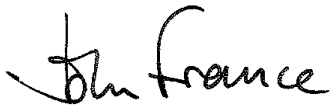
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There is no licence condition proposed for the mid-period review of outputs; the terms of the review are expressed in commitments that are outside the licence. The same could be true of a mid-period smart savings review or, if you preferred, it would be relatively straightforward to express this so that the review was governed by a licence condition.

Lastly, I think this treatment would also enable you to treat the slow-track licensees equitably with the fast-track licensees whose settlement does not include any adjustments for smart savings. You could propose this mid-period review approach for all licensees; after all the railway electrification uncertainty mechanism was never part of the WPD business plan so the principle that the fast-track settlement accepts the plan in its entirety or not at all was breached when Ofgem proposed an uncertainty mechanism that was not in the WPD plan.

Yours sincerely

A handwritten signature in black ink that reads "John France". The signature is written in a cursive style, with the first letters of "John" and "France" being capitalized and prominent.

John France  
Regulation Director