Rio Tinto Alcan

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**Non-confidential Response**

Nicholas Rubin
Distribution Policy
Ofgem
9 Millbank
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Dear Nicholas,

**Response to consultation document 88/10**

Rio Tinto Alcan welcomes the opportunity to respond to Ofgem's 'Charges for pre-2005 Distributed Generators' use of DNOs' distribution systems' consultation document.

Rio Tinto Alcan undertakes aluminium smelting activities at industrial sites connected to the Northern Electric Distribution Ltd (NEDL) and Scottish Hydro-Electric Distribution Ltd (SHEDL) networks. We have only a tiny and passive role in the electricity market and we are not signatories to the main industry commercial codes, and although we have certain derogations, we abide by the Distribution and Grid Codes in technical matters and with respect to data submissions as required.

Aluminium smelting is an electricity intensive process and our primary concern is the security of electricity supply to our smelters. In order to ensure security of electricity supplies, Rio Tinto Alcan produces its own electricity from on-site assets, whilst also having third party electricity supplies. On-site output is largely absorbed by the smelters, with the remainder exported onto the local distribution system.

The sites have a long history. For example, the Lynemouth site dates from around 1970, whilst Kinlochleven has been operational for 100 years. Investment in the on-site assets and supporting infrastructure was made under a different regulatory and charging environment from that which exists today. The sites effectively paid deep connection charges for secure connection to and use of the distribution network. This typically involved incurring a large, up-front capital cost to finance the required network investment

Over time, however, the regulatory arrangements and Rio Tinto Alcan's exposure to them has changed. In this context, the proposals relating to charging pre-2005 distributed generators (DG) for use of the distribution systems are a key issue for Rio Tinto Alcan. The consultation document in question focuses upon the mechanism for making and the principles for determining compensation payments for pre-2005 DG customers. Our response considers these issues, whilst also considering the wider issues in play.

Rio Tinto Alcan

**Exposure to GDUoS charges**

As highlighted above, our sites have a long history and pre-date the current regulatory regime. Investments at these sites are sunk and backed by contractual agreements that confer particular sets of rights upon the sites. The historical context cannot be ignored and deviation away from existing arrangements cannot be mandated. Rio Tinto Alcan must be given the choice to transfer to the proposed charging arrangements and should not be forced to do so. In this context, we believe that we should have an option to transfer to the new regime or to maintain our current position.

This decision is of significant importance to the future of our business. We are currently considering investment options at our sites, including re-powering options at Lynemouth. Potential future exposure to GDUoS could have a significant impact upon the economics of potential investments. However, it is not possible to assess this exposure because the analytical evidence base is lacking. For example:

- no indicative charges are available beyond the next charging year[1]; and
- no analysis of sensitivity to changes in generation/demand patterns is available.

Given the lack of robust analysis in relation to the potential variability of charges going forward, our ability to make informed business decisions is severely compromised. At present, this is an unmanageable risk and it is inappropriate for us to make decisions of such importance to our business in this situation. Only once this informational gap has been filled by Ofgem and the DNOs will we be able to make an informed choice.

**Exposure to generator and demand charges**

As flagged above, our sites are able to import and export power via the same network infrastructure. We already face exposure to demand DUoS charges, which are calculated to recover the costs associated with use of these network assets. If we are to additionally face exposure to generator DUoS charges, we risk being charged twice for use of the same network assets, which is clearly inappropriate. The ability of the both the LRIC and FCP methodologies to properly model this combined use of the assets has been recognised by the DNOs as a model weakness, where different and separate treatment is undertaken when considering generation and demand sites. It is important that individual demand and generation charges levied on a site are calculated such that an appropriate cost is recovered in aggregate. It is essential, therefore, that the charging methodologies are able to reflect industrial sites such as our own. We have raised the issue of double charging in previous consultation exercises. The issue remains of critical importance to Rio Tinto Alcan, given the potential for GDUoS charges to be applied to our sites.

**Compensation**

Any transfer to the proposed charging regime and acceptance of exposure to GDUoS charges, must be accompanied by payment of compensation specific to the site in question. This is a non-negotiable principle which must be adhered to.

The value attached to a compensation payment must be determined on a site specific basis and be reflective of the particular circumstances in force. Compensation should reflect, inter alia:

- costs incurred as part of the connection process;
- any contributions made under bilateral agreements to fund ongoing upkeep and future replacement of assets; and

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[1] We understand that even the proposed 2011/12 EDCM charges are 'work in progress', are set to be revised, and will not be known until after this consultation has closed.

- the value of future system usage that would be foregone as a result of any transfer, determined to reflect the potential for changes to the charging methodology in the future.

The compensation payment owed must not be affected by the level of initial GDUoS charges. If, for example, a site is projected to receive a rebate under its initial GDUoS charges, this should not be used as an argument to reduce compensation payments. Any cashflow linked to compensation and GDUoS charges should be considered entirely separately.

Full settlement of agreed compensation payments should be established as a pre-condition for the application of GDUoS charges. Facing GDUoS charges prior to full receipt of any compensation owed would create inappropriate financial exposure for any party that elects to transfer to the new regime. As such, this situation must be avoided.

If this principle is adopted, we are not opposed to the proposal for unbundling the determination of charges and compensation payments. However, this position is conditional on the assumption that an individual site only incurs GDUoS charges once compensation payments due to it have been fully paid.

**Wider issues**

The charging arrangements for embedded sites are in a period of upheaval, creating considerable regulatory uncertainty for affected parties. Alongside these proposals concerning GDUoS charges, National Grid has been leading work seeking to apply TNUoS charges to distributed generators. While these proposals appear to have been put on hold, pending a broader Ofgem consultation, they remain on the near horizon. This leaves us in a position where our potential exposure to network charges could change beyond recognition in the near-term

Regulatory and commercial risk of this proportion places a significant restriction on our business operations. Rio Tinto Alcan operates in a business cycle of 40-60 years. However, given the current developments, we have no clear idea of our potential liability for network charges over the next three years, never mind the coming decades. Our ability to make informed decisions in the coming years concerning the future of our sites is, therefore, severely restricted. It is essential that the network charging arrangements deliver stable and appropriate charges going forward.

We are keen to work with Ofgem and the energy industry in developing appropriate arrangements for distribution charging.

Yours faithfully

Jonathan Scott
Power Commercial Director