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Witness: Layle (Kip) Smith
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Case No.: ER-2012-0166

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Service Commission

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

**In the Matter of Union Electric
Company d/b/a Ameren
Missouri's Tariffs to Increase its
Revenues for Electric Service**

Case No. ER-2012-0166

Direct Testimony of Kip Smith

On behalf of

Noranda Aluminum, Inc.

July 19, 2012

Exhibit No. 524

**In the Matter of Union Electric
Company d/b/a Ameren
Missouri's Tariffs to Increase
its Revenues for Electric
Service**

STATE OF TENNESSEE)
)
COUNTY OF WILLIAMSON)

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Case No. ER-2012-0166

Direct Testimony of Kip Smith

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Kip Smith. My business address is Suite 600, 801 Crescent Centre Drive, Franklin, Tennessee 37067.

Q WHAT IS YOUR OCCUPATION?

A I am the President and CEO of Noranda Aluminum, Inc. ("Noranda"). I am familiar with, and am responsible for, all aspects of Noranda's business.

Q PLEASE DESCRIBE THE BUSINESS OF NORANDA.

A Noranda is an integrated aluminum manufacturer. In addition to its smelter near New Madrid, Missouri, Noranda owns and operates a bauxite mine in Jamaica and an alumina refinery in Gramercy, Louisiana. The New Madrid Smelter is Ameren Missouri's largest customer. The New Madrid Smelter produces molten aluminum and converts molten aluminum to aluminum products such as billet, rod, foundry products and primary ingots. The smelter has been operating in Southeast Missouri since February 25, 1971. Its primary product inputs are electricity and alumina. The alumina is delivered via barge over the Mississippi

River. Alumina, also known as aluminum oxide, is produced from bauxite ore. The New Madrid Smelter processes the alumina through three production lines (pot lines). The pot lines contain “pots,” which are large steel containers lined with carbon. Within these pots electrolysis occurs, breaking the bond between the aluminum and oxygen atoms in the alumina. The reaction requires a significant amount of electricity. The result of that reaction is molten aluminum. Electricity must be constantly available to the pots since the pots will be damaged if the liquid metal resulting from electrolysis solidifies inside of the pots. When at full production, the smelter produces over 260,000 metric tons of aluminum per year. The aluminum is sold primarily in North America. Noranda is one of the largest foil producers in North America and a major producer of light gauge sheet products.

Q WHY IS NORANDA INTERESTED IN THIS PROCEEDING?

A Electricity is the single largest operational cost of the New Madrid Smelter, constituting about one-third of its overall cost of producing primary aluminum. When the New Madrid Smelter is at full production, at current electric rates, it pays Ameren Missouri approximately \$148 million in base rates for electricity each year plus charges under the fuel adjustment clause. Ameren Missouri’s proposed rate increase of approximately 14.6 percent would drive the New Madrid Smelter’s electricity expenses up to approximately \$170 million each year plus charges under the fuel adjustment clause. The New Madrid Smelter, and thus Noranda, are deeply concerned with this case and have an abiding interest in supporting the Commission process.

Q WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A The purpose of my testimony is to show the Commission that its decision in this case is vitally important to the New Madrid Smelter's long-term operations. The New Madrid Smelter's sustainability in Southeast Missouri is inextricably linked to the well being of the approximately 900 Noranda employees and their families and dozens of Southeast Missouri businesses and the families that they support. I hope to show the Commission that a sustainable electric rate for the New Madrid Smelter is in the public interest.

Q WHY ARE ELECTRIC RATES SO IMPORTANT TO THE NEW MADRID SMELTER?

A The aluminum production industry is globally competitive. The commodity of aluminum produced by the New Madrid Smelter is essentially identical to that produced by other aluminum smelters. Also the price for aluminum is established on the London Metal Exchange (LME), and a producer such as Noranda has little or no influence on the LME price. For these reasons, the viability of a smelter is largely dictated by its cost to produce aluminum. Affordable electricity is essential to the New Madrid Smelter because electricity constitutes such a large percentage of the cost to produce aluminum.

Q WHAT IMPACT WOULD AMEREN'S PROPOSED RATE INCREASE HAVE ON THE NEW MADRID SMELTER?

A Ameren's proposed rate increase threatens the viability of the New Madrid Smelter. Ameren's proposed 14.6 percent rate increase would increase the New Madrid Smelter's electric rates by approximately \$22 million annually, at a time when business conditions are extremely challenging. To remain viable during the

recession, the New Madrid Smelter has been able to reduce nearly all of its costs except for electricity. Very sadly, the New Madrid Smelter was required in 2009 to cut approximately \$15MM of labor costs. Additional workforce cuts now of this magnitude are not an option because the New Madrid Smelter would be left with too few employees to operate the smelter. The New Madrid Smelter has achieved success in reducing nearly all of its other major costs, and it will continue to drive further efficiency. Since the New Madrid Smelter cannot directly control the price of its electricity, we can only influence slightly more than two-thirds of its cost structure. The New Madrid Smelter also has little or no influence over the LME price of aluminum and must constantly work to drive its overall costs down in real terms over time to remain competitive and viable. Ameren Missouri's rate increase would erase the gains that the New Madrid Smelter has worked so hard to achieve, and would take the New Madrid Smelter in a direction that is not sustainable in the long term.

Q ARE THERE ANY ATTRIBUTES TO THE NEW MADRID SMELTER'S DEMAND FOR ELECTRICITY THAT MAKE IT DIFFERENT FROM OTHER CUSTOMERS?

A Yes. First, as indicated above, the New Madrid Smelter consumes large quantities of power. Second, the New Madrid Smelter has a very steady demand for electricity, consuming it twenty-four hours a day, seven days a week, 365 days a year, with a 98% load factor. Third, as a result of the particular physical supply arrangements, none of the Ameren Missouri distribution facilities are used in providing service to the New Madrid Smelter, leading to lower losses and lower assignment of costs. All of these considerations lead to a much lower unit cost

for the service provided to the New Madrid Smelter as compared to other customers.

Q WHAT IS YOUR UNDERSTANDING OF THE COST TO PRODUCE THE ELECTRICITY SUPPLIED TO NORANDA VERSUS THE RATE CHARGED BY AMEREN MISSOURI FOR THAT ELECTRICITY?

A Based on the cost of service study prepared by Maurice Brubaker, it is my understanding that if Ameren Missouri would charge the New Madrid Smelter, based upon the cost to produce the electricity sold to it, the New Madrid Smelter would be paying a lower rate.

Q WHY IS A COMPETITIVE RATE FOR NORANDA IN THE PUBLIC INTEREST?

A The New Madrid Smelter has been an integral part of the economic landscape of Southeast Missouri for over 40 years. The New Madrid Smelter is one of the largest, if not the largest, employer in Southeast Missouri. Hundreds of Southeast Missouri families would be placed in peril if the New Madrid Smelter was forced to shut its doors. Millions of dollars flow into the homes and businesses of Southeast Missourians as a result of the revenues from Noranda products which are sold mostly outside of the state. Moreover, the New Madrid Smelter provides hundreds of skilled jobs that pay good wages and provides its employees good medical and retirement benefits. In addition, the New Madrid Smelter pays some 18.4% of the total taxes collected in New Madrid County and roughly 28% of the assessed tax paid for the New Madrid County Schools. Taxes paid by the New Madrid Smelter help keep the school systems viable and help to maintain the infrastructure and needed government institutions in Southeast Missouri. It is vital to our employees, to their families, to the

community, to the merchants that our employees frequent, to our vendors (including Ameren Missouri), and to their families, that the New Madrid Smelter remain viable. The rate supported by Mr. Brubaker that I am respectfully advocating for the New Madrid Smelter would greatly enhance the continuing viability of the smelter and thereby sustain the numerous benefits to the community and the State of Missouri.

Q WHAT STEPS HAS THE NEW MADRID SMELTER TAKEN TO REDUCE ITS COSTS?

A The New Madrid Smelter has been working intensely to reduce its costs to sustain its Missouri operations. Just three years ago, to survive the recent economic crisis, the New Madrid Smelter unfortunately was forced to reduce its workforce by approximately twenty percent, from 1,120 employees to less than 900 employees. The New Madrid Smelter has reduced its operating costs through vigorous interaction with its suppliers, investments in efficiency projects and programs to eliminate waste. The New Madrid Smelter has reduced every operating costs that it can directly influence and control, and will continue to do so. But this represents only two-thirds of our costs, and that is unfortunately not enough.

Q. WHAT IS THE NEW MADRID SMELTER'S STRATEGY FOR INVESTMENT IN MISSOURI?

A. Noranda's corporate strategy combines four key elements to build a sustainable, integrated aluminum company. First, we are a U.S. based, publically traded (NYSE) company focused on U.S. markets. Second, our U.S. production assets are supported by our bauxite mine in Jamaica and our refinery in Gramercy,

Louisiana, creating an integrated production system from basic raw materials to finished aluminum foil products. Third, we have a passionate focus on productivity supported by annual and three-year cost control and productivity goals. Fourth, we have a value-added sales strategy that has built long term relationships with quality U.S. customers.

This corporate strategy supports the short term performance and long term viability of the New Madrid smelter. Since 2009, Noranda has had an aggressive program to reduce its costs and increase productivity, achieving over \$220MM in productivity savings to date. New Madrid's share of this improvement was \$97MM. These savings are crucial to the viability and ongoing reinvestment in the New Madrid Smelter. Since 2007, Noranda has invested over \$294MM to preserve, improve and grow the capability of the facility.

As a commodity business, the New Madrid Smelter is essentially focused on cost, and electricity is the single most important cost. Our focus on productivity and cost control positioned the New Madrid Smelter to weather the 2009 recession as well as difficult periods of low aluminum prices such as we are experiencing now. Cost-based electric rates are crucial to the New Madrid Smelter's ability to make capital investments in Missouri, and globally competitive electric costs will sustain long-term investment.

New Madrid plays a key role in our value-added growth strategy in manufacturing high purity grades of aluminum as well as fabricated products – aluminum billet and aluminum rod. A key foundation of this strategy is the capability to manufacture cost competitive aluminum. To that end Noranda has authorized

\$38MM in capital to improve New Madrid's electrical efficiency, yielding an additional 35mm pounds of aluminum. Noranda has also authorized \$1MM for the engineering for a new rod mill. A final decision on this \$40MM project is expected yet this year.

Q. WHY IS THE COMMISSION PROCESS SO IMPORTANT TO NORANDA?

A. Electricity is one-third of the New Madrid Smelter's cost. While Noranda can bring market competition to bear on the cost of every other supply line of the New Madrid Smelter, electricity is the one cost we cannot directly control. Noranda relies on the Commission process to serve as virtual competition to control power costs. Noranda greatly appreciates the Commission's decisions in Ameren Missouri's last several rate cases to move Noranda's rate toward cost of service. The New Madrid Smelter will continue to operate because of these decisions, the support of the stakeholders, and the strength of the Commission's process. However, Noranda faces a constantly changing landscape with new electricity cost threats. In recent years, Noranda and other Ameren Missouri customers have experienced the profoundly negative impact of several significant rate increases under Ameren Missouri's fuel adjustment clause. We feel that the Commission's decisions in the prior rate cases, resulting from a fair process and the constructive work of all parties, continue to be set back by substantial increases and overcharges by Ameren Missouri under its fuel adjustment clause. Noranda and other consumers continue to face the threat of excessive rate increases that will undermine Missouri's economic development. Noranda respects the Commission process and seeks to strengthen this process by contributing evidence and engaging in constructive dialogue with all stakeholders. Noranda believes it can support the Commission's efforts to create

a more competitive environment for power in Missouri, including development of new generation alternatives that may include nuclear or even modular nuclear power. We hope that with the Commission's help, all stakeholders can move toward consensus on fair rates and toward constructive dialogue to achieve a sustainable energy future for Missouri.

Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A Yes, it does.