Exhibit No.:	
Issues:	Noranda Operations, Aluminum Industry and Fuel Adjustment Clause
Witness:	Donald Johnstone
Type of Exhibit:	Direct Testimony
Sponsoring Party:	Noranda
Case Number:	ER-2008-0318
Date Testimony Prepared:	August 28, 2008

AmerenUE

Case No. ER-2008-0318

Prepared Direct Testimony of

Donald E. Johnstone

On behalf of

Noranda Aluminum, Inc.

August 2008

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a AmerenUE for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area.	)))))	**ER-2008-0318**

AFFIDAVIT OF DONALD E. JOHNSTONE

STATE OF MISSOURI)
) ss
COUNTY OF Jackson)

Donald E. Johnstone, of lawful age, on his oath states: That he has reviewed the attached written testimony in question and answer form, all to be presented in the above case, that the answers in the attached written testimony were given by him; that he has knowledge of the matters set forth in such answers; that such matters are true to the best of his knowledge, information and belief.

Donald E. Johnstone

Subscribed and sworn to before me this 28th day of August, 2008.

Notary Public

ANGELA HEDGES
Notary Public - Notary Seal
State of Missouri - County of Jackson
My Commission Expires Aug. 15, 2009
Commission #05402477

[SEAL]

My Commission expires: 8-15-09

Before the
Missouri Public Service Commission

AmerenUE

Case No. ER-2008-0318

Prepared Direct Testimony of Donald E. Johnstone

Q PLEASE STATE YOUR NAME AND ADDRESS.

A My name is Donald E. Johnstone and my address is 384 Black Hawk Drive, Lake Ozark, Missouri, 65049.

Q BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A I am employed as President of Competitive Energy Dynamics, L. L. C.

Q PLEASE SUMMARIZE YOUR EDUCATION AND EXPERIENCE.

A I have a bachelor's degree in electrical engineering from the University of Missouri at Rolla and I hold a master of business administration degree from Oklahoma City University. After five years of military service I have spent 35 years working in the utility industry, first as an employee of an electric utility in the power operations and corporate planning departments. I have been

consulting in utility regulatory matters since 1981. My qualifications and experience are set forth in more detail in Appendix A.

Q WHAT ARE THE PURPOSES OF YOUR TESTIMONY?

A In this testimony I will introduce the witnesses appearing on behalf of Noranda, describe the service requirements of the Noranda Smelter, and describe aspects of the aluminum industry important to the matter at hand. I will also address the AmerenUE proposal for a fuel adjustment clause (FAC).

Noranda uses electricity provided by AmerenUE in its Smelter located in New Madrid County close to the town of New Madrid. In this testimony I will refer to the Noranda facility as the "Smelter."

Q WHAT OTHER TESTIMONIES ARE BEING SUBMITTED FOR NORANDA?

A Senator Robert Mayer and Representative Steve Hodges are providing testimonies that address the importance of Noranda as a socially responsible corporate resident of the State of Missouri. Commissioner Mark Baker of New Madrid County and Mr. Harvey Cooper of the Community Sheltered Workshop describe important contributions of Noranda to the Southeastern region. Mr. Steve McPheeters provides a factual perspective on Noranda as a part of the aluminum industry and also describes many of the favorable impacts of Noranda on the region, the State, and the Nation.

SUMMARY

Q PLEASE SUMMARIZE YOUR TESTIMONY.

A

- The continued operation of the Noranda Smelter is a matter of vital interest to the region and the State of Missouri, as further explained in the testimonies of:
    - Senator Mayer,
    - Representative Hodges,
    - Commissioner Baker,
    - Mr. Cooper, and
    - Mr. McPheeters.

- The Smelter provides revenues of roughly $130 million per year while consuming 475 MW of electricity around the clock.

- The Smelter is in an industry with a history of decline in the United States, due in large part to the cost of electricity.

- The Smelter operates in a competitive world market such that cost increases cannot be passed on to customers.

- The Smelter is working aggressively on all fronts to provide a secure and profitable future – to the benefit of all concerned.

- The Ameren proposal for an FAC should be rejected because
    - the financial incentive for AmerenUE to minimize costs would be eviserated,
    - the insured cost of replacement power due to generator outages would create a rate yo-yo with rates going up and going down needlessly,
    - consumers would be put in the position of insuring the replacement power costs of every outage, large and small, subject only to imprudence investigations months or years later,
    - the larger issue of the AmerenUE financial health cannot be solved with the proposed FAC and needs to be considered in a separate proceeding.

Q UNDER WHAT RATE DOES AMERENUE PROVIDE SERVICE TO THE SMELTER?

A AmerenUE provides service to the Smelter under the Large Transmission Service rate schedule. The service provided is firm and the Smelter consumes approximately 475MW around the clock - seven days a week. A measure of the Smelter's consistent use of the AmerenUE facilities is the ratio of the average use of electricity as compared to the peak use. In the Smelter's case the comparison is captured in a load factor of 98%. This leads to the efficient use of the Ameren facilities and services with one important result being a lower average cost per kWh delivered to the Smelter.

PUBLIC INTEREST CONSIDERATIONS

Q WHAT ARE THE PUBLIC INTEREST CONSIDERATIONS RELATED TO ELECTRIC UTILITY SERVICE FOR NORANDA?

A First, along with many other Missouri residents and businesses, the Smelter shares an interest in reliable and economical cost-based electrical service. In the particular case of the Smelter the dual needs for service that is economical as well as highly reliable are particularly critical due to the use and impact of electricity on the smelting operations.

On another level, the Smelter makes many contributions to the public interest in both economic and social terms. Those contributions include jobs, payroll, purchases from local suppliers, taxes, and many leadership

contributions to the communities surrounding the Smelter. Also, to state the obvious, the Smelter is making a very large energy purchase from another Missouri company, AmerenUE. Senator Mayer, Representative Hodges, Commissioner Mark Baker, Mr. Harvey Cooper, and Mr. Steve McPheeters explain the importance of the Smelter to Missouri in their testimonies.

SMELTER PRODUCTS AND ELECTRICITY REQUIREMENTS

Q PLEASE DESCRIBE THE PRODUCTS PRODUCED BY THE NORANDA SMELTER AND THE MARKET INTO WHICH THE PRODUCTS ARE SOLD.

A The plant produces four products: billet, rod, foundry products and primary ingots. The products are sold into markets that in most respects are world markets. Of course, the Smelter strives to exploit both its abilities to serve niches and its mid-continent location to sell to regional customers within the market. With respect to the State of Missouri, the Smelter is an export industry. This means that revenue from products sold mostly outside of Missouri flows into the State.

Q PLEASE DESCRIBE THE PROCESS USED TO SMELT ALUMINUM.

A The plant receives alumina via barge over the Mississippi river. The alumina is offloaded from the barges and moved to the Smelter by conveyer. There it is processed in one of the three production lines (pot lines) where electricity is used to break the bond between aluminum and oxygen in the alumina. The pot

lines operate at a high level of efficiency, over 90%, and the Noranda continuously strives for additional improvements. Generally the finished products are shipped via truck and to a lesser extent by rail.

Q OVER THE PERIOD OF A YEAR WHAT WILL BE THE APPROXIMATE QUANTITIES OF ALUMINUM PRODUCED AND ELECTRICITY CONSUMED?

A On an annual basis the plant will produce 571 million pounds of aluminum and consume about 4.1 million MWh (475 MW at 98% load factor). During the test year the amount paid to AmerenUE was roughly $130 million.

Q PLEASE DESCRIBE SOME OF THE IMPORTANT CHARACTERISTICS OF THE ELECTRICITY REQUIREMENTS OF THE SMELTER.

A First and foremost the supply must be reliable. The smelting process is continuous and cannot be cycled on and off. Any unmanaged interruption of the supply beyond an hour is very serious and would be likely to cause extensive damage to the process and create a major capital expense to repair and rebuild. The Smelter cannot predict with any certainty the future economic and operational impact should a major interruption occur in spite of all efforts to provide a reliable supply of power; the consequences could be so severe as to result in a permanent closure of the plant. Consequently, AmerenUE's ability to provide reliable service is extremely important.

Equally important is the impact of the cost of electricity on the economic viability of the plant. Electricity costs are important because electricity represents approximately 1/3 of the Smelter's operating cost and is the single largest operating cost. The Smelter's ability to remain viable depends on maintaining its ability to deliver a competitively priced product. Electricity has a large part to play in that. Of course, the prevailing market prices received for the products produced and other costs are all also important considerations. Although the Smelter is large, it is not a market maker so it must accept the market prices. Therefore, it is critical that all costs, and electricity in particular as the largest single cost, remain economical and under control.

NORANDA AS A PARTICIPANT IN THE ALUMINUM INDUSTRY

Q WHAT HAS BEEN THE HISTORY OF ALUMINUM SMELTERS IN THE UNITED STATES?

A The number of smelters and the quantity of primary aluminum produced in the US has been in general decline for many years. Given the electrical intensity of the smelting process there is no doubt that the cost of electricity has been a devastating consideration for most - perhaps all - of the smelters that have closed. The Noranda Smelter is a survivor.

Q IS NORANDA ACTIVELY MAKING PLANS TO SURVIVE AND SUCCEED IN THE FUTURE?

A Yes. I have been directly involved in their procurement of electricity for more than 10 years. The focus has always been on reliability and cost. That focus continues and is stronger than ever. Noranda is actively working on every aspect of their business to make it a stronger competitor with a cost structure that will enable it to continue to supply an expanding market. The continuing goal is a sustainable operation.

Q IS GROWTH A PART OF THE EQUATION?

A Yes. The Smelter is working on plans which, when they come to fruition, will further increase efficiency, increase production, and spread fixed costs over more units of production. One effect is to increase the consumption of electricity as a part of plans to increase its productive efficiency.

Q IS NORANDA FOCUSING ON ALL ASPECTS OF ITS OPERATION?

A Yes. While the importance of electricity looms large as the single largest cost, every aspect of the operation is under scrutiny for improvement. The objective is to pursue and achieve every measure that is necessary to secure a stable and profitable operation for years to come.

FUEL ADJUSTMENT CLAUSE

Q IS THE AMERENUE PROPOSAL FOR A FUEL ADJUSTMENT CLAUSE (FAC) A GOOD APPROACH TO RATEMAKING FROM THE PERSPECTIVE OF THE SMELTER?

A No. An FAC would increase the volatility of the cost of electricity for the Smelter and a particular concern is the possibility of large increases in cost for the Smelter. These concern are heighted because the proposal reduces the financial incentive for AmerenUE to control the net costs that would be subject to the proposed FAC, because the proposal would swap out regulatory oversight for the important financial incentives inherent in the traditional Missouri base rate approach to regulation, and because it would reduce the effectiveness of regulation as to several important consumer protections inherent in the traditional Missouri approach.

FAC – FINANCIAL INCENTIVES

Q WHY IS THE SMELTER CONCERNED WITH THE EFFECT OF THE FAC ON INCENTIVES?

A Financial incentive is a fundamental driving force in the free enterprise approach to markets and the economy. It is most certainly a driving force for the Smelter in that it must deliver its products at a competitive price in a world market to survive and prosper.

Q IS THE FACT THAT AMERENUE IS AN INVESTOR OWNED UTILITY RELEVANT?

A Yes. Of course, Missouri's electric utility industry continues to operate in the traditional regulatory fashion. It has neither been deregulated nor restructured as has occurred in some states. AmerenUE therefore remains a traditional regulated monopoly. There is the service obligation of AmerenUE that is a part of the consideration – with the benefits and obligations of a service franchise.

Q IN THE CONTEXT OF A STATE THAT CONTINUES WITH TRADITIONAL REGULATION OF INVESTOR OWNED ELECTRICITY SUPPLIERS, ARE THERE ALTERNATIVES TO THE INVESTOR OWNED UTILITY STRUCTURE?

A Yes. We have examples of several alternatives in Missouri, all with important distinctions. Alternative forms of organization include (1) investor owned regulated utilities such as AmerenUE, (2) public ownership such as the many municipal utilities in the State, and (3) the structure of the electric cooperatives that are by and large owned by their customers. Of the three, investor owned utilities have the highest financial costs largely because of the cost of investor supplied capital and income tax. In theory, an investor owned utility (IOU), in spite of the higher financial costs, may be preferred to either a publicly owned utility or a cooperative because the financial incentives inherent in the IOU structure lead to more efficient and economical service. However, if the financial incentives are not maintained, are not effective, or

perhaps even not needed as AmerenUE in part argues, then it would be logical to consider a move to a different form of ownership that would inherently lower the financial costs. Conversely, with the investor owned structure, financial incentives are essential to promote an economical result for consumers.

FAC – FINANCIAL RATINGS CONSIDERATIONS

Q WHAT IS THE PURPOSE OF FINANCIAL RATINGS OF AMERENUE?

A The ratings provide an indication of AmerenUE's financial strength and the cost of capital.

Q IS AMERENUE ONE PART OF A HOLDING COMPANY

A Yes. That means that factors beyond any action of the Commission in this rate proceeding are also relevant to the ratings that effect AmerenUE. In other words, the circumstances of other affiliates are also a consideration for the rating agencies. However, it does not follow that circumstances of affiliates ought to effect rates or rate policy for AmerenUE.

Q IS THE EXISTENCE OF AN FAC A CONSIDERATION IN THE FINANCIAL RATINGS?

A The existence of an FAC is considered. However, AmerenUE has operated without an FAC for many years and the ratings have gone up and down in response to factors other than the FAC. There has been no FAC in years.

The primary focus of the Commission regarding the FAC should not be on comments of the ratings agencies, but rather on good regulatory policy and equitable decisions for customers and AmerenUE.

FAC – THE RELEVANCE OF CAPITAL EXPANSION PLANS

Q ARE THE CAPITAL EXPANSION PLANS OF AMERENUE AN IMPORTANT CONSIDERATION IN REGARD TO THE PROPOSED FAC?

A Yes. In my opinion it is the capital expansion plans that are the primary source of the financial strains. In MPSC Case No. EO-2007-0409 Noranda recently filed a statement expressing concerns with AmerenUE's compliance with the Integrated Resource Plan (IRP) rule. The revenue requirements modeled by AmerenUE in the IRP lead to a pattern of declining financial health and in Noranda's opinion and do not appear to be consistent with the requirements of the Commission's IRP rule.

In its recent statement Noranda also suggested that Commission guidance is needed to establish a method for providing the revenues necessary to maintain AmerenUE's financial health during anticipated capital expansion. I renew that recommendation. While I cannot predict the result, it is apparent that adoption of an FAC before the problem is thoroughly aired is simply premature. There is a problem, but it is not a problem that can be solved by adoption of an FAC in this proceeding because an FAC alone cannot reach the underlying problem.

FAC – REGULATORY BURDEN

Q WOULD AN FAC REDUCE THE REGULATORY BURDEN ASSOCIATED WITH THE SUBJECT COSTS AND REVENUES?

A No. It would instead increase the burden on the Commission, its staff, and every party that is concerned about the level of rates. There would be generating unit efficiency tests, surveillance reports, rate filings every four months and annual prudence revues. Inasmuch as the prudence reviews would be the primary defense against excessive costs flowing to customers, the regulatory burden would be substantial. The burden leads to additional costs for regulators and, in turn, customers. While consumers would bear all of the additional regulatory costs, they in return would be left with not only higher and more volatile rates, but with fewer consumer protections under the AmerenUE proposal.

FAC – MISSING CONSUMER PROTECTIONS

Q WHAT ARE THE MISSING CONSUMER PROTECTIONS?

A Certainly a fundamental problem for consumers would be the trade off of a diminished financial incentive and the substitution of limited regulatory oversight in its place. The thousands of decisions related to fuel costs cannot possibly be individually reviewed for prudence so that once the financial incentive is eviscerated, consumers in many respects are left with little but good intentions.

Another fundamental issue is the automatic nature of the pass through of higher costs that are not caused by changes in the price paid for fuel. At first blush it might seem that the only benefit provided to AmerenUE by its proposed FAC is a protection from allegedly volatile fuel costs[1] by shifting the burden to ratepayers. But there is another benefit for AmerenUE at the expense of ratepayers. Under the proposed FAC there is tremendous erosion in the protection of consumers from extraordinary replacement power costs in the event of the outage of a low cost generator.

Q HOW WOULD THE OUTAGE OF A LOW COST GENERATOR INFLUENCE THE TOTAL COST THAT WOULD BE COLLECTED FROM RATEPAYERS UNDER THE PROPOSED FAC?

A One obvious consideration in the determination of fuel cost is generating unit efficiency. As required by the Commission's FAC rule, there would be a testing program to monitor generating unit efficiencies. But also important is whether or not a generator, regardless of its efficiency, is available for service. Yet there is no mechanism to protect consumers from an increase in FAC rates in the event of a generator outage.

The additional cost due to an outage would take the form of higher fuel and purchased power costs, and lower off-system sales revenues, all of which

[1] I do not agree that the fuel costs are sufficiently volatile and beyond the control of management to warrant the proposed FAC.

could be due to an equipment failure or an accident involving any base load generating unit.

Q HAS AMEREN PROTECTED ITSELF FROM THESE COSTS HISTORICALLY?

A Yes. In fact, Ameren has long had a policy of insuring against such exigencies. In the proposed FAC, AmerenUE expands the protections in two ways - both at the expense of customers.

First even though there would be insurance coverage for some of the increased costs (assuming AmerenUE continues to purchase the insurance), all of the costs, including the portion covered by insurance would be passed to customers. With a yo-yo effect rates would first go up to recover the insured costs and then later go down to refund the insured portion of the costs. In other words, the FAC as proposed would immediately pass through such cost increases to consumers and there would be a credit later to the extent of the insurance proceeds, if any.

Second, although insurance is purchased to cover some of the cost of some of the outages, customers would be required to cover the replacement power costs of every outage. There is no minimum. There is no maximum. Every loss is automatically covered by the operation of the FAC. All costs would flow to customers in the FAC rate, subject only to the ability of the regulatory process to identify imprudence months or even years after the fact. In contrast to the current situation where AmerenUE must submit a claim to an

insurance provider, there would be no claim process. With the proposed FAC AmerenUE will have all of the money in the bank and the burden of getting anything back for customers would fall to regulators and customers.

In stark contrast, assuming base rate regulation continues, the causes of any outages, the increases in cost, and the potential and/or reality of insurance proceeds will all be available for consideration before rates are changed. Moreover, rates will be more stable because they will change less frequently and they will be based on normal levels of generator availability. But an overriding point is that AmerenUE will have a continuing financial incentive to minimize the costs.

Q DID THE COMMISSION REJECT THE AMEREN PROPOSAL FOR AN FAC IN AMERENUE'S LAST RATE CASE?

A Yes.

Q DO YOU RECOMMEND REJECTION OF THE CURRENT FAC PROPOSAL?

A Yes.

Q DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A Yes it does.

Appendix A

Qualifications of Donald E. Johnstone

Q PLEASE STATE YOUR NAME AND ADDRESS.

A Donald E. Johnstone. My address is 384 Black Hawk Drive, Lake Ozark, MO 65049.

Q PLEASE STATE YOUR OCCUPATION.

A I am President of Competitive Energy Dynamics, L. L. C. and a consultant in the field of public utility regulation.

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A In 1968, I received a Bachelor of Science Degree in Electrical Engineering from the University of Missouri at Rolla. After graduation, I worked in the customer engineering division of a computer manufacturer. From 1969 to 1973, I was an officer in the Air Force, where most of my work was related to the Aircraft Structural Integrity Program in the areas of data processing, data base design and economic cost analysis. Also in 1973, I received a Master of Business Administration Degree from Oklahoma City University.

From 1973 through 1981, I was employed by a large Midwestern utility and worked in the Power Operations and Corporate Planning Functions. While in the Power Operations Function, I had assignments relating to the peak

demand and net output forecasts and load behavior studies which included such factors as weather, conservation and seasonality. I also analyzed the cost of replacement energy associated with forced outages of generation facilities. In the Corporate Planning Function, my assignments included developmental work on a generation expansion planning program and work on the peak demand and sales forecasts. From 1977 through 1981, I was Supervisor of the Load Forecasting Group where my responsibilities included the Company's sales and peak demand forecasts and the weather normalization of sales.

In 1981, I began consulting, and in 2000, I created the firm Competitive Energy Dynamics, L.L.C. As a part of my years in the consulting practice, I have participated in the analysis of various electric, gas, water, and sewer utility matters, including the analysis and preparation of cost-of-service studies and rate analyses. In addition to general rate cases, I have participated in electric fuel and gas cost reviews and planning proceedings, policy proceedings, market price surveys, generation capacity evaluations, and assorted matters related to the restructuring of the electric and gas industries. I have also assisted companies in the negotiation of power contracts representing over $1 billion of electricity.

I have testified before the state regulatory commissions of Delaware, Hawaii, Illinois, Iowa, Kansas, Massachusetts, Missouri, Montana, New Hampshire, Ohio, Pennsylvania, Tennessee, Virginia and West Virginia, and the Rate Commission of the Metropolitan St. Louis Sewer District.