

Exhibit No.:
Witness:
Type of Exhibit:
Issues:
Sponsoring Party:
Case No.:

Layle (Kip) Smith
Direct Testimony
Rate Design and Noranda Impact
Noranda Aluminum, Inc.
ER-2010-0036

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

**In the Matter of Union Electric
Company, d/b/a AmerenUE's
Tariffs to Increase Its Annual
Revenues for Electric Service**

Case No. ER-2010-0036

Direct Testimony of Kip Smith

On behalf of

Noranda Aluminum, Inc.

January 6, 2010

Noranda
Exhibit No. 456
Date 3/25/10 Reporter PF
File No. ER-2010-0036

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**STATE OF KENTUCKY)
)
COUNTY OF WILLIAMSON)**

SS

Affidavit of Kip Smith

Layle (Kip) Smith, being first duly sworn, on his oath states:

1. My name is Layle K. (Kip) Smith. I am the President and CEO of Noranda Aluminum, Inc., having its principal place of business at Suite 600, 801 Crescent Centre Drive, Franklin, Tennessee 37067.
2. Attached hereto, and made a part hereof for all purposes, is my direct testimony, which was prepared in written form for introduction into evidence in Missouri Public Service Commission Case No. ER-2010-0036.
3. I hereby swear and affirm that the testimony is true and correct.

Layle K. (Kip) Smith

Subscribed and sworn to before me this ____ day of January, 2010

Notary Public

Direct Testimony of Kip Smith

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

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

4

5 **Q WHAT IS YOUR OCCUPATION?**

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

8

9 **Q PLEASE DESCRIBE THE BUSINESS OF NORANDA.**

10 **A Noranda operates an aluminum smelter near New Madrid, Missouri ("New**
11 **Madrid Smelter"), where it produces molten aluminum and converts molten**
12 **aluminum to aluminum products such as billet, rod, foundry products and**
13 **primary ingots. The smelter has been operating in Southeast Missouri since**
14 **February 25, 1971. Its primary product inputs are electricity and alumina. The**
15 **alumina is delivered via barge over the Mississippi River. Alumina, also known**
16 **as aluminum oxide, is produced from bauxite ore. The New Madrid Smelter**
17 **processes the alumina through three production lines (pot lines). The pot lines**
18 **contain "pots," which are large steel containers lined with carbon. Within these**
19 **pots electrolysis occurs, breaking the bond between the aluminum and oxygen**
20 **atoms in the alumina. The reaction requires an enormous amount of electricity.**
21 **The result of that reaction is molten aluminum. Electricity must be constantly**
22 **available to the pots since the pots will be damaged if the liquid metal resulting**
23 **from electrolysis solidifies inside of the pots. When at full production, the smelter**
24 **produces over 260,000 metric tons of aluminum per year. The aluminum is sold**

1 primarily in North America. Noranda is one of the largest foil producers in North
2 America and a major producer of light gauge sheet products.
3

4 **Q ARE YOU FAMILIAR WITH THE OPERATIONS OF THE NEW MADRID**
5 **SMELTER, INCLUDING THE ECONOMICS OF PAST AND CONTINUED**
6 **OPERATIONS OF THE SMELTER?**

7 **A** Yes.
8

9 **Q ARE YOU FAMILIAR WITH THE LABOR FORCE USED AT THE NEW**
10 **MADRID SMELTER?**

11 **A** Yes.
12

13 **Q WHY IS NORANDA INTERESTED IN THIS PROCEEDING?**

14 **A** Electricity is single largest operational cost of the New Madrid Smelter,
15 constituting slightly less than one-third of its overall cost of producing primary
16 aluminum. When the New Madrid Smelter is at full production, at current electric
17 rates, it pays Union Electric Company approximately \$140M for electricity each
18 year. Union Electric Company's proposed rate increase of approximately 18%
19 would drive the New Madrid Smelter's operating costs up by around \$24M
20 annually, an increase that threatens its long-term viability in Southeast Missouri.
21 The outcome of this proceeding will have a substantial impact on the New Madrid
22 Smelter's viability in Missouri, and, therefore Noranda is deeply interested in
23 Commission's decision in this case.
24

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

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

8

9 **Q** **PLEASE IDENTIFY THE OTHER WITNESSES PRESENTING TESTIMONY ON**
10 **BEHALF OF NORANDA AND THE SUBJECT AREAS THAT EACH WILL**
11 **ADDRESS.**

12 **A** Mr. Keith Gregston, Executive Director of Primary Aluminum, will present
13 testimony regarding the operations of the New Madrid Smelter, the importance of
14 electricity costs to the viability of the New Madrid Smelter, and the reasons why a
15 sustainable electric rate for the New Madrid Smelter is in the public interest.

16 Missouri Senator Robert Mayer and Missouri Representative Steve Hodges will
17 testify regarding the economic benefits the New Madrid Smelter brings to
18 Missouri.

19 Mr. Rick Earnheart, Vice President of the United Steelworkers Local Union 7686
20 and employee of the New Madrid Smelter, will testify regarding the impact of the
21 New Madrid Smelter on its employees, the Union and the local community.

22 Mr. Henry Fayne will testify regarding Noranda's opposition to Union Electric
23 Company's proposal to impose "Take-Or-Pay" provisions in the Rate Schedule
24 LTS tariff applicable to the New Madrid Smelter. Mr Fayne will also provide
25 evidence regarding electricity rates for other smelters to support Noranda's
26 requested rate treatment in this case.

1 Dr. Adonis Yatchew, Professor of Economics at the University of Toronto, will
2 provide evidence regarding the policy considerations supporting electric rates
3 designed to retain or attract business and to sustain the aluminum producing
4 industry in Missouri.

5 Dr. Joe Haslag, Professor of Economics, at the University of Missouri, Columbia,
6 will testify regarding the impact of the New Madrid Smelter on Missouri's
7 economy.

8 Dr. Paul Coomes will present testimony regarding the regional importance of the
9 New Madrid Smelter and the likely economic and fiscal impacts to the region if
10 the New Madrid Smelter were to close.

11

12 **Q IS THE RELATIVE COST OF PRODUCTION IMPORTANT TO THE NEW**
13 **MADRID SMELTER'S CONTINUED VIABILITY?**

14 **A** Yes.

15

16 **Q WHY IS THAT?**

A The aluminum production industry is very 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. Because electricity constitutes such a large percentage of the cost to produce aluminum, the New Madrid Smelter's viability depends on affordable electricity. Union Electric Company's proposed rate increase would drive the smelter's production costs so high that it threatens the smelter's viability.

Q. WHAT ELECTRIC RATE IS NEEDED TO SUSTAIN THE NEW MADRID SMELTER?

A. While Union Electric Company's rates to its other customers are in the lowest quartile compared to electric rates nationally, as shown in the testimony of Henry Fayne, the New Madrid Smelter's rate is in the highest quartile of any aluminum smelter in the United States. Noranda needs a rate in the range of \$27 per MWH to compete with other aluminum smelters in the United States and globally. This electric rate would support the sustainability of the New Madrid Smelter.

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

3 A The New Madrid Smelter has been working intensely to reduce its costs to
4 sustain its Missouri operations. To survive the recent economic crisis, the New
5 Madrid Smelter unfortunately was forced to reduce its workforce by
6 approximately twenty percent, from 1,120 employees to less than 900
7 employees. In addition, Noranda has paid down its debt and the New Madrid
8 Smelter has reduced its operating costs through vigorous interaction with its
9 suppliers, investments in efficiency projects and programs to eliminate waste.
10 The New Madrid Smelter has taken action on the operating costs that it can
11 directly influence and control, and will continue to do so. We are surviving this
12 recession and are doing our part to build a cost platform for a sustainable
13 business in Southeast Missouri. But this represents only slightly more than two-
14 thirds of our costs, and that is unfortunately not enough. Our request for
15 consideration for fair and competitive electricity from the Commission comes only
16 after the New Madrid Smelter has taken difficult in-house cost-saving measures,

1 some of which have negatively impacted hundreds of Southeast Missouri
2 families.

3
4 **Q WHAT IMPACT WOULD UNION ELECTRIC COMPANY'S PROPOSED RATE**
5 **INCREASE HAVE ON THE NEW MADRID SMELTER?**

6 **A** Union Electric Company's proposed rate increase threatens the viability of the
7 New Madrid Smelter. This rate increase would increase the New Madrid
8 Smelter's electric rates by \$24M annually, at a time when business conditions
9 remain extremely challenging. If approved, this rate increase would be the
10 second rate increase to occur around the time of a recession and its difficult
11 aftermath. To remain viable during the recession, the New Madrid Smelter has
12 been able to reduce nearly all of its costs except for electricity. Very sadly, the
13 New Madrid Smelter has already cut approximately \$15M of labor costs. To take
14 additional workforce cuts of this magnitude now is not an option because it would
15 leave the New Madrid Smelter with an insufficient number of employees to
16 operate the smelter. The New Madrid Smelter has achieved success in reducing
17 nearly all of its other major costs, and we will continue to drive further efficiency.
18 But, without an ability to drive improvement in its cost of electricity, the New
19 Madrid Smelter can only influence slightly more than two-thirds of our cost
20 structure. Additionally, the New Madrid Smelter has worked tirelessly to maintain
21 its relationships with its customers, but increases in cost threaten our ability to
22 price our product competitively. The New Madrid Smelter also has little or no
23 influence over the London Metal Exchange (LME) price of aluminum and must
24 constantly work to drive its overall costs down in real terms over time to remain
25 competitive and viable. On the New Madrid Smelter's long term journey, Union

1 Electric's proposed rate increase would be a significant and unfortunate step on
2 the critical path to failure.

3

4 **Q ARE THERE ANY ATTRIBUTES TO THE NEW MADRID SMELTER'S**
5 **DEMAND FOR ELECTRICITY THAT MAKES IT DIFFERENT FROM OTHER**
6 **CUSTOMERS?**

7 **A** Yes. First, as indicated above, the New Madrid Smelter consumes large
8 quantities of power. Second, the New Madrid Smelter has a very steady demand
9 for electricity, consuming it twenty-four hours a day, seven days a week, 365
10 days a year, with a 98% load factor. Third, as a result of the particular physical
11 supply arrangements, none of Union Electric Company's distribution facilities are
12 used in providing service to the New Madrid Smelter, leading to lower losses and
13 lower costs. All of these considerations lead to a much lower unit cost for the
14 service provided to the New Madrid Smelter as compared to other customers.

15

16 **Q WHAT IS YOUR UNDERSTANDING OF THE COST TO PRODUCE THE**
17 **ELECTRICITY SUPPLIED TO THE NEW MADRID SMELTER VERSUS THE**
18 **RATE CHARGED BY UNION ELECTRIC COMPANY FOR THAT**
19 **ELECTRICITY?**

20 **A** Based on the cost of service study prepared by Maurice Brubaker, it is my
21 understanding that if Union Electric Company would charge the New Madrid
22 Smelter based upon the cost to produce the electricity sold to it, the New Madrid
23 Smelter would be paying a lower rate.

24

25 **Q HAS THERE BEEN A RECENT DISRUPTION OF POWER TO THE NEW**
26 **MADRID SMELTER?**

1 A Yes.

2

3 Q PLEASE EXPLAIN WHAT PRECIPITATED THAT LOSS OF POWER.

4 A In late January 2009, an ice storm hit Southeast Missouri. That storm downed
5 many power lines outside of the facility's fence lines, eventually resulting in the
6 loss of power to the facility. Although our facility was capable of operation
7 throughout the storm, the loss of power was so significant that a majority of the
8 smelter's pots "froze," resulting in a shutdown of 75% of the production capacity
9 and damage to the pots.

10

11 Q HAS THE NEW MADRID SMELTER FULLY RECOVERED FROM THE
12 OUTAGE?

13 A Not yet. However, we do have two of our three production lines back in full
14 operation, and 47% of our third pot line has been returned to operation. We
15 expect to have the third line in full operation before April 2010.

16

17 Q WHAT IMPACT DID THE POWER OUTAGE HAVE ON YOUR EMPLOYEES?

18 A We made the decision that the right thing to do was not to lay off employees as a
19 result of the power outage but rather to use them, to the extent possible, to repair
20 the damage and return the pot lines to operation. Our employees have been
21 working tirelessly to bring our production lines back to life, and we are deeply
22 grateful for their efforts.

23

24 Q EARLIER YOU INDICATED THAT YOU WOULD ADDRESS WHY AN
25 ELECTRIC RATE OF \$27 PER MWH FOR THE NEW MADRID SMELTER WAS

1 **IN THE PUBLIC INTEREST. WHY IS SUCH A RATE IN THE PUBLIC**
2 **INTEREST?**

3 A The New Madrid Smelter has been an integral part of the economic landscape of
4 Southeast Missouri for 38 years. As explained in more detail in the testimony of
5 Paul Coomes, the New Madrid Smelter is one of the largest, if not the largest,
6 employer in Southeast Missouri. Hundreds of Southeast Missouri families would
7 be placed in peril if the New Madrid Smelter was forced to shut its doors. Millions
8 of dollars flow into the homes and businesses of Southeast Missourians as a
9 result of the revenues from Noranda products which are sold mostly outside of
10 the state. Moreover, the New Madrid Smelter provides hundreds of skilled jobs
11 that pay good wages and provides its employees good medical and retirement
12 benefits. In addition, the New Madrid Smelter pays some 24% of the total taxes
13 collected in New Madrid County and roughly 33% of the assessed tax paid for
14 the New Madrid County Schools. Taxes paid by the New Madrid Smelter help
15 keep the school systems viable and help to maintain the infrastructure and
16 needed government institutions in Southeast Missouri. The poor economy has
17 had an impact on everybody, but Southeast Missouri seems to be particularly
18 hard hit. It is vital to our employees, to their families, to the community, to the
19 merchants that our employees frequent, to our vendors (including Union Electric),
20 and to their families, that the New Madrid Smelter remain viable. In order for the
21 smelter to remain viable, it is absolutely critical that the New Madrid Smelter
22 reduce its costs of operation, and the smelter's single largest cost remains its
23 cost of electricity. The \$27/MWh rate that I am respectfully advocating for the
24 New Madrid Smelter would greatly enhance the continuing viability of the smelter
25 and thereby sustain these numerous benefits to the community and the State of
26 Missouri.

1
2 **Q ARE YOU FAMILIAR WITH THE "TAKE-OR-PAY" PROPOSAL UNION**
3 **ELECTRIC COMPANY HAS SUBMITTED TO THE COMMISSION?**

4 **A** Yes. Union Electric Company's "Take-Or-Pay" proposal would essentially
5 require the New Madrid Smelter to pay for its contract demand and energy. If the
6 New Madrid Smelter were to use anything less than the full amount, it would be
7 forced, in effect, to resell the excess through Union Electric Company to a third
8 party, potentially at a loss.

9
10 **Q IF UNION ELECTRIC COMPANY'S "TAKE-OR-PAY" PROPOSAL IS**
11 **GRANTED, HOW WILL IT IMPACT THE BUSINESS OF THE NEW MADRID**
12 **SMELTER?**

13 **A** First, let me say that I believe that the Union Electric Company is the subject
14 matter expert in the production and marketing of power, and I hold them in high
15 esteem for the work they do in that field. The New Madrid Smelter, on the other
16 hand, is in the aluminum business. Union Electric Company's "Take-Or-Pay"
17 proposal is a grossly inappropriate transfer of the risk of producing and marketing
18 power from a utility company, which is uniquely designed to strategically
19 calculate the risks of the power business, to Noranda, a company with little or no
20 expertise in the business of selling power. The proposal would force the New
21 Madrid Smelter to pay for electricity, whether it needs it or not, and to assume the
22 risk of losing money on the resale of that power. The New Madrid Smelter is not
23 in the power business, and Union Electric Company's "Take-Or-Pay" proposal is
24 frankly unfair, unreasonable and untenable. Moreover, the proposal constitutes a
25 unilateral attempt to materially alter a contract into which the parties entered in
26 2005. Noranda has not agreed to this material change to its contract with Union

1 Electric Company, and the change fundamentally alters the bargain between the
2 two parties to the detriment of the New Madrid Smelter. We oppose this
3 unilateral proposal by Union Electric Company and hope the Commission rejects
4 it. To the extent the Commission determines that any alternative to Union
5 Electric Company's "Take-Or-Pay" proposal is proper, I refer the Commission to
6 the Direct Testimony of Mr. Henry Fayne.

7

8 **Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

9 **A Yes, it does.**

10