Exhibit No.:
Witness: Henry Fayne
Type of Exhibit: Direct Testimony
Issues: Rate Design and Noranda Issues
Sponsoring Party: Noranda Aluminum, Inc.
Case No.: ER-2011-0028

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-2011-0028**

Direct Testimony of Henry Fayne

On behalf of

Noranda Aluminum, Inc.

February 10, 2011

DIRECT TESTIMONY OF HENRY W. FAYNE

Q: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A: My name is Henry W. Fayne. My business address is 1980 Hillside Drive, Columbus, Ohio 43221.

Q: PLEASE BRIEFLY DESCRIBE YOUR BUSINESS AND EDUCATIONAL BACKGROUND.

A: Following my retirement from American Electric Power (AEP) at the end of 2004, I have been a consultant in the electric energy sector primarily negotiating electric energy contracts for various aluminum smelters in the United States. I was employed by AEP in various positions for thirty years from 1974 through 2004, including as Executive Vice President and Chief Financial Officer from 1998 until 2001, and as Executive Vice President Energy Delivery from 2001 until I retired in 2004. I have a bachelors degree in economics from Columbia College and an MBA in finance from Columbia Graduate School of Business.

Q: HAVE YOU TESTIFIED PREVIOUSLY?

A: Yes. During my tenure at AEP, I testified before the regulatory commissions in the states of Indiana, Kentucky, Michigan, Ohio, Oklahoma, Texas, Virginia and West Virginia on behalf of various operating companies of AEP. I have also testified before the Federal Energy Regulatory Commission. Since I retired from AEP, I have testified before regulatory commissions in the states of Kentucky, Ohio and West Virginia. I have also testified before this Commission in Case No. ER-2010-0036 and Case No. EO-2010-0255.

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

A: The purpose of my testimony is to provide information regarding the cost of electricity at other aluminum smelters and the regulatory treatment other states are providing to support the continued operation of aluminum smelters.

Q WHY IS THE COST OF ELECTRICITY OF SUCH IMPORTANCE FOR ALUMINUM SMELTERS?

A: Aluminum is a global commodity, much like copper, nickel, zinc and oil. It is sold at a price that is based on global supply and demand and established by trading activity on the London Metal Exchange, or LME. An individual smelter is, in effect, a price taker and cannot set the selling price of the base product; therefore, the success or viability of a specific smelting operation is determined primarily by its cost of production.

The cost of production will vary among smelters based on the cost of goods and services as well as the configuration of the plant. However, in general, the cost of alumina, labor and electricity accounts for 75%-80% of the cost, with alumina and electricity each comprising about one-third of the cost of production. The cost of alumina tends to be tied to the LME price. As a result, it is the cost of electricity that most significantly determines the ongoing success or viability of an aluminum smelter, particularly in the volatile market we have recently been experiencing.

That outcome is most dramatically shown by the shifts in production. In the U.S. in 1978, there were 34 smelters, producing more than 4 million metric tons,

accounting for about 31% of the world supply. In 2011, there are only 10 smelters expected to be operating in the U.S., projected to produce about 1.9 million metric tons annually, which is projected to account for only 4.2% of the world supply. In every instance, the smelter shut down because of high power costs (HWF Exhibit-1 shows the U.S. smelters currently in operation; Alcoa announced plans to restart its Massena East smelter).

Q: AT THE OUTSET, YOU INDICATED THAT YOU WOULD PROVIDE INFORMATION REGARDING THE ELECTRICITY RATES FOR OTHER SMELTERS. WOULD YOU PLEASE PROVIDE THAT INFORMATION?

A: Exhibit HWF-1 shows the electricity rates for each of the US smelters operating in 2010, as well as the rates for smelters outside the United States. As noted on that exhibit, the source of the data is CRU, an independent business analysis and consultancy group that is generally used in the industry as a source of such data. As shown on that exhibit, according to CRU preliminary data, the electricity rate for the New Madrid smelter in 2010 was $38.05/Mwh, which resulted in New Madrid having one of the three highest costs of electricity in the U.S. and a cost of electricity more than 40% higher than the average for non-U.S. smelters, excluding China. More importantly, if the Commission were to approve AmerenUE's rate request, the rate for the New Madrid smelter on a proforma basis is projected to be $43.60/Mwh.

Q: WHY DO YOU EXCLUDE CHINA?

A: China must be excluded because China heavily subsidizes its industry. In simple terms, the high cost of electricity is offset by the low cost of labor.

Q: WHY IS IT A CONCERN THAT THE NEW MADRID SMELTER HAS A HIGH COST RELATIVE TO OTHER U.S. SMELTERS AND TO SMELTERS IN THE REST OF THE WORLD?

A: As Mr. Smith explained, aluminum is a commodity, sold at a price that is based on global supply and demand established by trading activity on the London Metal Exchange, or LME. The price is set by the marginal producer. Therefore, if other producers have a lower cost of production, which is driven primarily by the cost of electricity, then the selling price will reflect such costs, and the higher cost producer will not be able to compete since the price will not cover the higher cost of production. The New Madrid smelter competes with all other smelters, regardless of location. If its costs are high relative to other producers, its continued viability is at risk, particularly if the aluminum market suffers a downturn.

Q: AT THE OUTSET, YOU INDICATED THAT YOU WOULD DESCRIBE THE REGULATORY TREATMENT THAT HAS BEEN PROVIDED IN OTHER JURISDICTIONS TO ADDRESS THE SPECIFIC NEEDS OF ALUMINUM SMELTERS. PLEASE PROVIDE THAT INFORMATION.

A: As I explained above, aluminum smelters are uniquely energy intensive and sensitive to the price of electricity. As a result, the number of smelters remaining in the U.S. has declined dramatically. Several states, therefore, have taken steps to support the continued operations of the smelters in their state and to protect the

high paying jobs. I have been involved in the negotiation of rates in Kentucky, Ohio and West Virginia. In broad terms, the regulatory treatment has included discounted rates in return for a commitment from the smelter to make capital investments and retain a certain employment level. In some cases, the treatment has tied the discount to the price of aluminum on the London Metal Exchange.

Q: WOULD YOU PLEASE PROVIDE SOME SPECIFIC EXAMPLES?

A: In Ohio, for example, pursuant to legislation passed to attract and retain energy-intensive industry, the Public Utilities Commission of Ohio approved a 10-year contract that provided a discounted rate tied to the LME and employment level at the smelter. To the extent that the rate paid by the Hannibal aluminum smelter is less than the tariff, the shortfall is allocated to other customers

In West Virginia, the Public Service Commission of West Virginia approved a Special Contract for the Ravenswood smelter which indexed the price paid for electricity to the LME; nonetheless, the smelter was shut down in 2009. However since that time, in an effort to support a restart of the smelter, the legislature passed a bill that provided a mandate for the Commission to approve special contracts for energy intensive industry to attract and retain jobs; the legislation authorizes the commission to allocate to other customers any shortfall created. In addition, efforts are currently underway to determine if there are additional mechanisms for the state to provide supplemental support

Q: Does this conclude your testimony at this time?

A: Yes, it does.

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STATE OF OHIO)
) **SS**
COUNTY OF FRANKLIN)

Affidavit of Henry Fayne

Henry Fayne, being first duly sworn, on his oath states:

1. My name is Henry Fayne. I am a consultant residing at 1980 Hillside Drive, Columbus, Ohio 43221.

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-2011-0028.

3. I hereby swear and affirm that the testimony is true and correct.

Henry Fayne

Subscribed and sworn to before me this 9th day of February, 2011

Notary

NOTARY PUBLIC * STATE OF OHIO *

JOSHUA J. WHITE
Notary Public, State of Ohio
My Comm. Expires Sept. 17, 2014

Exhibit HWF-1

ALUMINUM SMELTERS
COST OF ELECTRICITY
FOR THE YEAR 2010

	Smelter	Company Owner	Smelter Production (000 TPY)	Cost of Electricity ($/Mwh)
1	Ferndale	Italco	169.2	55.29
2	Mt. Holly	Century	223.0	51.56
3	New Madrid *	Noranda	255.9	38.05
4	Warrick	Alcoa	271.7	32.13
5	Hannibal	Ormet	183.3	31.46
6	Hawesville	Century	199.2	31.27
7	Sebree	Alcan	195.1	28.87
8	Massena West	Alcoa	130.0	18.38
9	Wenatchee	Alcoa	99.7	15.72
	TOTAL USA		**1,727.1**	**35.26**
	GLOBAL (Excl USA & China)		**23,387.0**	**27.13**

*** Proforma cost of electricity projected to be $43.60 if the proposed AmerenUE rate increase is approved**

Source: CRU, an independent business analysis and consultancy group focused on mining, metals, power, cables, fertilizer and chemical sectors