

Exhibit No.:
Witness: Layle (Kip) Smith
Type of Exhibit: Direct Testimony
Issues: Rate Design and Noranda Impact
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) **Case No. ER-2011-0028**
Company, d/b/a AmerenUE's)
Tariffs to Increase Its Annual)
Revenues for Electric Service)
_____)

Direct Testimony of Kip Smith

On behalf of

Noranda Aluminum, Inc.

February 10, 2011

**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**

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Case No. ER-2011-0028

STATE OF TENNESSEE)
)
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-2011-0028.
3. I hereby swear and affirm that the testimony is true and correct.

Layle K. (Kip) Smith

Subscribed and sworn to before me this 10th day of February, 2010

Notary Public

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Case No. ER-2011-0028

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 **Q WHAT IS YOUR OCCUPATION?**

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

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

8 A Noranda operates an aluminum smelter near New Madrid, Missouri ("New
9 Madrid Smelter"), where it produces molten aluminum and converts molten
10 aluminum to aluminum products such as billet, rod, foundry products and
11 primary ingots. The smelter has been operating in Southeast Missouri since
12 February 25, 1971. Its primary product inputs are electricity and alumina. The
13 alumina is delivered via barge over the Mississippi River. Alumina, also known
14 as aluminum oxide, is produced from bauxite ore. The New Madrid Smelter
15 processes the alumina through three production lines (pot lines). The pot lines
16 contain "pots," which are large steel containers lined with carbon. Within these

1 pots electrolysis occurs, breaking the bond between the aluminum and oxygen
2 atoms in the alumina. The reaction requires an enormous amount of electricity.
3 The result of that reaction is molten aluminum. Electricity must be constantly
4 available to the pots since the pots will be damaged if the liquid metal resulting
5 from electrolysis solidifies inside of the pots. When at full production, the smelter
6 produces over 260,000 metric tons of aluminum per year. The aluminum is sold
7 primarily in North America. Noranda is one of the largest foil producers in North
8 America and a major producer of light gauge sheet products.

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

10 A Electricity is the single largest operational cost of the New Madrid Smelter,
11 constituting about one-third of its overall cost of producing primary aluminum.
12 When the New Madrid Smelter is at full production, at current electric rates, it
13 pays Ameren Missouri approximately \$158M for electricity each year. Ameren
14 Missouri's proposed rate increase of approximately 10.8% would drive the New
15 Madrid Smelter's operating costs up by around \$15M annually. The
16 Commission's decision will impact whether the New Madrid Smelter will have
17 cost-competitive power, and accordingly will have a significant impact on the
18 New Madrid Smelter's near-term results and its long-term sustainability. The
19 New Madrid Smelter, and thus Noranda, are deeply interested in Commission's
20 decision in this case.

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

22 A The purpose of my testimony is to show the Commission that its decision in this
23 case is vitally important to the New Madrid Smelter's long-term operations. The
24 New Madrid Smelter's sustainability in Southeast Missouri is inextricably linked to

1 the well being of the over 900 Noranda employees and their families and dozens
2 of Southeast Missouri businesses and the families that they support. I hope to
3 show the Commission that a sustainable electric rate for the New Madrid Smelter
4 is in the public interest.

5 **Q WHY IS THE RELATIVE COST OF PRODUCTION IMPORTANT TO THE NEW**
6 **MADRID SMELTER'S CONTINUED VIABILITY?**

7 A The aluminum production industry is very competitive. The aluminum produced
8 by the New Madrid Smelter is essentially identical to that produced by other
9 aluminum smelters. Also, the price for aluminum is established on the London
10 Metal Exchange (LME) and a producer such as Noranda has little or no influence
11 on the LME price. For these reasons, the viability of a smelter is largely dictated
12 by its cost to produce aluminum. Because electricity constitutes such a large
13 percentage of the cost to produce aluminum, the New Madrid Smelter's viability
14 depends on affordable electricity. Ameren Missouri's proposed rate increase
15 would drive Noranda's cost of electricity, which is already among the highest
16 electricity costs in the United State for aluminum smelters, to even higher and,
17 therefore, less competitive levels. This will negatively affect Noranda's short
18 term results and our long term sustainability.

19 **Q. WHY ARE COMPETITIVE ELECTRIC RATES NEEDED TO SUSTAIN THE**
20 **NEW MADRID SMELTER?**

21 A. Ameren Missouri's rates to its other customers are in the lowest quartile
22 compared to electric rates nationally. However, as shown in the testimony of
23 Henry Fayne in this case, the New Madrid Smelter's electricity rate remains in
24 the top third of aluminum smelters in the United States, and substantially above

1 electricity rates around the world. To be sustainable and to be able to weather
2 the aluminum price cycles, the New Madrid Smelter needs a rate that allows it to
3 effectively compete with other aluminum smelters in the United States and
4 globally.

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

7 A Ameren Missouri's proposed rate increase threatens the viability of the New
8 Madrid Smelter. Ameren Missouri's proposed 10.8 percent rate increase would
9 increase the New Madrid Smelter's electric rates by \$15 million annually, at a
10 time when business conditions remain extremely competitive. Electricity is the
11 largest input cost and only major input cost that Noranda cannot directly
12 negotiate and influence. Increasing productivity is extremely important to
13 Noranda's short term and long term viability. For example, to remain viable
14 during the recession, the New Madrid Smelter was able to reduce nearly all of its
15 major input costs except for electricity. Very sadly, the New Madrid Smelter was
16 required in 2008 to cut approximately \$15M of labor costs. Since the recession
17 we have continued to increase productivity and reduce costs. However, since
18 the New Madrid Smelter cannot directly influence the price of its electricity, we
19 can only influence slightly more than two-thirds of our cost structure. The New
20 Madrid Smelter has worked tirelessly to maintain its relationships with its
21 customers, but increases in cost continue to threaten our ability to price our
22 product competitively. It is especially important to control our costs because the
23 New Madrid Smelter has little or no influence over the LME price of aluminum
24 and must constantly work to drive its overall costs down in real terms over time to

1 remain competitive and viable. Ameren Missouri's rate increase would take the
2 New Madrid Smelter in a direction that is not sustainable.

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

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

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

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

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

22 A The New Madrid Smelter has been an integral part of the economic landscape of
23 Southeast Missouri for 38 years. The New Madrid Smelter is one of the largest,

1 if not the largest, employer in Southeast Missouri. Hundreds of Southeast
2 Missouri families would be placed in peril if the New Madrid Smelter was forced
3 to shut its doors. Millions of dollars flow into the homes and businesses of
4 Southeast Missourians as a result of the revenues from Noranda products which
5 are sold mostly outside of the state. Moreover, the New Madrid Smelter provides
6 hundreds of skilled jobs that pay good wages and provides its employees good
7 medical and retirement benefits. Taxes paid by the New Madrid Smelter help
8 keep the school systems viable and help to maintain the infrastructure and
9 needed government institutions in Southeast Missouri. The poor economy has
10 had an impact on everybody, but Southeast Missouri seems to be particularly
11 hard hit. It is vital to our employees, to their families, to the community, to the
12 merchants that our employees frequent, to our vendors (including Ameren
13 Missouri), and to their families, that the New Madrid Smelter remain viable. In
14 order for the smelter to be competitive, it is absolutely critical that the New
15 Madrid Smelter have competitive costs of operation, and the smelter's single
16 largest cost remains its cost of electricity. The rate supported by Mr. Brubaker
17 that I am respectfully advocating for the New Madrid Smelter would greatly
18 enhance the continuing viability of the smelter and thereby sustain the numerous
19 benefits to the community and the State of Missouri.

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

22 **A** The New Madrid Smelter has been working intensely to reduce its costs to
23 sustain its Missouri operations. To survive the recent economic crisis, the New
24 Madrid Smelter unfortunately was forced to reduce its workforce by
25 approximately twenty percent, from 1,117 employees to less than 900

1 employees. The New Madrid Smelter has reduced its operating costs through
2 vigorous interaction with its suppliers, investments in efficiency projects and
3 programs to eliminate waste. The New Madrid Smelter has worked to make
4 every operating costs that it can directly influence and control as productive and
5 competitive as possible, and will continue to do so. But this represents only two-
6 thirds of our costs, and that is unfortunately not enough.

7 **Q. WHAT OTHER ACTIONS HAS NORANDA TAKEN TO IMPROVE RESULTS**
8 **AND INCREASE INVESTMENT IN MISSOURI?**

9 In 2010, Noranda conducted a successful public offering of its stock to access
10 public market funding. As an all primary offering, the net proceeds went to the
11 company. No dividends went to Noranda's owners. These funds were intended
12 for and were used to pay down debt to strengthen Noranda's balance sheet.

13 Through focused and effective efforts, Noranda has achieved financial results
14 that have supported reinvestment in the New Madrid Smelter. Rather than
15 distribute these results to its owners, Noranda announced a significant
16 investment of \$38 million in the New Madrid Smelter to expand capacity. These
17 investments will increase our capacity, support job preservation, support job
18 growth and contribute to Missouri's economic development. Noranda is
19 committed to a partnership with the State of Missouri to preserve jobs. Our goal
20 is to use the competitive advantages that we can gain to ensure the New Madrid
21 Smelter's sustainability.

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

2 A. Electricity is approximately one-third of the New Madrid Smelter's cost. While
3 Noranda can bring market competition to bear on the cost of every other major
4 supply to the New Madrid Smelter, electricity is the one cost we cannot directly
5 negotiate and influence. Noranda relies on the Commission process to serve as
6 virtual competition to control power costs. Noranda greatly appreciates the
7 Commission's decision in Ameren Missouri's last rate case to move Noranda's
8 rate toward cost of service. However, Noranda faces a constantly changing
9 landscape with new electricity cost threats. Since the last rate case, Noranda
10 unexpectedly experienced the profoundly negative impact of two enormous rate
11 increases under Ameren's fuel adjustment clause. We feel that the
12 Commission's decision in the last rate case, resulting from a fair process and the
13 constructive work of all parties, has been set back by substantial increases by
14 Ameren Missouri under its fuel adjustment clause. Noranda respects the
15 Commission process and seeks to strengthen this process by contributing
16 evidence and engaging in constructive dialogue with all stakeholders. Noranda
17 believes it can support the Commission's efforts to create a more competitive
18 environment for power in Missouri, including development of new generation
19 alternatives that may include nuclear or even modular nuclear power. We hope
20 that with the Commission's help, all stakeholders can move toward consensus on
21 fair rates and toward constructive dialogue to achieve a sustainable energy future
22 for Missouri.

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

24 A Yes, it does.