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Rate Design
Layle (Kip) Smith
Surrebuttal Testimony
Noranda Aluminum, Inc.
ER-2014-0258
February 6, 2015

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

_____)
_____)
_____)
In the Matter of Union Electric)
Company, d/b/a Ameren) **Case No. ER-2014-0258**
Missouri's Tariff to Increase Its)
Revenues for Electric Service)
_____)
_____)

Surrebuttal Testimony of
Kip Smith
(NON-PROPRIETARY (NP) VERSION)

On behalf of
Noranda Aluminum, Inc.

February 6, 2015

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

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In the Matter of Union Electric)	
Company, d/b/a Ameren)	Case No. EC-2014-0224
Missouri's Tariff to Increase Its)	
Revenues for Electric Service)	
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Surrebuttal 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.

5 **Q WHAT IS YOUR OCCUPATION?**

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

10 **Q DID YOU PROVIDE DIRECT TESTIMONY IN THIS CASE?**

11 A No.

13 **Q WHY NOT?**

14 A At the time our direct testimony was due I was dealing with a serious medical
15 condition relating to my eyes that required successive surgeries.

1 **Q WHAT IS THE PURPOSE OF THIS SURREBUTTAL TESTIMONY?**

2 A The purpose of this surrebuttal testimony is to address, respond to, and counter
3 issues raised primarily by Ameren in its rebuttal testimonies, particularly the
4 testimonies of Robert Mudge, David Humphries, and John Reed. My testimony
5 also responds to issues raised by Wal-Mart witness Steve Chris. Through this
6 surrebuttal testimony, I hope to clarify and establish the following facts: (i)
7 electricity is our largest single operating cost and has a direct impact on our short
8 term and long term viability and (ii) if the New Madrid smelter's cost of electricity
9 is not reduced and controlled over time, Noranda faces very real and significant
10 financial issues that threaten the continued viability of the New Madrid smelter;
11 and (iii) as part of its request, Noranda is including conditions intended to insure
12 the continued operation of the smelter and maintenance of its current
13 employment levels as well as to protect other ratepayers.

14 The fact that I do not address every point raised by these witnesses
15 should not be interpreted as agreement with those points or those witnesses.

16

17 **Q PLEASE EXPLAIN THE EXTENT TO WHICH ELECTRICITY HAS A DIRECT**
18 **IMPACT ON NORANDA'S SHORT TERM AND LONG TERM VIABILITY.**

19 A Electricity is Noranda's single largest purchased cost. In 2014, electricity
20 represented approximately 32% of the New Madrid Smelter's total costs. In 2014
21 Noranda purchased \$167 million of electricity from its power provider. Since 2008
22 \$1.0 billion dollars have flowed from Noranda to Ameren for the purchase of

1 power. Of that amount \$211 million have flowed to Ameren in rate increases
2 alone during that period.

3 The magnitude of these amounts and the huge increases in price has a
4 direct impact on our ability to generate cash and liquidity.

5
6 **Q BEFORE BEGINNING YOUR RESPONSE TO THESE WITNESSES, ARE YOU**
7 **FAMILIAR WITH THE DIRECT TESTIMONY FILED BY DALE BOYLES ON**
8 **BEHALF OF NORANDA?**

9 A I am familiar with Mr. Boyles' testimony. It is accurate and I fully support it.

10
11 **Q WOULD YOU PLEASE BRIEFLY SUMMARIZE THAT TESTIMONY?**

12 A Mr. Boyles addressed the same issue that I addressed in Case No. EC-2014-
13 0224, namely the likelihood of imminent closure of the New Madrid smelter in the
14 absence of prompt and significant rate relief. My focus in Case No. EC-2014-
15 0224 was the impact of our current electric rate on our liquidity and its threat to
16 our short-term and long-term sustainability. Mr. Boyles' testimony also is
17 concerned with the threat to our viability created by our current power rate.

18 However, his testimony is broader and considers the perils to the New
19 Madrid Smelter caused by the damage from our current power rate to our ability
20 to generate positive cash flow, as well as the need to maintain a minimum level
21 of liquidity. This extremely destructive impact to our cash flow and liquidity
22 threatens the smelter's viability in at least four ways.

- 1 1. We must refinance our debt in 2017 and our current power rate is
- 2 threatening our ability to do so.
- 3 2. Our current power rate reduces our cash flow and liquidity, making us
- 4 more vulnerable to running out of cash and liquidity due to unexpected
- 5 operational and financial shocks.
- 6 3. Our current power rate raises our cash flow breakeven, making it
- 7 difficult if not impossible to generate the cash over the course of the
- 8 cycle to make the investments to sustain the business and not run out
- 9 of cash and available liquidity.
- 10 4. Our current power rate exacerbates the threat caused by the volatility
- 11 in the LME by amplifying the risk of closure during LME downturns and
- 12 reducing our cash generation during LME peaks.

13

14 **Q: WHAT DO YOU CONCLUDE FROM MR. BOYLES' ANALYSES?**

15 A: Without a reduction in the price of electricity, the New Madrid smelter is

16 not sustainable. ** _____

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5 _____**

6 I am convinced an electricity rate such as that proposed in Mr. Boyles'
7 testimony (\$32.50/MWh with no FAC surcharge, for a term of seven years) is
8 necessary to insure Noranda's sustainability, and in the best interests of other
9 ratepayers and the State of Missouri.

10

11 **Q WHY IS REFINANCING ITS DEBT SO IMPORTANT TO NORANDA?**

12 **A** There are several reasons, and they are all central to the Smelter's ability to
13 meet its obligations as they come due.

- 14 • First, there is the access to liquidity, since the nearest maturity is of our
15 asset-based lending arrangement (ABL, or revolver), which expires in
16 2017. As Mr. Boyles has discussed in his testimony and as we have
17 reported in our public filings to the Securities and Exchange Commission,
18 we have repeatedly accessed our revolver since June 2014 to meet our
19 daily obligations such as Ameren's utility bill, raw materials, and payroll.
- 20 • Second, there is the availability of appropriate amounts of liquidity. If we
21 are able to renew our ABL before it expires in 2017, but are not able to
22 renew the entire facility, we will have dramatically reduced our liquidity
23 and our ability to meet the Smelter's obligations as they come due.

- 1 • Third, because of the inability to generate positive cash flow, without a
2 sustainable power rate, there is substantial risk that we will be unable to
3 refinance the outstanding balances on our debt when they come due in
4 2019, nor would we have sufficient funds to pay those balances outright.
5 If we are able to refinance our debt obligations it is highly likely the terms
6 will be much more restrictive, including performance covenants which
7 could accelerate debt maturities, and at a higher cost.

8
9 **Q. YOU ARE AWARE THAT THE COMMISSION RECENTLY REJECTED A**
10 **SIMILAR REQUEST IN CASE NO. EC-2014-0224. WHY SHOULD THE**
11 **RESULT BE DIFFERENT IN THIS CASE?**

12 A. Yes, I am aware of the Commission's decision in Case No. EC-2014-0224. I
13 have carefully reviewed that decision and believe that our request in this
14 proceeding, particularly with the conditions that I will outline, addresses the
15 Commission's earlier concerns. Based on that review and the Commission's
16 guidance therein, Noranda determined that in order to best ensure its survival we
17 would have to bring forward a different proposal for the Commission to consider.

18 In the 0224 case, Noranda requested a \$30/MWh rate (not subject to
19 FAC) for a period of ten years. This rate would still be appropriate and our
20 financial results demonstrate it. Despite recent positive volatility in the LME, we
21 desperately need rate relief in order for the Smelter to remain viable—to
22 refinance our debt, to reduce the risk of negative LME volatility, and to generate
23 more cash on a short-term and long-term basis to invest for the sustainability of

1 our business. The lower the power price, the more robust is Noranda's ability to
2 sustain and survive, in short, to remain viable.

3 Our focus is not just on liquidity, but also on cash flow. If Noranda is
4 unable to improve its cash flows and secure refinancing in 2017 and 2019, our
5 New Madrid Smelter will not survive. Our requested rate relief will materially
6 improve our ability to refinance our debt, removing the most imminent peril
7 created by our current power rate while providing more benefit to other
8 consumers through Noranda remaining on the system. Additionally, in response
9 to some of the rebuttal testimonies, and to address the Commission's concerns
10 expressed in Case No. EC-2014-0224, Noranda is willing to agree to reasonable
11 conditions that this Commission may impose in exchange for our requested
12 power rate.

13
14 **Q. WHY IS THIS RATE RELIEF SO CRITICAL TO NORANDA'S CONTINUED**
15 **VIABILITY?**

16 A. Under our current power rate, the new Madrid smelter is not viable and is not
17 sustainable. There is an urgent need to obtain rate relief to improve liquidity
18 ahead of the required refinancing of Noranda's debt, improve our ability to
19 withstand to operational and financial shock, reduce the LME volatility risk and
20 generate enough cash over the course of the cycle to survive while reinvesting in
21 the smelter. ** _____
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Clearly our focus on liquidity and cash flow was not misplaced. These activities are essential for our sustainability. The failure to secure a viable power rate for the New Madrid smelter creates both short-term and long-term peril for the Company. The short- term nature of the problem is driven largely by the need to refinance our debt and the risk of volatility of the LME and the risk of operational and financial shocks. The long- term threat of unsustainable power lies in our inability to husband cash to reinvest in our business and to weather the inevitable low points in the LME aluminum price cycle.

Conversely, a viable power rate for the New Madrid smelter will increase Noranda’s resistance to financial and operational shocks, support our ability to sustainably generate cash, support our imminent need to refinance our debt and moderate our exposure to the effects of the LME volatility.

Because the pricing of all commodities can swing so violently, every commodity company, including Noranda, must compete globally on the basis of the lowest possible cost position. This low cost position is essential to generate cash during aluminum price cycle peaks so that the company can survive during low points in the aluminum cycle. In addition, the company must maximize the amount of cash generated in the high points in the cycle to create cash for re-investment in plant and equipment. In other words, during the down cycle the company’s cash goes toward survival. During the upcycle our cash flow creates the cash for re-investment and sustainability. If Noranda’s cost structure creates

1 a liquidity problem, we are forced to decapitalize during the downturn and must
2 wait to recapitalize as pricing improves. This creates a potential death spiral
3 when the overall cost structure cannot support sufficient cash across the course
4 of the cycle. On the other hand, with our requested relief and a well-structured
5 cost position, we can generate enough cash across the cycle to be sustainable.

6 To be sure, Noranda is in a commodity business, so peril from price
7 volatility, market swings, increasing competition, and the prospect of declining
8 LME aluminum prices in real terms are all uncontrollable impacts that we deal
9 with daily. To be successful in the face of all of this uncertainty our most
10 important competitive weapon is our cost position. With our current rate and the
11 expectation of future increases, our cost position is not sustainable and power is
12 the most significant risk to our survival. The requested rate relief is key to
13 Noranda having a viable future. The nearest term threat to that viability is the
14 need to refinance our outstanding debt. We have seen that Noranda cannot
15 secure additional lending in any material amount because of the existing,
16 unsustainable power rate. In our efforts to secure financing for our Rod Mill in
17 New Madrid, it has become clear that not having a viable power rate is making it
18 difficult, if not impossible, to secure any new lending. If this situation carries over
19 to the refinancing of our existing debt, as we believe it would without rate relief,
20 there becomes a substantial likelihood of imminent closure.

21 The reduced rate that Noranda is requesting will make our business more
22 resistant to financial as well as operational shocks and “black swan” events. Just
23 as we predicted in the prior case, our liquidity has continued to decline. Separate

1 from pricing, we are always subject to the peril of operational and financial
2 shocks. For example, in the past several months we experienced a significant
3 operational upset at our smelter caused by unexpected, early pot failures. We
4 will invest approximately \$18 million in the first quarter of 2015 just to solve this
5 problem. Our ability to withstand these types of shocks will be greatly enhanced
6 by the requested rate relief and will reduce the risk that the company has the
7 financial capacity to deal with unplanned events.

8
9 **Q. WHAT CONDITIONS IS NORANDA WILLING TO AGREE TO IN EXCHANGE**
10 **FOR THE REQUESTED RATE?**

11 A. During any period of smelter operation when its electric rate is below its fully
12 embedded cost of service, Noranda will agree to the following conditions:

- 13 1. ** _____
14 _____**
- 15 2. Noranda agrees that it will maintain a minimum level of employment at
16 the New Madrid smelter of 850 employees.
- 17 3. Noranda agrees that it will maintain a minimum average annual, level
18 of capital expenditure of \$35 million at the New Madrid smelter.

19
20 **Q.** ** _____
21 _____
22 _____**

1 A. ** _____
2 _____
3 _____
4 _____
5 _____
6 _____**

7
8 **Q DID ROBERT MUDGE FILE TESTIMONY IN THIS CASE SIMILAR TO THE**
9 **TESTIMONY HE FILED IN CASE NO. EC-2014-0224 AND DO YOU AGREE**
10 **WITH IT?**

11 A. Yes he filed testimony but I do not agree with his conclusions in opposition to
12 Noranda's requested power rate.

13
14 **Q. PLEASE EXPLAIN.**

15 A. Mr. Mudge criticizes the company for basing its financial forecast on "an
16 unsubstantiated approach to forecasting aluminum prices not to [his] knowledge
17 previously articulated by Noranda[.]" He supports his argument with the
18 testimony of Mr. Humphreys, who asserts that the approach is not consistent with
19 industry practice. Simply put, the criticisms of Mr. Mudge and Mr. Humphreys
20 are invalid because neither apparently understands the purpose of the analysis.
21 Nor do they appear to understand or appreciate the type of analytics that
22 managers actually responsible for the well-being of a corporate enterprise must
23 evaluate in order to fulfill their fiduciary and ethical obligations. Despite Mr.

1 Mudge's assertions to the contrary, I can assure the Commission that to fulfill my
2 responsibilities as CEO, I constantly evaluate sensitivity analyses of the type we
3 have presented in this proceeding. To do otherwise, and to simply rely on a
4 single point forecast that does not reflect volatility, would be irresponsible.

5
6 **Q: MR. MUDGE ALSO CLAIMS THAT NORANDA'S APPROACH IN THIS CASE**
7 **FOR FORECASTING ALUMINUM PRICES IS FUNDAMENTALLY DIFFERENT**
8 **FROM THE APPROACH NORANDA EMPLOYED IN CASE NO. EC-2014-0224.**
9 **HOW DO YOU RESPOND?**

10 A. Mr. Mudge is correct that the approach for forecasting aluminum prices is
11 different from Noranda's analysis presented in Case No. EC-2014-0224. That
12 change was made to provide the Commission with a more robust analysis and to
13 eliminate the accusation, albeit an erroneous one, that Noranda was choosing a
14 specific aluminum price forecast solely to support its request. In that regard, I
15 note the following:

- 16 ▪ The analysis provided by Noranda is not a forecast; rather, it is a
17 sensitivity analysis to determine the company's performance under a
18 variety of aluminum price scenarios, recognizing that the price of
19 aluminum is extremely volatile.
- 20 ▪ As explained in the testimony of Mr. Boyles, the Company tested
21 eleven scenarios. To simplify the testimony, we presented three
22 scenarios that we viewed as reasonable outcomes. However, in
23 response to the criticisms, Mr. Boyles has provided the remaining

1 analyses in his surrebuttal testimony. That data confirms that we did
2 not select the worst case scenarios. **_____

3 _____
4 _____**

- 5 ■ It is also important to note that the reduced power rate requested
6 meets the Commission's criteria that it exceed Ameren's incremental
7 cost to insure that other ratepayers are better off than if the New
8 Madrid smelter were shut down or be served by a third party.

9
10 **Q. DOES IT CONCERN YOU THAT ONCE AGAIN THE COMMISSION IS FACED**
11 **WITH DUELING EXPERTS ON THE ISSUE OF NORANDA'S**
12 **SURVIVABILITY?**

13 A. Absolutely. As far as I can tell, Ameren Missouri has once again taken the
14 strongest position against our request even though Ameren Missouri is held
15 harmless under our requested relief. Rather, it is Ameren Missouri's other
16 ratepayers whose rates will increase modestly in order to keep Noranda on the
17 system. Those ratepayers at least appear interested in considering, our
18 proposal. While it is true that ratepayers' rates will be higher (as compared to
19 rates if Noranda received no rate relief yet still survived), those higher rates will
20 be lower than the rates they would pay if Noranda was forced to close the New
21 Madrid smelter.

22 Moreover, I am disappointed and concerned that once again the survival
23 of the New Madrid smelter, the livelihood of more than 850 families and, indeed,

1 the well-being of an entire community may depend on academic analyses of
2 dueling experts. We respect the experts that Ameren Missouri has brought
3 forward, but running a business is not a theoretical or an academic exercise. I
4 can assure this Commission that I believe the analyses we have presented in this
5 proceeding are reasonable and that they are being used internally to develop
6 action plans going forward.

7
8 **Q: MR. MUDGE APPARENTLY DOES NOT BELIEVE THAT NORANDA NEEDS**
9 **THE REQUESTED RATE RELIEF. HOW DO YOU RESPOND?**

10 A: We know that aluminum prices are volatile. That fact is beyond dispute. A
11 business like Noranda cannot simply assume that the average price of aluminum,
12 or that a one year projection of price, will prevail into the future given this
13 volatility. Mr. Mudge is a witness with no responsibility to employees,
14 shareholders, or the community in which Noranda operates. If he again
15 convinces this Commission to deny relief, but his opinions turn out to be wrong
16 (as we believe they are) and the smelter perishes, it is Noranda's employees and
17 shareholders, the communities in which Noranda does business, and Ameren
18 Missouri's other ratepayers who will suffer. I, on the other hand, have a personal
19 responsibility to keep the New Madrid smelter operational and to make it viable.
20 Therefore, I must take into account the volatility of the aluminum price in planning
21 Noranda's sustainability. Mr. Mudge's employer in this matter, Ameren Missouri,
22 will lose nothing if Noranda closes its business.

1 One can clearly see the turmoil to many businesses as a result of the
2 drastic downturn in oil prices (oil drillers for example). We know that there will be
3 peaks and troughs in the aluminum price; we just are unable to predict exactly
4 when they will occur. Even Ameren Missouri witness Humphreys does not
5 challenge the fact that the aluminum prices hover in the troughs more than the
6 peaks (Humphreys 7). Similarly, credit institutions know this as well and are
7 reluctant to provide financing when there is a risk that a downturn in the
8 aluminum price could prevent a borrower from returning principal, much less
9 paying interest. We attempted a reasonable approach to modelling the volatility
10 of the aluminum price and, with the conditions set forth above, believe that we
11 have protected consumers **-----**.

12

13 **Q: MR. CHRISS OF WAL-MART INDICATES THAT WAL-MART DOES NOT**
14 **OPPOSE YOUR REQUEST FOR RATE RELIEF (CHRISS 11), BUT HE DID**
15 **HAVE MORE TO SAY ON THIS ISSUE. WHAT DID HE SAY?**

16 A: To summarize, Mr. Chriss acknowledges Noranda's contribution to Ameren
17 Missouri ratepayers and to Southeast Missouri, including its impact to Wal-Mart
18 and Sam's stores near the New Madrid smelter (Chriss 9-13). He does
19 understandably want the Commission to determine that the "economics justify
20 the amount of relief granted." (Chriss 11). He also has concerns and
21 recommendations about the mechanics of granting the rate relief (Chriss 11-16).

22

1 **Q: HOW DO YOU RESPOND?**

2 A: First, I believe that the conditions to which Noranda agrees in consideration of
3 rate relief should provide that the economics justify the amount of rate relief.
4 Second, as to the specific issue of mechanics of implementing the rate relief, I
5 understand that Mr. Brubaker will be responding with specifics.

6

7 **Q: WHY ARE YOU SEEKING THIS RATE RELIEF FROM THE COMMISSION**
8 **AND NOT THE LEGISLATURE?**

9 A: Noranda continues to believe that the Commission has jurisdiction over this
10 matter and is the appropriate body to set our electric rates. We have been, and
11 remain, convinced that the Commission is the very best place to go to for
12 balanced rate relief. In fact, the Commission is the best body to truly balance the
13 interests of all parties potentially affected by Noranda's requested rate reduction.
14 At the same time, we did not believe that the relief we need could be achieved by
15 going to the legislature. We do not think it is possible to obtain relief in the
16 legislature without all parties being on board for the same result and we know
17 that is not the case currently. We are working to determine if a global settlement
18 of our request is possible. A global settlement here, before the Commission,
19 would be a marvelous indicator that we can create global solutions together with
20 Ameren and the other ratepayers. The guidance given by the Commission in our
21 prior case, that we should work to achieve this result, opened our eyes to the fact
22 that we need to come together constructively for the good of all of our companies
23 and the State of Missouri. We will try to accomplish that before this body. In any

1 event, Noranda must have rate relief for all the reasons I have outlined. That is
2 why we are still here asking the Commission for that outcome and must be
3 persistent in this regard.

4

5 **Q DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

6 **A** Yes, it does.