

Exhibit No.: 754
Issues: Rate LTS
Class Cost Of Service
Fuel Adjustment Clause
Witness: Donald Johnstone
Type of Exhibit: Direct Testimony
Sponsoring Party: Noranda
Case Number: ER-2008-00318
Date Testimony Prepared: Sept. 11, 2008

AmerenUE

Case No. ER-2008-0318

Prepared Direct Testimony of

Donald Johnstone

On behalf of

Noranda Aluminum, Inc.

September 2008

Noranda Exhibit No. 754
Case No(s). ER-2008-0318
Date 12-04-08 Rptr KF

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)
COUNTY OF Jackson) ss

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.

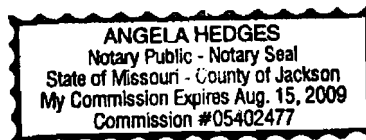
Donald E. Johnstone
Donald E. Johnstone

Subscribed and sworn to before me this 11 day of September, 2008.

Angela Hedges
Notary Public

[SEAL]

My Commission expires: 8-15-09



Before the
Missouri Public Service Commission

AmerenUE

Case No. ER-2008-0318

Prepared Direct Testimony of Donald Johnstone

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

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

4 **Q ARE YOU THE SAME DONALD JOHNSTONE THAT PREVIOUSLY SUBMITTED**
5 **DIRECT TESTIMONY IN THIS DOCKET?**

6 A Yes. My qualifications and experience are set forth in Appendix A to my
7 earlier testimony

8 **Q WHAT ARE THE PURPOSES OF YOUR TESTIMONY?**

9 A One purpose is to support cost of service as the appropriate basis for charges to
10 Noranda under the Large Transmission Service (LTS) rate schedule. While all
11 aspects of a class cost-of-service study are important, I will address in
12 particular several of the more important aspects. I will also make comments
13 on the design of the proposed FAC that serve to extend Noranda's opposition as
14 expressed in my earlier direct testimony.

1 Q PLEASE PROVIDE A SUMMARY OF YOUR DIRECT TESTIMONY ON RATE DESIGN
2 ISSUES.

3 A

- 4 ➤ Noranda is served under the Large Transmission Service (LTS) rate.
- 5 ➤ Service characteristics include a 475 MW load, a 98% load factor, service
6 provided at a transmission substation owned by AECl, and no distribution
7 facilities provided by AmerenUE.
- 8 ➤ The service characteristics of Noranda are unique and lead to an average
9 cost to serve that is well below average.
- 10 ➤ Although AmerenUE proposes a \$15.5 million, 12.1% increase for
11 Noranda. the AmerenUE class cost-of-service study shows that a smaller
12 increase to Noranda of \$ 7.5 million, 5.8% is required to recover costs-
13 assuming the full \$251 increase request is appropriate.
- 14 ➤ AmerenUE proposes to increase the rates to Noranda by \$ 8.0 million
15 above and beyond the cost-based increase, so the total increase of \$15.5
16 million more than doubles the cost-based increase.
- 17 ➤ Noranda recommends that any increase be set equal to the cost based
18 level that is consistent with the overall increase approved by the
19 Commission.
- 20 ➤ Noranda continues to oppose the FAC for reasons set forth in my earlier
21 direct testimony, for reasons set forth in earlier Staff testimony, and for
22 the reasons set forth in this testimony
- 23 ➤ In this testimony Noranda opposes the FAC because the 95/5 split
24 between the FAC and base rates does not provide a meaningful level of
25 incentive to align customer and utility interests and because it would
26 pass through potentially large costs that are not dependent on fuel
27 price, but on AmerenUE's operation of the generation system.
- 28 ➤ The proposed increase to Noranda is more than twice that which is
29 supported by the cost study and the proposed FAC only makes an
30 unfortunate rate increase proposal worse for Noranda. As explained in
31 earlier testimony, the aluminum markets set prices on a global basis and
32 the AmerenUE proposal for a rate that is \$8 million above cost and with
33 automatic adjustments every four months does not give adequate
34 consideration to the environment in which Noranda must strive to
35 endure.
- 36 ➤ A rate based on both cost and rate stability is important to Noranda and
37 the AmerenUE proposals taken together provide neither.

1 Q WHAT SERVICE DOES AMERENUE PROVIDE TO NORANDA?

2 A AmerenUE provides service to Noranda under the Large Transmission Service
3 rate schedule at its facility located near New Madrid, Missouri. I will refer to
4 the facility as the "Smelter." The service is described more fully in my earlier
5 direct testimony submitted August 28. In brief, service to the Smelter is firm
6 and it consumes approximately 475MW around the clock - seven days a week.
7 A measure of Noranda's consistent use of the AmerenUE facilities is the ratio of
8 the average use of electricity as compared to the peak use. In Noranda's case
9 the comparison is captured in a load factor of 98%. This leads to the full use of
10 the Ameren facilities and a lower average cost per kWh delivered to Noranda.

11 Q DO THE SIZE AND LOCATION OF THE SMELTER LOAD INFLUENCE THE
12 FACILITIES THAT ARE USED TO PROVIDE THE SERVICE?

13 A Yes. As a consequence of the size of the load and the proximity of the Smelter
14 to a transmission substation it is efficient for Noranda to receive its service at
15 the transmission substation. Noranda owns and operates the distribution
16 facilities that bring the electricity to the Smelter from the transmission
17 substation. The only delivery equipment of any kind that is not owned and
18 operated by Noranda is the metering. Another distinguishing feature of the
19 service to Noranda is the delivery of the power over the transmission facilities
20 of the Associated Electric Cooperative, Inc. (AECI). Noranda separately pays
21 AECI for transmission service. These several circumstances together make the

1 Noranda load unique on the AmerenUE system and result in a cost per kWh for
2 the Ameren portion of the service that is much lower than the average cost for
3 other customers. An appropriate rate will reflect this lower than average cost.

4 **Q WHAT IS AN APPROPRIATE BASIS FOR THE LARGE TRANSMISSION SERVICE**
5 **(LTS) RATE UNDER WHICH NORANDA RECEIVES SERVICE?**

6 **A** While factors such as understandability and ease of administration are
7 appropriately considered, the rate should be set primarily based on the cost of
8 the service provided. When a rate is appropriately based on cost, it is
9 equitable in that each customer will pay the costs that are incurred by Ameren
10 to provide the service that is consumed, no more and no less. As such,
11 Noranda does not expect other customers to pay costs incurred on its behalf
12 and Noranda likewise does not expect to pay costs associated with service
13 provided to other customers.

14 **Q HOW DOES THE RATE THAT AMERENUE PROPOSES FOR NORANDA COMPARE**
15 **TO THE COST TO SERVE NORANDA?**

16 **A** AmerenUE proposes an increase to Noranda of 12.1% while the AmerenUE costs,
17 as defined by the AmerenUE class cost-of-service study, only support an
18 increase of 5.8%. The test year revenue provided by Noranda was
19 \$128,201,000. The class cost-of-service study establishes a revenue
20 requirement of \$135,657,000 at the cost level of the April 4 AmerenUE filing.

1 Thus, the increase that would set the rates equal to the level of cost consistent
2 with its proposal for an overall increase of \$251 million would be \$7,456,000.
3 However, AmerenUE proposes to increase the rates another \$8,042,000 beyond
4 the level of cost. Noranda objects to the extra \$8 million increase. Of course,
5 Noranda also objects to the \$7,456,000 increase to the extent that any
6 approved increase is less than the \$251 million requested.

7 **Q IS THE RATE PROPOSAL A PROBLEM FOR NORANDA?**

8 **A** The proposed rate, with an increase that is twice that which is supported by
9 the cost study, is unjustified. The addition of a proposal for a FAC only makes
10 an unfortunate rate increase proposal worse. As explained in earlier
11 testimony, the aluminum markets set prices on a world stage and the
12 AmerenUE proposal for a rate that is \$8 million above cost and with automatic
13 adjustments every four months does not give adequate consideration to the
14 environment in which Noranda must strive to endure.

15 A rate based on both cost and rate stability is important to Noranda and
16 the AmerenUE proposals taken together provide neither.

17 **Q HOW SHOULD THE COST OF THE SERVICE BE DETERMINED FOR CUSTOMERS**
18 **THAT RECEIVE SERVICE REGULATED BY THIS COMMISSION?**

19 **A** In the context of regulated service the cost should be defined by a class cost-
20 of-service study which will allocate the AmerenUE costs (as ultimately

1 approved by the Commission) among customer classes based on the principle of
2 cost causation. As explained below, other factors are considered, but cost is
3 certainly the dominant consideration for service to Noranda.

4 **Q WHAT IS THE COST TO SERVE NORANDA?**

5 **A** AmerenUE has provided a class cost-of-service study that computes the cost
6 based on the case as filed by AmerenUE. However, a problem in the
7 circumstances of this case is the wide disparity among the parties on the level
8 of the AmerenUE total revenue requirement. Several of the issues will
9 substantially influence the result of any class cost-of-service study. In these
10 circumstances it is impossible to determine a specific cost for Noranda at this
11 time. Furthermore, even an estimate at this time would require judgments
12 and assumptions about the overall revenue requirement. Therefore, I plan to
13 review and respond to any class cost-of-service study that may be submitted to
14 ensure that any proposals for the LTS rate are based on the cost of service
15 principles I recommend.

16 **Q ARE THERE ESTABLISHED PROCEDURES FOR CLASS COST-OF-SERVICE**
17 **STUDIES?**

18 **A** Yes. AmerenUE in the testimonies of Mr. Warwick and Mr. Cooper describes
19 the process. Costs are “functionalized” according to the service function
20 provided, “classified” as fixed or variable, and then “allocated” among the

1 classes according the principle of cost causation. Based on the information
2 presently available, the Ameren class cost-of-service study uses a framework
3 that appears to be reasonable for the purpose.

4 **Q WHAT ARE SOME OF THE IMPORTANT CLASS COST-OF-SERVICE ISSUES THAT**
5 **MUST BE PROPERLY ADDRESSED IN THIS CASE AND THAT MAY BE**
6 **CONTROVERSIAL?**

7 **A** The issues, among others, include:

- 8 • The allocation of demand-related production costs
- 9 • The allocation of off-system sales costs and revenues
- 10 • The allocation of distribution costs.

11 While there are many important details in a class cost-of-service study, these
12 issues are particularly important for Noranda because of the large impact each
13 has on the Noranda cost of service.

14 **Q WHY ARE THE ALLOCATIONS OF PRODUCTION COSTS IMPORTANT?**

15 **A** Production costs are a large part of the costs of the system. In Noranda's
16 situation, service is provided via a transmission interconnection with AECl and
17 AmerenUE incurs no distribution costs to provide the service. This absence of
18 distribution costs means that production costs constitute a relatively larger
19 portion of the cost to serve Noranda than for other customers.

20 **Q PLEASE EXPLAIN SOME OF THE CONSIDERATIONS RELEVANT TO A PROPER**

1 **COST-BASED ALLOCATION OF PRODUCTION COSTS.**

2 A First, both variable and fixed production costs must be defined. The variable
3 costs incurred to provide service to customers are energy related and are
4 appropriately allocated among the classes according to the kWh of energy that
5 must be generated to supply the energy for each customer class. The variable
6 costs consist primarily of fuel for the generation needed to serve the load and
7 the energy component of purchased power for the same purpose. As a
8 consequence of the delivery to Noranda at a transmission substation, less
9 energy is consumed in delivering the energy as compared to other retail
10 customer classes where there is typically extensive use of the AmerenUE
11 distribution system. Energy consumed in delivery is defined as energy “losses.”
12 These “losses” are low for Noranda because of the particular transmission
13 service received and this fact must be properly reflected in the energy
14 allocation factor.

15 The remaining (non-energy related) production costs are the fixed costs
16 of ownership and operation of production facilities.¹ These costs are demand
17 related and depend on the capacity needs of the system. In turn, it is primarily
18 the contributions of customers to the peak loads of the system that create
19 these costs. Demand related production costs should be allocated in
20 proportion to the respective contributions of the customer classes to the peak
21 loads.

¹ In the case of purchased power the fixed production costs may be reflected in a demand charge.

1 Q WHY IS THE ALLOCATION OF DISTRIBUTION COSTS IMPORTANT TO NORANDA?

2 A Noranda, not AmerenUE, owns, operates and maintains the distribution
3 facilities used for service to Noranda. Thus, AmerenUE incurs no distribution
4 costs to serve Noranda. Any class cost-of-service study must reflect the
5 absence of distribution costs for Noranda.

6 Q WILL YOU HAVE REBUTTAL THAT IS SPECIFIC TO THE CLASS COST-OF-
7 SERVICE STUDIES SUBMITTED BY AMERENUE AND OTHER PARTIES?

8 A Yes. At the appropriate time I will provide rebuttal testimony.

9 Q WHAT COMMENTS DO YOU HAVE ON THE FUEL ADJUSTMENT CLAUSE THAT
10 HAS BEEN PROPOSED BY AMEREN?

11 A I provided comments in my direct testimony filed on August 18 and offered the
12 Noranda perspective in opposition to the establishment of an FAC. Noranda
13 continues to oppose the FAC because:

- 14 ○ the financial incentive for AmerenUE to minimize costs would be
15 eviscerated,
 - 16 ○ the insured cost of replacement power due to generator outages would
17 create a rate yo-yo with rates going up and going down needlessly,
 - 18 ○ consumers would be put in the position of insuring the replacement
19 power costs of every outage, large and small, subject only to
20 imprudence investigations months or years later,
 - 21 ○ the larger issue of the AmerenUE financial health cannot be solved with
22 the proposed FAC and needs to be considered in a separate proceeding.
- 23 Of course an always present consideration is the competitive world in which

1 Noranda must exist. Noranda cannot pass through cost increases
2 automatically. Regulation, if successful in emulating the competitive market
3 will similarly not allow an automatic pass through via an FAC. No doubt there
4 will be additional testimony from other parties that will address additional
5 perspectives. Noranda will review the additional testimonies and respond in
6 due course.

7 While Noranda continues to oppose the FAC, if there is to be one it is
8 important that the costs and revenues be clearly defined and allocated based
9 on the principles of cost causation, i.e., the same principles and procedures
10 that are appropriate for the design of base rates. A particular concern of
11 Noranda would be the inclusion of any demand related costs or revenues. Also,
12 if off-system sales costs and revenues are included, concern for an appropriate
13 treatment of the revenues and costs arises. The extraordinarily high load
14 factor of Noranda creates a large impact on Noranda if demand related costs or
15 revenues that should be allocated on the average and excess factor are instead
16 allocated on annual energy consumption. The impact may be either beneficial
17 or harmful to Noranda, depending on the circumstance. Of course any benefit
18 to Noranda would come at the expense of other customers while any benefit to
19 other customers would come at the expense of Noranda. Consequently, if
20 there is to be a mechanism, it is important that all included costs and revenues
21 flow to rates following the principles of cost causation. An approach to rate
22 design that rests on the cost of service is just as important for any FAC as it is

1 for base rates.

2 Another concern of Noranda is the incentive, or lack of incentive, that is
3 engendered by any FAC. AmerenUE acknowledges this consideration and
4 addresses it in a limited way with its proposal to track 95% of FAC cost
5 variations in the proposed rider while 5% would continue to receive base rate
6 treatment. A more substantial retention of base rate treatment would be
7 needed to better ensure a meaningful alignment of the interests of customers
8 and AmerenUE.

9 Another concern is that any FAC should include provisions that will limit
10 the exposure of customers to increases in fuel costs that do not arise from fuel
11 price variations. Such increases would be occasioned by the unavailability of
12 any generation facility, but a major base load facility is the most serious
13 concern. This issue is simply not addressed in the Ameren proposal, but the
14 effect on fuel costs could be very large. There has been no representation that
15 the operation of power plants is beyond the control of Ameren. Consequently,
16 this impact on fuel costs in an FAC is inapposite to the premise that eligible
17 costs are beyond the control of management. If there is to be a FAC, as a part
18 of the design there should be a floor/minimum level of base load generation.
19 With respect to AmerenUE this would ensure continuing consequences for
20 operations that are within the control of management. With respect to
21 customers this would be a protection. The protection would limit the extent to
22 which customers hold AmerenUE harmless for operational problems and

1 customers would avoid being put in a posture of insuring the availability of
2 AmerenUE power plants.

3 **Q PLEASE SUMMARIZE THE SEVERAL ADDITIONAL CONCERNS YOU HAVE**
4 **ADDRESSED IN THIS TESTIMONY IN REGARD TO THE FAC MECHANISM**
5 **PROPOSED BY AMEREN.**

6 **A** The concerns with the Ameren proposal are the following:

- 7 ➤ It is important to retain base rate treatment for a meaningful portion of
8 the fuel and off-system sales net costs to ensure a continuing alignment
9 of the interests of customers and AmerenUE.
- 10 ➤ Cost variations that may arise due to plant operations are not subject to
11 market forces, but instead are largely within the control of
12 management. Such cost variations should not flow to customers more or
13 less automatically pursuant to an FAC. Instead, any FAC should
14 incorporate a floor / minimum level of base load generation to protect
15 consumers and retain for management the consequences of their
16 management of the system.
- 17 ➤ Regulation, to the extent that it emulates the competitive markets in
18 which Noranda operates, will not establish a FAC.

19 These concerns are important to Noranda and serve to reinforce Noranda's
20 opposition to the proposed FAC.

1 Q DOES THIS CONCLUDE YOUR TESTIMONY?

2 A Yes it does.