BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of	)	
PACIFICORP for a Certificate of	)	
Convenience and Necessity Authorizing	)	Docket No. 04-035-30
Construction of the Lake Side	)	
Power Project	)	

REBUTTAL TESTIMONY OF RICHARD Y. ITO

October 15, 2004

Q. Please state your name.

A. My name is Richard Y. Ito.

Q. Did you previously offer testimony in this proceeding?

A. Yes. I submitted pre-filed direct testimony on May 28, 2004.

Purpose and Summary of Testimony

Q. What is the purpose of your testimony?

A. I will address the perceptions held and accusations made by the Utah Association of Energy Users (UAE) Intervention Group with respect to credit risk and its impacts on the outcome of the 2003A Baseload RFP process.

Credit Risk and Impact on 2003A Baseload RFP Process

Q. Mr. Weir of the UAE Intervention Group testifies that Bidder 213's history of building and operating power plants suggests that the credit standards used by PacifiCorp may be unreasonable. Do you agree?

A. No. Mr. Weir's testimony includes reference to Bidder 213's historic record of building and operating power plants as a reason to question the reasonableness of PacifiCorp's credit standards. In fact, PacifiCorp did consider Bidder 213's reputation and history when the Company entered into good faith negotiations with Bidder 213. PacifiCorp likely would not have entered into negotiations with Bidder 213 if the Company was not comfortable with Bidder 213's technical capabilities. However, a company's historical record of building power plants is no guarantee of future performance on its financial obligations. Credit ratings are used to provide independent assessment of the ability of a company to perform on its future financial obligations. PacifiCorp used Bidder 213's credit rating to help determine the type and level of mitigation necessary to protect its customers from a Bidder 213 default. This is a standard practice used in commercial transactions of all types.

Q. Mr. Weir contends that PacifiCorp's evaluation of Bidder 213's creditworthiness "seems to be more of an investor type evaluation, rather than a ratepayer evaluation." Is this a reasonable statement?

A. No. Mr. Weir fails to recognize that both ratepayers and investors have a common interest when it comes to a counterparty's creditworthiness. That is to ensure that the counterparty will perform as promised. I do not see a difference between an investor perspective or ratepayer perspective on this issue. Mr. Weir apparently fails to understand that Bidder 213's credit rating and its future ability to perform on its financial obligations are vitally important issues to both ratepayers and shareholders and deserve analysis, more sophisticated than simply looking to the company's historical record of building power plants. Indeed, I discuss below an example of a company with technical competence and a track record of building plants being forced to shut-down half-completed projects.

Q. Mr. Weir states the ability of Bidder 213 "to construct and operate a power plant should be based primarily on its track record of building and operating plants, not a credit rating." Do you agree?

A. No. Mr. Weir seems to believe that merely having the ability to build and operate a power plant qualifies a company to enter into a 35-year agreement to serve PacifiCorp's customers and is a good substitute for an in-depth credit analysis and structuring of a sound agreement to protect customers from default risk. Mr. Weir obviously believes that Bidder 213's credit rating and its future ability to perform on its financial obligations are not technical issues and deserve no analysis other than looking to the company's historical record of building power plants, even though Mr. Weir himself agrees that credit is a "relevant consideration." I respectfully disagree with Mr. Weir's uninformed opinion, which he has chosen to express with apparently no analysis of his own. PacifiCorp has an obligation to serve its customers and seeks to provide that service at the best cost/risk balance. Rolling the dice to bet on a company to perform when it has a 50% (approximate) chance of defaulting on its debt obligations over the next three years is simply an unacceptable risk for a Company with an obligation to serve. The Company did consider this default risk and sought to structure an agreement that provided the benefits of Bidder 213's technical capabilities to build and operate a power plant as well as guaranteed financial performance over an extended period of time.

Q. Can you provide an example of what PacifiCorp should do according to Mr. Weir's statements?

A. Yes. According to Mr. Weir's testimony, PacifiCorp should have been willing to enter into a contract with a company like National Energy Production Corporation (NEPCO). This company, which has its roots as a partnership beginning in 1938 and incorporated as NEPCO in 1974, had significant experience in building and operating power plants in the United States and in other countries. At one point, NEPCO was the nation's fifth largest power contractor with 5,000 employees and revenues of $1.2 billion. Unfortunately, NEPCO became a subsidiary of Enron Corporation in 1997 and subsequently became embroiled in the Enron bankruptcy filing. One result of Enron's bankruptcy was NEPCO's inability to complete several power plant projects due to cash being swept from NEPCO to Enron, resulting in NEPCO being unable to pay its subcontractors. The project sponsors had to bear most of the financial burden of this situation as well as scramble to come up with alternative plans to deal with construction risk. The attached report Exhibit UP&L **____** (RYI-1R) from "Risk Center" titled "US Project Finance Sponsors Bear Brunt of EPC Contractor Bankruptcies" summarizes NEPCO's failures resulting from the Enron bankruptcy. This summary shows the alternative plans that project sponsors had to develop. In cases where NEPCO defaulted, the project sponsors ended up contracting with a new firm, SNC – Lavalin, that purchased certain assets of NEPCO and hired substantially all of NEPCO's employees. However, the project sponsors had to assume significant credit, cost and/or completion risk as a result of the restructured agreements with SNC – Lavalin.

Q. Mr. Weir contends that PacifiCorp's credit analysis would lead you to believe that Bidder 213 "has only a 52% to 36% chance of completing a project that it has started." Does this make sense to you?

A. I am at a loss to understand Mr. Weir's statement. Again, Mr. Weir seems to be confusing a company's technical capabilities with its future ability to meet its financial obligations. If Mr. Weir had read the materials discussed in my direct testimony, *Moody's Default & Recovery Rates of Corporate Bond Issuers*, he would have learned that a company, like Bidder 213, with a Caa1 rating has a probability of defaulting on its debt obligations over the next three years of between 48% and 64%, based on the Moody's statistics. He would have also learned the Energy and Utilities Sector of corporate bond issuers experienced the highest default volume *worldwide* in 2003 with Mirant Americas Generation, LLC (an independent power producer similar to Bidder 213), Mirant Corporation and Northwestern Corporation defaulting on a total of approximately $5.9 billion of debt due to bankruptcy. These US-based companies represented approximately 82% of the default volume in this sector for 2003.

Q. Is there any explanation for Mr. Weir's contention?

A. Yes. Perhaps Mr. Weir was opining on a potential correlation between a Bidder 213 bankruptcy and its subsequent inability to complete a project due a lack of financial resources. If this is what Mr. Weir is referring to, I would tend to agree with Mr. Weir's inference that Bidder 213's ability to complete a project would be impaired. PacifiCorp understood from negotiations with Bidder 213 that Bidder 213 intended on "balance sheet financing" construction of the project up to approximately 80% of completion before it would seek permanent financing for the project. In this circumstance, a Bidder 213 bankruptcy prior to permanent financing (which could be well into 2006 or even into 2007) and subsequent default on its agreement with PacifiCorp could quite likely result in significant delays including delays resulting from Bidder 213's inability to complete the project.

Q. Mr. Weir claims a perception that credit issues may have been used to ensure a competitive advantage for a turnkey project to be owned and operated by PacifiCorp as opposed to a project to be owned and operated by a competitor. Is this perception accurate?

A. No. Bidder 213's poor credit rating was a disadvantage to Bidder 213 independent of any other bids.

Q. Does this conclude your testimony?

A. Yes.