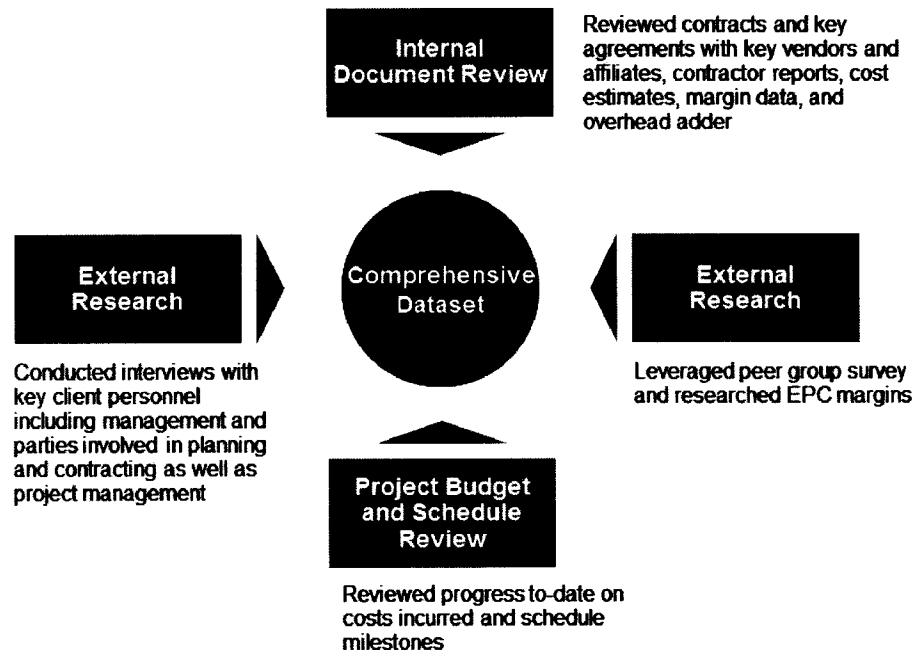


The chart below illustrates the approach taken to identify and obtain a comprehensive project and external environment dataset.

Figure 2 – Data Sources



To evaluate the key elements of affiliate charges and project costs, the analysis required insight and information from a variety of data sources. For example, to understand the full scope of affiliate contract administration and project management and oversight, it was necessary to review key documents, analyze internal WETT processes and conduct a number of direct interviews on this topic. The focus of the above tasks was to obtain sufficient information to understand WETT's management processes, decision-making and basis for capturing affiliate charges.

Specific information sources that were identified and reviewed included, but were not limited to:

- Permitting applications and decisions

- 1 • WETT budget
- 2 • Financial planning studies
- 3 • Affiliate invoices
- 4 • WETT project organizational plans
- 5 • Contracts with the EPC
- 6 • Agreements with other affiliates
- 7 • Project execution plans
- 8 • Project correspondence
- 9 • WETT project reports
- 10 • Third-party reports
- 11 • Prior testimony
- 12 • Commission filings and decisions

13 The above data provided a view of the project from inception through present
14 condition, to execution and completion plans. Through synthesis and review of this
15 information, a documentation and decision baseline was established to support the
16 analysis.

17 **Q. PLEASE ELABORATE ON THE EVALUATION CRITERIA USED IN**
18 **YOUR ASSESSMENT.**

19 A. The specific criteria used in performing analyses of WETT's affiliate charges,
20 decision to use I-USA as EPC contractor and EPC project management are
21 identified in the figure below

Figure 3 – Evaluation Criteria

Affiliate Charges	EPC Selection	Project Management
<p>Necessity and Benefit of Service</p> <ul style="list-style-type: none"> Do the activities represent legitimate and useful business activities? Is the performance of these activities discretionary? Are these activities consistent with those performed by similar companies? Are there benefits observable from activity performance? <p>Adequacy of Cost Assignments and Allocations</p> <ul style="list-style-type: none"> Are the assignment and allocation methods fully documented? Do assignment and allocation methods reflect acceptable standards? Do assignment and allocation methods reflect cost causation? Are assignments and allocation methods consistent with similar companies? <p>Budgeting and Cost Control</p> <ul style="list-style-type: none"> Is the activity cost budgeting process well defined and executed? Does activity cost budgeting provide adequate visibility into costs? Is the budgeting process consistent with that of similar companies? Does WETT have adequate input into the budgeting process? Are costs sufficiently controlled over the course of the year? Is there evidence of ongoing cost evaluation? Is there evidence of execution against previous cost control programs? Can direct benefits of cost control be demonstrated? 	<p>Evaluation of EPC Selection Process</p> <ul style="list-style-type: none"> Was the basis to select the EPC contractor appropriate? Was the allocation of contract risk considered and appropriately addressed? Was the decision to select the EPC contractor based on concrete benefits and advantages the contractor would deliver? <p>Adequacy of Contract Structure</p> <ul style="list-style-type: none"> Is the EPC contract similar to other contracts observed in the market? Do the terms and conditions and the structure of the EPC contract compare to other contracts observed? Were incentives considered and used in the EPC contract? <p>Appropriateness of Contract Margin</p> <ul style="list-style-type: none"> Does the margin level charged by the EPC contractor compare favorably to margins observed in the market? <p>Appropriateness of Overhead Adder</p> <ul style="list-style-type: none"> Does the overhead adder charged by the EPC contractor compare favorably to overheads observed in the market? 	<p>Management Oversight</p> <ul style="list-style-type: none"> Is the overall project management philosophy adequate? Are project management procedures and processes adequate to provide for the execution of indicated oversight responsibilities? Is cost and schedule management adequate and conducive to meeting project objectives? Are project management processes adequate to provide for the monitoring of project progress and performance and initiation of corrective action when required? Are project planning efforts adequate in light of the complexity of the tasks? Are project planning scope and efforts and level of specificity demonstrated within planning documents appropriate? <p>Owner Role in Execution</p> <ul style="list-style-type: none"> What is the degree of involvement of WETT in development analysis and approval of project plans and direction? Is the evaluation process used by WETT to review and select subcontractors comprehensive? Are roles clearly defined between WETT and subcontractors?

I have used similar criteria in related prior assessments.

V. REASONABLENESS OF AFFILIATE SERVICES

Q. PLEASE DESCRIBE THE PURPOSE OF THIS PART OF YOUR TESTIMONY.

A. This part of my testimony addresses whether the costs charged to WETT by its affiliates are reasonable for each class of affiliate services and not higher than the supplying affiliate's charges to other entities for the class of service. In particular, I review both construction support services carried out by I-USA, as well as corporate support services performed by affiliates on behalf of WETT. To do so, I examine whether the activities performed by the affiliates are necessary and provide tangible benefits. In addition, I review the assignment and allocation mechanisms used by WETT's affiliates to charge costs to WETT and determine whether they are based on sound principles. Finally, I review the budgeting processes in place both at

1 WETT and at its affiliates to ensure that WETT has sufficient input in the budgeting
2 process.

3 **Q. PLEASE DESCRIBE HOW THIS PART OF YOUR ASSESSMENT WAS**
4 **CONDUCTED.**

5 A. The review of affiliate costs involved the conduct of interviews, review of
6 internal processes and procedures and evaluation of cost controls to determine the
7 reasonableness of the construction and corporate support services and costs. The
8 specific analyses performed applied discrete criteria for each relevant area and
9 included the following evaluation dimensions:

- 10 • **Overview of WETT Organization.** An identification of the controlling
11 affiliate arrangements utilized to define the services to be provided to WETT,
12 as well as the level of costs incurred to-date
- 13 • **Affiliate Activity Necessity and Benefit.** The purpose and value of specific
14 corporate and construction support services provided by the affiliates
- 15 • **Cost Assignment and Allocation.** The nature and adequacy of the processes
16 for cost identification and distribution to WETT
- 17 • **Budgeting and Cost Control.** The effectiveness of the processes in place to
18 define, evaluate and control affiliate costs to be charged to WETT.

19 **Q WHAT SPECIFIC CRITERIA DID YOU UTILIZE IN ESTABLISHING THE**
20 **FRAMEWORK FOR ASSESSING ACTIVITIES?**

21 A. My experience led me to use the following criteria to evaluate necessity and
22 benefits:

- 23 • Do the activities represent legitimate and useful business activities?
- 24 • Is the performance of these activities discretionary?
- 25 • Are these activities consistent with those performed by similar companies?
- 26 • Are there benefits observable from performing the activities examined?

- 1 • Are the assignment and allocation methods fully documented?
- 2 • Do the assignment and allocation methods reflect acceptable standards?
- 3 • Do the assignment and allocation methods reflect cost causation?
- 4 • Are the assignment and allocation methods consistent with similar
- 5 companies?
- 6 • Is the activity cost budgeting process well defined and executed?
- 7 • Does activity cost budgeting provide adequate visibility into costs?
- 8 • Is the budgeting process consistent with that of similar companies?
- 9 • Does WETT have adequate input into the budgeting process?
- 10 • Are costs sufficiently are controlled over the course of the year?
- 11 • Is there is evidence of ongoing cost evaluation?
- 12 • Is there evidence of execution against previous cost control programs?
- 13 • Can direct benefits of cost control be demonstrated?

14 These criteria provided a definitive basis for the conduct of this part of the
15 assessment and established a specific framework against which the affiliate activities
16 could be reviewed.

17 **1. OVERVIEW OF WETT ORGANIZATION**

18 **Q. PLEASE DESCRIBE WETT AND THE RELATIONSHIP WITH ITS**
19 **AFFILIATES.**

20 A. WETT is a single-member LLC governed by WETT Holdings LLC (“WETT
21 Holdings”). Brookfield and Isolux Concesiones, through their subsidiaries, each
22 own a share of 50% of WETT Holdings. WETT Holdings is governed by a Board
23 of Managers comprised of three members representing Brookfield and three
24 members representing Isolux Concesiones. Because neither parent company

1 possesses a controlling interest in WETT, neither can act unilaterally and all
2 decisions require a consensus to be reached. This structure helps prevent self-
3 dealing in any transactions, affiliate or otherwise. WETT's ownership structure is
4 further discussed in the direct testimony of Wayne Morton, WETT's General
5 Manager.

6 As discussed in more detail in the direct testimony of Mr. Wayne Morton,
7 WETT expressed intent to take advantage of its parent companies' significant
8 worldwide experience constructing and operating transmission lines in the event that
9 CREZ projects were awarded to it by the PUC. As previously indicated, WETT
10 entered into the EPC Contract with an Isolux Ingeniería subsidiary, I-USA, to obtain
11 the construction support services necessary to design, develop and construct the
12 seven transmission lines and five substations it was awarded in the CREZ process.¹⁰
13 WETT also entered into: a Consultant Service Agreement or "CSA" with I-USA as a
14 predecessor to the EPC Contract and Affiliate Services Agreements or "ASAs" with
15 subsidiaries of both Brookfield and Isolux Concesiones for provision of corporate
16 support services.

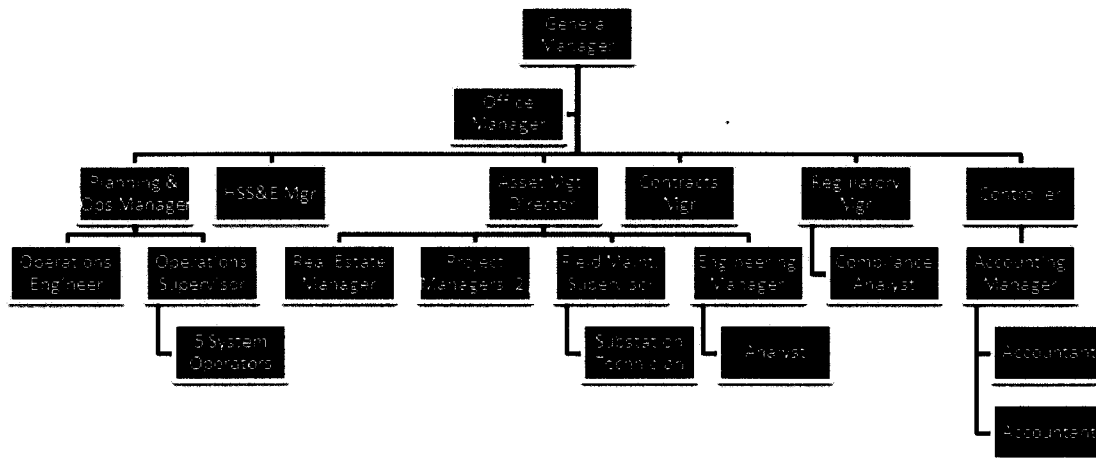
17 **Q. PLEASE DESCRIBE HOW WETT IS INTERNALLY STAFFED.**

18 A. As of mid-2012, WETT had 21 full time employees, with five vacant
19 positions, and utilized seven full time contract employees, principally for

¹⁰ WETT was selected as the transmission service provider ("TSP") for seven transmission lines and five substations in the CREZ TSP-selection docket, Docket No. 35665 (and, on remand, Docket No. 37902). WETT obtained specific authorization for these facilities and their routes through three certificate of convenience and necessity ("CCN") proceedings, Docket Nos. 38295, 38484 and 38825. WETT refers to these three projects as CCN1, CCN2, and CCN3, or collectively as the "CREZ Projects." Since the PUC's approval of the CREZ Projects, ERCOT authorized WETT to build a sixth substation, the Faraday Switching Station. This substation will be located in Borden County near CCN2 facilities.

construction related field monitoring. WETT's long-term staffing plans include the hiring of only a small number of additional employees, which positions WETT as a very lean corporate entity. This is consistent with its operating philosophy of minimizing cost incurrence and maximizing value from external capabilities. The figure below depicts WETT's current organizational structure, which is also discussed in the direct testimony of Mr. Morton.

Figure 4 – WETT Organization Chart



Q. PLEASE IDENTIFY THE UNIQUE CHARACTERISTICS OF SERVICE PROVISION BY WETT'S AFFILIATES.

A. WETT is fairly unique among Texas utilities in that it is a startup entity; therefore, it lacks many of the embedded capabilities that an established utility would possess. Accordingly, the Company has obtained certain corporate support services from its affiliates through the ASAs I previously mentioned.

WETT's approach to affiliate services provision differs from the typical approaches observed at more traditional utility companies in that WETT has the autonomy to fully define its necessary level of service rather than having the affiliate

1 establish minimum service levels. As an example, WETT maintains the option to
2 subcontract corporate support activities to third parties instead of having affiliates
3 provide these services.

4 Also unlike more traditional utilities, WETT obtains construction support
5 services for completion of the CREZ projects assigned by the Commission from an
6 affiliate at market-based pricing (meaning cost plus a small margin).

7 **Q. WHAT TYPES OF SUPPORT SERVICES ARE PERFORMED FOR WETT**
8 **BY ITS AFFILIATES?**

9 A. WETT's affiliates have provided WETT with various corporate support
10 services, including startup-related tasks, pursuant to the ASAs. Through these
11 agreements, WETT has been able to benefit from the expertise of its affiliates and
12 avoid the incurrence of additional fixed costs. Among the corporate support services
13 which have been or will be provided in the future to WETT by affiliates are: human
14 resources and recruiting services to assist WETT with hiring qualified personnel;
15 creating a financial model to support financing and project analysis; and drafting
16 initial budgets for project control and transmission planning support.

17 WETT has retained an affiliate, I-USA, to provide construction support
18 services for the CREZ projects. WETT hired I-USA to assist the Company with
19 preliminary detailed engineering and design for these projects pursuant to a CSA. I-
20 USA now provides comprehensive EPC services for the WETT CREZ projects
21 pursuant to the EPC Contract. WETT previously indicated to the Commission that it
22 intended to obtain such services from an affiliate of Isolux Ingeniería. The
23 Commission was aware of this intent when it assigned the identified CREZ projects

1 to WETT and when it approved the limited waiver of WETT's Code of Conduct.

2 Under the EPC Contract, I-USA outsourced engineering for items, such as
3 substations, and worked with its parent, Isolux Ingeniería, to outsource material
4 procurement and construction for transmission towers, conductors, foundations, and
5 other construction components. I-USA uses a competitive bidding process to select
6 major subcontractors. Specific project roles and responsibilities for construction
7 support services are outlined in Exhibit TJF-2.

8 **Q. EXPLAIN HOW AND WHY WETT UTILIZES AFFILIATE SERVICES.**

9 A. Since it has chosen to be tightly staffed, WETT relies on the skill and
10 expertise of its parent companies, as well as qualified third parties. At the outset of
11 the CREZ projects, the Company determined that hiring permanent internal
12 resources was not an optimal solution for many necessary functions during the pre-
13 construction and construction stages of the CREZ projects. Thus, WETT was left
14 with two options: (1) outsource corporate and construction support functions to an
15 affiliate, or (2) hire a non-affiliate, third party to perform these activities.

16 For the support services provided by affiliates through the ASAs, CSA, and
17 the EPC contract, WETT determined the first option was superior to the notion of
18 retaining non-affiliates. For certain other services, such as accounting and
19 information technology support, WETT determined third-party providers were the
20 better option. Similarly, when evaluating whether to outsource an activity or hire an
21 affiliate on an ongoing basis, WETT considers expertise of the potential service
22 provider, availability, efficiency, and cost.

1 **Q. PLEASE EXPLAIN THE CONTRACTS WETT HAS EXECUTED WITH**
2 **AFFILIATES FOR CONSTRUCTION SUPPORT SERVICES.**

3 A. WETT first entered into a CSA with I-USA. The CSA describes - through
4 documents called “Task Orders” - the engineering services to be provided by I-USA
5 prior to the commencement of the EPC work. These services are described as
6 “engineering services necessary to develop the WETT conceptual design into a
7 tender ready design.” The CSA details hourly rates and reimbursable costs and
8 specifies that costs may be directly assigned or allocated. In addition, the CSA
9 outlines general terms and conditions, details on the duration of the contract,
10 obligations of each party, and general payment details. WETT also entered into the
11 EPC Contract under which I-USA plans and oversees comprehensive construction
12 work. The EPC Contract is discussed in much more detail subsequently in my
13 testimony.

14 The figure below illustrates the sources of WETT’s various affiliate services
15 for both corporate and construction support services.

Figure 5 – Sources of WETT Affiliate Services

<i>(Applicable Contract) →</i>	Consultant Service Agreement	EPC Contract	Affiliate Services Agreements
Brookfield Affiliate			<ul style="list-style-type: none"> • Project Management • Advisory Services • Regulatory Affairs • Financing • Human Resources
Isolux Concesiones Affiliate			<ul style="list-style-type: none"> • Project Management • Advisory Services • Regulatory Affairs • Financing • Human Resources
I-USA (Isolux Ingeniería Affiliate)	<ul style="list-style-type: none"> • Pre-EPC engineering 	<ul style="list-style-type: none"> • Detailed Engineering • Procurement • Construction 	

The affiliate services provided to WETT are based on the Company's requested needs and are not duplicative.

Q. PLEASE DESCRIBE THE CONSTRUCTION SUPPORT SERVICES PROVIDED TO WETT BY I-USA.

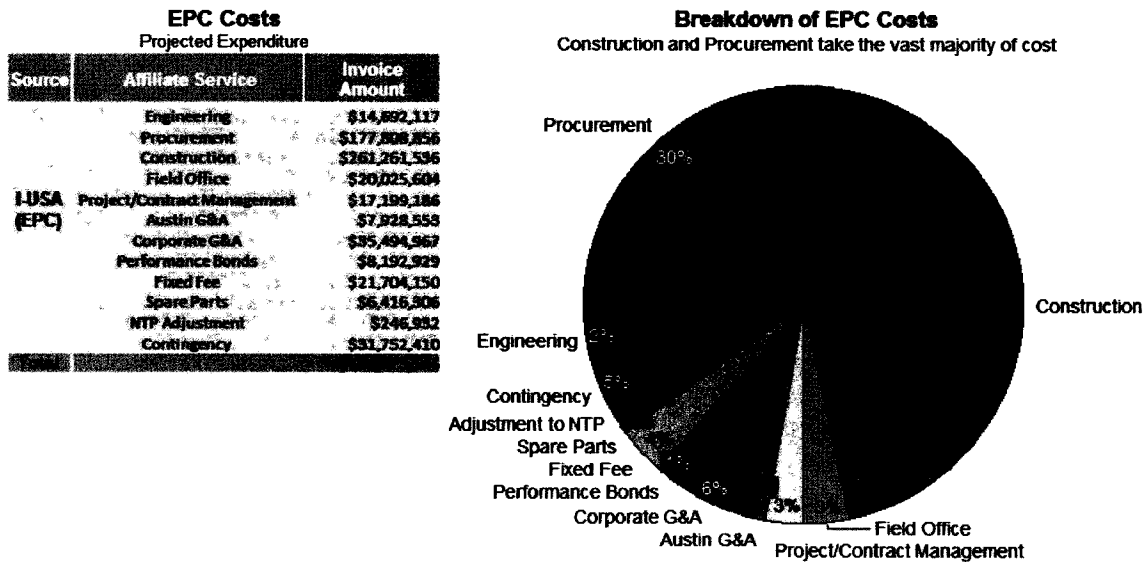
A. Prior to the commencement of the full EPC work, WETT contracted with I-USA to provide design and engineering services. The two companies entered into a CSA which set forth the scope of work, as well as the roles and responsibilities of each party. Under the CSA, I-USA helped WETT with certain engineering services necessary to develop the WETT conceptual design into a tender-ready design for the construction of the seven transmission lines and five substations. As of June 2012, I-USA had invoiced \$5,587,145 to WETT for services provided under the CSA.

1 After the CSA was in place, WETT and I-USA and their respective counsel
2 engaged in negotiations with WETT, which received significant input from its
3 independent evaluator and advisor, SAIC. As a result of these negotiations, WETT &
4 I-USA executed the comprehensive EPC contract. As of June 30, 2012, WETT has
5 been charged a total of \$149,656,202 for work performed under the CSA and the EPC
6 contract. As of the end of June 2012, the charges to I-USA related to front-end
7 “notice to proceed” payments of \$57,318,973, the necessity of which is explained
8 later in my testimony, \$29,254,663 for transmission line equipment, \$17,854,922 for
9 administrative costs, and \$12,522,435 for site development and engineering, with the
10 balance of the charges for transmission line construction and services under the CSA.

11 Several tasks related to the EPC work are further subcontracted by I-USA,
12 through competitive bidding, to achieve cost benefits and leverage the expertise of the
13 subcontractors. I-USA subcontracts the engineering part of the EPC work to three
14 companies: M&S Engineering, VI Engineering, and Jyoti Engineering. The
15 procurement work is carried out directly by I-USA with the support of its parent,
16 Isolux Ingeniería. Given its size, global presence and expertise, Isolux Ingeniería has
17 ties to numerous major international suppliers and an ability to deliver tangible
18 market-based benefits. Additionally, parts of the construction of the transmission
19 lines and substations are subcontracted to qualified construction companies. These
20 companies are: Henkels and McCoy provides transmission line construction services;
21 Lang and Mitchell provide substations construction services; and E.P. Breaux provide
22 electrical services. Figure 6 below provides further details about the specific EPC
23 cost amounts and relative percentage of the EPC costs forecast as of June 30, 2012.

Based on the forecast, EPC costs are about 80% of total project costs. As of the date the total project costs incurred are \$257.0 million out of which \$144.1 million are EPC costs and \$112.9 million are costs incurred by WETT.

Figure 6 – EPC Charges



Source: WETT Construction Project Tracking Records, Boaz & Company analysis

Q. PLEASE EXPLAIN THE CONTRACTS WETT HAS EXECUTED WITH AFFILIATES FOR CORPORATE SUPPORT SERVICES.

A. WETT entered into an ASA with subsidiaries of each of its parents, Brookfield and Isolux Concesiones. In accordance with the ASAs, WETT may engage its affiliates for the provision of several services, including but not limited to, human resources, procurement, information technology, regulatory services, administrative services, real estate services, legal services, accounting, environmental services, research and development, internal audit, community relations, corporate communications, financial services, financial planning and management support, corporate services, corporate secretary, lobbying, corporate

1 planning, general organization management, finances, taxes, and other services to
2 be defined.

3 Review of these corporate support services under the ASAs has focused on
4 what has been obtained from the WETT affiliates to-date. The ASAs provide for a
5 range of services that could potentially be obtained in the future, depending on
6 WETT's needs. WETT also retains the option to obtain such services from third
7 parties, if it finds greater efficiencies and/or cost savings elsewhere.

8 **Q. PLEASE DESCRIBE THE CORPORATE SUPPORT SERVICES PROVIDED**
9 **TO WETT BY ITS AFFILIATES.**

10 A. WETT has received several types of corporate support services from its
11 affiliates. WETT has incurred charges from its affiliates for corporate support
12 services related to affiliate staff working directly for WETT, affiliates providing
13 other corporate services and WETT Board of Managers expenses. Aggregate
14 corporate support service costs are outlined in Figure 7, below.

Figure 7 – Affiliate Corporate Services Billings

Corporate Services Billings			
Corporate Expense	Affiliate Billings to WETT	Affiliate Source	Affiliate Service
Finance, accounting, start-up support, communications, etc	\$368,030	Brookfield	Project Management
Transmission design support	\$119,948	Brookfield	Project Management
Legal support in contract development, financing, and permitting	\$44,136	Brookfield	Project Management
Human resource support in recruiting HSSE manager	\$10,439	Brookfield	Human Resources
Refinancing Assistance	\$178,440	Brookfield	Finance & Accounting
Regulatory assistance in permitting proceedings	\$16,166	Brookfield	Regulatory Affairs
Travel expenses for board of managers	\$178,205	Brookfield	Advisory Services
Board member costs	\$1,011,727	Brookfield	Advisory Services
Travel expenses for board of managers	\$253,903	Isolux	Advisory Services
Board member costs	\$1,066,979	Isolux	Advisory Services
Finance, accounting, start-up support, communications, etc	\$896,996	Isolux	Project Management
Refinancing Assistance	\$79,661	Isolux	Finance & Accounting
Human Resources	\$810	Isolux	Human Resources
Regulatory assistance in permitting proceedings	\$56,922	Isolux	Regulatory Affairs
Total Brookfield	\$1,927,092	Brookfield	
Total Isolux	\$2,355,271	Isolux	
Total	\$4,282,362		

Source: Isolux 2008, 2009, 2010, 2011 and 2012 Invoice Summaries, Brookfield 2009 – 2012 Invoice Summary, Booz & Company analysis

As of June 30, 2012, total corporate services provided through Brookfield amounted to \$1,927,092. A Brookfield affiliate has charged WETT for certain Board Member costs and expenses in the amount of \$1,189,932. Brookfield has also charged WETT \$10,439 for human resources support services it has provided. Specifically, the Brookfield human resources department assisted WETT with the selection of an HSSE Manager, thereby allowing WETT to capitalize on its affiliate's strong safety expertise and track record. Further, WETT paid Brookfield \$178,440 for its affiliate's assistance with financing for the project; WETT was able to leverage the experience and expertise of Brookfield's financing department which has participated in similar initiatives before. Finally, Brookfield also assisted WETT with support during WETT start-up, communications and CCN preparations (specifically, assistance with open houses) in the amount of \$368,030 for these services.

1 An Iccenlux affiliate has also charged WETT for certain Board Member costs
2 and expenses in the amount of \$1,320,882. These charges, combined with other
3 corporate services by Isolux Concesiones affiliates, amounted to \$2,355,271. The
4 corporate services support included charges for the time and expenses spent by Isolux
5 Concesiones employees on WETT-related tasks, including time spent by Isolux
6 Concesiones resources to support WETT with refinancing, start-up, communications
7 related tasks.

8 **Q. HAS WETT OBTAINED ANY CORPORATE SUPPORT SERVICES FROM**
9 **UNAFFILIATED THIRD PARTIES RATHER THAN AFFILIATES?**

10 A. Yes. As of June 30, 2012, WETT had outsourced several functions to
11 expedite project execution and leverage the expertise of qualified third parties,
12 including selected human resources, accounting, information technology, and legal
13 services. However, these non-affiliate charges are outside the scope of my
14 evaluation. They are addressed in the direct testimony of Mr. Brad Ballard.

15 **Q. DOES WETT HAVE AN AFFILIATE COMPLIANCE PLAN IN PLACE TO**
16 **GUIDE PERFORMANCE?**

17 A. Yes. WETT has a compliance plan in place to ensure adherence to its Code of
18 Conduct and to PUC affiliate rules. Its employees as well as its contractors have to
19 undergo mandatory compliance training to understand the requirements for doing
20 business with an affiliate entity. Furthermore, WETT has a compliance officer who
21 is responsible for the education of employees on the Code of Conduct and PUC
22 Affiliate Rules.

1 **2. AFFILIATE ACTIVITY NECESSITY AND BENEFIT**

2 **Q. WHAT IS THE PURPOSE OF CONDUCTING THE NECESSITY AND**
3 **BENEFITS ANALYSIS?**

4 A. Before one can judge overall cost reasonableness, it is first necessary to
5 understand the reason why a cost is being incurred. In WETT's case, its costs are
6 incurred primarily to license, build and operate the CREZ transmission lines
7 assigned to it by the Commission. Other costs incurred result from the non-
8 discretionary demands placed upon the business as a result of normal business
9 mandates (*e.g.*, need to satisfy regulatory requirements) or fiduciary responsibilities
10 (*e.g.*, need to reduce overall risk to the enterprise).

11 The necessity and benefits analysis assesses the need for Brookfield and
12 Isolux parent affiliate support activity performance and determines whether
13 discernible benefits can be identified with the associated activity. While WETT is
14 not a publicly-traded enterprise and does not bear the responsibility for public
15 market and related shareholder activities, it is responsible for performing certain
16 types of activities that fulfill its fiduciary needs to its owners. Thus, the traditional
17 framework that I have utilized for assessing traditional, publicly-traded service
18 company activities and charges is relevant for application to WETT.

19 A list of attributes was developed to evaluate the necessity of each of the
20 activities performed by affiliates (necessity attributes). My experience with the
21 purpose, structure, and performance of similar entities provided a basis from which
22 to determine whether WETT's activities are similar to those provided by similar
23 entities. A common set of attributes was also developed for use in identifying the
24 benefits of activity performance by WETT affiliates. These benefit attributes

1 provide a basis against which each functional category can be evaluated to determine
2 the nature of the benefit of activity performance.

3 **Q. HOW DID YOU DEVELOP A COMPREHENSIVE LIST OF THE**
4 **ACTIVITIES PERFORMED BY THE AFFILIATES?**

5 A. I developed the list based both on my past experience in defining the activities
6 of related costs at similar regulated entities, and after conducting the following
7 activities:

- 8 • Performing a review of Isolux and Brookfield's subsidiaries' costs charged to
9 WETT;
- 10 • Reviewing WETT organization charts;
- 11 • Conducting interviews to confirm the nature of the activities performed; and
- 12 • Reviewing agreements between WETT and its affiliates (Affiliate Services
13 Agreements, Consultant Service Agreement, and EPC Contract).

14 **Q. WHAT CORPORATE SUPPORT SERVICES ARE PROVIDED FOR IN THE**
15 **AFFILIATE SERVICES AGREEMENTS?**

16 A. Based on my review, I have consolidated the potential support services
17 enumerated in the ASAs within the categories below. To date, WETT has utilized
18 services as highlighted in bold text:

- 19 • **Corporate Communications**
- 20 • External Affairs
- 21 • **Finance & Accounting**
- 22 • **General Counsel**
- 23 • **Human Resources**
- 24 • Internal Audit

- 1 • Information Management
- 2 • **Regulatory Affairs**
- 3 • Procurement
- 4 • **Engineering and Construction Project Management**
- 5 • Tax Services
- 6 • Real Estate Services
- 7 • Environmental Services
- 8 • Administrative Services
- 9 • **Corporate Governance**
- 10 • **Corporate Planning**
- 11 • Research and Development

12 These corporate support activities are similar to those I have observed as performed
13 by other utility service companies. Refer to exhibit TJF-2 for detailed descriptions
14 of these services.

15 **Q. WHAT CONSTRUCTION SUPPORT SERVICES ARE PROVIDED FOR IN**
16 **THE CSA AND THE EPC CONTRACT?**

17 A. The services provided under the CSA and the EPC Contract include the
18 following items:

- 19 • Construction planning
- 20 • Basic engineering
- 21 • Detailed engineering
- 22 • Materials procurement
- 23 • Construction execution

- 1 • Maintenance services
- 2 • Emergency notification

3 Q. HOW DID YOU DETERMINE WHETHER AN AFFILIATE SERVICE
4 SHOULD BE CONSIDERED NECESSARY WITHIN YOUR FRAMEWORK?

5 A. From previous experience gained from examining the organization and
6 managerial priorities of a variety of utilities and other complex organizations, I
7 defined a series of necessity attributes, shown in the table below. Activities are
8 assessed as necessary if they satisfy any one of the six attributes listed in the figure
9 below.

10 **Figure 8 – Necessity Attributes**

Attribute	Definitions
Corporate Governance	Activities that are necessary to ensure that fiduciary responsibilities and enterprise-wide management and operation are effectively executed. Examples include managing cross-business issues, performing risk management activities and evaluating internal controls
Regulatory Mandate	Activities that are required to fulfill statutory, regulatory and other commitments or mandates. Examples include complying with FERC, ERCOT and PUC requirements
Legal Compliance	Costs incurred and activities performed as a direct result of legal proceedings, avoidance of legal proceedings, or compliance with legal requirements. Examples include performing litigation activities and responding to discovery requests
Management Control	Activities performed specifically to provide analysis, decision support data, and results to management personnel. Examples include managing projects and developing management reports
Operational Execution	Activities that are fundamental functions performed on a daily basis. Examples include performing maintenance activities, performing general accounting, and tracking employee information
Strategic Planning	Activities that encompass business unit planning and activities directed at providing enterprise-wide direction. Examples include performing strategic planning and providing business planning assistance

1 **Q. DESCRIBE THE OVERALL RESULTS OF YOUR NECESSITY ANALYSIS.**

2 A. To date, WETT has incurred two classes of affiliate charges: construction
3 support services and corporate support services. Based on my examination of these
4 charges, I found them to represent legitimate and useful business activities and to be
5 necessary. A detailed description of my necessity analysis can be found in Exhibit
6 TJF-3.

7 **Q. WHAT DID YOU CONCLUDE ABOUT THE NECESSITY FOR THE**
8 **CONSTRUCTION SUPPORT CLASS OF SERVICES PROVIDED TO WETT**
9 **BY I-USA?**

10 A. The construction support services provided to WETT by I-USA are essential
11 to completion of the CREZ transmission projects assigned to the Company by the
12 Commission. As a result, they closely relate to satisfying the “Operational
13 Execution” and “Regulatory Mandate” attributes. In addition, the engineering
14 services performed by I-USA employees on behalf of WETT were also deemed to
15 be necessary since they have enabled the Company to develop the technical
16 specifications and requirements for the CREZ projects through experienced
17 capabilities to drive lower costs, thus also satisfying the “Operational Execution”
18 and “Regulatory Mandate” attributes.

19 **Q. WHAT DID YOU CONCLUDE ABOUT THE NECESSITY FOR THE**
20 **CORPORATE SUPPORT CLASS OF SERVICES PROVIDED TO WETT BY**
21 **ITS AFFILIATES?**

22 A. Since WETT is a start-up entity, leveraging its affiliates’ corporate support
23 resources enables WETT to avoid creating permanent, fixed costs for certain

1 services and to reduce overall expenditures. In addition, the expertise that
2 Brookfield and Isolux Concesiones resources brought to WETT has enabled the
3 Company to operate more efficiently, with access to strong experience and skills.
4 For instance, being able to leverage the financial management expertise of
5 Brookfield employees has resulted in WETT having a thorough and sound budget in
6 place from the early stages of the project, without the requirement for full-time
7 internal resources. These activities were categorized under “Finance and
8 Accounting” in my activity necessity analysis and were deemed necessary since they
9 satisfy the “Management Control” and “Strategic Planning” attributes.

10 In the ASAs that WETT signed with Isolux Concesiones and Brookfield
11 subsidiaries, the Company states that it may engage its affiliates for the provision of
12 several other corporate services in the future. These services, although not yet
13 incurred, have been reviewed for their necessity to the same functions listed earlier.
14 Based on my analysis of the activities enumerated in the ASA that I described
15 earlier, as well as those already incurred by WETT, I can conclude that the activities
16 identified—whether utilized to-date or potentially in the future—are consistent with
17 the types of corporate support services that are normally provided to operating
18 companies by parent or service companies.

19 **Q. HOW DID YOU DETERMINE WHETHER AN ACTIVITY SHOULD BE**
20 **CONSIDERED TO PROVIDE BENEFIT?**

21 A. Benefits can include tangible impacts, such as reduced or avoided costs,
22 increased employee productivity, and increased reliability. They can also include
23 intangible benefits that do not provide readily measurable impact, such as

compliance or risk avoidance. For example, an activity related to meeting ERCOT requirements may have no directly discernable dollar-related benefit, but is required to fulfill regulatory responsibilities. Accordingly, six types of benefits listed in the figure below describe how corporate and construction support activities impact the overall business.

Figure 9 – Benefit Attributes

Attributes	Definitions
Reduce Risk	Actions designed to reduce liability and mitigate exposure to financial, operational, regulatory and other types of risk through activities such as implementing safety programs, performing internal audit, and developing policies, procedures and manuals
Increase Employee Productivity	Programs that enhance employees' abilities to perform their jobs more productively. Examples include implementing certain automated systems, providing certain types of training, implementing and administering employee health awareness programs, developing procedures, policies and practice manuals, developing employee communications and implementing and administering quality programs
Provide Management Information	Activities conducted primarily to provide decision support data and analysis to management personnel. Examples include developing budgets, monitoring operational and safety performance, performing corporate development, conducting strategic assessments and developing integrated information systems
Enhance Corporate Performance	Activities performed to enhance the abilities and effectiveness of management with respect to the business, including developing strategic plans, managing the performance review process, maintaining the inter/intranet and conducting benchmarking studies
Reduce or Avoid Costs	Activities performed to improve the cost effectiveness of operations. Activities include implementing certain automated systems or negotiating discounts with outside vendors
Increase Reliability	Activities performed to increase the reliability of energy delivery and to minimize the impact of disruptions

Q. WHAT DID YOU CONCLUDE ABOUT THE BENEFITS OF THE CONSTRUCTION SUPPORT CLASS OF SERVICES PROVIDED TO WETT BY I-USA?

A. The construction support services received by WETT from I-USA related to

1 engineering, procurement and construction have and will continue to provide
2 benefits to WETT and satisfy the necessary attributes identified. These services
3 provide WETT with capabilities that it does not presently maintain and with the
4 ability to leverage technical expertise that is critical to project design and subsequent
5 operations. Further, these services enhance WETT's ability to successfully execute
6 the assigned CREZ projects. Most fundamentally, those services will enable WETT
7 to complete the CREZ transmission projects assigned to it by the Commission in a
8 timely and cost-effective manner. These services enable WETT to deliver the
9 projects in a manner consistent with the Commission's objectives and to establish a
10 foundation for the effective operation of these assets post-completion. Were WETT
11 to have attempted to provide some or all of these services itself, I believe that the
12 costs of performance would have exceeded the costs incurred to-date as additional
13 resources would have been required and learning curve costs would have been
14 incurred. These services will, of course, be concluded with the completion of the
15 projects. More discussion regarding my assessment of construction support services
16 is provided in subsequent sections of my testimony .

17 **Q. WHAT DID YOU CONCLUDE ABOUT THE BENEFITS OF THE**
18 **CORPORATE SUPPORT CLASS OF SERVICES PROVIDED TO WETT BY**
19 **ITS AFFILIATES?**

20 A. The corporate support services received by WETT from its affiliates also
21 provided clear benefits. For example, WETT has received affiliate support for
22 human resources services related to hiring new staff by providing recruiting and
23 screening services. This support enabled WETT to leverage the affiliates'

1 experience in this field and expedite the hiring process. As such, these charges
2 delivered clear benefits in the form of more effective and expedited resource
3 candidate assessment and enhanced performance.

4 Affiliate staff that have worked closely with WETT have also delivered
5 tangible benefits for the Company. For example, the initial budget was created by
6 Brookfield and Isolux Concesiones employees in 2009; the initial financial model
7 was created by a financing team made up of Brookfield and Isolux Concesiones
8 employees with assistance from WETT staff, and this financial model served to
9 control costs and inform management. As such, affiliate staff provided the benefits
10 of "Provide Management Information," "Reduce Risk," and "Reduce or Avoid
11 Costs." In addition, initial transmission design and planning carried out by
12 Brookfield employees working for WETT has resulted in higher quality and
13 expedited execution. Affiliate staff therefore delivered the benefits of "Increased
14 Reliability" and "Reduce or Avoid Costs."

15 **Q. PLEASE PROVIDE A SUMMARY OF THE NECESSITY AND BENEFIT**
16 **ANALYSIS.**

17 A. The functions and activities provided to WETT by its affiliates meet a number
18 of managerial, operational and legal/regulatory needs. As this analysis has
19 demonstrated, the activities performed by the affiliates are largely nondiscretionary
20 in nature and are required to satisfy responsibilities to owners and governmental
21 entities and/or support management effectiveness. These activities enable WETT to
22 construct and operate the CREZ transmission facilities assigned to it by the
23 Commission. They provide direct and indirect benefits that enhance the effective

1 management and efficiency of WETT today and will provide similar benefits to
2 future customers once the transmission lines and substations are operational.

3 **3. COST ASSIGNMENT AND ALLOCATIONS**

4 **Q WHAT IS THE PURPOSE OF THIS SECTION OF YOUR TESTIMONY?**

5 A. The purpose of this part of my testimony is to review the assignment and/or
6 allocation methods used by WETT's affiliates for corporate support services under
7 the ASAs and construction support services under the CSA and the EPC Contract.
8 Affiliate services obtained to-date have been directly charged from the affiliates to
9 WETT. This section evaluates the reasonableness of the methodologies and
10 processes utilized by WETT's affiliates to allocate costs to WETT. The adequacy of
11 the affiliates' approach can be determined by evaluating the assignment and
12 allocation methodologies and allocation factors as well as by comparing these
13 assignment and allocation practices to those adopted by other companies.

14 **Q. PLEASE EXPLAIN THE STRUCTURE OF THE CONSTRUCTION**
15 **SUPPORT SERVICES COST ASSIGNMENT PROCESS.**

16 A. As would be expected, the vast majority of dollars incurred to-date by WETT
17 from its affiliates relate to the planning and physical construction of the transmission
18 lines and substations. These dollars are either billed on a direct charge basis or are
19 allocated based on a fixed arrangement from Grupo Isolux, the holding company for
20 the Isolux Group. For these types of cost incurred by I-USA on behalf of WETT,
21 the CSA and EPC Contract serve as the governing documents with respect to cost
22 recovery.

23 When I-USA performs construction support services on behalf of WETT,
24 these costs are directly billed to WETT. These affiliate services included direct

1 labor costs from pre-construction and construction activities that encompassed
2 engineering, materials, and structures. Construction support services incurred as of
3 June 30, 2012 include pre-EPC engineering and design work and construction
4 performed by I-USA. The engineering and design work performed by I-USA was
5 directly assigned to WETT and consisted of the hours worked by I-USA staff on the
6 project priced at the hourly rates as specified in the CSA and the EPC Contract
7 between the two companies. WETT and I-USA have agreed on the hourly labor
8 rates based on labor classifications contained within the EPC Contract at Exhibit C-
9 2. The hourly rates related to construction are calculated taking into consideration
10 direct payroll expenses (salaries and benefits) and burden (allocated local and
11 corporate overheads). These costs also include project staff and third- party
12 contractors directly attributable to the EPC project.

13 **Q. WHAT APPROACH HAS BEEN UTILIZED TO ALLOCATE RELEVANT**
14 **COSTS FROM ISOLUX TO WETT?**

15 A. Grupo Isolux also charges WETT a 6.29% corporate overhead allocation.
16 This percentage was calculated by PricewaterhouseCoopers ("PwC") for Grupo
17 Isolux to allocate the overhead costs of its corporate and business segment functions
18 among all of its affiliates. This calculation and the related supporting report from
19 PwC are found in Exhibit Q of the EPC Contract. The overhead allocation reflects
20 Grupo Isolux's allocated corporate functional and business segment support costs
21 incurred in support of its various business units, including I-USA's EPC-related
22 activities for WETT. In WETT's case, this overhead charge will apply only for

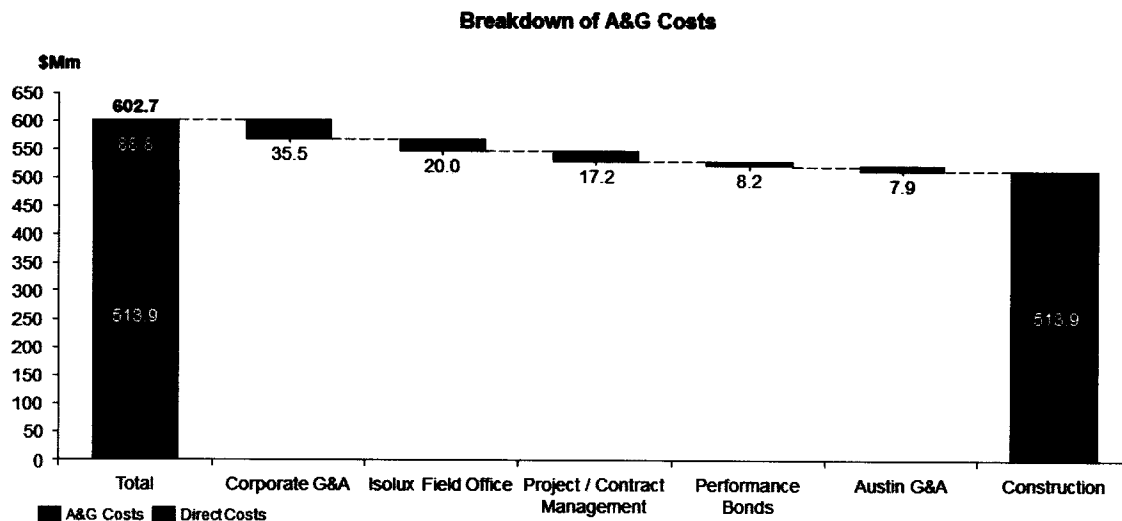
1 activities conducted within I-USA's EPC Contract while it is effect, and are not
2 intended to be applied in the future.

3 Grupo Isolux segregates and spreads these corporate and segment expenses
4 across each business unit on the basis of relative scale. Grupo Isolux uses revenue
5 as an allocation factor for its overhead costs, i.e., overhead expenses are allocated to
6 various business units in proportion to their revenue, i.e., the greater the revenue
7 level within a business segment, the greater the relative portion of the total corporate
8 and business segment charges to be allocated. In WETT's case, the 6.29% overhead
9 charge is based on the relative value of the T&D Business Segment (of which I-USA
10 is a part) in comparison with the revenue generated by other business units within
11 Grupo Isolux. The allocated costs are accumulated based on common expenses and
12 originate from Grupo Isolux support in the following three areas:

- 13 • **Corporate** - These corporate expenses represent general administrative
14 services from the parent. They include activities such as corporate finance
15 and accounting, human resources, and information technology
- 16 • **Engineering Business Division** - These expenses services provided by the
17 business division. They include activities such as business strategy, marketing
18 and business development, and vendor management
- 19 • **Transmission and Power Distribution Business Unit** - These expenses are
20 project and operational support services from the business unit that owns the
21 asset. They include activities such as administrative support services shared
22 across all projects

23 In my experience, such overhead charges by parent companies are common in the
24 construction industry and the approaches adopted to allocate these costs are normally
25 simplified and related either to how costs are incurred or services are provided.

Figure 10 - Construction Support Services Billings



Source: WETT Construction Project Tracking Records; Booz & Company analysis

Q. IS THE USE OF A SINGLE, SIMPLE ALLOCATION FACTOR THAT IS SCALE BASED CONSISTENT WITH THE AFFILIATE STANDARDS OF THE COMMISSION AND REASONABLE IN YOUR VIEW?

A. Yes, although it is clearly different than the approach typically utilized by utilities under the jurisdiction of the Commission, I believe it is generally consistent with the previous standards that have been utilized before. However, before discussing the questions of consistency and reasonableness, it is important to recognize that the circumstances related to WETT are unique and not comparable to prior situations observed by this Commission. First, the majority of the construction dollars that flow into WETT from I-USA are direct charges in the form of hourly loaded rates or direct third-party contract costs versus typical allocations. This indicates that the majority of the direct construction and support dollars from I-USA to WETT can be clearly identified and captured, rather than developed through a more typical cost apportionment process. Second, Grupo Isolux is not a utility and

1 has not been required to adopt conventional industry cost apportionment norms
2 recognized in traditional state regulatory reviews. Consequently, the approach it
3 utilizes is to simplify the approach for cost apportionment and adopt an overall
4 allocation basis that is based on broad enterprise composition and outcomes. Third,
5 it should be remembered that Grupo Isolux is a global enterprise and the US
6 regulated portion of its business is extremely small relative to the remainder of the
7 business. This means that the basis upon which the enterprise collects, attributes and
8 manages costs is defined to meet the needs of the broad business, rather than any
9 one individual business unit. These factors do not suggest that general cost
10 allocation principles cannot be applied to WETT, but they do suggest that previous
11 processes and methods utilized before this Commission may not be as applicable or
12 as relevant in this situation.

13 Notwithstanding the above, the approach taken by Grupo Isolux to allocation
14 of corporate and business segment support costs is similar in concept to that utilized
15 by other utilities that have filed before this Commission. As I have testified in prior
16 proceedings, one of the generally accepted bases for allocating costs is the use of a
17 “general” factor intended to reflect overall cost assignment when no other specific
18 allocation factor can be derived. The purpose of this type of allocation factor is to
19 recognize that costs incurred at the enterprise level can be broadly related and
20 beneficial to the business as a whole and cannot be allocated on any specific basis
21 other than using scale as a representative basis. Although other companies have
22 utilized a multi-part basis, e.g., the Modified Massachusetts Formula to accomplish

1 the allocation, these elements are also scale based and representative of broad
2 causation.

3 Thus, the use of an overall or "general" factor for allocation is consistent with
4 the approach adopted by other utilities operating in Texas and previously reviewed
5 and approved by this Commission. Although revenue is the only factor utilized for
6 these corporate and business segment costs by Grupo Isolux, it is an element of the
7 Modified (and original) Massachusetts Formula and recognized as related to
8 business volume and complexity. When combined with the use of direct charging as
9 the principal methods for cost assignment to WETT, the scale-based revenue factors
10 provides a common basis for cost apportionment and the approach taken by WETT
11 is reasonable. In the next section I will address the reasonableness of the specific
12 6.29% allocation.

13 **Q. PLEASE EXPLAIN THE STRUCTURE OF THE CORPORATE SUPPORT**
14 **SERVICES COST ASSIGNMENT AND ALLOCATION PROCESS.**

15 A. Affiliate charges to WETT for corporate services to-date have been directly
16 billed. In the future, such charges may be either directly billed or allocated using cost
17 causative allocation factors. For Brookfield, the service billing methodology is
18 determined when a new affiliate service is established and then reviewed at least
19 annually during the budgeting process. For Isolux Concesiones, the service billing
20 methodology is similar to Brookfield. When establishing or reviewing affiliate
21 services billing methodologies, WETT works with the affiliate that provides the
22 service to determine the appropriate cost causative basis for allocating costs.

1 **Q. IS THE METHODOLOGY UTILIZED BY WETT AND ITS AFFILIATES**
2 **FOR CORPORATE SUPPORT SERVICES COMMON IN THE UTILITY**
3 **INDUSTRY?**

4 A. Yes. Similar to WETT and its affiliates, utility service companies attempt to
5 directly charge operating companies for services consumed whenever possible. For
6 costs that are not directly charged, service companies generally employ a process to
7 allocate costs among the operating companies that comprise specifically identified
8 allocation factors closely related to the nature of the activity. Although these
9 processes vary among companies, they generally embrace the principal feature of
10 attempting to allocate costs to the entity for whose benefit the cost was incurred.

11 To date, affiliates providing corporate services have billed WETT directly. On
12 a going-forward basis, the only affiliate administrative and general or operations
13 expenses that WETT anticipates are either charges billed under the ASAs or
14 reimbursement of Board of Manager out-of-pocket expenses. The only affiliate
15 expenses included in Schedule II-D-2 (Administrative and General Expense),
16 sponsored by Dr. Bruce Fairchild, are direct out-of-pocket expenses of the Board of
17 Managers. Similar to more traditional utility service companies, WETT's affiliate
18 cost distribution methodologies follow a cost causation philosophy

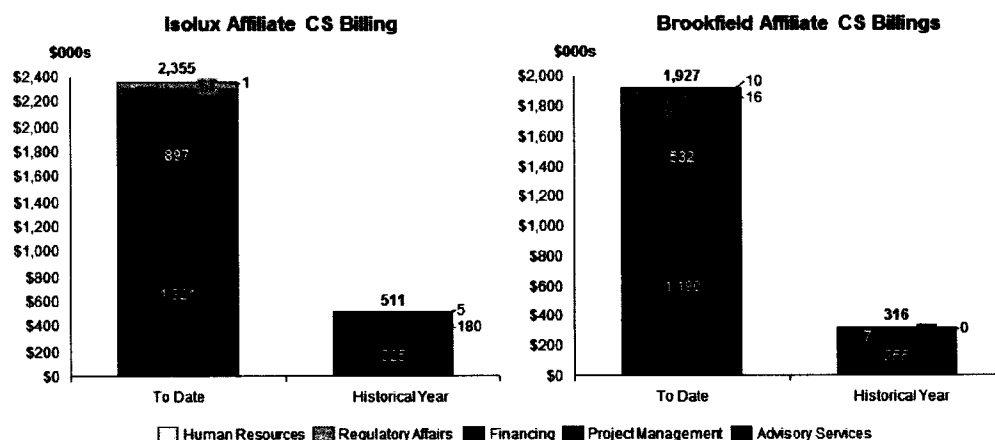
19 **Q. PLEASE DESCRIBE THE MIX OF COST ALLOCATION AND COST**
20 **ASSIGNMENT FOR CORPORATE SERVICES USED AT WETT.**

21 A. Among the corporate support services charged to WETT by its affiliates is the
22 time of affiliate staff working directly for WETT. To-date, work performed by
23 Brookfield and Isolux Concesiones employees on behalf of WETT has been directly

1 charged to the Company based on the number of hours these employees spent
 2 working for WETT. These affiliate services are provided at the direct cost of labor,
 3 *i.e.*, salary, bonus, and benefits, which equates to a 25-30% labor loader. Brookfield
 4 intends to utilize the same process for any corporate support services provided after
 5 completion of the construction phase. In the event that Brookfield subsequently uses
 6 allocation factors to distribute charges to WETT, it plans to develop these allocation
 7 factors in accordance with appropriate regulatory guidelines. Isolux Concesiones,
 8 also has so far used only direct billing for corporate support services, however in the
 9 future, WETT could receive an allocation of Grupo Isolux's corporate costs using an
 10 allocation methodology, although no such costs are currently planned.

11 To date the aggregate amount of charges directly assigned to WETT for
 12 corporate support services by Brookfield was \$1,927,092 and the aggregate amount
 13 of charges by Isolux Concesiones was \$2,355,271 with all the charges directly
 14 assigned.

15 **Figure 11 – Corporate Support Service Billings**



Source: Isolux 2008, 2009, 2010, 2011 and 2012 Invoice Summaries, Brookfield 2009 – 2012 Invoice Summary, Booz & Company analysis

16

1 To understand the overall impact of the corporate support services billings to
2 WETT, I reviewed the assumptions used in the WETT cost of service study for the
3 historical year periods, as presented in the direct testimony of Dr. Bruce Fairchild.
4 Since corporate support services costs are primarily billed to FERC Administrative
5 and General (“A&G”) accounts, the change in these cost levels reflect the increased
6 need in operational activity support once the project assets are energized.

7 **Q. IS THE COST ASSIGNMENT METHOD UTILIZED FOR CORPORATE**
8 **SUPPORT SERVICES REASONABLE?**

9 A. Yes. Neither parent has needed to use an allocation method to charge for their
10 services to-date since all costs were directly billed. Going forward, it is the intention
11 of the parent companies to use direct charges for any affiliate costs. However, if
12 direct charges are not made and costs are allocated, the allocation method will
13 comply with PURA. It is expected that any assignment and allocation processes to
14 be employed will be based on direct charging or representative allocation factors as
15 is done today for construction services costs. In these situations, costs will be
16 segregated and shared based on the relative scale of the respective business unit.

17 A review process exists involving the affiliates and WETT for the services
18 provided that is meant to provide transparency in costs and levels of service prior to
19 cost incurrence. The ASA also enables WETT and the affiliates to engage a third
20 party independent consultant to review transactions to ensure compliance with
21 WETT’s code of conduct. WETT can also review or audit the affiliate’s records for
22 any related services provided to WETT. Both of WETT’s affiliates, Brookfield and
23 Grupo Isolux follow the same process for all subsidiaries.

1 **Q. WOULD YOU SUMMARIZE YOUR TESTIMONY WITH RESPECT TO**
2 **THE REASONABLENESS OF THE CONSTRUCTION AND CORPORATE**
3 **SERVICES COST ASSIGNMENT AND ALLOCATION?**

4 A. WETT's affiliates have generally used direct charging for EPC project
5 services. Further, the use of Task Orders under the ASA provide for direct visibility
6 and authorization for specific service required by WETT. Allocating EPC corporate
7 and business segment services based on application of an overall overhead allocation
8 is also a common practice in the market for such services. In addition, based on the
9 market survey discussed later in my testimony, the 6.29% overhead loader charged
10 to I-USA by Grupo Isolux is within the range of typical level for arrangements of
11 this kind. As a result, WETT's payment of direct costs and a 6.29% allocation is
12 reasonable for the corporate and construction support class of services it receives. In
13 addition, the 6.29% overhead allocation is not higher than the charge by Grupo
14 Isolux to other entities for the same class of services.

15 The overall cost assignment process produces a fair and equitable result in that
16 those costs are charged in a manner that reflects their responsibility for cost
17 incurrence. This process also provides that costs are allocated in a manner consistent
18 with the extent to which an entity causes and benefits from those costs, i.e., using a
19 scale based factor. As a result, costs billed to WETT using this methodology are not
20 greater than the costs billed to other entities by WETT affiliates for the same class of
21 services.

22 **4. BUDGETING AND COST CONTROL**

23 **Q. PLEASE EXPLAIN THE PURPOSE OF DISCUSSING THE BUDGETING**
24 **AND COST CONTROL PROCESSES OF WETT AND ITS AFFILIATES.**

1 A. As I discussed in Section IV of my testimony, PURA requires that charges to
2 WETT from affiliates be reasonable, necessary, and not higher than that affiliate
3 would charge another entity for the same item or class of items. Budgeting and cost
4 control processes are a key mechanism used by utilities to limit the total resources
5 required for operations without compromising performance. Moreover, these
6 processes also foster a level of transparency that allows for review and assessment of
7 the various cost elements included in the budgeting process. The purpose of this
8 section is to evaluate the effectiveness of the structure and execution of WETT's
9 budgeting and cost control mechanisms as a means to limit costs.

10 **Q. PLEASE ELABORATE ON THE SCOPE OF YOUR ANALYSIS.**

11 A. To determine whether budgeting and cost control processes were effective, I
12 first assessed the structure of the budgeting process as a means of limiting
13 expenditures and assuring appropriate scrutiny of costs. I also reviewed the manner
14 in which WETT and its affiliates exercise control over the absolute level of budgeted
15 dollars and the methods available to and utilized by WETT to participate in the
16 budget development process. Finally, I reviewed the cost control processes utilized
17 within WETT and its affiliates to ensure that actual costs are in line with the
18 spending levels agreed upon during the budgeting process.

19 A clear understanding of the design of WETT's budgetary processes and an
20 evaluation of the elements of the processes WETT follows to control its budget
21 provides an important element of the basis for assessing the reasonableness of
22 WETT's costs. Critically examining this process provides insight into the
23 philosophy, approach and methods that WETT and the affiliate companies employ

1 to minimize and control budgets. The examination of the budget and cost control
2 process thus allows for identification of the fundamental elements of effective cost
3 management that are indicative of the rigor with which corporate and construction
4 support costs are controlled.

5 **Q. PLEASE DESCRIBE THE BASIS UPON WHICH WETT'S COST TARGETS**
6 **ARE ESTABLISHED.**

7 A. WETT's cost targets are based on a model created to estimate the costs of
8 building and operating the transmission infrastructure. Capital costs are comprised
9 of the cost of building the CREZ projects and the sixth substation ERCOT
10 authorized WETT to build (Faraday, *supra* n.7), with each of the seven transmission
11 lines and six substations having a unique budget. The Company has been able to
12 leverage Brookfield's expertise in transmission design and planning to estimate the
13 cost of development and construction of the transmission assets. WETT has
14 significant influence into how project priorities are set through the planning
15 interaction that exists. And as mentioned previously, WETT maintains the option to
16 subcontract corporate support activities to third parties instead of having affiliates
17 provide these services if that proves more cost effective.

18 On the operating expense side, costs are divided into operations and
19 maintenance (O&M), depreciation and amortization, and income tax and other taxes.
20 As of June 30, 2012, WETT was finalizing its post-project completion operation and
21 maintenance budget. WETT has also hired KEMA as an independent consultant to
22 assist with the estimation of O&M costs and assess the business case related to
23 WETT operating its own control center.

1 In developing the construction and O&M budgets, WETT collaborates closely
2 with its affiliates to ensure that planned costs are consistent with requirements of the
3 project and that appropriate review and approval is attained from development
4 through Board of Managers review. The ongoing review and dialogue process
5 among the affiliates provides an effective mechanism for monitoring affiliate costs
6 and is another element of the overall control process to ensure that affiliate charges
7 are reasonable and necessary. In addition, WETT's 50/50 ownership structure
8 provides for additional cost control because neither parent has a controlling interest.
9 As a result, transactions with affiliates of either parent are subject to the oversight of
10 the unaffiliated parent, which has an interest ensuring all work is done at a price no
11 higher than what the affiliate would charge a third party.

12 **Q. DESCRIBE THE OVERALL COST CONTROL PROCESS AND THE ROLE**
13 **OF WETT IN AFFILIATE COST REVIEW.**

14 A. The Asset Management Director, Contracts Manager, and Controller at
15 WETT are directly responsible for controlling affiliate construction costs. WETT
16 has a budget in place for the key performance functions, e.g., engineering, of each
17 transmission line and substation. Costs and adherence to budgeted amounts are
18 tracked by WETT's Controller and the Asset Management Director. In addition,
19 WETT is actively involved in project planning and design, and WETT participates in
20 creating the tracking mechanisms and budgets used in construction cost review.
21 WETT's Accounting Department is ultimately responsible for reviewing its
22 affiliates' charges and the Controller monitors WETT's cost performance and reports
23 to the General Manager and to the Board of Managers. Budget adherence is

1 formally reviewed in every meeting of the Board of Managers, with any variances
2 identified and discussed and corrective actions taken, if necessary.

3 In addition, costs are monitored through the weekly Finance Subcommittee
4 conference calls. Participants include three members of WETT's Board of
5 Managers, the General Manager, and the Controller. Topics addressed during these
6 calls include weekly cash disbursements, as well as a high level review of variances.

7 The Company's procedures for budget modifications require final approval
8 from the General Manager and the Board of Managers. After reviewing project
9 documentation and interviewing appropriate WETT staff, there have been three
10 modifications to WETT's budget as of June 30, 2012, with one potential change
11 being further evaluated. Two were related to the change of engineering design and
12 placement of monopoles due the topography difference in various geographical
13 areas. Another was related to the addition of a sixth substation, the Faraday
14 Switching Station, which ERCOT authorized WETT to build.

15 **Q. DISCUSS THE ROLE OF WETT IN CONSTRUCTION COST REVIEW.**

16 A. WETT is actively involved in the review of construction costs incurred to
17 date. The Company utilizes periodic meetings with I-USA to discuss project
18 progress against overall budgets and schedules. I-USA and WETT also hold
19 monthly meetings to discuss construction progress and potential issues. In addition,
20 I-USA participates in the monthly WETT Board of Managers meetings. Weekly
21 construction meetings are also held by the Asset Management Director and attended
22 by representatives from both WETT and I-USA. Finally, weekly engineering
23 meetings are held to address transmission line and substation planning activities. All

1 these meetings provide a structured and informed basis to monitor and control
2 project costs.

3 **Q. WHAT PROCESSES DOES WETT HAVE IN PLACE TO OVERSEE**
4 **CONSTRUCTION SUPPORT SERVICE COSTS CHARGED BY I-USA?**

5 A. Adherence to planned construction costs is controlled by regular review of the
6 invoices and comparison of actual costs to budget. I-USA's invoices are reviewed
7 by WETT and are not approved unless the costs have been found justified relative to
8 work performed. WETT has an authorization policy which requires that if the actual
9 costs are higher than budget, WETT's Asset Management Director and Controller
10 and I-USA are required to engage in a detailed review process to identify areas
11 where costs can be brought down to planned budgetary limits. Changes to
12 budgetary limits due to changes to the project scope are required to go through a
13 formal change order approval process in accordance with the EPC Contract.

14 **Q. PLEASE DESCRIBE WETT'S CONSTRUCTION COST MONITORING**
15 **AND CONTROL MEASURES.**

16 A. WETT's construction budget has been created to control the Company's
17 project development and construction costs over the course of the build-out period.
18 The Company's interests are preserved by ensuring that project costs, affiliate or
19 otherwise, are continuously monitored and controlled and that the budgeting process
20 is sufficiently independent from WETT's affiliates. The budget is monitored by
21 WETT's Controller and variances between budgeted amounts and actual costs are
22 escalated to WETT's General Manager, and, if necessary, the Board of Managers.

1 Cost control is achieved by ensuring detailed visibility into costs and cost drivers
2 and frequent communication with contractors.

3 WETT's project budget has been reviewed and approved by the Board of
4 Managers. In October 2009, the Board of Managers established subcommittees to
5 provide additional oversight to key decisions in all aspects of WETT's business.
6 The subcommittees are comprised of representatives from both Brookfield and
7 Isolux Concesiones and include:

- 8 • **Finance/Audit/Reporting:** Ensures all state, federal and corporate financial
9 reporting requirements are followed
- 10 • **EPC:** Develops the plan and protocols required to ensure the EPC Contract
11 complies with both the term sheet and code of conduct requirements.
- 12 • **Communications:** Ensures consistency in interactions with WETT
13 stakeholders
- 14 • **Human Resources:** Provides oversight of human resources requirements
15 including resource requirements, compensation, annual reviews, benefit
16 programs and pension plans
- 17 • **Execution Plan:** Provides oversight of scope, schedule and cost of the
18 CREZ awarded projects
- 19 • **Regulatory/Rate:** Supports preparation of any regulatory filings and
20 ensures regulatory compliance measures are in place
- 21 • **Health and Safety/Environment:** Ensures WETT activities align with
22 world class health, safety, and environmental standards

23 **Q. PLEASE DESCRIBE THE SPECIFIC MECHANISMS IN PLACE TO**
24 **REVIEW CONSTRUCTION COSTS EXPENDED.**

25 A. WETT reviews costs and tracks adherence to budgets by using Oracle's
26 eBusiness Suite. Project budgets and forecasts are entered into the system by
27 account. Each update or modification of the budget or forecast is tracked separately
28 through accounts that have been created for each transmission line, substation and

1 easement segment. Further, an administration account was established to capture
2 costs to be allocated.

3 In addition, WETT has also established a cash projection mechanism for the
4 extent of the project with projections reviewed on a regular basis. Based on the
5 monthly cash outflow experience, updates and changes are made to the yearly
6 forecast, with particular focus on the subsequent three months. These cash forecasts
7 are then reviewed by the Finance Subcommittee on a regular basis.

8 **Q. DESCRIBE WETT'S ROLE IN ON-GOING OVERSIGHT OF AFFILIATE**
9 **CORPORATE SUPPORT SERVICES.**

10 A. The General Manager and the Board of Mangers of WETT ultimately decide
11 whether needed services are to be performed by affiliates or an outside third party.
12 When deciding whether to hire an affiliate or an outside vendor, the main
13 considerations are expertise, availability, efficiency, and cost.

14 WETT has procedures and mechanisms in place to track corporate support
15 service costs. When requesting a corporate support service from either of its
16 affiliates, WETT issues a specific "Task Order." This document describes the
17 services requested, location where these services are to be performed, a timeline of
18 execution, all the necessary details related to compensation, and the expenses to be
19 incurred while performing the service. Once the Task Order has been received by
20 the affiliate, it informs WETT of its acceptance or rejection.

21 Oversight of affiliate corporate support service charges occurs through several
22 mechanisms, including weekly and monthly meetings that discuss these charges and
23 address variances from budgeted amounts. For example, the time spent by affiliate

1 staff on financial management and transmission planning activities performed on
2 behalf of WETT is closely tracked and reported to WETT's Controller during
3 weekly meetings of the Board's subcommittee on financing.

4 **Q. PLEASE PROVIDE YOUR CONCLUSIONS RELATED TO THE**
5 **BUDGETING AND COST CONTROL ANALYSIS CONDUCTED.**

6 A. WETT's cost control process—comprised of up-front budgeting, tight cost
7 monitoring, and outsourcing of selected activities—provides an effective means to
8 control costs, particularly affiliate costs. WETT's collaborative budget-setting
9 process provides for the clear understanding of targets and the alignment of
10 objectives. Cost control mechanisms are also in place to ensure that costs incurred
11 are kept within specified budget projections. Finally, WETT has used market
12 analysis to understand its relative cost position and achieve competitive costs. Based
13 on my review of WETT's cost control mechanisms and budgeting processes, I
14 conclude that they have been effective to-date, and provide a reasonable basis for
15 ongoing cost control.

16 **Q. PLEASE SUMMARIZE YOUR REVIEW OF AFFILIATE SERVICES AND**
17 **THE REASONABLENESS OF COSTS CHARGED TO WETT.**

18 A. Based on my review, I conclude that the affiliate services charged to WETT
19 are reasonable, satisfy the requirements of PURA, and should be fully recognized for
20 recovery by the PUC. I base my conclusion on the following determinations:

- 21 • The activities performed by affiliates are necessary, and required to complete
22 the CREZ transmission projects assigned to WETT by the Commission and to
23 meet responsibilities to owners and government entities to operate the
24 business effectively.

- 1 • WETT receives identifiable benefits from the performance of affiliate
2 services, as will its customers in the future.
- 3 • The budgeting process incorporates appropriate and effective mechanisms that
4 allow WETT to provide adequate input into service and cost levels.
- 5 • WETT utilizes multiple mechanisms to monitor and control its costs that are
6 effective and consistent with typical processes used to rigorously control cost
7 incurrence.
- 8 • Costs are assigned or allocated to WETT using processes consistent with
9 those used in the industry.
- 10 • The construction support services provided by I-USA are distinct from the
11 services usually provided by the parent companies of utility peers. However,
12 the cost of the construction support services reflects the market value of those
13 services.
- 14 • The corporate support services performed by affiliates are consistent with
15 those performed by the service companies of utility peers.
- 16 • The cost of affiliate services provided to WETT is not greater than the cost
17 charged by the supplying affiliate to other affiliated or unaffiliated entities for
18 the same class of service.
- 19 • The affiliate services and costs to-date for corporate support and construction
20 support classes of services have been reasonably incurred and are beneficial to
21 customers.

22 **VI. EPC CONTRACTING**

23 **Q. PLEASE DESCRIBE THE PURPOSE OF THIS PART OF YOUR**
24 **TESTIMONY.**

25 A. The purpose of this section of my testimony is to evaluate the reasonableness
26 of WETT's EPC contract.

27 Specifically, I first review WETT's decision to use I-USA, the prevailing
28 circumstances at the time of EPC selection, and the alternatives available to WETT.

29 Next, I review the structure of the EPC Contract and examine the contract planning
30 and development initiatives undertaken by WETT. Then, I analyze I-USA's margin

1 and compare it to that of other companies. Finally, I compare Grupo Isolux's
2 overhead allocation to that observed by other market participants. Although my
3 testimony focuses on the EPC Contract between WETT and I-USA, the analysis
4 generally applies to the CSA as well.

5 **Q. PLEASE DESCRIBE HOW THIS PART OF YOUR ASSESSMENT WAS**
6 **CONDUCTED.**

7 A. The EPC contracting review was conducted through several interviews within
8 WETT and the review of the EPC Contract. In addition, I conducted external
9 surveys related to EPC margins and overhead charges and analyzed publically
10 available information related to EPC financial performance. I structured my analysis
11 around the following four areas of evaluation based on the focus if this assessment
12 and applied specific criteria to guide this analysis:

- 13 • **EPC Contractor Decision.** The appropriateness of WETT's decision to
14 select I-USA as the EPC contractor in light of available options
- 15 • **EPC Contract Structure and Development.** The comparability of the
16 details and structure of the EPC Contract, to industry norms
- 17 • **EPC Margin Review.** The appropriateness and comparability of the I-USA
18 margin included in the EPC Contract
- 19 • **EPC Overhead Charges Review:** The appropriateness of the overhead
20 charge allocation basis and the comparability to industry peers

21 **Q. WHAT SPECIFIC CRITERIA DID YOU USE IN YOUR ANALYSIS?**

22 A. I used several objective criteria based on my experience and my
23 understanding of PURA standards. These include:

- 24 • Was the basis for selecting the EPC contractor appropriate?
- 25 • Was the allocation of contract risk considered and appropriately addressed?
- 26 • Is the EPC Contract is similar to other contracts observed in the market?

- 1 • Do the terms and conditions and the structure of the EPC Contract compare to
2 other contracts observed?
- 3 • Does the margin level charged by I-USA compare favorably to EPC
4 contractor margins observed in the market?
- 5 • Does the overhead allocation contained with the EPC Contract compare
6 favorably to that typically found in other contracts?

7 These criteria provided a definitive basis for the conduct of this part of the
8 assessment and established a specific framework against which the EPC Contract
9 related elements could be reviewed.

10 **1. EPC CONTRACTOR DECISION**

11 **Q. PLEASE DESCRIBE YOUR APPROACH TO EVALUATING WETT'S EPC**
12 **CONTRACTOR DECISION.**

13 A. The goal of this section of my testimony is to evaluate whether WETT's
14 decision to use I-USA as its EPC contractor was reasonable. In doing so, I use the
15 PURA definition of reasonableness and prudence outlined in Section IV of this
16 testimony. Specifically, I note the PUC's review of WETT's planned transactions
17 with I-USA during the Transmission Service Provider selection and Code of
18 Conduct waiver process. I also review WETT's EPC contractor selection options,
19 the EPC planning undertaken by WETT and its independent evaluator and advisor
20 (SAIC), the prevailing circumstances at the time of EPC contractor selection, and the
21 basis for selecting I-USA. I conclude this section of my testimony by describing the
22 implications and potential benefits of WETT's decision to engage I-USA and
23 determine that WETT's decision was prudent.

1 **Q. DESCRIBE THE PREVAILING CIRCUMSTANCES AT THE TIME OF EPC**
2 **CONTRACTOR SELECTION AND THE APPROACHES AVAILABLE TO**
3 **WETT.**

4 A. As discussed in the direct testimonies of Mr. Morton and Mr. Ballard, WETT
5 had previously informed the PUC in 2009 of its intent to use Isolux Ingeniería in the
6 EPC role when it applied to be awarded CREZ projects. Isolux Ingeniería's
7 capabilities and positioning were believed to favorably align with WETT's
8 requirements related to quality, risk and cost. Moreover, Isolux Ingeniería had
9 extensive transmission experience and had sourcing access to international markets.
10 Isolux Ingeniería's affiliate, I-USA, also proposed a margin that was below market
11 average and below what it would charge a non-affiliate.

12 Given the number of CREZ projects planned throughout Texas from 2008
13 through 2013, as well as existing relationships between the other project sponsors
14 and EPC contractors, shortages of qualified contractors was considered a real
15 concern to WETT as a new market entrant. Many of the large engineering and
16 construction companies, such as Zachry and Quanta Services, had already been
17 engaged by other CREZ project owners when WETT was ready to pursue an EPC
18 contract, thus potentially limiting the availability or capacity of these firms to handle
19 additional work with the same level of highly qualified management and supervisory
20 teams – an issue observed with EPCs around the country at this time. This further
21 increased the bargaining power of EPC firms which could potentially have forced
22 WETT to offer financial concessions, either in the form of higher margins or by
23 accepting higher risk. The combined effect of the potential shortage of skilled

1 management and limited capacity of the major EPC contractors was viewed as
2 posing both potential execution and quality risks for the project.

3 Recognizing these market realities, a number of different approaches were
4 available to WETT for EPC selection at the time its process was undertaken:

- 5 • Open competitive bidding process
- 6 • Selective competitive bidding process
- 7 • Sole source to a non-affiliate
- 8 • Sole source to an affiliate

9 The aforementioned factors, along with other factors I discuss below, motivated
10 WETT to choose to sole-source contract with I-USA.

11 **Q. WHAT WAS THE BASIS FOR SELECTING I-USA AS THE EPC**
12 **CONTRACTOR?**

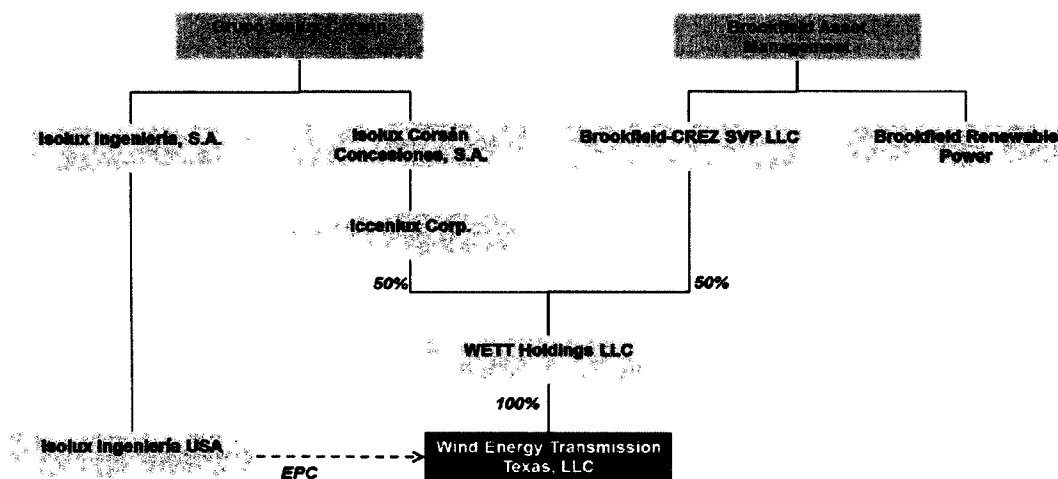
13 A. Isolux Ingeniería, I-USA's parent, is a well-respected entity in the EPC field
14 with substantial project execution capabilities and familiarity with the technical
15 scope of the projects. For example, Isolux Ingeniería has worldwide transmission-
16 related experience and has executed similar, large-scale projects in Latin America
17 and elsewhere. The company has built 60 transmission line projects totaling over
18 5,000 miles as well as 90 substations in the past 10 years. Because Isolux Ingeniería
19 is a global company and has access to international markets, its ability to source
20 materials and components from abroad has the potential to deliver significant cost
21 savings. Isolux's size was also perceived to be an advantage with regard to securing
22 lending.

As indicated, WETT previously informed the Commission of its intention to leverage Isolux Ingeniería's experience in the EPC process. The Commissioners acknowledged these strengths in selecting WETT to construct the awarded CREZ transmission projects. Moreover, Isolux Ingeniería's involvement with WETT throughout the CREZ transmission service provider selection process at the PUC meant that Isolux Ingeniería already had familiarity with the CREZ projects that a third-party might not have had.

The aforementioned potential benefits delivered by Isolux Ingeniería and its subsidiary, I-USA, coupled with the potential risks to the project of the unavailability of qualified EPC resources, formed the basis for selecting I-USA to carry out the EPC work. This decision was affirmed by the PUC when it granted a waiver of the WETT Code of Conduct to enable the retention of I-USA without competitive bidding.

The figure below illustrates the relationship between I-USA, Isolux Ingeniería, Isolux Concesiones, and WETT.

Figure 12 - WETT Ownership Structure



1 **Q. DID WETT CONSIDER A COMPETITIVE BIDDING PROCESS TO**
2 **SELECT AN EPC?**

3 A. Yes, for a time. To assure that WETT would have access to a qualified EPC
4 contractor in the case the PUC did not approve WETT's Code of Conduct waiver,
5 the Company, with the advice and support of SAIC, began planning a Request for
6 Proposal ("RFP") for the EPC of the CREZ Projects. However, since the
7 Commission subsequently approved WETT's Code of Conduct waiver, WETT was
8 able to contract directly with I-USA, and the RFP process was never executed.
9 Preparing for a potential competitive bidding process, even with the indicated
10 benefits from selection of I-USA available to WETT, was a sound action in the event
11 that PUC approval was not received. Additionally, WETT applied the "functional
12 requirements" and other preparations for the potential RFP process to the CSA and
13 EPC contract, so these efforts were useful.

14 Though I-USA was not selected through a competitive bidding process, much
15 of the EPC work is being incurred through competitive bidding, because the EPC
16 Contract has I-USA directly procuring subcontract labor and required materials..
17 Thus, WETT is receiving the benefits of competitive market pricing through the EPC
18 contract, notwithstanding the relationship between I-USA and the Company.

19 **Q. PLEASE DESCRIBE ANY POTENTIAL BENEFITS OF SELECTING I-USA**
20 **FOR THE EPC CONTRACT.**

21 A. Based on my review, I concluded that there are several tangible benefits to
22 WETT's decision to use I-USA as the EPC contractor. WETT's decision to contract
23 with I-USA provides the following benefits: