- **Reduced Margin** – I-USA's margin, as discussed in a later section of my testimony, is lower than that sought by typical EPC firms on similar projects and lower than what Isolux Ingeniería would typically charge a non-affiliate.
- **Common Objectives** – WETT, its parent organizations, and I-USA are committed to the successful completion of this project and have the common goal of providing quality services to Texas customers.
- **Reduced Contractor Risk** – Using an affiliate reduces risk to WETT of contractor default by aligning EPC contractor and WETT project objectives.
- **Established Relationship** – Contracting with I-USA allows WETT to capitalize on its relationship with Isolux Ingeniería, and Isolux Ingeniería's familiarity with the CREZ Projects.

These factors have the overall effect of reducing costs, expediting project execution, mitigating risk, and assuring more effective cooperation, which benefits both WETT and its stakeholders and ultimately customers within Texas.

Q. WAS WETT'S DECISION TO USE I-USA AS THE EPC CONTRACTOR REASONABLE AND PRUDENT?

A. Yes. I have reached this conclusion based on my review of WETT's EPC selection options, the prevailing circumstances at the time of EPC selection, the Commission's previous review of WETT's relationship with Isolux Ingeniería, WETT's unique ownership structure, the implications of selecting an affiliate, and the associated benefits of having certain common objectives through an established relationship.

Based on my review, I have found the EPC planning activities undertaken by WETT and SAIC to be adequate and appropriate. In addition, I-USA's services are cost competitive (and, in fact, certain elements are clearly below industry average) and the firm enjoys the backing of Isolux Ingeniería, a respected name in the EPC industry. Finally, selecting an affiliate served to align objectives, reduce costs, expedite project execution, and mitigate and avoid risks that are inherent to construction projects. Given these factors, I have concluded that WETT's decision to select I-USA to perform the EPC Contract was reasonable and prudent.

2. EPC CONTRACT STRUCTURE AND DEVELOPMENT

Q. WHAT IS THE PURPOSE OF REVIEWING THE EPC CONTRACT STRUCTURE AND ITS DEVELOPMENT?

A. The purpose of my review of the EPC Contract structure is to assess the reasonableness of the contract and its protection of WETT's interests. While WETT and SAIC witnesses testify about how WETT and I-USA negotiated to reach the EPC Contract's terms, I reviewed the EPC Contract's development and terms retrospectively and compare them to industry standards. The focus of the review I conducted is to ascertain whether management actions were appropriate and decisions were prudent given the information available at the time of EPC selection.

Q. PLEASE DESCRIBE HOW THE ASSESSMENT OF THE CONTRACT STRUCTURE WAS CONDUCTED.

A. I based my analysis of contract structure and development on my experience with dozens of construction projects over my career. I utilized the evaluative criteria presented at the beginning of this section of my testimony to assess the appropriateness of the contract structure and development. While reviewing the

EPC contract, I compared the structure, selected components and level of specificity to other contracts and leading practices. Finally, I reviewed the terms and conditions, scope of work, and functional and business requirements in the contract to determine whether they are appropriate given the project's scale and complexity.

Q. PLEASE DESCRIBE WETT AND SAIC'S CONTRACT-PLANNING ACTIVITIES.

A. SAIC acted as WETT's independent evaluator and advisor and was heavily involved in contract planning and structuring. SAIC's advice was based on its experience and standard industry practices observable in the market place.

WETT and SAIC conducted a comprehensive planning phase, which preceded the formulation of the contracting strategy. The companies performed an assessment of WETT's capabilities and worked to identify and mitigate gaps in WETT's processes and resources. WETT approached this project planning process mindful of the regulatory reporting requirements applicable to the CREZ projects, in addition to the reporting and monitoring requirements it developed for its own purposes for managing the CREZ project.

WETT and SAIC formulated a clear approach to risk management related to its contract planning activities. WETT formally tracked risk across four broad areas: safety, scope, cost, and schedule. Specifically, WETT identified potential areas of risk including price escalation, project execution, labor shortages, technology, and project management risk, and then tracked and monitored these risk areas. An example of a risk that WETT has managed to-date relates to land and right-of-way acquisitions. Legislation approved in 2011 created the risk of delays in negotiations

and various land acquisition costs. By closely monitoring the identified risk (potential delays in condemnation scheduling caused by a new law, Senate Bill 18) before it was even passed and planning relevant staffing, budgets, and schedules accordingly, WETT was able to mitigate the identified risk while also managing other aspects of its projects. The result of this risk identification and management was that Senate Bill 18 had only a minimal impact upon WETT's land acquisition schedules.

WETT and SAIC worked together to determine the most appropriate contracting strategy for the EPC work. During contract planning, SAIC advised WETT on the functional and business requirements to be included in the EPC contract. Furthermore, the two companies worked together to develop the commercial terms and conditions and related project schedules and milestones. As part of this project planning effort, WETT also reviewed several subcontractors and compiled a list of preferred vendors. SAIC supported WETT in vendor communications and was present during the EPC Contract negotiations. SAIC also assisted WETT in reviewing these contract terms.

Q. PLEASE DISCUSS THE CONSIDERATIONS ASSESSED IN CONTRACT STRUCTURING.

A. Among others, WETT and SAIC considered structuring the contract as either: 1) lump sum / turnkey; 2) fixed price with escalation, or; 3) a hybrid with cost plus elements. SAIC helped WETT analyze the trade-offs between these three approaches. The trade-off analysis performed by WETT for each approach took into

account the costs, benefits, risks and mitigation options, as well as the macro-economic conditions at the time of the decision.

WETT and SAIC also considered different pricing and incentive structures, including cost incentives, performance incentives, and end-of-project bonuses. Since WETT decided to select an affiliate whose project completion objectives were aligned with that of WETT, there was little need to further incent I-USA. Therefore, WETT decided not to include any provisions for performance incentives or end-of-project bonus in the EPC contract. In addition, cost-effective performance was encouraged by the terms of the EPC Contract because costs were capped at "maximum phase amounts" and a "maximum project amount."[11] Liquidated damages provisions for certain delays and performance bond provisions also help to encourage timely performance.

One of the major considerations assessed in structuring the EPC Contract was to distribute risk in a way that was acceptable to WETT and in line with the Company's risk tolerance and staffing levels. To do so, SAIC advised WETT on the trade-offs between various contracting models and the implications for overall cost and project execution.

The need to effectively manage the project budget and schedule was addressed in the contract structuring phase as well. Specifically, WETT and SAIC

[11] Maximum phase and project amounts stated in the EPC Contract are not absolute; they can be adjusted if certain enumerated, unforeseen circumstances occur and specific procedures are followed. Unforeseen circumstances which may warrant the adjustment of caps are referred to in the EPC Contract as "equitable adjustment events." Further, if WETT needs to add facilities or otherwise alter the scope of work—such as adding the Faraday Switching Station—it can do so by submitting change orders, which may also affect capped amounts.

discussed the nature of cost control mechanisms to be used (*e.g.*, cost reporting, frequent meetings, hands-on vendor oversight, etc.) and how project progress was to be tracked. WETT established a set of project milestones and associated due dates.

WETT and SAIC also considered the need for engineering and design work to be completed early during the project life-cycle. This would result in lower overall EPC costs since more detailed design and engineering completion reduces uncertainty and risk to the EPC contractor (and subcontractors), which is an element typically incorporated into contract margin determinations.

Yet another consideration addressed during contract structuring was the degree of involvement in EPC project execution required from WETT. SAIC and WETT analyzed different approaches and identified the level of involvement that each approach would require from WETT. Governance and decision rights were also discussed during contract structuring. Specifically, with the advice of SAIC, WETT established a structure to effectively manage the EPC contractor as well as all other vendors involved in ROW and permitting. WETT established requirements to report project cost and cash flow projections, as well as progress estimation, by project category, in connection with invoice submissions.

Q. DESCRIBE THE GENERAL STRUCTURE OF THE EPC CONTRACT.

A. WETT's EPC Contract with I-USA is a turnkey contract, on an open book basis, with a cost plus 4% margin on all reimbursable costs and 6.29% overhead allocation. The contract stipulates that I-USA shall supply materials, labor, equipment, project-related utilities, and all other resources necessary to carry out the CREZ Projects. In addition, I-USA is responsible for the inspection, storage,

transportation, and payment of procured materials. WETT is required by the contract to provide certain permits, timely access to the construction sites, financing, utility services, insurance, and maintenance personnel for project completion.

The statement of work ("SOW") contains, among other things, provisions requiring I-USA to:

- Design and engineer the CREZ transmission infrastructure awarded to WETT
- Procure necessary materials and equipment, and construct the seven transmission lines and five (now six) substations
- Complete the EPC work in accordance with pertinent legislation and regulations
- Complete the requested work in accordance with the terms and conditions set forth in permitting agreements
- Support WETT in obtaining project permits
- Obtain construction permits
- Coordinate and cooperate with WETT's contractors and consultants
- Test and commission the transmission infrastructure

My review of the terms and conditions and the scope of work of the EPC Contract between WETT and I-USA indicated that it contained the typical elements, definitions and limits, i.e., responsibilities; rights, duties and obligations; project milestones and schedule; guaranteed completion; delay liquidated damages, etc. as other similar contracts. Based on my review, I conclude the EPC Contract is reasonable, prudent, and comparable to other such contracts and in line with typical practices.

Q PLEASE DISCUSS KEY CONTRACT COMPENSATION ELEMENTS.

A. Once the decision was made to sole-source the EPC work to an affiliate, WETT had several options regarding EPC pricing and compensation, including conventional firm price, cost plus, or a hybrid contract. WETT made the decision to use a cost plus approach with a cap on total costs, subject to Change Orders and any Equitable Adjustment Event. With this cost plus approach, WETT accepts some project risks, but is also able to retain contractor payments for incomplete work. The cost plus approach allows for transparency into detailed project costs, while the cap on each phase and on total project costs allows WETT to mitigate execution risk.

EPC contractor compensation was designed with the goal of aligning I-USA's interests with project success. The EPC Contract between WETT and I-USA is a cost plus contract (with a maximum price) including a margin of 4%. The total project costs are capped and there are no performance or cost incentives for the EPC contractor. Furthermore, there is no end-of-project bonus available for the contractor. The contractor is required to pay liquidated damages if certain delays occur, and had to post performance bonds as a further guarantee of performance.

WETT's CREZ projects are divided into three "phases" in the EPC contract. The payment amounts to I-USA are bound by maximum phase amounts described in the EPC contract. The contract contains detailed estimates of the costs of each phase as well as each transmission line and substation. Since project costs are capped for each phase, I-USA is responsible for covering costs in excess of these phase-based,

maximum project amounts unless certain "Equitable Adjustment Events" or change orders occur and specific processes are followed.

The payment schedule included in the EPC Contract specifies that WETT is required to pay I-USA 10% of the maximum contract amount once the notice to proceed is issued. WETT agreed under the EPC Contract to make protected and offsetting advance payments to I-USA in the amount of 10% of the total cost of any work authorized by WETT for performance by I-USA. The payments are protected in that I-USA must provide an advance payment bond to WETT in an amount equal to any such payment as security. The payments are offsetting in that WETT will subtract 10% of the amount otherwise authorized to be paid to I-USA under each application for payment until such time as the aggregate amount so subtracted by WETT equals the full amount of all advance payments made by WETT. The advance payments greatly accelerated I-USA's ability to ramp up its engineering and design activities and the procurement processes applicable to WETT's transmission line project, thereby aiding WETT to meet its overarching goal of completing its project on an expedited basis. The purpose of the advance payments was to allow WETT to benefit from efficiencies that were made available in part through I-USA's ready access to such payments.

Subsequent monthly payments to I-USA are contingent on project progress and the attainment of certain project milestones. I-USA is responsible for demonstrating progress by providing WETT with detailed cost and schedule reports. To receive payment, I-USA must provide WETT with an application for payment accompanied by:

- Contractor certification stating that all subcontractors have been paid
- Copy of a work status report
- All invoices
- Evidence of equipment delivery or shipment

These compensation elements are in line with and actually favorable to WETT when compared to similar EPC contracts in the industry.

Q. PLEASE IDENTIFY KEY TERMS AND CONDITIONS OUTLINED IN THE EPC CONTRACT.

A. The EPC Contract terms and conditions are comparable to standard contracts in the market and include sections on:

- **Responsibilities of Contractor** – As described above, the EPC Contract sets forth I-USA's responsibilities and clearly details each requirement including design, procurement, and construction.
- **Rights, Duties and Obligations of WETT** – The contract also highlights WETT's rights as well as obligations, including the acquisition of ROW and required environmental permits.
- **Pricing and Compensation** – The contract specifies that I-USA is to receive a 4% margin on reimbursable costs. There are no performance or cost incentives for I-USA. Furthermore, I-USA is responsible for any costs that exceed phase and project maximum amounts, barring the application of certain equitable adjustment events or change orders.
- **Project Milestones and Schedule** – WETT has formulated key milestones which coincide with the completion of the three CREZ project phases.

(Phases I, II, and III contain CCN1 facilities, CCN2 facilities, and CCN3 facilities, respectively.) In addition, WETT has established clear due dates for each milestone. Controls built into the contract include reporting and tracking activities to ensure milestones are met.

- **Safety Requirements** – The EPC Contract requires I-USA to perform the work in accordance with a health, safety, security, and environmental management plan, subject to review and approval by WETT, in compliance with well-defined safety standards.
- **Pre-approved Contractors** – I-USA needs to seek WETT's approval for any primary subcontractor it hires to perform work on the EPC project, except for contractors that have been pre-approved by WETT and included in the EPC contract.
- **Testing** – I-USA is required to perform inspection and testing of the transmission lines and substation prior to completion. The contractor is required to notify WETT in advance of these tests to assure WETT representatives are present at the testing site.
- **Guaranteed Completion** – For each of the three project phases, there is a deadline for ready for energization, guaranteed substantial completion, and guaranteed final completion.
- **Delay Liquidated Damages** – In the event of project delays, I-USA is required to pay damages to WETT. Specifically, I-USA pays 0.02% of each phase's maximum contract amount per day up to maximum amount of 10% if

it fails to meet either the guaranteed substantial completion date or the guaranteed final completion date.

- **Equitable Adjustment Events** – Changes to project schedule or cost are only allowable under the occurrence of an equitable adjustment event, which is defined as certain circumstances that a reasonable contractor could not foresee.
- **Force Majeure** – The EPC Contract contains force majeure provisions to protect both contractor and WETT.
- **Performance Securities** – The contract proposes two options for performance securities: performance bonds for the maximum project amount or retainage of 10% of all amounts due to I-USA.
- **Title and Risk of Loss** – The contract stipulates that title of equipment passes to WETT on the earlier of delivery or on the payment of amount due and that I-USA bears the risk of loss or damage of the project.
- **Warranties** – I-USA warrants, among other things, that all work and materials are free of errors, defects or damage and in compliance with project requirements as set forth in the EPC contract.
- **Termination** – This section of the contract describes the rights of each party to terminate the contract given specific circumstances.
- **Dispute Resolution** – This EPC Contract describes the alternative dispute mechanisms and legal channels available to the parties for dispute resolution.

- **Overhead allocation** – This section describes the allocation methodology of charges from the parent company to the project for shared general and administrative expenses.

These elements reflect the those normally identified in contracts of this type with the general terms consistent with these contracts.

Q. PLEASE DISCUSS THE BASIS FOR THE INCLUSION OF A 4% MARGIN.

A. Since the project and phase costs are capped, subject to qualifying Equitable Adjustment Events or change orders, I-USA is exposed to more risk in the event of price escalation above the cost caps, or delays in project execution (though certain increases beyond the capped amounts might be allowable as Equitable Adjustment Events or change orders). As in typical large construction projects, the margin serves to compensate for this risk and offer I-USA a fair and reasonable return. The margin level is discussed in more detail in the next section of my testimony.

To determine what margin to charge WETT, I-USA reviewed the range of margins Isolux Ingeniería had charged on similar and recent power transmission and delivery EPC projects. A 4% margin was the lowest that Isolux Ingeniería had charged on the projects analyzed. The region closest to the US where Isolux Ingeniería has performed transmission and delivery EPC work is Latin America, where Isolux Ingeniería has charged from 7 to 9% fees on similar projects.

Since this is the first power transmission and delivery EPC project to be performed in the U.S. by Isolux Ingeniería or any of its affiliates, WETT commissioned a third-party study which was performed by Booz to determine the

profit margins typically charged by other EPC providers for similar projects in the U.S. This study is further discussed below.

Q. PLEASE PRESENT YOUR CONCLUSIONS REGARDING THE EPC CONTRACT STRUCTURE AND DEVELOPMENT.

A. Based on my review, I conclude that the EPC Contract compares favorably to other construction contracts in the market place. The EPC Contract includes standard terms and conditions common in similar contracts. WETT was closely involved in EPC Contract design and development and benefited from the advice of SAIC which it had retrained to assure successful project completion. The contract structure provides WETT with both the means to achieve effective control over the EPC, as well as minimize project costs and risks.

3. EPC CONTRACT MARGIN REVIEW

Q. WHAT IS THE PURPOSE OF CONDUCTING THE EPC CONTRACT MARGIN REVIEW?

A. The purpose of this review is to provide a basis from which to assess the justification, comparability, and reasonableness of the 4% margin charged by I-USA for EPC work.

Q. PLEASE DESCRIBE THE SCOPE OF YOUR MARGIN ASSESSMENT.

A. WETT requested that Booz conduct a review of EPC margins as a basis for assessing I-USA's margin. The overall scope of the assessment was to: 1) provide a basis for current margin-level comparison; 2) develop an indication of margin trends and the underlying causation factors; 3) establish a baseline of profit margins earned by EPC firms across industries; 4) identify current margin trends and key

macroeconomic elements affecting EPC margins; and 5) identify other indirect sources of profit margins (*e.g.*, risk contingencies, incentives).

Q. PLEASE DESCRIBE HOW YOU CONDUCTED THIS EPC MARKET MARGIN ASSESSMENT.

A. The EPC margin review process consisted of primary and secondary assessments based on three key analyses. First, I conducted a survey of utilities, EPCs, a trade association and a utilities market procurement data firm . Then, I reviewed analyst reports, and SEC filings of major EPC firms. Finally, I analyzed the EPC margins across a variety of utility and non-utility projects, as well as in public-private capital projects. The results of my study are presented in Exhibit TJF-5.

The initial step of the assessment was to obtain empirical data on the level of traditional EPC margins contained within contracts in the U.S. I obtained this data by examining market studies, reviewing available regulatory filings, studying public and private partnerships in other non-power sectors, and conducting surveys of owners and EPC firms. From this data, I then developed a view on the factors influencing the range of EPC margins observed or reported.

As part of the primary assessment, I conducted a direct interview-based survey of key industry stakeholders to provide perspectives on contract margins. The participants – representing the power, transmission, and related service sectors – were seven utilities, two EPC firms, a trade association, and a firm that specializes in collecting relevant market transaction data. The focus of the survey was to obtain

specific data on margin levels, identify factors affecting these margin levels and risk premiums, and capture perspectives on future margin levels.

As part of the secondary assessment, I cataloged specific examples of project profit margins from publicly available sources. I first reviewed SEC filings and analyst reports on eleven major public EPC firms. From the filings, I analyzed margin trends from 1995 forward with a focus on the underlying factors influencing margin levels from 2Q-2006 to 3Q-2010. I also compiled analysts' estimates of margins for 2012 and the factors expected to influence them.

Finally, I examined public-private partnership agreements for comparable profit margin data. Public-private partnerships were included in the assessment because they are similar to EPC contracts in terms of project cost allocation.

Q. WHAT WAS THE TIMEFRAME OF YOUR ANALYSIS?

A. The analysis was performed over a six week time period in 1Q-2011. The EPC profit margin results analysis was updated in September 2011 to include full-year figures for 2010 and to identify any factors that could affect the results of the prior analyses.

Q. WHAT WERE THE RESULTS OF THE PRIMARY (COMPARABILITY) ANALYSES RELATED TO EPC MARGINS IN THE MARKET?

A. Based on the interviews conducted with the utility owners, the following key takeaways emerged relative to margins:

- The general consensus on mega projects is that margin levels fall into the 10 to 15% range with potential for higher levels dependent on project type.
- The consensus on transmission project margin levels falls into the 5 to 10% range.

- The general outlook on future margins is that they would stay consistent with today's levels.

- Owners prefer to break contract work into discrete modules to match margins, scope, and risk.

Based on the interviews conducted with EPC firms, the following findings emerged relative to margin levels:

- The EPC contractors placed the margin levels in the 10 to 15% range, which is in line with the utility owners.

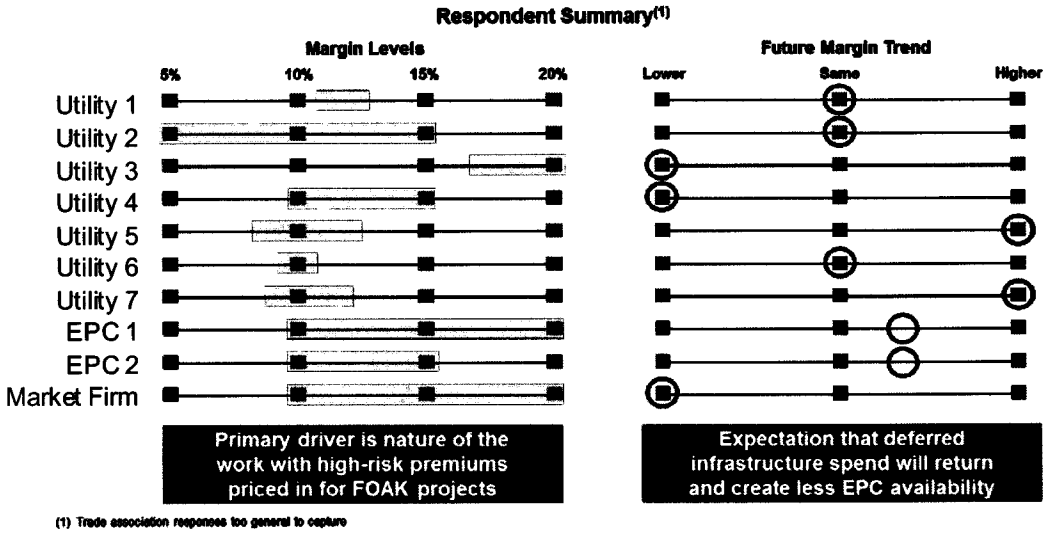
- The level of margin varies based on the nature of the work and the degree of risk being assumed.

- Earned margins have been lower than what EPC contractors would like due to performance issues and owner contracting approach, but EPC contractors are expecting higher margins in the future.

- There is a perception that moving from a sellers-to-owners-to-sellers' market may result in slightly increasing margins.

The above information was also corroborated by the firm that specialized on market data collection and analysis and, in total, provided a 10 to 20% margin range for major projects with more complexity, such as nuclear power projects.

Figure 13– Survey Results



Those companies surveyed were also asked to distinguish the margin rates among the various types of work within the power sector (services, transmission, fossil, and nuclear). Transmission work margins were stated to be in the 5 to 10% range while maintenance service work had the lowest margin in the 2 to 8% range.

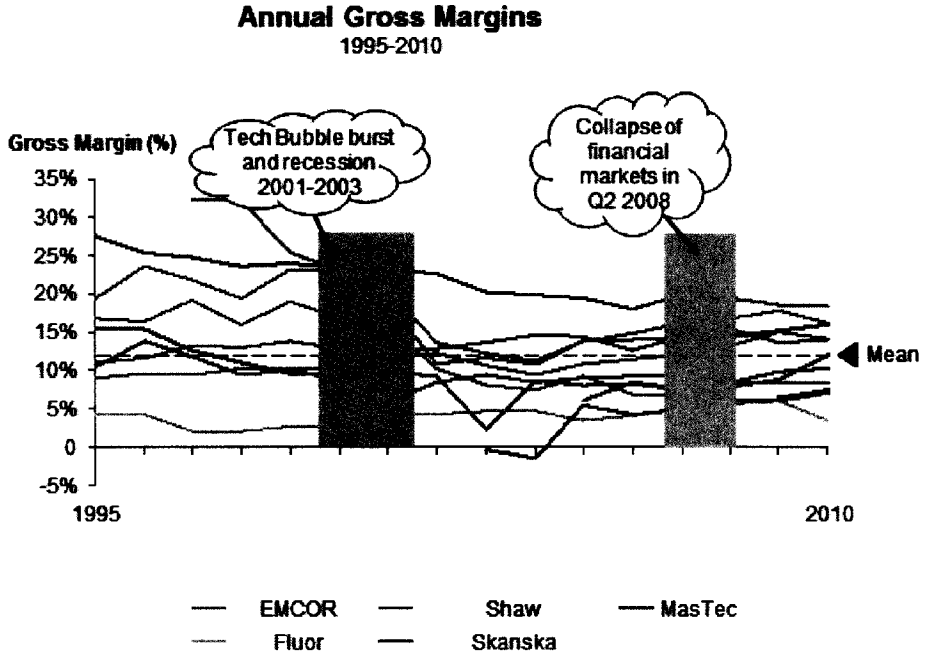
Survey analysis suggested the following factors had influence on margin levels:

- Amount of engineering complete at bid
- Complexity associated with project execution
- Role to be performed by the EPC
- Risk apportionment model in place
- Size of the overall contract
- Nature of the owner – EPC relationship
- Potential for future work
- General market conditions and scarcity

Q. WHAT WERE THE RESULTS OF THE COMPARABILITY ANALYSES RELATED TO EPC MARGINS IN THE MARKET?

A. Based on data gathered from SEC filings and analyst reports on eleven major global EPC firms, corporate profit margins earned have consistently centered on the 10% level across all project types since 1995, with the exception of a few firms, for a few periods, where they have been both higher and lower than this range. It should be noted that when margin levels fall below the historical mean, these results are often the product of project losses where costs have not been recovered by the EPC, rather than solely a pricing-based impact.

Figure 14– Industry Margin History



Note: Gross Margin (in most cases) equals total revenues minus cost of goods sold
Source: Capital IQ, Booz & Company analysis

Though the corporate profit margins have been relatively constant from the period 1995 to 2010, there have been observed periods of increases and decreases. The decreases resulted from and lagged behind fluctuations in global economic performance (such as the 2001 to 2003 recession caused by the technology bubble and the collapse of the financial markets in 2008). Increases are likely attributable to solid work backlogs accumulated during favorable economic times, *i.e.*, creation of a "sellers' market." Work backlogs and the long-term nature of EPC projects also insulate these major EPC firms from large margin swings. Likewise, the global growth of firms has insulated margins against fluctuations in local markets.

Future margin levels may increase gradually as the EPCs backlog of work grows with economic recovery and increased capital project spending. Additionally, significant growth is expected to take place in the power sector in transmission and

generation to meet increased demand as well as in retrofit work to meet new emissions regulations. These factors should result in increased demand in EPC services, which in turn allows firms to be more selective in projects and resistant to margin concessions.

Q. DID YOU REVIEW ANY OTHER NON-UTILITY PROJECTS?

A. Yes. I examined public private partnerships, which are ventures that are operated and funded by a combination of several private entities and public agencies. Public private partnerships are formed to execute large-scale projects that are capital intensive and entail substantial financial risk. These undertakings are, in these respects, similar in nature to the CREZ projects undertaken by WETT. Review of public private partnerships highlighted typical offerings of 10 to 20% margins as incentives to obtain project participation. Furthermore, for construction, materials and labor, profit levels were typically in the range of 10 to 25%. A markup can also be applied to work completed by subcontractors (including affiliates), materials, and additional equipment procured for repair.

Q. WHAT DID YOU DETERMINE TO BE THE FACTORS THAT MOST AFFECTED EPC MARGIN LEVELS IN THE MARKET?

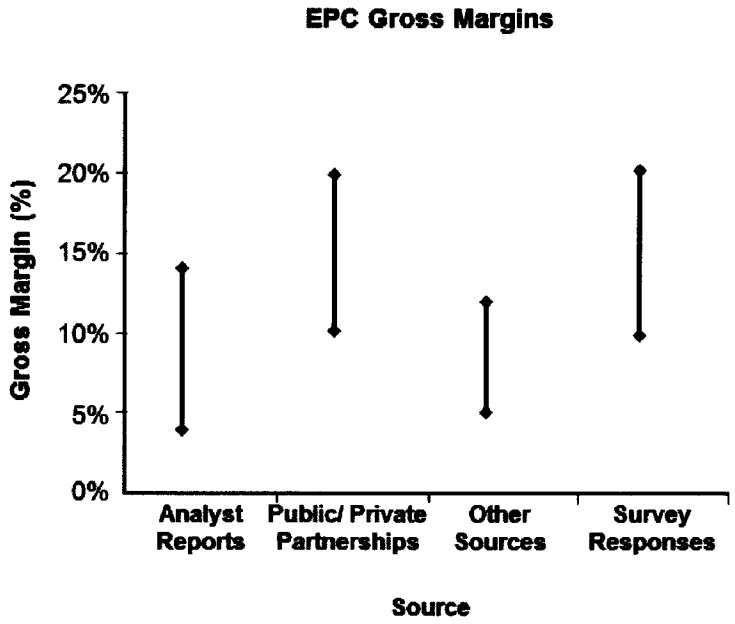
A. My causation analysis identified those factors that impacted risk and hence margin levels. The factors determined to have the greatest impact on risk are the complexity of the project, the uncertainty of ROW acquisitions and project design, and familiarity with regulatory procedures. EPC margins are determined to a great extent by the design carried out prior to project start. The more aggressive the design and schedule are, the higher the risk and the margins. Conversely, the more

engineering completed prior to project start, the lower the uncertainty and thus the margins. EPC firms tend to build in considerable contingencies to protect against delays when there is uncertainty, *e.g.*, right-of-way issues and regulatory approvals. The reason for this is that EPC firms are typically held liable for not meeting the project schedule set by the owner/operator. In addition, EPCs usually have more exposure to idle cost when projects are delayed or during work stoppage periods.

Q. WHAT ARE THE CONCLUSIONS AND IMPLICATIONS OF THE OVERALL EPC MARGIN ASSESSMENT?

A. My overall assessment has revealed that profit margins, on average, range from 10 to 15% on large capital projects and from 5 to 10% on typical transmission projects. My conclusion reflects comprehensive analyses of data collected from multiple sources (surveys, reports, public filings). My analyses relied on results from various and diverse EPC contractors in different sectors (power, T&D, services) and also included some of the EPC contractors working in the CREZ, as well as public private partnerships.

Figure 15 - Summary of EPC Margin Ranges



My analysis of major EPC firms has revealed that margins have largely converged around a mean of 10% during the period of 1995 to 2010, which indicates that there has been relative stability and less variability in EPC margins as a group. These margins may increase in future years due to increased competition, increased demand for power, and increased capital project spending fueled by a potential economic recovery.

Although transmission and delivery EPC work is not complex compared to other mega-projects, it involves right-of-way and regulatory uncertainty. This uncertainty increases project risk and commands a small premium. Due to these risks, EPC margins for transmission and delivery projects tend to center around 5 to 10%.

Q. HOW IS THE ANALYSIS YOU HAVE PERFORMED RELEVANT TO ESTABLISHING THE REASONABLENESS OF I-USA'S MARGIN?

A. My analysis provided a comprehensive basis for current margin-level comparison while providing an indication of margin trends and the underlying causation factors that affect margin levels. The analysis I have performed is relevant since it compares I-USA's 4% margin to the margins of other EPC firms engaged in similar work. Since I-USA's margin is well less than what other firms have charged for similar projects and lower than what I-USA would have charged a non-affiliate, I believe that the margin charged by I-USA is reasonable and prudent.

Q. OVERALL, WHAT IS YOUR ASSESSMENT OF THE REASONABLENESS OF I-USA'S MARGIN?

A. Based on this assessment and the results presented above, I-USA's 4% margin is reasonable since it is lower than typical profit margin ranges for comparable work. It is significantly below both the profit margin range for public private partnerships (10 to 20%) and large capital projects (10 to 15%). I-USA's rate is also below the transmission work profit margin range (5 to 10%) revealed from the survey analysis. Finally, I-USA's rate is below what its parent company Isolux Ingeniería has charged for similar work in nearby markets (7 to 9%), leading me to conclude it is below what I-USA would charge an unaffiliated entity.

4. EPC OVERHEAD CHARGE REVIEW

Q. WHAT IS THE PURPOSE OF CONDUCTING THE EPC OVERHEAD CHARGE REVIEW?

A. The purpose of this review is to provide a basis from which to assess the justification, comparability and reasonableness of the 6.29% overhead charged by Grupo Isolux for allocation of corporate and business segment overhead costs.

Q. PLEASE DESCRIBE THE SCOPE OF YOUR OVERHEAD ASSESSMENT

A. The scope of the assessment conducted addressed the: nature of charges reflected in the allocation; the basis for the development of the overhead allocation; and the comparability of the 6.29% rate to what has been observed in the market for allocation of corporate and business segment costs related to similar undertakings.

Q. PLEASE DESCRIBE HOW YOU CONDUCTED THE EPC OVERHEAD CHARGE ASSESSMENT.

A. I initially addressed the nature of the services provided and costs incurred by Grupo Isolux to I-USA to understand the basis for the allocation itself. This task involved reviewing the PwC basis for calculation and discussing these services, costs and allocations with representatives from WETT and I-USA. The purpose of these discussions was to understand which functional elements of the corporate and business segment and unit organizations were reflected in the overhead calculation and to determine the mechanics of the overhead allocation calculation.

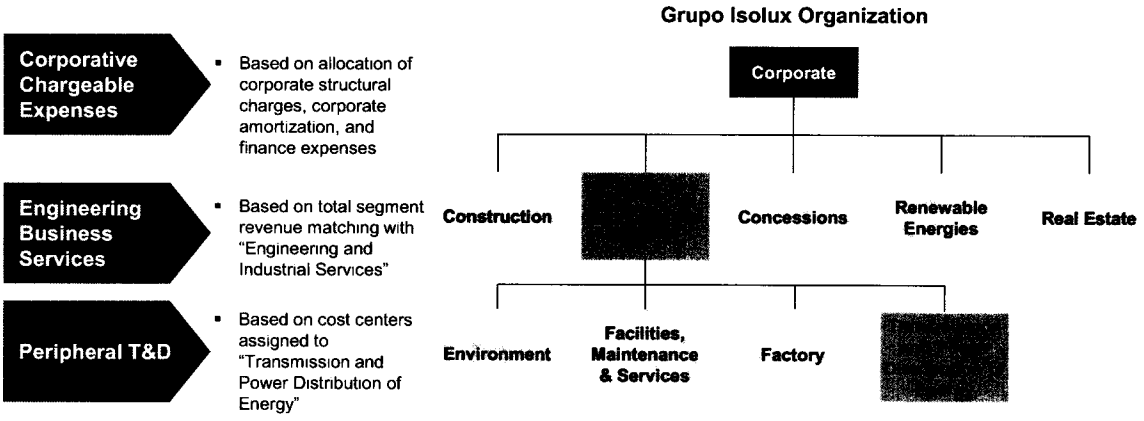
In addition to this initial analysis, I also conducted a brief survey within the power sector to understand the level of overhead costs typically observed in contracts by other utilities, EPCs and market data analysts. This survey focused on identifying an industry perspective on overhead levels and on factors affecting how overheads were recognized.

Q. WHAT ELEMENTS OF THE GRUPO ISOLUX BUSINESS ARE INCLUDED IN THE DEVELOPMENT OF THE OVERHEAD ALLOCATION?

A. A portion of the relevant overhead costs are incurred for headquarters function at the Grupo Isolux level. The figure below also identifies the overall business

segments and selected business units within Grupo Isolux and which segments or units are the subject of the development of the overhead allocation.

Figure 16 – Segment Components of the EPC Overhead allocation



The specific business components that are involved in the calculation of the overhead allocation are the Engineering and Industrial Services Division (Engineering Business) at the primary business segment level and the Transmission and Power Distribution of Energy area (T&D Unit) at the business unit level within this segment.

Q. PLEASE DESCRIBE THE BASIS UTILIZED BY GRUPO ISOLUX FOR ALLOCATING OVERHEAD COSTS TO ITS BUSINESS SEGMENTS.

A. As mentioned, Grupo Isolux owns and manages a diverse portfolio, of which the T&D Unit where I-USA resides is a particular business unit within the Engineering Business segment. Corporate costs for headquarters functions such as finance and accounting, human resources, information technology, to meet enterprise fiduciary and management needs are incurred at the Grupo Isolux level. In addition, the various business segments incur a separate set of costs related to the management and administration of their business, such as for business planning,

project or asset portfolio management and technical support. Both of these types of costs are typically spread across the business segments and / or assets that comprise the overall portfolio. For construction projects, EPCs typically aggregate these costs and determine a simple basis for allocation across the business, e.g., the use of an overhead allocation, to represent this cost component.

The approach taken by Grupo Isolux mirrors this model. This approach is predicated on the initial premise that corporate support dollars are appropriately distributed based on the notion of relative contribution, i.e., these support dollars will flow to the business segments or units in proportion to the size of the Transmission and Distribution business unit relative to Grupo Isolux as a consolidated group. This relative scale-based approach reflects that business volume, as represented by revenue, is a contributor to relative service performance focus and an indicator of cost responsibility.

For business segment or unit costs, these amounts are similarly spread based on the relative level of the expense element compared to T&D business unit business unit revenue, e.g., Engineering Business expenses as a percent of total T&D Unit revenue. This approach reflects the notion that business segment or unit support costs should flow to the responsible entities based on a standard percentage that reflects overall business activity, i.e., revenue levels. These components are derived and then combined to develop a scale weighted percentage allocation for these corporate and business segment or unit costs.

Q. WOULD YOU PROVIDE A MORE SPECIFIC WALK-THROUGH OF THE METHODOLOGY UTILIZED BY GRUPO ISOLUX TO DERIVE THE OVERHEAD ALLOCATION?

A. Yes. The methodology utilized by Grupo Isolux reflects a common basis for cost allocation that has been used for some time within this entity. The methodology is reviewed by PwC on an annual basis and the calculations verified for accuracy and appropriate data sourcing.

The specific methodology is summarized below on a step-by-step basis:

- Annually, relevant costs and revenues are captured for Grupo Isolux and its business segments and units
- The specific cost elements and revenues that are captured for the T&D Unit calculation reflect three categories: Corporate (which consists of Corporate Structural Costs, Corporative Amortization and Financial Expenses for the Grupo Isolux); Periphery T&D Structural Costs; and Engineering Business Expenses
- The three Corporate level expense categories are aggregated and a ratio calculated between these costs and T&D Unit revenue
- The Engineering Business segment expenses are also used to calculate a ratio between these costs and T&D Unit revenue
- Periphery T&D Structural Costs are similarly used to calculate a ratio relative to T&D Unit revenues
- The above three components – Grupo Isolux costs, Engineering Business segment costs and Periphery T&D Structural Costs are then combined and a total overhead

allocation amount is derived, which has been calculated at 6.29% based on the most recent PwC review

- The 6.29% allocation is ultimately applied to actual construction expenditures for the CREZ project on a monthly basis and invoiced to WETT

The application of the 6.29% provides a fixed overhead allocation based on the composition of corporate and business segment and unit expense. This percent allocation reflects incurred costs on behalf of the Grupo Isolux and the Engineering Business segment and T&D Unit, both of which provide support across the asset portfolio. The approach to development of this overhead allocation is consistent with the approach utilized by other EPCs and the inclusion of an allocation for general, administrative, and business support overheads is typical within the power sector, as will be discussed later in my testimony.

Q. WHY DOES GRUPO ISOLUX UTILIZE REVENUE AS THE BASIS FOR ALLOCATING OVERHEAD TO ITS BUSINESS SEGMENTS?

A. Most businesses are faced with the need to spread corporate overhead across the business segments and units within their portfolio. And, most businesses utilize top-down approaches to accomplish this result to simplify the process.

From a top-down perspective, some factor or factors needs to be utilized as the basis for spreading these costs that reflects relative business scale. Revenue is a factor that represents relative business size, i.e., volume, and reflects the relative contribution of a business segment or unit to the enterprise or segment. Using this factor to apportion corporate and business segment and unit expenses simply

provides an easily recognized and understood basis and enables costs to be spread in proportion to business activity levels.

As mentioned earlier, revenues have been utilized as one basis for the allocation of costs within the utility industry and have been an accepted part of the Modified Massachusetts Formula.

Q. HAS THIS OVERHEAD ALLOCATION LEVEL CHANGED OVER TIME?

A. Yes, it has. Grupo Isolux has conducted annual reviews with PwC to determine the level of the overhead allocation. This percent will change as the business activity volume changes, i.e., it will follow expenditure and revenue levels, although the process for calculation is consistent. For example, in 2008 the overhead allocation was 5.89% and then increased to the 6.29% level as the overall revenues of Grupo Isolux declined while the T&D Unit revenues actually increased.

Q. HOW DID YOU ASSESS THE REASONABLENESS OF THIS 6.29% OVERHEAD ALLOCATION?

A. Similar to the EPC margin survey, I believed it was necessary to obtain external empirical data to compare the relative level of the overhead allocation. Consequently, I developed a similar panel of potential interviewees with whom to conduct a short, targeted interview.

The interviewees consisted of entities that would be familiar with the topic of EPC contracting and largely came from the supply chain or project management functions within the utilities or project owners and the business development area of the EPCs. In addition, an interview was conducted with an entity that supports the utilities industry in sourcing and maintains a proprietary repository of detailed data

from previous client sourcing situations. In total, 12 interviews were conducted to obtain specific data on EPC overhead levels and develop a view of current commercial approaches expected when engaging an EPC firm for construction.

A specific question was asked regarding the interviewee's perspective on the level of overhead that they had observed in prior EPC contracting events. A number of the interviewees referred to a range for overhead allocations, while others centered on a number they viewed as most representative of their experience. The collection of these market-based insights provides clear empirical evidence into the experience of the power sector with respect to overhead allocations within the EPC sector. This information also enables a direct comparison of the Grupo Isolux overhead allocation to other EPC related contract situations. This data thus provided a basis for determining the reasonableness of the 6.29%.

Q. WHAT WERE THE RESULTS OF THE ANALYSES RELATED TO EPC OVERHEAD CHARGES OBSERVED IN THE MARKET?

A. Based on the interviews conducted with the utility owners, EPC contractors and a market firm, several key take-aways emerged:

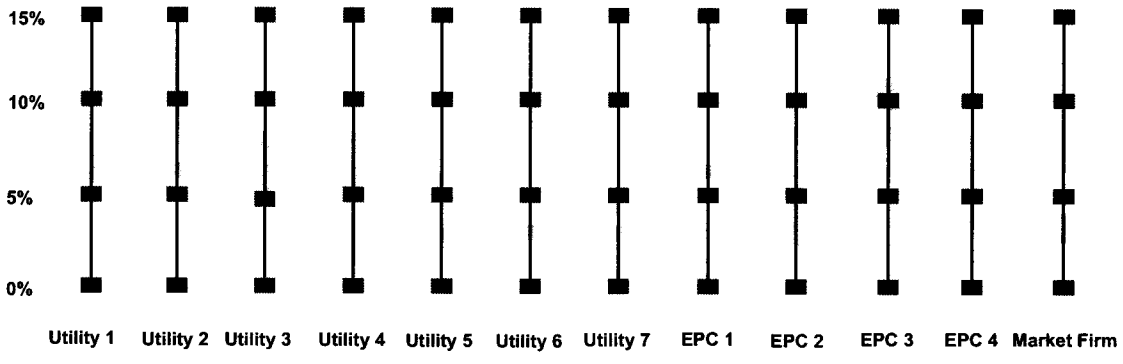
- A "typical" approach to overhead allocation recovery is uncommon since factors such as project complexity, risk levels, owner preferences, and contract form all influence the selected approach
- The approach for overhead recovery tends to either be to reflect these costs as a multiplier to the hourly rate provided for work performed or to utilize an allocation specifically for these charges

- EPCs and subcontractors can define overhead costs somewhat differently, e.g., with respect to home office costs, and owners frequently do not provide for the recovery of certain costs
- EPC overhead charges for overhead typically fall into a 3 – 12% range and are subject to the effect of the factors enumerated above
- The allocation percentage range above reflects the nature of the project commercial contract structure and can vary based on EPC and owner agreement

Q. HOW DOES THE 6.29% OVERHEAD ALLOCATION COMPARE TO THE LEVEL OBSERVED BY YOUR SURVEY INTERVIEWEES?

A. Based on the data gathered from interviewing four global EPC firms, seven utility owners, and one market firm, we compiled the results of the survey in Exhibit TJF 5 also shown in Figure 17. Results suggest that the overhead levels vary across a wide range from 3-12% allocation with a median 5.5% among the interviewees.

Figure 17- EPC Overhead Survey Results



This variation is observed both within the utility owners and EPC companies. All the interviewees stated that indirect overhead is some form of a multiplier in the hourly loaded rates (typically used by smaller contactors) or as a % loader (typically used by EPCs) based on the project construction scope and scale. Contracts dictate

the specifics of items that can or cannot be included in the overhead allocation, which largely explains the variability in overhead levels. For example, certain contracts disallow the inclusion of marketing or business development charges. Commercial contracts and federal contracts have different rules and preferences on activities that can be included.

Q. DOES THE ABOVE AVERAGE POSITION OF GRUPO ISOLUX SUGGEST THAT THE 6.29% LOADER IS EXCESSIVE?

A. No, it does not. The 6.29% that Grupo Isolux charges to I-USA is within the range observed within the EPC market based on interviews conducted directly with both EPCs and their customers. While this factor is slightly above the calculated median of 5.5% from the survey interviewees, it is not indicative of an inflated allocation as the survey illustrates the variability of these adders given differences in organizational alignments, cost composition, project types, contract structures, and project risks.

In addition, it should be remembered that the use of hourly loaded rates can also influence the development of an overhead allocation as certain cost elements, e.g., home office support, can sometimes be reflected in these rates rather than as an overhead, which would depress the calculated adder.

Q. HOW IS THE ANALYSIS YOU HAVE PERFORMED RELEVANT TO ESTABLISHING THE REASONABLENESS OF GRUPO ISOLUX'S OVERHEAD ALLOCATION?

A. My analysis provided a comprehensive basis for EPC overhead charge comparison and the underlying causation factors that affect overhead levels. The

analysis I have performed is relevant since it compares Grupo Isolux's 6.29% overhead to the overheads of other EPC firms and contractors engaged in similar work. Since I-USA's overhead is comparable to what other firms have charged for similar projects I believe that the analysis conducted provides a sound basis for assessing the reasonableness of the overhead allocation.

Q. OVERALL, WHAT IS YOUR ASSESSMENT OF THE REASONABLENESS OF GRUPO ISOLUX'S OVERHEAD ALLOCATION?

A. Based on this assessment and the results presented above, Grupo Isolux's 6.29% overhead allocation to I-USA is reasonable since it is comparable to the overhead ranges for comparable work in the industry and is the same rate that I-USA's parent holding company (Grupo Isolux) charges for similar work for other affiliates.

Q. IN CONCLUSION, WERE WETT'S EPC CONTRACTING PROCESSES REASONABLE AND PRUDENT?

A. Yes. I have reached this conclusion based on my review of WETT's EPC options, the prevailing circumstances at the time of EPC selection, the implications of selecting an affiliate, and the associated benefits of selecting an affiliate in general and I-USA specifically.

WETT's decision to select an affiliate for EPC work was reasonable and prudent given the unique features of the organization, Commission review of the intent to use an affiliate for engineering and construction, and the prevailing market circumstances at the time this decision was made. EPC planning and oversight activities undertaken by WETT and SAIC have been adequate as performed to-date.

In addition, I-USA's services are offered at a lower margin than industry average, and the firm enjoys the backing of Isolux Ingeniería, a respected name in the EPC industry. Finally, the Grupo Isolux overhead allocation basis and loader are reasonable and in the range of those observed in other peer project situations.

Based on my review of the terms and conditions, scope of work, and compensation elements of the EPC Contract, I conclude it is comparable to other such contracts and in line with typical practices. Finally, selecting an affiliate and using the described contract structure served to align objectives, reduce costs, expedite project execution, and mitigate risk. Given these factors, I have concluded that WETT's decision to use I-USA to perform necessary EPC functions was reasonable and prudent.

VII. EPC PROJECT MANAGEMENT

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

A. The purpose of this part of my testimony is to evaluate the effectiveness of WETT's affiliate contract administration and project management relating to the planning and development of its transmission lines and substations.

My evaluation of WETT's project management is limited to its management of affiliates; Mr. Ballard addresses WETT's project management processes with regard to management of third party vendors in his direct testimony.

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

A. To determine the effectiveness of WETT's affiliate contract administration and project management, I conducted a series of interviews and reviewed relevant

documents, plans and reports used by WETT for project management. Based on my experience with similar projects, I reviewed three key areas to determine the effectiveness of project oversight:

- **Structure, Roles and Interfaces**. The adequacy of the structure and role definition and the interfaces and communications among key stakeholders
- **Decision-Making and Controls.** The ability for project management to establish an overall governance that supports making cost and schedule decisions in a timely manner to meet project objectives.
- **Performance Management and Monitoring.** The adequacy of project management processes for monitoring progress and performance and initiation of corrective action when required.

Q. WHAT SPECIFIC CRITERIA DID YOU UTILIZE IN ESTABLISHING THE FRAMEWORK FOR YOUR ANALYSIS?

A. I used several discrete criteria based on my experience and expertise:

- Is the overall project management philosophy adequate?
- Are project management plans 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 the level of specificity demonstrated within planning documents appropriate?
- 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 alternative contractors comprehensive?
- Are roles clearly defined between WETT and its subcontractors?

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

1. STRUCTURE, ROLES AND INTERFACES

Q. PLEASE DESCRIBE THE ROLE OF WETT IN OVERALL PROJECT MANAGEMENT.

A. My review revealed that WETT is actively engaged in project management, including planning, oversight, and execution. WETT's philosophy related to project management is based on: 1) outsourcing activities to outside contractors or affiliates, thereby leveraging their expertise and scale; 2) collaborating closely with I-USA on EPC work to assure timely and cost-effective execution; and 3) overseeing I-USA's management of subcontractors. The Company has hired SAIC, an outside consulting firm, to act as an advisor to the affiliate project management process.

The Company has been actively involved since the project planning phase. In collaboration with I-USA, WETT formulated the technical requirements for the engineering, procurement, and construction of the CREZ projects. WETT worked closely with I-USA to develop an integrated project schedule, which is used to track project progress against concrete milestones and deadlines. Further, WETT is continuously engaged in the detailed monitoring and review of I-USA execution activities including detailed design, engineering, procurement, and construction.

I-USA manages all the primary contractors engaged in the execution of the CREZ project. WETT has established an effective interface and communication plan for reporting with I-USA, as well as subcontractors hired to assist with right-of-way,

permitting and regulatory filing. Reporting occurs via regular meetings to provide updates on project progress. These meetings cover all functional areas, such as finance and accounting, permitting, engineering, construction planning, and project execution. The information discussed at these meetings is further reviewed during WETT's monthly Board of Managers meeting.

In addition to I-USA, WETT has hired other subcontractors to assist with, among other things, right-of-way acquisitions, environmental permitting and regulatory filings that are within WETT's scope of work. The progress of land acquisition and permitting is closely monitored and a requirements matrix was created to show progress and tasks to be completed. These details are further addressed in the direct testimony of Mr. Ballard. The primary project interfaces, focus areas and frequency are shown in Figure 18 below.

Figure 18– WETT and I-USA Interface and Touch Points

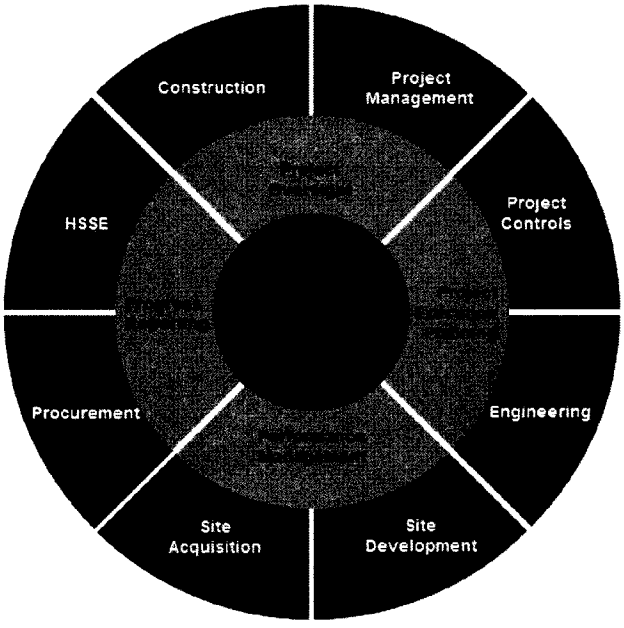
WETT	Focus Area	Frequency	I-USA
General Manager	Overall Project Performance	Monthly formal meeting	General Manager
Program Director	Operational Issues related to project progress and performance	Monthly formal meeting	Operations Director
Program Director	Procurement: supply chain issues, material shipment, vendor management	Informal weekly or daily discussions, monthly formal meetings	Procurement Manager
Controller	Finance and Accounting, such as, Invoices and Cash Management	Monthly formal meeting	CFO
Project Manager CCN1, CCN2, and CCN3	Planning, Scheduling & Managing Construction Contractors	Weekly formal meeting	Planning & Construction Manager
Contracts Manager	Contractual Issues: (Change Orders, Claims and Equitable Adjustments)	Informal daily discussions, monthly formal meetings	Contract Manager
Controller	Cost Control, Invoicing and Reporting	Informal weekly discussions, monthly formal meetings	Project Controls Manager
HSSE Manager	HSSE	Weekly meeting	HSSE Manager
Project Manager CCN1, CCN2, and CCN3	Quality Assurance/Quality Control	Informal weekly discussions, monthly formal meetings	QA/QC Manager
Engineering Manager	Engineering functions: design reviews, design changes	Informal weekly discussions, monthly formal meetings	Engineering Manager
Field Monitors (Construction, Safety)	Field construction activities	Daily meetings	Construction Manager

WETT is solely accountable for decision-making for developing the CREZ project. However, WETT collaborates with I-USA for day-to-day project management activities. The Company oversees I-USA and the progress of the EPC

work on the transmission lines and substations through daily, weekly, and monthly status meetings. WETT reviews periodic progress reports compiled by I-USA and other contractors and monitors individual contractor progress as well as overall project progress. WETT also reviews and approves the subcontractors that I-USA hires for different parts of the EPC work.

The Company relies on the expertise of SAIC to provide third party independent review and evaluation of the progress reports to complement the review of WETT's project management staff and the advice from its Board of Managers. With respect to project delivery, the Asset Management Director plays the most influential and pivotal role. While specific details are provided in Mr. Ballard's direct testimony, the Asset Management Director is involved in all functions and oversight aspects of the project.

Figure 19- WETT Asset Management Director's Role



As project cost, scheduling, and engineering activities progress during construction, WETT will likely continue to leverage the expertise and capacity of its affiliates and third-party entities. WETT continues to evaluate the need for additional personnel in its own organization to maintain adequate project involvement for extended periods, thus providing continuity within the related control functions.

Q. PLEASE DESCRIBE THE ROLE OF SAIC IN EPC PROJECT MANAGEMENT.

A. WETT hired SAIC to act as an independent adviser and evaluator leveraging SAIC's broad expertise with similar projects. Whereas I was retained to review WETT's affiliate interactions and management processes retrospectively, SAIC was retained to provide real-time, independent advice and evaluation during the development of WETT's affiliate transactions. SAIC provides its advice based on its experience in similar projects and its knowledge of standard industry practices observed in the market place for similar projects across the country. As further outlined in the direct testimony of Mr. Pullin, SAIC was tasked with:

- Providing guidance and advice on decisions
- Organizing aspects of the project
- Providing guidance on EPC selection
- Monitoring construction
- Opining on prudence of decisions at the request of the Board of Managers

Accordingly, SAIC advises WETT management and project management staff on project activities to ensure that decisions made and actions taken by WETT are

appropriate, reasonable and prudent. While WETT's project management staff is engaged in continuous review of the I-USA's project activities and related project management, SAIC provides periodic observations and support based, in part, on its experience in transmission and distribution (T&D) projects, particularly as it relates to EPC-driven projects.

SAIC was heavily involved in advising WETT during the project planning phase. It assisted WETT in compiling the technical requirements for the EPC contract, formulating the EPC contracting strategy, structuring the EPC Contract, and drafting an integrated project schedule.

SAIC is also responsible for advising WETT on change orders and Equivalent Adjustment Events and their implication for overall project execution, as well as providing guidance on contract management as it relates to the EPC. WETT communicates with SAIC through established channels of communication which includes daily project activity meetings, weekly and monthly project status and update meetings, as well detailed project status updates. SAIC also periodically attends the monthly meetings of the WETT Board of Managers at WETT's request. In addition, at WETT's request, SAIC attends formal meetings between WETT and I-USA, which occur on a monthly basis, and other informal meetings which are held regularly.

SAIC staff report and interact most directly with WETT's General Manager, Asset Management Director, and Contract Manager. A clear reporting structure has been created by WETT to assure effective communication, with multiple WETT interfaces in place to ensure consistent dialogue and accountability.

The Company engages with SAIC on a continual basis regarding EPC oversight. SAIC advises WETT on any future change orders and their potential impact on overall project completion. In addition, SAIC continues to act as a formal adviser evaluating the prudence and reasonableness of project management. The direct testimony of Mr. Pullin is included in WETT's application in this proceeding and further describes SAIC's role.

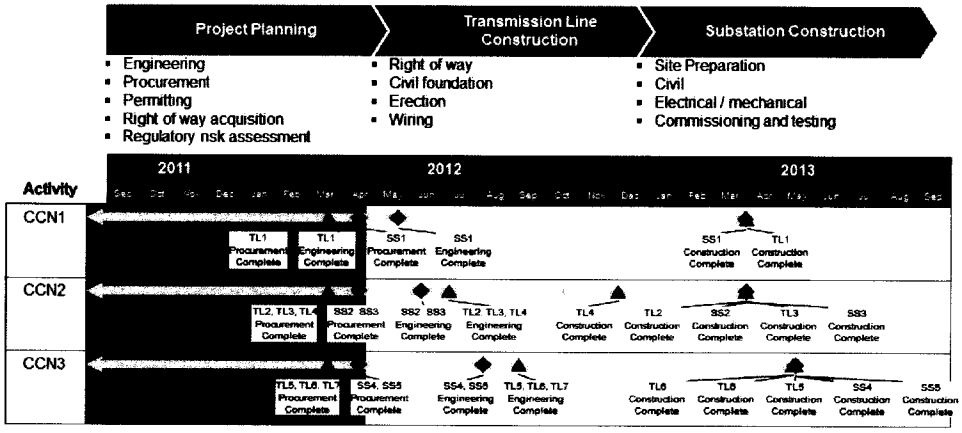
Q. PLEASE DESCRIBE WETT'S STRUCTURE FOR PROJECT OVERSIGHT ACTIVITIES.

A. WETT is responsible for overseeing EPC and project progress. Based on my review, WETT is actively engaged in overseeing project progress, with the support of SAIC, and continually interfaces with I-USA regarding project progress at all levels of the project organization. A well-defined reporting structure and information requirements have been put in place in the interface and communication plan and reporting roles and responsibilities have also been clearly articulated and defined. Exhibit TJF-2 outlines the project structure, roles, and responsibilities.

WETT interfaces with I-USA at various levels of the organization from leadership to functional interactions. These interfaces are conducted both through formal and informal channels. Formal meetings are more common with operational issues that have a high impact on project progress and performance relative to schedules and budget baselines. Day-to-day oversight is conducted through field monitors that are present in the field to observe construction-related activities. WETT assures proper oversight by working closely with I-USA, as well as with certain contractors for specific scope of work for right-of-way, permitting and

regulatory planning matters. The parameters of how WETT approaches project planning, oversight and management are contained within the Communications Plan that is part of WETT's project management framework. Periodic meetings are held with I-USA to review project progress and potential issues. EPC progress is assessed based on concrete milestones and deadlines across several key areas. The figure below provides an overview of the strategic and tactical project aspects monitored currently, as well as the key milestones and associated dates currently anticipated by WETT project management over the three phases that I-USA will execute.

Figure 20– Project Milestones Overview



Note: 1) The Green area represents actual completion months as the precise day was not ascertainable
2) Triangles are Transmission Milestones. Diamonds are Substation Milestones. Orange is a completion of Engineering. Blue is a completion of Procurement. Red is a completion of Construction
3) "Complete" means substantial completion. Work remains for the months before energization
Source: WETT Progress Reports, Discussions with WETT Management; Booz & Company analysis

WETT utilizes a variety of mechanisms to facilitate the execution of its affiliate project management responsibilities during pre-construction and currently during construction. These mechanisms include formal project plans, reports, and meetings, in addition to the informal coordination and communication provided by the relationships maintained between I-USA and its contractors. The execution of

these mechanisms is critical to the success of WETT in accomplishing its objectives with respect to project management.

WETT resources dedicated to project management have prior relevant experience and operate within clearly defined responsibilities with the General Manager, Asset Management Director, and Contracts Manager having direct responsibility for managing the project. As the project has matured, moving from planning to construction, the number of project personnel has increased to meet the evolving needs of the project. WETT intends to adhere to its plans to retain its lean staffing model, with additional staff, such as, construction monitors hired as contract employees. WETT's personnel plan continues to leverage the outsourcing model and complements the level and depth of internal experience in these activity areas. As an example, responsibilities related to owner's engineering and environmental compliance and GIS mapping are outsourced to third-party firms with oversight from WETT. Continuity on the project is acknowledged to be important and is maintained by establishing control and oversight mechanisms and by following a consistent philosophy.

Q. WHAT ARE YOUR CONCLUSIONS REGARDING THE STRUCTURE, ROLES AND INTERFACES OF WETT'S PROJECT MANAGEMENT OVERSIGHT?

A. Based on my review, I believe that WETT's project oversight structure and the related roles have provided an effective means by which to monitor the activities undertaken by I-USA and the sub-contractors to-date. This oversight model, and its inherent roles and responsibilities, defines and aligns the discipline and functional

interfaces across various levels within the project organization. WETT leverages this project responsibility and oversight structure to ensure the adequacy of project management from a senior strategic level to a more tactical functional level, as well as to provide a means by which to maintain high project visibility and involvement. WETT utilizes a variety of reporting, interface and communication mechanisms to facilitate the execution of its project management responsibilities. These mechanisms include defined project plans, recurring reports, formal and informal meetings, and specific project control systems. Combining these elements with the independent evaluation and advisory activities from SAIC, WETT has developed, implemented and maintained an effective project management oversight structure to ensure that reasonable and prudent decisions are made.

2. DECISON-MAKING AND CONTROLS

Q. PLEASE DESCRIBE YOUR ASSESSMENT OF WETT'S PROJECT INVOLVEMENT.

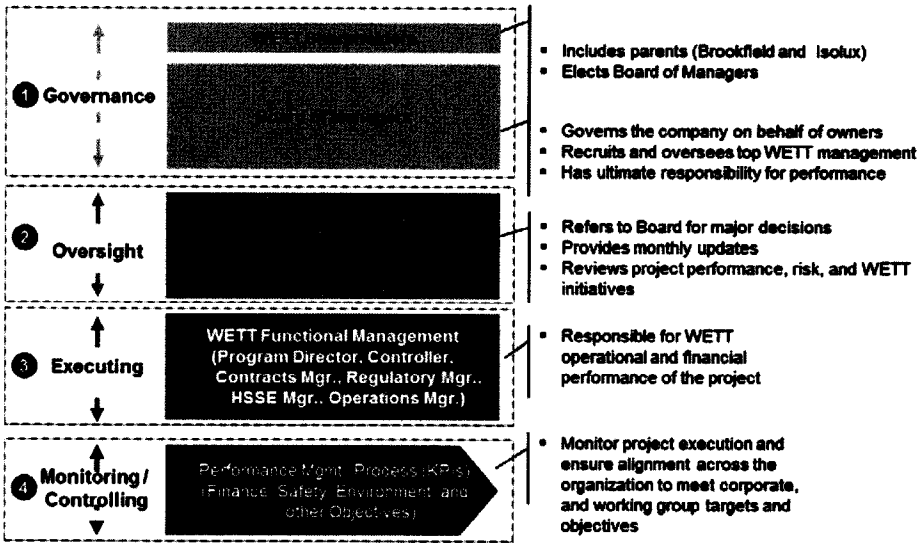
A. To assess the adequacy of WETT's project involvement, I reviewed relevant documents and conducted a series of interviews to determine WETT's overall governance structure, its role and level of engagement in decision-making oversight and project oversight.

Effective deployment of project governance is regarded as fundamental to maximize performance value and manage risk. In designing the right governance structure WETT has assessed its organizational capability and developed processes and mechanisms to provide clarity around accountabilities. WETT has adopted a multi-layer governance framework with the Board of Managers acting on behalf of the ultimate parent owners and ultimately responsible for overseeing WETT's

project performance. The day-to-day operations and overall project oversight rests with the General Manager, details of which are provided in Mr. Morton's direct testimony. WETT's project execution is conducted by WETT's functional management, which includes the Asset Management Director, Controller, Project Contracts Manager, Regulatory Manager, Operations Manager, and HSSE Manager. This functional management is responsible for managing the processes and monitoring the key performance indicators.

WETT has developed a comprehensive set of key performance indicators (KPIs) to monitor and control business performance. These KPIs link overall WETT performance targets with project objectives and also ultimately with individual performance. For the year 2012, WETT has a set of KPIs in connection with several high impact business objectives. For example, WETT CCN1 which is Cottonwood substation and Cottonwood-Dermott transmission line are scheduled to be in commercial operation by December 20, 2012 milestone date. WETT's KPIs are set on a 1-5 scale with the highest score obtained if WETT is able to complete CCN1 ahead of schedule by December 1, 2012 and a lower score is obtained if there are schedule delays beyond the target milestone date. Using these KPIs WETT plans to continuously drive towards project completion within schedule, subject to anticipated schedule revisions I discussed above. Figure 21 below illustrates the overall governance hierarchy.

Figure 21- WETT Governance Structure



I have found that the Company has been actively engaged in decision making and project oversight in every aspect of the project, from the pre-planning phase through direct execution, which to-date includes all aspects of project management and execution covering project planning, design and engineering, procurement, and construction. WETT retained SAIC to provide guidance on project controls and integrated a number of I-USA personnel into the project organization to complement its resources. WETT was advised by SAIC on multiple issues ranging from compiling a project schedule to formulating the technical requirements for the project.

Through the early stages of the project, cost and schedule estimating and control responsibilities have been centralized and WETT and I-USA have consolidated various budgeting, cost estimating, engineering, scheduling, and cost administration activities to enhance role clarity and execution effectiveness. Further, since the EPC Contract is an open book contract, WETT has access and visibility to all relevant information developed or received by I-USA or any

subcontractor relating to costs incurred by the project (e.g., cost estimates, vendor bids, target prices, optimizations, schedule, scheduling information, rate schedules, rate buildups, including profit margins, overheads, and per diems, etc.).

Within WETT, decision rights are clearly articulated and understood given the small scale of the organization and the manner in which project responsibilities are aligned. Clear understanding is also established on issue identification, escalation, and resolution of issues through the WETT organization. WETT has developed an authorization policy document approved by the Board of Managers that explains the rules related to decision-making and establishes the personnel or positions authorized to make decisions around contractual commitments, procurements and change orders.

As I have said, WETT holds daily, weekly, and monthly update meetings with I-USA and other contractors to monitor project execution with a focus directed towards formalized exchange and discussion of project progress and performance related information. These meetings are conducted for specific functions and on a project-wide basis and bring together the key management resources of WETT, I-USA, and SAIC as well as other specific vendors or contractors, as required. These formal mechanisms enable WETT to engage in detailed project review and assessment with I-USA and SAIC. These interfaces are also used to identify potential project issues and options that will require WETT evaluation and provide the bases for effective project related decision-making.

These mechanisms—and the related processes through which such mechanisms are maintained and utilized—provide an effective means of

communicating information to and from WETT and I-USA and for required decision-making.

Q. PLEASE DISCUSS WETT'S CHANGE ORDER APPROVAL PROCESS

A. As a part of the EPC Contract WETT requires I-USA to obtain advanced approval for changes in project scope that result in a change in project budget. Depending on the magnitude and material impact of these changes, WETT may need to request additional approval from its lenders. To execute the change order requirements as specified in the EPC contract, WETT requires I-USA to first provide all the required deliverables: revised schedule, budget and engineering design documents. As part of the change order approval process, these documents are approved by designated WETT personnel and the overall change order package has to be finally approved and executed by WETT's General Manager in accordance with the authorization policy document. To approve the change orders, WETT develops the scope of the change and then conducts reviews of the design, schedule, bill of materials, and cost. The impact of these changes is evaluated relative to WETT's baseline schedule and budgets commitments. To date, WETT has executed two change orders as described in Figure 22 and are in the process of negotiating several other small changes that may be combined into one change order.

Figure 22- Executed Change Orders

Change Order No	Description of change	Effective Date	Rationale	Impact
1	Non-CREZ project to add Faraday switching station; increase in EPC Contract by $7,992,144	Dec 30, 2011	To accommodate an ERCOT approved secondary power source for Oncor via the WETT grid	Increase in project cost by $7,992,144 net No impact on original contract dates
2	Increase due to monopoles is $44,310,975; savings due to reduction in EPC costs by $22,769,302 resulting in a net increase of $21,541,672	Dec 30, 2011	Comply with CCN final orders' requirements, routing and due to landowner related issues	Net increase in project costs by $21,541,672 No impact on schedule for CCN1

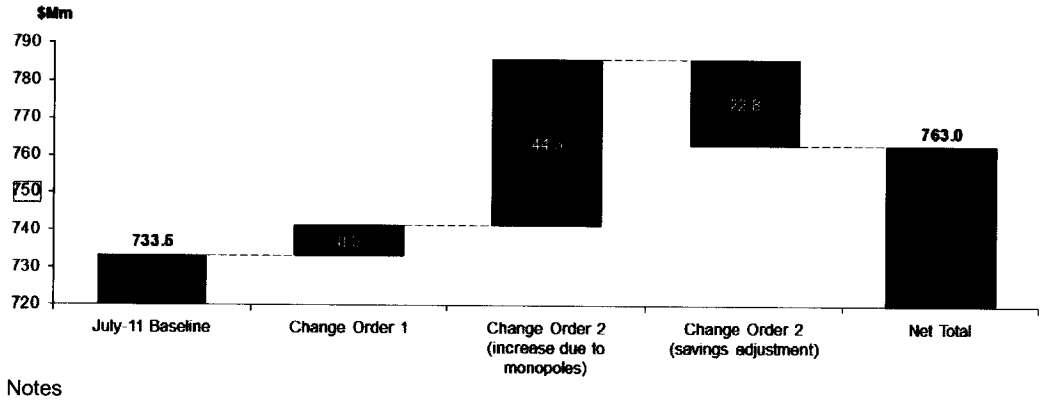
Change Order 2 work is nearing completion, however, due to special site and routing conditions, continued design engineering is required which will most likely result in a follow-on change order to cover the additional costs.

In addition, WETT and I-USA are continually monitoring construction and tracking performance execution. As execution issues arise, WETT evaluates whether these challenges may result in any potential cost and schedule changes. At the time my testimony was prepared, WETT was evaluating a potential modification to the project cost and schedule to reflect coordination of project segment completion with other CREZ participants, contractor execution, and optimization of the remaining line segment construction schedule.

In summary, as shown in Figure 23, the baseline budget was developed in July 2011. Since July 2011 WETT has executed two change orders. Change Order 1 resulted in an increase in EPC budget and Change Order 2 also resulted in a net

increase in EPC budget due to addition of monopoles and a from reduction of overall EPC costs.

Figure 23 - Project Budget Adjustments



Notes

- Effective December 30, 2011 – Change Order #1 for Faraday added $7.99 million
- Effective December 30, 2011– Change Order #2 for monopoles added net of $21.54 million.
- Change Order #2 includes $44.3 million increase due to addition of monopoles and savings of $22.77 million in EPC costs

Source: WETT Internal Budget Reports

Q. PLEASE DEFINE THE EPC CONTRACT PROVISION FOR AN EQUITABLE ADJUSTMENT EVENT

A. An Equitable Adjustment Event relates to changes in the maximum EPC Contract amount, Maximum Phase Amount, or the critical path established in the project schedule requested by WETT. As described in the EPC Contract, an Equitable Adjustment Event can only be initiated under specific circumstances, e.g., change in law, failure of WETT (as owner) to fulfill its contractual obligations in a timely manner, force majeure, inability to provide adequate site access to the EPC contractor. On authorization of an Equitable Adjustment Event, the EPC contractor is not held in default or is liable for delay or failure in performing its obligations. Changes related to Equitable Adjustment Event are distinct from WETT initiated changes to the work scope which are authorized and executed under the Change