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IDAHO PUBLIC
UTILITIES COMMISSION

Chas. F. McDevitt
Dean J. (Joe) Miller

February 17, 2012

Via Hand Delivery

Jean Jewell, Secretary
Idaho Public Utilities Commission
472 W. Washington St.
Boise, Idaho 83720

**Re: Case No IPC-E-12-02
Hoku Materials, Inc.**

Dear Ms. Jewell:

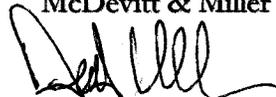
Enclosed for filing are an original and nine (9) copies of the Direct Testimony of Scott Paul in Support of Settlement Stipulation. A copy of the Direct Testimony has been designated as the "Reporter's Copy." In addition, a disk containing MS Word version of the Direct Testimony is enclosed for the Reporter.

If you have any questions, please do not hesitate to contact me.

Kindly return a stamped copy.

Very Truly Yours,

McDevitt & Miller LLP



Dean J. Miller

DJM/hh

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IDAHO PUBLIC
UTILITIES COMMISSION

Attorneys for Hoku Materials, Inc.

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

**IN THE MATTER OF THE PETITION OF
HOKU MATERIALS, INC. FOR
REPARATIONS AND REFORMATION
OF ITS AMENDED SPECIAL
CONTRACT WITH IDAHO POWER
COMPANY**

Case No. IPC-E-12-02

DIRECT TESTIMONY OF SCOTT PAUL

IN SUPPORT OF SETTLEMENT STIPULATION

11/19/10

1 Q. Please state your name and business address.

2 A. My name is Scott Paul and my business address is One Hoku Way, Pocatello, Idaho
3 83204.

4 Q. By whom are you employed and in what capacity?

5 A. I am employed by Hoku Corporation, as its Chief Executive Officer (“CEO”).

6 Q. Please describe your duties and responsibilities as CEO of Hoku Corporation.

7 A. I am the principal executive officer for Hoku Corporation and its subsidiary companies,
8 including Hoku Materials, Inc. (“Hoku”). I report to Hoku Corporation’s board of
9 directors, of which I am one of seven members. I also serve as a director of each
10 subsidiary company, including Hoku. My primary responsibility is to manage the
11 operations of Hoku Corporation, and to work closely with the management team of each
12 subsidiary company to ensure that the companies are executing within the operating plan
13 and budget approved by the board of directors. My direct reports include our principal
14 financial and accounting officer, human resources, the president of Hoku Corporation,
15 and the president of each of our two primary operating companies: Hoku Materials and
16 Hoku Solar.

17 Q. Have Hoku, Idaho Power Company (“Idaho Power”) and the Commission Staff entered
18 into a Stipulation resolving all the pending issues in this proceeding?

19 A. Yes they have, and the Settlement Stipulation is being filed with the Commission at the
20 same time as this testimony.

21 Q. What is the purpose of your testimony in this matter?

22 A. I will first describe Hoku’s business operations and the existing agreement for electric
23 service between Hoku and Idaho Power. I will then describe the circumstances that made

1 it necessary to Hoku to initiate this proceeding by the filing of the Complaint for Contract
2 Reformation. I will then discuss the key features of the Settlement Stipulation. Finally, I
3 will urge the Commission to approve the Settlement Stipulation without change or
4 condition.

5 Q. Please describe the manufacturing facility that Hoku is constructing at Pocatello, Idaho.

6 A. Hoku is constructing a manufacturing facility at Pocatello for the purpose of
7 manufacturing, marketing and selling polysilicon to the solar industry. Construction
8 began in 2007, and in 2010, we successfully completed our first production
9 demonstration. When fully operational, our designed production output will be 4,000
10 metric tons per annum, which would enable the production of approximately 500
11 megawatts of photovoltaic, or PV, modules each year. We have pre-engineered and
12 constructed our plant infrastructure to support further expansion to 8,000 metric tons per
13 year, or one gigawatt of PV modules. To date, we have invested more than \$600 million
14 in the engineering, construction, and operation of our plant. We plan to commence
15 operations in 2012.

16 Q. Has Hoku paid for the cost of constructing necessary substation and transmission lines to
17 serve the facility?

18 A. Yes. Hoku has paid to Idaho Power the entire cost of constructing facilities to serve
19 Hoku's load. In September of 2008, Hoku and Idaho Power entered into an agreement
20 whereby Hoku agreed to pay the entire cost of constructing approximately six miles of
21 138,000 volt overhead transmission, a new 138,000-13,800 volt substation to supply up
22 to 82 MWs with two 67 MVA transformers. Hoku also paid for required additional

1 facilities at other Idaho Power existing substations. Hoku has fully performed that
2 agreement and has paid to Idaho Power \$18,049,182 for construction of the facilities.

3 Q. Please describe the expected electric power usage of the facility when it is fully
4 operational.

5 A. The conversion of silicon to polysilicon is extremely energy intensive and is
6 accomplished through the use of large electric power reactors. When fully operational,
7 the expected monthly demand will be approximately 82,000 KW. When fully
8 operational, it is expected that the Hoku facility will produce approximately \$35.9 million
9 per year of revenue to Idaho Power.

10 Q. Because of the expected level of electric power demand, was it necessary for Hoku and
11 Idaho Power to enter into a special contract for electric service?

12 A. Yes. The expected level of electric power demand exceeds that contemplated by Idaho
13 Power's Tariff Schedule 19, and therefore a special contract was required.

14 Q. Please briefly describe the background of the agreement entered into by Hoku and Idaho
15 Power.

16 A. On September 17, 2008, Hoku and Idaho Power entered into an Agreement for Electric
17 Service for the supply of electric power and energy to the Facility. On June 19, 2009,
18 Hoku and Idaho Power entered into an Amended and Re-stated Agreement for Electric
19 Service ("AESAs") which superseded and replaced the September 17, 2008, Agreement
20 for Electric Service. On July 24, 2009, the Commission entered Order No. 30869, Case
21 No. IPC-E-08-21 approving the AESAs. A true copy of the AESAs is attached to the
22 Settlement Stipulation.

23 Q. Please describe the portions of the AESAs that are relevant to this proceeding.

1 A. Pursuant to the AESA, Hoku's demand and energy requirements are divided into two
2 segments for pricing purposes, referred to as the First Block and Second Block. The
3 AESA defines First Block Contract Demand as the number of kilowatts Idaho Power has
4 agreed to make available as listed in Section 6 of the AESA. These amounts are fixed by
5 month in the AESA. First Block Energy is the number of kilowatt hours determined by
6 multiplying the First Block Contract Demand by the number of hours in the billing
7 period, multiplied by the Contract Load Factor. Under the AESA, commencing in April
8 of 2011, Hoku became obligated by the terms of the AESA to pay the First Block
9 Demand and Energy Charges regardless of whether it actually consumed demand or
10 energy. This feature of the AESA has been referred to as a "take or pay" obligation.

11 Q. Were there circumstances that made it impossible for Hoku to begin consuming the
12 expected level of demand and energy in April of 2011?

13 A. Yes. As I explained in my Affidavit in Case No. IPC-E-11-28, in 2011, the spot market
14 price for solar-grade polysilicon, the product to be manufactured by Hoku Materials,
15 dropped below \$30 per kilogram, its lowest point in recent memory. When Hoku
16 Materials entered the polysilicon business in 2006, the spot market price for polysilicon
17 was approximately \$200 per kilogram, customers were signing 10-year fixed price
18 contracts, and industry analysts were forecasting robust demand in the years to come. In
19 2008, market prices climbed even higher, in some cases exceeding \$500 per kilogram.
20 The high demand for polysilicon led to unprecedented increases in polysilicon production
21 capacity from incumbent and new producers; and, in the second half of 2011, supply
22 began to exceed demand by an extraordinarily wide margin. What was expected to be a
23 short-term glut has turned into a prolonged downward cycle in the market, with today's

1 prices falling below the industry's average production costs. This is expected to continue
2 for at least the next six months, until the excess inventory is consumed by the
3 downstream solar cell market. In the meantime, to mitigate losses, many polysilicon
4 plants around the world are reducing their production output or idling plants. This
5 market situation was not generally foreseen by industry analysts, and is not within the
6 control of Hoku Materials.

7 Q. Did the take or pay provision of the AESA create financial burdens for Hoku?

8 A. Yes, in an extreme way. The First Block Energy charge is Hoku's largest single operating
9 expense. Hoku became obligated to pay the First Block Demand and Energy charges in
10 April, 2011. Hoku was not physically interconnected to the Idaho Power system in April,
11 2011, and did not become interconnected until November, 2011. Between April and
12 November, Hoku paid to Idaho Power Company a total of \$11,572,211 for First Block
13 Demand and Energy minimum charges; despite the fact Hoku did not consume any
14 energy. In November, December and January, after Hoku was physically interconnected,
15 its actual energy consumption was at a minimal level, but Hoku remained obligated to
16 pay contractual minimums under the take or pay provision.

17 Q. Please describe the circumstances that lead to the filing of the Complaint for Contract
18 Reformation in this proceeding.

19 A. Idaho Power's invoice to Hoku for service in November, 2011 was in the approximate
20 amount of \$1.8 million and Hoku did not have sufficient funds on hand to pay the invoice
21 when it became due. Hoku communicated this concern to Idaho Power, and Idaho Power
22 issued a Notice of Termination of Service. In response, Hoku filed a Complaint
23 Contesting Termination of Service on December 29, 2011, Case No. IPC-E-11-28.

1 Q. Please describe the subsequent activity in Case No. IPC-E-11-28.

2 A. With the consent of the parties, the Commission adopted an expedited schedule for
3 consideration of the Complaint and set an Oral Argument for January 11, 2012, after
4 giving the parties the opportunity for written submissions. While Case No. IPC-E-11-28
5 was pending, Hoku filed the Complaint for Contract Reformation in this case. On
6 January 13, 2012, the Commission issued its Final Order No. 32437 in the IPC-E-11-28
7 case, requiring that Hoku make payments for the November and December invoices.
8 Hoku subsequently made those payments, as required.

9 Q. Are there portions of Order No. 32437 that are relevant to this case?

10 A. Yes. The Order provided:

11 We also direct Idaho Power and Hoku to immediately enter into negotiations
12 regarding Hoku's Petition to reform the amended special contract. Staff counsel
13 shall facilitate the negotiation in an effort to determine whether the parties can
14 settle the issue in Hoku's reformation petition. Without deciding the issue, we
15 advise the parties that waiver of the first block energy charge beginning with the
16 January 2012 bill should be part of their negotiations. Order No. 32437, Pg. 11.

17 The Order also required Staff Counsel to provide a progress report by February 1, 2012.

18 Q. Did Hoku, Idaho Power and the Commission Staff comply with this directive?

19 A. Yes. Between January 23, 2012 and February 1, 2012 the parties met on four occasions
20 in an effort to reach a settlement. A final meeting was held on February 2, 2012 as a
21 result of which the parties reached an agreement in principle on terms that are now
22 incorporated into the written Settlement Stipulation.

23 Q. Please describe the negotiation process between the parties.

1 A. In my opinion the negotiation process was conducted efficiently, and in a professional
2 way. Each party was candid in identifying issues of importance from their perspective,
3 but at the same time each party was willing to consider the needs and desires of the
4 several stakeholders, including the ratepayers.

5 Q. Please describe the key features of the Settlement Stipulation from Hoku's perspective.

6 A. Paragraphs 6.1 through 6.6 of the Settlement Stipulation set forth terms upon which the
7 AESA will be reformed. In summary, those provisions are:

8 1. Between January 1, 2012 to June 30, 2013 (18 months) (the "Deferral Period")the
9 monthly Billed Minimum Energy charge will be reduced to \$800,000 to be
10 applied to the current First Block Energy charges plus the current First Block and
11 Second Block Demand charges.

12 2. On July 1, 2013 there will be a return to existing contract payment structure
13 (minimum approx. \$2 million per month).

14 3. To cover the cost difference between the current contract's Minimum Billed
15 Energy charge and the proposed amendment to the Minimum Billed Energy
16 charge for the Deferral Period, Idaho Power shall receive a \$3.8 million extra
17 payment due upon Commission approval of the Settlement Stipulation payable to
18 Idaho Power as follows: a) Idaho Power shall immediately apply \$2 million of the
19 existing \$4 million deposit it has to the \$3.8 million extra payment. Beginning
20 with its January 2012 invoice, Hoku shall pay to Idaho Power, in addition to any
21 amounts provided for under this settlement proposal, an additional amount equal
22 to \$100,000 per month for a period of 18 months which shall be applied to the
23 remaining amounts due of the extra, one-time payment of \$3.8 million.

- 1 4. An extension of the term until December 2014 (12 month extension) with the
2 current Block 1 Energy charge being reduced to the current Block 2 Energy
3 charge (i.e. all energy charges would be at embedded cost based rates) effective
4 beginning with the January 2014 invoice for services rendered in December 2013.
- 5 5. Hoku agrees to a cap on its monthly power demand during the Deferral Period of
6 20 MWs. Prior to increasing the cap, Hoku must provide Idaho Power a firm 12-
7 month ramp-up schedule at least 6-months in advance of any change in energy
8 consumption above 20 MWs. Idaho Power would agree to provide Hoku
9 additional power above 20 MWs 30 days after receipt of any required additional
10 deposit amounts. Hoku agrees that failure to comply with the ramp schedule
11 and/or any additional deposit requirements as a result of Hoku's request for
12 additional energy relieves Idaho Power of the obligation to provide Hoku with the
13 additional power requested.

14 Q. Are these provisions agreeable to Hoku?

15 A. Yes. In the end, I feel that we negotiated a solution that addressed Hoku's primary
16 concerns of obtaining relief from the near-term cash flow burden while staying connected
17 to the grid and maintaining flexibility to ramp-up production as the market conditions
18 improve. Hoku also understood that a re-structuring of the AESA would require that
19 Idaho Power and other ratepayers be held harmless and I believe the settlement terms
20 accomplish that objective.

21 Q. If the Settlement Stipulation is approved will Hoku work cooperatively with Idaho Power
22 to prepare and submit to the Commission a Second Amended and Restated Electric
23 Service Agreement containing terms consistent with the Settlement Stipulation?

1 A. Yes. Hoku will devote the effort necessary to prepare and submit an amended agreement
2 within thirty (30) days of the Commission's Final Order.

3 Q. As part of the Stipulation Agreement, is Hoku waiving any claim for reparations relating
4 to prior payments?

5 A. Yes. In consideration of the other terms of the Settlement Stipulation, Hoku is willing to
6 waive any claim for reparations. Hoku also agrees that upon submission of an amended
7 agreement its Complaint may be dismissed.

8 Q. Has Hoku made the payment required by paragraph 6.1 of the Settlement Stipulation?

9 A. Yes. On today's date, the first payment of \$932,000 was wire transferred to Idaho
10 Power.

11 Q. Do you believe the Commission should approve the Settlement Stipulation?

12 A. Yes. For the reasons discussed above, Hoku urges prompt approval of the Settlement
13 Stipulation without condition or modification.

14 Q. Do you have any concluding observations?

15 A. Yes. Hoku wishes to express its appreciation to the Commission Staff for its effort in
16 facilitating a settlement. I believe the guidance provided by Staff allowed the parties to
17 reach a compromise that takes into account the interests of all concerned.

18 Q. Does that conclude your testimony?

19 A. Yes it does.
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23