BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

In the Matter of the Application of The Nevada Hydro Company for a Certificate of Public Convenience and Necessity for the Talega-Escondido/Valley-Serrano 500 kV Interconnect.	)	Application 10-07-001 (Filed July 6, 2010)

Direct Testimony of E. Scott Medla

on behalf of

The Nevada Hydro Company

November 30, 2010

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on behalf of The Nevada Hydro Company

Q. Please state your name, title, and business address.

A. My name is E. Scott Medla and I am Managing Partner of TAG Energy Partners, LLC ("TAG"). TAG is located at 237 Park Avenue New York, NY 10017.

Q. Please describe your employment and other relevant experience.

A. I have been employed in the banking business since 1980 when I joined Irving Trust Company and have been involved as a specialist in power and utility banking since 1985. At Irving Trust, I was employed in the power and utilities department as a Vice President. In 1986, I became a Vice President of Citibank where I managed relationships with utility companies headquartered in the middle part of the United States. At Citibank, I participated in the syndication of billions of dollars of bank financings, securitization transactions and leases with utilities and utility holding companies. Thereafter, I joined Deutsche Bank Securities where I founded the power and utility practice and was involved in billions of dollars of financings and advisory engagements with utilities. At Deutsche Bank, I was Managing Director and Industry Head of the power and utilities practice for the Americas. After seven years at Deutsche Bank, I joined Fieldstone as a Managing Director and later joined New Harbor as a Managing Director. After a brief stint as a Managing Director in the utility group at Banc of America Securities, I became Managing Director and head of investment banking for CIT Energy where I was involved in building an investment banking practice, principally with power and utility clients. And in July, 2010 I formed TAG Energy Partners, a boutique investment bank focused on the power and utility industries. I am a graduate of Union College and Cornell University where I earned an MBA.

Q. On whose behalf are you submitting this testimony?

A. I am submitting this testimony on behalf of The Nevada Hydro Company ("TNHC").

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to discuss the financial viability of the proposed Talega-Escondido/Valley-Serrano transmission line project. The Talega-Escondido/Valley-Serrano transmission line project would create a new link between the Southern California Edison (SCE) and the San Diego Gas & Electric company's (SDG&E) electric systems. Interconnecting TE/VS to the transmission grid will require the installation of upgrades to the transmission systems of SCE and SDG&E. For purposes of this testimony, I refer to the Talega-Escondido/Valley-Serrano transmission line as the "TE/VS Interconnect." The upgrades to the systems of SCE and SDG&E are defined as the "Network Upgrades." I refer to the TE/VS Interconnect together with the associated Network Upgrades as "the Project."

Q. What services is TAG providing to TNHC?

A. TAG has been retained by TNHC to raise debt and equity to fund the remaining costs of development and then the construction of the Project. The Project will require debt and equity capital in the approximate aggregate amount of $780 million, including costs associated with financing fees, financing costs during construction and the provision for a debt service reserve. TAG has been in dialog for months with prospective investors and lenders to gather market information in support our on-going analysis of debt and equity market conditions including market depth, transaction capital structure, security, terms and conditions, financial covenants and pricing etc.

Q. How will construction of the Project be funded?

A. For purposes of calculating the revenue required to be realized by the TE/VS Interconnect, we assume the hypothetical 50%-50% debt-equity structure the Federal Energy Regulatory Commission addressed in its Rate Incentives Order.[1] For purposes of raising funding to construct the Project, we may raise equity and debt in these proportions, and we may fund a portion of that equity through the issuance of debt obligations by one or more of the equity participants.

Q. How will the Network Upgrades be financed?

A. The Network Upgrades will be financed as part of the Project. Revenue produced by the Project and costs of the Project will be part of the overall transaction.

Q. Please identify the principal issues that will impact the ability of TNHC to raise capital and state your opinions with respect to whether sufficient capital will be raised to fund the Project?

A. The following factors will impact the ability to raise capital for TEVS: credit and equity investment considerations and assumptions, overall market conditions, project finance market conditions, equity market conditions, market depth and debt financing strategy. I will address each separately below:

<u>Credit and Equity Investment Considerations and Assumptions</u>

Upon receipt of a CPCN, TNHC will become a public utility and, accordingly, will be in a position to access a very deep pool of capital available from both debt and equity sources. The capital markets have a very deep and longstanding base of experience with investment in regulated entities. Investors and lenders with this deep utility experience understand the commercial business characteristics, specialized

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[1] *See The Nevada Hydro Company, Inc.*, 122 FERC ¶ 61,272 (2008) ("Rate Incentives Order").

accounting practices and financial characteristics of businesses that operate as public utilities. This long and broad base of capital market experience with utility transactions provides additional comfort that capital will be available to the Project after it receives a CPCN.

The power transmission business has a low business risk profile. And, in the case of the Project, although there is a reliance on single asset there is no exposure to commodity prices. In addition, its assets are very long lived and have low operating risks. The project is big enough to be viewed as attractive by the market but is small enough that market capacity is more than sufficient to fund the debt and equity capital requirements. The construction period is relatively short at 24 months and the proposed principal contractor, Siemens AG, is financially strong. Revenues are premised on an assumed 13.5% allowed return on equity and a 50:50 capital structure consistent with the FERC's Rate Incentives Order.

<u>Overall Market Conditions</u>

The lending market continued to show significant improvement starting toward the end of 2009 and continuing through 2010 to date. Improvement in the economy broadly and improvement in the loan default outlook have contributed to a trend of improving market confidence. It is expected that this trend of improvement will continue through 2011 and beyond. As a consequence, total US lending volume for 2010 is up substantially on a year to year basis. In addition, the reopening of the institutional market for debt is another key indicator of improving market conditions for debt.

Project Finance Market Conditions

Lending for project finance has also improved substantially over the past 12 months and continues to strengthen. Many lenders are now looking for new loans and the market has strengthened materially since the period ending in early 2009 when project debt was difficult to source.

Equity Market Conditions

The equity markets for the power and utility industry was not as severely impacted in the recession as the debt market. It remains available for projects that have good prospects for completion, good regulated returns and with regulated revenues.

Market Depth

We estimate that the Project may require approximately $545 million of construction debt from the banks. Assuming a typical syndication with average hold positions among the banks in the amount approximate amount of $40 million, a syndicate of 14 banks will be required, a number well within the population of banks active in the US project finance market today.

Debt Financing Strategy

Improved market conditions have supported a return to the market of underwritings and best efforts syndications. An underwriting is where one or more banks provide a contractual commitment to finance a transaction prior to the date when the transaction is offered on a broad basis to the bank market. Underwritings enable a project to obtain certainty with respect to obtaining credit. A best efforts syndication is one in which a bank or banks take a deal to the market for broad syndication but without the commitment to fund if market appetite is inadequate. During the recent recession, bank market appetite was inadequate to support underwritten or best efforts syndications and, accordingly, most transactions were pursued on a club basis with each bank participating on a negotiated basis. The return of underwritings and best efforts syndications to the bank market demonstrates the significant improvement realized in the bank lending segment of the capital markets.

Based on market conditions at the time the debt is offered to the market, we will pursue a bank syndication on a best efforts or underwritten basis to obtain commitments for construction financing with a conversion at completion to a term loan.

Q. Considering the factors you identified in your last answer, and any other factors you consider material, please state your opinion regarding whether or not financing for TEVS will be available?

A. My opinion is that financing would be available to support the completion of development, and construction in a timely manner. My colleagues under my direction and I reviewed the Project and assessed its financial viability in markets for both debt and equity. Based on receipt of the CPCN and of all necessary permits and other regulatory approvals, our review of information available from public sources, information provided to us by TNHC, discussions with potential investors and lenders and, in consideration of our experience with utility financings of this type and the testimony of Mr. Drzemiecki, we have concluded that the Project is financeable from the perspective of both required debt and equity following our material assumptions that are significant to that opinion.

It is our expectation that after completion of construction we will refinance the construction loan with long term debt at operating company level and at holding company level.

Comparable Analysis

The Project will be project financed but will become a utility upon receipt of a CPCN. Our identification of comparables, therefore, is based on transaction activity arising in the project finance market but with protections consistent with its status as a utility. Due to this hybrid character, we have concluded that the Project should be priced for purposes of debt as well as equity near the bottom of the pricing range for each in current markets.

Bond Ratings

We anticipate issuance of debt to refinance construction financing in the bond markets at both operating company and holding company level. We have assumed credit ratings of BBB- at the operating company and BB+ at the holding company.

Transaction Terms and Conditions

We believe that the market structure available to the Project for construction financing will provide debt during construction in an amount sufficient to complete construction over a projected construction period of 24 months. Upon completion, the loan will convert to an amortizing term loan with a final maturity of at least five years. Nevertheless, it is our expectation that TNHC will refinance the construction loan soon after completion in the public market with a bond issue. The amortizing term loan will be retained for a protracted period only if market conditions at project completion are such that bank accommodations are more attractive than bond issuance.

We assume that bonds issued at the operating company on a senior secured basis will have an average life of 12 years and a 20 year final maturity with a coupon of 5.4% (coupon excludes upfront fees). We have assumed that the debt service coverage ratio in the operating company financing should incorporate a debt service coverage ratio of a minimum of 1.45x.

Revenue requirement

Based on our review of the revenue requirement testimony provided by Mr. Drzemiecki (demonstrating a total revenue requirement of $152,967 thousand including revenue requirements of $126,329 thousand for the TE/VS Interconnect), and assuming a 50:50 capital structure at the TE/VS Interconnect operating company level, we conclude that revenue will be sufficient to attract the required debt and equity.

Q. Are there potential investors interested in the project?

A. Yes, we have conducted an assessment of market appetite for equity investors in the Project. There are several credible investors that have demonstrated interest in providing equity capital. Investors that have demonstrated interest by signing confidentiality agreements and undertaking due diligence have included sophisticated financial investors examples of which include private equity firms, infrastructure firms and unregulated subsidiaries of public utility holding companies that do not operate as utilities in California.

Q. Would receipt of a CPCN affect the likelihood of raising capital?

A. Receipt of a CPCN is an important milestone in the development of the TE/VS Interconnect and demonstrates a substantial de-risking of the project. With a CPCN, investors will more likely spend the time, effort and development capital necessary to complete the development process and proceed to construction.

Q. Does this conclude your testimony?

A. Yes, thank you.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of

"DIRECT TESTIMONY OF E. SCOTT MEDLA ON BEHALF OF THE NEVADA HYDRO COMPANY"

on all known parties to A.10-07-001 by transmitting an electronic mail message with the document attached to each person named in the official service list who provided an electronic mail address.

Executed this 30th day of November, 2010 at Washington, D.C.

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