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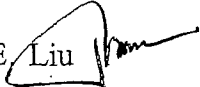
DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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November 13, 2007

TO: Aaron S. Fujioka, Administrator
State Office of Procurement

FROM: Theodore E. Liu 

SUBJECT: Requests for Proposals No. RFP-07-11-SID
Hydrogen Investment Capital Special Fund and
Renewable Hydrogen Program Management Services

This Memorandum follows our meeting and discussion of Friday, November 9, 2007.

I have reviewed your September 25, 2007, Final Review and Determinations letter on the above-captioned solicitation ("Final Review"), setting out certain corrective actions, including rescinding the selection of and award letter to H2Energy LLC; reviewing the evaluation committee (EC) evaluation memorandum dated July 31, 2007; and "if the EC's evaluation is in compliance with the applicable procurement law," issuing a new award based on said memorandum.

The purpose of this memorandum is to request (i) your confirmation of my continuing authority, as the Department's Procurement Officer, to cancel said solicitation completely under section 103D-308, Hawaii Revised Statutes, and section 3-122-95, Hawaii Administrative Rules; and (ii) your confirmation of the Department's authority to adjust, change or reduce the scope of services to be sought and provided under said solicitation.

My understanding is that the Final Review required certain actions only under the circumstances that the Procurement Officer found the solicitation still desirable and in the best interests of the State, and to assure that the selection process was proper and valid under the Hawaii Procurement Code. Although not explicitly covered in the Final Review, my understanding is that, should the Procurement Officer find that this solicitation is no longer in the best interest of the State, the entire solicitation may be cancelled.

My understanding is also that, should circumstances change in the process of such solicitation or in the process of implementing any agreement or contract resulting from a solicitation, the Department can act to reduce the scope of services solicited or delivered.

To assist you in the analysis of the above confirmations, I present two procedural and one substantive reasons why I believe that this solicitation is not in the best interest of the

State and may be cancelled. The substantive reason set forth below is also the basis of why I believe the scope of services sought or delivered may be reduced.

Flawed Procurement Process

Point 5 on page 2 of your Final Review states that DBEDT's interpretation and practice of reserving the ultimate authority in the DBEDT Director for the final selection of an offeror was inconsistent with the State Procurement Office's interpretation of the State's procurement code and rules. Prior to my Memorandum dated September 17, 2007, the Department's long-standing interpretation and practice had been that such final selection authority was the Director's.

In the subject solicitation, members of the EC conducted its deliberations and made its recommendation upon the explicit understanding and assumption that the Director would make the final selection. As you may recall, a member of the EC and DBEDT's administrative services and contracting staff testified to this effect at the hearing convened by the Senate Committee on Tourism and Government Operations on September 4, 2007 (Senate Hearing).

Subsequent to receipt of the Final Review, members of the EC have stated that if this change in assumption – that the ultimate authority for final selection resided with the EC and not the Director – had been known at the time of their deliberation, it would have impacted their decision-making in the subject solicitation. I believe the fact that the subject solicitation was based upon an erroneous basic assumption and may have rendered the entire process flawed.

It may not be in the best interest of the State to abide by the result of a flawed process.

Independence of the EC

At the Senate Hearing, the impartiality and independence of the EC was called into question. The issue was raised based on the fact that one of the EC members had been referenced in submissions by one partner of the H2 Energy LLC consortium.

Paragraph 5 on page 2 of the Final Review sets-out that after the EC has made its evaluation, the Procurement Officer is charged with reviewing "the evaluation process to determine if all EC members were fair, independent and impartial in their evaluations of the offers...." It is only after that determination has been made that the Procurement Officer can "proceed to make the award to the highest ranked proposal."

Previous hereto, I have reviewed evaluation committee recommendations using a "conflicts-of-interest" standard. Based upon the guidance of the Senate Hearing and the Final Review, I have reviewed the EC process in the subject procurement using a "fairness

and impartiality" standard. Indeed, it will be the Department's practice going forward to apply a "fairness and impartiality" standard.

On the basis of this review, I have ascertained that all three members of the EC had relationships and dealings with all three best and final offerors that rose to the level criticized at the Senate Hearing. The strongest and most direct of these relationships of the EC members is with HNEI, a partner in Kolohala consortium. Among these relationships, the most direct one is that members of the EC awarded HNEI \$800,000 for a State cost-match from the very Hydrogen Fund that is the subject of the solicitation for management. It was also understood at the time of the award that members of the EC would work with HNEI on the project that this cost-match funded.

In light of the Senate Hearing and the Final Review, I believe that these actions would constitute a relationship that may implicate the issues of independence and impartiality. The State interest may not be served by accepting the recommendation of the EC under these circumstances.

Change in Circumstances

* Unknown at the time of the subject solicitation's formulation, advertisement, or proposal evaluation, related events had been moving forward that questions if and how to continue it.

I request that you treat this issue with the strictest confidentiality, as negotiations are ongoing and the need for secrecy remains vital until the final decision is to be made in first quarter of 2008¹.

In recent weeks, Department representatives have had high-level meetings with a third party interested in renewable energy development in Hawaii. As a result of these meetings, this third party is in a decision-making process that could result in establishing an unprecedented presence in Hawaii. This decision is based on this third party's conclusion that the United States' national imperative to use renewable energy and develop a hydrogen economy should have Hawaii as its most natural center of technology and infrastructure testing and deployment.

The fact that this third party is in a decision-making process alone validates the initial assumption that if the State made a tangible commitment to a renewable hydrogen program, public and private sector funding would follow. This third party presence would bring with it, among other things, funding streams of up to \$15 million to \$20 million a year for up to five years. One of the fundamental rationales for the Hydrogen Fund was as a source of "cost match" to attract such third-party funding. DBEDT had projected an "optimistic

¹ Premature leakage of this information may cause this third party to withdraw. Several important processes, including budgetary, need to be completed, and premature discussions may imperil these.

scenario" of a resulting 10-times match of the State's initial \$10 million investment. In fact, one of the tasks of the Hydrogen Fund manager was to attract such federal funding.

However, as with almost all such third-party grants, a State "cost match" would be required. Should the presence be established in Hawaii, this third party expects that State matching moneys would come from the Hydrogen Fund. In fact, the existence of this fund is one of the factors considered by this third party for the establishment of a presence in and dedicating the federal funding streams to Hawaii.

As such, until such time as this decision-making process is completed (expected to be first quarter of 2008), it is in the State's best interest to keep the funds in the Hydrogen Fund available and unencumbered.

Request for confirmation

Based on the foregoing reasons, I would request your confirmation of my continuing authority, as the Department's Procurement Officer, to cancel the solicitation completely under section 103D-308, Hawaii Revised Statutes, and section 3-122-95, Hawaii Administrative Rules, and that, notwithstanding your Final Review, I retain the authority to cancel the solicitation entirely should such a cancellation could be found to be in the best interests of the State.

I also request your confirmation, based on the "Change in Circumstances" discussed above, of my authority to alter, change or reduce the scope of services sought or delivered pursuant to the solicitation². Such alteration, change or reduction could take place during the process of finalizing the agreement with the awarded offeror of the solicitation or after such agreement has been executed.

Thank you for your time and attention to this matter.

² The solicitation contemplates three related, but distinct, services: (i) management of a Renewable Hydrogen Program; (ii) soliciting federal or private grants, for which a cost match would be required; and (iii) making seed or private equity investments in emerging technologies. In concept, should the third party initiative come to fruition, the solicitation of grants requiring a state cost-match may be reduced from the scope of services sought or delivered.