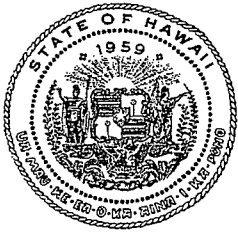


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DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Web site: www.hawaii.gov/dbedt

LINDA LINGLE
GOVERNOR
THEODORE E. LIU
DIRECTOR
MARK K. ANDERSON
DEPUTY DIRECTOR

Telephone: (808) 586-2355
Fax: (808) 586-2377

STATEMENT OF

THEODORE E. LIU

Director

Department of Business, Economic Development & Tourism

before

SENATE SPECIAL INVESTIGATORY COMMITTEE

S.R. 2

Thursday, March 13, 2008

3:00 PM

Members of the Senate Special Investigatory Committee:

As set out in S.R. 2, dated January 18, 2008, I understand the scope of this Committee to be as follows:

1. "Investigate the selection of a manager for the hydrogen investment capital special fund in 2007; and
2. "Inquire into, gather, and analyze information, including other contracts, that may provide relevant information concerning procurement improprieties relating to paragraph (1)."

I will seek to address both areas of this scope in my statement and testimony before you.

First, though, I'd like to address an issue of fundamental fairness and also the issue of certain inaccuracies and misstatements in both S.R. 2 and in Special Committee Report No. 4, also dated January 18, 2008.

As the person who is clearly the target of this Investigatory Committee, I am very concerned that the investigation conducted, the deliberations made and findings issued be the result of a process that is fundamentally fair. I believe a fundamental basis of our system of government is that investigations of a judicial or quasi-judicial nature be conducted by fair and impartial Trier and Arbiter. I am concerned this is not the case with the process I am facing.

Ever since the first time we met each other in February of 2003, the Chair of this Investigatory Committee has had a history of leveling accusations at me personally. The Chair again is the accuser in this investigation. She made the accusations, the subject of this Investigatory Committee, publicly in her Spring 2008 Newsletter and in a February 19, 2008, opinion article in the Honolulu Advertiser (both included in "Tab 1"). Setting aside the question whether the Chair had, in fact, reached a conclusion before this Investigatory Committee even commenced its work, she authored and was the sole introducer of S.R. 2, which, in a self-fulfilling manner, appointed herself as the Chair of this Committee.

Governor Linda Lingle pointed this out in her letter to the Senate President on March 6, 2008. Already, the process by which the Chair has conducted this investigation has drawn criticism by the State's Attorney General, who I point out is the chief legal officer for the entire State government, not just the Executive branch. A copy of the Attorney General's letter is attached as "Tab 2" to this testimony.

I respectfully suggest that if the Senate and this Investigatory Committee wishes to have a full and fair inquiry into and desires an independent judgment of the facts, the chief accuser in the investigation you are conducting should not also sit as the judge rendering findings on your behalf. I believe this violates principles of fundamental fairness.

Therefore, as the target of this Investigatory Committee, I respectfully request that this Investigatory Committee designate a member other than the Chair or her staff to write

and issue its findings. I believe principles of fundamental fairness require this; I believe public confidence requires this.

Related to this issue of fundamental fairness, I wish to raise certain inaccuracies and misstatements in both S.R. 2 and in Special Committee Report No. 4, both dated January 18, 2008.

S.R. 2, dated January 18, 2008:

- (1) The first "WHEREAS" on page 2 makes reference to an "evaluation committee recommendation." As testified to at the September 4, 2007, hearing by Mr. Maurice Kaya, the Chairman of said evaluation committee, and as testified to on Friday, March 7, 2008, by Mr. William Parks and Dr. John Tantlinger, the two other members of said evaluation committee, there was no recommendation by the evaluation committee. This reference is erroneous.
- (2) The second "WHEREAS" on Page 2 reference is made to H2Energy as the "lowest ranking bidder for the contract." The fact is, that there were two other bidders for the contract ranking lower than H2Energy. H2Energy was the lowest-ranked bidder in a tight competitive range emerging from the "best and final offer" round.

Special Committee Report No. 4, dated January 18, 2008:

- (1) In the second full paragraph on page 2, reference is made to an "evaluation committee's recommendation." As testified to at the September 4, 2007, hearing by Mr. Maurice Kaya, the Chairman of said evaluation committee, and as testified to on Friday, March 7, 2008, by Mr. William Parks and

Dr. John Tantlinger, the two other members of said evaluation committee, there was no recommendation by the evaluation committee. This reference is erroneous.

- (2) Point (5), page 3 of the Findings references the content of the July 31, 2007, memorandum from Mr. Maurice Kaya, Chairman of the evaluation committee, to the DBEDT Director. That memorandum did neither indicate nor contain "numerical values assigned by the evaluation committee." That memorandum, which constitutes the only formal finding of the evaluation committee as a whole, explicitly stated that the three proposers were in a "competitive range." Again, no numerical values were assigned. This reference is erroneous.
- (3) Point (6), page 3, of the Findings states "Subsequent to July 31, 2007, the DBEDT Director, at some point, expressed his dissatisfaction with the evaluation committee's ranking of the proposals." There is no evidence whatsoever of the contention of this Finding. Voluminous materials have been delivered to this Committee and the previous committee, and there exists written transcripts and video recordings of the September 4, 2007, hearing. No evidence whatsoever exists of this contention of "dissatisfaction." This reference is erroneous.
- (4) Point (8), pages 3 to 4 of the Findings misrepresents the "conflicts of interest" point in December 28, 2007, letter from the DBED Director to the Administrator of the State Procurement Office. In that letter, the DBEDT Director referred to questions of "independence and impartiality" first raised by Senator Kim at the September 4, 2007, hearing and sought clarification on its impact on the selection process. Nothing in the letter or any other communication has ever expressed any concern over members of the evaluation committee member having a "conflict of interest." These statements are misrepresentations.

- (5) Point (9), page 4, of the Findings 4 references an “admission” by the DBEDT Director of “engaging in discussions anew to negotiate a new contract ... with an unnamed third party.” This finding is again erroneous. Nowhere in the November 13, 2007, memorandum or in any related communications is there any reference to any “new negotiations” on a “new contract”. These statements are misrepresentations.
- (6) The first full paragraph on page 5 alleges that “the DBEDT Director may have manipulated the process to select H2Energy LLC.” There is no evidence whatsoever for this allegation.

It is clear that these inaccuracies and misstatements in Special Committee Report No. 4, dated January 18, 2008, formed the basis for S.R. 2, dated January 18, 2008. The establishment of a Senate Special Investigatory Committee should not be on the basis of such inaccuracies and misstatements. Should you decide to ignore these inaccuracies and misstatements, I would hope this Committee bases its findings on accurate facts and statements.

I. Special Committee scope (1): “Investigate the selection of a manager for the hydrogen investment capital special fund in 2007.”

A. Selection Process Undertaken.

With regard to the selection of a manager pursuant to the Hydrogen Investment Capital fund and Renewable Hydrogen Program Management Services request for proposals (the “RFP”), as the departmental Procurement Officer, I have consistently maintained that we followed procurement rules as we understood them to be in effect at the relevant times of the RFP. I have also consistently testified that if mistakes were made, I would take full responsibility and take corrective actions.

I believe that the testimony provided to your Committee by the Administrator of the State Procurement Office on March 6, 2008, indicates that all corrective actions have been taken.

The RFP was handled pursuant to the "competitive sealed proposals" sections of the Hawaii Administrative Rules, HAR Section 3-122-41 to Section 3-122-60 (the "Rules"). As I have consistently testified, DBEDT's interpretation of the Rules and its practice in effect for several administrations had been that, under circumstances where the departmental procurement officer convenes an independent evaluation committee to evaluate the proposals, the authority to make the final selection of the proposer is explicitly reserved in the departmental Procurement Officer. I attach my Statement to the September 4, 2007 informational hearing as "Tab 3" hereto.

On this point, you have heard consistent testimony from the departmental Administrative Services Officer and all three members of the evaluation committee that this was their assumption and their practice in the RFP. If you called all Division Administrators and Branch Chiefs in the department, you would have heard the same testimony.

In the subject RFP, this reservation of the authority to make the final selection of proposer was explicitly reserved in the DBEDT Director. This explicit reservation was acknowledged by the evaluation committee members and was contained in the RFP documents and communications to potential bidders.

In the subject RFP, the evaluation committee and the departmental Administrative Services Officer met with me on July 31, 2007, to formally report on the RFP process. The evaluation committee, as a whole, and each individual member of the evaluation committee, did not have a recommendation for the selection of a proposer whose overall technical quality

was, in their view, measurably higher than that of the other proposers. I spent a significant amount of time probing and discussing this position of the evaluation committee.

At the July 31, 2007, meeting, the evaluation committee was reluctant to even provide any numerical scoring or ranking of the best and final proposals. I spent a significant amount of time probing and discussing this position of the evaluation committee. At the insistence of Ken Kitamura, the departmental Administrative Services Officer who was present at the meeting, the evaluation committee did provide me with an "after-the-fact" evaluation committee memorandum, which I received on August 7, 2007.

In light of this result and on the basis of the department's interpretation of HAR Section 3-122-57, as the departmental procurement officer on August 6, 2007, I made the final selection of a proposer based on "best value" to the State, as required by that section. I also documented the "basis of selecting the successful offeror" as required by HAR Section 3-122-57 (a).

B. Precedence for the Selection Process Undertaken.

The Committee has asked about precedence for this process. During my tenure as Director, this is the first time an evaluation committee has not come forward with a recommendation of a selection. As such, there is no precedent that covers this situation.

The practice in effect at that time was that in all RFPs, the evaluation committee makes a formal recommendation of a selection to the Procurement Officer. The Procurement Officer must review the evaluation committee's recommended selection, including its numerical scores. Should the Procurement Officer not concur with a recommended selection of an evaluation

committee, he or she could formally reject the recommendation, as is provided for in the evaluation committee recommendation form. However, the reason for such rejection must be in writing, be based on the evaluation criteria and be included in the contract file as is required by HAR Section 3-122-57 (a).

In the subject RFP, the evaluation committee simply did not make a recommendation for the selection of a proposer. You have heard testimony verifying and substantiating this from all three members of the evaluation committee.

This is admittedly a rare occurrence when an evaluation committee does not make a recommendation. When that happens, as in the case of the RFP, presence or absence of precedence becomes less relevant.

C. Procurement Process Employed in the RFP

Your Committee has queried the role of the Strategic Industries Division (SID) and the departmental Contracts Office in the RFP. Specifically, there have been questions regarding the role of the department's Contracts Specialist in the RFP.

The release of the funds for the hydrogen investment capital fund took longer than expected. In early 2006, several legislative committee hearings sharply questioned why DBEDT was late in implementing the fund. My response and decision was to place the RFP on a high-priority track. However, the departmental Contracts Office is typically very busy and procurements are conducted on a "first-in/first-out" basis. As Ken Kitamura testified on March 6, 2008, before your Committee, to be fair to the other pending procurements, it was decided not to preempt the other "first-in/first-out" priorities.

As such, I decided that SID would take the lead in processing the RFP (drafting documents and addenda, organizing meetings, etc.) while the departmental Contracts Office would continue to be involved in a consulting role. That role included review of all of the documents and the process led by the SID team. At no time did I direct the department's Contracts Specialist to be "taken off" the assignment. I believe the email communications, copies of which this Committee has, substantiates that the department's Contracts Specialist continued to be involved in the RFP.

D. Evaluation Criteria Employed by the Procurement Officer

Much has been made of my justification, as the Procurement Officer, of H2Energy, contained in the memorandum to files, dated August 6, 2007, regarding "Renewable Hydrogen consultant/manager selection." I have consistently testified that I believed at that time that my selection was based on the more general and strategic criteria set forth in the RFP.

In my final selection of a proposer, I intentionally decided not to re-evaluate based on the specific technical criteria used by the evaluation committee members. It was clear that a competent and experienced evaluation committee had utilized that set of technical criteria and resulted in a "competitive range." The technical evaluation had been completed.

Instead, I intentionally decided to evaluate the proposers on the basis of achieving the State's strategic interests in issuing the RFP. As I testified at the September 4, 2007, hearing, my review and evaluation focused on which proposer was best positioned to deliver the results expected by the RFP. As explicitly stated in the August 6, 2007, memorandum, ***"Director's assessment and judgment was based primarily on the relative ability to deliver on the***

promises made in the proposals and the prospects of short-term positive impact on specific projects in the renewable energy and hydrogen sectors.

As I have consistently testified, I believe this more strategic criterion is based on requirements within the “four corners” of the RFP. Basis position for this includes:

- On page 4 and page 14 of the RFP, there is the express statement of DBEDT’s and the State’s overarching objective: ***“ultimate objective to maximize the prospects of a viable and growing advanced energy technology sector in Hawaii.”***
- The definition of “Quality,” one of the evaluation criteria categories, is “achieving the strategic energy needs of the State and ***the potential for near- and long-term support for private development.***”
- Page 9 of the RFP references “innovative management approaches with effective professional investment and ***technical monitoring and support...***”
- Page 13 of the RFP specifies:
 - “high degree of emphasis on innovative management approaches that are supported by or ***can access proven experience in relevant scientific and technical analysis*** and technology investments”; and
 - that ***“continued monitoring and venture support for the investment will be necessary.”***
- Page 14 of the RFP refers to “organizational structure that ***best meets the above-stated preferences and objectives, including ... venture mentoring and support ... implementation of Program-directed activities ... review, analysis and assessment of proposals ...***”
- Addendum 2 to the RFP specifies ***innovative ideas, proven experience, and scientific and technical analysis in technology investments*** to

maximize the state's ability to achieve a viable and growing advanced energy technology sector in Hawaii..."

The factors in the August 6, 2007, memorandum's H/M/L matrix, "Strength of Point of Interface (POI) with the State;" "Senior executive back-up/support for POC;" "Local resources for implementation;" "Local presence;" "Federal institutional contacts;" and "Delivery of additional capital;" were all relevant to the ability to deliver the maximum "prospects of a viable and growing advanced energy technology sector in Hawaii" and the ability to make "short-term positive impact." A copy of my August 6, 2007, memorandum is attached as "Tab 4" hereto.

I believe the foregoing criteria-employed selection justification memorandum all have a basis in the RFP. It was, however, an intentionally different emphasis than that employed by the evaluation committee.

E. Final Selection Process Time-Line

Your Committee has inquired as to the final selection timeline, including document flows. The time-line and document flows were as follows:

On July 31, 2007, the evaluation committee, together with Ken Kitamura, met with me to report on their findings. As testified by all three members of the evaluation committee, no recommendation of a final selection was made; this selection was explicitly left with the Procurement Officer.

From July 31, 2007, to August 2, 2007, I gave much thought to the final selection.

On August 3, 2007, I had a meeting with Maurice Kaya where I advised him on my preliminary decision selecting H2Energy. See email at 400572. After that meeting on August 3, 2007, Maurice Kaya instructed staff to prepare the selection memorandum and notification letters. See email at 400572.

From August 3, 2007 to August 6, 2007, I worked on-and-off on the August 6, 2007, selection justification memorandum. Because this was my decision, I personally drafted, typed and revised the memorandum.

On August 3, 2007, pursuant to Maurice Kaya's instructions, John Tantlinger sent me drafts of the notification letters and I provided comments thereon. In the same communication with John Tantlinger, I was advised that the "evaluation committee memo" was being processed and sent to me through the departmental Contracts Office. See email at 400570.

On August 5, 2007, I received comments and feedback from Maurice Kaya to my comments on the August 3, 2007, draft of the notification letters. See email at 400593.

On August 6, 2007, I received communications from John Tantlinger that the notification letters and the "evaluation committee memo" had been finalized and were being delivered to the Director's Office. See email at 400566.

On August 6, 2007, anticipating the "evaluation committee memo," I finalized and signed the August 6, 2007, selection justification memorandum.

On August 7, 2007, I received the "evaluation committee memo" from Maurice Kaya dated July 31, 2007 (attached as "Tab 5" hereto). Please note that the inter-departmental routing slip is dated 8/6/07 and references "RFP Selection Memo." I signed said RFP Selection Memo in the "Director's

Selection" line provided therein. On the inter-departmental routing slip, I directed that the original be sent back to Maurice Kaya with a copy to ASO (Ken Kitamura). My assistant, Dawn, corrected the routing to ensure that the original RFP Selection Memo was sent to ASO/Contracts.

On or about August 7, 2007, I received the final hard copies of the notification letters, dated August 10, 2007, and I signed the notification letters on August 8, 2007. Those were then routed to ASO/Contracts for processing.

Upon immediately completing the foregoing, I recall asking Eileen Harada whether the final RFP selection process had been completed. I recall her indicating that, upon my signature, that it had.

It is important to note that the key operative documents are the RFP Selection Memo and the notification letters. Once those have been executed, the RFP selection has been made. Those were signed in due course and returned to ASO/Contracts.

I believe that I attached the August 6, 2007, selection justification memorandum to the RFP Selection Memo, dated July 31, 2007. Regardless, the original of the August 6, 2007, selection justification memorandum was kept in my own working file.

II. Special Committee scope (2): Inquire into, gather, and analyze information, including other contracts, that may provide relevant information concerning procurement improprieties relating to paragraph (1).

I have attempted to ascertain "contracts" that DBEDT may have with any of the principals, directors or executives from any of the RFP proposers. The following is a listing of what I know to date:

1. Debra Guerin Beresini: Hawaii Strategic Development Corporation (HSDC) entered a ten-year Limited Partnership Agreement with the International Venture Fund I, managed by Ms. Guerin-Beresini and Kirk Westbrook who are based in northern California. HSDC committed \$4 million to the fund in 2000 and increased that amount by \$500,000 in 2004.
2. Enterprise Honolulu: The department regularly co-sponsors events with Enterprise Honolulu (EH). The department also has contracts with EH pursuant to which legislative grants-in-aid (GIA) have been disbursed.
3. HiBEAM: HSDC co-sponsored HiBEAM venture capital conferences, as follows:
 - a. FY03 Silicon Valley Conference: \$5,000.
 - b. FY08 Executive Summit: \$2,500.
5. Kolohala Holdings: In 2007, HSDC invested \$75,000 in HEAVEN Fund I Series II managed by Kolohala Ventures.
6. William K. Richardson: HSDC, since 1995, has committed funds to three HMS venture capital partnerships managed by William Richardson and his partner Richard Grey. These ten-year commitments are as follows:
 - a. HMS Investments, L. P. (1995) \$2 million as the sole limited partner.
 - b. HMS Hawaii, L. P. (1999) HSDC \$2 million.
 - c. HMS III, L.P. (2004) \$360,612.
7. Barry Weinman: In 2005 HSDC invested \$50,000 in the DragonBridge Capital Merchant Bank, of which Mr. Weinman is the chairman. In 2007, the

Hawaii Technology Development Corporation entered into a lease agreement with DragonBridge for sub-leasing space at a technology incubator in Beijing, China, operated by Hawaii Technology Innovation Corporation (HTIC), a subsidiary of HTDC.

8. Ventana Capital: In 2004, HSDC invested \$500,000 in Technology Gateway Partnership II L.P., a venture capital fund managed by Ventana Capital.

With the exception of (i) EH GIAs in item 2 above, (ii) DragonBridge sub-lease in item 7 above, and (iii) the Ventana commitment in item 8 above, I did not participate in discussions or decisions relating to any of the above-mentioned contracts, including HSDC investment agreements. As DBEDT Director, I may have signed co-sponsorships agreements referred to in 2 and 3 above.

With regard to any "information" referred to in the Special Committee scope (2), I note that over 7,000 pages of emails and other documents have been submitted pursuant to this Committee's requests. Below, I highlight a few emails that may relate to principals, directors or executives from any of the RFP proposers.

1. In August, 2006, prior to the drafting and issuance of the RFP, I solicited and discussed by email, ideas regarding the management of the hydrogen fund with Mr. Barry Weinman. These ideas are clearly preliminary in nature and none of the suggestions discussed found their way into the RFP. See 400320 to 400326.
2. In September and October, 2006, I personally requested Michael Pfeffer to bid on the RFP. See 400362 to 400363.
3. On January 23, 2007, in an email to Mr. John Chock, I suggest potential proposers who should be notified about the RFP. Mr. Barry Weinman, Sennet

Capital and Hawaii Natural Energy Institute (HNEI) are listed among 15 names. See 400547.

4. On March 5, 2007, in a telephone conversation with Michael Pfeffer, I encouraged him to attend the RFP bidders conference to be held on March 7, 2007. See 400431.

There may be other "contracts" or "information" the Committee may be interested in and I would be happy to answer any questions on them.

In closing, I would hope that, unlike S.R. 2 and Special Committee Report No. 4, both dated January 18, 2008, this Special Investigatory Committee bases any of its findings on facts and not on allegations, inaccuracies and misstatements. Nor, in my view, should the Committee base its findings on mere differences of opinion or differences of recollection. More importantly, I would hope this Committee does not base its findings on mere personal animosity.

The RFP was an ambitious and complicated one. Any mistakes made are my sole responsibility. However, none of the mistakes made were intentional or malicious. There was no malfeasance or misfeasance.

Thank you for the opportunity of making these comments. I would be happy to answer any questions.