



**TESTIMONY OF THE STATE ATTORNEY GENERAL
TWENTY-FOURTH LEGISLATURE, 2008**

ON THE FOLLOWING MEASURE:

H.E. NO. 2401, H.D. 1; AUTHORIZING THE ISSUANCE OF SPECIAL PURPOSE REVENUE BONDS TO ASSIST OCEANLINK HAWAII LLC.

BEFORE THE:

HOUSE COMMITTEE ON FINANCE

DATE: Thursday, February 21, 2008 **TIME:** 10:00 AM

LOCATION: State Capitol, Room 308
Deliver to: Committee Clerk, Room 306, 2 Copies

TESTIFIER(S): Mark J. Bennett, Attorney General
or Brian Aburano, Deputy Attorney General

Chair Oshiro and Members of the Committee:

The Attorney General has comments regarding whether the special purpose revenue bonds proposed by this bill would be tax-exempt under current federal tax laws.

This bill is to authorize the issuance of special purpose revenue bonds under part V, chapter 39A, Hawaii Revised Statutes (HRS), in a total amount not to exceed \$20,000,000, for the purpose of assisting Oceanlink Hawaii LLC with the planning, design, and construction of a hydrokinetic power generation facility off-shore of Maui [page 3, lines 1-11].

Generally, the purpose of issuing special purpose revenue bonds is to issue tax-exempt bonds, i.e., bonds that will pay interest that is exempt from federal income taxes. Tax-exempt bonds have lower interest rates than taxable bonds or commercial loans since they produce interest that is exempt from federal taxation. As outlined below, current federal tax laws will make it difficult for the special purpose revenue bonds proposed by this bill to be tax-exempt bonds.

Tax-exempt bonds may be issued under 26 U.S.C. § 142(a)(8) so long as 95 percent or more of the net proceeds of the bonds are used

to provide "facilities for the local furnishing of electrical energy or gas." However, this provision is limited to entities that were engaged in the furnishing of electrical energy or gas on January 1, 1997, and the proposed facility must serve the area served by that entity on January 1, 1997. See 26 U.S.C. § 142(f)(3). Oceanlinx Hawaii LLC would not qualify to issue tax-exempt bonds under this provision, because it was not furnishing electrical energy in Hawaii on January 1, 1997.

Tax-exempt bonds may be issued under 26 U.S.C. § 144(a) if they are "qualified small issue bonds." Bonds issued after December 31, 1986, do not qualify as "qualified small issue bonds" unless 95 percent of the net proceeds of those bonds are used to provide a "manufacturing facility" or farm property. See 26 U.S.C. § 144(a)(12)(A) and (B). A "manufacturing facility" is defined as a facility used "in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property)." See 26 U.S.C. § 144(a)(12)(C). Oceanlinx Hawaii LLC's proposed hydrokinetic power generation facility would not qualify as a "manufacturing facility" as the production of electrical energy is not the production or manufacture of tangible personal property. Further, the amount of the proposed bonds exceeds the amount that is allowed for small issue bonds. See 26 U.S.C. § 144(a)(1) and (4) (\$1,000,000 and optional \$10,000,000 limit).

Tax-exempt bonds may be issued under 26 U.S.C. § 145(a) if all property to be provided by the net proceeds of the bonds is to be owned by a 501(c)(3) organization, i.e., a nonprofit organization under 26 U.S.C. § 501(c)(3). The records of the Department of Commerce and Consumer Affairs do not indicate that Oceanlinx Hawaii LLC is a nonprofit organization. Rather, they indicate that it is a domestic limited liability company. As such, the bonds to be issued under this bill would not appear to qualify as tax-exempt bonds under 26 U.S.C. § 145(a).

Cumulative List of Organizations described in section 103 of the Internal Revenue Code of 1986 does not list Hui Mana'Oma'o as an organization described in 26 U.S.C. § 501(c)(3). As such, the bonds to be issued under this bill would not qualify as tax-exempt bonds under 26 U.S.C. § 145(a).

While not tax-exempt, the proposed bonds could receive favorable tax treatment if they qualify as "clean renewable energy bonds" (CREB) under 26 U.S.C. § 54. However, the borrower who uses the proceeds of CREB special purpose revenue bonds must be a mutual or cooperative electric company, i.e., a nonprofit organization organized under 26 U.S.C. § 501(c)(12) or 1381(a)(2)(C). See 26 U.S.C. § 54(d)(1)(B) and (j)(5). Hui Mana'Oma'o does not appear to be such a company. The bonds proposed by this bill also may not meet other requirements for CREB bonds set out in 26 U.S.C. § 54, including a current requirement that the bonds be issued before December 31, 2008. See 26 U.S.C. § 54(m).

While not tax-exempt, the proposed bonds could receive favorable tax treatment if they qualify as "clean renewable energy bonds" (CREB) under 26 U.S.C. § 54. However, the borrower who uses the proceeds of CREB special purpose revenue bonds must be a mutual or cooperative electric company, i.e., a nonprofit organization organized under 26 U.S.C. § 501(c)(12) or 1381(a)(2)(C). See 26 U.S.C. § 54(d)(1)(B) and (j)(5). Oceanlinx Hawaii LLC does not appear to be such a company. The bonds proposed by this bill also may not meet other requirements for CREB bonds set out in 26 U.S.C. § 54, including a current requirement that the bonds be issued before December 31, 2008. See 26 U.S.C. § 54(m).

TESTIMONY OF GERALD A. SUMIDA, ESQ.
ON BEHALF OF OCEANLINX HAWAII LLC
OCEANLINX HAWAII LLC

BEFORE THE
COMMITTEE ON FINANCE
HOUSE OF REPRESENTATIVES

ON

H.B. NO. 2401, H.D. 1 AUTHORIZING THE ISSUANCE OF SPECIAL PURPOSE REVENUE
BONDS TO ASSIST OCEANLINX HAWAII LLC
FEBRUARY 21, 2008

Mr. Chair and Members of the Committee:

I am Gerald A. Sumida, Of Counsel in the Hawaii law firm of Carlsmith Ball LLP. I am very pleased to appear before you on behalf of Oceanlinx Hawaii LLC, a Hawaii limited liability company ("Oceanlinx"), and to present testimony in favor of H.B. No. 2401, H.D. 1 to authorize the issuance of up to \$20,000,000 of special purpose revenue bonds ("SPRBs") to Oceanlinx.

As a preliminary matter, I would respectfully mention to the Committee that an editorial in the Honolulu Star-Bulletin, Saturday, February 8, 2008, stated that Oceanlinx is "declining lawmakers' offer to pass legislation for \$20 million in revenue bonds." This statement is inaccurate and Oceanlinx has notified the newspaper of this error. Oceanlinx deeply appreciates the support and assistance of the Legislature as embodied in H.B. No. 2401, H.D. 1 and strongly supports this legislation which will support Oceanlinx's wave energy project offshore of the Island of Maui.

Oceanlinx is a recently formed company whose purpose is to undertake the development and operating of a wave energy conversion facility offshore of the Island of Maui. This facility will have a capacity of 2.7 megawatts and will provide electricity to Maui Electric Company, Limited ("MECO") on Maui to help meeting Maui's electric energy demand. Oceanlinx is a subsidiary of Oceanlinx Ltd., based in Botany, Australia, which is engaged in developing wave energy conversion systems throughout the world. I am pleased to provide an overview of Oceanlinx's wave energy project in Hawaii (the "Project").

PROJECT DESCRIPTION

The Project is a 2.7 megawatt wave energy conversion system, which will be located about 1/2 to 3/4 of a mile offshore of Maui's Pauwela Point. It will consist of 2 or 3 wave energy conversion units, depending on the outcome of our wave logging analysis. These units will float on the ocean surface and, by use of a patented Oscillating Water Column device, will generate electric energy from the motion of the ocean waves. The Project's total electricity out will be 2.7 megawatts and will be sold to MECO for distribution to Maui's general public. There will be no emissions or other discharges from this Project.

The Project will be located offshore of Maui's Pauwela Point. This location has been chosen after an analysis of the wave energy potential in this area. This location is far away from any commercial or recreational boating and shipping routes, any surfing and wind surfing areas, and any fishing locations. The coastal area of Maui at this location is one of high cliffs, and the land area above the cliffs is comprised of agricultural lands.

Oceanlinx has been in preliminary discussions with MECO for arrangements to provide Maui with electricity generated from one of Maui's, and Hawaii's, most plentiful renewable energy resources. The electricity generated by the Project will be delivered from the Project to MECO's grid through undersea electric transmission cables. These cables will be buried once they reach the shore area.

PROJECT STATUS

Oceanlinx has held ongoing information meetings with Maui's community, including Maui's governmental officials, and is pleased to have substantial support from the community. We have also had similar meetings with persons from the State Government, the University of Hawaii and the business and environmental communities, and have received strong support for our technology as well as our plans to harness Hawaii's ocean wave energy resources.

Oceanlinx is in the process of obtaining the necessary permits, which includes an environmental assessment. We hope to complete the Project and begin operations by late 2009.

BENEFITS FROM THE PROJECT

Oceanlinx's Project will provide many benefits to Maui and also to the State of Hawaii and beyond:

- The Project will provide electric energy to Maui's public that will be generated by one of Hawaii's most abundant renewable energy resources, the power inherent in the energy of the ocean's waves. This will help in furthering the County of Maui's goal and the State of Hawaii's goal of using Hawaii's renewable energy resources to generate electric energy, reduce Hawaii's dependency upon very expensive imported fossil fuels, and increase Hawaii's energy self-sufficiency.
- The Project will use a proven, innovative technology that is environmentally sound and clean, with no emissions or other discharges that would raise environmental concerns. It will also showcase renewable energy development initiatives on Maui and Hawaii, and provide an important example for other areas in the world that have the potential for wave energy conversion projects.
- The communities and leaders in Maui, and in Hawaii, have expressed their strong support for this Project and Oceanlinx's efforts, and Oceanlinx will continue to work closely with them.

BACKGROUND ON OCEANLINX LIMITED

Oceanlinx Limited is an international renewable energy company based in Australia, with headquarters in Botany, New South Wales, Australia. Oceanlinx Limited is currently developing wave energy conversion projects, using its own technology, in Australia, Rhode Island, the United Kingdom, Namibia and Hawaii.

The company was originally founded in 1997 and was initially called Energetech Australia Pty. Ltd., and changed its name in 2007 to Oceanlinx Limited.

PROJECT COST AND SPRB AUTHORIZATION REQUEST

The total cost of the Project is estimated to be some \$20,000,000 to 30,000,000. Of this, Oceanlinx desires to fund approximately \$20,000,000 through the issuance of SPRBs to assist in developing the Project. As the Committee is aware, the repayment of these types of bonds is guaranteed by either the borrower or a financial institution, and the interest paid to the bondholders is exempt from taxation. This enables the borrower to pay an interest rate which is lower than interest rates on non-exempt taxable borrowings. Section 39A-161 of the Hawaii Revised Statutes specifically provides that SPRBs are not an obligation of the State of Hawaii and are payable solely from the revenues pledged from the Project for the repayment of the SPRBs.

Given Oceanlinx's development schedule, Oceanlinx is currently planning to seek to issue the authorized SPRBs during 2008 to assist in financing the Project's development.

We thus respectfully request your favorable action on H.B. 2401, H.D.1, since this will greatly assist Oceanlinx in the development of this innovative and important renewable energy project to assist MECO and the Island of Maui's public as well as assist in furthering the State's policy to developing and harnessing Hawaii's indigenous renewable energy resources and reducing Hawaii's dependency upon oil.

Mr. Chair and Members of the Committee, I would be very pleased to respond to any questions that you may have.

Thank you very much for the opportunity to appear before your Committee.

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Testimony before the
House Committee on Finance

H.B. 2401, H.D. 1 Authorizing the Issuance of Special Purpose
Revenue Bonds to Assist Oceanlinx Hawaii, LLC
Thursday, February 21, 2008
10:00 a.m., Conference Room 308
Agenda #1

By Ed Reinhardt
President, Maui Electric Company, Inc.

Chair Oshiro, Vice Chair Lee, and members of the Committee:

My name is Ed Reinhardt and I am testifying orally on behalf of Hawaiian Electric Company, Inc., and its subsidiary utilities, Maui Electric Company, Ltd., and Hawaii Electric Light Company, Inc.

The Hawaiian Electric companies support House Bill 2401, H.D. 1, which would authorize issuance of Special Purpose Revenue Bonds in the amount of \$20 million to assist Oceanlinx Hawaii, LLC.

Oceanlinx Hawaii, the local subsidiary of Australia-based Oceanlinx, has developed a unique, commercially efficient system for extracting energy from ocean waves and converting it to electricity.

Oceanlinx proposes to install floating wave energy converters at sea north of Pauwela Point in Northeast Maui and a sub-sea cable crossing east of Maliko Bay, where it will feed into a substation and provide up to 2.7 megawatts to the Maui grid. This wave farm could be expanded to provide additional energy to the Maui grid and throughout the islands.

The Hawaiian Electric companies, in common with most Hawaii residents, are concerned with Hawaii's dependence on imported fossil fuel and the economic, security and environmental vulnerability that brings. We are actively seeking environmentally-friendly ways to reduce Hawaii's dependence on imported fossil fuel, increase our energy security and reduce our global warming impact.

Over the last dozen years, Hawaiian Electric's renewable energy specialists have closely monitored the progress of more than a dozen ocean energy technologies – and our companies have consulted and assisted with those companies' efforts whenever possible. In Oceanlinx, we believe we have found a wave technology that makes sense for Hawaii.

Oceanlinx Hawaii will prepare an Environmental Impact Statement as part of the approvals it must seek. Maui Electric Company will work with Oceanlinx to negotiate a purchase power agreement beneficial to Maui ratepayers and fair to that company. That PPA will, of course, be subject to approval by the Hawaii Public Utilities Commission.

Wave energy will be an excellent complement to other renewable resources on Maui, including biomass energy from the Hawaiian Commercial & Sugar (HC&S) plantation, wind energy from UPC's Kaheawa Wind Farm, the small Makilo Hydro plant we hope to see returned to service and plans to use clean, renewable biodiesel to fuel our generators at Ma'alaea which comprise 85 percent of Maui's generation capacity. This is the true definition of a renewable portfolio: a variety of sources of power, and the more that are local the better.

In discussions with the Mayor and Maui County officials and environmental leaders on Maui, we have heard nothing but support for this project. We all know the tremendous advocacy role for ocean energy that has been played by Representative Cynthia Thielen. In addition, Representative Angus McKelvey has been instrumental in bringing this ocean energy project on Maui, along with other members of the Maui delegation.

Getting started with wave energy will not be inexpensive. Although costs should go down with mass production, wider deployment and greater experience, being a first mover has costs and risks. That cost, to be borne by Oceanlinx and its investors, is estimated at \$30 million.

Clearly, being able to finance this project in part under the auspices and preferred rates of a Special Purpose Revenue Bond would help move this project forward at no cost or liability to Hawaii taxpayers.

We urge you to pass this bill. Thank you for the opportunity to testify.