

HB 2661 HD2



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

ON THE FOLLOWING MEASURE:

H.B. NO. 2661, H.D. 2, RELATING TO SPECIAL PURPOSE REVENUE BONDS TO ASSIST INDUSTRIAL ENTERPRISES.

BEFORE THE:

SENATE COMMITTEE ON ENERGY AND ENVIRONMENT

DATE: Tuesday, March 18, 2008 **TIME:** 3:15 PM

LOCATION: State Capitol, Room 414
Deliver to: Committee Clerk, Room 208, 1 Copy

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

Chair Menor 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 \$38,000,000, for the purpose of assisting Hui Mana'Oma'o or an enterprise or commercial entity in which Hui Mana'Oma'o possesses a vested equity interest, for establishment of facilities to convert renewable energy resources into electrical energy [page 2, lines 5-13].

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). Hui Mana'Oma'o 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). Hui Mana'Oma'o's proposed facility for the production of electrical energy from renewable resources 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 Hui Mana'Oma'o is a nonprofit organization. Rather, they indicate that it is a domestic limited liability company. Also, IRS Publication 78, 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).

HAWAII STATE SENATE
THE TWENTY-FOURTH LEGISLATURE
REGULAR SESSION OF 2008

COMMITTEE ON ENERGY AND ENVIRONMENT

**Tuesday, March 18, 2008
3:15 p.m., Room 414**

TESTIMONY OF HUI MANA 'OMA'O, LLC

**SUBJECT: H.B. 2661-HD2, RELATING TO THE ISSUANCE OF SPECIAL PURPOSE
REVENUE BONDS TO ASSIST INDUSTRIAL ENTERPRISES.**

The Honorable Ron Menor, Chair and Members of the Committee:

Good morning. My name is William W. Milks. I am the managing member of Hui Mana 'Oma'o, LLC (HMO), a Hawaii business entity. Thank you for scheduling H.B. 2661-HD2 for a hearing this afternoon.

HMO supports enactment of H.B. 2661-HD2. Earlier, its companion bill, S.B. 2329 was referred to your Committee which took favorable action on it, on February 14, 2008.

Hui Mana 'Oma'o is Hawaiian for Consolidated Green Power. HMO is dedicated to the development and operation of renewable energy projects for delivery of electricity to Hawaii's franchised electric utility companies.

HMO is in the process of developing more than one renewable energy project for the Island of Oahu. To date it has spent considerable time and funds preparing to be responsive to Hawaiian Electric Company's (HECO) RFP for 100 mw of renewable energy, which RFP is soon to be formalized and approved by the Hawaii Public Utilities Commission.

Authorization of up to \$38 million of SPRBs is for Phase I of HMO's currently planned, three-phased multi-project effort. Phase I is planned to include a solar thermal facility on one site and generators converting methane to electricity on one or more other sites. The methane-related project could substantially reduce the volume of Oahu's municipal solid waste. The plan is to integrate energy from at least two stand-alone sites in order to make the energy "firm," or "dispatchable." HMO's power hopefully will qualify as reliable renewable energy.

BACKGROUND

In 2007, the Island of Oahu spent slightly more than \$2,000,000.00 a day (on average) just for fossil fuels needed to generate Oahu's electricity. What amounted to three quarters of a billion dollars spent on Oahu, in 2007, will certainly be more costly each ensuing year: early 2008, the market price for petroleum exceeded \$100.00 per barrel, for the first time in history. Refer, a Pacific Business News press clip (attached), dated March 14, 2008.

Hawaii's dependence upon oil is to the point of being extreme, not only because of our continuing need for oil to generate electricity, but also for vehicles, for jet fuel, and for utility gas. Also, many of our consumable products and fertilizer for our agricultural products are oil based.

The following points demonstrate that HMO's objective of providing renewable electric energy for Oahu's consumers is in the public interest.

- While nuclear power may be a solution, it requires amendment to our State Constitution. While coal supplies might be abundant, thermal pollution and carbon emissions require us to be less reliant on coal for Oahu's future. And while the development/commercialization of bio-fuels offers some hope, that industry is currently experiencing its own set of uncertainties.
- As the world's demand for petroleum accelerates, the number of newly discovered oil fields declines. The laws of supply and demand and political and military might will dictate the availability and price of oil in the future.
- Bringing renewable energy technologies to commercialization is costly, but such costs must be incurred. Electric utility companies have chosen to place those high costs—and the inevitable failures—on developers such as HMO.
- To make “dispatchable” renewables a reality for Oahu, cooperation among government developers and the utility company will be essential.
- Direct funding from the State of Hawaii to financially assist developers of renewable energy currently is beyond the state's available funds and will remain so for the foreseeable future.
- To integrate renewables into existing electrical systems, all forms of kokua are needed: Act 221/Act 215 provisions are needed; special purpose revenue bonds are needed; Department of Land and Natural Resources leases for sites are needed; a goal-oriented PUC is needed; and an aggressive and enlightened electric utility is needed.

HMO SHALL BE THE “RESPONSIBLE PARTY” FOR THE "PROJECT'S" SPRBs

H.B. 2661, HD2 would authorize the Hawaii Department of Budget and Finance (B & F) to proceed to qualify HMO. For HMO obtain B & F's declaration as a “Responsible Party” to arrange for the underwriting and sale of bonds for the “Project,” HMO will need to submit volumes of information with regard to its project's economic forecasts and financial feasibility.

Until such time as details of the projects are encompassed in a submittal to B & F, financials will not be available for public disclosure.

The processes set up by the Legislature and codified as Chapter 39A, Haw.Rev.Stat., provide safeguards to maintain the State of Hawaii's financial integrity: required guarantees will be in place or the bonds will not be underwritten. Indentures in the bonds absolve the State from being the ultimate financial recourse.

Special purpose revenue bond funding procedures cost the State of Hawaii virtually nothing. The "Project" has to reimburse B & F for all of the costs it incurs.

Further, this process does not require expenditure of General Funds. Ultimately, the project will benefit consumers, advance sustainability, and mitigate green house gas emissions.

Here, the State of Hawaii will lend its name to an energy projects developer in order to provide tax incentives to investors in renewable energies. The HECO family of companies has been the recipient of special purpose revenue bonds on numerous occasions over the past several years. That has been a good deal for Oahu's consumers in the past; HMO's use of SPRB in the future will be in the public interest, as well.

CONCLUSION

Oahu's need for electric energy from renewable resources is extreme. The State's cooperation to develop renewables is essential, but both the State and HECO have such other compelling priorities that capital intensive renewable projects cannot be directly funded by either of them. The franchised utility has provided ample evidence over the past several years that it is unwilling to assume the costs of developing renewable energy resources suited for island environments. Therefore, the passage of S.B. 2329 is in the public's interest.

Thank you for your attention and serious consideration to the merits of the proposal set forth in H.B. 2661, HD2. HMO urges favorable Committee action on H.B. 2661, HD2.

HMO will be happy to respond to any questions you may have.

PACIFIC BUSINESS NEWS

Honolulu, Hawaii

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HECO fuel charges up 21% in 5 months

BY NABES KALANI
PACIFIC BUSINESS NEWS

As oil prices hit record levels, Hawaii businesses and residents are being shocked not only at the gas pump but at the electric meter.

Since October, the fuel surcharge that Hawaiian Electric Co. passes on to its customers

has shot up 21 percent.

It now accounts for 57 percent of the average customer's bill on Oahu, with some Neighbor Island customers paying even more.

While other utilities across the nation also levy fuel surcharges, they are modest compared with the fuel costs charged by Hawaiian Electric Co. and its subsidiar-

ies, Maui Electric Co. and Hawaii Electric Light Co.

(Other states rely on a mix of coal, natural gas, oil, nuclear power and hydroelectricity, but 90 percent of Hawaii's power comes from oil-fired generators.)

This week, oil prices touched a record \$110 per barrel, suggesting even higher prices lie ahead for

Hawaii consumers.

Gary Groendyke, who owns the 16,000-square-foot Punahou Fitness & Spa in Honolulu, said he's now paying \$6,500 a month for electricity to power his fitness machines, pool filters, saunas, steam rooms and air conditioning.

"It's a really big concern because people are on memberships

here so I can't just arbitrarily raise their rates," Groendyke said. "My profit margin really starts taking hits and I don't feel there's a whole lot I can do."

Last October, HECO's fuel surcharge — labeled "energy cost adjustment" on its bills — was

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ELECTRIC: Efforts to conserve erased by bigger bills

FROM PAGE ONE

12.368 cents per kilowatt-hour. This means the average Oahu home, which uses 600 kilowatt-hours of electricity a month, paid a \$74.21 surcharge.

This month, with the fuel surcharge at 14.937 cents per kilowatt-hour, the average homeowner will see a bill for \$159.33 with a surcharge of \$89.62, \$15 more than in October.

The surcharge is calculated a month in advance based on projected fuel costs, and does not require the approval of the state Public Utilities Commission. The same formula is applied to both residential and commercial customers' kilowatt-hour usage.

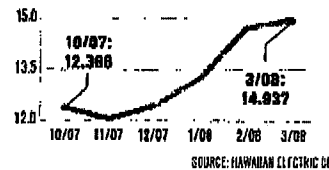
HECO stresses that it doesn't profit from the surcharge, which has been applied to all customer accounts since 1953.

"The energy cost adjustment clause ensures customers that Hawaiian Electric doesn't make a penny [and] guarantees they're only paying for actual cost of fuel," said HECO spokesman Darren Pai. "The PUC and the [state] Office of Consumer Advocacy review all of our fuel contracts and the surcharge appears as a separate line on their bills."

HECO and its subsidiaries spent \$774.1 million on fuel oil in 2007, according to the most recent financial statement of parent

Pennies per hour add up

Hawaiian Electric Co. adds a fuel surcharge to its bills labeled "energy cost adjustment." The charge goes directly to pay the utility's fuel costs. It is calculated monthly in cents per kilowatt-hour, and has risen 21 percent since October.



SOURCE: HAWAIIAN ELECTRIC CO.

company Hawaiian Electric Industries, which also owns American Savings Bank. The utilities collectively sold 10.1 million kilowatt-hours in 2007.

The formula HECO uses to determine each month's fuel surcharge looks at its projected cost of fuel for providing electric service to customers and compares that with the fuel cost already included in the utility's rates.

"The difference is used to make the calculation for the following month," Pai said. "In the event that the estimate is off, there is a reconciliation to make up the difference between actual and estimated."

One of the biggest problems for HECO is that it has been aggressively pushing energy conservation, but rising fuel costs are wiping out savings from low-power light bulbs, luke-warm showers and most solar systems.

Pai said HECO has received a number of complaints, especially from those who have invested hundreds or thousands of dollars in energy-efficient equipment.

"When customers do install things like solar water heaters but fuel costs continue to drive their bills, it's very understandable that they're unhappy," he said. "But we try to do as much as possible to have incentives and help them control the energy they're using."

He said over the past 11 years HECO has paid out \$62 million in rebates to customers who have installed energy-efficient systems.

The Maui Ocean Center in Maunaloa has seen its electric bill double since opening a decade ago and is working to install wind turbines to help reduce its dependence on the utility.

"But our usage has stayed the same, or in fact, is down 2 percent," said General Manager Kate Zolezzi.

Zolezzi said that aquarium pumps running 24 hours a day drive most of the center's energy costs, which currently exceed

\$600,000 annually to keep alive sea life in its main 750,000-gallon aquarium and 85 smaller exhibits.

Last year, Maui Ocean Center announced plans for a \$46,000 wind turbine project to help reduce energy costs.

Maui Electric Co. agreed to contribute \$10,000 for the six, 1,000-kilowatt turbines that are expected to be on line in September.

Groendyke, the owner of the Punahou fitness club, switched the facility's air conditioning system in 2001 to one that used less power but he's since seen those savings disappear.

"I figured I would pay for the redo over three years," he said. "I cut the electricity charges by over \$2,000 the first month I installed it, but that's been long ago eclipsed and it's back up to \$6,500 a month again."

HECO's position is that fuel surcharges will only come down when Hawaii uses less oil, generating a larger share of power by renewable means, including solar, wind and wave power.

"We see a definite need to move away from being so dependent on oil, and we're continuing to work to develop renewable energy sources that can provide reliable service to our customers," Pai said.

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Staggering utility costs require action now

Hawaii's efforts at being even slightly less energy dependent are lurching along at a disappointing pace, while the speed with which fuel surcharges and pass-throughs are tacked on to shipping, electricity and airfares is astonishing.

Take a look at your most recent electric bill and you'll find that more than 40 percent comes from the "energy cost adjustment" line item. That's what Hawaiian Electric Co. is getting charged for the fuel that keeps its generators running and it's passing along the cost to you.

So what incentive do we have to invest in solar or take cold showers if our bills keep going up anyway?

While there are a lot of interesting alternative energy projects under way in Hawaii, we're concerned that none of them seems to have much traction.

As PBN reported last week, Hawaii

isn't a bit closer to producing one drop of ethanol than it was in 2004 when the state moved to require all locally sold gasoline to be blended with 10 percent ethanol.

The production of biodiesel, which is supposed to cut the importation of "straight" diesel and help revive Hawaii's agriculture industry, is having its own financial and technological challenges.

Experiments with algae, oil palms and crops like jatropha, which could produce the "bio" to add to the diesel, still are in early stages and there is plenty of disagreement over which crops produce the most "juice" and cause the least environmental damage.

Solar, wind, biomass, biodiesel, geothermal, hydroelectric and wave energy all have their advocates and all have their limitations when it comes to providing cheap, reliable power to a remote chain of islands.

Gov. Linda Lingle is correct to be con-

cerned about the "security" of Hawaii, with its 90-percent dependence on oil, far more than other states that mostly use a mix of oil, coal, natural gas and nuclear energy to run their power plants.

"We are completely dependent on foreign governments for our energy security for our economic survival," Lingle told the National Governors Association in February. "The fact is that we are the most energy-insecure state in America."

Lingle deserves credit for wading into this confusing arena and trying to provide leadership and focus.

So far, the Legislature has simply added to the muddle by proposing more studies and offering more chatter about sustainability. (We do, however, support the landmark "Right to Dry" legislation that gives us all the right to use a clothesline.)

But even the Lingle initiatives are aimed further into the future than we're

comfortable with.

The looming spectre of \$4 gasoline can only lead to budget-blowing "energy cost adjustments" that could stop what meager economic growth is forecast for the year.

In the short run, we'd suggest more meaningful incentives for conservation. HECO, with the blessing of the state Public Utilities Commission, should move ahead with a tiered rate structure that would reward off-peak usage.

Substantial rebates for customers who cut usage by 10 percent or more should also be considered — now that might be a fun family project.

And the state needs to think about what it can do through grants or aggressive tax incentives to get lenders and investors moving more quickly to fund projects like the Gay & Robinson ethanol enterprise on Kaula, or to get someone to start a jatropha plantation before gas hits \$5 a gallon.