SB 2329

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

ON THE FOLLOWING MEASURE:
S.B. NO. 2329, RELATING TO THE ISSUANCE OF SPECIAL PURPOSE REVENUE BONDS FOR HUI MANA'OMA'O.

BEFORE THE:
SENATE COMMITTEE ON ENERGY AND ENVIRONMENT

DATE: Thursday, February 14, 2008 **TIME:** 2:45 PM
LOCATION: State Capitol, Room 414
Deliver to: Committee Clerk, Room 208, one copies

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 1-7].

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 Affaris 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

Thursday, February 14, 2008
2:45 p.m., Room 414

TESTIMONY OF HUI MANA 'OMA'O, LLC

SUBJECT: S.B. 2329, 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 S.B. 2329 for a hearing this afternoon.

HMO supports enactment of S.B. 2329. Its companion bill, H.B. 2661 was referred to the House Committee on Energy and Environmental Protection.

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.

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.

<u>HMO SHALL BE THE "RESPONSIBLE PARTY" FOR THE "PROJECT'S" SPRBs</u>

S.B. 2329 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 S.B. 2329. HMO urges favorable Committee action on S.B. 2329.

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