

**Written Testimony before the  
Senate Committee on Ways and Means**

**H.B. 2262 HD2 SD1**

**Thursday, March 29, 2012  
9:00 AM, Conference Room 211**

**By Cecily Barnes  
Manager, Biofuels  
Hawaiian Electric Company, Inc.**

Chair Ige, Vice-Chair Kidani, and Members of the Committee:

My name is Cecily Barnes. I am the Manager of Biofuels for Hawaiian Electric Company. . I submit this testimony on behalf of Hawaiian Electric Company and its subsidiary utilities, Maui Electric Company and Hawaii Electric Light Company, hereby referred to collectively as Hawaiian Electric Company.

Hawaiian Electric Company supports the intent of HB 2262, HD 2, SD 1, which amends the statutes to broaden the original intent from ethanol incentives to renewable fuel production for bioenergy development in Hawaii. The SD1 amendment to the measure specifies that only renewable transportation fuels would be eligible for the tax credit. We respectfully request an amendment to restore the applicable fuels to include all renewable fuels.

This change will eliminate many applicability questions that may arise, such as off road, marine, and farming usage. In addition, keeping track of the end use of renewable fuel may place an undue burden on renewable fuel producers and in many cases may be beyond their control. In addition, renewable fuel producers may be able to develop a facility that may serve to meet demand for biofuel used to generate electricity wherein that facility will concurrently produce transportation biofuel. Since the current supply of renewable fuel is limited, additional conditions will distract from the primary goal of increasing the overall supply of renewable fuel. Finally, the goal of the Hawaii Clean Energy Initiative is to reduce the State's dependence on imported oil overall and any replacement of imported oil is a step towards reaching that goal.

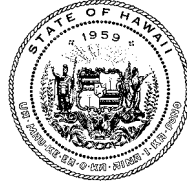
Hawaiian Electric Company is committed to exploring and using biofuels in its existing and planned generating units. The use of biofuels can reduce the State's dependence on imported oil and increase the amount of renewable energy from sustainable resources.

In conclusion, Hawaiian Electric Company supports the intent of HB 2262 HD2 SD1 as a way to stimulate biofuel development in Hawaii but respectfully requests an amendment to restore applicability to all renewable fuels to increase opportunities for a successful local biofuel industry.

Thank you for the opportunity to present this testimony.

NEIL ABERCROMBIE  
GOVERNOR

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LT. GOVERNOR



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To: The Honorable David Y. Ige, Chair  
and Members of the Senate Committee on Ways and Means

Date: Thursday, March 29, 2012  
Time: 9:00 A.M.  
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director  
Department of Taxation

Re: H.B. No. 2262 HD 2, Relating to Energy

The Department of Taxation (Department) appreciates the intent of H.B. No. 2262 and offers the following information and comments for your consideration.

H.B. 2262 HD2 amends the existing ethanol production facility tax credit to cover facilities that produce other renewable transportation fuels; creates a biofuel production facility tax credit; increases the maximum amount of tax credit available to an individual facility to \$3,000,000; decreases the minimum production level required to claim the tax credit; and applies to taxable years beginning after December 31, 2012 and sunsets on January 1, 2029.

Renewable Transportation Fuels Production Facility Tax Credit:

The Department notes that the British Thermal Unit (BTU) is a measurement of energy, and not a measurement of quantity. In this context, the BTU apparently refers to the heat value of the fuel produced; however, it is unclear how the heat value of the fuel produced is to be determined. Subsection (d) indicates that the Department of Business, Economic Development, and Tourism (DBEDT) is to certify the amount of renewable fuel that each taxpayer, claiming this tax credit, has produced. Although the Department defers to DBEDT regarding whether it believes BTU is an effective standard of measurement, DOTAX is concerned about its ability to ensure compliance with the fuel tax laws if the BTU standard is adopted.

Subsection (d) of the proposed amendments to Section 235-110.3 indicates that this tax credit has an aggregate cap which is administered at the discretion of DBEDT, and which for any given tax year has no set value. The Department notes that aggregate caps create substantial uncertainty for taxpayers, and an aggregate cap with no set dollar value will create an even higher level of uncertainty. The Department notes that in general, aggregate caps are difficult for the Department to administer.

The Department additionally notes that the requirement that the renewable fuel be produced from feed stocks produced within the State, as well as the requirement that the renewable fuel be sold within the State, may be in conflict with the Commerce Clause of the United States Constitution. The Department defers to the Department of the Attorney General with respect to this issue.

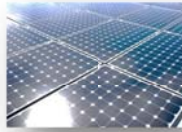
Biofuel Production Facility Income Tax Credit:

The Department defers to DBEDT as to the merits of such a tax credit. However, as written, the Department would have difficulty in administering the bill due to the lack of clarity in many of the provisions of section 3 of the bill. For example:

- Several terms, such as "hires" in subsection (f)(2) and "development or construction stage" in subsection (f) should be defined for clarity.
- Subsection (h) is unworkable. Specifically, the bill requires the taxpayer to repay the tax credits claimed, but not until ten years has passed after the taxpayer last claimed tax credits. More problematic is whether the Department would even be able to even require the taxpayer to repay the tax credit amount, because the statute of limitations would have expired many years prior.

Additional clarity also is needed regarding when the tax credit may be claimed. Some provisions infer that once the project is certified, the credits may be taken; however, a project may not meet all the requirements prior to certification. Also, the bill does not address recapture of the tax credits should the project fail to meet certain requirements, such as be in production by January 1, 2017 or fail to meet the \$10 million minimum project size.

Thank you for the opportunity to provide comments.



## **SENATE COMMITTEE ON WAYS AND MEANS**

March 29, 2012, 9:00 A.M.

Room 211

**(Testimony is 1 page long)**

### **TESTIMONY IN SUPPORT OF HB 2262 HD2 SD1, SUGGESTED AMENDMENTS**

Chair Ige and members of the Ways and Means Committee:

The Blue Planet Foundation supports HB 2262 HD2 SD1, a measure that expands the ethanol facility tax credit to include other liquid biofuels and makes other amendments to the credit. This policy will provide greater support for Hawaii's diverse biofuel production infrastructure.

Biofuels will likely play a major role in Hawaii's clean energy future—particularly as a substitute for petroleum-based transportation fuels. Transportation fuels in Hawai'i can be made from renewable resources, such as biomass in various forms, algae, and waste products. These materials are neither as scarce nor as expensive as crude oil. Even more importantly, these materials are available here. Hawai'i should set a clear course for a steady, incremental transition to renewable fuels including local and sustainable biofuels.

#### **SUGGESTED AMENDMENTS**

Blue Planet respectfully requests that HB 2262 HD2 SD1 be amended so the credit applies to biofuel facilities utilizing Hawaii-grown and produced feedstocks only. This policy should encourage Hawaii's clean, local, renewable energy industries. We want to avoid a distorted outcome where oil crops are being shipped across the Pacific (from potentially destructive sources, like former rainforest land) for use in Hawai'i. Please ensure that this policy does not simply replace one import (oil) with another one (imported oil crops).

Blue Planet also has concerns with sections 4 and 5 of the measure, which may exempt biofuel refineries from the environmental review process. Because biofuels and the processes needed to convert them into useable products can entail significant tradeoffs (overall energy use, water use, etc.), an environmental review process for the refining infrastructure may be warranted.

Thank you for the opportunity to testify.

Jeff Mikulina, executive director • [jeff@blueplanetfoundation.org](mailto:jeff@blueplanetfoundation.org)

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**HB 2262 HD2 SD1**

**RELATING TO ENERGY**

**JOEL K. MATSUNAGA  
CHIEF OPERATING OFFICER & EXECUTIVE VP  
HAWAII BIOENERGY, LLC**

**March 29, 2012**

Chair Ige and Members of the Senate Committee on Ways and Means:

I am Joel Matsunaga, submitting comments on behalf of Hawaii BioEnergy on HB 2262 HD2 SD1, "Relating to Energy."

**SUMMARY**

Hawaii BioEnergy, LLC ("HBE") supports HB 2262 HD2 SD1, which amends the ethanol facility income tax credit to apply to various types of renewable fuel, with production and minimum required capacity to be measured in British Thermal Units. HBE also supports the increase of the maximum available amount of the tax credit available to an individual facility, the inclusion of a local feedstock provision, and the incorporation of language from SB 2666 SD2 which creates an income tax credit for development and construction costs for biofuel production facilities. However, HBE does not support the amendments made in Senate Draft 1 which restrict the credit to facilities producing biofuels for transportation. HBE and other companies are moving forward with projects that could produce biofuels for both transportation and power generation. Limiting the scope of this legislation to transportation fuels would limit investment in the sector and undermine Hawaii's energy security and renewable energy goals. HBE respectfully submits that HB 2262 HD2 SD1 should be amended to:

1) Explicitly state in Parts I and II that the legislation and associated credits apply to biofuels facilities producing renewable fuel for both transportation and power generation;

2) Further clarify the local feedstock language by requiring that eligible facilities utilize at least 75% local feedstock, if available, in order claim the full amount of the credit; such an

amendment would help to attract greater upstream investment into the agricultural and nascent biomass sectors and help to secure the off-take market for local producers. HBE recognizes that testimony has been submitted to other committees expressing concern over local feedstock provisions and potential conflicts with the U.S. Constitution's Interstate Commerce Clause. However, four other U.S. states, including Montana, Missouri, Louisiana, and Wyoming have passed similar biofuels incentives that require the use of local feedstock in order to be eligible for the incentive. These bills have been passed and successfully implemented without encountering conflicts with the Interstate Commerce Clause or being legally challenged; and

3) Increase the credit period from five (5) years to eight (8) years, the period presently contained in HRS §235-110.3.

### **HAWAII BENEFITS FROM LOCAL BIOFUELS PRODUCTION**

Hawaii BioEnergy is a local company dedicated to strengthening the state's energy future through sustainable biofuel production from locally grown feedstocks. Among its partners are three of the larger land owners in Hawaii. HBE and its partners would like to use significant portions of our land to address Hawaii's existing and growing energy needs.

Understanding the urgency of these needs and anticipating growing demand, HBE has dedicated the last several years to feedstock trials, extensive technology evaluation and detail financial modeling of various production pathways in an effort to ensure HBE's ultimate production is as productive, efficient and sustainable as possible. HBE's own research, development and demonstration (RD&D) efforts have been accelerated by funding from the US government's Defense Advanced Research Projects Agency (DARPA), Office of Naval Research, as well as a Congressional Appropriation administered through the Air Force Research Laboratory. Collectively, this analysis has enabled HBE to clearly understand the production potential and challenges associated with Hawaii's unique natural resource base, geography, climate, market and infrastructure. HBE has recently signed a 20-year off-take

agreement for high density fuels with Hawaiian Electric Company and is prepared to move forward with the production of advanced fuels for both the power generation and transportation sectors.

While Hawaii holds tremendous potential to produce a range of advanced, high-density biofuels from locally produced feedstocks and innovative next generation technologies, the industry is still in its infancy and faces a myriad of cost and development challenges. Many of these challenges are attributed to the fact that Hawaii's agricultural and otherwise productive lands are relatively small, non-contiguous parcels with varying microclimates and other conditions which limit scale and increase operational costs. Such limitations and cost impacts are particularly pronounced in Hawaii where the cost of doing business is already disproportionately high relative to the mainland. Maintaining a local feedstock provision for the facility credit and incorporating a credit for development and construction costs would help to offset a portion of the upfront costs associated biomass production as well as advanced technology facility construction.

Clarifying HB 2262 HD2 SD1 to incorporate a 75% local feedstock provision would help to expand investment in and development of dedicated renewable energy feedstocks while helping to secure the off-take market for producers of these new products. HBE recognizes that there has been some concern expressed by the Hawaii Attorney General's office that such a provision may conflict with the US Constitution's Interstate Commerce Clause. However, HBE would like to point out that several other states have passed and implemented legislation fostering in-state biofuels feedstock production without encountering Interstate Commerce issues. Specifically, Montana, Missouri, Louisiana and Wyoming have implemented per gallon tax and grant incentives that require facilities to use specified levels of feedstocks produced within the state in order to be eligible for the incentive. HBE contacted state bioenergy coordinators in each of these states and none have encountered Interstate Commerce issues nor has the matter been legally challenged.



HB 2262 HD2 SD1 and other, related measures before this legislature which provide both upstream and downstream support bioenergy producers are key to attracting investment, minimizing risk, and jumpstarting production. Expanding the Ethanol Facility Credit would help to attract a wider range of investors and help offset the technology and capital risks inherent in the establishment of a new industry. The credits are of particular importance to companies such as HBE that intend to utilize advanced, next generation feedstocks and conversion technologies which are more efficient and have the potential to produce high density, drop-in fuels, but carry substantially higher capital costs than first generation biofuels. Basing the credit on British Thermal Units helps to achieve that goal. Extending the credit from five (5) to eight (8) years would further this objective as well as help attract investment capable of creating local jobs, stimulating the economy, and broadening the tax base. These supports are important to the bioenergy industry as a whole and should apply to producers developing product for both the transportation and power generation sectors. Restricting the legislation to the transportation sector would limit the measure's potential impact for the sector and for Hawaii's economy.

#### **CONCLUDING REMARKS**

HBE is moving forward with advanced, bio-based energy projects from locally grown feedstocks that will help provide a local, renewable source of energy for Hawaii. HBE believes that HB 2262 HD2 SD1 will help to accelerate and expand Hawaii's bio-based renewable energy economy and help to reinvigorate the state's agricultural sector more broadly. Based on the aforementioned, Hawaii BioEnergy respectfully requests your support for HB 2262 HD2 SD1 with the proposed amendments.

Thank you for the opportunity to comment.

# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Renewable fuels production facility tax credits

BILL NUMBER: HB 2262, SD-1

INTRODUCED BY: Senate Committees on Energy and Environment and Economic Development and Technology

**BRIEF SUMMARY: Renewable Transportation Fuels Production Facility Tax Credit** - Amends HRS section 235-110.3 (d) to change the name of the ethanol facility tax credit to the renewable transportation fuels production facility tax credit including changing any reference to ethanol to renewable transportation fuels production. The credit shall not be claimed for more than five years.

The annual dollar amount of the credit shall be 30 cents per 115,000 British thermal units (BTU) of renewable transportation fuels using the lower heating value produced for distribution in Hawaii; provided that the production by the facility is not less than 15 billion BTUs units of renewable transportation fuels per year. Limits the amount of tax credit that may be claimed by a taxpayer to \$3 million per taxable year.

Repeals the provisions in order to claim the credit requiring: (1) the qualifying ethanol production facility to be operated at a level of production of at 75% of its nameplate capacity on an annualized basis; and (2) that the qualifying ethanol production facility is in production on or before 1/1/17.

Defines “qualifying renewable transportation fuel production” to mean production of renewable transportation fuels from renewable feedstocks produced in the state; provided the renewable fuel is sold in the state. Defines “qualifying renewable transportation fuels production facility” as a facility located in Hawaii that produces from renewable feedstocks fuel grade renewable transportation fuels for the production of: (1) methanol, ethanol, or other alcohols; (2) hydrogen; (3) biodiesel or renewable diesel; (4) biofuels derived from biological materials, including algae; or (5) renewable jet fuel, renewable gasoline, or liquid or gaseous fuels.

If in any year, the annual amount of certified credits reaches \$ \_\_\_\_\_ in the aggregate, the department of business, economic development, and tourism (DBEDT) may discontinue certifying credits and notify the department of taxation. Permits DBEDT to increase the cap according to the level of demand of qualified renewable transportation fuel production; provided that DBEDT report to the legislature on the rationale and justification of such increase.

Repeals the provision limiting the qualifying renewable fuels facility tax credit to 40 million gallons per year.

This section shall be applicable to tax years beginning after December 31, 2012.

**Biofuel Production Facility Income Tax Credit** - Adds a new section to HRS chapter 235 to allow a taxpayer to claim a refundable biofuel production facility income tax credit of 15% of the qualified development and construction costs of the facility. To qualify for the credit a facility shall: (1) be located in the state; (2) meet the definition of a qualified biofuel production facility; (3) have a production capacity of at least 5 million gallons; (4) have qualified development and construction costs totaling at least \$10 million; and (5) be in production on or before January 1, 2017. The total credits claimed per qualified biofuel facility shall not exceed \$60 million.

Requires the taxpayer to first prequalify for the credit by registering with DBEDT during the development or construction stage. Failure to comply with this provision may constitute a waiver of the right to claim the credit. Requires every taxpayer claiming the credit to submit a written, sworn statement to DBEDT no later than 90 days following the end of a tax year.

Every taxpayer claiming the credit must submit a written statement to DBEDT within 90 days of the close of the tax year of the qualified costs, amount of tax credits claimed and the number of hires related to the development or construction of the facility in a taxable year. Requires DBEDT to maintain records of the taxpayers claiming the credit, obtain and total the aggregate amounts of the construction costs for each facility and provide a letter to the director of taxation delineating the amount of tax credits for each facility and the cumulative amount claimed for all years.

In the case of a partnership, S corporation, estate, or trust, the tax credit allowable shall be for qualified production costs incurred by the entity with the cost upon which the tax credit is computed to be at the entity level. Distribution and share of the tax credit shall be determined by rule adopted by the director of taxation. If a deduction is taken under section 179 (with respect to election to expense depreciable business assets) of the Internal Revenue Code, no tax credit shall be allowed for those costs for which the deduction is taken. The basis for eligible property for depreciation of accelerated cost recovery system purposes for state income taxes shall be reduced by the amount of credit allowable and claimed.

Credits in excess of tax liability may be applied to subsequent tax liability until exhausted. Requires all claims for the credit to be filed before the end of the twelfth month following the end of tax year. The director of taxation shall prepare forms as may be necessary to claim the credit and may adopt rules pursuant to chapter 91. A recipient of the tax credits shall refund the state the entire amount of the credits earned and claimed in one payment in the tenth taxable year after the recipient obtains its final tax credit.

Defines “net income tax liability,” “qualified biofuel production facility” and “qualified development and construction cost” for purposes of the measure.

This section shall be applicable to tax years beginning after 12/31/11; provided the tax credit shall: (1) apply to qualified development and construction costs of qualified biofuel production facilities incurred on or after 7/1/11, and before 1/1/17; and (2) be repealed on 1/1/29.

EFFECTIVE DATE: Upon approval as noted

STAFF COMMENTS: The legislature by Act 289, SLH 2000, established an investment tax credit to encourage the construction of an ethanol production facility in the state. The legislature by Act 140,

SLH 2004, changed the credit from an investment tax credit to a facility tax credit. This measure proposes to change the ethanol facility tax credit to a renewable transportation fuels production facility tax credit and proposes a biofuel production income tax credit.

While it has been almost ten years since the credit for the construction of an ethanol plant in Hawaii was enacted and ground has not broken yet, it appears that there are other far more efficient biofuels which could be developed and, therefore, the existing credit, which is specific to ethanol, might not be available to assist in the development of these other types of fuels.

While the idea of providing a tax credit to encourage such activities may have been acceptable a few years ago when the economy was on a roll and advocates could point to credits like those to encourage construction and renovation activities, what lawmakers and administrators have learned in these past few months is that unbridled tax incentives, where there is no accountability or limits on how much in credits can be claimed, are indeed irresponsible as the cost of these credits goes far beyond what was ever contemplated. As an alternative, lawmakers should consider repealing this credit and look for other types of alternate energy to encourage through the appropriation of a specific number of taxpayer dollars. At least lawmakers would have a better idea of what is being funded and hold the developers of these alternate forms of energy to a deliberate timetable or else lose the funds altogether. A direct appropriation would be preferable to the tax credit as it would provide some accountability for the taxpayers' funds being utilized to support this effort.

This proposal verifies what has been said all along about legislators latching onto the fad of the month without doing very serious research. While ethanol was the panacea of yesterday, lawmakers have learned that there are more down sides to the use of ethanol than there are pluses. Ethanol production demands more energy to produce than using a traditional petroleum product to produce the same amount of energy and the feedstock that is used to produce ethanol basically redirects demand for that feedstock away from traditional uses, causing those other products to substantially increase in price. Thus, such proposals should come under closer scrutiny instead of being left to interpretation by a taxpayer wanting to utilize the tax incentive to underwrite the cost of what would still be a questionable use of taxpayer dollars.

An appropriation of taxpayer dollars for such untried and unproven technologies would be far more accountable than the tax credit as such technologies would have undergone the scrutiny of lawmakers. Providing a tax incentive is an indicator that lawmakers are unwilling to do the hard research and unwilling to impose strict discipline in the expenditure of hard-earned tax dollars. The tax incentive approach represents nothing more than a hope and a wish that some breakthrough will be made, no matter how inefficient it may be, that some alternative to fossil fuel will be found. In the mean time, those tax dollars will be wasted on some unproven folly. If this were an appropriation, taxpayers would then know who to hold accountable for the waste of those tax dollars. Such was the case of the Act 221 credits for high technology investments and research which proved to be a scam for many claimants of the credit. And, true, there have been some successes, but those materialized much like a crap shoot in Vegas. Much of the more than \$1 billion in Act 221 tax credits created few, if any, jobs or any real industry. Thus, the tax incentive approach represents an abdication of responsibility on the part of lawmakers to do the real homework necessary to make a well-researched and judicious decision in spending taxpayer dollars. Such is the case as evidenced by this proposed permutation of a tax credit for renewal fuels.

Finally, the measure provides that the recipient of the biofuel production income tax credit refund the entire amount of the tax credits claimed ten years after the year the recipient received the final tax credit payment. The addition of this provision turns the tax credit into a no-interest loan. The taxpayer may be unable to repay this "loan" and there are no provisions in this bill for this scenario.