



**TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
TWENTY-EIGHTH LEGISLATURE, 2016**

ON THE FOLLOWING MEASURE:

S.B. NO. 2652, RELATING TO TAXATION.

BEFORE THE:

SENATE COMMITTEE ON TRANSPORTATION AND ENERGY

DATE: Tuesday, February 2, 2016 **TIME:** 2:50 p.m.

LOCATION: State Capitol, Room 229

TESTIFIER(S): Douglas S. Chin, Attorney General, or
Kristie Cruz Chang, Deputy Attorney General

Chair Inouye and Members of the Committee:

The Department of the Attorney General provides the following comments on S.B. No. 2652.

The purposes of this bill are to establish a five-year renewable fuels production tax credit and to repeal the ethanol facility tax credit. This measure allows qualifying taxpayers to claim a refundable income tax credit equal to twenty cents per seventy-six thousand British thermal units of qualifying renewable fuel produced and sold for distribution in Hawaii. The credit in this bill is capped at \$3,000,000 per taxpayer per year and the total credit for all taxpayers is capped at \$3,000,000 per year. This bill also: (1) requires the Department of Business, Economic Development, and Tourism (DBEDT) to certify all tax credits and submit a report regarding the production and sale of qualifying renewable fuels to the Governor and to the Legislature each year; (2) applies to taxable years beginning after December 31, 2016; and (3) repeals the tax credit on December 31, 2021.

S.B. No. 2652 contains wording that could be subject to challenge as violative of the Commerce Clause of the United States Constitution. Article I, Section 8, Clause 3, of the United States Constitution provides that the Commerce Clause grants Congress power to “regulate Commerce . . . among the several States.” “It has long been accepted that the Commerce Clause not only grants Congress the authority to regulate commerce among the States, but also directly limits the power of the States to discriminate against interstate commerce. New Energy Co. of In. v. Limbach, 486 U.S. 269, 273-74, 108 S. Ct. 1803, 1807-08, 100 L. Ed. 2d 302 (1988). “Discrimination against interstate commerce in favor of local business or investment is *per se*

invalid, save in a narrow class of cases in which the municipality can demonstrate, under rigorous scrutiny, that it has no other means to advance a legitimate local interest.” C & A Carbone, Inc. v. Town of Clarkstown, N.Y., 511 U.S. 383, 392, 114 S. Ct. 1677, 1683, 128 L. Ed. 2d 399 (1994), *citing* Maine v. Taylor, 477 U.S. 131, 106 S. Ct. 2440, 91 L. Ed. 2d 110 (1986). The United States Supreme Court stated in a case arising from a Hawaii tax law that the cardinal rule of Commerce Clause jurisprudence is that “[n]o State, consistent with the Commerce Clause, may ‘impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.’” Bacchus Imports Ltd. v. Dias, 468 U.S. 263, 268 (1984), *citing* Boston Stock Exch. v. State Tax Comm’n, 429 U.S. 318, 329 (1977). In Bacchus, the United States Supreme Court struck down a Hawaii law that provided an exemption from the liquor tax for liquor produced in the State.

In this bill, a tax credit will be provided “[f]or each taxpayer producing *renewable fuels*, the annual dollar amount of the *renewable fuels* production tax credit during the five-year period shall be equal to 20 cents per seventy-six thousand British thermal units of *renewable fuels* using the lower heating value *produced and sold for distribution in Hawaii*” (emphases added). See, S.B. No. 2652, pg. 4, lines 1-6. While the foregoing wording may be interpreted to require production in the State, the wording on p. 8, lines 13-16, requires the Director of DBEDT to report : [t]he number, location, and production of renewable fuels production facilities in the State and outside the State that have claimed a credit under this section.” This requirement makes evident that this credit may be claimed for renewable fuels produced outside the State. However, the definition of “renewable fuels” is specifically defined as “fuels produced from renewable feedstocks having its point of origin within the State”. The credit provides a distinct advantage to taxpayers who produce and sell renewable fuels within the State as they would presumably have cheaper access to feedstock “having its origin within the State”. While it is true that an out-of-state taxpayer can receive the credit, such taxpayer can only receive the tax credit if it produces renewable fuels using feedstock having its origin within the State AND sells it within the State. These requirements may be subject to challenge under the Commerce Clause.

S.B. No. 2652 is distinguishable from Bacchus in that it provides a tax credit instead of a tax exemption. However, we believe that this bill is subject to a legal challenge under the

Commerce Clause because it has “both the purpose and effect of discriminating in favor of local products.” Bacchus, 468 U.S. 263, 273. It is “not the formal language of the tax statute but rather its practical effect.” Comptroller of Treasury of Md., 135 S. Ct. 1787, 1795 (2015), *citing* Complete Auto, 430 U.S. 274, 279, 97 S. Ct. 1076 (1977).

The Department of the Attorney General recommends that S.B. No. 2652 be amended to avoid constitutional challenges. The definition of “renewable fuels” should be amended to delete “point of origin within the State.” Also, page 4, line 5, should be amended to either delete “produced and” or amended to read “produced within the State or outside of the State.”



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In SUPPORT of SB 2652 RELATING TO TAXATION

**Before the
SENATE COMMITTEE ON TRANSPORTATION AND ENERGY**

February 2, 2015 2:50 p.m.

Aloha Chair Inouye, Vice-Chair Gabbard and members of the Committee.

My name is Erik Kvam. I am a Director of Renewable Energy Action Coalition of Hawaii (REACH). REACH is a trade association whose vision is a Hawaiian energy economy based 100% on renewable sources indigenous to Hawaii.

REACH is in **SUPPORT** of SB 2652.

Hawaii is far behind in achieving its renewable goals for transportation. Transportation fuels account for about two-thirds of all the energy consumed in Hawaii. Virtually all of Hawaii's energy for transportation comes from imported fuels.

Without renewable fuel production from sources indigenous to Hawaii, Hawaii will have virtually no fuel available for critical transportation needs when imported fuels stop flowing to Hawaii.

REACH **SUPPORTS** SB 2652 – creating a production tax credit of so-many cents per 76,000 BTUs of renewable fuels produced from sources indigenous to Hawaii -- to encourage the development of renewable fuel production from sources indigenous to

Hawaii. REACH **SUPPORTS** SB2652, so that Hawaii has the transportation fuels it needs when imported fuels stop flowing to Hawaii.

Thank you for providing this opportunity to testify.



SENATE COMMITTEE ON TRANSPORTATION AND ENERGY

February 2, 2016, 2:50 P.M.

Room 229

(Testimony is 3 pages long)

TESTIMONY IN SUPPORT OF SB 2652

Aloha Chair Inouye, Vice Chair Gabbard, and Committee members:

The Blue Planet Foundation supports SB 2652, expanding the eligibility for biofuel production facilities beyond ethanol. This policy—providing a biofuel facility tax credit to incentivize the needed development and construction of such facilities—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. While much of our work has been focused on renewable energy and reducing electricity use, transportation in Hawaii (cars, trucks, ships, and planes) accounts for approximately two-thirds of the oil consumed. **In 2014, Hawaii cars and trucks burned nearly 500 million gallons of gasoline and diesel fuel.** For a typical car, that’s enough fuel to cover the distance equivalent to over 21,000 round trips to the moon.

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.

Blue Planet also supports policy to require that a certain percentage (5% - 10%) of diesel fuel sold in Hawai`i be biodiesel. One of Hawai`i’s entrepreneurial success stories is biodiesel, a fuel that can be created from recycled cooking grease and oils or grown locally, and that can be substituted in place of fossil fuel-based diesel for transportation. Already, this local industry is creating enough fuel to displace 5% of transportation diesel fuel sold in the state. The biofuels industry is also making headway on the state’s use of aviation fuels; HawaiiBioenergy has completed an agreement with Alaska airlines to power Hawai`i flights with biofuels starting as soon as 2018. Blue Planet supports a mandate to blend biodiesel with all locally sold diesel fuel. This smart step will help to continue the momentum for a local industry to supply indigenous clean energy for our transportation energy needs.

While Gov. David Ige vetoed a bill similar to SB 2652 (SB 349 CD1), we believe that the proposed policy to produce locally produced sustainable biofuel withstands scrutiny.

The Governor's rationale for vetoing SB 349 in 2015 was because the law "does not allow for companies outside of Hawai'i to be qualified" and that this "potentially violates the Commerce Clause of the U.S. Constitution, and could subject our state to potential litigation."¹

This rationale does not warrant vetoing the bill. Under this rationale, all tax credits are "potentially" subject to litigation over negative Commerce Clause claims.² The more pertinent legal question is whether promoting energy security through locally produced sustainable biofuels is a "legitimate public purpose." For a state with no indigenous fossil fuel resources, with its nearest state neighbor thousands of miles away, the answer to this question is "yes."

The U.S. Supreme Court has stated: "As long as a State does not needlessly obstruct interstate trade or attempt to 'place itself in a position of economic isolation,' it retains broad regulatory authority to protect the health and safety of its citizens and the integrity of its natural resources."³

Based on this principle, the legal test is not whether the law "allow[s] for companies outside of Hawai'i to be qualified." Under the U.S. Supreme Court's legal test, a tax credit is valid if it "serves a legitimate local purpose" and this purpose could not be served as well by other available means, even if it the tax credit favors Hawai'i taxpayers over other taxpayers in interstate commerce.⁴

Section 1 of SB 2652 explains that its purpose is to "achieve greater energy security for Hawaii."
The threshold question policymakers should ask is whether this is a "legitimate local purpose" or whether instead the law is simply intended as economic isolationism against interstate commerce.

Hawai'i's unique situation and context makes energy security a *bona fide* and legitimate local purpose. With the nearest out-of-state energy infrastructure thousands of miles away, local energy production is a direct solution for greater energy security. Hawai'i has no indigenous fossil fuels; indigenous biofuels are presently the *only available source* of secure and sustainable transportation fuels for internal combustion engines in Hawai'i. Establishing a local industry to produce feedstocks and process those feedstocks into fuels is sound policy. Local

¹ See <http://governor.hawaii.gov/newsroom/news-release-governor-releases-intent-to-veto-list/>.

² See, e.g. W. Hellerstein & D.T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 795 (1996) (noting that an overly broad reading of rhetoric in jurisprudence on the negative Commerce Clause would "cast a constitutional cloud over all state tax incentives").

³ *Maine v. Taylor*, 477 U.S. 131, 151 (1986) (quoting *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935)).

⁴ *Id.* at 138 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979)).

sustainable energy resources serve the purpose of energy security better than any other means, irrespective of the impact on Hawai'i taxpayers in comparison to other taxpayers.⁵

This is not about economic isolationism, it is about safeguarding Hawai'i's unique population and environment. Indeed, Hawai'i biofuels do not need economic protection. Biofuels are already a local success story; one of the oldest and most successful biofuel firms⁶ is located here, processing waste products into biodiesel fuel for Hawai'i consumers. This local industry doesn't need protection, it needs support to expand access to local feedstocks to serve a larger portion of our energy needs, thus strengthening the state's energy security.

Energy security through locally produced biofuels a "legitimate local purpose" for which there are no better solutions available today. Please advance SB 2652 to foster building Hawai'i's diverse biofuel production infrastructure.

Thank you for the opportunity to testify.

⁵ Notably, Hawai'i's isolated island geography also makes it uniquely susceptible to environmental risks and climate change caused by emissions from imported fossil fuels and transporting imported biofuel feedstocks. Hawai'i has a "legitimate interest in guarding against [even] imperfectly understood environmental risks." *Id.* at 148. The "constitutional principles underlying the commerce clause cannot be read as requiring the State of [Hawai'i] to sit idly by and wait until potentially irreversible environmental damage has occurred" *Id.*

⁶ Pacific Biodiesel was founded in 1995 on Maui. One indication of this company's long success in the industry is the fact that it holds the web domain www.biodiesel.com.