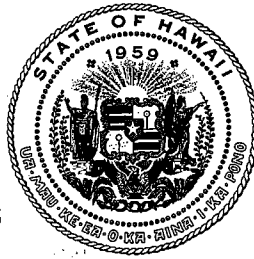


ORIGINAL

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917



LESLIE H. KONDO
State Auditor

RECEIVED
SENATE
OFFICE OF THE PRESIDENT
(808) 587-0800
lao.auditors@hawaii.gov

DEPT. COMM. NO. 373

July 19, 2017

VIA HAND DELIVERY AND EMAIL

The Honorable Ronald D. Kouchi
Senate President
415 South Beretania Street
Hawaii State Capitol, Room 409
Honolulu, Hawaii 96813

Re: Report No. 17-07, Report of Hawaii Superferry Final Expenses

Dear President Kouchi:

We are enclosing a copy of Report No. 17-07, *Report of Hawaii Superferry Final Expenses*. Copies of the report have also been delivered to the Governor, Lt. Governor, Director of Finance, and Director of the Department of Transportation, as well as to each member of the Senate and House of Representatives. The report is also accessible through the Office of the Auditor's website at <http://files.hawaii.gov/auditor/Reports/2017/17-07.pdf>.

If you have questions about the report, please contact me.

Very truly yours,

Leslie H. Kondo
State Auditor

LHK:RTS:lfs

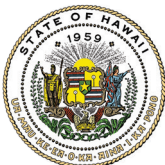
c: Legislative Reference Bureau Library
Carol T. Taniguchi, Senate Chief Clerk
Ben Villaflor, Senate Sergeant-At-Arms

Enclosure

Report of Hawai'i Superferry Final Expenses

A Report to the Governor
and the Legislature of
the State of Hawai'i

Report No. 17-07
July 2017



OFFICE OF THE AUDITOR
STATE OF HAWAI'I



OFFICE OF THE AUDITOR STATE OF HAWAII

Constitutional Mandate

Pursuant to Article VII, Section 10 of the Hawai'i State Constitution, the Office of the Auditor shall conduct post-audits of the transactions, accounts, programs and performance of all departments, offices and agencies of the State and its political subdivisions.

The Auditor's position was established to help eliminate waste and inefficiency in government, provide the Legislature with a check against the powers of the executive branch, and ensure that public funds are expended according to legislative intent.

Hawai'i Revised Statutes, Chapter 23, gives the Auditor broad powers to examine all books, records, files, papers and documents, and financial affairs of every agency. The Auditor also has the authority to summon people to produce records and answer questions under oath.

Our Mission

To improve government through independent and objective analyses.

We provide independent, objective and meaningful answers to questions about government performance. Our aim is to hold agencies accountable for their policy implementation, program management and expenditure of public funds.

Our Work

We conduct performance audits (also called management or operations audits), which examine the efficiency and effectiveness of government programs or agencies, as well as financial audits, which attest to the fairness of financial statements of the State and its agencies.

Additionally, we perform procurement audits, sunrise analyses and sunset evaluations of proposed regulatory programs, analyses of proposals to mandate health insurance benefits, analyses of proposed special and revolving funds, analyses of existing special, revolving and trust funds, and special studies requested by the Legislature.

We report our findings and make recommendations to the Governor and the Legislature to help them make informed decisions.

For more information on the Office of the Auditor, visit our website:
<http://auditor.hawaii.gov>

Foreword

Last year, the Legislature appropriated \$50,000 to the Hawai'i Department of Transportation (DOT) to study the feasibility of establishing an interisland and intra-island ferry system similar to the ferry systems operated by Washington State and Alaska. Among the myriad issues to address, the Legislature requested that the study emphasize compliance with the State's environmental protection laws, identify appropriate routes and harbors for the ferry system, consider the potential costs and revenues of the ferry system, and include financing options for the ferry system, including rates or fees to address operating costs.

DOT received an additional \$500,000 from the U.S. Department of Transportation's Maritime Administration for the study, signing a cooperative agreement on February 28, 2017. Pursuant to that agreement, DOT is expected to assess different scenarios for the ferry system, one of which would be a State-owned and operated ferry. Should DOT decide to pursue a private ferry operation or public-private partnership as a model for the proposed ferry service, DOT is required to develop a Request for Proposal to solicit potential commercial ferry operators to operate and maintain the proposed ferry service. The agreement is effective until August 28, 2018.

As DOT studies the feasibility of an interisland ferry system, we report the final costs to the State – some of which the State continues to pay – for support of Hawai'i Superferry operations.

This study was not conducted in accordance with Generally Accepted Government Auditing Standards. However, we planned and performed the study to obtain sufficient, appropriate evidence to provide a reasonable basis for the information reported herein. We believe that the evidence obtained provides a reasonable basis for our report.

Leslie H. Kondo
State Auditor



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PHOTO: OFFICE OF THE AUDITOR

Underwater: State's Costs of Hawai'i Superferry Total \$71 Million

The Hawai'i Superferry stopped its operations on March 19, 2009, over 8 years ago; yet, the State continues to pay costs it incurred for support of Hawai'i Superferry operations—and will continue to pay those costs until 2028.

Last year, the Legislature appropriated \$50,000 to the Hawai'i Department of Transportation (DOT) to study the feasibility of establishing an interisland and intra-island ferry system. DOT received an additional \$500,000 for the study from the U.S. Department of Transportation's Maritime Administration.

As DOT considers the feasibility of another interisland ferry system, this report updates the total costs the State incurred—and taxpayers are still paying—to support Hawai'i Superferry operations. The costs we report herein are from DOT's financial accounting records. We did not independently verify the costs or test the department's accounting of those costs. Costs and other expenditures that other state agencies incurred or that DOT did not directly attribute to the Hawai'i Superferry or its operations are not included in our calculation of the total costs incurred by the State. For example, the costs we report do not include personnel costs, such as the salaries of DOT and other State officials and employees whose responsibilities involved Hawai'i Superferry's operations, the attorney's fees and other costs relating to the legal actions against the State, or the costs associated with the 2007 Special Session of the Legislature.

... this report updates the total costs the State incurred—and taxpayers are still paying—to support Hawai'i Superferry operations.

Significant Costs of Note



PHOTO: OFFICE OF THE AUDITOR

Barge-and-ramp systems

TOTAL

\$38,127,915

DOT PAID OVER \$38.1 MILLION to Healy Tibbitts Builders (Healy Tibbitts) for the barges and vehicle ramp systems for the Hawai'i Superferry. The department's contract required Healy Tibbitts to design, build, and install a barge system consisting of a barge, mooring system, and fenders. The barges at Honolulu and Kahului were 280.5 feet long and Kawaihae's barge was 201.8 feet long. Honolulu's and Kawaihae's barges were 75.5 feet wide while Kahului's was 105 feet wide.

A mooring system secured the barge-and-ramp systems by means of cables, anchors, or lines to bollards (posts) on the piers in each harbor. Fenders were required between the barge and pier to absorb energy from barge motions due to surge waves and high wind.

**HAWAI‘I SUPERFERRY
TOTAL COST TO THE STATE**

Total capitalized costs (assets) \$45,260,843*

- | | |
|---|---------------|
| 1. Barge-and-ramp systems | \$ 38,127,915 |
| 2. Capital Improvement Project related to Hawai‘i Superferry operations | \$ 4,424,990 |
| 3. Wharf improvements | \$ 1,520,786 |
| 4. Land improvements | \$ 1,187,152 |

Tug service and transportation of barges to and within Honolulu Harbor \$730,036

Total interest on general obligation bonds \$24,615,245

TOTAL \$70,606,124

THANK YOU!

*In FY2009, DOT claimed \$41.4 million (net of depreciation of \$3.9 million) in capital costs as an “extraordinary loss.” By classifying this loss as an extraordinary loss, the State acknowledged that the barge-and-ramp systems had no foreseeable use by any other operator for the purposes for which they were acquired, rendering their value to \$0.



PHOTO: OFFICE OF THE AUDITOR

Kahului barge mooring system repair

\$273,859

Kahului interior barge repair and replace Pier 2B plate bollard

\$169,411

TOTAL

\$443,270*

*included as part of barge-and-ramp systems

SHORTLY AFTER ENTERING SERVICE in August 2007, Kahului's barge-and-ramp system repeatedly damaged its pier during storm surges and high winds. In mid-September 2007, mooring lines broke and the pier fender was damaged. Mooring lines broke again in mid-October 2007, mid-November 2007, early December 2007, mid-January 2008, and again in early April 2008. Each time the mooring lines broke, the size and strength of the mooring lines were increased until ultimately they became stronger than the pier-side post, or bollard, that they were secured to. Eventually, the bollard was pulled out of the pier.

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Eventually, the bollard was pulled out of the pier.

After the November 2007 incident, the barge's internal framing was buckled and twisted, brackets were tripped and buckled, and the side shell plate was dented. Also, the fender system was extensively damaged. Following heavy surge conditions and high winds in December 2007, the barge's hand railings and stanchions were bent and fractured, and the access ladder was damaged.

The contract with Healy Tibbits required that all of the barge-and-ramp systems be extremely reliable and operate through all kinds of weather conditions, including storm surge conditions, occasional high wave action, occasional high winds, and rain. However, according to the contractor, the damage to Kahului Harbor's barge and ramp occurred when weather conditions exceeded the mooring system's operational limits. The mooring system was a DOT responsibility.

General Obligation Bond Repayment Schedule

FY	Principal	Interest	Total
2007	\$ -	\$ 1,106,473	\$ 1,106,473
2008	\$ -	\$ 1,336,618	\$ 1,336,618
2009	\$ -	\$ 1,830,941	\$ 1,830,941
2010	\$ 966,555	\$ 1,858,207	\$ 2,824,762
2011	\$ 1,140,760	\$ 1,819,229	\$ 2,959,989
2012	\$ 1,609,314	\$ 1,771,602	\$ 3,380,916
2013	\$ 1,678,482	\$ 1,702,350	\$ 3,380,832
2014	\$ 1,757,503	\$ 1,623,176	\$ 3,380,679
2015	\$ 1,844,233	\$ 1,536,820	\$ 3,381,053
2016	\$ 1,932,016	\$ 1,448,638	\$ 3,380,654
2017	\$ 2,022,854	\$ 1,357,966	\$ 3,380,820
2018	\$ 2,122,232	\$ 1,258,386	\$ 3,380,618
2019	\$ 2,227,919	\$ 1,152,889	\$ 3,380,808
2020	\$ 2,336,771	\$ 1,044,012	\$ 3,380,783
2021	\$ 2,450,903	\$ 929,861	\$ 3,380,764
2022	\$ 2,572,554	\$ 808,084	\$ 3,380,638
2023	\$ 2,700,654	\$ 680,024	\$ 3,380,678
2024	\$ 2,835,218	\$ 545,735	\$ 3,380,953
2025	\$ 2,976,657	\$ 404,299	\$ 3,380,956
2026	\$ 3,124,940	\$ 255,883	\$ 3,380,823
2027	\$ 1,135,535	\$ 100,183	\$ 1,235,718
2028	\$ 893,484	\$ 43,869	\$ 937,353
Total	\$ 38,328,584	\$ 24,615,245	\$ 62,943,829

Ship Has Sailed On, but State Still Owes \$32.6 Million

TO FINANCE barges and ramps for Honolulu, Kahului, and Kawaihae Harbors, as well as a fixed ramp for Nāwiliwili Harbor, in 2008, the State issued approximately \$38 million in 20-year general obligation bonds, which it will be paying off through 2028. From FY2007–FY2028, the state will have paid over \$62.9 million in principal and interest.

WHAT THE STATE STILL OWES

Outstanding Balance as of July 1, 2017

\$32.6 million



PHOTO: OFFICE OF THE AUDITOR

Daily Tug Service for
Kahului Barge, FY2008
and FY2009

TOTAL

\$506,804

AFTER THE U.S. COAST GUARD expressed concern about the instability of the barge-and-ramp system at Kahului Harbor, DOT commissioned a tugboat to hold the barge snug against the pier during Hawai'i Superferry operations to provide the safe loading and unloading of vehicles. During periods of strong ocean surges, regardless of whether the ferry was in port or not, the tug boat was also needed to hold either the barge snug against the pier to minimize damage or move the barge off the pier.

Daily tug service of about two-and-a-half hours to three hours a day started in December 13, 2007. DOT paid \$506,804 for tug services in Kahului Harbor from December 2007 through September 2008, passing along these expenses to Hawai'i Superferry in October 2008. The company never reimbursed the State.

Transportation of barge-and-ramp systems to and within Honolulu Harbor after the shutdown of service, FY2010 and FY2011

TOTAL

\$223,232

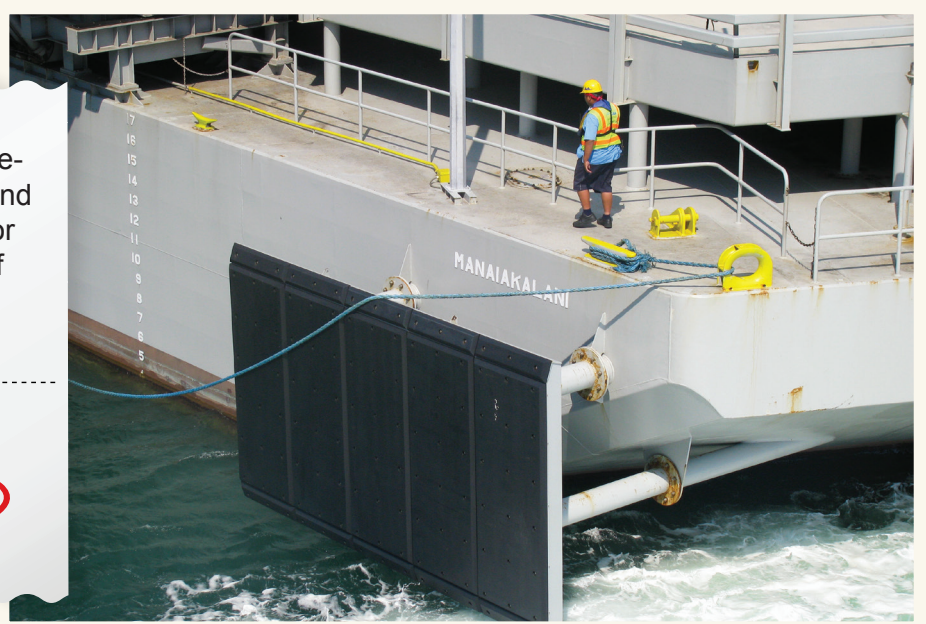


PHOTO: OFFICE OF THE AUDITOR

State Recovered About 1 percent of Barge-and-Ramp System Costs

Barge-and-Ramp Systems Sold to Vogel Equipment on October 29, 2013, for \$382,500

THE THREE STATE-OWNED BARGES were built in China and therefore were not part of the Jones Act Fleet. The Jones Merchant Marine Act of 1920, often referred to as The Jones Act, is a federal statute passed by Congress in 1920 to regulate maritime commerce in U.S. waters and between U.S. ports and to protect the domestic shipping industry. The Jones Act requires vessels engaged in U.S. domestic shipping to be U.S.-flagged vessels built in the United States. Since the State's barges were built in China, they could not be converted to cargo carriers, since they would be prohibited from carrying merchandise and cargo between U.S. ports. In addition, the barge-and-ramp systems were designed specifically for Hawai'i Superferry's use and could not be repurposed by other harbor users. These factors likely had profound impacts on the resale value of the barge-and-ramp systems.

ORIGINAL COST OF BARGE-AND-RAMP SYSTEMS

\$38,125,915

MONEY RECOUPED BY THE STATE FOR BARGE-AND-RAMP SYSTEMS

\$382,500

Background of the Program

The Hawai'i Superferry was a high-speed inter-island ferry service that operated from August 26, 2007, to March 19, 2009, between the islands of O'ahu, Maui, and Kaua'i. The company's ship, the *Alakai*, was a catamaran-style vessel capable of sailing at speeds of up to 35 knots (40 mph) and carrying up to 866 passengers and 282 cars.

To load and unload its vehicles, the *Alakai* had to either carry its own loading ramp on board or rely on pier-side facilities. The Hawai'i Superferry elected to go with a pier-side solution. Initially, DOT opposed paying for these facilities. At the time, DOT's policy was clear: The department was responsible for providing the piers, associated mooring devices, lighting, bull rails, and the dredging of pier-side submerged lands. DOT was not responsible for loading ramps and other pier-side equipment. However, after a meeting with then-Governor Linda Lingle's office, DOT reversed its position and agreed to provide barges and ramps at its harbors to support Hawai'i Superferry operations.

Superferry Timeline

August 26, 2007

Alakai begins serving O'ahu, Kaua'i, and Maui.

August 27, 2007

A Maui court issues a temporary restraining order barring the *Alakai* from accessing Kahului Harbor. The court found that DOT must perform an environmental impact statement for Kahului Harbor improvements.

August 31, 2007

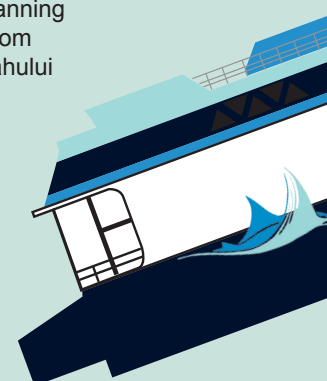
The Hawai'i Supreme Court decides DOT cannot exempt the Hawai'i Superferry from performing an environmental impact statement.

November 2, 2007

Governor Lingle signs Act 2, which allows "large-capacity ferry vessels" to operate between ports in the Hawaiian Islands while an environmental impact statement is prepared.

November 14, 2007

A Maui court lifts the injunction banning the *Alakai* from sailing to Kahului Harbor.

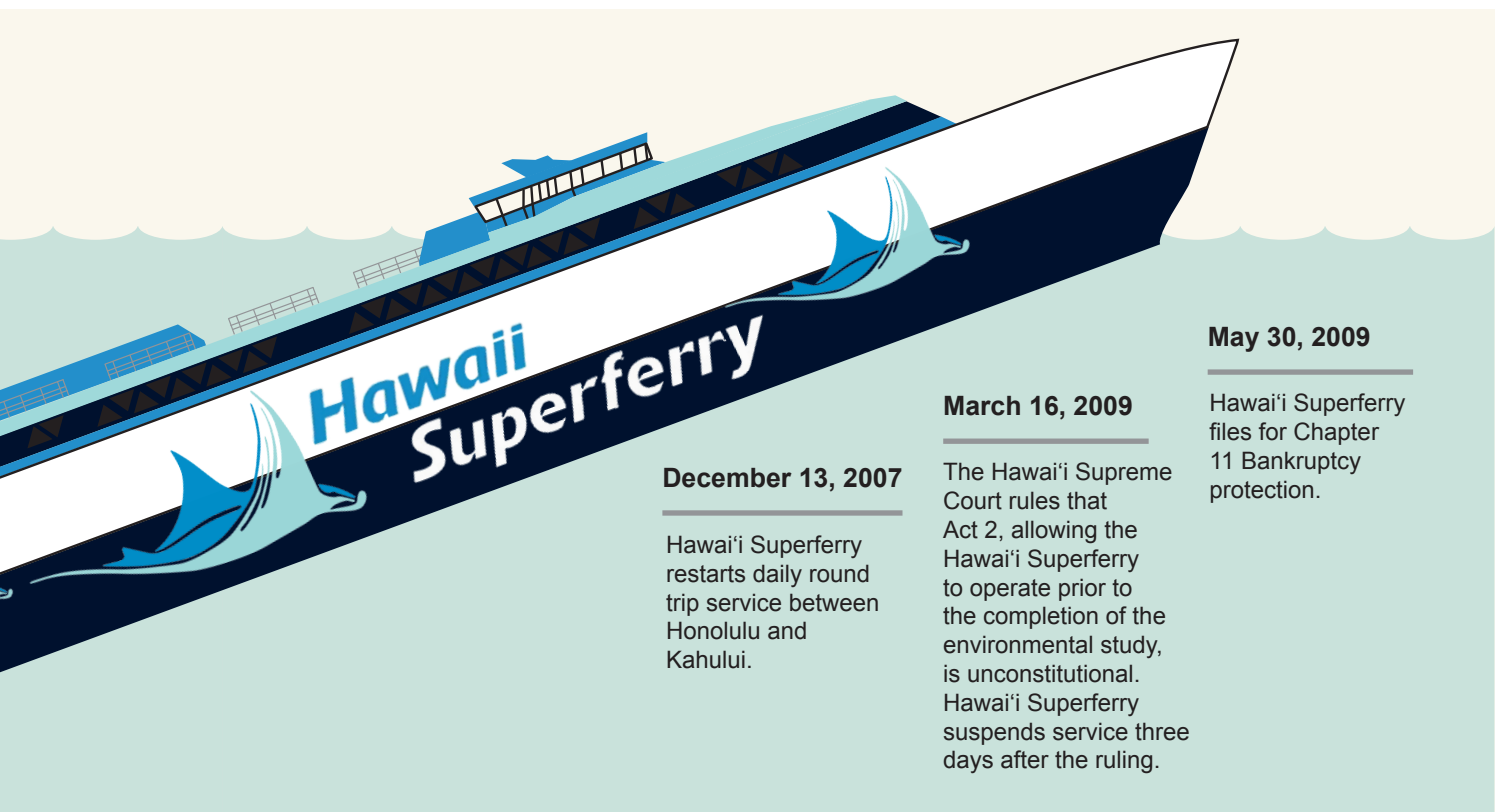


To meet a deadline imposed by the Hawai'i Superferry, DOT exempted its harbor improvements, specifically the barge-and-ramp systems needed to load and unload vehicular cargo, from an environmental assessment. However, on August 31, 2007, less than a week after the Hawai'i Superferry began operations, the Hawai'i Supreme Court ruled that DOT had erred by not requiring the environmental review. A court subsequently halted the Hawai'i Superferry's use of the barge-and-ramp system at Kahului Harbor until the State had completed an environmental assessment.

The Legislature was called into special session on October 23, 2007, to consider a bill to allow "large-capacity ferry vessels" to operate between ports in Hawai'i while an environmental impact statement was prepared. The bill was signed on November 2, 2007, as Act 2, and the Hawai'i Superferry restarted its service to Maui on December 13, 2007. However, on March 16, 2009, the Hawai'i Supreme Court ruled that Act 2 was unconstitutional. Hawai'i Superferry shut down operations three days later. At that point, the Hawai'i Superferry had been in operation for about one year and nine months. The company filed for bankruptcy on May 30, 2009.

DOT's policy was clear: The department was not responsible for loading ramps and other pier-side equipment.

However, after a meeting with then-Governor Linda Lingle's office, DOT reversed its position on providing pier-side equipment and agreed to provide barges and ramps at its harbors to support Hawai'i Superferry operations.



December 13, 2007

Hawai'i Superferry restarts daily round trip service between Honolulu and Kahului.

March 16, 2009

The Hawai'i Supreme Court rules that Act 2, allowing the Hawai'i Superferry to operate prior to the completion of the environmental study, is unconstitutional. Hawai'i Superferry suspends service three days after the ruling.

May 30, 2009

Hawai'i Superferry files for Chapter 11 Bankruptcy protection.

Prior Audits

In April 2008, we issued Report No. 08-09, *Performance Audit on the State Administration's Actions Exempting Certain Harbor Improvements to Facilitate Large Capacity Ferry Vessels From the Requirements of the Hawai'i Environmental Impact Statements Law: Phase I*, which found that DOT abandoned efforts to require an environmental review for harbor improvements needed to accommodate the ferry service. Instead, the department took advantage of the State's Environmental Impact Statements law and rules, invoking its exemption determination list and bypassing environmental review. In our audit, we concluded that efforts to support Hawai'i Superferry's interests may have compromised the State's environmental policy.

In December 2008, we issued Report No. 08-11, *Performance Audit on the State Administration's Actions Exempting Certain Harbor Improvements to Facilitate Large Capacity Ferry Vessels From the Requirements of the Hawai'i Environmental Impact Statements Law: Phase II*, which found that with the impending arrival of Hawai'i Superferry, DOT reversed a long-standing policy of not providing additional pier-side equipment for harbor users. We also found that the state-funded \$38.5 million harbor improvement system provided to Hawai'i Superferry proved to be problematic, best exemplified by Kahului Harbor's barge, which was continually battered by high winds and waves. The barge also required the services of a tug boat to secure it to the pier during ferry operations. In addition, we determined that the legislation on behalf of Hawai'i Superferry compromised the State's environmental laws and set a worrisome precedent for future government accommodation that puts the interests of a single business before the State's environmental, fiduciary, and public safety responsibilities.

