HB 371

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IN REPLY REFER TO:

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION
869 PUNCHBOWL STREET
HONOLULU, HAWAII 96813-5097

April 3, 2009

TESTIMONY OF THE DEPARTMENT OF TRANSPORTATION

HOUSE BILL NO. 371 H.D. 2, S.D. 1

COMMITTEE ON WAYS AND MEANS

House Bill 371, H.D. 2, S.D 1 will repeal the sunset provision relating to the one cent tax on naphtha fuel used in a power generating facility.

The Department does not take a position on the naphtha fuel issue outlined in this bill. The Department does not include the naphtha fuel tax into its revenue projections for the State Highway Fund.

However, **the Department does support** the language that deletes the repeal date such that the one cent increase in the state fuel tax approved as part of Act 103, Session Laws of Hawaii 2007, remain in place so as not to reduce the amount of revenue into the State Highway Fund.

Currently, a 1-cent state fuel tax generates $5 to $7 million each year in State Highway Fund revenues. If the fuel tax rate was lowered, we would lose this revenue. At a time when the Highways Division is looking for new ways to generate revenue and maintain current revenue levels, any decrease would be detrimental to the health of the State Highway Fund. The revenue from the fuel tax accounts for more than 40% of the State Highway Fund revenues and is the primary means of funding the operations and maintenance, and construction of our state highways.

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: FUEL, Rate on naphtha used for power generation

BILL NUMBER: HB 371, SD-1

INTRODUCED BY: Senate Committee on Energy & Environment

BRIEF SUMMARY: Amends Act 103, SLH 2007, to repeal the provision sunsetting the 1 cent tax on naphtha fuel used in a power generating facility.

EFFECTIVE DATE: July 1, 2009

STAFF COMMENTS: The legislature by Act 103, SLH 2007, provided that naphtha used in a power generating facility shall be taxed at the rate of one cent per gallon until December 31, 2009. This measure would make this provision permanent by repealing the sunset provision of Act 103.

It should be remembered that receipts of the fuel tax are realizations of the state's transportation funds, largely the state highway fund. Since naphtha used to generate electricity does not utilize the highway infrastructure, such fuel should remain exempt from the state fuel tax. Setting out that fuel used to generate electricity is subject to the state fuel tax to fund the transportation infrastructure further underscores the inappropriateness of imposing the tax on non-highway use. Thanks to our legislators, the cost of the additional tax on naphtha fuel used to generate electricity has contributed to rising energy costs for all taxpayers including government.

Digested 4/1/09

Testimony Before the Senate Committee on
Ways and Means

By: Randall J. Hee, P.E.
President and Chief Executive Officer
Kauai Island Utility Cooperative
4463 Pahee Street, Suite 1, Lihue, Hawaii, 96766-2000

Friday, April 3, 2009, 9:45 a.m.
Conference Room #211

House Bill No. 371, HD2, SD1 – Relating to Taxation

To the Honorable Donna Mercado Kim, Chair; Shan S. Tsutsui, Vice-Chair,
and members of the Committee:

Thank you for the opportunity to testify on this measure. I am Randy Hee, President and CEO at Kauai Island Utility Cooperative. I am here today to testify on HB371, HD2, SD1 that would repeal the sunset provision on Act 103 on 2007 Legislative session and leaves naphtha, a fuel used in a power-generating facility, to the fuel tax at a rate of 1 cent per gallon.

Act 103 was the result of a question raised regarding interpretation of language contained in HRS §243 pertaining to which types of liquid fuels are subject to which types of taxes.

Specifically at issue is how naphtha should, or should not, be taxed.

KIUC believes that the primary purpose of the fuel tax is to provide funds for highway construction and maintenance (or in the case of aviation fuels, funds for airport construction and maintenance). This has been accomplished over the years by imposing the tax on fuel sold for on-highway use. KIUC believes that the intent of the law is to exclude Naphtha sold and used for power generation purposes from the state vehicle transportation and respective county fuel taxes and be treated similar to diesel with a 1 cent per gallon tax.

Act 103 clarified this interpretation.

KIUC annually uses approximately 15 million gallons of naphtha annually in the generation of electricity, which represents approximately 50% of KIUC's yearly electrical energy production.

Applying the current 16¢/gallon state transportation tax to the 15 million gallons of naphtha KIUC annually uses would result in a $2.4 million annual tax liability that would need to be passed on to KIUC's customers.

Applying the current 13¢/gallon county of Kauai fuel tax to the 15 million gallons of naphtha KIUC annually uses would result in a $2.0 million annual tax liability that would be passed on to KIUC's customers.

The additional $4.4 million tax expense would have increased KIUC's cost of purchased fuel. For the year 2006, the increased fuel cost would have raised KIUC customers' energy bills by almost 7%.

As you know, KIUC is a member-owned electric cooperative. Unlike for profit corporations (i.e. investor owned utilities), cooperatives are non-for-profit and member run. Without the need for profits and shareholder dividends, cooperatives are free to invest what would normally be profits (cooperatives call them "margins") in the business by allocating margins to the cooperative's members as capital credit contributions, or, eventually, by making patronage capital refunds to its members; and otherwise generally using the monies collected for the general welfare of the cooperative members. Any additional expenses would be passed through to our members and reduce KIUC margins that would impact patronage capital refunds back to our members.

KIUC is also committed to reducing its dependency on imported fossil fuels as KIUC Strategic Plan calls for 50% renewable generation by 2023. However this will take time as any investment in renewable energy will be borne by KIUC member/shareholders and economics and reliability should be properly evaluated.

For these reasons, KIUC supports HB371, HD2, SD1 and, therefore asks that this bill be passed.

Thank you again for the opportunity to inform you of KIUC's position on this matter.

CARLSMITH BALL LLP

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April 2, 2009

VIA E-MAIL SENKIM@CAPITOL.HAWAII.GOV

Senator Donna Mercado Kim
Hawaii State Capitol, Room 210
415 South Beretania Street
Honolulu, HI 96813

Re: HB 371 HD2 SD1
Hamakua Energy Partners, L.P. Position Statement

Dear Senator Kim:

Hamakua Energy Partners, L.P. (Hamakua), is strongly in favor of HB 371, HD 2, SD 1 Relating to Taxation. This bill amends § 243-4 of the Hawaii Revised Statutes by repealing the sunset provision relating to the 1¢ per gallon tax on naphtha fuel used in a power-generating facility and thereby making it clear that naphtha used for producing electrical power is taxed at 1¢ per gallon.

Hamakua operates a 60 megawatt power plant near Honokaa on the Island of Hawaii. That power plant currently supplies approximately one third of all the electricity consumed on the Big Island. Because it produces electricity with naphtha (as required by its Clean Air Act Permit), it is also the lowest cost and has the lowest air emissions of any fossil fuel power plant on the Big Island. To accomplish these things, the plant consumes between 26 and 28 million gallons of naphtha every year.

Hamakua supports HB 371, HD 1, SD 2 which is the product of a joint effort by Hamakua and Kauai Island Utility Cooperative (the only other user of naphtha in Hawaii). The bill clarifies the legislature's intent that naphtha used in power-generating facilities, such as Hamakua Energy Partners' plant, is taxed at 1¢ per gallon under § 243-4 of the Hawaii Revised Statutes. If § 243-4 was to be interpreted otherwise and the full fuel tax applied to naphtha, then it could result in the following negative consequences:

- A 17¢ per gallon State fuel tax on naphtha. This would increase Hamakua's annual State fuel tax from approximately \$260,000 to \$4,420,000.

- Hamakua's power purchase agreement with Hawaii Electric Light Company, Inc. does not allow for the pass through of the State fuel tax. As such Hamakua would have to absorb the increased tax.

- Imposition of the full 17¢ per gallon State fuel tax on naphtha would threaten Hamakua's continued economic viability. Accordingly, Hamakua would be forced to seriously consider using diesel as an alternative fuel. Use of diesel would eliminate all of the environmental benefits gained through Hamakua's use of naphtha and send the exact wrong message about the environment.

It has been suggested that naphtha might be taxed at 2¢ per gallon. Such a tax rate would put naphtha and off-road diesel at the same level. In that scenario, there would be no economic incentive to use the cleaner burning naphtha instead of diesel and the market price would determine which fuel was used.[1] Hamakua does not believe this is sound environmental policy.

Accordingly, Hamakua Energy Partners strongly urges your favorable consideration of this bill with an effective date of July 1, 2009.

Very truly yours,

Ian L. Sandison

4810-9797-9651.1.052656-00013

[1] A copy of the historical prices paid for naphtha and diesel is attached. While not evident from this data, we ask that you note that the prices do not remain stable with respect to one another and there are times when naphtha is more or less expensive when compared to diesel.