

STATE OF HAWAII  
DEPARTMENT OF LAND AND NATURAL RESOURCES  
Land Division  
Honolulu, Hawaii 96813

January 23, 2015

Board of Land and Natural Resources  
State of Hawaii  
Honolulu, Hawaii

Hawaii

Approve Mediated Settlement of Rent Reopening Dispute in General Lease No. S-5721, Keahole Point Fish LLC, Lessee, Kalaoa 1st through 4th, North Kona, Hawaii, Tax Map Key: 3rd/7-3-43: seaward of Kalaoa.

APPLICANTS:

Keahole Point Fish LLC, a Delaware corporation, Lessee, and Land Division, Department of Land and Natural Resources.

LEGAL REFERENCE:

Section 171-17, Hawaii Revised Statutes, as amended.

LOCATION:

Portion of Government lands of Kalaoa 1st through 4th situated at North Kona, Hawaii, identified by Tax Map Key: 3rd/7-3-43: seaward of Kalaoa, as shown on the attached maps labeled Exhibit A.

AREA:

90.00 acres, more or less.

TRUST LAND STATUS:

Section 5(b) lands of the Hawaii Admission Act

DHHL 30% entitlement lands pursuant to the Hawaii State Constitution: NO

CHARACTER OF USE:

Mariculture purposes.

TERM OF LEASE:

20 years, commencing on November 1, 2004 and expiring on October 31, 2024. The first and only rental reopening was scheduled for November 1, 2014.

ANNUAL RENTAL:

For the first ten years, \$2,100.00 per annum or 1% of the gross revenue, whichever is greater.

DCCA VERIFICATION:

Place of business registration confirmed:	YES <u>X</u>	NO <u>__</u>
Registered business name confirmed:	YES <u>X</u>	NO <u>__</u>
Good standing confirmed:	YES <u>X</u>	NO <u>__</u>

REMARKS:

General Lease No. S-5721 was issued Kona Blue Water Farms, LLC (KBWF LLC) by direct negotiation on October 19, 2005, pursuant to Hawaii Revised Statutes Chapters 171 and 190D. On September 1, 2009, KBWF LLC converted from a Delaware limited liability company to a Delaware corporation called Kona Blue Water Farms, Inc. (KBWFI). At its meeting of January 8, 2010, Item D-25, the Board consented to the assignment of the lease from KBWFI, as assignor, to Keahole Point Fish LLC (KPF), as assignee.

Since that time, KPF has operated an offshore aquaculture facility on the lease premises subject to the conditions set forth in Conservation District Use Permit Nos. HA-3118B and HA-3497. Under CDUP No. HA-3497, KPF is permitted to operate up to five net pens in production, none larger than 7,000 cubic meters, and together totaling no greater than 24,000 cubic meters.

General Lease No. S-5721 is a 20-year lease, and the rent for the first ten years was set at \$2,100.00 per annum or 1% of the gross revenue, whichever was greater. A rent reopening was scheduled for November 1, 2014. The State procured an appraiser for the reopening and the appraisal report came back with a substantially higher rent. The appraiser set the rent for the second half of the lease at the greater of \$86,400 per annum or percentage rent on a sliding scale of between 2% to 3%. Specifically, the scale would have worked as follows:

<u>Gross Revenue Amount:</u>	<u>Percent Rent:</u>
Less than or equal to \$3.5 million	3.00%
Greater than \$3.5 to less than or equal to \$4.5 million	2.50%
Greater than \$4.5 million	2.00%

On July 23, 2014, Land Division sent a rent reopening offer letter to KPF setting forth the new rent determination. On August 18, 2014 KPF responded that it rejected the new rent and appointed its own certified appraiser in the matter. KPF's appraiser prepared an appraisal report stating that the rent should be \$2,700.00 per annum or 1% of the gross revenue, whichever is greater.

Disputes in rent reopenings for leases of public lands are governed by Hawaii Revised Statutes Section 171-17, as amended. Prior to July 1, 2014, rent disputes were generally arbitrated by a three-member arbitration panel. However, the Legislature amended HRS Section 171-17 effective as of July 1, 2014 to require mediation by a single mediator prior to arbitration.<sup>1</sup> Under this amended provision, the parties scheduled a mediation before appraiser Edward Becker for December 16, 2014.

The mediation included discussion of the origin of the initial rents established for submerged lands leases. Commercial mariculture operations are a fairly recent phenomenon in Hawaii, and it is believed the low base rents set for this lease and two other mariculture leases in the State<sup>2</sup> were designed to encourage this fledgling industry and determine whether commercial fish farming could succeed in Hawaii. All three leases provide for a percentage rent of 1% to the State.

Under the applicable percentage rent, KPF's operation off of North Kona has resulted in the following gross income and percentage rents paid to the State in recent years:

<u>Year Ending:</u>	<u>Gross Revenues:</u>	<u>Percentage Rent (1%):</u>
Oct. 31, 2011	\$ 320,480	\$ 3,205
Oct. 31, 2012	\$4,201,796	\$42,018
Oct. 31, 2013	\$5,012,148	\$50,121

The mediator generally agreed that the base rents should be adjusted upward from the low rates initially set, but did not believe that the \$86,400 determined by the State's appraiser was justified. The mediator also noted that KPF's operation does not have a large profit margin, with operating expenses for such items as the fingerlings, fish food, labor, land

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<sup>1</sup> Additionally, under the amended law, arbitrations are now submitted to a single arbitrator for determination, rather than to a three-member panel. The amending act is Act 168 Session Laws of Hawaii 2014.

<sup>2</sup> The two other mariculture operations are the Hawaii Oceanic Technology, Inc. (HOTI) with lands off of North Kohala under General Lease No. S-6017. Although the lease is executed, HOTI has not yet gone into operation on the premises. The other mariculture lease was General Lease No. S-5654 to Grove Farm Fish & Poi, LLC. After a number of years of productive use, Grove Farm ceased operations and obtained a mutual cancellation of its lease at the Board meeting of June 13, 2014, under agenda Item D-18.

costs, etc.<sup>3</sup> Accordingly, the parties settled on a base rent of \$40,000 per annum or 1% of gross revenue, whichever is greater, subject to the Board’s approval. Staff is comfortable with the proposed settlement and recommends the Board approve it.

KPF is compliant with all lease terms and conditions including rent, insurance and performance bond.

RECOMMENDATION:

That the Board approve the mediated settlement of the rent reopening in General Lease No. S-5721, Keahole Point Fish LLC, Lessee, for the period November 1, 2014 through October 31, 2024 in the amount of FORTY THOUSAND AND NO/100 DOLLARS (\$40,000.00) per annum or ONE PERCENT (1%) of gross revenue, whichever is greater.

Respectfully Submitted,



Kevin E. Moore  
Assistant Administrator

APPROVED FOR SUBMITTAL:



Carty S. Chang, Acting Chairperson



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<sup>3</sup> KPF also has a land based operation on lands leased from the Natural Energy Laboratory of Hawaii Authority at Keahole Point, Kona.

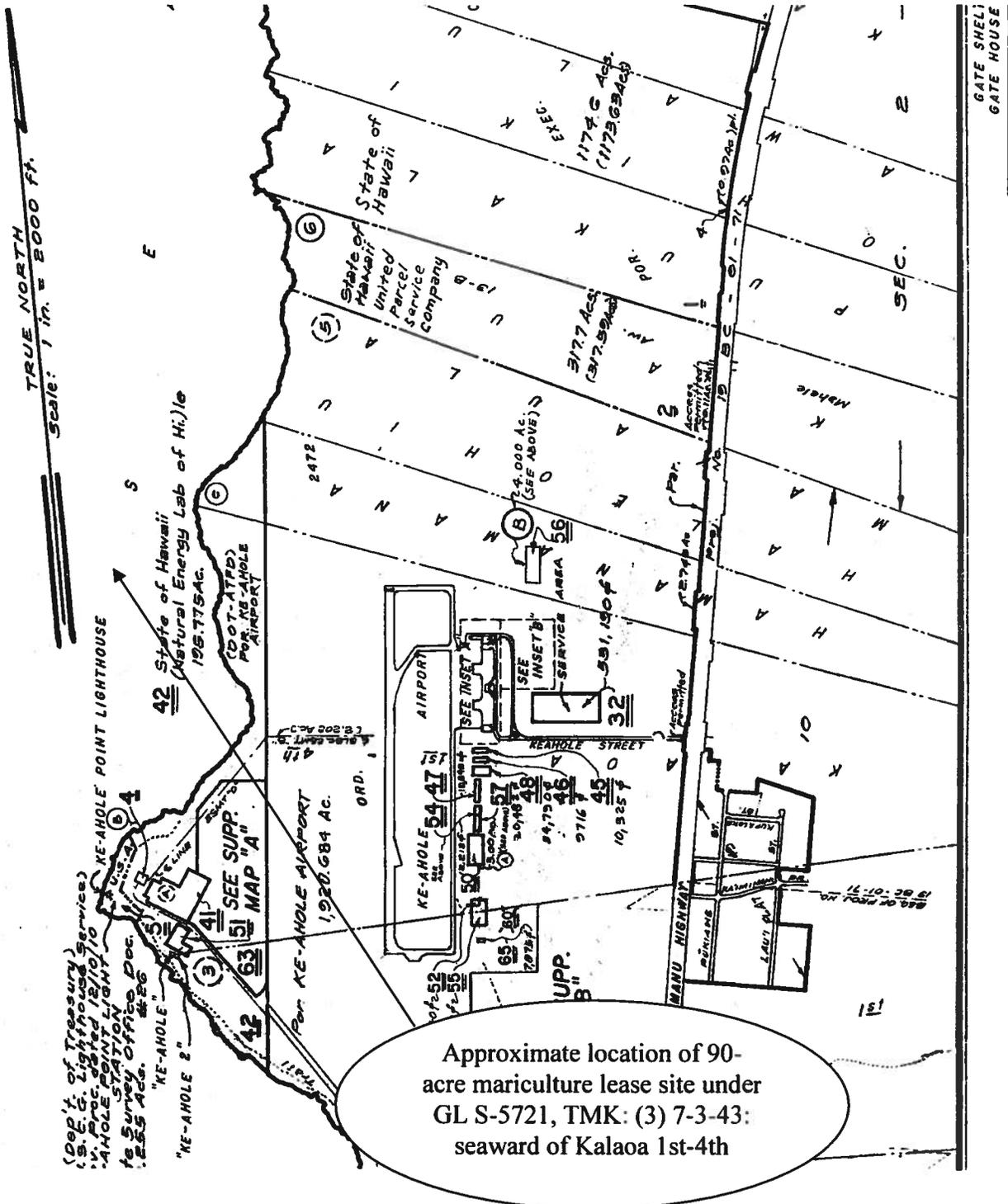
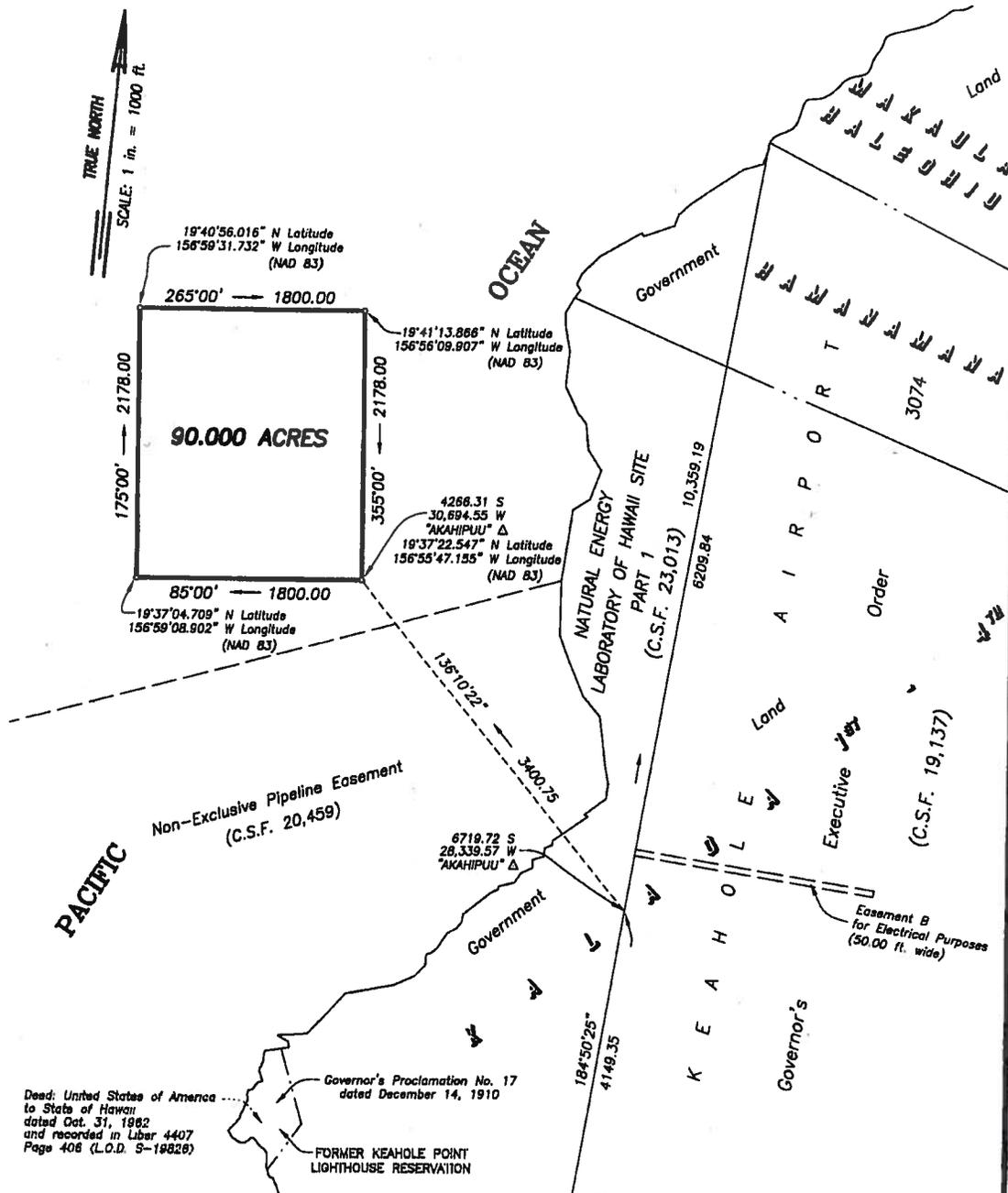


EXHIBIT A



**MARICULTURE LEASE**

Situate in the offshore waters of  
Kalaea 1st-4th, North Kona, Island of Hawaii, Hawaii

Scale: 1 inch = 1000 feet

Job H-72(04)

2. BK.

TAX MAP 7-3-43: Seaward

C.S.F. NO. 23,857

SURVEY DIVISION  
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES

STATE OF HAWAII

RDM September 30, 2004