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**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**

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

Report No. 08-09  
April 2008



**THE AUDITOR**  
STATE OF HAWAII

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## Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawai'i State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds are existing funds meet legislative criteria.
7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.
8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.
9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawai'i's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.



### THE AUDITOR STATE OF HAWAII

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# OVERVIEW

## ***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***

Report No. 08-09, April 2008

### **Summary**

We conducted this first phase of a performance audit in response to Act 2, Second Special Session Laws of Hawai'i 2007. Act 2 requested the Auditor to conduct a performance audit on the state administration's actions in exempting certain harbor improvements to facilitate large capacity ferry vessels from the requirements of conducting an environmental assessment or environmental impact statement under the Hawai'i Environmental Impact Statements (EIS) law, Chapter 343, Hawai'i Revised Statutes (HRS). The audit request includes a review of the State's actions in not considering potential secondary environmental impacts of the harbor improvements prior to granting the exemption from these requirements. Our audit work was delayed by access issues, including access to public information and allegedly private, attorney-client, and executive privileged information. The attorney general took an active role in reviewing requested documents and interceding in our audit interviews. Moreover, Hawaii Superferry, Inc. declined to participate in our audit unless we amended our standard audit procedures. Because of these delays, the results of Phase II of our audit will be presented in a later report.

We found that faced with too little time and opposition from Hawaii Superferry, Inc., the state Department of Transportation abandoned efforts to prepare an environmental review for harbor improvements needed to accommodate the ferry service.

We also found that the flawed EIS law and rules enabled the department to invoke its exemption determination list and ignore calls for and bypass the environmental review. The Office of Environmental Quality Control (OEQC) implements the Environmental Impact Statements law, Chapter 343, HRS, and its director is responsible for advising the governor on environmental issues as well as providing advice and assistance to private industry and government agencies. The Environmental Council serves as a liaison between the OEQC director and the general public on issues concerning ecology and environmental quality. The council is the rule-making body for the EIS law and its rules are adopted as Chapters 11-200 and 201, Hawai'i Administrative Rules (HAR). Both OEQC and the Environmental Council are administratively attached to the Department of Health.

Details surrounding the DOT's efforts to validate the origin of a purported June 30, 2005 deadline that drove the entire process are murky. We found that it is likely



that the department relied on Hawaii Superferry, Inc.'s representation that the date was a federal deadline instead of Superferry's shipbuilding deadline.

In the end, the State may have compromised its environmental policy in favor of a private company's internal deadline. It remains to be seen whether these decisions will cost the State more than its environmental policy. These are issues we intend to discuss in Phase II of our audit.

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## Recommendations and Response

Our recommendations are designed to address the flawed EIS law and rules. We recommend that the Legislature consider making appropriate changes in the law to empower an entity with authority to enforce the Environmental Impact Statements law and rules and require agencies to provide OEQC with individual agency exemption determinations in a timely fashion.

We recommend the Environmental Council amend the EIS rules to require agencies to document and file records of their findings that have been determined to be exempt; review, update, and submit their exemption lists every five years; and consult with the OEQC director and outside agencies and individuals prior to reaching a decision of an exemption determination.

We recommend the OEQC establish guidelines and processes to ensure that all of the steps required to protect the environment have been properly addressed before an agency declares an exemption determination, that the Environmental Council is notified when the director of the OEQC receives a request for an opinion or consultation from an agency, and that exemption determination documentation is maintained and available for public review.

Finally, we recommend the DOT Harbors Division modify its record-keeping process to facilitate public review of exemption determinations.

In its response to our draft report, the Department of Transportation does not dispute either our findings or recommendations and generally supports our recommendations. After a careful review and consideration of the department's comments, we made minor changes and clarifications to our report, none of which affected our findings and conclusions.

The department's response also included comments from the Department of the Attorney General. The attorney general raised concerns about the breadth and scope of our audit activities and requests and the impact it had on his staff. Had we been allowed to follow our normal audit process, the Department of the Attorney General would have had limited involvement and we would not have encountered delays.

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Submitted by

**THE AUDITOR**  
STATE OF HAWAI'I

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## Foreword

This first phase of a 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 was conducted in response to Act 2, Second Special Session Laws of Hawai'i 2007. Our audit focused on the State's proceedings that exempted harbor improvements related to the operation of Hawaii Superferry, Inc. from an environmental review under Chapter 343, Hawai'i Revised Statutes, including why secondary impacts were not considered. It also focused on the State's statutes and rules regarding the exemption determination process. The results of Phase II will be presented in a later report.

We wish to express our appreciation for the cooperation and assistance extended to us by officials and staff of the Department of Transportation and by others whom we contacted during the course of the audit.

Marion M. Higa  
State Auditor

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# Chapter 1

## Introduction

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The Hawaii Superferry, Inc. is an inter-island ferry service between the islands of O‘ahu, Maui, Kaua‘i, and Hawai‘i, using harbor facilities on each island. Initially incorporated in 2002, the Hawaii Superferry, Inc. has been embroiled in controversy and legal challenges relating to its impact on Hawai‘i’s environment. Since beginning service in August 2007, it has encountered interrupted service amid protests over the necessity of an environmental review under the Hawai‘i Environmental Impact Statements law.

The controversy centers on the decision of the state Department of Transportation (DOT) to exempt the harbor improvements related to ferry operations from an environmental review. Proponents of the ferry service cited the need for an alternative means of inter-island transportation, while opponents raised environmental concerns and fears of overdevelopment on the neighbor islands. Environmentalists challenged the department’s decision in court. Ultimately, the Hawai‘i Supreme Court, in its August 31, 2007 decision, held that the department erred in determining that the improvements to Kahului Harbor for the ferry service were exempt from the requirements of the Hawai‘i Environmental Procedure Act. The court stated that the department did not consider whether the DOT’s facilitation of the project would probably have minimal or no significant impacts, either primary or secondary, on the environment. In October 2007, the Second Circuit Court on remand halted Superferry’s operations until the State had completed an environmental assessment.

Thereafter, the governor called the Legislature into session through executive proclamation. After much debate and voluminous testimony, the Legislature passed Senate Bill No. 1, Senate Draft 1, amending the law to permit operation of a large capacity ferry vessel company while the State does an environmental review. On November 2, 2007, the governor signed the bill into law as Act 2, Second Special Session Laws of Hawai‘i (SSSLH) 2007.

Act 2 also requests the Auditor to conduct a performance audit on the state administration’s actions in exempting certain harbor improvements to facilitate large capacity ferry vessels from the requirements of conducting an environmental assessment or environmental impact statement under the Hawai‘i Environmental Impact Statements (EIS) law, Chapter 343, Hawai‘i Revised Statutes (HRS). The audit request includes a review of the State’s actions in not considering potential secondary environmental impacts of the harbor improvements prior to

granting the exemption from these requirements. Act 2 requests that the governor and other state officials cooperate with the Auditor and provide all documents and information relevant to the audit.

The Office of the Auditor carries out Phase I of this audit pursuant to Section 23-4, HRS, which requires the Auditor to conduct post audits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions.

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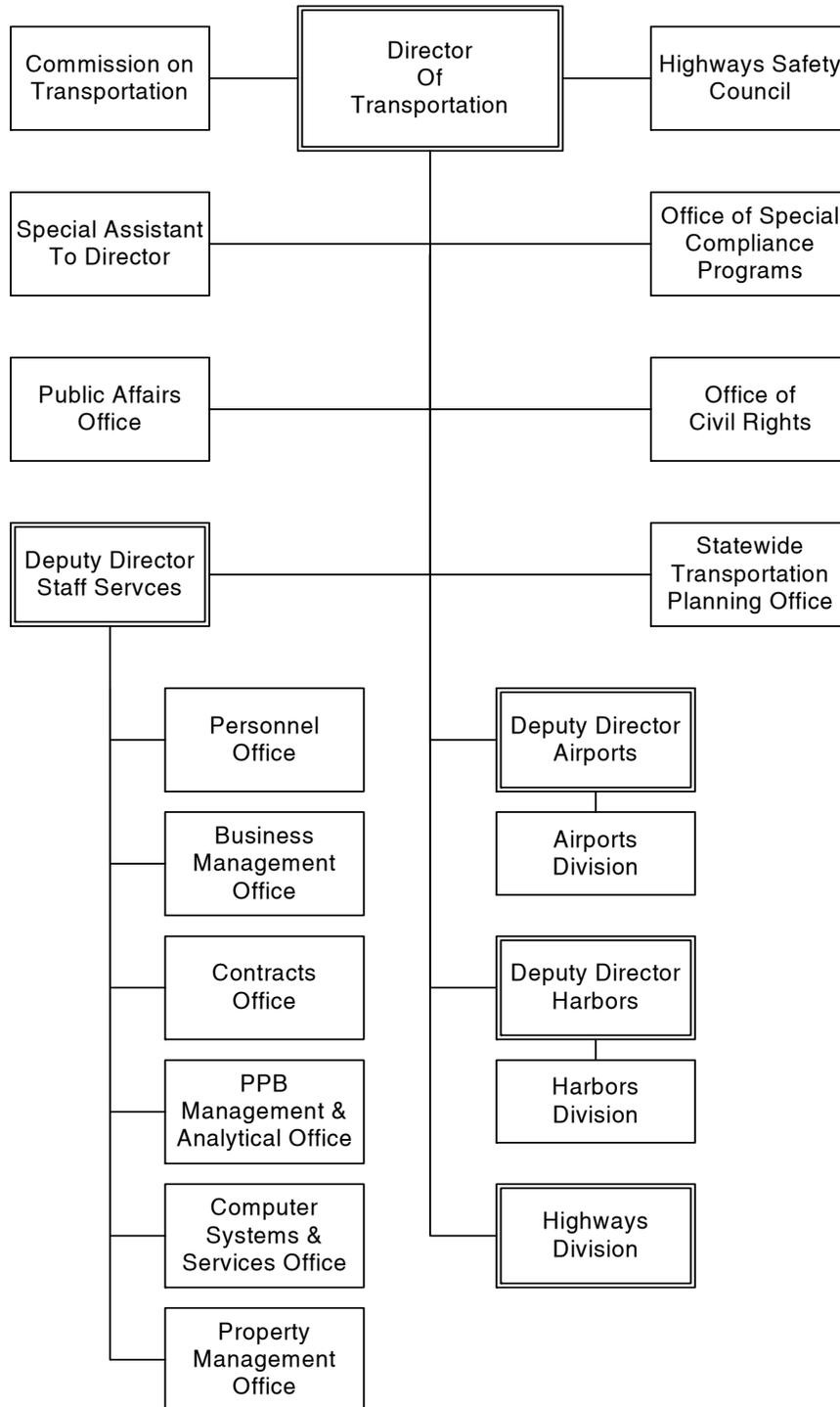
## Background

### *Department of Transportation*

The state Department of Transportation is the lead agency in establishing, maintaining, and operating all intrastate transportation facilities. Its mission is to provide a safe, efficient, accessible, and inter-modal transportation system that ensures the mobility of people and goods, and enhances and preserves economic prosperity and the quality of life in Hawai'i. The department is responsible for the planning, design, construction, operation, and maintenance of state facilities for all modes of transportation, including air, water, and land.

The department coordinates its activities with other state, county, and federal programs to achieve its objectives. The department currently provides, operates, and maintains 11 commercial service airports, four general aviation airports, ten commercial harbors, and 2,450 lane miles of highway. The transportation program comprises four principal sub-programs: Air Transportation Facilities and Services, Water Transportation Facilities and Services, Land Transportation Facilities and Services, and Overall Program Support for Transportation Facilities and Services. There are three DOT operational divisions—airports, harbors, and highways—supported by ten departmental staff offices. Exhibit 1.1 shows the DOT's organizational structure.

**Exhibit 1.1**  
**Organizational Structure of the Department of Transportation**



Source: Department of Transportation

## Harbors Division

The department’s Harbors Division has care and control over all state-owned or controlled commercial harbors, harbor facilities and lands, and all vessels and shipping within the harbors. Its mission is to provide and effectively manage a commercial harbor system that facilitates the efficient movement of people and goods to, from, and between the Hawaiian Islands, and supports economic prosperity and quality of life. The major activities of the harbors program are to:

- maintain, repair and operate the ten commercial harbors which comprise the statewide harbors system;
- plan, design, and construct harbor facilities; provide program planning and administrative support;
- manage vessel traffic into, within, and out of harbor facilities;
- provide for and manage the efficient utilization of harbor facilities and lands; and
- maintain offices and facilities for the conduct of maritime business with the public.

Hawai‘i’s ten commercial harbors are located in four districts, as shown in Exhibit 1.2.

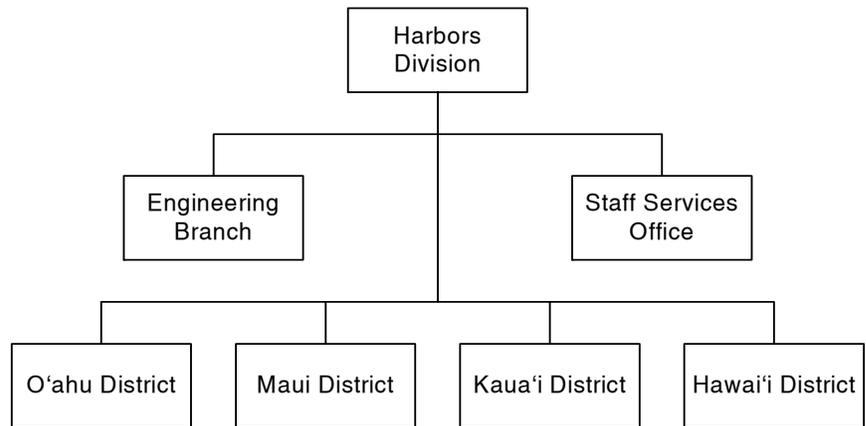
### Exhibit 1.2 The State of Hawai‘i’s Commercial Harbor System

|                  |  |
|------------------|--|
| Kaua‘i District  | Nāwiliwili Harbor and Port Allen Harbor                          |
| O‘ahu District   | Honolulu Harbor, Kalaeloa Barbers Point Harbor, and Kewalo Basin |
| Maui District    | Kahului Harbor, Kaunakakai Harbor, and Kaunalapau Harbor         |
| Hawai‘i District | Hilo Harbor and Kawaihae Harbor                                  |

Source: Department of Transportation

The Harbors Division consists of a Staff Services Office, Engineering Branch, and district offices on O‘ahu, Maui, Kaua‘i, and Hawai‘i. Exhibit 1.3 shows the organizational structure of the Harbors Division.

### Exhibit 1.3 Organizational Structure of the Harbors Division



Source: Department of Transportation

The Staff Services Office provides administrative support to the division in such areas as financial management; management information systems; personnel management; and property management. The Engineering Branch consists of Engineering Systems Staff and four sections: Planning, Design, Construction, and Maintenance. The district offices for O'ahu, Maui, Kaua'i, and Hawai'i support the operations of the commercial harbors, including maintenance and repair, construction, traffic control, pier utilization, utility services, sanitation and groundskeeping, among others. The district managers for the Hawai'i, Maui, and Kaua'i districts are also the harbor masters for the commercial harbors within their respective districts.

#### Engineering Branch

The Engineering Branch is responsible for the planning, design, construction, and maintenance of facilities for the State commercial harbors system and consists of a systems staff office and four sections. The **Engineering Systems Staff** provides computer-aided design and drafting operation and maintenance services and is responsible for computer system application and computer system network management to all sections of the branch.

The **Planning Section** formulates operational and development programs, prepares project justifications, updates master plans, prepares budget requests for capital improvement projects, in addition to preparing

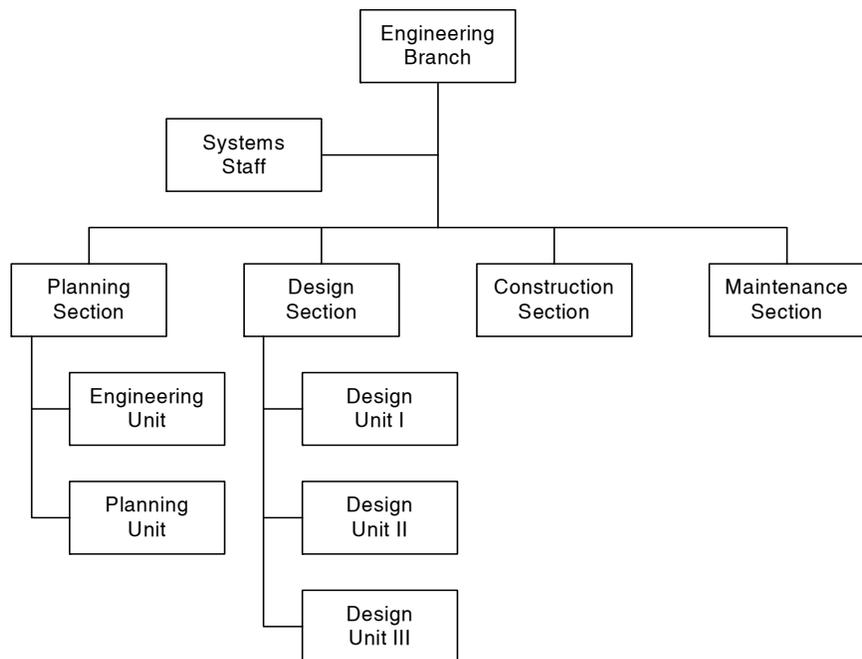
planning reports, feasibility studies, and answering public inquiries. The section serves as the division’s environmental coordinator and reviews and processes environmental reports.

The **Design Section** prepares plans and specifications for capital improvement projects, requests allotments for the design and construction of capital improvement projects, prepares environmental impact statements for capital improvement projects, and holds public hearings, secures permits, and coordinates design of capital improvement projects.

The **Maintenance Section** performs periodic inspection of all harbor facilities and is responsible for planning, budgeting, and scheduling maintenance, repair, and rehabilitation projects. The **Construction Section** manages all construction projects for the Harbors Division.

Exhibit 1.4 shows the organizational structure of the Engineering Branch in 2004 when decisions were made for Superferry harbor improvements. Although not shown in the department’s chart, an Environmental Unit was added in 2005.

**Exhibit 1.4**  
**Organizational Structure of the Engineering Branch**



Source: Department of Transportation

## ***National Environmental Policy Act and Hawai'i Environmental Impact Statement Law***

A series of environmental disasters occurring in 1969, including the Cuyahoga River fire in Cleveland, Ohio and the Santa Barbara oil spill off the coast of California, catalyzed the movement for developing a national environmental policy. That same year, the National Environmental Policy Act (NEPA) of 1969 was passed by Congress. The act has three main provisions:

- the establishment of a national environmental policy;
- the establishment of a Council of Environmental Quality, which advises the President of the United States on the overall health of the environment; and
- the creation of an environmental impact review process, which provides for public review.

These provisions require federal agencies to conduct environmental impact studies for major federal projects and to encourage public participation in that process.

### **Hawai'i's environmental review process**

Hawai'i's environmental impact statement process was patterned after the federal NEPA. The Hawai'i Environmental Impact Statements law was enacted in 1974 and codified as Chapter 343, HRS. The purpose of the Hawai'i Environmental Impact Statements law, as stated in Section 343-1, HRS, is to establish a system of environmental review which will ensure that environmental concerns are given appropriate consideration in decision making along with economic and technical considerations.

The law is administered by the Office of Environmental Quality Control (OEQC), which is administratively attached to the Department of Health. The law also creates an Environmental Council that is also administratively attached to the Department of Health. The council serves as a liaison between the OEQC director and the general public by soliciting information, opinions, complaints, recommendations, and advice concerning ecology and environmental quality through public hearings or any other means and by publicizing such matters. The council may make recommendations concerning ecology and environmental quality to the OEQC director and monitors the progress of state, county, and federal agencies in achieving the state's environmental goals and policies. Council membership reflects a broad and balanced representation of educational, business, and environmentally pertinent disciplines and professions, such as the natural and social sciences, the humanities, architecture, engineering, environmental consulting, public health, and planning; educational and research institutions with

environmental competence; agriculture, real estate, visitor industry, construction, media, and voluntary community and environmental groups. Pursuant to Chapter 343, HRS, the Environmental Council is the rule-making body. Its rules are adopted as Title 11, Chapters 200 and 201, Hawai‘i Administrative Rules (HAR), entitled *Environmental Impact Statement Rules* and *Environmental Council Rules of Practice and Procedure*, respectively.

The Environmental Impact Statements law is designed to integrate environmental review with state and county planning processes. An overview of the process is shown in Exhibit 1.5 and is described in more detail below.

### **Environmental assessment (EA)**

According to the OEQC comprehensive guide, *The Environmental Guidebook: A Guidebook for the Hawaii State Environmental Review Process*, if a proposed action is subject to the environmental impact statements law, the environmental review process begins with the development of a draft environmental assessment (EA). The draft assessment is subject to a 30-day review period by the public.

### **Finding of no significant impact (FONSI)**

After the agency finalizes the assessment, the agency determines if any “significant” environmental impacts are anticipated. If the agency determines that the project will not have a significant environmental impact, it issues a finding of no significant impact (FONSI), which allows the project to proceed without further study. Within 30 days of the notice of this finding, the public may challenge an agency’s determination by filing suit in circuit court.

### **Environmental impact statement (EIS)**

If the agency determines that the action may have a significant impact, an environmental impact statement must be prepared. An EIS preparation notice is then issued and undergoes an additional 30-day comment period to define the scope of the draft EIS. Publication of an EIS preparation notice initiates a 60-day period during which an aggrieved party may challenge the determination in court. The draft EIS is subject to a 45-day review by the public and government agencies.

After a final EIS is submitted and accepted by the accepting authority (governor, mayor) or approving agency, the action may be implemented. The publication in the OEQC’s *The Environmental Notice* of an acceptance or non-acceptance determination initiates a 60-day legal challenge period. Additionally, an applicant may administratively appeal a non-acceptance determination directly to the Environmental Council.

**Exhibit 1.5**  
**Overview of Hawai'i's Environmental Review Process**



Source: Office of Environmental Quality Control

## Exemptions

Certain activities are deemed minor or routine by the state or county agency that has oversight. The agency can declare the activity exempt from environmental review. There are 11 classes of exempt actions under the EIS rules. The exempt classes of actions, found in Section 11-200-8, HAR, generally concern:

- operations, repairs, or maintenance of existing structures, facilities, equipment;
- replacement or reconstruction of existing structures and facilities;
- construction of small facilities or structures;
- minor alterations in the conditions of land, water, or vegetation;
- interior alterations involving things such as partitions, plumbing, and electrical conveyances;
- demolition of structures; zoning variances except shoreline setback variances; and
- continuing administrative activities including, but not limited to, purchase of supplies and personnel-related actions.

The exemption process does not afford an opportunity for public comment, but does include a 120-day legal challenge period after a determination that a project is exempt.

All exemptions under the classes in this section are inapplicable when the cumulative impact of planned successive actions in the same place and over time, is significant, or when an action that is normally insignificant in its impact on the environment may be significant in a particularly sensitive environment. Requests for exemptions shall be submitted to the council, in writing, and contain detailed information to support the request.

### ***Hawaii Superferry, Inc.***

Incorporated in September 2002, Hawaii Superferry, Inc., was publicized as an inter-island travel alternative for Hawai‘i’s residents and visitors, and modeled after ferry operations on catamarans in Spain. On December 30, 2004, the Public Utilities Commission (PUC) conditionally granted Hawaii Superferry, Inc. a Certificate of Public Convenience and Necessity to operate as a water carrier of passengers and property between the islands, pursuant to the *Water Carrier Act*,

Chapter 271G, HRS. The condition of authorization required Hawaii Superferry, Inc. to show full compliance with all applicable EIS, National Oceanic and Atmospheric Administration (NOAA), and U.S. Coast Guard laws, rules, regulations, and requirements. On June 12, 2007, the PUC was satisfied that based on the representations made, Hawaii Superferry, Inc. had met the PUC's conditions for a Certificate of Public Convenience and Necessity.

In January 2005, Hawaii Superferry, Inc. entered into a letter of commitment with the U.S. Department of Transportation, Maritime Administration (MARAD) for a loan guarantee for the construction and mortgage financing of two 105 meter, high speed roll-on/roll-off passenger and vehicle ferries through the Title XI federal ship financing program. MARAD administers financial programs to assist private companies in obtaining financing for the construction of ships or the modernization of U.S. shipyards; to develop, promote, and operate the U.S. merchant fleet; to determine services, routes, and ships necessary to develop and maintain American foreign commerce; and to maintain equipment, shipyard facilities, and reserve fleets of government-owned ships essential for national defense.

Each ferry is capable of carrying up to 866 passengers and 282 cars, or 28 trucks or buses and 65 cars per trip, at speeds of 35 knots (40 mph). Construction of the first ferry by Austal USA, LLC, in Mobile, Alabama, was begun in June 2004. The first ferry, as shown in Exhibit 1.6, arrived in Honolulu in June 2007, in anticipation of the start of service in August 2007. Initially, Hawaii Superferry, Inc. planned to operate in three of the state's harbors: Honolulu Harbor on O'ahu, Kahului Harbor on Maui, and Nāwiliwili Harbor on Kaua'i. Service to Kawaihae Harbor on the Big Island will commence in 2009 after the second ferry is completed.

#### **Exhibit 1.6** **Hawaii Superferry in Honolulu Harbor**



*Photograph courtesy of the Office of the Auditor.*

On August 26, 2007, Hawaii Superferry, Inc. began service from Honolulu Harbor to Nāwiliwili and Kahului. On August 27, 2007, the Sierra Club obtained a temporary restraining order issued by the Second Circuit Court on Maui that prevented Hawaii Superferry, Inc. from using Kahului Harbor. On that same day Hawaii Superferry, Inc. encountered a large protest group that prevented it from docking at Nāwiliwili Harbor on Kaua‘i. On August 28, 2007, Hawaii Superferry, Inc. temporarily suspended its operation to Kaua‘i and Maui.

On December 13, 2007 ferry service to Kahului Harbor resumed under conditions to protect the environment while the State conducts an EIS pursuant to Act 2, SSSLH 2007. Service to Nāwiliwili Harbor has not resumed. Due to weather conditions and equipment-related shutdowns, Hawaii Superferry, Inc. suspended service to Kahului Harbor to undergo maintenance and mandatory recertification by the U.S. Coast Guard. As of March 2008, Superferry’s Catamaran—the Alakai—remains in drydock. Exhibit 1.7 reflects a chronology of events relating to Hawaii Superferry, Inc.

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## Previous Audits

The Office of the Auditor has issued three audit reports on the Department of Transportation since 1999: Report Nos. 99-8, *Financial Audit of the Airports Division of the Department of Transportation*, 00-09, *Management Audit of the Highways Division of the Department of Transportation*, and 05-05, *Audit of Selected State Agencies’ Procurement of Professional Services Contracts*. The first two audits were not related to the department’s Harbors Division, and the third audit focused in part on the Harbors Division’s procurement practices. None of the reports are related to this audit.

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## Objectives of the Audit

1. Assess the State’s proceedings in determining that harbor improvements related to the operation of Hawaii Superferry, Inc. should receive an exemption from the need to conduct either an environmental assessment or environmental impact statement under Chapter 343, Hawai‘i Revised Statutes, including why secondary impacts were not considered.
2. Evaluate the State’s statutes and rules regarding the exemption determination process.
3. Make recommendations as appropriate.

## Exhibit 1.7 Hawaii Superferry Timeline

### CHRONOLOGY OF EVENTS – DOT/HAWAII SUPERFERRY, INC.

- **September 22, 2002**-Hawaii Superferry, Inc., previously named HSF, Inc., registers in the State of Hawai'i as a corporation with the Department of Commerce and Consumer Affairs.
- **November 15, 2004**-Letter from the Department of Transportation (DOT) to the Office of Environmental Quality Control (OEQC) seeks confirmation that intended harbor improvements for Hawaii Superferry, Inc. fall within the DOT's approved list of exemptions.
- **November 23, 2004**-Response letter from OEQC to DOT, states that the proposed improvements fall within the scope of work described in the approved exemption list.
- **December 9, 2004**-DOT provides Hawaii Superferry, Inc. a letter of intent.
- **December 30, 2004**-PUC conditionally grants Hawaii Superferry, Inc. a Certificate of Public Convenience & Necessity to operate as a water carrier of passengers and property between the islands of O'ahu and Kaua'i, Maui, and Hawai'i.
- **January 25, 2005**-Hawaii Superferry, Inc. enters into a letter agreement with U.S. Dept. of Transportation, Maritime Administration (MARAD) for loan guarantee for the construction and mortgage financing of two 105 meter, high speed roll-on/roll-off passenger and vehicle ferries.
- **February 23, 2005**-Letter from DOT Harbors to OEQC exempting harbor improvements needed for Hawaii Superferry, Inc. from the environmental review process.
- **March 31, 2005**-MARAD issues notice that a categorical exclusion excludes the Hawaii Superferry project from federal environmental review.
- **September 7, 2005**-DOT and Hawaii Superferry, Inc. enter into a Harbors Operating Agreement.
- **February 22, 2007**-The Environmental Council rules that DOT had erred in granting an exemption for harbor improvements from an environmental review.
- **June 12, 2007**-PUC informs Hawaii Superferry, Inc. that based on the representations made, Superferry has satisfied PUC's requirements.
- **August 24, 2007**-Facing possible legal restrictions, Hawaii Superferry, Inc. prepares to launch 2 days ahead of schedule offering \$5 fares.
- **August 26-27, 2007**-Hawaii Superferry, Inc. operates from Honolulu Harbor to Nāwiliwili Harbor, Kaua'i and Kahului Harbor, Maui, and encounters a large protest group on Kaua'i.
- **August 27, 2007**-Second Circuit Court grants a temporary restraining order that keeps Hawaii Superferry, Inc. from operating in Kahului Harbor.
- **August 31, 2007**-Hawai'i Supreme Court issues a decision stating that the exemption was erroneously granted as DOT considered only the physical improvements to Kahului Harbor in isolation and did not consider the secondary impacts on the environment.
- **October 5, 2007**-DOT hires firm Belt Collins to prepare a statewide environmental assessment (EA) on Hawaii Superferry, Inc. operations.
- **October 9, 2007**-Second Circuit Court issues a decision that Hawaii Superferry, Inc. cannot operate in Kahului Harbor until an EA is completed.
- **October 23, 2007**-The governor calls the Legislature into special session.
- **October 29, 2007**-The Senate passes Senate Bill 1 Senate Draft 1, which allows Hawaii Superferry, Inc. to resume service while the State conducts an EA of the project, with a vote of 20-5.
- **October 31, 2007**-The House passes Senate Bill 1, Senate Draft 1 with a vote of 39-11, with 1 excused. The measure must now be signed into law by the governor.
- **November 5, 2007**-The governor signs Senate Bill 1, Senate Draft 1 into law as Act 2, 2<sup>nd</sup> Special Session.
- **November 14, 2007**-Second Circuit Court lifts the injunction citing that Act 2 allows the ferry to operate while the environmental review is under way.
- **December 13, 2007**-Hawaii Superferry, Inc. resumes service to Kahului Harbor on Maui.

Source: Office of the Auditor

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## Scope and Methodology

As requested by Act 2, SSSLH 2007, this performance audit includes a review of the state administration's actions in declaring the harbor improvements to support Hawaii Superferry, Inc.'s operations exempt from the requirement to conduct an environmental assessment or environmental impact statement. The audit also includes a review of the state administration's actions in not considering potential secondary environmental impacts of the harbor improvements prior to granting the exemption from these requirements.

The audit looked at the process followed and documented during FY2004-05 by the involved agencies to reach the decision that the harbor improvements would be exempt from an environmental review. Other years were reviewed as required to research this decision.

Audit procedures included interviews with legislators, selected administrators, managers, and staff in the Department of Transportation, DOT Harbors Division, as well as the Office of the Governor, Department of Health, Office of Environmental Quality Control and selected members of the Environmental Council, Hawai'i Public Utilities Commission, U.S. Department of Transportation, Maritime Administration, Hawaii Superferry, Inc., and other agencies, organizations, companies, and community groups as required. We refer to state officials by their titles and positions during the timeframe of our audit, which is focused on FY2004-05. Since that time, some officials have retired, left state service, or changed positions. In fact, one individual has filled many positions, including deputy director of harbors, director of transportation, and governor's chief of staff. We clarify his role during our audit timeframe by referring to him, for example, as the "then-deputy director of harbors."

We examined the various agencies' policies and procedures, letters, emails, reports, and other relevant documents and records to assess and evaluate the various agencies' decisions relating to exemption of harbor improvements for compliance with pertinent laws, rules and regulations, and policies and procedures.

This audit was conducted according to the Office of the Auditor's *Manual of Guides* and generally accepted government auditing standards (GAGAS).

### **Auditor's access to information**

At the onset of our audit we obtained documents from the Hawai'i Supreme Court's records. We sent numerous requests for information to executive branch agencies and to Hawaii Superferry, Inc. A request for documents is standard procedure during the preliminary planning phase

of an audit. Our first request for documents and electronic mail to the Department of Transportation on November 19, 2007, requested a reply date of November 28, 2007. Similar requests sent to other executive branch agencies on November 23, 2007, requested a reply date of November 30, 2007. To date, we have received about half of the documents requested from the DOT. Only the Public Utilities Commission responded timely and provided the documents we requested.

Further, the Department of the Attorney General has taken an active role in our audit, which is unique and unprecedented. We have been told that the attorney general, the first deputy attorney general, and at least three deputy attorneys general are actively involved in our audit. The attorney general has denied us access to department records and communications between his deputies and other administration officials on the State's decision to exempt state harbor improvements relating to ferry service from an environmental review. The attorney general directed his deputies to collect, screen, and cull documents submitted by agencies in response to our request for information, as well as to attend our audit interviews of state current and former employees. According to the attorney general, the review of both public and allegedly confidential documents and electronic mail was intended to remove attorney-client privileged information and executive privileged information. We were told by deputy attorneys general that their participation in our audit interviews was to represent current and former Department of Transportation officials and staff and to protect attorney-client or executive privileged information, even though there is no pending litigation relating to our audit.

### **Records disclosure**

Requested records have been screened and released piecemeal to us over an extended period of time, from the first boxes received on December 21, 2007 to the most recent delivery of March 18, 2008. We were told by a deputy attorney general that he and other deputies were assigned to screen documents twice for attorney-client and executive privileged information, a unique and time-consuming process. Their review first addressed the documents requested from the Department of Transportation, then the documents submitted by other departments, and finally the electronic mail. The deputies were instructed to protect attorney-client and executive privileged information by removing entire pages of submitted documents. The attorney general informed us that he was invoking the attorney-client privilege with respect to communications to and from officials and employees and deputy attorneys general concerning legal advice and counsel. He also informed us that executive privilege extended to documents and policy discussions involving the governor, lieutenant governor, the governor's chief of staff,

and the governor's policy advisors, directors and deputy directors of executive departments, executive agency heads, and any administrative assistants to those officials. The attorney general and then-director of transportation cited these same privileges several times during the hearings relating to Act 2, SSSLH 2007, in declining to disclose what, if any, legal advice the then-director received before he made the decision to exempt the Superferry project from an environmental assessment. By March 2008, we received 22 boxes of DOT documents which had been screened by the Department of the Attorney General.

Regarding our request for electronic copies of selected emails from various departments, on March 18, 2008, over four months after submitting our requests, we were provided with six boxes of printed emails and four DVDs containing electronic copies of some of the emails. We were provided with a subset of the electronic mail that we originally requested, but were not provided a list of what had been included or excluded from our request. For example, we were not provided emails from the Office of the Governor or the Office of the Lieutenant Governor, although these records had been requested.

Further, the deputy attorney general stated that he would provide a log reflecting documents and emails that had been removed due to privilege. As of March 2008, we have not received that log. We know, however, that documents have been removed because the missing ones are referenced in other documents and emails. In many cases, there are print job cover sheets with no attached print jobs.

### **Audit interviews**

The Department of the Attorney General has also interceded in our audit interviews of current and former DOT staff. We were told that current and former employees whom we interview would be represented by one or more deputy attorneys general to invoke either the attorney-client communication privilege or executive privilege depending on the question being asked.

Usually, we interview one person at a time. We do not permit other auditee staff to sit in during the interviews because such interference may impact interviewee candor. Although we expressed concern that the presence of the deputy attorneys general might impact the interview, the deputies remained in the room. They did, however, agree to hold the interviews confidential as required by our audit process and to destroy their notes to limit breach of audit confidentiality.

**Act 2 audit provision**

The initial draft of the bill that would become Act 2, SSSLH 2007, asked the governor to waive attorney-client privilege in connection with the audit. After concerns were raised by the administration, lawmakers removed the language and instead requested the governor and other state officers to provide all relevant documents and to fully cooperate with any requests for information made by the Auditor. This language was agreed to by the administration, Hawaii Superferry, Inc., and the Legislature. In the end, the administration testified in support of the compromise measure that requested our audit and became Act 2, SSSLH 2007.

As described above, the administration's efforts to comply with our document requests have been slow and incomplete, at best. Further, Hawaii Superferry, Inc. has minimally cooperated with our requests. At first, Hawaii Superferry, Inc. officials expressed a willingness to satisfy our document requests, but ultimately provided a small portion of the documents requested and cited confidentiality or attorney-client privilege as the reason for its nondisclosure of information. For example, when the Office of the Auditor requested to review Hawaii Superferry, Inc.'s shipbuilding contract, the company initially agreed, but later omitted pages that contained what it considered to be confidential and proprietary information. To date, those pages of the contract have not been shared with us even though our law and audit process require that the document be kept confidential.

Upon our request for interviews, Hawaii Superferry, Inc. refused to participate unless we agreed to submit written interview questions prior to the interview. Our audit procedures do not include submission of written questions prior to the interview; thus, we did not conduct the interviews.

**Audit delays**

Our requests for information in this audit do not differ from requests in prior audits. We routinely request preliminary information to plan and define our audit fieldwork. Such information includes public information such as department organization charts, functional statements, budget documents, and procedural manuals. Lacking such foundational information, we filled in gaps in our knowledge with interviews of departmental employees and former employees.

**Auditor's authority to access information**

The Office of the Auditor has broad authority to access information. Section 23-5, HRS, gives the Auditor authority to examine and inspect all accounts, books, records, files, papers, and documents and all financial affairs of every department, office, agency, and political subdivision. Further, Section 92F-19, HRS, of the Uniform Information

Practices Act, requires agencies to share records with the Office of the Auditor. The administration's withholding of records from the Auditor is in contravention to the law and prevents the Auditor from carrying out her constitutional and statutory audit authority. Finally, we find the administration's efforts to stymie our audit disingenuous, especially after it agreed to and supported the audit provision in Act 2, SSSLH 2007.

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# Chapter 2

## State Circumvents Environmental Review To Meet Purported Federal Deadline

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### Introduction

Hawai‘i’s Environmental Impact Statements (EIS) law—Chapter 343, Hawai‘i Revised Statutes (HRS)—requires the preparation of environmental assessments and environmental impact statements for many development projects, but not all projects fall under the scrutiny of environmental review. Many are exempt by the law’s exemption determination process, a process that we have found to be flawed. This process, which allows departments to make autonomous exemption determinations, undermines the intent of the EIS law.

The state Department of Transportation (DOT) utilized this exemption determination process to exempt the harbor improvements needed to support the Superferry project. By circumventing the environmental review process, the department was able to meet a purported federal deadline of June 30, 2005. We found, however, that the date was not a federal deadline. Instead, we found that the date represented a deadline imposed by Hawaii Superferry, Inc.’s shipbuilder and that the department may not have verified the date’s origin. Ultimately, this internal Superferry project deadline “drove the process” and pushed the State to bypass an environmental review.

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### Summary of Findings

1. Flawed exemption determination process undermines the intent of the Environmental Impact Statements law.
2. Purported federal deadline for Superferry “drove the process” and the State’s decision-making.

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### Flawed Exemption Determination Process Undermines the Intent of the Environmental Impact Statements Law

Modeled after the National Environmental Policy Act (NEPA), Hawai‘i’s EIS law:

requires that [state] government give systematic consideration to the environmental, social and economic consequences of proposed development projects prior to allowing construction to begin. The law also assures the public the right to participate in planning projects that may affect their community.

However, the EIS law's administrative rules, adopted by the Environmental Council to implement the law, establish an exemption determination process that is contrary to the law's principle of public participation and does not allow any realistic opportunity for public input. In fact, the rules give agencies, such as the state Department of Transportation, wide discretion to make exemption determinations virtually autonomously with no clear oversight. In the case of the DOT's exemption determination of the harbor work associated with the Hawaii Superferry project, we found that the lack of transparency in the process left the public in the dark about the department's determination that exempted the harbor work from environmental review. Moreover, the process allowed the State to ignore the early calls for an environmental assessment from county officials and public interest organizations.

We also found that the EIS law and administrative rules do not require that exemption determinations be published or posted, which is contrary to the underlying principle of public participation. Further, at one agency—the state DOT's Harbors Division—the record-keeping of these determinations is done in such a fashion that makes it burdensome for public review. In the case of the exemption determination of the harbor work associated with the Superferry project, the lack of transparency in the process has resulted in public criticism of the Department of Transportation and has eroded public confidence in the State and its environmental review process. The department's actions also resulted in litigation and provided the impetus for this audit request by the Legislature.

Finally, we found that the EIS law and rules neither identify nor empower an agency or entity with enforcement power over determinations made pursuant to the environmental impact statement process. Lacking an enforcement component, the State cannot ensure the accountability of its exemption determination process.

***Agency exemption determinations do not include public input***

We reviewed three versions of the EIS rules, Chapter 11-200, Hawai'i Administrative Rules (HAR), including the 1985 rules, the 1996 amendment, and finally the 2007 amendment. Adopted by the Environmental Council, these rules implement the exemption determination process that is articulated in the EIS law. The law empowers the council to establish procedures that determine specific actions to be exempt from an environmental assessment. In our review, we found the rules provide little if any realistic opportunity for public input or participation in the agency exemption determination process. This is contrary to the principle of public participation embodied in the State's environmental review process. Moreover, although agencies are required by law to maintain records of actions they have determined to be exempt and must produce the documents upon request, we found the

record-keeping system at the DOT's Harbors Division makes any meaningful public review of such documents a time-consuming and arduous task.

Our review shows the one recourse provided by law for the public to voice its concerns regarding an agency exemption determination is litigation. In the case of the Superferry project, legal action was taken and eventually led to a legislative request for the Office of the Auditor to review the administration's actions.

### **Environmental review process intended to alert decision-makers to significant environmental effects**

According to the EIS law, one of the purposes of an environmental review process is to alert decision-makers to significant environmental effects which could result from the implementation of certain actions by state or county agencies. The other purpose is to encourage cooperation and coordination as well as public participation "which benefits all parties involved and society as a whole."

Not all projects or actions, however, should trigger the environmental review process. These classes of actions, or exemptions, are listed by the Environmental Council in its EIS rules. The purpose of having exempt classes of activities is to prevent agencies from being bogged down by going through a time-consuming, sometimes costly review process for projects that will have little or no significant effect on the environment. Currently, the EIS rules establish 11 classes of actions that may be declared exempt by an agency.

### **Approved exemption lists enable agencies to decide exemptions on their own**

The rules direct agencies to develop their own lists of specific types of actions that fall within the rules' 11 exempt classes, which are reviewed by the Environmental Council and must be "consistent with both the letter and intent expressed in the exempt classes [of the EIS rules] and chapter 343." Agency lists describe actions pertinent to the agency's particular field or area of responsibility. For example, the exemption list for the Department of Transportation may list actions relating to airports, roadways, and harbors.

After an agency develops its proposed exemption list, the list is submitted to the Environmental Council for concurrence. Upon the council's concurrence, it is then published in the *Environmental Notice*, a periodic bulletin required by law to be published by the Office of Environmental Quality Control (OEQC) to notify the public about such things as the availability of environmental documents, as well as notices

filed by agencies of environmental assessment determinations. The OEQC implements the Hawai'i EIS law.

Publication of a notice triggers a 30-day review period. This process provides the public an opportunity to comment on the proposed exemption list. The council considers these public comments before taking action. Thereafter, the council may concur with the agency's proposed list, recommend changes, or reject it. The process can take between a month to a year to complete.

Once the council concurs and an agency has an approved exemption list, however, the agency can determine *on its own* whether a particular project or action is exempt from an environmental assessment without the need for any further or additional review and concurrence. The rules do not require agencies or the OEQC to publish any public notice of projects or actions agencies have determined to be exempt.

### **The rules do not specify a timeframe for the review of agency exemption lists**

When an agency seeks to amend its exemption list, it is required once again to submit it to the council for review and concurrence. Although the public has an opportunity to provide input to agencies on which actions should be exempt, this opportunity arises only when the agency chooses to amend its list.

For example, as applied to the State Department of Transportation, the department last amended its exemption list in November 2000. In 2006, the Exemption List Committee Chairman of the Environmental Council requested state agencies with exemption lists older than 2002 to update them and submit them to the council for review and concurrence. According to the committee chairman, to date, the Department of Transportation has yet to comply. Although the council made a request to the department, it cannot require the department to comply with its request as the council lacks enforcement power over its exemption list process.

Moreover, the EIS rules also state that the council must "periodically" review the exemption lists of state agencies. However, the rules do not specify a timeframe for this review and, hence, it is left to the discretion of the council.

The Environmental Center of the University of Hawai'i at Mānoa addressed this subject in a 1997 review of the State's exemption process. The Environmental Center was created by the Legislature in 1970 and is dedicated to the advancement of environmental management through education, research, and service. In its 1997 report, the center noted that

when the council is given an opportunity to review an agency exemption list, it provides the public an opportunity to be an active participant in the environmental review process. For an agency, the review ensures that its exemption list is appropriately current. The review provides the council a greater complement of information on which to base its decision of whether to concur or change an agency's list. The report also noted that absence of a specific timeframe for when exemption lists must be reviewed provides no assurance that the statutory intent of the environmental review process is being met.

Currently, the council is proposing changes to the EIS rules that would require agencies to review their exemption lists every five years. Although this appears to be a step in the right direction, the rules fall short of requiring agencies to submit their exemption lists to the Environmental Council for review and concurrence. The proposed changes simply state that agencies are required to *consider* this action, which leaves the decision at the discretion of the agency. The proposed rules provide no assurance that agencies will submit their lists to the council.

Given that the Department of Transportation shirked compliance with the council's request to update its exemption list without recourse, we conclude that the language in the proposed rules needs to be strengthened. We recommend that the rules be amended to require agencies to submit updated exemption lists to the council for review and concurrence every five years. Doing so would increase opportunities for public participation in the review process, which upholds the underlying principle and intent of the EIS law.

### **Agencies decide whether rules requirements are satisfied**

Under the exemption determination process, the EIS rules require agencies to satisfy a number of requirements before they reach an exemption determination. First, an agency must determine whether a proposed action or project will have a significant effect on the environment. The analysis should include an evaluation of the projected cumulative effects as well as short-term and long-term effects.

The EIS rules also state that there are two conditions under which exemptions are inapplicable. One condition is "when cumulative impact of planned successive actions in the same place, over time, is significant." Although the condition is clearly stated in the rules, the Environmental Center pointed out in its 1991 report that the rules do not outline a process that agencies are required to follow. In the absence of guidance, it is left to an agency to determine on its own whether it has satisfied the rule.

In addition, according to the EIS rules, agencies must obtain the advice of outside agencies or individuals who have jurisdiction or expertise as to whether a proposed action may be exempt. Here again, the rules do not specify which outside agencies or individuals to consult. It is left to an agency's discretion to choose who to consult and determine on its own whether it has fulfilled the requirements set forth in the rules.

In its most recent draft rules, the Environmental Council has proposed to eliminate the consultation requirement altogether in regards to individual exemption declarations. We have determined that this proposed change would not only reduce agency oversight, but also make the process more isolated and less inclusive, which is contrary to the intent of the EIS law.

### **Department record-keeping of exempted projects discourages public review**

The EIS rules require an agency to keep the memo declaring a project exempt from an environmental assessment on file and available for review by the public. The rules do not specify, however, the types of documents an agency must maintain on file, which could create an inconsistency among agencies in the quality and quantity of information that is available to the public.

Records of harbors-related projects, including those determined to be exempt, are maintained by the DOT Harbors Division. A project number is assigned to project correspondence such as internal memos and letters. Project correspondence is then placed into a project folder which is numerically filed in a filing cabinet. Documents for exempted projects are housed with all of the department's project files and are not maintained in a separate filing cabinet, as shown in Exhibit 2.1.

This method of record-keeping was described in the Environmental Center's 1997 report, which concluded that any meaningful inspection of project exemption records would require a person to examine every project file within the agency's domain. We found this to be the case at the Harbors Division. To fulfill a request by our office for a list of exempted harbors projects from 2004 to 2007, a Harbors Division employee needed to sort through thousands of project folders by hand.

The Harbors Division said it took its employee two weeks to complete the task. When asked whether a member of the public would have taken as long to complete the task, the Harbors Division Engineering Program manager said it would have taken a member of the public even longer because: 1) the Harbors Division office staff would not provide any research assistance as it is not required by law to do so; and 2) the Harbors Division would first need to look through the requested files to ensure confidential documents are removed before they are made

**Exhibit 2.1**  
**Department of Transportation's Harbors Project Filing Cabinets**



Cabinets containing thousands of DOT Harbors Division's files of on-going projects. Files of completed projects are housed in a separate room. *Photographs courtesy of the Office of the Auditor.*

available for public review. Thus, not only are exempted projects filed among non-exempted projects, but confidential documents are filed in the project files and not segregated from information that should be available for review by the public.

In its 1997 report, the Environmental Center concluded:

The inability to readily examine a collected record of exemption designations makes meaningful review of the system impractical and highly unlikely. . .the lack of a centralized file of exemption notices. . .violates both the letter and the intent of the EIS Rules.

The condition reported by the center in 1997 continues today at the DOT. Its record-keeping system inhibits any meaningful review of project documents and does more to discourage, rather than encourage, public participation in the exemption process.

***Agency exemption determination process lacks accountability***

Our review of the EIS rules as well as interviews we conducted with key stakeholders reveal there is no clear agency or entity responsible for providing oversight of the agency exemption determination process. In fact, agencies with the statutory authority to provide guidance and thereby preserve and promote the intent of Chapter 343, HRS, are given few, if any, opportunities to provide input in the exemption process. The only means provided by law that creates some level of oversight for agency exemption determination is the public's right to bring the matter to court. Even the public's right to sue, however, does not vest until after the agency's exemption determination has been decided.

This lack of oversight and enforcement leaves an agency to police itself and decide whether its actions are within the exemption framework. In this respect, Hawai'i's EIS law differs from the National Environmental Protection Act (NEPA). By law, NEPA is administered by the Environmental Protection Agency (EPA), and compliance with the nation's environmental laws is the goal of the EPA's Office of Enforcement and Compliance Assurance. As the federal NEPA recognizes, enforcement is a vital part of encouraging the regulated community to meet their environmental obligations. Enforcement deters those who might otherwise profit from violating the law and levels the playing field with environmentally compliant companies. To carry out its duties, the EPA has civil, cleanup, and criminal enforcement programs.

Unlike NEPA, Hawai'i's EIS law does not name an enforcement agency, and therefore neither the OEQC nor the Environmental Council has the means to enforce the environmental review process. Lacking these critical components, we conclude that there is no established mechanism to hold an agency accountable for its exemption determinations.

### **EIS laws and rules lack enforcement authority**

The Office of Environmental Quality Control and the Environmental Council share the duty of administering the EIS system. However, the EIS law does not grant enforcement authority to the OEQC or the Environmental Council. Section 343-6, HRS, states that the council may adopt, amend, and repeal the EIS rules. The law also directs that the council's rules include nine specific areas, including prescribing the contents of an EIS, prescribing procedures for the preparation and contents of an EIS, establishing criteria to determine the acceptance or nonacceptance of a statement, among other areas. The law does not, however, name an enforcement authority or require that the council's rules include a means for enforcement of the EIS law.

Interviews with current members of the Environmental Council and a former director of the Office of Environmental Quality Control confirmed that neither entity has any statutory enforcement authority. Thus, agencies are left to police themselves.

### **Environmental Council and Environmental Center have limited involvement**

By statute, the opinion of the director of the OEQC carries significant administrative weight. The OEQC director is responsible for advising the governor on environmental issues as well as providing advice and assistance to private industry and government agencies. However, the EIS rules do not require agencies to consult with the OEQC director in matters of exemption. Even though the OEQC director is empowered to offer guidance to the governor and government agencies on environmental issues, it is questionable what weight the director's opinion carries, if any.

The functions of the Environmental Council, which is administratively attached to the OEQC, include the ability to make recommendations to the director of the OEQC in matters of ecology and environmental quality. The council also serves as an information conduit through which the OEQC director is able to learn about the public's concerns and positions on environmental matters.

Similarly, the Environmental Center, which represents all members within the university community who have a direct interest in ecological and environmental issues, also plays a significant role in facilitating and coordinating the transfer of environmentally pertinent, interdisciplinary information from the university system to federal, state, and county agencies and other organizations. One of its primary purposes is to assist the OEQC director to stimulate and coordinate efforts to determine and maintain environmental quality in the state.

The EIS law and rules overlook these valuable resources and fail to ensure a coordinated and cooperative working relationship between agencies, the OEQC, the Environmental Council, and the Environmental Center. Interaction and collaboration among these entities would further support the intent of the EIS law.

At present, the EIS rules allow agencies to make exemption determinations on their own. For example, the Department of Transportation, though not bound by statute or regulation, chose to consult with the OEQC director on the exemption for the harbor improvements relating to the Superferry project. Before issuing her opinion to the department, the OEQC director did not seek the advice of the center or the council even though their statutory functions are to assist the director in matters of environmental quality. When asked why she had not consulted with either the center or the council, the director stated that there was no statute or regulation that obligated her to do so. Thus, the director told us that she made the decision on her own.

In fact, efforts by one member of the council, the then-chair of the council's Rules Committee, to bring DOT's letter relating to the Superferry project to the council at its regularly scheduled meeting in March 2005 was stymied. The member had missed the filing deadline for the agenda, and there were insufficient members present at the meeting to add the item. Even knowing of this and of other members' interest in the Superferry project, however, the OEQC director did not notify the council that she had issued a letter of concurrence to the department regarding its exemption determination. As there was no council meeting in April 2005, the matter would have had to wait until the May 2005 meeting. Given the delay, the council member did not pursue the agenda item.

The exclusion of the Environmental Council and the Environmental Center prevented both from providing guidance at the outset in matters of ecology and environmental quality. We also found that the OEQC director's autonomous decision-making and lack of consultation with the council contributed to an overall lack of awareness that this project circumvented public scrutiny and was being considered for exemption.

To avoid such autonomous decision-making, and in accordance with the intent of the EIS law to encourage public participation, cooperation, and coordination in the environmental review process, we encourage development of an exemption process that requires the OEQC director to solicit input from the Environmental Center when agencies request advice and assistance from the OEQC director regarding exemption determinations. Furthermore, protocols should be established directing the OEQC to notify the council when such developments occur to make the exemption determination process more transparent. Notification not

only serves to involve the council in advice given by the OEQC director, but also informs the public by including the item in a properly noticed agenda.

### **Public involvement in exemption process is through litigation**

In the case of an exemption determination, the public's only recourse is litigation. The law provides a 120-day window of opportunity for the public to file a lawsuit to contest an agency's determination that a particular project is exempt from environmental review.

In its 1991 review, the Environmental Center concluded that litigation was not often utilized by the public due to the expense of taking legal action and the difficult odds of convincing the courts to overturn an agency determination. As set forth by the Hawai'i Supreme Court in its opinion in the Superferry litigation, in order for the department's exemption determination to be overturned, the court must determine whether the agency's factual determinations were *clearly erroneous*, and whether it otherwise complied with the EIS law and its implementing regulations, as a matter of law. The "clearly erroneous" standard is very difficult to overcome as the review is significantly deferential, requiring a definite and firm conviction that a mistake has been committed.

If litigation is the only avenue for public participation in an agency exemption determination process and the standard of review is significantly deferential to the agency, we conclude that the EIS system, including both the law and its rules, is flawed. The exemption process affords wide discretion to agencies and neither enhances environmental consciousness nor encourages cooperation.

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### **Construed as a Federal Deadline, Hawaii Superferry, Inc.'s Shipbuilding Date Drove the State's Decision-making**

In 2004, the State developed an overall strategy and policy direction for the Superferry project, but expressed frustration over the Hawaii Superferry, Inc.'s delays in delivering an operational plan. During that year, the department's "ferry project team"—employees who played key roles in the project—expressed a preference for a strategy that included constructing permanent harbor improvements and conducting an environmental review. It became clear, however, that the department's preferred strategy was contrary to Hawaii Superferry, Inc.'s preference, which it stated was to avoid a time-consuming environmental review and meet its June 30, 2005 deadline obligation to the U.S. Department of Transportation, Maritime Administration (MARAD). Ultimately, a decision involving the governor's office was made that directed the "ferry project team" to pursue scenarios that would exempt the ferry harbor work from an environmental review. We found, however, that the June 30, 2005 deadline that drove the entire process was not a federal

MARAD deadline, but instead Superferry's shipbuilding deadline. Details remain murky as to whether the department's "ferry project team" ever verified the origin of the June 30, 2005 deadline.

Based upon our review of department emails sent between May 2004 and February 2005 as well as interviews with current and past department employees, we identified several employees who comprised the "ferry project team." They included the director of transportation, the department's deputy director of administration, chief planning officer, deputy director of harbors, and the Harbor Division's administrative services officer, planning engineer, and project engineer.

***Project team expresses frustration in developing Superferry harbor plan***

In April 2004, the department held an internal policy meeting to develop an overall strategy and policy direction for the Superferry project. At that meeting, a policy decision was made by the director of transportation, and project team members were told to keep at a minimum the harbor improvement work to accommodate the Hawaii Superferry, Inc. They were also told that major improvements would not be constructed until the company established itself as a viable operation.

Department emails and documents reveal, however, that the project team's efforts to carry out the policy were hampered by Hawaii Superferry, Inc.'s failure to submit an operational plan. Project team members also expressed frustration as strategies to accommodate the Superferry were in constant flux, sometimes at the directive of department leadership.

**Lack of Superferry operating plan hinders project team members**

In September 2004, department emails show that project team members became aware that Hawaii Superferry, Inc. had no operational plan and expressed amazement at the lack of available documentation for a project of that size. The lack of operational planning by the Hawaii Superferry, Inc. was cited by a project team member as the cause of many of the problems they had encountered.

On September 29, 2004, the chief planning officer requested Hawaii Superferry, Inc. to provide an operations plan for each of the ports it planned to call in Hawai'i. What the project team received from Superferry, however, was not an operations plan but what one team member described as "a generic presentation of needs." As shown in Exhibit 2.2, one of the project engineers said he would like to be more forceful with Superferry but was fearful the company would complain to the governor who openly supported it.

## Exhibit 2.2

### Email From DOT Project Engineer to Superferry Project Team Member

Would like to be more aggressive with HSF, but concerned that they will run to the Governor and we will be painted as not being helpful..

Source: Department of Transportation

Later emails among project team members show that Hawaii Superferry, Inc. still had not submitted a proper operations plan to the project team as late as December 2004.

### Ever-changing scenarios to accommodate Superferry raised anxiety for project team

Throughout Fall 2004, the then-deputy director of harbors told us the department was looking at various alternatives to enable Hawaii Superferry, Inc. to meet its targeted commencement date and that “things were constantly changing.” This constant change added to the anxiety of the project team as evidenced in an email, Exhibit 2.3, reacting to a last-second change by department officials to move the Superferry berthing location at Kahului Harbor.

## Exhibit 2.3

### Email From DOT Superferry Project Team Member to Other Team Members

Its quite obvious we are in deep kimchee. We need to meet with **1** and **2** ASAP to figure out what the heck the CIP improvements are at each harbor. Are you aware that **1** is talking about not doing the notch pier but to have Superferry operate at Pier 3 at Kahului? I don't know if that's what he told OEQC and whether you guys were at the 9:00 a.m. meeting he had with staff (I wasn't there but know **3** was) on Wednesday. They want to get the Letter of Intent draft up to **4** and company by Friday (yes, you're reading this on Friday!) and attach diagrams of the improvements which led to the question: what the @#%\*! are we doing? Maybe I'm the only confused one -- if you guys know, that's fine - please let me know.

#### Legend:

- 1 = Then-Deputy Director for Harbors, DOT
- 2 = Then-Deputy Director for Staff Services, DOT
- 3 = Then-Planner VI, DOT
- 4 = Then-Chief of Staff, Office of the Governor

Source: Department of Transportation

The chief planning officer told us the project team members had been rushed from the onset and that they could not work any faster than they did.

### ***A June 2005 Superferry deadline “drove” department actions***

In late 2004, Hawaii Superferry, Inc.’s targeted start date for its inter-island ferry service was January 2007. Based on this projected date, the state Department of Transportation worked to complete all necessary tasks to enable Superferry to begin service.

During our audit, we reviewed department documents and emails and conducted interviews with key department officials to determine what actions the department took to prepare the state’s harbors to accommodate the high-speed ferry service. During our review, we identified a single date—June 30, 2005—that significantly impacted the department’s decision-making and actions. In fact, we found that this date drove the DOT’s exemption determination process.

### **Project team expresses preferred Superferry project strategy**

Our review of department documents reveals that in December 2004, the department’s ferry project team expressly preferred a strategy that included constructing permanent harbor improvements and conducting an environmental review. This strategy was cited as being the most viable option because it was cost-effective and would reduce contracting and procurement time for the State. In the long run, building permanent harbor improvements would be more cost-effective than building interim harbor improvements first, and permanent harbor improvements later.

The preferred strategy also would have required the Hawaii Superferry, Inc. to prepare a statewide environmental assessment related to its operations and the ferry system. The reason given by the department’s ferry project team for this particular recommendation was that it would reduce the State’s risk of a legal challenge. Members of the ferry project team expressed the opinion that lack of a statewide environmental assessment would leave the department “open to questions.” Members also expressed that it was important for Hawaii Superferry, Inc. to have the lead in performing an environmental assessment because it—and not the State—would bear the responsibility for any delays. Also, Hawaii Superferry, Inc. would be forced to do its own due diligence. Members in favor of this recommendation also argued that an environmental assessment would address public concerns and that it was the “right thing to do.”

### **A “new hurdle” for the department surfaces in 2004**

Around December 2004, Hawaii Superferry, Inc. informed state officials that failure to meet a June 30, 2005 deadline would prevent the company

from operating in the islands. Department records and our interviews of department officials reveal that department administrators accepted Hawaii Superferry, Inc.'s assertion that meeting that deadline would determine whether it would be able to operate in the state. Our audit research indicates, however, that the department did not conduct sufficient due diligence to verify whether the deadline was valid for the reasons Hawaii Superferry, Inc. claimed. In fact, we found that in order to meet the deadline, department administrators elected to implement strategies that eliminated an environmental review of harbor improvements in connection with the Superferry project. These decisions were made against the preferred strategies of key members of the department's ferry project team. Ultimately, these key members believed that pursuing a strategy to meet the Hawaii Superferry, Inc.'s deadline would end up being more costly and expose the State to a greater risk of litigation and public criticism.

Documents show that Hawaii Superferry, Inc. disclosed the June 2005 deadline to the department's ferry project team during a meeting on December 17, 2004. According to documents and interviews, Hawaii Superferry, Inc. attributed the deadline to the MARAD which provided a key financing component for the Superferry project.

During the December 17, 2004 meeting, Hawaii Superferry, Inc. told the department's ferry project team that MARAD had qualified its loan guarantee commitment by requiring all environmental clearances to be in place by June 30, 2005. Thus, if this condition were not met, Hawaii Superferry, Inc. would lose its loan guarantee, which would prevent it from operating in Hawai'i. A department official describes Hawaii Superferry, Inc.'s disclosure of the June 2005 deadline as a "new hurdle. . . which changes the whole picture."

### **The June 2005 deadline "drove the process"**

According to department documents, Hawaii Superferry, Inc. refused to do an environmental assessment. A department deputy director said the level of "push back" the department received from Hawaii Superferry, Inc. when the project team suggested that it do an environmental assessment was not expected. The department's chief planning officer added that the company consistently held to its position that it not be required to conduct an environmental assessment. According to the then-director of transportation, the then-deputy director of harbors, and the chief planning officer, Hawaii Superferry, Inc. stated that any environmental review would be time-consuming and prevent it from meeting its June 30, 2005 deadline obligation to MARAD. According to department officials, Superferry stated that requiring an environmental assessment would be a "deal breaker."

A meeting involving members of the department's ferry project team, the Hawaii Superferry, Inc., and the governor's chief of staff was held on December 30, 2004 at the governor's office. Department emails show a decision was made during this meeting, although they do not reveal who made the decision. Current and former department officials and employees who worked on the ferry project were either unable to recall who made the decision at that meeting or chose to invoke executive privilege when asked who directed the team. The decision directed the ferry project team to pursue scenarios that would exempt the ferry harbor work from an environmental assessment.

An email sent shortly after the December 30<sup>th</sup> meeting by the chief planning officer expressed confusion and surprise over the decision. The text of the email is shown in Exhibit 2.4.

**Exhibit 2.4**  
**Chief Planning Officer's Email About the December 30, 2004 Meeting**

How did we get to this position?--That's the part I can't figure. HSF is saying MARAD is qualifying their commitment as our having the environmental clearances in place by June 30, 2005--so that excludes everything but the Exemption route. And if not, that is the deal breaker. [REDACTED]

Source: Department of Transportation

The chief planning officer also noted in her email that in order to have all environmental clearances in place by the June 2005 deadline, all options except for the exemption route would be excluded. In an interview with the then-director of transportation, he related that the meeting focused on how to make the Superferry a reality and that the June 2005 deadline "was driving the entire process."

Department documents show that some team members acknowledged that while an exemption strategy would satisfy the June 2005 deadline, it was also "risky" in that it would invite legal challenges. In a department email, the chief planning officer wrote, "We would be crazy to go exemption." Another department document states that "holding ourselves to June 30, 2005 deadline for environmental clearance. . .this does not appear to be in our best interest." In an interview, a department deputy director recalled that "everyone recognized [an exemption] was not a 100 percent lock that it would be okay."

The then-deputy director of harbors acknowledged that even though ferry project team members may have preferred other options, he believed those options were not viable and that the staff viewed things through a

limited perspective and not from a policy standpoint. The deputy director added that the June 2005 deadline “whittled down” the options of what the department could do and by when it could do it. He admitted that the deadline meant excluding options that would have required an environmental assessment.

### **Details about the department’s efforts to validate the June 2005 deadline are murky**

The department director said it was the DOT’s obligation to verify with MARAD that the date was valid. The director said this responsibility fell on the deputy director of the Harbors Division. The then-deputy director of harbors told us he could not recall if the date was verified but that the department “probably” did so because the department would not simply take Hawaii Superferry, Inc.’s word that all environmental clearances had to be given by June 30, 2005. He was convinced the June 30, 2005 date was from MARAD and that the date could be verified on MARAD’s letter of commitment with Hawaii Superferry, Inc.

Under the Title XI program, upon MARAD’s commitment of loan financing, a letter of commitment is issued to the applicant by the U.S. Maritime Administrator. The letter of commitment includes numerous requirements the applicant must fulfill in order to close the loan guarantee.

According to Hawaii Superferry, Inc., on December 29, 2004, MARAD issued a draft letter recommending the company’s loan guarantee for approval. A copy of the letter was shared with the state Department of Transportation on January 4, 2005. MARAD’s letter of commitment was accepted by Hawaii Superferry, Inc. on January 25, 2005. Among the preconditions outlined in the January 2005 letter of commitment was a requirement that Hawaii Superferry, Inc. confirm—prior to the closing of its agreement—that the State had appropriated the funds for infrastructure improvements.

According to the letter of commitment, Hawaii Superferry, Inc. had until January 2006 to fulfill all the preconditions set forth by MARAD. In order to meet this timetable, Hawaii Superferry, Inc. needed state lawmakers to appropriate funding for the project during the 2005 legislative session. Our review of state records shows that the harbor work associated with the Superferry project was not in the 2004 executive budget but was included in the 2005 executive budget.

Contrary to the department deputy director’s assertion, however, the associate administrator in charge of the Title XI applications processing office at MARAD and the project manager both confirmed that the letter of commitment does not reference a specific deadline date. A copy of

the letter is shown in Appendix A. Hawaii Superferry, Inc. had up to one year to meet MARAD's preconditions in order to close the deal. Our review found no reference to June 30, 2005.

The associate administrator at MARAD also noted this one-year period was not a "hard deadline" and could have been extended if agreed to by MARAD and Hawaii Superferry, Inc. Moreover, on three separate occasions, the associate administrator at MARAD told us that she does not recall receiving an inquiry from the state Department of Transportation to verify whether MARAD required that environmental clearances be in place by June 30, 2005.

**Questions surround  
the origin of the  
deadline**

Department documents stated that Hawaii Superferry, Inc., attributed a deadline of June 30, 2005 to MARAD. If the State was to meet the deadline, there was no time to conduct an environmental review. Our review of the MARAD documents uncovered no mention of the deadline. Despite this, both the director of the transportation department and the deputy director of harbors continue to attribute this deadline to MARAD. They also agree that this deadline was significant and ultimately drove the decisions that would follow.

**MARAD denies issuing a deadline to Superferry**

During three separate interviews with our office, the associate administrator at MARAD denied having set a June 30, 2005 deadline requiring the Hawaii Superferry, Inc. to have all environmental clearances in place. Contrary to Hawaii Superferry, Inc.'s assertions, as described in department documents, MARAD officials stated that it would be inaccurate to attribute this date to MARAD. The MARAD project manager, who coordinated the drafting of the closing requirements for Hawaii Superferry, Inc., also supported the associate administrator's position. MARAD's Title XI letters of commitment set no deadlines other than the standard one-year period applicants receive to meet all the preconditions. Indeed, the letter shown in Appendix A does not refer to a June 2005 deadline.

**To meet Superferry's deadline, the State abandons an  
environmental assessment**

MARAD said Title XI loan guarantee cases are typically categorically exempt from environmental review as the loan guarantees simply provide the financial means to build the ships. These vessels usually have port facilities already in place that are designed to accommodate the ships.

When asked, MARAD clarified that the Hawaii Superferry case was different because the vessels' planned ports of call needed to be altered,

which might have triggered an environmental assessment. If an environmental assessment was performed, there was always the possibility that the port facilities could not be built due to environmental concerns. MARAD's position was that it was not willing to finance the construction of any vessel that might be unable to operate because it has no port.

As a result of those concerns, MARAD inserted a requirement in its letter of commitment to Hawaii Superferry, Inc. The precondition was that the State had to provide confirmation that an environmental assessment of the port facilities would not be required. MARAD reiterated that it did not impose a June 30, 2005 deadline, or any specific date, as part of this precondition. The only deadline MARAD issued was the standard one-year period that began January 2005 when its letter of commitment was issued to and accepted by Hawaii Superferry, Inc.

### **Deadline tied to Superferry's agreement with shipbuilder**

In a declaration by Hawaii Superferry, Inc.'s chief executive officer to the Second Circuit Court of Hawai'i, the chief executive officer stated that the June 30, 2005 date was a deadline established under an agreement with its shipbuilder, Austal USA, LLC. This agreement calls for Hawaii Superferry, Inc. to secure financing by the June 2005 deadline in order to pay Austal to build its vessels.

MARAD said its loan guarantee was important for Hawaii Superferry, Inc. because it enabled the company to issue the bonds to finance the construction of the vessels. MARAD also pointed out that the chief executive officer's court statement makes clear the June 30, 2005 deadline is based on a two-party agreement between Hawaii Superferry, Inc. and Austal and does not represent a MARAD deadline.

Our attempts to interview Hawaii Superferry, Inc. executives for this report were unsuccessful. Because Hawaii Superferry, Inc. sought certain preconditions for any interviews with company representatives in connection with this audit, we elected not to conduct the interviews. The preconditions are not aligned with the policies and practices of the Office of the Auditor. However, we were able to review portions of the company's contract with its shipbuilder, Austal USA, LLC, and confirmed that the June 30, 2005 deadline was driven by a need to secure financing in order to pay Austal to build its vessels.

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## **Conclusion**

Faced with too little time and opposition from Hawaii Superferry, Inc., the state Department of Transportation abandoned efforts to require an environmental review for harbor improvements needed to accommodate

the ferry service. Flawed EIS law and rules enabled the department to trigger its exemption determination list and bypass the environmental review. Details surrounding the department's efforts to validate the origin of the June 30, 2005 deadline are murky, making it likely that it relied on Hawaii Superferry, Inc.'s representation that the date was a federal deadline. In the end, the State may have compromised its environmental policy in favor of a private company's internal deadline. It remains to be seen whether these decisions will cost the State more than its environmental policy. These are issues we intend to discuss in Phase II of our audit.

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## Recommendations

1. The Legislature should consider:
  - a. Making appropriate and aligned changes in the Hawai'i Revised Statutes to identify and empower an agency or entity with authority to enforce the Environmental Impact Statements laws and rules; and,
  - b. Requiring agencies to provide the Office of Environmental Quality Control (OEQC) individual agency exemption determinations in a timely fashion for publication in the Environmental Notice and for posting on the OEQC's website. The Environmental Council shall determine the form of the information provided.
2. The Environmental Council should:
  - a. Amend the EIS rules to require agencies to document and file records of their findings that address HAR 11-200-8(b) for actions that have been determined to be exempt and identify the kinds of documents the agencies must maintain for actions that have been determined to be exempt;
  - b. Amend the EIS rules to require the director of the OEQC to consult with the Environmental Center of the University of Hawai'i before the director issues an opinion of whether an individual action is exempt;
  - c. Amend the EIS rules to require that agencies should review, update, and submit their exemption lists every five years—or sooner if the Environmental Council determines that changes are required—to the Environmental Council for review and concurrence;

- d. Amend the EIS rules to require agencies to contact the director of the OEQC as one of the required outside agencies or individuals to consult prior to reaching a decision regarding an exemption determination;
  - e. Amend the EIS rules to require agencies to consult with outside agencies and individuals as the Environmental Council deems appropriate prior to reaching a decision of an exemption determination; and,
  - f. Amend the EIS rules to ensure the OEQC provides training and assistance to agencies to ensure statutes and rules are complied with when they propose actions subject to the EIS law.
3. The Office of Environmental Quality Control should:
- a. Establish a process by which the Environmental Council is notified when the director of the OEQC receives a request for an opinion or consultation from an agency if a proposed action is exempt and provide the Environmental Council a copy of the resulting opinion and any consultation records;
  - b. Establish a process by which the director of the OEQC consults with the Environmental Center of the University of Hawai'i before the director issues an opinion if a proposed action is exempt;
  - c. Ensure that documentation of such environmental exemption notices and opinions is maintained by the OEQC and is made available for public review; and,
  - d. Establish guidelines including a checklist for use by agencies to ensure that all of the steps required by Section 11-200-8 (b), HAR, to protect the environment have been properly addressed for a proposed action before reaching a decision of an exemption determination.
4. The Department of Transportation Harbors Division should:
- a. Modify its record-keeping process to facilitate public review of exemption determinations.

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## Appendix A



U.S. Department  
of Transportation

Maritime  
Administration

400 Seventh Street, S.W.  
Washington, D.C. 20590

John L. Garibaldi  
Chief Executive Officer  
Hawaii Superferry, Inc.  
Pier 19 Ferry Terminal  
Honolulu, HI 96817

JAN 24 2005

Dear Mr. Garibaldi:

On January 21, 2005, the Maritime Administrator with respect to the application dated June 4, 2004, as amended, from Hawaii Superferry, Inc. (HSF) for a guarantee of obligations pursuant to Title XI of the Merchant Marine Act, 1936, as amended (the Act), for construction and mortgage period financing of two 105 meter high speed roll-on-roll off passenger and vehicle ferries (Vessels), took the following actions subject to the conditions contained herein:

- I. Approved HSF and Hornblower Marine Services, Inc. (Hornblower), pursuant to Section 1104A (b) (1) of the Act, and subject to compliance with the requirements stated herein, as possessing the ability, experience, financial resources, and other qualifications necessary to the adequate operation and maintenance of the Vessels which serve as security for the Title XI guarantees.
- II. Approved the design of the Vessels provided that the Vessels are completed in accordance with the terms and conditions of the shipbuilding contracts between HSF and Austal, dated April 9, 2004 (the Shipbuilding Contracts) and pursuant to Section 1104A(b)(2) of the Act found that the Vessels are eligible for a guarantee of 87 1/2 percent of the actual cost of construction (Actual Cost).
- III. Approved Austal USA, LLC of Mobile, Alabama (Austal) as shipbuilder for the Vessels.
- IV. Required that the Shipbuilding Contracts between HSF and Austal for construction of the Vessels be in form and substance satisfactory to MARAD and amended to include MARAD's standard construction contract clauses, including, but not limited to requiring that (1) HSF and Austal assign the Shipbuilding Contracts to MARAD and assign their security interest in the Vessels during construction to a collateral trustee for the benefit of MARAD and, after the Refund Guarantee (as defined in Recommendation VI below) has been fully

The Auditor's Office received this document with handwritten remarks, notes, symbols, and underscoring. The document was not altered by our Office.



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drawn by MARAD, for the benefit of the bank issuing the Refund Guarantee, (2) MARAD shall have the right to inspect work in progress under the Shipbuilding Contracts, (3) MARAD's prior written consent be obtained before substantial technical or significant cost changes occur under the Shipbuilding Contracts, and (4) the Shipbuilding Contracts be amended to conform to the requirements contained in 46 CFR 298.32(a)(4) and include the billing schedule contained in the letter between Austal and HSF, dated April 9, 2004 (Billing Schedule), so long as no change to that schedule may be made without the prior written consent of MARAD.

- V. Determined based on Recommendation VI below, that a performance bond is not required pursuant to 46 CFR 298.32(a).
- VI. Required that Austal obtain a Refund Guarantee in the form of a documentary letter of credit issued by a U.S. commercial bank or a U.S. branch of a foreign commercial bank, in either case, with a bond rating from a nationally recognized bond rating agency (e.g., Moody's or Standard & Poor's) of not less than "A", in form and substance satisfactory to MARAD. Required that the Documentary Letters of Credit and the documentation for the collateral trustee arrangement are in form and substance satisfactory to MARAD, assigned to MARAD, and executed prior to the Closing<sup>1</sup> except the Documentary Letters of Credit shall be issued in favor of MARAD and shall allow MARAD to draw down on the Documentary Letters of Credit if the shipbuilder is in default under the Shipbuilding Contracts even if HSF was previously in default, or subsequently is in default under the Shipbuilding Contracts. Required that the aggregate guaranteed ceiling of the Documentary Letters of Credit always equal or exceed the amount of Title XI principal and accrued interest for which MARAD is at risk.
- VII. Noted that HSF and the State of Hawaii (the State) have entered into a letter of intent dated December 9, 2004 (LOI) which outlines the general terms to be included in an agreement between HSF and the State regarding the port and infrastructure facilities to be utilized by the Vessels. MARAD noted that the LOI does not represent the final agreement between HSF and the State and that the terms and conditions to the final agreement are still to be negotiated. Therefore, MARAD is requiring (as indicated in Recommendation VIII below and other recommendations herein) that the final arrangements between the State and HSF conform to these recommendations and otherwise be in form and substance satisfactory to MARAD prior to the Closing. It is further noted that the LOI is not and should not be construed as creating any obligation on the part of MARAD. \*

<sup>1</sup> Closing is defined as the date when MARAD executes the Authorization Agreement and HSF executes the Security Agreement.

- VIII. Required that HSF enter into a final, definitive agreement with the State that sets out (i) the responsibilities of the State and HSF for providing satisfactory shoreside improvements, equipment and terminal facilities at each port in time for HSF to commence operations to such port following the delivery of the relevant Vessel and (ii) the rents, fees, and charges to be imposed by the State on HSF in connection with the use of the shoreside infrastructure provided under the agreement. Such agreement and all related agreements and leases shall be assigned to MARAD for security purposes and afford MARAD the right to enforce the State's promises to HSF. Such agreement(s) shall cover the full term of the financing and be executed prior to the Closing. Required that the form and substance of the agreement(s) be satisfactory to MARAD, and include a provision that MARAD has the right to reassign such lease in the event of default. Additionally, required that HSF submit, prior to the Closing, documents confirming that the State has appropriated the funds required for financing the infrastructure improvements, in form and substance satisfactory to MARAD. Permitted the State to be granted a fully subordinated third mortgage on the Vessels provided these third mortgages are in form and substance satisfactory to MARAD. Required HSF to provide an acceptable legal opinion at or prior to the Closing indicating that HSF and MARAD have the right to enforce the State's promises to HSF under the final, definitive agreement and any related agreements.
- IX. Required that HSF submit to MARAD prior to the Closing, details of their shoreside operations and their plan for performing these activities which demonstrate acceptable shoreside operations, in form and substance satisfactory to MARAD.
- X. Determined that the Closing shall be preconditioned on MARAD's finding that
- (i) the Hawaii Public Utilities Commission shall have granted HSF a Certificate of Public Convenience and Necessity authorizing HSF to engage in operations as a water carrier in accordance with Section 271G-10, Hawaii Revised Statutes upon which HSF shall, pursuant to State regulations, be exempt from paying a Port Entry Fee or has indicated the circumstances under which the Port Entry Fee will or will not be waived and MARAD is satisfied that the amount of such fees do not adversely affect the project's economic soundness. HSF shall have factored such exemption into the financial projections;
  - (ii) the State has appropriated the funds needed to finance its shoreside contributions and the appropriated funds are sufficient to pay for the construction of improvements, equipment and other work that the State will in fact undertake to pay for and a determination that, if additional work needs to be performed, that HSF has the resources to do it and that these additional expenditures do not adversely affect the project's economic soundness;
  - (iii) the State has given all the governmental and environmental clearances (including a confirmation that there is no need for an environmental assessment of the port facilities) necessary to commence and complete the shoreside

closing =  
transaction  
6/30/05.

improvements, the leasing of equipment, the construction of the temporary passenger terminal facilities, and the operation of the ferries by HSF, and the periods of all applicable State and Federal statutes of limitation have run on the right of plaintiffs to block the project;

*ops of ferry  
as it is tied to  
inputs (vs.  
ops system)*

(iv) the State and HSF have worked out the dockage, passenger and vehicle fees and other rents for real property, improvements and equipment, and all other charges with finality and that MARAD has had an opportunity to review these expenses and is satisfied that they do not adversely affect the project's economic soundness;

(v) the State has agreed that all right, title and interest in HSF under any and all agreements with the State that are relevant to ship operations in Hawaii shall be assigned to MARAD and MARAD shall have 60 days to cure any of HSF's defaults under these agreements;

(vi) the State shall have provided a satisfactory list of equipment and improvements with all necessary State approvals with firm delivery dates upon which HSF may rely;

(vii) the State shall have determined that all of its conditions for funding the construction of the equipment and the improvements are satisfied; and

(viii) the State acknowledges that its third mortgage in the Vessels will be strictly passive, allowing it no rights to affect the sale or the operation of the Vessels, and that MARAD will not be required to enter into a cooperation agreement of any kind with the State as a precondition to the State's participation in the project.

- XI. Noted that a review under the National Environmental Policy Act of 1970 (NEPA) may be required pursuant to 40 C.F.R. Part 1500 and that MARAD will promptly make a decision as to the necessity for such review. If MARAD determines that a NEPA review is necessary, MARAD will promptly initiate such review (including an Environmental Assessment and Environmental Impact Statement, as appropriate) of the environmental impacts of this project. Any required NEPA review must be concluded prior to the occurrence of any Closing. Unless MARAD is satisfied that compliance with the requirements of NEPA is complete, MARAD is under no obligation to close on the Letter Commitment and may, in its sole discretion, cancel the Letter Commitment. Required that HSF pay for any NEPA review determined by MARAD to be necessary.
- XII. Determined that MARAD has confirmed the feasibility of HSF's alternative route north of Molokai.
- XIII. Found, pursuant to Section 1104A (d) of the Act, that the project, with respect to which the guaranteed obligations are to be issued, is economically sound.
- XIV. Approved HSF's request as contained in their Title XI application to include the cost of foreign items in the Vessels, in the amount of \$42,783,100 for both

Vessels, as the requirements for waiver in accordance with 46 CFR 298.13 have been met, subject to appropriate verification and the requirements of Recommendation XV being met. Determined that none of these foreign items constitute a major component of the hull or superstructure. Any other foreign items identified in the future shall be excluded from Actual Cost unless they meet cargo preference policy requirements and a waiver is granted for such items in accordance with 46 CFR 298.13(b)(2).

- XV. Required that for all containerized shipments of foreign items included in Actual Cost, that bills of lading be provided substantiating U.S. flag transport, unless MARAD grants a waiver in accordance with the regulations governing implementation of the pertinent cargo preference acts.
- XVI. Noted that HSF has elected to include the estimated guarantee fee, which is due and payable at the Closing, as an element of Actual Cost of the Vessels. Required that the Title XI guarantee fee for the Vessels authorized by Section 1104A(e) of the Act be: (1) determined in accordance with the variable rates set forth in 46 CFR 298.36; (2) based on the pro forma balance sheet of HSF at the closing, reflecting the completion of the proposed financing; and (3) based on the discount rate at the time of the Closing, the actual guarantee amount, the construction period disbursement schedule, and any changes in the transaction affecting the fee. Noted that the guarantee fee on both Vessels is estimated at \$8,779,745 and will be recalculated at Closing in accordance with the above. Required that HSF submit a revised construction period disbursement schedule and revised calculation of net interest during construction, in form and substance satisfactory to MARAD, six weeks prior to the Closing.
- XVII. Determined, in accordance with Recommendations XIV and XVI and pursuant to Sections 1101(f) and 1104A(e)(5) of the Act, that the total estimated Actual Cost of the Vessels subject to adjustments as determined by the Associate Administrator for Shipbuilding, is as indicated below:

|   | <u>Vessel 1</u>        | <u>Vessel 2</u>        | <u>Total</u>            |
|---|------------------------|------------------------|-------------------------|
| Shipyard Contract Price                   | \$77,303,125.00        | \$77,303,125.00        | \$154,606,250.00        |
| Escalation                                | -                      | 1,596,063.00           | 1,596,063.00            |
| Changes and Extras                        | 2,274,605.00           | 2,274,605.00           | 4,549,210.00            |
| Other Items: (Spares and Lubes)           | 61,795.00              | 61,795.00              | 123,590.00              |
| Owner Furnished Items                     | 163,600.00             | 163,600.00             | 327,200.00              |
| Design, engineering and Inspection        | <u>480,000.00</u>      | <u>460,000.00</u>      | <u>940,000.00</u>       |
| <b>Total Estimated Construction Costs</b> | <b>\$80,283,125.00</b> | <b>\$81,859,188.00</b> | <b>\$162,142,313.00</b> |
| Net Interest During Construction          | 3,642,710.00           | 3,438,297.00           | 7,081,007.00            |

|                                  |                    |                    |                    |
|----------------------------------|--------------------|--------------------|--------------------|
| Estimated Guarantee Fee          | <u>\$4,520,757</u> | <u>\$4,258,988</u> | <u>\$8,779,745</u> |
| Total Estimated Actual Cost (AC) | \$88,446,592       | \$89,556,473       | \$178,003,065      |
| Maximum Guarantee at 87.5%       | \$77,390,768       | \$78,361,914       | \$155,752,682      |
| Guarantee at 78.5% of AC         | \$69,430,575       | \$70,301,831       | \$139,732,406      |
| Title XI Bond Amount at 78.5%    | \$69,430,000       | \$70,301,000       | \$139,731,000      |

- XVIII. On the basis of Recommendation XVII above, fixed the amount of the Maritime Administration's (MARAD) guarantee at \$139,731,000, which amount does not exceed 87 1/2 percent of the estimated Actual Cost of the Vessels. The amount of the guarantee will be adjusted if necessary to reflect the Actual Cost of the Vessels as of the Closing as determined by MARAD and will be in accordance with Recommendation XIX below. Notwithstanding Recommendation II, noted that HSF has requested and MARAD has agreed to cap the guarantee at 78.5% of the estimated Actual Cost of each of the Vessels.
- XIX. Authorized the Associate Administrator for Shipbuilding to approve the form and authorize the delivery of all appropriate documents and to take such other actions as may be necessary to effectuate the purpose of this Recommendation including, but not limited to, the authority to approve any increase in (1) the Actual Cost of the Vessels up to, but not exceeding, 10 percent of the Actual Cost as approved herein, and (2) the authorized amount of the Title XI obligations to be guaranteed resulting from (1), provided an increase does not result in the project becoming economically unsound in accordance with the determination made herein and that appropriated funds are available to provide for the cost to the Government of such increase.
- XX. Required that the equity portion and any other costs associated with the proposed project that are not included in the Actual Cost determination, i.e. legal and accounting fees, or other items excludible from Actual Cost, be paid by or on behalf of HSF.
- XXI. Determined that this Letter Commitment may be terminated at the option of the Secretary, if HSF has not had a guarantee Closing within twelve months of the date of this Letter Commitment.
- XXII. Approved the amortization of the proposed obligations on a level debt basis with semi-annual payments of principal and interest for a period of twenty years from each Vessel's delivery. During the construction period, only interest payments will be required. Payment of principal and interest will be required to commence approximately six months after each Vessel's delivery, but in the case of a Vessel that has not been delivered, in no event later than 18 months from the scheduled

delivery dates under the Shipbuilding Contracts. Upon each Vessel's delivery, HSF will be required to issue long term obligations, in form and substance satisfactory to MARAD, including but not limited to having an interest rate which conforms to 46 CFR 298.20(c).

**XXIII.** Required that: 1) each request for withdrawal from the Escrow Fund or draw from a Credit Facility be accompanied by a certification by a responsible officer of HSF a) that there are no liens or encumbrances on the Vessels or their component parts; b) that neither the Shipbuilding Contracts nor the Security Agreement is in default, c) as to the amount of Actual Cost paid, and d) that each item in these amounts is properly included in the Actual Cost of the Vessels; and 2) any amounts paid from the Title XI obligations at the Closing and the final draw per Vessel be accompanied by a Certified Public Accountant certification or other evidence satisfactory to MARAD as to a) to d) above. Additionally, required that Austal submit a no lien certificate on behalf of itself and its subcontractors with each requested draw from the Escrow Fund or Credit Facility. Required that all items of paid Actual Cost be submitted at least ten days prior to the Closing to be eligible for reimbursement at the Closing. Noted that prior to any use or disbursement of Title XI obligations, MARAD will ensure that the milestone has been billed in accordance with the Billing Schedule.

**XXIV.** Required that prior to disbursement of any Title XI funds for a Vessel, HSF demonstrate to the satisfaction of MARAD, with an independent auditor's certification, that it has paid its 21.5 percent equity share for that Vessel. Accordingly, for the first and second Vessel, HSF must demonstrate that it has paid at least \$19,016,592 and \$19,255,473, respectively, prior to any disbursement of Title XI funds. Such amount is subject to increase based on the most recent approved Actual Cost and corresponding guarantee amount in accordance with Recommendations XVIII and XIX above.

**XXV.** Required that all liens and all non Title XI debt relating to the Vessels, if any, be subordinated in a manner satisfactory to MARAD or discharged at or prior to the Closing.

**XXVI.** Required that HSF submit to MARAD evidence of satisfactory construction period insurance coverage at least ten days prior to the Closing. Said insurance shall provide that MARAD is named as the sole loss payee and an additional assured. Required that HSF submit to MARAD at least ten days prior to the delivery Closings, evidence of its marine insurance coverage on the Vessels in form and substance satisfactory to MARAD and required that HSF submit a statement from its broker on an annual basis stating that HSF is current on the premiums for said insurance coverage.

**XXVII.** Required that the management agreements between HSF and Hornblower for the construction supervision, preparation of policies and procedures manuals, and operations management dated June 1, 2004 (Management Agreements) be amended, as necessary, to

be in form and substance satisfactory to MARAD, and assigned to MARAD at or prior to the Closing.

**XXVIII.** Required that the subordinated debt agreement between HSF and Austal be in form and substance satisfactory to MARAD and conform to the provisions of 46 CFR 298.13(h) in order for MARAD to include the subordinated debt as equity. Permitted Austal to be granted a fully subordinated second mortgage on each Vessel provided these second mortgages are in form and substance satisfactory to MARAD and that HSF and Austal enter into an agreement with MARAD as provided in the third sentence of 46 CFR 298.13(h).

**XXIX.** Required that the engine repair and maintenance agreement between HSF and MAN B&W Diesel (MAN) be in form and substance satisfactory to MARAD. Also required that HSF be required to enter into another satisfactory maintenance agreement, if they do not renew their contract with MAN. Further required that HSF notify MARAD three months prior to the expiration of the agreement, of their intent to either renew the MAN Agreement or enter into another satisfactory engine repair and maintenance agreement.

**XXX.** Required that any default under the terms and conditions of the Subordinated Loan Agreement, Refund Guarantee, Documentary Letters of Credit, Collateral Trustee Agreements (under the Refund Guarantee), Management Agreements between HSF and Homblower, Port Facility Lease Agreements with the State, Shipbuilding Contracts, or MAN Engine Repair and Maintenance Agreement constitute a default under the Security Agreement.

**XXXI.** Required HSF to enter into a Title XI Reserve Fund and Financial Agreement (RFFA) in form and substance satisfactory to MARAD to: (1) conform to the current regulations, documentation, practices, and policies of MARAD, and (2) be subject to the Section 8 financial requirements and covenants, as modified herein.

**XXXII.** Required that HSF meet the following qualifying and ongoing financial requirements for purposes of Section 8 and 10 of the RFFA:

1. Working Capital of at least \$3.3 million at Closing and following delivery of the second Vessel and \$1.00 from the Closing until delivery of the second Vessel.
2. Long-Term Debt to Net Worth ratio no greater than 2.0 to 1.0.
3. Minimum Net Worth of \$68 million at Closing and following delivery of the second Vessel, and \$58 million from Closing until delivery of the second Vessel (and provided that while the Minimum Net Worth is set at \$58 million, HSF will be subject to RFFA provisions 8(b)(1) through (6)).
4. On an ongoing basis, no default under the Security Agreement.

XXXIII. Required that in determining Net Worth under Section 10 of the RFFA (qualifying requirements), that only the principal amount of \$16.1 million of the subordinated debt, as projected to be due on the date the project is to be completed, may be included in Net Worth. In determining Net Worth under Section 8 of the RFFA (ongoing requirements), permit HSF to include the principal balance of \$15.4 million on the subordinated debt plus the principal amount of any subordinated loans made with respect to adjustments to the Basic Purchase Price as defined in the Construction Contracts.

XXXIV. Required that HSF establish a Debt Service Reserve Account (Reserve Account), funded with cash to cover one semi-annual debt service payment on both Vessels, currently estimated at \$6.5 million. This amount will be finally determined following the delivery of the second Vessel, when the Final Actual Cost of the Vessels is determined and the terms of the mortgage period financing are set. One-half of this amount will be funded at or prior to the first draw down under the Credit Facility for the first Vessel (anticipated in early summer, 2005), and the remaining balance will be funded at or prior to the earlier of (1) the delivery of the first Vessel or (2) the first draw down under the Credit Facility for the second Vessel. The Reserve Account funds shall be released to HSF once it demonstrates that operations are generating a positive cash flow, (defined in a manner satisfactory to MARAD), at the following levels, over four consecutive fiscal quarters as evidenced by financial statements submitted in accordance with the Title XI RFFA as follows: one-third of the funds shall be released when HSF demonstrates a positive operating cash flow to senior debt service ratio (Ratio) of 1.3 to 1.0; an additional one-third shall be released when HSF has a 1.40 to 1.0 Ratio; and the final amount shall be released when HSF attains a 1.5 to 1.0 Ratio. The Office of Accounting will insure that the Reserve Account funds are distinguishable from the standard Title XI Reserve Fund account funds, but shall still be MARAD's collateral.

XXXV. Required that each of the outstanding common and Series A Preferred stock and the Series B Preferred stock documents be in form and substance satisfactory to MARAD, including that the terms and conditions of each of the outstanding common and Series A Preferred stock and the Series B Preferred stock be in form and substance satisfactory to MARAD, and that the common stock, the Series A Preferred stock and the Series B Preferred stock in the aggregate amount of approximately \$61 million (\$3 million of Series A Preferred Stock already issued, \$55 million of Series B Preferred Stock committed plus the additional credit enhancement of \$3 million of Series B Preferred Stock) be funded to HSF prior to the Closing. In order to determine the acceptability of the equity offering, HSF will be required to submit as part of the documentation for the Closing, information regarding the impact on HSF's ownership as a result of the stock offerings, the amount of securities held by J. F. Lehman and Company, identification of the investors, and the timing of equity funding. Furthermore, required that HSF provide MARAD with satisfactory evidence confirming the funding of the common, the Series A and the Series B Preferred stock of approximately \$61 million prior to the Closing.

XXXVI. Required that HSF submit a legal opinion in form and substance satisfactory to MARAD, that they complied with all applicable securities laws in their issuance of common and preferred stock.

XXXVII. Required that, in accordance with Section 1104A (m) of the Act, HSF provide the Secretary with additional collateral. The additional collateral, as described herein, will be promptly, at the request of MARAD, provided by HSF whenever (1) HSF does not meet any of its Section 8 (b) of the RFFA financial requirements or does not file its financial statements within 30 days of the due date for their submission in accordance with RFFA requirements and (2) the value of any funds on deposit in the Reserve Fund and the Reserve Account and the value of the delivered Vessels is less than 110% of the HSF outstanding Title XI debt as indicated by an Appraisal conducted by an appraiser specifically approved by MARAD to conduct the appraisal, who has followed an appraisal methodology approved by MARAD and which appraisal is not more than twelve months old. The additional collateral will consist of (1) a first security interest in all unencumbered HSF assets, and (2) a satisfactory subordinated security interest in all encumbered HSF assets. If the additional collateral includes cash or accounts, the cash and the accounts (as earned) shall be deposited into a U.S. commercial bank insured with the FDIC (which may be HSF's regular commercial bank so long as the bank waives any right of set off or any other claim to the proceeds on deposit) and shall be pledged to MARAD as security and perfected in accordance with the provisions of the Uniform Commercial Code. It shall be a condition of this cash collateral account that HSF may make such withdrawals from the account as not prohibited by the RFFA without consulting MARAD, but upon the happening of a payment default as defined in the Security Agreement, MARAD may prohibit HSF from making any withdrawals by the giving of a notice to the depository. The additional collateral will be released upon HSF's meeting the financial levels specified in Section 8(b) of the RFFA for four consecutive quarters as evidenced by HSF's financial statements, submitted in accordance with the RFFA. Additionally, whether or not HSF is meeting its Section 8(b) financial requirements, the prior written consent of MARAD shall be required prior to HSF's pledging any assets to a third party, unless HSF provides MARAD with an Appraisal of the Vessels, as described above. If this Appraisal indicates that the value of the Vessels plus the amount then on deposit in HSF's Reserve Fund and Reserve Account is less than 110% of HSF's outstanding obligations, it may not pledge its assets to the third party without first obtaining MARAD's consent. In addition, HSF will not pledge any assets at any time unless (1) the pledge documentation permits the granting to MARAD, when and if it may be required, of a satisfactory subordinated security interest in a form to be prescribed by the Security Agreement, and (2) it provides the draft pledge documentation to MARAD that conforms to the form prescribed by the Security Agreement. So long as HSF complies with the preceding sentence, the prior written consent of MARAD shall not be required in connection with the HSF Pledge to the State as provided in Paragraph K of the LOI referred to in Recommendation VII above.

XXXVIII. Required that HSF submit annual audited financial statements prepared in accordance with GAAP and in accordance with Section 9 of the RFFA. Also required that HSF submit unaudited financial statements prepared in accordance with GAAP on a quarterly basis, within 45 days of the end of its fiscal first, second and third quarters. Such quarterly statements shall be accompanied by (1) a certification from an officer of the company as to their accuracy, (2) an officer's certificate as to whether the company is in default (in accordance with Section 9 (b) of the RFFA), and (3) for all four quarters, officer certified calculations of its compliance with the financial requirements stipulated in Recommendations XXXII and XXXIV above. Required that HSF submit unaudited financial statements prepared in accordance with GAAP, certified by an officer of the company as to their accuracy, on a monthly basis if HSF files for bankruptcy.

XXXIX. Required that HSF submit, at least ten business days prior to the Closing, a detailed pro forma balance sheet, including adequate disclosures in accordance with GAAP, dated as of the closing date, reflecting the completion of the proposed financing and certified by an officer of the company as to accuracy of the balance sheet and that HSF meets the qualifying requirements contained in Recommendation XXXII above. The pro forma balance sheet shall be based on HSF's 12/31/04 audited financial statements, prepared in accordance with GAAP including footnote disclosures, and reconciled to the Closing. A copy of HSF's 12/31/04 audited financial statements shall be provided to MARAD together with the detailed pro forma balance sheet described above.

XL. Required that HSF submit quarterly reports pertaining to the construction of the Vessels, and the construction of the port facilities infrastructure within 45 days of the end of their fiscal first, second, third, and fourth quarters. Such statements shall be provided until such time as the second Vessel is delivered. The report should indicate a description of whether the Vessels and port facilities are being constructed on schedule, and whether or not there are any anticipated delays or cost overruns. HSF will also be required to submit its marketing plan at least one year prior to the delivery of the first Vessel. After submission of the marketing plan, HSF will be required to submit quarterly marketing reports on the status of their marketing efforts. These quarterly status reports are to include (1) a comparison of actual activity to the marketing plan and (2) an explanation for any significant deviations from the plan. Any letters of intent or arrangements for the employment of the Vessels shall be included as part of the marketing efforts section of the quarterly reports. Failure to submit these quarterly reports on a timely basis shall constitute a default under the Security Agreement.

XLI. Required HSF to submit to MARAD a copy of the monthly report sent to the State of Hawaii Harbors Division, containing the following activity statistics for each harbor within fifteen days following the end of each month in which the activities occur:

- a. Number of passengers embarking and disembarking, specifically identified by the port of embarkation or disembarkation.

- b. Number of automobiles and commercial vehicles, embarking and disembarking, specifically identified by the port of embarkation or disembarkation.
- c. Daily vessel movements.
- d. Gross receipts.
- e. Any additional information deemed necessary by the State for the calculation of any fees and charges.
- f. All other reasonable information as determined by the Harbors Division in maintaining statistical data on inter-island ferry operations.

Along with the above mentioned monthly report, required HSF to provide MARAD with a copy of the payment calculations due to the Harbors Division for (1) port entry fees (if any), (2) dockage fees, (3) passenger and vehicle fees, and (4) the greater of the applicable percentage of gross receipts or the applicable monthly portion of the minimum annual guarantees. Failure to submit these monthly reports on a timely basis shall constitute a default under the Security Agreement.

XLII. Required that HSF: (1) submit satisfactory evidence at each delivery closing that the Vessels are (a) built in accordance with the plans and specifications submitted to MARAD, (b) built in accordance with the Classification Rules of Germanischer Lloyds, and (c) Coast Guard inspected and (2) maintain the Vessels in class, and 3) submit an officer's certificate annually stating that the Vessels continue to remain in class and (4) permit MARAD to commission an independent inspection or survey of the Vessels at HSF's expense on an annual basis if HSF is not meeting their financial tests as stipulated in Recommendation XXXII.

XLIII. Required that HSF deliver a certification with respect to each Vessel at each delivery closing and at each disbursement under the Credit Facility with respect to the Vessels, that there have been no occurrences (or a full description of such occurrences, if any) which would adversely or materially affect the condition or progress of construction of the Vessels. If there has been such an occurrence, the Secretary will take such action as deemed appropriate by the Secretary.

XLIV. Determined that HSF and Hornblower have established U.S. citizenship pursuant to 46 CFR Part 355 and required that they submit evidence of continuing U.S. citizenship at the Closing with pro forma evidence of U.S. citizenship to be submitted ten days prior to the Closing.

XLV. At the delivery closings, required HSF to grant MARAD a First Preferred Mortgage on the Vessels in form and substance satisfactory to the Secretary. Required at the guarantee Closing, that HSF grant MARAD a first priority security interest in HSF's collateral as described in Recommendation XLVII below.

XLVI. Required at the delivery closings, that HSF provide MARAD with information satisfactory to MARAD from the U.S. Coast Guard that the Vessels are Jones Act eligible.

XLVII. Required that the documentation and legal opinions (including mortgage, Security Agreement, note and other documents as shall be required by the Secretary to preserve the Government's rights) relating to this transaction be: 1) in form and substance satisfactory to the Secretary, to the effect, inter alia, that all security interests including but not limited to those granted to the Secretary in the construction contract and all monies due thereunder, the hull and all parts installed or to be installed therein, the Title XI Reserve Fund and the Escrow and Construction Fund, as applicable, and the contents thereof, proceeds of insurance policies, and the proceeds of each thereof, are fully perfected and of first priority, except for the property governed by the collateral trustee agreement (as part of the Refund Guarantee) which agreement shall be in form and substance satisfactory to MARAD, and 2) submitted at least six weeks prior to the Closing unless otherwise noted and that all final documents be submitted at least one week prior to the Closing, and (3) all items of paid cost be submitted at least ten days prior to the Closing. Such legal opinions shall be delivered by independent counsel licensed in the appropriate jurisdictions, and shall include opinions, among other things, which confirm the perfection, enforceability and first priority of all items of MARAD's collateral except as indicated above.

XLVIII. Determined that the investigation fee authorized by Section 1104A(f) of the Act is \$212,164 for the Vessels and required that this amount, less the \$5,000 filing fee previously paid, or \$207,164, be paid in full prior to the issuance of a Letter Commitment. An additional investigation fee will be assessed if the actual amount of Title XI obligations issued differs from the amount approved herein.

XLIX. Determined that approval of this application complies with the provisions of the Federal Credit Reform Act of 1990 and authorized the Director, Office of Accounting, to obligate in the Program Account (693/51752 and 69X1752) the subsidy amount required pursuant to the Federal Credit Reform Act as specified by the Director, Office of Ship Financing and apportioned by the Office of Management and Budget (OMB). If: (1) MARAD determines at the time of the Closing, in its sole discretion, that the subsidy amount obligated under this paragraph is insufficient to cover the subsidy cost of the HSF project as MARAD, in consultation with OMB, then determines it to be, and (2) MARAD does not have sufficient unobligated subsidy funds available to cover the incremental increase in the subsidy cost, MARAD shall cancel and terminate the Letter Commitment (and HSF shall have no right to require MARAD to perform the Closing) unless (a) HSF elects in writing to decrease the amount of funds to be guaranteed by MARAD to a level that can be supported by appropriated funds available for subsidy, and (b) HSF complies with all the other terms and conditions of this Letter Commitment.

L. Determined that MARAD has complied with the Department of Transportation Credit Council guidelines for an external review of HSF's Title XI application and noted that the external review concluded that the project provides an adequate basis for a Title XI

Commitment, subject to the implementation of all the conditions herein. Further noted that the financial evaluation of the project by the internal DOT financial advisor reflected concurrence with the conclusions of the external reviewer and concluded that HSF has the financial capacity to undertake the project.

LI. Determined that a full and fair consideration of all the regulatory requirements, including economic soundness and financial requirements applicable to HSF and other applicable parties, and a thorough assessment of the technical, economic and financial aspects of HSF's application has been made. Further determined that MARAD has complied with the due diligence requirements imposed by the DOT Credit Council.

LII. Required HSF to execute a declaration at the Closing as required by 31 U.S.C. 1352 and the Lobbying Disclosure Act of 1995 (Public Law 104-65) disclosing all lobbying activities with respect to this application.

LIII. Required HSF to meet all other requirements of the Act and the applicable regulations of MARAD including the execution in form and substance satisfactory to the Secretary, of all required documentation.

LIV. Authorized the Chief Counsel or his delegate to represent MARAD at the Closing and to take any actions necessary to implement the preceding actions.

LV. Determined that the Letter Commitment may be terminated at the option of the Secretary if the Secretary determines, at or prior to the Closing, that: (1) HSF is in violation of Federal law and such violation would have a substantial adverse effect on the interests of the United States of America; or (2) the consummation of the Letter Commitment would violate Federal law. As a condition to Closing, required HSF to submit an Officer's Certificate that represents and warrants, as of the Closing date, the truth and accuracy of the preceding sentence and that no such violation has occurred.

LVI. In the event the investigation fee is not paid by the date of the approval of this Letter Commitment, authorized the execution of a letter to HSF indicating: (1) the date on which the Letter Commitment was approved by the Secretary; (2) that the Secretary has approved the issuance of the Letter Commitment upon payment in full of the investigation fee; and (3) that the Letter Commitment may be terminated at the option of the Secretary if the investigation fee is not paid within 30 days of the date of the letter to HSF.

LVII. Authorized the execution of a letter to HSF which shall constitute a Letter Commitment subject to the conditions set forth herein, and required that HSF accept the provisions thereof by signing and returning a copy to the Director, Office of Ship Financing, within 30 days or the Letter Commitment may be terminated at the option of the Secretary.

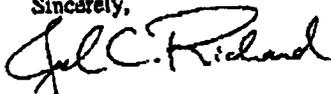
LVIII. Required HSF to enroll the Vessels in the Voluntary Intermodal Sealift Agreement (VISA) program upon their delivery.

LVIX. Required HSF and Austal to grant MARAD, at the Closing, a royalty free license of the proprietary information and/or patents used to construct and/or design the Vessels, in form and substance satisfactory to MARAD, for the term of the Title XI financing with the right of MARAD to transfer its royalty-free license to end users of the Vessels in case of a default by HSF.

LX. Required Austal to provide to MARAD, in form and substance satisfactory to MARAD, at the Closing, a certification from its lenders (other than with respect to the liens granted to the collateral trustee, as part of the Refund Guarantee), that they do not possess any liens on the Vessels under construction or that if they do, they waive those liens.

LXI. Required that a copy of the executed Credit Facility be provided to MARAD at Closing, and that the terms of the Credit Facility be in form and substance satisfactory to MARAD, including but not limited to the interest rate, appropriate triggers on capping or fixing the interest rate to ensure that the project remains economically sound, and that it include the agreement of the lender that it will not possess any liens in any of HSF's property or the Vessels.

Sincerely,



Joel C. Richard  
Secretary  
Maritime Administration

ACCEPTED:  
Hawaii Superferry, Inc.



JOHN L. GARIBALDI  
Name

CHIEF EXECUTIVE OFFICER  
Title

JANUARY 25, 2005  
Date

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## Response of the Affected Agency

### Comments on Agency Response

We transmitted a draft of this report to the Department of Transportation on April 4, 2008. A copy of the transmittal letter is included as Attachment 1. The department responded to the draft in Attachment 2 and included a comment section from the Department of the Attorney General.

In its response, the department does not dispute either our findings or recommendations and generally supports our recommendations. The department stated that it has already started a program to revise its records retention practices for exemption determination records.

The department provided specific comments, including an objection to our use of a 2004 Engineering Branch organizational chart. The 2004 organization structure is significant as analysis and decisions relating to the Superferry harbor improvements were made by staff in 2004 and 2005, prior to later branch reorganizations. Later charts—for example, 2005 or 2006, as the department suggests—are not relevant to the Superferry decision timeframe and may be confusing. We have further clarified in the report our use of the 2004 organization chart.

The department also objected to our description of a Harbors Division employee needing to sort through thousands of exempted harbors project folders by hand. The department stated that there would have been “hundreds,” not “thousands,” of files. Yet, the statement in our report is a quote of the division’s engineering program manager’s answer to our interview question. When asked roughly how many files did the employee have to search to compile the list, the manager told us “thousands.” Thus, our statement is a quote of the manager’s response to our question.

The department disagreed with our report that to date, we have received about half of the documents requested from the department. The department included as an attachment to its response a letter dated March 19, 2008 where it disputed this statement. We disagree with the contents of this letter. In fact, in many cases where the department said it responded, the request has never been addressed or was only partially fulfilled.

For example, we requested a list of detailed harbor improvements reviewed by the department along with any notes and analysis performed that demonstrate the department went through the steps required by the

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environmental law and rules before declaring exempt the harbor improvements needed to support the Superferry project. This documentation would show the harbor improvements would have minimal or no significant impacts, both primary and secondary; no short term, long term, or cumulative effects; do not affect an environmentally sensitive area; do not negatively impact the economic and social welfare and cultural practices; and fall within the exemption classes listed on DOT's Comprehensive Exemption List. Though the department claims to have responded to this request, we only received documentation of how the barges and ramps fall within the DOT's exemption classes.

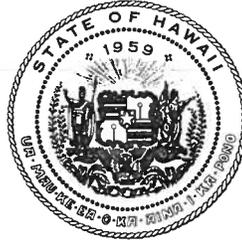
The department rejects any inference that a decision was made by the governor's office directing DOT to pursue exemptions. Yet, the department's emails detailing that a decision was made during the December 30, 2004 meeting at the governor's office are self-explanatory. Further, we corroborated the emails with interviews of former department officials. Accordingly, we stand by our finding.

In its response, the department also included comments from the Department of the Attorney General. We do not generally include in our reports comments from agencies other than the agency being audited, in this case, the Department of Transportation. However, the attorney general's insistence on commenting on our report by inserting his response into the DOT's response is consistent with his level of involvement throughout our audit. His objections to our requests and attempts to limit our audit scope and access to records and department officials are inappropriate and interfere with the Auditor's constitutional and statutory responsibility to conduct audits.

The attorney general went through extraordinary and time-consuming measures to interfere with our audit process by conducting reviews of both public and allegedly confidential documents and electronic mail and monitoring our interviews of department staff. Our request for documents is a normal part of our audit process. In fact, agencies usually give us direct access to department records and we perform our own searches through their records. Had we been allowed to follow our normal audit process, the Department of the Attorney General would not have had to spend so much time reviewing documents and emails and we would not have encountered delays. Moreover, we note that our request for digital copies of electronic mail was never met; instead, the attorney general provided hardcopy printouts of emails, thus undermining our ability to do electronic searches and further delaying our audit fieldwork.

After a careful review and consideration of the department's comments, we made minor changes and clarifications to our report, none of which affected our findings and conclusions.

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



MARION M. HIGA  
State Auditor

(808) 587-0800  
FAX: (808) 587-0830

April 4, 2008

**COPY**

The Honorable Brennon Morioka, Director  
Department of Transportation  
Aliiimoku Hale  
869 Punchbowl Street  
Honolulu, Hawaii'i 96813

Dear Mr. Morioka:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Performance Audit on the State Administration's Actions Exempting Certain Harbor Improvements to Facilitate Large Capacity Ferry Vessels from the Requirements of the Hawaii'i Environmental Impact Statements Law*. We ask that you telephone us by Monday, April 7, 2008, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Thursday, April 10, 2008.

The Governor and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

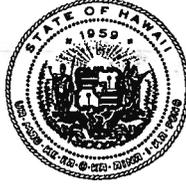
Sincerely,

A handwritten signature in black ink, appearing to read "Marion M. Higa".

Marion M. Higa  
State Auditor

Enclosures

LINDA LINGLE  
GOVERNOR



BRENNON T. MORIOKA  
DIRECTOR

Deputy Directors  
MICHAEL D. FORMBY  
FRANCIS PAUL KEENO  
BRIAN H. SEKIGUCHI

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

IN REPLY REFER TO:  
DEP-H 5114.08

April 11, 2008

RECEIVED

Ms. Marion M. Higa, State Auditor  
Office of the Auditor  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813-2917

2008 APR 11 PM 3:06

OFC. OF THE AUDITOR  
STATE OF HAWAII

Dear Ms. Higa:

Subject: Performance Audit on the State Administration's Actions Exempting Certain Harbor Improvements to Facilitate Large Capacity Ferry Vessels from the Requirements of the Hawaii Environmental Impact Statements Law (Phase I)

Thank you for the opportunity to offer comments in response to the above-referenced audit report. The following DOT comments correct misstatements noted in the report:

- 1. Page 5. "The Engineering Branch consists of Engineering Systems Staff and four sections: Planning, Design, Construction, and Maintenance."

Comment: Following a re-organization in 2005, the Engineering Branch no longer includes Engineering Systems Staff. Instead, the Engineering Branch consists of five sections: Planning, Design, Construction, Maintenance and Environmental. A description of the Environmental Section should be included and the organizational chart for 2005 and 2006, which was provided to the Auditor, should be included in lieu of an old chart requiring a reference to an "Environmental Unit...added in 2005."

- 2. Page 13. CHRONOLOGY OF EVENTS – DOT/HAWAII SUPERFERRY, INC.

Comment: The chronology fails to include reference to the numerous consultation letters sent by DOT on February 8, 2005 and February 15, 2005, copies of which were provided to your office and evidence actual notice of an intent to use OEQC exempt boarding ramps on barges in advance of the February 23, 2005 exemption decisions. Notices were sent to the Department of Design and Construction, City and County of Honolulu, Department of Planning and Permitting, City and County of Honolulu, Department of Transportation, City and County of Honolulu, Department of Public Works and Waste Management, County of Maui, Department of Planning, County of Maui, Planning

Department, Hawaii County, Public Works Department, Hawaii County, Public Works Department, County of Kauai, Planning Department, County of Kauai, Plant Quarantine Branch, Department of Agriculture, State of Hawaii, Office of Planning, State of Hawaii, and Highways Division and Statewide Planning, Department of Transportation, State of Hawaii. On February 23, 2005, DOT sent actual notice of its decision to use OEQC exempt barges with ramps to major harbor users, including ILWU Local 142, Honolulu, Sause Ocean Towing Co., Horizon Lines, Matson Terminals, Inc., Hawaiian Tug & Barge/Young Brothers and NCL America. These notices contradict the Auditor's inference that DOT failed to solicit input regarding its proposed exemption decisions.

3. Page 15. "To date, we have received about half of the documents requested from the DOT."

Comment: Via letter dated March 10, 2008, the Office of the Auditor provided a list of documents it characterized "still not received." In its written response dated March 19, 2008, DOT indicated it had sequestered and produced all non-privileged documents to the Office of the Auditor. For the Auditor to claim, subsequent to the receipt of DOT's letter dated March 19, 2008, that "about half of the documents requested from the DOT" have not been received as of the date of the report is disingenuous to DOT and misleading to the public. A copy of DOT's letter dated March 19, 2008 is attached hereto and incorporated by reference herein.

4. Page 24. "To fulfill a request by our office for a list of exempted harbors projects from 2004 to 2007, a Harbors Division employee needed to sort through thousands of project folders by hand."

Comment: There were approximately 80 projects between 2004 and 2007 which translates into hundreds of project folders, not thousands.

5. Page 29. "Ultimately, a decision involving the governor's office was made that directed the 'ferry project team' to pursue scenarios that would exempt the ferry harbor work from an environmental review."

Comment: DOT rejects any inference that a decision was made by the Governor's office directing DOT to pursue exemptions. As DOT has previously stated, DOT made the exemption decisions and, as the Auditor notes, "EIS rules allow agencies to make exemption determinations on their own." Further, DOT made the exemption decisions only after consulting with the Director of the Office of Environmental Quality Control (OEQC), who, as the Auditor states, "issued a letter of concurrence." This critical fact is supported by the Auditor's finding that: "[T]he Department of Transportation, though not bound by statute or regulation, chose to consult with the OEQC director on the exemption for the harbor improvements relating to the Superferry project." As noted

above in detail, DOT also sent numerous consultation letter between February 8, 2005 and February 15, 2005, copies of which were provided to your office and evidence actual notice of an intent to use OEQC exempt boarding ramps on barges in advance of the February 23, 2005 exemption decisions. As also noted above in detail, on February 23, 2005, DOT sent actual notice of its decision to use OEQC exempt barges with ramps to major harbor users. Following DOT's exemption decisions, a lawsuit was filed. Circuit Court Judge Cardoza ruled in favor of DOT and found that DOT had followed the law in granting the exemptions, thus agreeing with both the OEQC Director and DOT. Thirty months after the exemption decisions were made, the Hawaii Supreme Court ruled that DOT had incorrectly issued the exemptions.

6. Page 30. "Harbor Division's administrative services director" and "chief planning officer."

Comment: Reference should be to an "administrative services officer" and a "planning program administrator."

With respect to the Recommendations contained in the report, all but one pertains to changes in the EIS laws and/or OEQC rules and procedures. While DOT supports many of the recommendations, we leave further substantive comment to those empowered with authority to implement the proposed changes. As for the recommendation that Harbors Division "[m]odify its record-keeping process to facilitate public review of exemption decision," revised retention practices were directed in late 2007 and the Harbors Division is in the process of coordinating its new procedures with DOT's Highways and Airport divisions so that a uniform policy for the retention of exemption determination records can be implemented at the department level.

At the Attorney General's request, we include the following comment section from the Department of the Attorney General.

1. The Auditor claims that cooperation has been "slow and incomplete, at best." This is wholly untrue.

The statutory scope of the Audit itself was quite limited. Section 14 of Act 2 provides that "[t]he auditor shall conduct a performance audit on the state administration's actions in exempting certain harbor improvements to facilitate large capacity ferry vessels from the requirements of conducting an environmental assessment or environmental impact statement under chapter 343, Hawaii Revised Statutes. The audit shall also include the state administration's actions in not considering potential secondary environmental impacts of the harbor improvements prior to granting the exemption from these requirements." These actions covered by the Audit took place in late 2004/early to mid-2005.

Even though it was DOT that exempted the action, the Auditor requested documents from many state departments, and provided almost no time for production (DOT, for example, was given nine days to produce many tens of thousands of documents). In many cases, the Auditor requested tens of thousands of documents that had absolutely nothing to do with the scope of Audit—for example, every single email from scores of individuals during a particular 2007 time frame—completely and totally unlimited in scope—amounting to more than 60,000 separate emails (many containing multiple pages).<sup>1</sup> The amount of time devoted to just those email requests from the Auditor was enormous.<sup>2</sup> It also took an enormous amount of time just to gather, collate, and copy all of the requested documents, which were not arranged by the departments or agencies according to the Auditor's requested categories.

The Auditor was unhelpful in narrowing or prioritizing—although she was requested to do so. Indeed, as noted, the Auditor originally agreed to provide a list of search terms for the emails, and then changed her mind.

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<sup>1</sup> As was noted in the Attorney General's February 15, 2008 letter to the Auditor: "This request [for emails from scores of individuals in many departments] covers tens of thousands of emails on every conceivable subject. We requested that you provide us with search terms relating to your audit so that we could do word searches of the email to expedite the review process and provide you with the relevant emails. You originally agreed to provide the search words, however, you have since changed your position and are now requesting all email whether they relate to your Act 2 program audit or not." It is estimated that in excess of 60,000 separate emails were thus requested, many with multiple pages.

<sup>2</sup> The Auditor states that with regard to emails, "we were not provided a list of what had been included or excluded from our request." This is untrue. Attached is the Attorney General's March 17, 2008 letter to the Auditor (without attachments—the attachments listed the more than 150 individuals whose emails were searched). The letter described the search process, which included that all of the emails were subject to a key word text search, with the following search terms: "HSF, Kahului, Superferry, Super, Ferry, EA, Environment, Environmental, EIS, OEQC, MARAD, Garibaldi, Hall." In other words, what was intended to be produced to the Auditor was every non-privileged email from the requested time frame, from the files of more than 150 individuals, using any one or more of those terms, even if the email had nothing to do with the Superferry. [Thus, for example, every single non-privileged email from the individuals listed with the word "super," or "ferry," or "superferry," or "environment" or "environmental" was produced. And, as noted, even these thousands of emails were far less than the many tens of thousands requested, as the requests were for every single email on every single subject]. Many emails that had absolutely nothing to do with the scope of the audit were produced—because the request was totally unlimited as to subject. Unfortunately, even though the Auditor originally agreed to provide her own list of search terms, she changed her mind, and went back to the position that she wanted every email on any and every subject. Because review for privilege of that requested email group would have taken months, there was a search made using the above terms, and then a privilege review. This process itself took a very long time. Even so, the Attorney General's March 17, 2008 letter stated: "If you wish other email searches done, please contact us." There was never a response.

We believe that in excess of 100,000 pages<sup>3</sup> of documents have been produced to the Auditor. As the Attorney General wrote to the Auditor on February 15, 2008: "We would be remiss if we did not reiterate that what you characterize as delays have occurred largely for two reasons—first, because you have requested many tens of thousands of documents; and second, because your requests are unreasonably broad in scope."

2. **Privileged Communications.** The Governor made it absolutely clear *before* the passage of Act 2 that privileges would be asserted and would not be waived in connection with the audit, and that materials protected by applicable privileges would not be produced. And, the Legislature did not request in Act 2 that any privileges be waived. Indeed, even though as the Auditor points out, some legislators *originally* wanted to request a waiver of privilege, that position was abandoned.

Because all the documents requested needed to be screened for privilege, this added to the time of production.<sup>4</sup> But, what added the most to the time required was the vast scope of the Auditor's requests, including tens of thousands of pages of emails and other documents that had absolutely nothing to do with the Superferry or the scope of the audit. As noted, likely in excess of 100,000 pages of documents have so far been produced to the Auditor.

It is ironic that the Auditor seems to complain of the number of attorneys assigned to the task of screening.<sup>5</sup> The use of many attorneys working at the same time is what allowed the process to go forward in the time it did. If only one or two lawyers had been assigned, the production process would have taken many, many more months—because of the incredibly broad scope of the requests, and therefore the vast amount of documents needing to be reviewed.<sup>6</sup>

The Attorney General wrote to the Auditor on February 15, 2008, in response to her written request, setting out in detail the privileges that would be asserted and the legal bases for the privileges. The statement in the draft audit that withholding documents on the ground of privilege is in contravention of the law is simply untrue.

3. The Auditor claims that she has received only half of the documents requested from the Department of Transportation. This is also untrue. As DOT pointed out in its March 19, 2008 letter to the Auditor (attached), many categories of documents that the Auditor claims were not produced, were in fact produced.

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<sup>3</sup> There is not an exact count of the number of pages turned over to the Auditor. As the Auditor notes, in addition to hard copies in 28 boxes (just of DOT documents and emails), certain documents were produced to the Auditor on DVDs.

<sup>4</sup> Attorneys were present at some interviews, also to protect privileges.

<sup>5</sup> The Auditor also seems to complain about "piecemeal" production. In fact, when documents were ready to be produced, they were produced. Surely the Auditor did not wish a circumstance where no documents were produced until all could be.

<sup>6</sup> We must note again, however, that what made the process so lengthy and time-consuming (and why even now the process is not completed) is because the scope of the requests was so vast, and in many cases totally unrelated to the statutory scope of the audit.

Ms. Marion M. Higa, State Auditor  
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4. Future production and a privilege log. In response to a recent inquiry, the Auditor asked that production of documents be given a priority over production of a privilege log. Production is still not complete—more documents will be produced, and a privilege log will also be produced. However, if the scope of the Auditor's requests had been equal to the scope of the actual audit mandate, all production tasks likely would have been completed long ago. Indeed, if only the vast email requests had been limited to subjects relevant to the audit (as the Auditor had originally agreed), all production tasks likely would have been completed.

In closing, DOT trusts the Office of the Auditor will consider the comments contained herein prior to finalization of its Phase I audit report. Given the very short timeframe for responsive comments, DOT reserves the right to offer additional comments subsequent to receipt of the auditor's Phase II report.

Very truly yours,

A handwritten signature in black ink, appearing to read 'B. Morioka', with a stylized flourish at the end.

BRENNON T. MORIOKA, Ph.D., P.E.  
Director of Transportation

Attachments



STATE OF HAWAII  
DEPARTMENT OF TRANSPORTATION  
HARBORS DIVISION  
79 S. Nimitz Highway  
Honolulu, Hawaii 96813

BRENNON T. MORIOKA  
DIRECTOR

Deputy Directors  
MICHAEL D. FORMBY  
FRANCIS PAUL KEENO  
BRIAN H. SEKIGUCHI

IN REPLY REFER TO:  
DEP-H 5106.08

March 19, 2008

Ms. Marion M. Higa, State Auditor  
Office of the Auditor  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813-2917  
Attn: Mr. Stephen Wilson

Dear Ms. Higa and Mr. Wilson:

Subject: Stephen Wilson's Email to Russell Suzuki dated March 11, 2008

I was provided a copy of the subject email wherein Mr. Wilson referenced the Auditor's initial Request for Information list sent to DOT on November 19, 2007. Attached to Mr. Wilson's email to Mr. Suzuki was a word document which provided the Auditor's position on the Department of Transportation's (DOT) document production as of March 10, 2008.

As a general response to the subject email, DOT sequestered any and all Hawaii Superferry documents. The documents were reviewed by our counsel and, save privileged documents, copied and provided to your office. To my knowledge, there are no Hawaii Superferry documents in the possession of DOT yet to be reviewed by our counsel and/or produced to your office.

As a more specific response, I reviewed the contents of six (6) produced boxes of documents and found documents I believe responsive to practically every item listed as "not received or partially received" on Mr. Wilson's March 10, 2008 document status list.

For example, there are numerous emails and documents discussing DOT considered harbor improvement options, including infrastructure improvements which would require an EIS/EA versus those which would come under DOT's OEQC exemption list. I also located handwritten notes of meetings wherein environmental concerns and harbor infrastructure improvements were discussed. These documents appear to be clearly responsive to Items 7, 8 and 13.

For Item 14, your assumption that a new Operating Agreement was necessary is incorrect. For Item 18, I had my secretary, Debbie Kuwaye, provide your office with a copy of the table of contents for our staff manual.

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For Item 9, I located DOT correspondence with state and county agencies, private industry and concerned citizens which were part of DOT's consultation process, all documents responsive to your request.

I located DOT management reports wherein DOT engineers reviewed proposed facility layout plans offering comments as to necessary revisions, documents responsive to your Item 22.

I located email correspondence between OEQC and DOT in addition to Salmonson's letter of November 23, 2004, Item 10 on your list.

I located operational plans required by the operating agreement, Item 15.

And, perhaps most illustrative of the incorrect status report attached to Mr. Wilson's email, I located Pier 19 ferry terminal documents responsive to Item 4, including documents provided to the auditor's office on 12/20/2007 via signed receipt, a copy of which I am attaching for your review.

In closing, DOT has sequestered and produced all Hawaii Superferry documents known to us. I am confident a thorough review of the documents will enable you and your staff to make informed decisions as to which documents are responsive to the items identified in your November 19, 2007 letter.

Very truly yours,

  
MICHAEL D. FORMBY  
Deputy Director-Harbors

Attachment

As requested, a copy of contracts for HC10020-Ferry Terminal at Pier 19, Honolulu Harbor and HC90018-Design and Build Barges and Vehicle Ramp Systems for Inter-Island Ferry Service Statewide have been provided to the Office of the Auditors on 12/20/07. The list of contracts and amendments are as follows:

1. Contract 46877-Pacific Architects, Inc. (HC10020)✓
2. Contract 48972-R. M. Towill Corporation (HC10020)✓
3. Supplemental Agreement No 1 to Agreement 48972 (HC10020)✓
4. Supplemental Agreement No 2 to Agreement 48972 (HC10020)✓
5. Contract 48517-Allied Construction, Inc. (HC10020)✓
6. Amendment No 1 to Contract 48517 (HC10020)✓
7. Amendment No 2 to Contract 48517 (HC10020)✓
8. Contract 53994-Healy Tibbitts (HC90018) ✓
9. Contract DOT-05-008 Moffatt & Nichol (HC90011)✓
10. Supplemental Agreement No 1 to Agreement for Contract DOT-05-008 ✓
11. Supplemental Contract No 2 to Contract DOT-05-08 Moffatt & Nichol (HC 90011)

  
Signature

  
Date

LINDA LINGLE  
GOVERNOR



MARK J. BENNETT  
ATTORNEY GENERAL

**STATE OF HAWAII**  
**DEPARTMENT OF THE ATTORNEY GENERAL**  
425 QUEEN STREET  
HONOLULU, HAWAII 96813  
(808) 586-1500

LISA M. GINOZA  
FIRST DEPUTY ATTORNEY GENERAL

March 17, 2008

Via Hand Delivery

The Honorable Marion M. Higa  
State Auditor, State of Hawaii  
Office of the Auditor  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813-2917

Dear Ms. Higa,

As you know, your office requested tens of thousands of e-mails from various departments, limited by time (September 15, 2007 to November 15, 2007), in some instances limited by division or person, but completely unlimited as to content or subject matter. Although you had originally agreed to provide us a list of search terms so as to try to narrow the extraordinarily broad scope of your requests for emails, you changed your mind, refused to provide a list of search terms, and later reiterated your request for all of the emails, unlimited in subject matter scope. You have unfortunately kept to this position even though you have been advised that the unlimited breadth of the request encompasses tens of thousands of emails and it would take an undue length of time for my deputies to review such an extensive group of emails.

Despite the fact that your position on this matter has caused my Department to spend far more time reviewing emails than we should have, and far more time than was reasonable, we have nonetheless sought to find a reasonable accommodation that would meet the scope of the audit as set forth in Act 2 - i.e. "actions in exempting certain harbor improvements to facilitate large capacity ferry vessels". Therefore, we have undertaken a key word search and review.

The Honorable Marion M. Higa  
State Auditor, State of Hawaii  
March 17, 2008  
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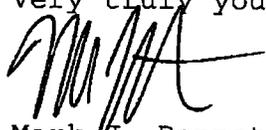
For the governing time period, we have searched what we have been provided as the email accounts for approximately 153 individuals. See attachments A and B. The dates governing your requests were confirmed with you several times during calls with Lisa Ginoza and me.

We subjected the above emails to an electronic search for any of these terms: HSF, Kahului, Superferry, Super, Ferry, EA, Environment, Environmental, EIS, OEQC, MARAD, Garibaldi, Hall. The keyword search identified emails with one or any combination of these terms, and regardless of whether the words were capitalized or not. We then reviewed the identified emails and removed privileged emails. We are now producing those documents to you, some printed in hard copy and the rest on Lotus Notes format, which total well into thousands of emails and even more pages of documents. As you will be able to see from your review, even limited by the above search terms, many of the documents have nothing to do with the subjects of your audit.

Consistent with the prior documents already produced, these documents are being produced to your office with the understanding that they will be used solely for the purposes of the Act 2 audit and will not be provided to anyone else. Further, as set forth in Hawaii Revised Statutes §92F-19; the responding departments are allowed to provide a response to your office under §92F-19(a), but "[a]n agency receiving records pursuant to subsection (a) shall be subject to the same restrictions on disclosure of the records as the originating agency."

If you wish other email searches done, please contact us.

Very truly yours,



Mark G. Bennett  
Attorney General

Attachments