Report of Findings

Business Energy Tax Credit Program Investigative Examination

Dated September 7, 2016

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COVER LETTER

September 7, 2016

Prepared for: Oregon Secretary of State's Office

Dear Secretary of State Atkins, Ms. Wenger, and Ms. Bond;

Please reference the enclosed report of the investigative examination for the Business Energy Tax Credit Program administered by the Oregon Department of Energy. The analysis and conclusions provided reflect the findings from the examination.

The examination detailed in this report provides information pertaining to the BETC program's controls and risks, the state of compliance and comparative analysis of risks and controls, and an investigative review of projects appearing suspicious. During this examination, Marsh Minick reviewed nearly 4,000 BETC project files, performed extensive research and analysis, conducted about 40 interviews, attained and analyzed database queries, and reviewed paper documentation from a multitude of sources.

This report contains the findings from performing the examination. Accompanying this report is supporting evidence and reference material.

Marsh Minick, P.C. a Financial Crime Consultancy Firm, performed the examination. Melissa Frick Minick, serving as Supervisory Examiner, and Brandi Marsh as Lead Investigator. Marsh and Minick hold specialized credentials in financial crime subject matter and advanced degrees in financial forensics.

If you need to contact us, please do so through telephone at 971-266-1846 or by email at info@marshminick.com.

Thank you for the opportunity to conduct this investigative examination and deliver this report of findings to you.

Sincerely,

Brandi Marsh, MS, CAMS, CFE, CFCI

Melissa Frick Minick, MS, CFE, CFCI

Table of Contents

COVER LETTER 2
REPORT OF FINDINGS 4
BACKGROUND 4
EXECUTIVE SUMMARY 5
SCOPE 8
APPROACH 8
Project File Sampling 9
EXAMINATION 12
Legislative Overview 12
Administrative Rules Overview 33
Scope Objective 1 Risks and Controls 35
Scope Objective 2 Control Compliance Assessment 45
Scope Objective 3 Investigation 56
Influences and Pressures 58
FINANCIAL IMPACT 66
Examination Assessment of Financial Impact 66
FINDINGS 69
Overall Findings 69
RECOMMENDATIONS 72
ENCLOSURE 74
Memoranda 74
Glossary 75

REPORT OF FINDINGS

BACKGROUND[1]

The Oregon Department of Energy (ODOE) administered the Business Energy Tax Credit (BETC) program. The program was operational from 1979 until July 1, 2014, when the program issued its final tax credits and the program sunset. Its basic purpose was to promote and encourage business investments in energy conservation and renewable projects in Oregon through issuance of energy tax credits acting as an incentive. During the program's lifespan, its purpose evolved to include considerations for the stimulation of the economy and jobs for Oregon.

The predicate for the investigative examination began when the Oregon Audits Division (OAD), in the Secretary of State Office (SOS), received information from the ODOE Director concerning the adequacy of documentation that may be present throughout the BETC program's records indicating that there may be undetected instances of fraud in the records of the BETC program administered by the ODOE. OAD sought out an independent third party to perform an investigative examination.

The purpose of the engagement was to perform an investigative examination of the BETC program that includes:

- Assess and identify controls within the BETC program. Assess compliance with controls, whether controls aligned with risks, and if vulnerabilities or deficiencies existed within the controls that were exploited
- Forensically analyze information and data to determine if there is evidence of alleged fraud, abuse, and/or impropriety within the BETC program
- Deliver a comprehensive, reliable and meaningful report of findings to the Oregon Audits Division within the Oregon Secretary of State's Office

[1] *MMINV4, MMINV7, MMINV16, MMINV27, MMINV219, MMINV271*

EXECUTIVE SUMMARY[2]

The investigative examination began on May 18, 2016 and concluded on August 15, 2016. The three scope objectives were to (1) identify BETC program controls, whether controls aligned with program risks, (2) assess compliance with controls, and (3) perform an investigation for evidence of fraud, waste, or abuse.

SCOPE OBJECTIVES		FINDINGS
1	CONTROLS	Controls are partially functional and mitigate risks to a limited extent
2	COMPLIANCE	Controls are not adequate to ensure compliance with rules or laws
3	INVESTIGATION	Circumstantial evidence of suspicious activity exists

Controls

The governance structure for the BETC program was the statutes and administrative rules, which acted as partially functional controls mitigating risk to a limited extent. The ODOE had not performed a control or risk analysis of the BETC, and projects reflected inconsistent compliance with established program controls.

Compliance

In our analysis of the sampled project files, an effort to comply with the statutory controls was evident, but a retrospective evaluation against a reasonable set of risks raised significant questions. Although the ODOE relied upon statutes and administrative rules, employees did formally, and informally, raise their concerns of the broadness of the statutes hindering the agency's ability to mitigate risks. There were statutory limitations for how the agency was able to administer the energy incentive program.

In summary, there were administrative problems with the BETC program. It lacked formal training, employee turnover caused a loss of institutional knowledge, there had been cultural clashes between employees, the work volume and sometimes the complexity overwhelmed staffs' abilities, and there was missing quality and compliance oversight.

While the ODOE had administrative issues, there were high-aiming energy policy goals and directives that applied pressure on the agency. This pressure inhibited the agency's ability to mitigate risks and reduce revenue impacts when red flags became apparent.

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[2] *MMINV3, MMINV10, MMINV11, MMINV12, MMINV16, MMINV255, MMINV271, MMINV278, MMINV283, MMINV23, MMINV218, MMINV222, MMINV223, MMINV227, MMINV239, MMINV246, MMINV247, MMINV263, MMINV264, MMINV267, MMINV269, MMINV233, MMINV301, MMINV304, MMINT4, MMINT20, MMINT23, MMINT24, MMINT37, MMINT60, MMINT119, MMINT126, MMINT128, MMINT129, MMPFC11807, MMPFC12705, MMPFC10818, MMPFC10819, MMPFC11808, MMPFC11809*

Investigation

The investigation discovered circumstantial evidence inferring suspicious activity pertaining to a specific number of the BETC projects reviewed. The Examiners have been instructed to refer suspicious activity of wrongdoing or concerning possible statute violations to the Oregon Department of Justice (ODOJ) under separate cover. This examination did not reveal what seemed to be direct evidence of fraud.

Summary of Findings

The examination included data testing on the population of BETC projects, review and analysis of project files, interviews with key contributors external to the program and ODOE staff and management. The information garnered from the examination identified 14,494 BETC projects completed with an estimated $2.4 billion in certified costs between January 1, 2006 and July 1, 2014, worth approximately $1.039 billion tax credits. Forensic data analysis was performed on the 14,494 projects that had final tax credits issued. The physical investigation examined 3,895 BETC project files in energy renewables and conservation.

In summary, there were influences outside the ODOE, such as the energy policy goals of two Governors, which led to decision-making of BETC projects. Legislative expansion and contraction of the program, and economic development tied to the advancement of commercial interests in the clean energy industry, also influenced the project outcomes. The expansion of the BETC program coincided with an economic downturn. The BETC program aimed not just to incentivize businesses to perform energy projects, but also to incentivize economic growth and job creation goals. Evidence supports these pursuits, speculation and estimations about the BETC revenue impacts on the Oregon State General Fund were underestimated. The inherent risk of the poor economic situation applied pressures to the BETC program that lacked a fully controlled environment, resulting in the program being vulnerable, and deficiencies in controls especially exploitable.

There were no complete lines of defense in place at ODOE, such as a risk management program, internal audits for BETC, proactive fraud detection, or other measures to capably and effectively mitigate risks. Weaknesses in the BETC program controls became apparent with the rush in volume of BETC projects. ODOE staff were overwhelmed with production-based work of processing applications as quickly as possible to meet applicant and statutory timeline requirements. Rushing production and inadequate staffing was systemic to compliance and quality control problems noted during this examination. Moreover, the BETC program staff seemed to have lacked the

especial financial risk management savviness necessary to administer a high-dollar and high-exposure tax credit program. Key individuals having some form of financial background were relied upon too heavily in this capacity, and did not have specific risk management experience needed to mitigate program risks.

Governor Kulongoski's visionary plan was to use the green energy industry for job stimulation in the downturn economy to incentivize businesses to participate in the BETC program. The Governor's plans spurred the legislative changes that occurred in the 2007 expansion. The ODOE staff lacked the appropriate tools, resources, and support to manage the risks presented by this robust energy-incentivizing program, one lawmaker claimed was more generous than any other state in the country. Finally, identified weaknesses in statutes and rules hindered the Agency's ability and authorization to specifically deny tax credits.

The BETC was an Oregon energy incentives program widely available for energy renewable and conservation projects of all types, which evolved into providing economic stimulation. The program expansion attracted domestic and international conglomerates seeking to take advantage of the financial incentives, often through the pass-through process of selling an Oregon tax credit for a lump sum cash payment. Government officials had influence on the project outcomes, including the Governors in office at the time, and Legislators, who made changes to the program. This was evident by emails, news media, and endorsements from political officials many contained in the project files. Both Governors proposed legislative concepts and facilitated energy policy advisory groups, whose members had their own special interests. Extensive participation of the program had direct and indirect fiscal impacts on Oregon.

Results

The ODOE was ill equipped to administer a rapidly expanding high-dollar high-value financial incentive program. The ODOE is an energy agency, not a financial agency, and lacked functional roles reasonably needed to mitigate the BETC risks. Agency Directors lacked especial financial risk management experience to have foreseen or comprehended the risks posed. Subordinate middle managers lacked specific risk management experience to have appropriately advised or led change management efforts for the BETC. The Agency lacked a third party risk management advisor who could have assisted with mitigating risks identified during the program operation.

Documents showed the ODOE Director Grainey did identify and propose some risk-mitigating measures for the BETC, when the first year of expansion resulted in above-projected revenue impacts. The Director applied continuous pressure to make restrictive

changes to the BETC program. Governor Kulongoski vetoed legislative changes that would have added legally binding controls to mitigate program risks as recommended by the Director.

The ODOE Directors in office during the program period sought assistance and support to mitigate risks they identified. The ODOE management appears to have complied with the Governor's Office directives.

The overall findings from this examination are that the ODOE Agency:

- Lacked tools, resources and support
- Did not have staff or assistance to create a risk management program
- Were under political and high-aiming energy policy pressures
- Had statutory limitations, not favoring the agency's ability to deny tax credits

SCOPE

There were three scope objectives for the investigative examination. The period under review was from 2006 until the BETC program sunset July 1, 2014. The population of BETC project files with certified final credits was 14,494. Issued certified credits ranged from less than a hundred dollars, up to millions of dollars. The three scope objectives for the BETC investigative examination were as follows:

1. Identify BETC program controls in place between 2006 and the sunset of the program in 2014, and whether controls aligned with risks
2. Assess compliance with controls
3. Perform an investigation for evidence of fraud, waste, abuse or other impropriety

APPROACH

Independence and Professional Skepticism Procedure

The Examiners maintained independence free from any influences and conflicts of interest. The nature and extent of investigative procedures deployed include a professional level of skepticism when collecting and analyzing data and information. The purpose of this objectivity was to ensure effectiveness of investigative procedures and to support the merit of the findings resulting from the examination.

Evidence Procedure[3]

The Examiners utilized chain of custody procedures for collection and retention of the physical records reviewed in the examination room at the ODOE. Records were stored in a secured location to prevent the likelihood of unauthorized access; an electronic copy was taken of relevant evidence, and it was inventoried.

During the examination, the ODOE received public records requests it needed to fulfill. To address this, the Examiners and ODOE worked together to ensure agency business needs did not affect the evidence procedures.

Fraud Examination Methodology

The Examiners approached the examination by following the ACFE Fraud Examination Methodology. This is an orderly process where general information is first collected before specific information, which is then used to address concerns based on the totality of information gathered during the examination. Along the steps of the examination, the information is continuously assessed.

To support findings this examination relied on ODOE data, records, and project files; supportive written, video and audio material including legislative records, public records, emails, memos, and press reports; and interviews with Legislators, current and former ODOE management and staff, other government agency staff, and participants in the BETC program. The Examiners sought sufficient and appropriate evidence to afford a reasonable basis to infer findings.

Fraud Theory Approach and Empirical Evidence

The investigative examination aligned with the ACFE Fraud Theory Approach, beginning with assumptions about what might have occurred based on the facts that existed as a predicate to the examination.

Project File Sampling[4]

As determined by the scope of work the population of project files was 14,494 between 2006 to July 1, 2014, when the program sunset. This examination focused its efforts to seek out and forensically review “high-risk credits.” Project files were reviewed in four-rounds during the examination.

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[3] *MMINV13*

[4] *MMINV285*

Round 1 Project Sample

Less than $1 million: The majority of projects fall within the $1 million or less final tax credit stratification. The initial sample size is weighed on the population of final certified project costs. The sample size accounted for 22% of the total projects in that range of costs. These project files were randomly sampled using a computer-aided audit and fraud detection software.

More than $1 million: For final certified project costs of $1 million or more the examination aimed for 100% of the population of projects. Any projects of concern in this higher dollar stratification could potentially yield a sizable exposure of impact to the State.

Final Certified Project Cost	Population	Sample Size	Sample Size Weight %	Population %
Less than $100K	12570	2804	22%	86.73%
$100K to $500K	1332	297	22%	9.19%
$500K to $1M	272	61	22%	1.88%
$1M to $3M	176	176	100%	1.21%
$3M to $5M	48	48	100%	0.33%
$5M+	96	96	100%	0.66%
Total	**14,494**	**3,482**		

Round 1 Project Sample

Project files targeted for the original sample under $1 million were randomly selected using a computer-aided audit and fraud detection software. The physical project files received from the ODOE included 311 of the 320 files in excess of $1 million, and 3,150 files of the 3,162 requested under $1 million.

Round 2 Project File Review

Project files targeted for review in round two resulted from compliance and risk testing, and information attained during interviews. This review contained 401 project files.

Round 3 Project File Review

Project files targeted for review in round three were hand-pulled based on observations made while reviewing other project files. This review contained 11 project files.

Round 4 Project File Review

Project files targeted for review in round four were isolated to specific project files where red flags pointed to possible suspicious activity. This sample contained 22 project files.

Sample Success[5]

In total, the examination had a 99% success rate in locating 3,895 project files. There were 21 project files not located during this examination. Two project files examined were labeled as copies.

Confidence Level and Interval

Based on the sample size of all four rounds during this examination, taking into account the project files not located in round 1, this examination provided a 99% confidence level and 2.03% confidence interval.

Interviews[6]

The Examiners conducted interviews with 42 different individuals during the investigative examination including internal ODOE employees as well as external parties and entities deemed to have some engagement with the BETC program during the examination period. Those interviewed during the examination includes:

- Current and former employees from ODOE such as those who–
    - Created BETC project files
    - Performed database entries
    - Reviewed and approved both preliminary and final BETC applications
        - Administrative personnel
        - Technical personnel
    - Project inspectors
    - Pass-through transaction management and processors
    - Program managers, division administrators and assistant directors
    - Directors
    - Energy policy advisors
    - Legislative liaisons
    - Rule makers
    - Department auditors
    - Other staff and management
- Legislators
- Tax credit brokers and intermediaries

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[5] *MMINV274*

[6] *MMINT, Filtered by Completed*

- Oregon Department of Revenue (ODOR) employees

EXAMINATION

Oregon Revised Statutes "statutes" (ORS) and Oregon Administrative Rules "rules" (OARs) referenced in this report were used to understand the context of the BETC program, its evolution, risks, and controls, in order to perform the agreed upon scope objectives during this investigative examination, and are not for legality purposes.

Legislative Overview[7]

During the examination period, Oregon lawmakers passed legislation that affected the BETC program administration by ODOE. Eight impactful legislative bills occurred, affecting the BETC incentives, bringing about expansion and contraction of the BETC program and proposed changes to taxation, raising project facility tax credit eligibility, and the encouragement of large-scale renewable manufacturing. Due to the revenue impacts of the expansion, combined with a downturn in the economy, the BETC program contracted and eventually sunset by July 1, 2014.

One proposed legislative bill affecting BETC failed to become law in 2009 and exposed Oregon to prolonged risks of revenue impacts from the BETC program. Revenue impacts to the State General Fund was 3511% above original projections by 2008, in the first biennium of BETC expansion. The vetoed bill would have added risk-mitigating controls to the BETC program that had seen significant expansion, aimed to reduce revenue impacts on the State.

Another proposed bill failed to become law in 2013 and corresponded with a moratorium of auditing BETC taxpayer returns from about 2009 and 2010. The moratorium on special projects to audit returns exposed Oregon to lost opportunities to collect tax revenue from adjustments of errors. The proposed bill would have made the sale of a BETC a non-taxable event in conflict with federal tax code.

Year	Legislative Impacts BETC Program 2006-2014	Program Change
2005	REAP Renewable Energy Action Plan (preface)	Policy Plan
2006	REWG Renewable Energy Working Group	Policy Advisory
2007	House Bill 2211 (amended into HB 3201)	Expansion
2007	House Bill 3201	Expansion
2008	House Bill 3619 (special session)	Expansion

[7] *MMINV17, MMINV30, MMINV222, MMINV232, MMINV231, MMINV252, MMINV253, MMINV254, MMINV261, MMINV267, MMINV301, MMINV303, MMINV304, MMINV305, MMINV328, MMINT6, MMINT8, MMINT9, MMINT47, MMINT48, MMINT80, MMINT81, MMINT85, MMINT115*

2009	House Bill 2472 (vetoed)	Restricting
2010	House Bill 3680 (special session)	Restricting/Sunset
2011	House Bill 2523	Transferred
2011	House Bill 3672	Sunset
2011/2012	Oregon Energy Task Force	Policy Advisory
2013	House Bill 2218 (failed in the House)	Tax Change

2005 / 2006, Oregon's Renewable Energy Action Plan[8]

A precursor to the major legislative changes for the BETC was Oregon's Renewable Energy Action Plan (REAP), released April 12, 2005. The REAP was created at the request of Governor Kulongoski, who had tasked at least seven State Agencies, including ODOE, with collecting public comment and stakeholder input on renewable energy. The REAP was created as the result of the State Agency coordination, and outlined both short and long term goals for renewable energy.

The REAP detailed actions from State Agencies with "Key coordination initiatives to be taken by the Governor's [Kulongoski] Office. Support of a Renewable Energy Working Group (REWG) to be coordinated by the Governor's Office and the ODOE to guide the implementation of this Plan." The Plan was for the Governor's Office, ODOE and REWG to work with various State Agencies and stakeholders in the clean energy industry.

On the title page of the REAP, it says the Plan is specifically prepared for the Oregon Department of Energy and for Governor Ted Kulongoski. The report begins with a quote from Kulongoski, "We can make Oregon the national leader in renewable energy and renewable product manufacturing… and create jobs." In addition, the report indicates the driving forces behind the REAP was initiated under Governor Kulongoski's leadership. Furthermore, "The Plan's goal is to encourage and accelerate production of energy from renewable resources, stimulate economic development, particularly in rural areas of the state." The Plan outlined specific actions for resources and technology:

- Biofuels – Biodiesel and Ethanol
- Biogas
- Biomass
- Combined Heat and Power Systems
- Fuel Cells
- Geothermal
- Hydroelectric Generation

[8] *MMINV237, MMINV227, MMINV237, MMINV239, MMINV246, MMINV264, MMINV306, MMINT60, MMINT76, MMINT129, MMINV335*

- Ocean Energy
- Solar
- Wind

A statement released by the Office of the Governor titled “Governor Kulongoski’s Action Plan for Energy” dated February 24, 2006 indicates the Plan was created due to an increase in gas and energy prices, the environmental health crisis, and need for jobs. In the release, Kulongoski’s position is that “Oregon must act to strengthen the economic recovery… promote energy independence and create new jobs that serve the market for innovative technologies and energy conservation.” The release also articulates that Kulongoski has committed to “set the state on the path to aggressive pursuit of energy options that maximize economic, environment and community benefits.”

In the October 24, 2006 Oregon Gubernatorial Debate, Governor Kulongoski stated his third goal was “We’re going to make Oregon the renewable energy capital of this country…We are on the cusp of doing it, we have a renewable energy plan… if we do this, we are going to make Oregon the best trained, best skilled, best educated State in this country.”

Statements made by ODOE Director Grainey was that the REAP was created at the Governor’s [Kulongoski] direction in the renewable energy efforts. The Director then referenced an Oregonian front-page (Sunday) news story from 2007, with the headline “This Governor’s legacy runs on clean energy.” The article explains, “Gov. Ted Kulongoski says, he wants Oregon to be the clean energy capital of the nation;” it outlines Kulongoski’s vision, and also quotes Kulongoski as saying, “he wants ‘to do something that dramatically changes the way we are… That… is the legacy issue.’”

A prior ODOE Communications Manager made supporting comments saying Governor Kulongoski had a theme of sustainability, grow a green economy, and be a sustainable leader. The manager explained the economic theme was a new concept for ODOE, because in her opinion, the ODOE was not built to be an economic development program. Historically, ODOE goals had been for progression of energy conservation and renewables, then it became, “oh, you can build jobs, a green industry.”

Statements made by a prior ODOE Conservation Assistant Director explained that the energy incentives program expanded to include economic development goals that were driven by Governor Kulongoski’s office. She described the ideal goal was to “build clusters of industry, in small areas.” From her perspective, “what we [ODOE] were trying

to do was market transformation. We did this by giving incentives until saturation of the market, and then take it away," continually raising the energy goal progression bar.

The REAP set the bar for Oregon's energy policy goals, set the high standards of clean energy and economic expectations, and spurred the ensuing legislative changes that reverberated throughout ODOE.

2006 / 2007, Renewable Energy Working Group[9]

The Renewable Energy Working Group, REWG, was charged with policy advising for implementation strategies of REAP. A consensus of REAP members endorsed the BETC program changes to increase the value of tax credits, which would later become law beginning in 2007.

ODOE Director Grainey at the time was also a member of REWG. The February 21, 2006 Charter for the REWG reflects its creation was the result of a collaborative process with the ODOE and Governor Kulongoski's Office. The Charter says its purpose is "to play an advocacy and advisory role… [and] will work to find and implement solutions – in the legislative arena, in the private sector, and elsewhere – that encourage the growth of renewable energy and accompanying economic development in Oregon." The REWG met iteratively from 2006 to 2009, and directly influenced implementation of energy policies.

A legislative concept endorsed by the REWG brought about the legislative changes that expanded the BETC program.

- The REWG began meeting in February 2006
- In a REWG meeting on December 7, 2006, the members had on their agenda a legislative concept - a draft of a bill that would change and expand the BETC program, dated November 30, 2006.
- The draft bill from November 30, 2006, uses similar language as an October 4, 2006 legislative concept, LC 563 (ODOE LC-1), to change the BETC incentive. The draft bill and the legislative concept both propose an increase to renewable energy credits from 35% to 50%, and cost increases from $10 million to $20 million per project. The concept would retroactively date back to January 1, 2007, which seems to anticipate the possibility a bill would be picked up in the 2007 Legislative Session.

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[9] *MMINV223, MMINV227, MMINV232, MMINV237, MMINV238, MMINV240, MMINV241, MMINV242, MMINV245, MMINV247, MMINV250, MMINV251*

- According to a progress report issued on March 23, 2007 by REWG to Governor Kulongoski, “The economic incentives subcommittee met to discuss the BETC… and how your [Kulongoski] legislative proposals to improve these programs... could be further enhanced.”

This same Progress Report sent to Governor Kulongoski details REWG’s activities and accomplishments describing that the REWG formed an economic incentives subcommittee to review the BETC legislative proposals, and was able to amass a “general consensus among REWG members that led to their endorsement of… these [energy incentive tax credit] proposals.”

Director Grainey stated, “The plan was developed with the input and support of the Renewables Energy Working Group [REWG]… comprised of renewable energy industry experts, utilities, local governments, and other interested citizens throughout the state.” He explained the REWG spurred legislative action adopted by Governor Kulongoski for his legislative energy package in 2007.

Based on a REWG membership document from March 12, 2007, there were 31 members, including one Chair an additional four Legislators, plus one representative from the Governor’s Office. However, according to an Oregon government website, the REWG eventually had 34 members, including two Co-Chairs, staffers from offices of six Legislators, and the Governor. This indicates the membership for REWG did not stay constant while in existence.

Several REWG members had connections to BETC projects through company affiliation, direct engagement, or information contained in files or research. This may have been problematic as there were increased opportunities for conflicts of interest, particularly when considering some REWG Members were from companies that received millions of dollars in tax credits, including credits sold for lump sum cash payments. REWG had members in various clean energy industries such as wind, ocean wave, biofuel, solar, utility, and energy industry consultants and experts.

2007, House Bill 2211 - B (amended into HB 3201) [10]

The Oregon State Legislative Information website shows HB 2211-B in the 2007 session was at the request of Governor Kulongoski for the ODOE. The language in HB

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MMINV229, MMINV230, MMINV231, MMINV244

2211 is similar to the draft bill reviewed by the REWG in their December 2006 meeting. The HB 2211 proposed expanded energy incentives offered through the BETC by increasing renewable energy tax credits from 35% to 50% of project costs and a per-project increase in the maximum costs eligible for a tax credit from $10 million to $20 million. These proposed energy incentives were to run for almost a decade through a sunset date of January 1, 2016. The bill passed unanimously in the House.

On June 11, 2007, the Senate Committee on Finance and Revenue held a public hearing and working meeting on several bills, including HB 2211. During the forum, the Committee heard Director Grainey give a statistic of $300 million a year in energy savings from the BETC. The Legislator made comment that savings of $300 million a year is going to show up on someone's profit statement, and in the end, revenue will be positive, essentially because of economic and job stimulation.

The Chair on the aforementioned Senate Committee made comment about tax credits, saying in general, it is common for tax credits to pass unanimously when it goes to the floor, but that any push back is typically because of State General Fund and budget implications. This statement was followed by a comment soon thereafter that the Committee will probably combine what tax credits do occur into one bill.

Eventually, HB 2211 was amended into a single tax credit bill, HB 3201, which was passed into law, as an omnibus tax credit bill, and used as the vehicle to expand BETC.

2007, House Bill 3201[11]

On September 27, 2007, HB 3201 became law as an act related to taxation. The bill was filed at the request of the Oregon War Veterans Association, not Governor Kulongoski, as was HB 2211. The Oregon War Veterans Association requested the bill to increase military active duty pay. The bill passed, with only one naysayer from the House and a few naysayers from the Senate. Several sections of the bill apply to the ODOE for the BETC program.

LEVEL	BETC PROJECT CATEGORY	ELIGIBLE COST LIMIT	% TAX CREDIT
1	**Renewable Energy** – Using or Producing Resources, or Equipment Manufacturing Facilities	**$20 million** per facility per year ORS 469.200(1)(a)	**50%** of eligible project costs ORS 315.354(1)(a)-(c)
2	**Conservation Energy** – All Other Facilities	**$10 million** per facility per year	**35%** of eligible project costs

[11] *MMINV220, MMINV249, MMINV257*

	(Facilities defined by 469.185)	ORS 469.200(1)(c)	ORS 315.354(1)(a)-(c)

Section 14 has several amendments to ORS 315.354; overall, it provides for tax credits based on certified costs of a facility:

- (1)(a) Describes a 35% tax credit as standard, claimed over five years, in proportions each year at a rate of 10% for the first two years, and 5% for the remaining three years; exceptions are (b) and (c):
- (1)(b) Permits a one-year tax credit, specifically when certified costs do not exceed $20,000, claimed in the first allowable tax year, and not exceeding the taxpayers liability.
- (1)(c) Allows a 50% tax credit, specifically for a facility that “uses or produces renewable energy resources or is a renewable energy resource equipment manufacturing facility,” claimed over five years, in proportions each year at a rate of 10%, but cannot exceed tax liability of the taxpayer.
- (2)(c) Permits a one-year tax credit specifically for “high performance home” facilities, claimed in the first allowable tax year, not exceeding the taxpayers liability.

Section 14 of ORS 315.354 has controls for the administration of the BETC program. These controls, in concept, assist with risk mitigation for the administration of the tax credits:

- (3)(a) Facilities must be located in Oregon
- (3)(b) A final tax credit must be issued before it can be claimed
- (3)(c) The tax credit applicant must be eligible
- (5)(a) Provision for the ODOE Director to revoke a tax credit “upon any sale, termination of the lease or contract, exchange or other disposition of the facility.” Furthermore, any new owner is “limited to the amount of credit not claimed by the former owner.”

However, Section 14 of ORS 315.354 limited the ability for ODOE to make revocations.

- (5)(b) Limits the ODOE Director from being able to revoke a tax credit after transfer to another eligible taxpayer

Provisions for rolling forward a tax credit impacts revenue in future years per Section 14 for ORS 315.354:

- (6) A tax credit may be carried forward for taxpayer's tax liability for the next succeeding years, up to the eighth year.

Section 15 of ORS 315.356, provides a control to prevent combined tax credit and federal grant monies from exceeding the project cost:

- (1) Grants from the federal government reduce on a dollar for dollar basis the eligible costs of the project for a tax credit. In addition, it required the grant applicant notify the ODOE within 30 days of application, and after the receipt of any grant.

Section 16 of ORS 469.185, defines facilities, projects and costs, to determine qualification for BETC incentives. The definition of what qualifies as a project and facility is wide sweeping. Qualified costs are vague and lack the kind of detailed specificity that would have helped ODOE management and BETC program managers, who were primarily reliant upon the terms of the statute to set parameters for the program:

- (1) Alternative fuel vehicle
- (2) Car sharing facility
- (3) Car sharing program
- (4) Cost is capital cost and expenses to acquire, erect, construct, or install, including site development
- (5) An energy facility is a capital investment with a simple payback of greater than one year, and (5)(a) especially used for renewable energy resources, with a wide range of eligible facility types, such as land, structures, installation, equipment, device, etc.
- (6) Facilities defined as energy, recycling, transportation, car sharing, sustainable building, alternative fuel, heat and power, and manufacturing (ODOE refers to these as project types)
- (10) Qualification for mass transportation passes

- (11) Recycling Facility
- (12)(a) Renewable energy resource includes but is not limited to, farm and forestry plant matter, animal biomass, solar energy, wind power, water power, geothermal or
- (12)(b) Hydroelectric generating facility (i) not exceeding 10 megawatt capacity or (ii) qualifies as a research, development, and demonstration (RD&D) project
- (13) Manufacturing facility for equipment, machinery or other products for renewable energy resources in trade and business

Section 17 for ORS 469.200, provides for maximum (may not exceed) tax credit amounts based on certified costs of a facility:

- (1)(a) “$20 million, in the case of a facility using or producing renewable energy resources, a renewable energy resource equipment manufacturing facility, or a high efficiency combined heat and power facility”
- (1)(b) “$10 million, in the case of any other facility”
- (2) Authorizes the ODOE “Director shall determine the dollar amount certified for any facility and the priority between applications” with emphasis on, RD&D facility of new renewable resource generating and conservation technologies or a qualified transit pass contract in the determination

Section 18 of ORS 469.205 provides details of the preliminary application process administered by the ODOE. Such as defined in Section 16, the preliminary application allows for a wide array of eligible project types:

- (1) A preliminary application submitted to ODOE, prior to starting erection, construction, installation and acquisition of the project
- (1)(c)(A), (B), (i), and (ii) Requires the applicant to be in the position of ownership, planned interest, or control of the project of facility
- (1)(c) The project applicant is to meet one of the criteria as follows:
    - (A) applicant is a person the tax credit was transferred to, or

    - (B) applicant is the owner or contract purchaser, and (i) plans to utilize the facility in connection with Oregon property, or (ii) plans to lease the facility in connection with Oregon property
- (2) The preliminary application requires detail of project plans, information on expected energy savings or generation, projected cost, and applicable supporting documentation for the following types of projects eligible for a BETC, (2)(a)(A) to (2)(a)(O):
    - plans to convert from a purchased energy resource to renewable energy resource facility
    - plans for a renewable energy facility
    - plans to use renewable energy resource to generate electricity
    - plans to reduce consumption of purchased energy
    - plans for recycling
    - plans for alternative fuel vehicles
    - plans for a facility to operate an alternative fuel vehicles
    - plans to acquire mass transit passes
    - plans for a transportation facility
    - plans for a car sharing program
    - plans for high efficiency combined heat and power project
    - plans for homebuilder installed renewable energy systems
    - plans for high performance homes
    - plans for a renewable energy resource equipment manufacturing facility
- (4) Provides a waiver option when the ODOE Director finds a project applicant did not file the preliminary, prior to the start of the project:
    - (a) a special circumstance rendering an earlier filing unreasonable, and
    - (b) the facility would qualify for a tax credit

Section 19 of ORS 469.206 pertains to the transferring of tax credits through a pass-through process administered by the ODOE:

- (1) A tax credit can be transferred in exchange for a cash payment equal to the present value of the tax credit
- (2) Provides the ODOE the directive to establish uniform discount rates

Section 20 amended ORS 469.215; requiring a final tax credit not be issued unless the facility completed its project in accordance with what was approved on the preliminary application:

- (1) A final tax credit is not to be issued unless the facility was acquired, erected, constructed, or installed as expected from the preliminary application project details, in accordance with provisions, and any applicable rules or standards set by the ODOE Director
- (2)(b)(A) A final tax credit application is submitted after completion of the project, or if the facility is a qualified transit pass contract
- (3)(a) The final tax credit application should contain a statement of compliance with the conditions of the preliminary certificate
- (3)(b) Actual project costs, if less than $50,000, requires copies of receipts from purchase and installation, or if costs for a project are $50,000 or over, an independent Certified Public Accountant (CPA) is to certify costs
- (3)(c) The applicant should give a statement that the facility is in operation, or if not in operation, has made every effort to make it operational
- (3)(d) Any other information as determined by the ODOE Director, such as an inspection, necessary prior to issuance of the final tax certificate
- (4) Allows the Director to certify a tax credit for up to 10% over the project, up to 110%, of costs approved on the preliminary certificate

Section 22 addresses the need for ODOE to establish an Oregon Administrative Rule (OAR) for BETC facilities:

- (1) High performance homes
- (2) Homebuilder-installed renewable energy system
- (3) High efficiency combined heat and power facility
- (4) Renewable energy resource equipment manufacturing facility

Section 26 sets a sunset date with no more tax credits issued on or after January 1, 2016, with Section 27 of this bill and its amendments applying retroactively to facilities acquired, erected, constructed or installed on or after January 1, 2007, and for tax years thereafter.

2008, House Bill 3619 (Special Session)[12]

At the request of the House Interim Committee on Revenue, HB 3619 unanimously passed in a 2008 Special Session, as an act related to taxation that modified the BETC for renewable energy resource equipment manufacturing facilities. This bill effective May 23, 2008, retroactively applied to BETC preliminary applications approved on or after January 1, 2008. The bill amended ORS 469.200 reflecting an increase in the total eligible cost of a BETC for manufacturing renewable energy facilities.

Essentially, Section 2 created of three levels, from the previous two levels, of maximum eligible costs for a BETC:

- (1)(a) A facility using or producing renewable energy resources or a combined heat and power facility still qualifies for a $20 million eligible cost BETC, but
- (1)(b) A modification was made to increase only renewable energy manufacturing, up from $20 million to $40 million per facility; providing certain risk mitigating stipulations, such as performance contract expectations
- (1)(c) $10 million in the case of any other facility

Level	BETC Project Category	Eligible Cost Limit	% Tax Credit
1	Renewable Energy - **Manufacturing** Resource Equipment	**$40 million** per facility per calendar year ORS 469.200(1)(b)	**50%** of eligible project costs ORS 315.354(1)(a)-(c)
2	Renewable Energy – **Using or Producing** Resources or **Combined Heat and Power**	**$20 million** per facility per year ORS 469.200(1)(a)	**50%** of eligible project costs ORS 315.354(1)(a)-(c)
3	Conservation Energy – **All Other Facilities** (Facilities defined by 469.185)	**$10 million** per facility per year ORS 469.200(1)(c)	**35%** of eligible project costs ORS 315.354(1)(a)-(c)

For the maximum level of $40 million of manufacturing BETCs, risk-mitigating stipulations were added to the program. Per Section 2, ORS 469.197, the ODOE was required to establish rules (OARs) for the manufacturing category of BETCs, including:

- (4) Renewable energy resource equipment manufacturing facility
- (4)(a) Standards for the equipment, machinery and other products being manufactured
- (4)(b) Standards for what constitutes a single facility [reference 469.185]

[12] MMINV235, MMINV237, MMINV255, MMINV256, MMINT129

- (4)(c) Standards for minimum level of employment
- (4)(d) Standards of financial viability of the applicant
- (4)(e) Standards for long-term success
- (4)(f) Standards for likelihood an applicant will locate or expand in Oregon

ORS 469.197(1) placed the responsibility of establishing controls for the minimum standards of issuing manufacturing BETC onto the ODOE in their rulemaking (OAR) process. According to a budget note response from ODOE to the Joint Committee on Ways and Means (in HB 5100 on January 31, 2011), "the above mentioned standards [ORS 469.197(4)(a)-(f)] codified the discussions and practices already initiated at the request of the Governor's [Kulongoski] Office… due to increased demand for the manufacturing BETC from companies across the globe." This reveals the Governor's office is driving policy for the BETC program administration.

The budget note to the Joint Committee on Ways and Means (HB 5100 in 2011), reveals that the ODOE and Oregon Business Development Department (OBDD) had "prior to the adoption of HB 3619… began discussions on how to effectively administer the standards and criteria established in legislation. Those discussions, and subsequent legislation, resulted in the two agencies entering into an Interagency Agreement (IGA) in July 2008. This IGA was used to establish a formal relationship between the agencies regarding the manufacturing BETC and the due diligence and recommendations to be performed on prospective projects."

Resulting from the IGA between ODOE and OBDD[13], as described in the response to the budget note, was that the ODOE would pay for services from OBDD "to perform the activities and to contract with an independent, third-party entity to ensure all potential projects met the standards and criteria outlined in HB 3619." The IGA as described by ODOE and OBDD in the budget note had four phases and areas of responsibility between the agencies, which adds critical risk mitigating controls to the administration of manufacturing BETC at the highest eligible value, $40 million in certified project costs:

1. Pre-Qualification and Application
    a. OBDD is the primary point of contact for manufacturing facility companies
    b. OBDD pre-screens and assists with preparation of BETC applications
    c. ODOE participates in facility presentations, eligibility, technical and financial overview

[13] *Manufacturing BETC project files with the OBDD were not included in the population, or in scope for this examination*

    d. ODOE receives fees and process
2. Pre-Certification and Due Diligence
    a. OBDD performs due diligence and feasibility review, including initiation of RFP to contract with a third-party expert to conduct technical and financial review and risk assessment on the project
    b. OBDD executes the contract with the third-party expert
    c. OBDD makes a recommendation whether to approve BETC with conditions for precertification
    d. ODOE assists in a joint review of bids from RFP
    e. ODOE attends presentation of contractor's final report
    f. ODOE makes final decision for preliminary certification
3. Performance Agreement and Final Certification
    a. OBDD negotiates terms agreement with the manufacturing facility with the assistance of the ODOJ, per the risk-mitigating stipulations in HB 3616, aforementioned for ORS 469.197(4)(a)-(f).
    b. OBDD signs the resulting agreement with the manufacturing facility
    c. OBDD participates in a facility inspection
    d. ODOE signs the resulting agreement with the manufacturing facility
    e. ODOE participates in a facility inspection
    f. ODOE reviews the eligible costs of the project
    g. ODOE provides assistance with the pass-through process for the sale of tax credits
    h. ODOE prepares, reviews, and issues a final tax certificate
4. Compliance and Program Reporting
    a. OBDD tasked with administering and verifying the company is meeting its contractual agreements, such as performance agreements for five years with the manufacturing facility
    b. ODOE charged with the ability to revoke tax credit default and non-performance of the agreements with the manufacturing facility
    c. ODOE responsible for budget oversight, rulemaking and performance measure reviews

Prior Director Grainey who also later went to work for the OBDD stated in an interview that the typical BETC (Level 2 and 3 maximum BETCs) was a "credit of right;" if you met the criteria of the credit, you got the credit, there was no "discretion to deny" the credit.

However, the manufacturing BETC (Level 1 maximum BETC), had conditions and requirements, such as the number of employees, salary requirements, and length of time in operation. If the conditions were not met by the manufacturing facility, the option of a "claw-back" was considered. He stated the provisions of the contract were negotiated with each company, and a third-party expert was contracted to do due diligence. He does recall declining two BETC credits for manufacturers, as they were deemed financially inadequate, and the result was, "two unhappy Legislators."

2009, House Bill 2472[14]

Proposed in the 2009 regular Session and sponsored by the House Committee on Revenue, HB 2472, aimed to scale-back the BETC program. The bill would have added various risk-mitigating controls providing direct advantages to Oregon. The Legislation passed and Governor Kulongoski vetoed the bill on August 7, 2009.

Governor Kulongoski's Office and OBDD received notification about "long-term revenue impacts" the BETC was having on the State General Fund by November 12, 2008, per a memo by Director Grainey. As stated by the Director, manufacturing BETCs for just seven solar manufacturing facilities accounted for about $168 million in revenue impacts (Level 1 maximum BETC)[15]. In an accompanying chart found in his memo, it shows potential expansion of existing manufacturing plants with emphasis on job creation. During an interview with the prior Director, he spoke about job and economic growth goals, pointed to several economic studies, and indicated his active involvement with seeking out clean energy industries for operations in Oregon.

By December 29, 2008, Director Grainey had shared with Governor Kulongoski's office the impacts on revenue from wind facilities. This memo reflected $33 million in final tax credits issued for 2008, with another $14.5 million in outstanding preliminary certificates issued. Applications pending preliminary BETC certifications in 2008 were $120 million, of which ODOE anticipated $80 million to receive tax credits for wind farms. The memo outlines job creation for five wind farms that when completed was expected to provide 110 operational jobs. Below is an excerpt of estimated revenue impact stated in the 2008 memo:

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[14] MMINV225, MMINV226, MMINV231, MMINV232, MMINV233, MMINV237, MMINV261, MMINV262, MMINV263, MMINV264, MMINV267, MMINV268, MMINV269, MMINV275, MMINT60, MMINT119, MMINT129

[15] OBDD administrating manufacturing BETC per IGA from July 2008

	2007-2009	2009-2011
Total BETC Program	$68.6 million	$143.8 million.
Windfarms	$15.1 million	$53.4 million.

As shown in the excerpt above, from 2008, Director Grainey estimated the total revenue impact of BETC was $68.6 million for the 2007-2009 biennium. This same biennium was estimated to have only a $1.9 million revenue impact based on the earlier 2007 revenue impact statement from HB 2211. Comparing the 2007 to the 2008 revenue impact estimates, a 3511% underestimation is reflected for the biennium, a significant underestimation of foregone revenue for the biennium from the BETC program.

Revenue Impact: For 2007-2009 biennium	
Projected HB 2211 in 2007	Actual 2008 Reported by Grainey
$1,900,000	$68,600,000
Revenue Impact: Variance	
Difference	Variance
$66,700,000	3511%

To control revenue impacts Director Grainey proposed several reduction options to Governor Kulongoski's Office, Legislators, and other interested persons in 2009.

In an audio recording from a June 24, 2009 joint House and Senate Conference Committee for HB 2472-B, the committee discussed the scale-back of the BETC program. What sounds to be a Senator stated the bill was a "reasonable move based on concerns", and the Senator recounted that BETC is by order of magnitude more generous than any other state in the country.

HB 2472 would have reduced eligible project costs for larger scale projects, affecting particularly wind projects. As explained by Director Grainey in an audio recording from the House Committee on Revenue on April 17, 2009, wind projects under 20 megawatts were considered "smaller." He went on to state, "it takes about a 5 megawatt facility to get you up to $10 million" in project costs. Using this figure, it would have affected the BETC Level 2a population of project applicants. Based on this estimation, larger wind

projects would have been hindered because a BETC Level 2a limit on megawatts resulted in a lower eligible project cost percentage qualifying for a tax credit. Reference the table below:

Level	BETC Project Category	Eligible Cost Limit	% Tax Credit
1	Renewable Energy - Manufacturing Resource Equipment	$40 million per facility per calendar year ORS 469.200(1)(b)	50% of eligible project costs ORS 315.354(1)(a)-(c)
2a	Renewable Energy – With an ***Installed Capacity of 10 Megawatts or <u>More</u>*** and Using / Producing Resources ***(Larger Wind)***	$20 million per facility per year ORS 469.200(1)(a)(A)-(B)	***35% of eligible project costs*** ***ORS 315.354(1)(c)***
2b	Renewable Energy – With an ***Installed Capacity of 10 Megawatts or <u>Less</u>*** and Using / Producing Resources ***(Smaller Wind)***		***50% of eligible project costs*** ***ORS 315.354(d)***
3	Conservation Energy – All Other Facilities (Facilities defined by 469.185)	$10 million per facility per year ORS 469.200(1)(c)	35% of eligible project costs ORS 315.354(1)(a)-(c)

2010, House Bill 3680 (Special Session)[16]

Sponsored by the House Committee on Revenue, HB 3680 is a bill related to taxation with effectively became law on May 27, 2010, passed with no naysayers. This bill made several amendments to the BETC program and has various effective dates.

Most notably for this examination, changes to BETC in this bill included capping the dollar amount of preliminary certifications, creating deadlines for processing applications, establishing a competitive process for preliminary certifications, and other risk-mitigating statutes. This bill begins the contraction of the BETC program.

Caps were added to the BETC preliminary processing for facilities using or producing renewable energy (Level 2 BETC) in Section 2, ORS 269.210:

- (1)(a) May not exceed $300 million for the biennium ending June 30, 2011
- (1)(b) May not exceed $150 million for biennium July 1, 2011 to June 30, 2012
- (3)(a) Applications less than $6 million have a preliminary decision within 90 days
- (3)(b) Applications $6 million or more have a preliminary decision within 6 months

[16] *MMINV235, MMINV269, MMINV270, MMINV271, MMINV272, MMINV275, MMINT119, Control Matrix*

Caps were added to the BETC preliminary processing for renewable energy resource equipment manufacturing facilities (Level 1 BETC) in ORS 246.210:

- (4)(a) May not exceed $200 million for the biennium ending June 30, 2011
- (4)(b) May not exceed $200 million for the biennium ending June 30, 2013
- (4)(c) May not exceed $50 million for the six months through December 31, 2013

Section 8, ORS 469.200 limited tax credits in a calendar year to:

- (1)(b) $40 million for renewable energy resource equipment manufacturing facilities other than manufacturing of electric vehicles, or
- (1)(c) 5% of the total cost of the facility or $7 million for wind facility with an installed capacity more than 10 megawatts
- (1)(d) $2.5 million for renewable energy resource equipment manufacturing facilities used to manufacture electric vehicles

Level	BETC Project Category	Eligible Cost Limit	*Sunset Dates*
1a	Renewable Energy - Manufacturing Resource Equipment	$40 million per facility per calendar year ORS 469.200(1)(b)	***Preliminary certification by January 1, 2014*** ***ORS 315.357(2)***
1b	Renewable Energy - ***Manufacturing Resource Equipment Electric Vehicles***	***$2.5 million per facility per calendar year*** ***ORS 469.200(1)(d)***	
2a	Renewable Energy – With an Installed Capacity of 10 Megawatts or <u>More</u> and Using / Producing Resources (Larger Wind)	***$7 million per facility per year or 5% cost of facility (gradual reduction)*** ***ORS 469.200(1)(c)***	***Final certification by January 1, 2012*** ***ORS 315.357(1)***
2b	Renewable Energy – With an Installed Capacity of 10 Megawatts or <u>Less</u> and Using / Producing Resources (Smaller Wind)	$20 million per facility per year ORS 469.200(1)(a)(A)-(B)	
3	Conservation Energy – All Other Facilities (Facilities defined by 469.185)	$10 million per facility per year ORS 469.200(1)(c)	

Two sunset dates were established for the BETC program under Section 5, ORS 315.357:

- (2) Preliminary certification for renewable energy manufacturing projects (Level 1) no later than sunset date of January 1, 2014
- (1) Final certification for all other BETC projects (Level 2 and 3) no later than sunset date of July 1, 2012

Several program controls were added to the BETC program that are risk mitigating:

- ORS 315.354 (5)(d) Requiring the tax credit not be claimed for a year prior to when it was obtained
- ORS 469.195 (2) Requiring the ODOE to establish by rule a tiered priority system, based on the cost of the facility, to be used in evaluating applicants using or producing renewable energy resources; also allows the ODOE discretion in evaluating projects in a more competitive way using established criteria.
- ORS 469.197 (6) Standards for what constitutes as single facility
- ORS 469.205 (2)(a)(O)(b) The facility must remain in operation for at least five years, with discretion for the ODOE Director to shorten required operations
- ORS 469.210 (2) Certificate indicates conditions for claiming the tax credit
- ORS 469.210 (3) ODOE Director authorized to add conditions or deny preliminary tax certification under certain criteria
    - (b) duplicative costs
    - (c) unable to demonstrate the facility is economically viable without credits
    - (d) cancellation of related applications when such action taken on one
    - (e) applicant of a limited liability company in arrears on money owed to the government

Controls added in this bill for evaluating economic impacts and assurances for Oregon include:

- ORS 469.197 (4)(b)(B) Considerations for increased production, number of jobs created or maintained by the applicant, and expansions or additions to facilities

- ORS 469.205 (2)(f) Information about the amount and type of jobs being created, and the number of jobs sustained throughout construction, installation and operation
- ORS 469.205 (2)(g) Compliance with applicable, state and local laws, licenses and permits
- ORS 469.215 (3)(d) A final certificate cannot be issued unless the number and type of jobs over the following five-year period and economic activity of the state is received
- ORS 469.215 (3)(e) A final certificate cannot be issued unless the project sufficiently demonstrated it will be in operation for five years
- ORS 469.215 (3)(f) A final certificate cannot be issued unless the project sufficiently demonstrated all attempts were made to make it operational for a RD&D project
- ORS 469.215 (3)(g) A final certificate cannot be issued unless compliance with state and local laws
- ORS 469.225 (1)(b) ODOE Director may suspend or revoke the tax credit if the project failed to have constructed or operated the facility
- ORS 469.225 (1)(c) ODOE Director may suspend or revoke the tax credit if the facility is no longer in operation

2011, House Bill 2523[17]

This HB 2523 transferred the administrative responsibilities from the ODOE to the OBDD for renewable energy resource equipment manufacturing facilities.

2011, House Bill 3672[18]

It was after Governor Kitzhaber took office that Legislators passed a bill that would sunset the BETC program and create a new Energy Incentive Program (EIP). In the 2011 Legislative Session, HB 3672, sponsored by the Joint Committee on Tax Credits passed and effectively became law September 29, 2011 as an omnibus bill relating to tax expenditures. HB 3672 passed overwhelmingly, with a couple naysayers.

The bill extended sunset dates and modified provisions for BETC, required an auction of tax credits to occur, and fund the new EIP program. It established the EIP administered

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[17] *MMINV282, MMINV283, MMINV284, MMINV333*

[18] *MMINV259, MMINV277, MMINV278, MMINV279, MMINV280, MMINV281, MMINT63, MMINT128*

by the ODOE to replace the BETC. The processing of BETC and the EIP happened dually during this transition in energy incentive programs.

The sunset provisions of the BETC program outlined by HB 3672 are as follows:

- ORS 315.357 (1)(a), (b), and (c), a preliminary tax credit certification cannot be issued after July 1, 2011 and a final tax credit certification cannot be issued after January 1, 2013 for energy facilities other than renewable energy resource equipment manufacturing

Level	BETC Project Category	Eligible Cost Limit	% Tax Credit	Extended Sunset Dates
1a	Renewable Energy - Manufacturing Resource Equipment	$40 million per facility per calendar year ORS 469.200(1)(b)	50% of eligible project costs ORS 315.354(1)(a)-(c)	***Preliminary Application before January 1, 2014*** ORS 315.357(2)
1b	Renewable Energy - Manufacturing Resource Equipment Electric Vehicles	$2.5 million per facility per calendar year ORS 469.200(1)(d)		
2a	Renewable Energy – With an Installed Capacity of 10 Megawatts or <u>More</u> and Using / Producing Resources (Larger Wind)	$7 million per facility per year or 5% of the total cost of the facility ORS 469.200(1)(c)	35% of eligible project costs ORS 315.354(1)(c)	***Preliminary Application before April 15, 2011*** ***Preliminary Certificate before July 1, 2011*** ***Final Certification before July 1, 2013 (6 month extension), or Evidence Begin Construction before April 15, 2011*** ORS 315.357(1)(a)-(c)
2b	Renewable Energy – With an *Installed Capacity of 10 Megawatts or <u>Less</u>* and Using / Producing Resources (Smaller Wind)	$20 million per facility per year ORS 469.200(1)(a)(A)-(B)	50% of eligible project costs ORS 315.354(d)	
3	Conservation Energy & Transportation (Facilities defined by 469.185)	$10 million per facility per year ORS 469.200(1)(c)	35% of eligible project costs ORS 315.354(1)(a)-(c)	***Any preliminary certification outstanding as of July 1, 2011, shall expire on July 1, 2014*** Section 43(7) & Section58(6)

2011-2012 Oregon Energy Task Force[19]

By October 2011, the Oregon Energy Action Plan Task Force was formed. According to a report of "Recommendations to Governor Kitzhaber" on March 2, 2012, the Task Force was "an advisory committee, charged with recommending to the Governor [Kitzhaber] actions and initiatives that the State of Oregon can take … and was made up of volunteer participants who were hand-selected by the Governor's office on the merits of their individual expertise and experience."

2013, House Bill 2218[20]

Additionally, HB 2218 proposed at the request of Governor Kitzhaber's Office, failed to become law when it died in the House in 2013. The bill would have subtracted the taxable income from the sale of tax credits, in conflict with the federal tax code. The ODOR assisted the Governor's Office with the legislative concept for the bill. On April 11, 2012, the ODOR Director Bucholz placed a moratorium on special projects to audit taxpayer returns until otherwise directed by the Governor's Office. Despite ODOR auditor attempts and stated concerns, the moratorium was affecting revenue "to the tune of millions of dollars." When the bill failed to become law, Director Bucholz lifted the moratorium on July 8, 2013. The moratorium resulted in missed opportunities to collect money due to the State General Fund, from underpaid capital gains from the sale of a BETC and other errors on taxpayer returns claiming BETC. As the ODOR may only audit the recent three tax return years for errors, the period foregone and excluded from auditing was approximately April 2009 to July 2010; a period with heightened risk in the BETC program because of inadequate risk-mitigating controls.

Administrative Rules Overview

ORS and OARs referenced in this report are used to understand the context of the BETC program, its evolution, its risks, and its controls.

Revisions of OARs[21]

During the examination period of 2006 to 2014, there were 21 versions of Oregon Administrative Rule (OAR) changes cataloged by the ODOE for the BETC program.

Year	Effective Date of OAR for BETC
2006	1-1-06

[19] *BETC26871, MMINV250, MMINV293, MMINV294, MMINV295, MMINV296, MMINV297*

[20] *MMINV17, MMINV30, MMINV222, MMINV232, MMINV231, MMINV252, MMINV253, MMINV254, MMINV261, MMINV267, MMINV301, MMINV303, MMINV304, MMINV305, MMINT6, MMINT8, MMINT9, MMINT47, MMINT48, MMINT80, MMINT81, MMINT85, MMINT115*

[21] *MMINV218, MMINV269*

2006	10-1-06
2006	12-1-06
2007	12-1-07
2008	3-21-08
2008	6-20-08
2009	11-3-09 thru 5-1-10 (Temp)
2010	1-8-10
2010	4-30-10
2010	5-27-10 thru 11-23-10 (Temp)
2010	11-23-10
2011	4-18-11 thru 10-14-11 (Temp)
2011	9-29-11
2011	10-25-11
2011	11-30-11
2012	1-13-12 thru 7-10-12 (Temp)
2012	7-10-12
2012	11-16-12 thru 5-14-13 (Temp)
2013	5-13-13
2013	10-2-13
2014	4-1-14

When BETC program risks had become apparent, Director Grainey sought legislative changes appropriately. Then after a veto of risk-mitigating legislation, Governor Kulongoski instructed the ODOE Director to make rule changes for the BETC program, essentially relegating program risks to be resolved through rulemaking changes within the Agency's authority to undertake. While rules governing the administration of BETC program were assistive, the rules were under pressure, as statutory authority did not fully support the rules. Without supportive statutes, the ODOE was possibly disadvantaged in defending decisions it made on projects to mitigate risks. The frequent revisions in the rules were ODOE's attempts to figure out how to best mitigate its risks, while also meeting its stakeholders' needs and energy policy goals.

Public Interest OAR Rulemaking[22]

The rulemaking files from the ODOE show numerous stakeholders expressed public interest and participated in the BETC rulemaking process, particularly when rules were expected or proposed to restrict or sunset the program. In the BETC rulemaking files from 2009 and 2010, the public comments show at least 19 oral comments and 35 written comments from public hearings, with the Separate and Distinct (S&D) multiple

[22] *RULES 11.2009 Public Comment, RULES 2010 Public Comment*

facility rules being of the top noted reason for public comment, along with criteria for project eligibility, the eligible costs of a project, and Oregon based economic changes.

Public comments appear to be made by various stakeholders in the energy industry, and interest groups of stakeholders, without any particular energy specialty dominating the feedback. Public comments reviewed during the examination included:

- Energy Producers
- Energy Manufacturers
- Efficient Trucking
- Transit
- Utilities
- Weatherization Vendors
- Government Entities
- Tax Fairness Advocates

Scope Objective 1 Risks and Controls

The first objective during the examination was to determine what, if any, preventive and detective controls were in place for the BETC program and whether controls aligned with risks. ODOE either could not locate or did not perform a risk assessment, an internal audit, or receive an external audit for the BETC program. Inquiries elsewhere at the State and with former ODOE employees for these records produced no specific results for the examination.

In this examination, five risks were identified as having no mitigating controls. Statutes and rules were not sufficiently aligned to mitigate program risks. Together these risks made the program vulnerable for financial abuse or misuse. Compliance deficiencies for established program controls compounded risk concerns for the BETC program.

A matrix for both risks and controls was created for the examination as a baseline to assess how controls aligned with risks for the BETC program.

Risk Assessment

To examine the sufficiency of controls in place and to perform a risk-based examination, an assessment was performed to identify inherent, known, and perceived risks, and evaluated the likelihood and severity of these risks. Collectively, these are:

- The risks the program has simply from operating

- The risks specific for industry complexities
- The anticipated risks from issues that might arise
- The probability and magnitude of these risks happening

The results from the risk assessment were used to create a risk matrix to assess the BETC program controls, to evaluate the robustness of preventive and detective controls in place or the controls' ability to detect errors and irregularities. The risk matrix categorized whether risks were a concern based on program exploitation, circumvention of controls, or opportunity and pressures for abuses.

These are the considerations used in creating the BETC program risk matrix:

- Frequent turnover in staff and unfilled positions (including internal auditor)
- Loss of institutional knowledge from turnover
- Tone from the top, culture, and office morale
- Volume of projects to process
- Dollar amount of projects responsible for
- Clean energy industry reliance on incentive programs
- Outside of the State interests
- Downturn economy
- Progressive nature of clean energy project types
- Advertisement for pass-through option as "lump sum cash payment"
- Perceived opportunities for conflicts of interest
- Lack of fully dedicated quality control process, risk or compliance officer
- Predicate for this examination

Control State

There were 33 risks identified in the risk matrix and 59 controls documented in the control matrix. Controls were statutes and rules for the BETC program, with the following four additions that had added some form of controls in other capacities at the ODOE:

1. A third-party intermediary assisted the ODOE with handling of pass-through payments between project owners and pass-through partners; this was deemed a control for separation of duties when being performed.

2. Project files generally were worked in some form of dual control, with an administrative approver and a technical approver. Project files toward the end of the program also included a management approver.
3. Program authority limits existed and were updated annually at ODOE, which established a controlled governance structure to carry out responsibilities.
4. Seeking legal counsel for guidance on administrating program statutes and rules to mitigate program risks when identified, as supported by documentation in project files and interviews.

Generally, program controls were found to align with program risks. About 30% of the program controls assisted with mitigating program errors and 30% acted in a detective capacity. Most all 47 of the 59 program controls acted in a proactive capacity.

Risk: Exploitation of BETC Program					
Risk	**Risk Description**	**Risk Factors**	**Impact**	**Likelihood**	**Controls**
No Oregon tax liability, private not public entity	Project Applicants that are of a private origin without an Oregon tax liability, and are not a public entity.	Individuals or shell companies claiming tax credit; difficult to determine business industry to substantiate eligible costs; tax credits issued to entities registered out of state or out of country.	High	Probable	Yes (3 or more)
Non or limitedly Oregon projects or applicants	Applicant represents a project is to be performed / located in Oregon but is not or partially is in Oregon.	Businesses using goods/services not derived from Oregon ('buy American, by local' initiative), possibility of loss of Oregon tax revenue for locations not in Oregon.	High	Possible	Yes (3 or more)
Internal influence	Project applicants with relations, arrangement, influence, ownership, or other connection with a State worker or public influencer.	Favoritism, corruption, pressure, circumvention of controls or turning of a blind eye.	Medium	Possible	Yes (3 or more)
Outside controlling interest	Applicants of BETC with a controlling interest and/or economic impact largely outside of Oregon.	Loss of Oregon interests; decisions and credits supporting entities in other states/countries. No certainty that jobs or businesses will remain in Oregon. Businesses using program to acquire assets then moving operations to another state and/or country.	High	Likely	Yes (3 or more)
Non-CPA attestation	Applicant submits a letter of cost attestation by a non-licensed CPA (non-CPA), or disqualified CPA.	Nonqualified individuals certifying high-dollar projects, with ODOE not providing oversight on attesters. Could result in a tax credit loss to Oregon. Disqualified may be a CPA on official reprimand by Public Accountancy Board, a non-independent CPA, or an individual not a CPA.	Medium	Remote	No
Repeat projects	Projects without an end, such as those on an ongoing basis, done in phases, or other repetitive ways.	Multiple BETC funds collected for the same project. Projects may be structured in a way to conceal	Extreme	Possible	Yes (3 or more)

		multiple projects for the same project. May lead to abuse or over reliance on BETC funds.			
Projects limited energy benefits	Projects with a stretched energy benefit, perhaps with a limitedly impactful payback, or return on investments for foregone tax revenue.	Companies may go out of business, projects dismantled/ not operational, sold off or transferred after completion. Dual loss for Oregon: loss of tax credit and loss of project benefits (jobs, energy savings, and future taxable income).	Extreme	Possible	Yes (3 or more)
Projects not completed as purported	Projects that were purported to be completed as stated, when in fact were done differently, not at all, not operational, or not in a way to provide expected energy benefits.	Incomplete projects provide no benefit to Oregon and may be a violation of ORS, risks of losing project assets, jobs, and miscalculation of energy savings.	High	Possible	Yes (3 or more)
Not an incentive	Projects that are completed before application, would have needed to be completed anyway, or limitedly acting as an incentive.	The incentive program used as a reimbursement program; projects would have been done regardless of tax incentives; waste of taxpayer funds.	High	Possible	Yes (3 or more)
Pass-thru partner with possible conflict of interest	Pass-through partner is controlling owner or in collaboration with party that has conflict of interest. This could be project owner, project vendor, tax professional (attestation, intermediary), ODOE employee or other.	The lack in the separation of duties creates an opportunity for illicit activity and behavior. This could result in over inflating costs, creating of fictitious documents, circumventing controls for financial gain.	High	Likely	No
Favoritism in handling of projects	Expedited requests, expeditious handling, inconsistent administration of rules, political pressures, out of order processing, special treatment.	Risk of favorable treatment by obtaining tax credits or preliminary approvals before other applicants. May cause delay in other projects, corruption, kick-back, or other types of illicit gain scams.	High	Probable	Yes (3 or more)
Incentives exceed cost	Subsidies, tax credits, grants or other incentives exceed the cost of the project, net positive to project owner.	Projects no longer an incentive when funds are more than the project costs; can create a “double dipping” effect. Projects when completed result in a net gain.	High	Possible	2
Bustout	Suspiciously timed sale of a project, facility, or tax credit.	Sale nearly after project origination or completion, possibly to a different entity and/or non-Oregon interest holder. Timed nearly before, around, or after a financial collapse or financial hardship.	High	Possible	2

Risk: Circumvention of BETC Program Controls

Risk	Risk Description	Risk Factors	Impact	Likelihood	Control
Tax credit year structuring	Projects structured so tax credits are taken in one (1) year instead of five (5) years.	This is concerning as there are more favorable pass-through rates to project owners for 1-year credits verses 5-year credits. Also 1-year credits reduce the risk to pass-through partners having to estimate future tax liability.	High	Likely	No
Know your customer: controlling interest	Applicants for BETC with an undisclosed controlling interest in the project (ownership or contractor); or have no controlling interest at all; or	Such as shell companies, applicants with no ownership rights, or no control over facility or project, or applicants starting the	Extreme	Likely	Yes (3 or more)

	created the project intended to sell the project.	project with the intent to sell the company, or project to another entity. Not knowing beneficial ownership can hinder the ultimate owner of assets.			
Proof of costs	Applicant submits receipts and invoices that are indistinguishable, forged, false, misleading, or not substantive.	Incorrect expenses, or unproven expenses can cause undue burden on the State General Fund.	Extreme	Possible	1
CPA attestation structuring	Applicant structures projects or costs to avoid, or be required to have, a CPA attestation at $50,000 cost threshold.	High impact because may be combined or influenced by other risks identified; project owner costs of having costs certified by an independent third party.	High	Probable	No
Projects same site	Multiple projects done on the same site, by the same project owner or ownership interest, appearing to be separate and distinct, when may not be totally exclusive.	Such as different project types at the same site, or multiple project owners at same site, many project stakeholders of a particular site. Challenging to determine rights. Strongest control was the S&D Committee formed in about 2010.	Extreme	Probable	Yes (3 or more)
Pass-thru transaction rate not in compliance	Transaction rate different than in OAR, and pass-thru payment more or less than required for net present value.	Possible OAR violation; may result in favoritism to project owner or pass-through partner at a discount or premium.	Extreme	Possible	Yes (3 or more)

Risk: Opportunity & Pressure for BETC Abuse

Risk	Risk Description	Risk Factors	Impact	Likelihood	Controls
No Oregon tax liability, and no pass-thru partner	Applicants without Oregon tax liability, no secured pass-thru partner with a tax liability.	Possible sale or exchange of tax credit without notifying ODOE.	High	Probable	Yes (3 or more)
Tax credit not used as issued	Final tax credit used in a year not permitted, in incorrect yearly proportions, or by a taxpayer not as issued.	Influenced due to downturn in economy. Unexpected impacts to the State General Fund; claimed by taxpayer where costs were not incurred.	Extreme	Likely	Yes (3 or more)
Tax credit issuance issues	Tax credits issued for incorrect amounts, years, projects, names, or otherwise not correct.	May include amounts over program maximum caps, a tax credit year other than in the year the final tax credit was issued, in a name and SSN/TIN other than cost eligible project owner.	Medium	Possible	Yes (3 or more)
Tax credit sales	Tax credits passed-thru, transferred, donated, or gifted not in accordance with applicable rules or rates.	Set rates, ODOE is mainly middle-man, tax credit impacts to State are mostly capital gains.	Low	Possible	Yes (3 or more)
Outside Oregon connections and interests	Applicants of projects with outside Oregon connections, operations, lobbying, or stakeholders.	Political pressure, bribery, kickbacks, corruption.	High	Likely	Yes (3 or more)
Project type	Applicants that apply for a BETC with a project that is either limitedly so or not of a qualifying type.	Unlikely because so many kinds of projects are of a qualified project type, ORS 469.205(2)(a)(A) to (2)(a)(O).This excludes the concept of waste. Speaks only to projects that qualify, not whether or not that qualification was a waste to taxpayers.	High	Unlikely	Yes (3 or more)
Overlapping projects	Applicants of BETC with concurrent projects and /or with the possibility of cost overlaps.	Multiple projects for the same project; possible circumvention of separate and distinct.	High	Possible	Yes (3 or more)

Certifiable costs	Applicant submits costs for project that are not eligible, questionable relevance, or not in good faith with program purpose.	Project owners and/or CPAs adding costs that are not eligible as project expenses (CPA fees, BETC application fees, etc).	High	Probable	Yes (3 or more)
False CPA attestation	Applicant submits a CPA letter that is indistinguishable, incorrect, false, or with costs calculated incorrectly.	Unable to verify attestation of large ($50k+) projects. ODOE did not require invoices and receipts for over $50k projects to identify a false attestation.	Extreme	Possible	2
CPA acted in other capacity	The CPA that attested to project costs also acts as an intermediary.	Commissions from sales by intermediaries may influence attested costs. Opportunities for conflicts of interest; lack of segregation of duties.	Medium	Possible	No
Cost inflations and overruns	Projects with costs that are inflated without discernable legitimate reason or with overruns.	Such as purchasing equipment at a premium, or used equipment with reduced lifespan, or mismanagement of project costs.	High	Likely	Yes (3 or more)
Multiple incentive programs	Projects utilizing other public energy programs, such as grants, incentives, or loans in excess of project costs	Such as ARRA, SELP, USDOE, ETO; incentives may be before or after project completion. No central location to identify incentives; reliance on self-disclosure.	Medium	Possible	Yes (3 or more)
Projects without fair treatment	Projects of a similar basis that receive different treatment of handling.	May include favoritism, different outcomes, different requirements enforced. Impact mainly a liability issue.	Low	Likely	Yes (3 or more)
Approval without authority	Waivers, exceptions or tax credits issued not in accordance with approved limits or authority.	Lack of quality control and segregation of duties. Rubber-stamping approval on projects.	High	Possible	Yes (3 or more)

While there were several controls aligned with a specific risk, there were some program vulnerabilities and gaps of risks compared to controls as a whole.

Extreme Impact Risks

Eight risks were deemed to pose an extreme impact if uncontrolled. Each of these eight risks were identified as having at least one corresponding program control.

One of the eight extreme risks for “projects at same site” not only posed an extreme impact but also a probable likelihood; yet, it had at least three corresponding controls in the BETC program to mitigate that risk. Multiple projects at the same site can be problematic because it multiplies how many tax credit projects a project owner may qualify for, thereby multiplying the impacts of any errors.

The “proof of costs” risk for indistinguishable, forged, or otherwise bad proof of cost, presented an extreme risk having only one mitigating control noted. A lack of controls for this risk is extreme because tax credits issued for certified costs might be unsubstantiated and not proven.

High Impact and Probable Likelihood Risks

When examining the likelihood of a probable risk event, six risks were noted in the matrix as probable to happen. One risk previously mentioned, “projects at the same site,” is also a probable likelihood for circumvention. This is posed to be a highly likely situation because of the financial benefit a project owner would stand to gain by splitting their projects up into multiple files.

The other seven were probable risks deemed to pose high impact. One of the probable high impact risks had no corresponding control. It was the risk for “CPA attestation structuring;” where project owners structure their projects in a favorable way to either be required to get or to avoid attestation of project costs by a CPA. This is problematic as project owners may perceive one cost accounting for projects as more rewarding than the alternative cost verification.

Most Vulnerable Risks

Altogether, there were five risks documented with no corresponding program controls, which posed varying impacts and likelihoods on the program. There were no controls in place to prevent, detect or mitigate risks from:

- CPA attestation structuring
- Tax credit year structuring
- Non-CPA attestation
- CPA acting in another capacity
- Pass-through partner with a possible conflict of interest

As a whole, these risks without corresponding controls reflect a gap in critical financial aspects of the BETC program. Several uncontrolled CPA risks were identified as problematic. Project owners had opportunities to manipulate the processing of their project files. There was a lack of separation of duties if a CPA certifying project costs also brokered tax credits. The use of CPAs to certify costs obscured information from the ODOE as to the true costs certified for a project. Based on the certified project costs, a project owner may receive a one or five-year tax credit. Depending on the tax one or five-year credit, the pass-through rates are different and may be more favorable to the project owner. Project owners may manipulate their projects more favorably due to the lack of controls.

These financial related risks posed the most vulnerability and therefore were an overall threat to the program, as BETC project costs directly affect the value of the tax credit issued, and in turn, affect the revenue impact on the State General Fund.

Residual Risks

Controls established do not account for the handling of residual risks and the threat remaining after all efforts to identify and eliminate the risk. Typically, there are four ways to deal with residual risks: reduce it, avoid it, accept it or transfer it. Given the lack of risk assessment, internal, or external audit documents for the BETC program, it appears there was no process to reduce residual risks. Risk avoidance was sought when ODOE management and staffers sought ODOJ legal counsel when risks or questions of risk were posed. Transference of risk appeared to occur in the pass-through process, as the ODOR is responsible for auditing taxpayer returns and managing of the one-time transfer of tax credits. While there is no documentation of a risk acceptance statement, given the BETC program's tenure without critical risk management processes in place, it seems the residual risks were generally accepted.

Risk Management and Financial Crime[23]

The ODOE did not have a fully dedicated risk or compliance officer on staff. When the deficiencies became prevalent, the ODOE specifically lacked a qualified financial risk and compliance officer to manage improvements. This dedicated risk and compliance officer's sole responsibility would have been to ensure risks, trends, and threats were mitigated, prevented, and detected. Furthermore, there was no specific financial crime prevention or detection function in the BETC program. This was a risk because the ODOE was administering high-dollar tax credits with transferrable monetary value, directly affecting revenue in the State General Fund.

In addition, the ODOE experienced large gaps of time without having an internal auditor on staff, and when this position was filled, no specific BETC program audit was discovered as having been performed. Currently, there is a manager with a limited purview of "compliance" at ODOE, but this person was found to primarily manage the EIP operations. The internal audit position has been left vacant to date, when the manager transferred to become the EIP and compliance manager. Prior to this manager, no specific compliance group seemed to have existed for the BETC program.

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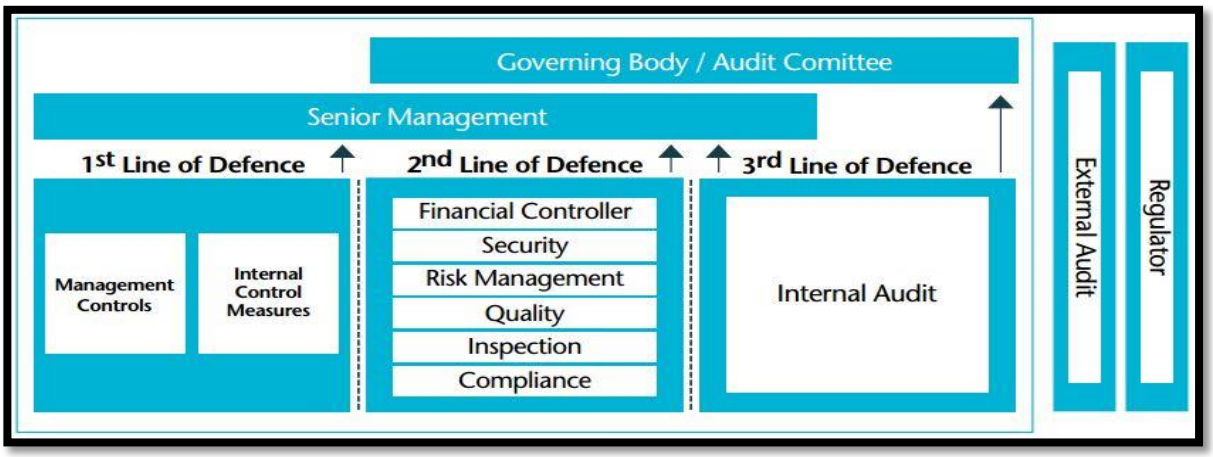
[23] *MMINT3*

There was no risk management program specifically in place at the ODOE, such as the three-lines-of-defense model, which typically govern risk management practices.

Reference the illustration of the three lines of defense model. Each of the three lines of defense were not fully functional, or functioning at all, causing risks to go unchecked and unmanaged during the period examined for the BETC program.



The first line of defense are management and internal controls. The ODOE used the statutes and rules for the BETC program as their primary controls and operational procedures. As stated previously, these controls did not fully align with risks, particularly the financial risks exploitable for financial abuse or misuse of the program. The second line of defense also was not fully functioning; there was no risk management program defined or observed for the BETC program. Project inspections did take place on a limited basis until 2010, when two dedicated inspectors were hired for the BETC program. However, these inspectors were tasked with ensuring energy projects were completed as stated in the BETC preliminary application. The inspectors performed a sampling of projects and did not inspect other critical aspects of the BETC program. Inspections, therefore, were not fully functional to the BETC program as a whole for their second line of defense. Not having a dedicated and specific compliance officer, or quality control function supporting the BETC program, also reflects the second line of defense was lacking. Lastly, the third line of defense was essentially not operational. No internal audits for the BETC program had been performed for the examination period.

In the three lines of defense model, there is an external audit function. No external audits were identified as having been performed specifically for the BETC program.

Senior management has a role in risk management. Without a fully functioning three lines of defense, the expertise, or advisers, it appears the ODOE management did the only thing they knew was an option, which was seeking legislative changes and rulemaking.

Senior management did have the ability to revoke tax credit. However, this was done limitedly because many tax credits had been passed-through posing challenges for recovery. The BETC program statutes had wide sweeping language for eligibility but provided limited recourse and specificity to deny tax credits.

A fully functioning risk or compliance function was lacking at the ODOE. The propensity for the program to be exploited, particularly financially, was elevated. A financial crime program (line of defense 2) was also not in place at the ODOE; meaning there was no specific work unit actively performing measures to prevent, detect, or seek out concerns of fraud, waste, or abuse in the BETC program.

Scope Objective 2 Control Compliance Assessment[24]

The second objective of the examination was to assess compliance with the control statutes and rules for the BETC program. The 3,895 BETC project files reviewed during this examination were screened for compliance with controls. In addition to physical project file reviews, all 14,494 projects with a final tax credit issued were tested in a fraud detection data analytics software. Moreover, inquiries were made during interviews about compliant activity.

Based on the physical inspection of project files, interviews and results of testing, it was found that the projects lacked adherence to, and consistency with, established statutes and rules. Based on findings, a number of factors attributed to compliance deficiencies with controls, including:

- Clarity, applicability and effectiveness of the controls
- The frequent turnover of ODOE staff and management
- Lack of a formal training program for ODOE employees
- Unfilled critical staffing positions
- The high-volume of projects stimulated by the energy incentive program
- The lack of quality control function
- Political pressures for BETC approvals to act as a job stimulus
- Energy policy pressures for BETC to support clean energy goals

The Examiners have been instructed to refer suspicious activity concerning possible statute violations to the ODOJ under separate cover.

Lack of Internal Written Procedures[25]

The BETC program extensively relied on the statutes and rules for controls and process procedures for BETC projects. While it is critical the BETC program run according to statutes and rules, it is also critical to have internal written procedures. There was no master document, official job aide, or formal proof of training located, that detailed the intricacies of the BETC workflow, handling of specific application phases, and guidance for complexities of each file. The lack of internal written procedures limited compliant decisions, especially with nuances and requirements of each project type. There are

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[24] *MMINV302*

[25] *MMINT4, MMINT14, MMINT17, MMINT33, MMPFC13765, MMPFC13773*

instances of project files processed differently, including those approved on about the exact same date, with the exact same issues, but receiving different treatment.

In several of the later-year files reviewed, there was a checklist utilized to provide consistency to files, but the checklist was limitedly used. The checklist was a poorly-performing tool for compliance consistency. Sometimes the checklist was half-filled out, sometimes not filled out, sometimes changed from how it was printed; sometimes it was completely filled out. There did not appear to be any reason for who or when the checklist was to be utilized. At one point, a signoff approval document was created that details steps performed on the file and required management's signature. This compliance process was an improvement, but no quality control function enforced its consistent application for all project files.

Compliance with utilizing the communication log affixed to the inside of most files was lacking. Often this log was left blank or limitedly used. Yet files contained numerous sticky notes, loose-leaf notes, taped, stapled or glued on information to record communications with project owners, vendors and others, instead of utilizing the communications log. Loose-leaf communication notes were at risk of falling out of project files. The lack of order poses a challenge for verifying who was communicated with, when, why, and other information that may be necessary for consistent and timely compliant processing of files. Especially with various ODOE employees handling files, and turnover, a communication log would have aided with providing timely and accurate services for the projects they were working on.

Condition of Files and Data[26]

There was over a 99% success rate in locating project files sampled during this examination. Consistently, project files were boxed correctly, labeled clearly, with project documentation inside the file. Corresponding database entries for the projects were in most instances matching the files, although project names sometimes did not match. This typically was seen when there were project ownership changes, such as a company in process of a BETC that was sold to another company. Database column (input) information on projects was sporadic, as information collected for the BETC program changed with its evolution over the years.

On a consistent basis, project files had some degree of issues complying with the perceived established controls and general good standards for completeness. The

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[26] *MMINV14, MMINV302, MMINV274, MMINV314, MMINT20, MMPFC12828, MMPFC11217, MMPFC11348, MMPFC12034, MMPFC11119, MMPFC12446*

compliance issues seemed to be a symptom of not having internal written procedures, internal oversight, or a quality control function. Some frequent file problems noted were:

- Whiteout, sometimes extensively used on documents
- Scanned, faxed, emailed documents in replace of original documents
- No proof of vendor payment, such as no copies of cancelled checks front/back, or receipts. Handwritten notes on invoices “paid,” a few were noted with similar writing. There was apparent rubber-stamping of proof of eligible costs.
- Missing invoices or proposals used as invoices. Invoices not clearly labeled for the project (example: site address, project name). Invoices not clearly showing what was purchased, how it was relevant to the project, and contained line items for other projects or purchases.
- Inconsistently approved costs as eligible for projects (example: fare box revenue for transportation projects). Disqualifying a cost as eligible on one file, but not on the other file.
- CPA letters lacked specificity or inclusion of what documentation they reviewed to ascertain certifiable costs, having to take CPA letters at face value. CPA letters without a CPA name, CPA license number, or not on letterhead were discovered as accepted. CPA letters where the CPA acted in another capacity on the project or for the company, possibly causing conflicts of interest.

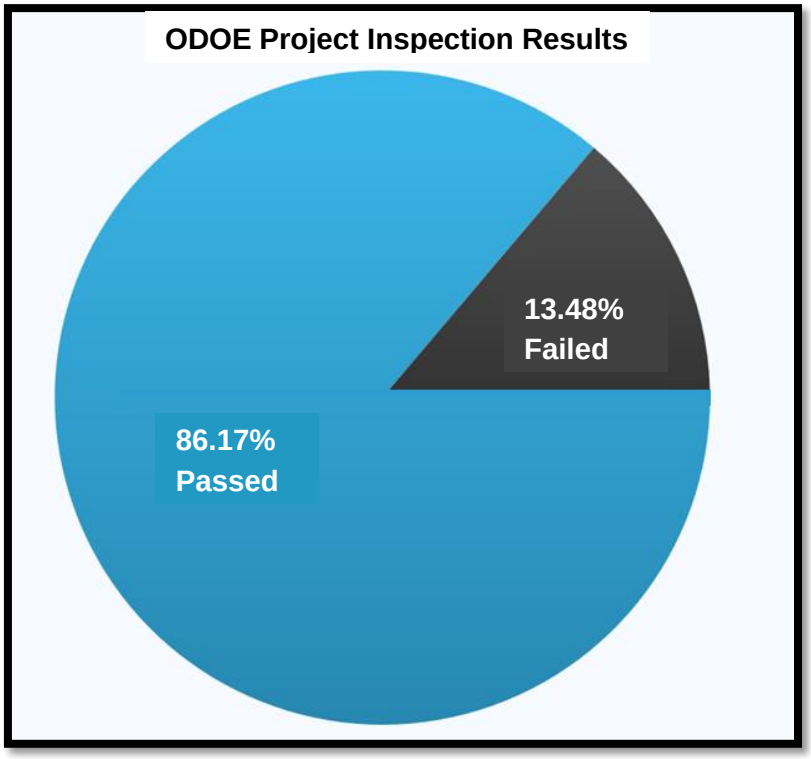
It was observed that non-compliant or loosely compliant findings with project files mostly pertained to costs related to the project. After examining the vulnerability of risks to the financial aspects of the BETC program, the notable compliance deficiencies with the costs are expected.

Failed Compliance Inspections[27]

Based off the projects reviewed during the examination, compliance was problematic on 38 projects where ODOE performed inspections on projects. These project inspections were important for compliance as this was the only way for the BETC program to validate a project was completed as agreed. Prior to 2010, no BETC compliance inspections were noted. This is concerning, as compliance inspections observed between 2010 until 2014 reflected a 13.48% failure rate. This may indicate a similar rate of failures for projects across the entire BETC program; therefore, prior to 2010 it may be expected that one in ten projects have compliance issues not recorded or detected.

These findings reflect that compliance was not functional and not well, for about half of the years examined.

Compliance failure rates explained are instances where project owners may be the cause of compliance problems. However, internally to ODOE, there were also compliance problems with the approval of project files. This risk-based examination focused on identification of groups of issues to point out overarching themes of compliance concerns or possible problems with projects.



Projects Exceeding Eligible Maximums[28]

This examination noted at least 12 instances where compliance failures appear to exist. These project files exceeded maximum program caps for eligible costs and tax credit issuance limits per calendar year. Examples of projects where these compliance issues appear to have happened are in wind, solar, biofuel and biomass project types.

Program cap controls did not appear functional as evidenced by projects exuding the following qualities:

[28] *MMPFC10798, MMPFC10818, MMPFC10819, MMPFC10820, MMPFC11889, MMPFC10615, MMPFC10653, MMPFC12639*

- Instances where final tax credits were corrected and adjusted after issuance and project completion from an amount allowable under the program cap to an amount seemingly above the program cap
- Projects where final tax credits were issued for nearly double the amount allowable in a single calendar year for a renewable energy facility
- Examples of projects where 10% of project overruns were permitted as eligible costs exceeding tax credit program caps
- Instances where the project simple-payback period was exceeded, because of the 10% project overruns were permitted

Project Started Before Preliminary[29]

Statutes and rules reference the need for a project owner to have filed a preliminary application with ODOE before starting the project. The purpose of this was to ensure the BETC acted as an incentive for the energy project. This incentive control acts to validate the project is not already underway or completed, as would happen in a rebate program.

The BETC program allowed a waiver when the preliminary application was filed within 90 days after the project started. The examination noted 93 instances of waivers requested for projects. The waiver control process observed by the ODOE in project files was not well functioning:

- Some waivers were observed to have been denied, but then later overturned after an appeal by the project owner
- There are numerous questionable hardships accepted as waivers, as what constitutes a hardship was vague and open to interpretation
- Rarely was a waiver formally approved; rather, waivers are presumed to have been approved simply by virtue of the project having received a final tax credit
- Projects were completed prior to submission of the preliminary application
- Projects where work started in excess of the 90 days prior to submission of the preliminary application

[29] *MMINV309, MMPFC10469, MMPFC10835, MMPFC11609*

Projects Inoperable or Incomplete[30]

Statutes and rules provided allowances for the ODOE to revoke tax credits for project owners that have failed to construct or make projects operational. There are other problems with projects receiving a final tax credit and then becoming inoperable soon thereafter being sold off or dismantled. In addition, there are provisions applying to later project files, to revoke a tax credit when a facility may no longer be operational for 5 years after receiving a tax credit. However, the ability for ODOE to revoke a tax credit was limited in instances where the tax credit had been sold through the pass-through process.

Compliance deficiencies were seen in projects identified as being inoperable or incomplete, such as:

- Projects where the machinery or equipment purchased had not been installed, or had been installed but later dismantled, or sold off
- Projects where equipment had not been purchased as expected in the stated description of the project application
- Instances where projects occurred for businesses that filed for bankruptcy, went out of business, or ceased operations within the five years of receiving the tax credit
- Projects where the equipment or machinery may be inoperable at a worksite, or may be operable in a worksite unknown to the ODOE, or where equipment is operable at multiple locations undisclosed to the ODOE

CPA Attestation and Brokering Issues[31]

Certified Public Accountants (CPA) had dual opportunities within the BETC program. Projects with eligible costs of $50,000 or more were required to have a CPA attest to costs, including comparing invoices with paid expenses, and ensuring that all expenses were incurred after the preliminary date. However, CPAs also participated in the brokering of tax credits between project owners and pass-through partners. This created opportunities for conflicts of interest through the lack of duty separation. Various compliance issues were discovered through project files and data testing:

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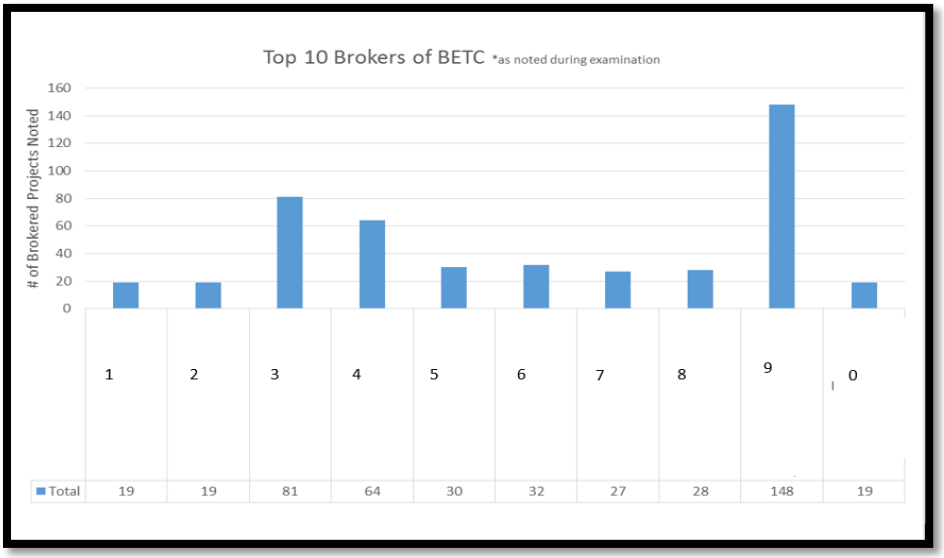
[30] *MMPFC11040, MMPFC11041, MMPFC12809, MMPFC13054, MMPFC12265, MMPFC12878, MMPFC13468, MMPFC10653*

[31] *MMINV266, MMPFC12182, MMPFC12181, MMPFC10246, MMPFC12649, MMPFC13149, MMPFC12303, MMPFC11809, MMPFC12950, MMPFC12057*

- Instances where the $50,000 CPA letter requirement was not enforced on costs for projects, including projects with the same project owner, and projects with file numbers in successive order and at the same worksite
- Projects where costs were modified seemingly to avoid the CPA attestation
- Situations where the ODOE does not have documentation as to which CPA attested to costs, because the attestation was accepted without a CPA name, just the name of the CPA firm, and sometimes the CPA name was illegible
- Project files that contained attestations for costs not on letterhead and there was no documentation theODOE verified the attester was truly a licensed CPA
- Instances of costs certified by the CPA that may not have been eligible, or may have questionably been eligible, or where the CPA had to rely on incomplete data to verify costs
- An instance where the project owner attested to costs in lieu of a CPA
- An instance of a project file that shows the CPA may have brokered a tax credit for less than present value

Favoritism of Intermediary[32]

Allegations were reported in the news media of possible favoritism of particular intermediaries brokering BETCs, between project owners and pass-through partners. For this reason, this examination made an especial attempt to track project intermediaries and CPA attesters, to demonstrate the landscape of brokers engaging in the BETC program. Interviews also occurred seeking information related to this matter.

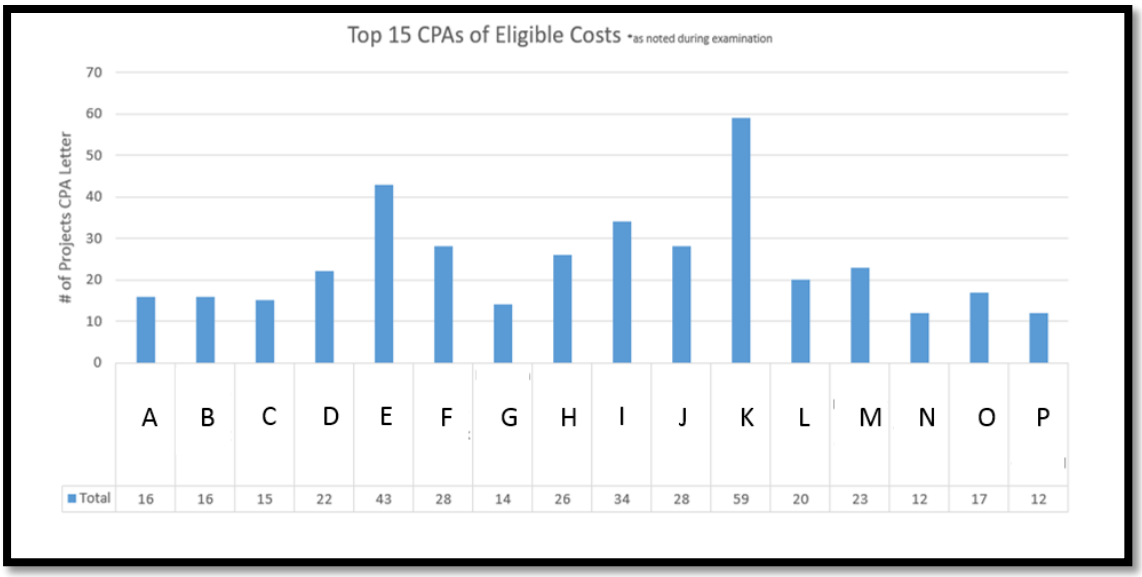


[32] *MMINV288, MMINV289, MMINV307, MMINV328, MMINT63, MMINT85, MMINT125, MMINT128*

According to examination data, Broker #9 was the intermediary most noted for brokering of BETCs, and it was noticed during the examination that #9 brokered tax credits for at least two tax firms, and possibly others. Broker #9 nearly doubled the number of BETC tax credits than the second highest intermediary #3.

Broker #0, who had been named in news media regarding energy tax credits, was of the three lowest top five brokers observed. This examination lumped Broker #0 with another tax credit brokering firm, since it was identified the two firms may have had crossover of employees. Based on information received during the interviews and data recorded of the top ten brokers, the findings did not substantiate favoritism towards the firm alleged.

All of the top ten tax-credit brokers are CPAs; of those, three CPAs were identified to have attested to project costs and brokered the final tax credit sale. The more ways a CPA engages with the project owner or transaction increases the opportunities for conflicts and separation of duty issues. It is concerning that with the CPA attestation of project costs, the ODOE did not require invoices and receipts from projects attested to by a CPA. There is opportunity for not eligible costs to be included as eligible costs. This process obstructs the ODOE from knowing what costs were considered eligible. Moreover, there is additional opportunity for CPAs who both attested and brokered the tax credit to inflate costs in favor of their client or to offset their billing charges to their customer(s).



Three firms overlap, when comparing the top 10 intermediaries with the top 15 CPAs attesting to eligible costs: Firm #K, Firm #E, and Firm #G that had Broker #9 on staff.

Additionally, Firm #F is one of the top 15 CPAs attesting to eligible costs, and, for several years they were a contractor for the BETC program with the ODOE. Firm #F assisted ODOE with the processing of pass-through transactions and provided tax credit program consulting. The contract for Firm #F was granted by the ODOE on February 21, 2007 with an end date through December 31, 2010.

During the interview with employees at Firm #F, they indicated their firm has separate duties for engagements they had with the BETC program. The business function for processing of intermediary payments between project owners and pass-through partners was different from the function to certify eligible costs, broker tax credits, and tax return preparation. Firm #F still had documents relating to the BETC program, and submitted these records for examination. When these documents were compared to BETC records, no red flags were observed. One of the documents Firm #F provided was a letter from ODOE to CPAs with instructions on who was permitted to certify project costs. In the letter, it describes only a CPA with a current licensed who is not an employee of the project owner is permitted to certify costs. This control was lacking, as the ODOE does not seem to have required the CPA be independent, free from any opportunities or perceived conflicts of interest.

Broker #0 stated in an interview that the allegations in news media about favoritism was the result of poor customer service and miscommunications between staffers at the ODOE. This had to do with the coexistence of the BETC and EIP programs, and the method used to broker the sale of tax credits. In at least one occasion, Broker #0 sought guidance from a prior ODOE manager for clarification of using the transfer process for selling tax credits. Broker #0 explained that “Once the BETC program was dismantled by the legislature and replaced with the EIP[33] program is when things got confusing in the marketplace for tax credit owners around how they could monetize their credits.” Broker #0 mentioned a specific project had been raised publicly as a concern, but “was simply an idea and the… proposal was to bring this idea into the public realm for direct discussion between the [project owner] and ODOE in order to get clarity around the rules for monetizing/selling EIP tax credits.”

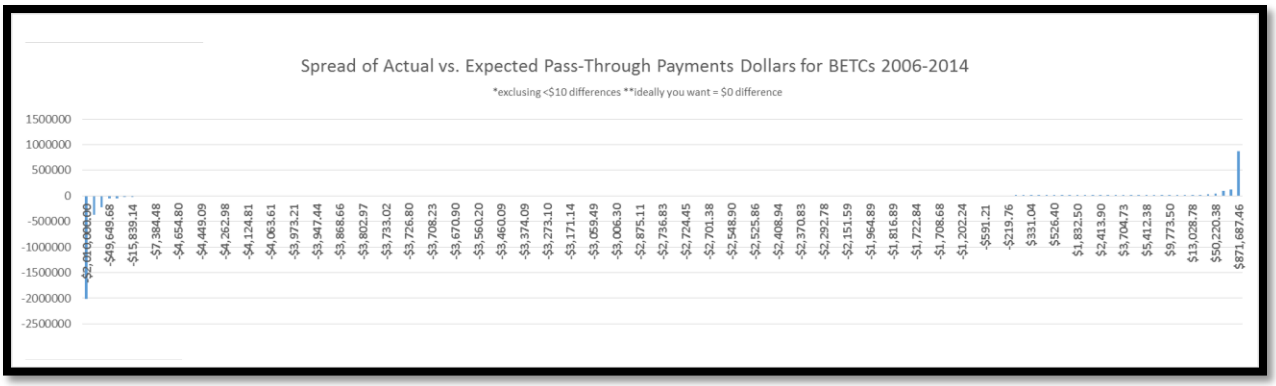
[33] The energy incentive program (EIP) was not in scope for this examination

In the interview with the prior ODOE manager, he recalls customer service being an area of improvement for the ODOE. The manager does remember hand-delivering tax credits on two occasions, but that was not for Broker #0. The manager said he hand delivered tax credits for upset participants in the BETC program to provide a better customer experience, and was able to do so conveniently on his way home from work. The ODOE manager described working with the ODOR to develop the transfer process, which was very similar to the pass-through process, but aligned more closely with ODOR needs. An ODOR employee recalls working with an ODOE manager, specifically on the tax credit changes, from the pass-through to the transfer process.

Pass-Through Transaction [34]

Statutes required ODOE to establish rules for net present value pass-through rates for BETCs. According to the rules provided by the ODOE, pass-through rates changed once, effective January 1, 2010. The net present value is the amount the pass-through partner should pay the project owner for their tax credit. The pass-through partner would then claim the tax credit on their Oregon taxpayers return. The ODOE oversaw the administration of the pass-through process.

ODOE database records on the pass-through payment amounts reflected rounding errors, as a single project file might have several pass-through partners. These small fractions of rounding cents add up over time. In reviewing a spread of differences in actual versus expected payments made for the pass-through of BETCs, a net negative $1,811,617.08 was discovered, meaning collectively there was more favorable money to the pass-through partner (discount) across all tax credits passed-through.



[34] *MMINV318, MMPFC12576*

The above illustration of the spread of actual versus expected pass-through payments for BETCs, shows three outliers on both ends of the spectrum, favoring pass-through partners on the left (discount) and favoring project owners on the right (overage). A review of the project file for the largest negative dollar outlier revealed that this project received an email from Broker #3 seeking to have one of the pass-through partner payments returned for $3 million, and that the remaining balance of the tax credit be issued directly to the project owner. According to the ODOE database query, no pass-through or transfer partner was recorded, and no documentation could be located in the file showing proof the project owner received payment for the tax credit, or that the ODOE issued a final tax certification. This situation appears to be the cause of the outlier detected in the illustration, but the record in the database was not updated to reflect the situation that had occurred.

Scope Objective 3 Investigation[35]

The investigation discovered circumstantial evidence that may imply improper conduct, pertaining to a specific number of the BETC projects reviewed. The Examiners have been instructed to refer BETC project file activity concerning possible statute violations to the ODOJ under separate cover.

The investigation included the totality of efforts made by the examination team to ascertain if evidence exists of fraud, waste or abuse. To support findings this examination relied on ODOE data, records, and project files; supportive written, video and audio material including legislative records, public records, emails, memos, and press reports; interviews with Legislators, current and former ODOE management and staff, other government agency staff, and participants in the BETC program. The Examiners sought sufficient and appropriate evidence to afford a reasonable basis to infer findings.

In summary, examination findings did not directly reveal intentional deceit of a fraud, but suspicious activity and red flags existed that may deserve additional scrutiny. Investigative efforts were driven by the possible impact and magnitude of issues. There were varying degrees of concern and red flags amongst all project types.

Examination findings are that certain project files could be construed as waste and abuse using the defined parameters of needless, careless, extravagant, excessive, wrongful, or improper. This seems to be symptomatic of lacking an adequate and effective controls and risk management program. A summary of problems that existed with files includes:

- Conceivable unnecessary foregoing of tax revenue
- Projects with limited benefits, assurances, or lifespan
- Incentives in exchange for a seemingly incommensurate return on investment
- Costs eligible for regulatory or mandated activities or operations
- Project outcomes perhaps with limited to no direct beneficial impact for Oregon
- Costs for projects presenting red flags of their relevancy
- Pressures and influences for decision making on projects
- Opportunities presented for conflicts of interest to possibly gain an advantage

[35] *MMINV234*

Ongoing Projects and Operating Costs[36]

This examination revealed eligible certified costs for ongoing operations of certain project types, in addition to projects that seemed to lack a formal completion or ending period. Instances of these operational costs were observed most prevalently in RD&D, transportation, and solar project types. While operational and ongoing costs were allowed in certain circumstances, they may be deemed as extravagant and excessive. Some examples include:

- Prizes (Example: hot air balloon ride with brunch, gift cards, etc.)
- Bad debt (line item of expense)
- Salaries and benefits
- Seminars and training
- Utilities (Example: electric, water, etc.)
- Mandated social services

Reoccurring projects and operational costs were for private companies, public companies, non-profits, and government entities. Most all ongoing and operational projects were observed to utilize the pass-through process, receiving a lump sum cash payment. A summary of concerns with this grouping of projects are:

- Project owners were identified as participating in the program year-after-year, possibly operating concurrently, or even running conflicting projects
- Participants receiving a BETC solely from operational costs which seemed to lack the quality of being an energy incentive
- Possibly project structuring intending to break up projects in a manner to be considered separate and distinct to be more favorable
- Projects that operated similar to a grant
- Projects having questionable results, direct assurances, or a return on investment
- National and multi-national conglomerates structuring complex financial arrangements for projects
- Projects with questionable direct Oregon benefits

[36] *MMINV302, MMINV309, MMINV250, MMPFC10194, MMPFC11432, MMPFC11434, MMPFC10460, MMPFC13717, MMPFC13769, MMPFC11930, MMPFC12155, MMPFC10660, MMPFC10703, MMPFC11449 MMINT24, MMINT33*

Influences and Pressures[37]

This examination revealed energy policy workgroups and task forces where opportunities for possible conflicts of interest existed. In addition, numerous projects revealed government officials, politicians, and private interests showed specific interest in project outcomes. This was problematic as influencers and pressures reduced the effectiveness of program controls, and in kind, the ODOE's ability to fairly and properly administer the program. Examples of where these issues seemed to have arisen were:

- Written endorsements by government officials, politicians, and special interests in project files seeking to influence the approval for a BETC
- Projects and companies where special attention was given to them because of particular interest groups and priorities external to ODOE
- Projects receiving a BETC where energy policy advisors were employed by the project owner, or may have been a project owner, project vendor, project contractor or sub-contractor, or pass-through partner
- Project owners expressing their interests or lobby through campaign contributions and influence on legislation or rulemaking

Comparing energy policy advisors and BETC project owners to contributors for both Governor campaigns for office reflected that at least two renewable energy companies donated $50,500 over five transactions made in 2010, 2012, and 2014. A Vice-Chair on the Governor's Oregon Energy Task Force worked for a company that contributed. The company for the Vice-Chair received at least $70,013,462 in BETCs that passed through for a lump sum cash payment. In addition, the other campaign contributor was related to a project site, which received BETCs upwards of $20,700,149, belonging to different project owners where most all opted for the pass-through option.

Comparing energy policy advisors to details in project files, a Co-Chair of the REWG who was also a Leader of the Oregon Energy Task Force, had communicated with ODOE about BETC projects. This is concerning as there may have been opportunities for conflicts of interest for energy policy advisors engaging with the BETC program in supporting capacities, such as vendors or contractors.

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[37] *MMINV19, MMINV29, MMINV227, MMINV232, MMINV237, MMINV239, MMINV250, MMINV264, MMINV267, MMINV269, MMINV273, MMINV293, MMINV294, MMINV295, MMINV301, MMINV325, MMINV326, MMINV327, MMINV330, MMINV332, MMPFC12576, MMPFC12705, MMPFC10306, MMPFC12303, MMPFC11808, MMPFC11809, MMPFC11889, MMPFC10077, MMPFC11164, MMPFC12688, MMPFC10818, MMPFC12284, MMINT4, MMINT7, MMINT9, MMINT14, MMINT17, MMINT20, MMINT23, MMINT24, MMINT30, MMINT32, MMINT33, MMINT37, MMINT42, MMINT43, MMINT44, MMINT50, MMINT60, MMINT61, MMINT63, MMINT76, MMINT87, MMINT119, MMINT128, MMINT129, RULES 2009 and 2010 Public Comment*

ODOE Response to Program Problems

Attempts were made by ODOE to seek assistance with possible fraud, waste and abuse related red flags, as well as other program vulnerabilities. Nevertheless, efforts were futile because of pressures on the BETC program to be a driver of clean energy expansion and economic growth in an economy desperate for jobs. Examination findings are that energy goals were high aiming and impacts underestimated.

Some examples of efforts the ODOE took in response to program problems were:

- Timely communication by ODOE staffers and management to persons of authority about concerns with the BETC program
- Continuous pressure by ODOE to seek legislative changes to add controls to the BETC program
- Reacting and responding to Legislative and Gubernatorial directives
- Numerous changes to BETC rules to add clarification and sideboard to the program administration
- Change management efforts to refine and reshape the operations of the organization to be better equipped to manage risk enforce compliance
- Sought advice of legal counsel

When the BETC legislative expansion was first introduced the revenue impacts from the tax credit incentives were underestimated. BETC revenue impacts were 3511% above original projections by 2008, for the 2007-2009 biennium. According to ODOE management interviewed as part of this examination they recall immediately taking actions to report the fiscal impacts to appropriate government offices. Memos, letters and testimony given by ODOE support statements about reporting program problems to appropriate authorities.

On February 19, 2009, Director Grainey testified in front of the House Revenue Committee about the revenue impacts of the BETC program. In prepared testimony, the Director indicated just 23 BETC projects accounted for 75% of the revenue impact. The Director then offered several risk-mitigation and revenue impact-reducing measures for the Revenue Committee to consider for legislation. These recommendations by Director Grainey were similar to language proposed in HB 2472 that the House Revenue Committee sponsored, Legislators passed, and Governor Kulongoski vetoed.

Also on February 19, 2009 Director Grainey contacted Governor Kulongoski's Energy Advisor, and proposed the same risk mitigating and revenue impact-reducing measures:

- Require 5 years of facility operation
- Consider job creation with the project application
- Require applicant to be in compliance with ODOR requirements
- Authority to combine multiple projects into one tax credit application
- Require closer ties to Oregon for power production

Director Grainey also contacted the Legislative Revenue Office on February 23, 2009, regarding "Options for reducing revenue impacts from large BETC projects." In this memo, the Director proposed similar risk-mitigating and revenue impact-reducing measures, slightly changed to only affect large projects of $5 million or more:

- Ability to revoke tax credit for the full amount of the credit
- Consider jobs and economic development, whether the credit is necessary to complete the project, and revenue impacts compared to expected benefits
- Require compliance with local licensing requirements
- Performance contracts for tax credits in excess of $5 million

By March 13, 2009, Director Grainey had also sent a memo to the Chair of the Senate Revenue Committee and Chair of the House Revenue Committee outlining the revenue impact reduction measures being proposed.

In an interview with Director Grainey, he indicated around March 11, 2009 he met with Governor Kulongoski regarding the revenue impact reduction measures being proposed. To corroborate this meeting, Director Grainey referenced an email dated March 11, 2009, from the Governor's Energy Advisor, which showed the Governor wanted to meet and discuss the BETC. In this meeting, the Director recalled that the Governor did not want any reduction of the BETC incentives. The Director explained that his understanding was the Governor felt it was important to not rollback or add sideboards to the BETC program.

Two months after meeting with Governor Kulongoski about the BETC reductions, Director Grainey stated he was given 24 hours' notice to resign and "wasn't given a reason why he was asked to leave" by the Governor's Office. Consequently, the Director says he drafted his resignation letter dated May 14, 2009. According to Director Grainey, about a year after his resignation, he happened to have a discussion

with Governor Kulongoski about his resignation. The Director explained the Governor told him the reason for the resignation was because of “complaints from Legislators,” who “didn’t like the direction you [Director] were going.” The Director stated the Governor’s reasoning felt “puzzling and odd,” because he was asked to transfer and work for another State Agency.

In an interview with a prior ODOE Assistant Director, she corroborated some of the Director’s recollections of this period, saying when she saw the “huge” 2009 revenue impact statement she immediately went to Director Grainey. The Assistant Director stated she was invited to talk about revenue impacts when the Revenue Committee met in 2009. The Assistant Director remembers the committee decided to write a bill to reduce the BETC revenue impacts, which the Governor had vetoed. The understanding of the Assistant Director for why the bill was vetoed is because the Governor did not want to decrease the BETC incentives.

When Director Grainey was asked to resign, it was in the period leading up to and in the midst of the 2009 Legislative Session. By May 2009, Director Long was appointed by the Governor and transferred to the ODOE from another State Agency.

On August 26, 2009, Governor Kulongoski addressed a memo to Director Long stating, “The BETC program has proven to be an effective tool to accelerate the growth of Oregon’s green economy which has created much needed jobs and invaluable benefits for our environment.” The Governor goes on to explain the reason for his veto of the bill was that “We need to study the economics of energy projects before we make significant adjustments to our program.” The Governor reinforced his position to “align incentives with policy outcomes we want to achieve.” The directives given to Director Long resulting from this memo was to “study and implement BETC rule changes for the following areas,” quite similar to the risk-mitigation controls proposed by prior Director Grainey and in the bill that was vetoed:

- Single versus multiple facilities, which later does get put in the rules as Separate and Distinct criteria
- Ensuring Oregon permitting and licensing laws are complied with, which resulted in project files containing such documents
- How job creation and terms for facilities are handled, becoming noticeable in changes to the application that questions the number of jobs created and a 5-year in-operation requirement

- Handling of RD&D projects and cost overruns are addressed, which led to an RD&D committee, and elimination of the 110% overage cost eligibility
- Giving discretion for Director Long to take necessary steps to clarify the BETC rules and provide consistency

In an interview with a prior Energy Policy Division Administrator tasked with addressing the various issues outlined by Governor Kulongoski in 2009, she recalled Director Long asked her to join the ODOE to “create a policy shop”. The Division Administrator explained the Director’s vision was to create a work unit at the ODOE specifically for policy and rulemaking. According to the Division Administrator, the Governor had given her an “unrealistic deadline” to accomplish the directives laid out. She explained that her delegated tasks were direct from the top “priority one rules,” where she spent “many nights working until 2am.”

In a letter dated November 17, 2009, Governor Kulongoski wrote to Director Long, with another statement for why he vetoed the bill that would have added risk-mitigating statutes to the BETC program. The Governor said, “the state was facing rapidly declining revenue… I was not willing to take this economic risk without the information necessary to ensure economic losses, and job losses, would not follow.” Governor Kulongoski goes on to clarify, “My veto was never intended to shut the door on this issue or this important public policy debate.” The Governor concluded his memo with a directive that he “would like an interim review of the BETC program as it is applies to large scale renewable energy generation facilities,” expecting recommendations for the upcoming February 2010 Legislative Session.

BETC Rulemaking Process & Challenges

During interviews, various ODOE staffers described a collaborative process for rulemaking up until about the 2009 / 2010 timeframe. Prior to 2009, Director Grainey explained his management style was running the Agency based on a team approach. An ODOE employee for energy incentives also explained rulemaking had been a team atmosphere, but after 2010, only certain people were involved.

The Energy Policy Division Administrator responsible for rulemaking changes explained she isolated herself for the transition period between 2009-2010. The Division Administrator was brought in and delegated with undertaking a review of existing rules and their conditions, and created rule changes in a short timeframe. The Division Administrator said she aimed to add common sense sideboards to the program.

An ODOE Policy Analyst said he helped produce a bill analysis report about what the Agency felt should happen in the 2010 Legislative Session to sunset the BETC. He recalls the report was challenging because the sunset posed hardship. People had built businesses and reliance for continued work from the BETC incentives. The ODOE staffer described the sunset of BETC was to change the revenue impact, and he remembers doing lots of research trying to give advice for Legislators to write a good bill.

A prior BETC project Inspector remembers that during the emergency rulemaking session in 2010, she assisted rule makers to ensure ODOE met legislative requirements and stakeholder needs, while trying to scale back and rollback the program.

The rulemaking process during 2009 and 2010 was described by ODOE staffers as being hampered because ODOE had been split into two office buildings in near proximity. With the energy incentives staffers located in the annex (satellite) office, and policy and rulemaking staffers located in the main building. A prior BETC Program Manager anecdotally said it felt to some like “you got annexed to the annex.” The manager attributed the building separation caused problems because the incentives team lost their “internal rulemaking support… lost communications in the different buildings.” An ODOE energy incentives processor stated being in the satellite office meant “policy people were out of hand’s reach.” Moreover, an ODOE Technical Lead also described the “different atmosphere” at the annex, and that the “annex changed the culture a lot… quality people left”.

Another BETC program manager explained Director Grainey “had been hands off with policy” and then Director Long “came in and made changes that upset some people that had been there [ODOE] a long time.” This manager summarized the workplace issues at ODOE as being change-management related.

Many ODOE employees described the period leading up and through the 2010 Legislative Session and sunset of BETC as unbearable. Both management and staff regularly articulated in interviews, and corroborated incidents, of direct conflicts, disagreements, and the feeling of turmoil while working at ODOE. Both ODOE management and staff recalled the use of improper nicknames, terms, and phrases used in the office. Consistently ODOE employees used strongly worded glorified language to describe the turbulence of culture changes at the agency and the strain on office morale. ODOE management and staffers explained the agency approach and turnover was challenging, some expressed concerns in exaggerated words to articulate

practices they felt were unfair and wrong. One lawmaker hailed this same period, and described the change management activities as “absolutely incredible”.

ODOE Handling of BETC Restrictions and Sunset

By the next Legislative Session in 2010, however, Director Long had resigned from his position. According to a press release on April 23, 2010, at the request of the Governor Kulongoski, Director Long had accepted a one-year appointment to review and propose changes that improved the transparency and accountability of the BETC program.

Governor Kulongoski appointed Interim Director Repine from within the Agency. Interim Director Repine explained in an interview there was a “cleansing” when the prior ODOE Director had taken over, but that it was “not uncommon for new Directors to make changes.” In addition, the interim Director indicated he had a previous working relationship with the Governor in other capacities. He commented on his lengthy experience in State government positions, and that the Governor was the “champion of the [BETC] program.”

Interim Director Repine indicated he had similar goals as prior Director Long, to evaluate the program and to “create better parameters,” and recalled spending an “enormous amount of time” doing so. The Interim Director anecdotally explained that the 2007 and 2008 BETC program period was a “gold rush,” and there were “101 ways to get a BETC.”

During an interview with a prior ODOE Division Administrator, she recalled implementing risk-mitigating controls into the BETC program; first as rules, and then as statutes that eventually closely aligned with rules. This Division Administrator indicated that prior to 2010 the goal was to “get as much energy savings in Oregon as possible,” because in her estimation the Governor “had broad statements on energy policy.” According to the Division Administrator, HB 3680 scaled back the BETC program and considered energy benefits with costs of projects. She recalled the bill added “sideboards,” followed by several rulemaking changes that posed “difficult and contentious” problems for BETC applicants who already had preliminary certificates and projects in progress. The Division Administrator surmised some applicants were after “entitlements” and explained her understanding was when the BETC program “started it had no standards for denial.”

It was during this period of constricting the BETC program from 2010-2011 that Governor Kitzhaber followed Governor Kulongoski in office starting January 10, 2011.

New legislation passed that required the sunset of BETC and for the ODOE and ODOR "to conduct an auction of tax credits" with net funds benefiting the Clean Energy Development Fund (CEDF). The CEDF is a distinct account separate from the State General Fund, and the "Moneys in the fund are continuously appropriated to the State Department of Energy… to provide grants and loans… or clean energy projects in this state." This may mean that tax credits issued to forego future revenue in the State General Fund were sold with benefits going to the CEDF.

The BETC and EIP programs ran concurrently at the ODOE, which seemed to have caused confusion for the marketplace. A FAQ document put forth by the ODOE dated July 15, 2011 says the EIP program is "formerly" the BETC program. The FAQ document seems to have been issued prior to the passing of the bill that created the EIP program two months later in September 2011. This seemingly early announcement of the EIP, the differences yet similarities between the BETC and EIP, and their overlapping operations, caused confusion for the applicants and tax credit brokers participating in the programs.

The final years of the BETC program were between 2012 and its sunset by July 1, 2014. Preliminary certifications ceased for BETC renewable energy using and producing facilities and for conservation projects. Project owners received mailers and notifications of the programs sunset dates and reminders to turn in proof of costs and final applications. By the end of December 2012 BETC project owners with outstanding final certified amount letters were issued sunset tax credits, with a stated and established value for use as a tax credit or if transferred in a sale. Sunset tax credits for projects were issued until July 2014.

FINANCIAL IMPACT

Examination Assessment of Financial Impact

The forensic review of the project files revealed various degrees of concern. This financial impact assessment specifically targeted BETC projects that seemed to be improper, violated statutes, or rules, or exhibited suspicious activity. These projects are of concern because they demonstrated the following characteristics:

- Direct conflicts of interest
- Projects that were never operational
- Businesses that closed or went out of business
- Indistinguishable, missing or suspicious eligible cost documents
- Projects with unaccounted for equipment
- Brokering conflicts and intermediary issues
- Illogical or contradictory projects
- Red-flags that may imply improper conduct

These calculations have excluded projects with certified operational expenses.

This financial impact assessment is solely an estimation of projects of concern based on findings from this examination.

Project files over $1 million in Certified Project Costs

This examination included a review of 311 of 320 project files with certified costs of $1 million or more. Of the 311, there were 79 projects, or 25.4%, flagged by the Examiners as exhibiting at least one characteristic of concern. The majority of projects in this stratification were wind and biomass project types.

Concerned Project Dollars ***$1 million and over***		
Concern File Percentage	Certified Project Costs	Tax Credits Issued
25.4%	$704,570,983	$339,883,549

The examination included a review of 97.18% of projects with certified costs of $1 million or more, almost the entire population of projects in this stratification.

Project files under $1 million in Certified Project Costs

For projects sampled that were under $1 million in certified project costs, there were 86 files out of 3,150 projects with concerns. Findings are that 2.7% of the projects under $1 million were concerning.

Concerned Project Dollars ***under $1 million***		
Concern File Percentage	Certified Project Costs	Tax Credits Issued
2.7%	$17,631,173	$7,395,881

Top 4 Project Types of Concern

Projects of concern vary amongst project types. The top four types of projects with concerns are biomass, RD&D, solar and wind. These charts below reflect the total concerned dollars reviewed during the examination segmented by project type.

Top 4 Project Types*: Concerned Certified Cost Dollars						
	< $100k	$100k - $500k	$500k - $1m	> $1m	Total Dollars	Total Projects
Biomass	$218,424	$621,514	$851,624	$111,209,511	$112,901,073	22
RD&D* **	--	$813,606	$3,975,557	$64,684,385	$69,473,548	22
Solar	$189,234	$6,389,351	--	$107,079,669**	$113,658,254	39
Wind	--	--	--	$350,023,655	$350,023,655	20

*Project types are from ODOE Fox Pro Platform database column "system"
**Two solar projects manually calculated as the ODOE Fox Pro Platform database were blank in the project type column
***Includes both RD&D renewable and RD&D non-renewable

Top 4 Project Types*: Concerned Tax Credit Dollars					
	< $100k	$100k - $500k	$500k - $1m	> $1m	Total Tax Credit Dollars
Biomass	$107,917	$239,966	$298,068	$53,952,598	$54,598,549
RD&D* **	--	$334,457	$1,526,024	$27,063,243	$28,923,724
Solar	$94,617	$3,194,678	--	$53,539,837**	$56,829,132
Wind	--	--	--	$175,011,827	$175,011,827

*Project types are from ODOE Fox Pro Platform database "system"
**Two solar projects manually calculated as the ODOE Fox Pro Platform database were blank in the project type column
***Includes both RD&D renewable and RD&D non-renewable

Total concerned dollars in the BETC program

Based on the examination findings of projects of concern, percentages were distributed among the population of projects receiving a final tax credit. These total concerned dollars are an estimation based on findings during this examination.

Extrapolated dollars across the population of projects provides a financial assessment of the total dollars of concern for BETC projects under $1 million in certified costs. This seems reasonable as the examination included a sampling of projects under $1 million with a 99% confidence level with a 2.03% confidence interval. The non-extrapolated dollars are inclusive of the entire population of projects for $1 million or more in certified costs, which equates to 97.18% of the population reviewed durin the examination.

There were 14,494 projects in the population, of which 14,174 had certified costs under $1 million, and 320 had certified costs over $1 million in the examination. Sampled projects under $1 million consisted of 25.28% of total projects in the population. Of those projects under $1 million, only 2.7% had concerning findings; and when extrapolated across the population, it resulted in an estimated $7,188,681 of concerned tax credits. For projects over $1 million, 97.18% of the population was reviewed in this examination with 25.4% noted to be of concern.

Extrapolated Dollars						
Final Certified Project Cost*	Population*	Population Dollars*		Concerned Dollars		Reviewed
		Certified Costs	Tax Credits Issued	Certified Costs	Tax Credits Issued	Percent of Population
Less than $100K	12570	$210,421,373	$76,381,910	$5,681,377	$2,062,311	25.28%
$100K to $500K	1332	$303,977,932	$116,616,498	$8,207,404	$3,148,645	
$500K to $1M	272	$191,906,514	$73,249,087	$5,181,475	$1,977,725	
Non-Extrapolated Dollars						
$1M and over	320	$1,700,541,021	$772,959,061	$704,570,983	$339,883,549	97.18%
Totals						
Total	14,494	$2,406,846,840	$1,039,206,556	**$723,641,239**	**$347,072,230**	

*Population dollar data origination is from ODOE Fox Pro Platform database

FINDINGS

SCOPE OBJECTIVES		FINDINGS
1	CONTROLS	Controls are partially functional and mitigate risks to a limited extent
2	COMPLIANCE	Controls are not adequate to ensure compliance with rules or laws
3	INVESTIGATION	Circumstantial evidence of suspicious activity exists

Overall Findings[38]

Governor Kulongoski's legacy on renewable energy, REAP and REWG, spurred legislative changes to the Business Energy Tax Credit (BETC) program from 2007 until the sunset of the program in 2014. The changes to BETC brought about renewable energy expansion in projects and manufacturing, investments in clean energy technology, and conservation projects, aimed at energy savings in a comprehensive way, touching expansive industries throughout Oregon.

The height of the BETC program during this period was in the middle of an economic downturn, and the BETC aimed to incentivize businesses to conduct energy saving projects, with the goal of ultimately creating jobs and stimulating the economy. In these pursuits, speculation and estimations about the BETC revenue impacts on Oregon's State General Fund were drastically underestimated. The inherent risk of the poor economic situation applied pressures to the BETC program controls, making the program vulnerabilities and deficiencies especially exploitable. Advertising of "lump sum cash payments" for project owners who complete BETC projects utilizing the pass-through option, would have been enticing and alluring for nefarious activity.

Yet, there were no complete lines of defense in place at ODOE, such as a risk management program, internal audits for BETC, proactive fraud detection, or other measures to capably and effectively mitigate risks. Weaknesses in the BETC program controls became apparent with the rush in volume of BETC projects. ODOE staff were overwhelmed with production-based work of processing applications as quickly as possible to meet statutory timeline requirements. Rushing production and inadequate staffing at the ODOE for extended periods of time were systemic to compliance and quality control problems noted during this examination. Moreover, the BETC program

[38] *MMINV3, MMINV10, MMINV11, MMINV12, MMINV16, MMINV255, MMINV271, MMINV278, MMINV283, MMINV23, MMINV218, MMINV222, MMINV223, MMINV227, MMINV239, MMINV245, MMINV246, MMINV247, MMINV263, MMINV264, MMINV267, MMINV269, MMINV233, MMINV301, MMINV304, MMINT4, MMINT20, MMINT23, MMINT24, MMINT37, MMINT60, MMINT119, MMINT126, MMINT128, MMINT129, MMPFC11807, MMPFC12705, MMPFC10818, MMPFC10819, MMPFC11808, MMPFC11809, MMINV264*

staff seemed to have lacked the especial financial savviness necessary to administer a high-dollar and high-exposure tax credit program. Key individuals having some form of financial background were relied upon too heavily in this capacity. No specific ODOE employee was identified as having risk management experience.

When the time came for Legislators to rein in the BETC program it was already exploited so extensively it was referred to by ODOE employees as “the political hot potato.” The ODOE management and staff turned over several times leading to a lack of institutional knowledge compounding the challenges felt within the program. Trying to add controls and mitigate so many different risks all at once caused strain on the existing program. When the ODOE was taking public comment on rulemaking changes of controls proposed to the BETC program, there was a heightened public response against proposed controls for fear of having economic impacts. In addition, Governor Kulongoski’s memo to the ODOE Director regarding the vetoed bill stated the Governor was concerned of economic impacts.

There was also public interest spurred because the program became a hefty impact on revenue for the State General Fund. The BETC was not only used as an incentive for energy savings, but a stimulus to spur growth in the economy. Conglomerates, domestically and internationally took advantage of the financial incentive by selling the tax credit in exchange for a lump sum cash payment. Conglomerates without an Oregon tax liability would sell their BETC to an Oregon taxpayer purchasing the credit for their tax return.

During the height of the program, lawmakers had an influence on the project outcomes, reflected by endorsements found in BETC project files. At the time, lawmakers made extensive changes to the BETC program. When project owners had problems or received unfavorable responses from the ODOE, they lodged complaints to their Legislators, who in turn complained to the Governor. Both Governors Kulongoski and Kitzhaber had stringent and high-aiming clean energy goals, which at times were in conflict with the ODOE recommendations.

As the Governor is the head of the State, ODOE is obliged to comply with the Governor’s directives. The Governor’s vision was embedded in the decisions ODOE staff were making on project files. The ODOE made wide sweeping approvals of BETC because of the goal to become a nationwide and global leader in clean energy. Wind, solar, fuel cell, biomass, weatherization, transportation - all of these industries were thrown money at and incentivized. Many, however, went out of business (some with

investors), sold out of Oregon, or never truly had direct ties to Oregon to begin with. Pressure to approve these progressive projects, which relied heavily on BETC funding, led to the financial burden on State fiscal revenue.

In totality, the BETC program had limitedly functioning controls, compliance with controls was not functioning well, and circumstantial evidence of suspicious activity was present.

RECOMMENDATIONS

Following recommendations from this examination do not provide assurance that fraud does not or will not exist. Having completed these examination steps the ODOE may consider strengthening its risk management practices. The following are suggestions the ODOE may consider based on the report findings:

Recommendations for Future Energy Tax Incentive Programs

- Consider a qualified risk and compliance officer, whose sole function is to oversee risk and compliance at the Agency
- Evaluate workflow compared to staffing levels on a regular basis to ensure adequate staffing. Hire/Appoint staff with the unique and adequate skills necessary to perform position requirements, such as managerial, financial risk, engineering, and energy experience.
- Seek to participate in or form a committee, meeting regularly in a roundtable fashion to discuss trends, topics, concerns and best practices regarding risk as it relates to tax credits, frauds, and schemes.
- Establish a financial crime compliance program and, at minimum, perform quarterly prevention and detection measures. Any red flag should immediately be reviewed for site inspections and other preventive measures.
- Eliminate rubber-stamping of documents and approvals; prohibit the use of whiteout and other forms of document manipulation.
- Reconsider accepting complex financial arrangements as proof of payment for a project. At minimum, require these to be put through an additional due diligence process conducted by a qualified risk or legal professional, or both.
- Implement controls on the services of CPAs. Randomly conduct examinations and audits on CPAs attesting to projects. Require the CPAs to furnish all material used to attest to the eligible project costs to determine accuracy in their reporting. Implement rules around CPAs, including a rule to prevent the same CPA firm from attesting to project costs and brokering tax credits. Create a CPA verification process.
- Continue to perform site inspections using random and risk-based approaches.
- Require energy incentive project owners to maintain original wrapping or packaging of materials for jobs, as additional proof of purchase, and consider auditing as needed.
- Perform an annual internal audit and risk assessment of energy incentive programs

- Encourage legislative bodies to provide the agency with statutory recourse authority when there are improper incentive tax credit claims, such as:
    - Criteria for when civil recourse options should be considered
    - Situations when it may be appropriate to seek liens on property or assets
    - When repossession of the assets from the project may be viable
    - Ability to establish a repayment program
    - Amnesty period for self-disclosure of errors or omissions resulting in a minimal penalty
    - Disqualification for those found to be improper from engaging in another energy tax credit program for life

Recommendations for Possible Action

The ODOE should consider enforcing any existing performance agreements for BETC credits outstanding. Furthermore, the ODOE may find it beneficial to seek out and assess projects failing to be operational for 5-years for possible revocation of the tax credit based or other options per ORS 469.205(2)(a)(O)(b) and 469.225(1)-(2).

ENCLOSURE

The Oregon Audit Division will receive one printed copy of the Report of Findings, as well as an electronic storage thumb drive containing the electronic version of the Report of Findings and all accompanying memoranda during the exit meeting.

Thank you,

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Memoranda

- Project Investigation Log (MMPFC)
  Investigation Worksheet
- Project Control Log (MMCL)
  Sampling Worksheet
- Program Control Matrix (CM)
- Risk Matrix (RM)
- Evidence Control Log (MMINV)
  Documentation, Files, Notes, Records, and Tests
- Interview Log (MMINT)
  Contacts Made for Interviews
- Project File Scans (BETC)
- Rulemaking Scans (RULES)
- Interview Working Papers (Paper)
- Physically Collected (Paper)

Glossary

ACRONYM REFERENCE
BETC BUSINESS ENERGY TAX CREDIT
CEDF CLEAN ENERGY DEVELOPMENT FUND
CPA CERTIFIED PUBLIC ACCOUNTANT
EIP ENERGY INCENTIVES PROGRAM (AFTER BETC SUNSET)
HB HOUSE BILL
IGA INTERGOVERNMENTAL AGREEMENT
OAD OREGON AUDITS DIVISION
OAR OREGON ADMINISTRATIVE RULE
OBDD OREGON BUSINESS DEVELOPMENT DEPARTMENT (BUSINESS OREGON)
ODOE OREGON DEPARTMENT OF ENERGY
ODOJ OREGON DEPARTMENT OF JUSTICE
ODOR OREGON DEPARTMENT OF REVENUE
ORS OREGON REVISED STATUTE
RD&D RESEARCH DEMONSTRATION & DEVELOPMENT
REWG RENEWABLE ENERGY WORKING GROUP
REAP RENEWABLE ENERGY ACTION PLAN
S&D SEPARATE AND DISTINCT FACILITIES
SELP STATE ENERGY LOAN PROGRAM
SOS OREGON SECRETARY OF STATE OFFICE

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