



Oregon

Kate Brown, Governor



OREGON
DEPARTMENT OF
ENERGY

625 Marion St. NE
Salem, OR 97301-3737
Phone: (503) 378-4040
Toll Free: 1-800-221-8035
FAX: (503) 373-7806
www.Oregon.gov/ENERGY

September 3, 2015

Gary Blackmer
Director, Audits Division
Office of the Secretary of State
255 Capitol St. NE, Suite 500
Salem, OR 97310

Dear Mr. Blackmer:

Thank you for your September 3, 2015, letter detailing steps the Office of the Secretary of State has taken to follow-up on a hotline call about Oregon Department of Energy tax credit administration. We appreciate your review of our energy tax credit programs and our administrative practices.

The Oregon Legislature established energy tax credits to support renewable energy development and energy conservation. For more than 35 years, the Oregon Department of Energy (ODOE) has been charged with overseeing programs that approve, certify, and inspect energy projects and with issuing corresponding tax credits.

ODOE's Business Energy Tax Credit (BETC), while encouraging investment in thousands of energy projects across the state, was besieged by problems. These problems did not materialize overnight. Issues accumulated over the years and are still being dealt with today, hopefully in ways that demonstrate our commitment to improving our practices and restoring our agency's credibility. More simply put: where we find problems, we fix them. And that is the situation we found ourselves in with regard to sales of energy tax credits.

Your findings lay out some of the pressing issues, including inconsistent understanding among staff of ODOE administrative rules and related agency program goals; inconsistent communications to stakeholders; and poor program tracking. I would add to that list broader issues with ODOE tax credit programs: inconsistent data, lack of certainty for entities currently pursuing energy projects, and a history of the department not ensuring that staff practices match agency rules, and vice versa.

On this last point, earlier this year, our agency embarked on a rulemaking intended to clarify ODOE rules so that they better reflected the department's practices and the options available to tax credit-holders. We were motivated by several factors. First, our rules and our business practices need to be aligned. Second, we wanted to ensure those public and private entities that have applied for tax credits for projects that are in various stages of development, likely informed by inconsistent programmatic information from ODOE, have the flexibility they expected from the state's investment in their projects. Third, we had to address confusion within the agency about how our programs worked. Our decision to move forward on a rulemaking has since garnered media attention and perhaps prompted the hotline

call to your office. We have seen the issue become conflated with other facets of the Business Energy Tax Credit program and the agency's admittedly troubled past.

Your letter provides a concise overview of how energy tax credits work. Some of the feedback we have received during our rulemaking process implies that energy tax credits cannot be sold, are only available to a select few to purchase, or that the sale price of the tax credit affects the impact to the general fund. Project owners have a variety of financial reasons for choosing to sell their tax credits. Anyone with a tax liability in Oregon may buy a tax credit, or a portion of a tax credit, to offset their liability. Tax credits for energy projects are available for purchase, and the state of Oregon also sells tax credits via auction. Whether a tax credit is used to offset a tax liability or monetized in the form of a purchase to a third-party, the effect on the state's general fund is exactly the same.

It has also been asserted that these tax credits exist only for the benefit of the end purchaser. That's simply not true. Energy tax credits exist to help spur investment in renewable energy and energy conservation. The resulting projects provide a public benefit in the form of renewable energy production and/or energy savings, not to mention other benefits like reduced greenhouse gases, job creation, and in-state energy resources.

Much of the feedback received during our rulemaking illustrates the complexity of tax credit programs in general, and ODOE's programs in particular. We provided background material at our August 25, 2015, rulemaking hearing in an attempt to describe the options available to energy tax credit holders.

Project owners have three options:	Tax Incentive Amount	Sale Price of Credit	General Fund Liability
Take possession of tax credit and use it to offset their own tax liability, generally over a period of five years.	\$1 million to the project owner	Not applicable – no sale	\$1 million
Seek ODOE assistance in finding and selling the credit through pass-through program to a third-party.	\$1 million to the purchaser of the tax credit	Determined by the discount rate ODOE sets at the time of preliminary certification (BETC) or project application (EIP)	\$1 million
Take possession of tax credit, then sell it to a third party independent of ODOE involvement. In this case, the project owner must report the transfer of the tax credit, and the price paid for the credit, to ODOE before the credit is reissued to the third-party.	\$1 million to the purchaser of the credit purchaser	Negotiated privately between the project owner and the third-party buyer	\$1 million

As simple as the above chart is, ODOE's programs, particularly the Business Energy Tax Credit program, became increasingly complex from 2007 on, and the changes and nuances were not fully understood or explained consistently by staff. This in turn affected stakeholders, who may not have had the same understanding of agency practices and rules. Beginning in 2011, the agency moved forward on new practices without updating corresponding rules. In 2011, ODOE was challenged in court by a tax credit holder on the issuance of a final tax credit. The legal challenge prompted conversations internally and with the Oregon Department of Revenue on whether ODOE had the authority to enforce a particular

sale price when the sale was negotiated without ODOE involvement. The decision at the time was that project owners could take possession of their tax credit, and then sell it independent of ODOE involvement so long as it hadn't already been sold or used.

This "transfer" option offered flexibility to project owners. In many cases, it was also a quicker option. Three or four years ago, the huge volume of BETC applications waiting to be sold through a department-administered program called "pass-through" meant some sellers might wait years to find a buyer. Being able to negotiate the sale of the credit on their own was preferable to some project owners.

However, the department's reasoning at the time was also practical: by statute, ODOE was required to issue all tax credits remaining as the Business Energy Tax Credit program moved toward its sunset. This meant that project owners who were working with the department to find a buyer for their credit would have no choice but to take possession of the credit and look for a buyer on their own. Further, management at the time decided that though the agency established a rate for tax credit sales administered by ODOE, the agency did not have the authority to define the price for a negotiated sale directly between a tax credit holder and a third-party buyer.

ODOE sent letters with basic information on this transfer option to all affected project owners leading up to the BETC sunset. However, the agency did not update rules to be more specific, nor are we sure the agency communicated consistently with project owners or their respective representatives. This led to confusion, and also to the same problems being replicated in the program that followed BETC, the Energy Incentives Program. The 2015 recent rulemaking was an attempt to begin to remedy this long-standing issue.

ODOE tax credit programs have seen numerous changes over the years – with changes in statute, rule, program administration, and ODOE personnel, all of which contributed to inconsistent program management and implementation. Just in researching this issue, we found examples of incorrect rates being issued as the BETC statute changed, and after the transition from BETC to the smaller Energy Incentives Program. Under BETC, tax credit sale rates were issued to project owners when the owners received their *preliminary certification*; under EIP, rates are set at the time of *project application*, but it's unclear if staff were made aware of the difference. For tax credit sales specifically, despite recurring staff meetings on the subject in 2012, the department did not administer the program consistently or update its rules.

The decision to update our rules in 2015 was an attempt to clean up the inconsistency between what the agency allowed leading up to and immediately following the BETC sunset, and what the rules implied. Though ODOE's data is historically problematic, when we look at BETC projects back to July 1, 2012, on average, we see that those projects that were "transferred" sold at slightly higher prices than those projects brokered by the Oregon Department of Energy. The reasons for this relate to the department's formula for establishing a pass-through rate and the market conditions both at the time the rate was set and when the tax credit was sold.

As mentioned above, projects were assigned a rate early on in the development process – either at preliminary certification or preliminary application. This was intended to give certainty to project owners. But the conditions at which a rate was set could change considerably by the time – often years later – the project reached its final certification. So BETC projects that received their tax credit sale rate in 2008 or 2009, when Oregon's economy faced enormous hurdles, encountered a very different marketplace when they were eligible to be sold in 2012 or 2013.

Projects in ODOE's Energy Incentives Program faced the opposite problem. As you noted in your letter, steeper discounts have been the norm in EIP. Due to ODOE's present value formula and the related economic inputs, pass-through rates for EIP projects appear to be too high to be competitive on the tax credit market in Oregon. We have accordingly seen tax credit sales that conform to current market conditions for those projects that have reached their final certification.

More than 100 projects in EIP will be eligible for final certification over the next few years. It is likely many of these project owners will want to sell their tax credit. Selling a tax credit is a preferred route for some businesses, and the only route available to public agencies and nonprofits because they do not have a tax liability. In general, these tax credits are portioned out over five years. In many cases, selling them and realizing an immediate return proves to be a more beneficial financial decision for project owners. While we have heard concerns about our proposed rule changes, we also heard from people very much in favor of codifying ODOE's long-standing practices. These entities are rightfully seeking certainty for projects they have invested in based on the state's support, and we owe it to them to take the recommendation in your letter to work with the Legislature on a program reassessment. It is possible that many of those project owners have received conflicting information about their options following completion of their projects. We are committed to working with them and ensuring that their needs are taken into consideration.

One of the main things I take away from your letter is that the department is not compelled to take on this heavy lift alone. We recognize that we have a responsibility to Oregonians to tighten our rules and processes, improve our data management, and learn from past program challenges. And we look forward to the assistance of the Legislature, businesses, government agencies, other stakeholders, and Governor Brown on next steps. More immediately, we will not be filing permanent rules on tax credit transfers; the temporary rule filed earlier this year will expire September 18, 2015, and we will revert to the previous rules until given direction otherwise by the Oregon Legislature.

Thank you again for your review and recommendations for next steps. We appreciated the professionalism and thoughtfulness of your staff as they have researched this issue, and we welcome continued conversations that help ensure we are delivering on behalf of Oregonians.

Sincerely,



Michael Kaplan
Director

cc: V. Dale Bond, CPA, CISA, CFE