Oregon Department of Energy
Joint Committee on Ways & Means
Subcommittee on Natural Resources
Supplemental Information

Audits of the Agency Conducted by the Office of the Secretary of State

July 2015 & September 2016

The SELP program financial statements are audited annually by the Secretary of State's Office. The 2013/2014 report, released in July 2015, included a finding related to improving internal controls over financial reporting. The report recommended that management improve our review of the draft financial statements and notes prior to submission to the auditors for review, and that adequate documentation be maintained. Management agreed with the finding, noted that staff vacancies and turnover during the audit presented difficulties in preparing the statements and documentation, and agreed to institute additional procedures to ensure adequate review of financial statements. The 2015 SELP statements released in 2016 did not have any findings or deficiencies.

Links to audits:

http://sos.oregon.gov/audits/documents/2015-16.pdf

http://sos.oregon.gov/audits/documents/2016-23.pdf

September 2015

Based on a hotline call, SOS reviewed our agency's tax transfer processes and recommended ODOE work with the Legislature to clarify the intention of the transfer process.

Links to audits:

http://sos.oregon.gov/audits/documents/330-2015-09-01.pdf

Agency response attached: 330-2015-09-01 response.pdf

September 2016

SOS and Marsh Mininck conducted a review of the sunset of the Business Energy Tax Credit program in the spring and summer of 2016. The report confirmed many of the concerns that led the Governor and Director to request the audit and identified recommendations that could have

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reduced the risk of the BETC program, if it were not already sunset. ODOE agreed and responded that, to the extent possible, we would look to apply the recommendations to other tax credit programs, most of which will sunset with the 2017 tax year, and use the results to inform future discussion on energy incentives.

http://sos.oregon.gov/audits/Documents/2016-20.pdf

Agency response attached: 2016-20-agency-response.pdf

September 2016

SOS reviewed the Residential Energy Tax Credit Program, releasing a report focused on solar photovoltaic systems in September 2016. The report determined the department's residential energy tax credits for PV systems are generally issued in compliance with state laws. The report contained recommendations to add clarifying language to the RETC pass-through application, consider the pass-through discount rate, and establish and maintain a method to update website information and forms that will provide consistent, accurate, and current information necessary for RETCs to be issued and transferred according to legislative requirements. ODOE agreed to implement recommendation to the extent possible given the program sunset.

http://sos.oregon.gov/audits/documents/330-2016-09-01.pdf

Agency response attached: 330-2016-09-01-agency-response.pdf

Cost Per FTE at the Oregon Department of Energy

Oregon Department of Energy	2015-17 LAB	2017-19 GB
Salary & Wages	$15,468,311	$14,267,371
Health Benefits	$3,257,100	$3,025,242
PERS & Pension Obligation Bond	$3,254,901	$3,557,447
All Other Personnel Costs	$1,104,998	$992,118
TOTAL	**$23,085,310**	**$21,842,178**
FTE	104.5	90.75
Average FTE Cost	$220,912	$240,685
Total Operating Budget	$38,264,285	$37,793,786
Percentage of Operating Budget	60.30%	57.80%

Proposed Technology Projects

During the 2013-15 budget process, the agency funded a policy package that allowed for the hiring of a consulting firm to review the business and technology processes associated with the acquisition, storage, and dissemination of energy related data. Over the course of six months, the contractor, Delaris, directed extensive discovery of ODOE's current infrastructure, policies, and processes. Delaris concluded the current staffing, policies, and data systems are endangering the agency's ability to continue to fulfill our mission. The study is attached.

One of the recommended solutions prescribed by the Delaris study included the implementation of a Customer Relationship Management (CRM) solution to help track the Department of Energy's interactions with Oregon citizens and energy stakeholders.

Currently, no system exists to track communication and activities with our customers and partners. Relationships and activities are tied specifically to individual employees, which limits our overall ability to serve customers if specific employees are unavailable. Additionally, our agency currently cannot see a holistic view of our interactions with customers. Creating a stakeholder activity and service profile consists of manual business processes, with extracts being created and complied from each individual business unit. The end result is generally unreliable and requires a substantial amount of staff time to create.

Currently, the Department of Energy works with the following customer/partner types:

- Federal agencies
- State agencies
- State of Oregon legislature
- Local government
- Publically owned utilities
- Independently owned utilities
- Special districts
- Non-profit energy organizations
- Private businesses
- Private citizens

Each customer type creates unique data collections requirements, defined interactions, and distinct business process requirements. Each agency division interacts with a variety of the defined stakeholders, but we do not currently have a way to comprehensively see either intra or inter division interactions with stakeholders. The lack of a centralized system results in inefficient stakeholder interaction and a significant administrative overhead expenditure of agency resources.

This biennium, the agency is putting forward **Policy Option Package 151 - Energy Data Consolidation & Enhancement**, to implement the recommended CRM system. It will allow the agency to manage and analyze customer interactions and data across all divisions and all channels, with the goal of improving business relationships and streamlining processes. The package requests two positions/ 2.00 FTE (one Information Systems Specialist 5 and one ISS 7) and $819,073 OF.

UPDATED OTHER FUNDS ENDING BALANCES FOR THE 2015-17 & 2017-19 BIENNIA

Agency: Department of Energy
Contact Person (Name & Phone #): Joshua Sweet 503-373-7398

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Other Fund Type	Program Area (SCR)	Treasury Fund #/Name	Category/Description	Constitutional and/or Statutory reference	2015-17 Ending Balance In LAB	2015-17 Ending Balance Revised	2017-19 Ending Balance In CSL	2017-19 Ending Balance Revised	Comments
Limited	100 - Planning, Policy and Technical Analysis	00401 Oregon State General Fund	Other, Public Purpose Charge - Industrial	ORS 757.612, 469.040, OAR 330-140-0140	19,061	68,773	1,647	90,028	Fee based on percent of project. System project should be completed prior to completion of the biennium. Revised ending balance covers 2-3 months of operations.
Limited	100 - Planning, Policy and Technical Analysis	00401 Oregon State General Fund	State Energy Efficient Design	ORS 276.900-915	0	37,769	0	69,046	Fee for service. Without the Universities being required to utilize the program there is little activity. There is a small operating balance.
Limited	200 - Development	00401 Oregon State General Fund	Operations: Business Energy Tax Credit (BETC) Program	ORS 316.140-142, 317.104 and 469.185	398,018	177,396	16,543	0	BETC program sunsetted in AY13, remaining balance for final compliance and pass-through activities that can continue for 5 years.
Limited	200 - Development	00401 Oregon State General Fund	Operations: Energy Incentive Program (EIP)	ORS 469B.164, 469B.294, 469B.335	(16,931)	762,218	78,359	78,687	Fee based cost recovery program that will sunset January 1, 2018. Fees not subject to SB 333 process and were revised during the AY17 biennium.
Limited	200 - Development	00401 Oregon State General Fund	Operations: Biomass Tax Credit	ORS 469B.403	(143,996)	(90,986)	(5,632)	(5,632)	Fees adjusted in the AY17 to address deficit.
Limited	200 - Development	01492 Alternative Fuel Vehicle Revolving Fund	Grant Fund: Alternative Fuel Vehicle Revolving Fund	ORS 469.690 - 469.966	917,146	3,150,320	908,180	898,577	Level of revolving activity is currently unknown. There has not been any lending activity to date, but expenditures are included in the budget to support possible activity.
Limited	200 - Development	01433 Renewable Energy Development Fund	Grant Fund: Renewable Energy Development Program	ORS 469B.253, 469B.256, 469B.259	2,151,100	4,546,072	2,099,554	99,554	Seperate treasury fund, funds are obligated to projects, but are not distributed until projects are completed. Balance changes are due to timing of projects. May create limitation issue in AY17 if more projects are completed than expected. Package 120 addresses the necessary expenditure limitation as project have not been finaled as expected.
Limited	200 - Development	00573 OF Oil Heated Dwellings Energy Audit Account	Other [Operations & Grant Fund]: State Home Oil Weatherization (SHOW)	ORS 469.681	260,775	257,063	335,498	335,598	Assessment is intended to be fully expended within the assessment time frame.
Limited	200 - Development	01357 Loan Offset Grant Fund (EEAST)	Grant Fund: Renamed under HB 2960 (2011) to Jobs, Energy and Schools Fund	ORS 470.575, HB 2960 (2011 Legislative Session)	1,040,682	0	0	0	Ending balance represents performance grant award reserve and will be released when compliance is met [CEWO]. Funds can be transferred to the Clean Energy Deployment Fund.
Limited	300 - Nuclear Safety	00401 Oregon State General Fund	Other, Radioactive Waste Transport Fee	ORS 469.605, 469.611	300,284	203,988	308,041	271,931	Reserves are held to adequately cover the agency's response to accidents in transporting radioactive waste in the State.
Limited	500 - Admin Services	00401 Oregon State General Fund	Other, Energy Supplier Assessment (ESA)	ORS 469.421	2,144,497	3,194,930	776,271	1,355,192	Assessment. Target ending balance is $2.5M which funds a 4 months of service. 2017-19 balance at CSL does not inclued pkg 070 that reduces ESA expenditures and would increase ending balance to better level. 2019-17 balance at GB includes a reduction of Indirect revenue that will need to be adjusted at LAB.
Non-Limited	200 - Development	1469: Clean Energy Deployment Fund	Other [Operations & Grant Fund]: Clean Energy Deployment Fund	ORS 470.800 - 470.810	0	0	0	0	Funding transferred from the Jobs, Energy and Schools Fund.
Non-Limited and Non-Limited Debt Service	200 - Development	00493: Small Scale Local Energy Loan Fund 00494: Small Scale Local Energy Proj Admin & Bd	Loan Program, Small Scale Energy Loan Program	Oregon Constitution XI, ORS 470.090 & .091	26,679,031	16,438,353	8,713,872	16,438,353	Ending balance for SELP Non-Limited and Non-Limited Debt Service is constitutionally dedicated and cannot be used for any purposes other than indenture and constitutional bond requirements until all bonds are paid off and no longer outstanding. Variance in the ending balance is attributed to the changes in activity including Treasury not recommending to issue bonds on behalf of the agency.

Oregon
Kate Brown. Governor

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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

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September 8, 2016

Jeanne P. Atkins
Secretary of State
136 State Capitol
Salem, OR 97310-0722

Dear Secretary Atkins:

This letter is in response to the "Report of Findings Business Energy Tax Credit Program Investigative Examination," issued by Marsh Minick P.C. through your office on September 8, 2016. I would be remiss if I did not begin my response by thanking Governor Brown for recognizing the need for and continuing to pursue a thorough review of the Business Energy Tax Credit Program. In multiple communications to your office and legislative leadership, Governor Brown has acknowledged that the BETC program, despite ending in 2014, remains an anchor on the Oregon Department of Energy. The Governor has pushed to find definitive answers to questions that remain about the Department of Energy's handling of BETC. We appreciate the commitment your office has made to advance that effort.

The "Report of Findings Business Energy Tax Credit Program Investigation Examination" provides a deeper look at problems our agency has called into question over the past two years. In a September 2015 letter to your Audits Division, I wrote that BETC was "besieged by problems." I've criticized the department's management of BETC in multiple presentations to the Oregon Legislature, starting in August 2014 and most recently in June, when I discussed the department's BETC problems at length. Administrative issues I've highlighted include flawed internal processes, unreliable data management, and inconsistent staff training and understanding of program rules and statutes. Marsh Minick's report confirms these assessments, providing an evaluation of projects and procedures that illustrate ODOE's missteps and mistakes administering the BETC program.

As a state agency, it is our responsibility to implement laws passed by the legislature and signed by the governor – and to do so with care and duty. With BETC, ODOE failed this responsibility. The administrative problems identified by Marsh Minick could have been solved by management and staff, even without legislative changes, at the time the program was expanded in 2007 or at any point over the next seven years. It is not enough for a state agency to merely flag problems and expect solutions; ODOE also had the responsibility to solve those problems using a variety of tools, including better in-house oversight and management. Requesting fixes in the legislature is a resource to address policy issues and not a mechanism to correct systemic management challenges.

Across all divisions in our department, our team is committed to being accountable for our actions and the oversight of BETC and every other program under our purview. Since the program ended in June 2014, we continue to face and work to overcome problems from ODOE's handling of BETC. We take full responsibility for BETC's problems in light of glaring and years-long evidence that shows unequivocally that ODOE simply did not manage BETC well.

We acknowledge and appreciate the recommendations included in the Marsh Minick report for future tax incentive programs. To the extent we can implement these recommendations, or the recommendations provided to us by your office on the afternoon of September 7, we will. Further, we believe these recommendations should inform every discussion about future state incentives. However, in a June letter to legislative leadership, Governor Brown called for our existing tax credit programs to end with their legislatively approved sunset. This is the appropriate path for these programs.

With recent actions taken by the Oregon Department of Justice addressing one case of alleged BETC fraud, the large number of high-value "projects of concern" identified by Marsh Minick, and the systemic administrative faults within the BETC program articulated in this report, we suspect that the 2.7 percent of projects of $1 million or less identified as "projects of concern" is optimistic. It's difficult to resolve that the program's considerable problems, which impacted such a high percentage of large BETCs, did not similarly influence smaller projects that were subject to even fewer controls during application and review processes.

The Department of Energy made significant mistakes administering the BETC program. We do not want the state to compound those past mistakes by failing to comprehensively understand and document BETC.

Sincerely,

Mike Kaplan
Director, Oregon Department of Energy

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October 3, 2016

Audits Division
Secretary of State
255 Capitol St. NE, Suite 500
Salem, OR 97310

Dear Audits Division:

Thank you for your office's review of the Residential Energy Tax Credit. The Oregon Department of Energy is pleased that out of 6,841 photovoltaic project files provided, the Secretary of State Audits Division concluded that the overwhelming majority were properly processed, with only five errors identified.

After 40 years of encouraging the adoption of energy saving technologies, the RETC program will sunset at the end of 2017. ODOE will work to implement the recommendations in this report to the extent feasible given the impending expiration of the program.

These include recommendations to reduce the 0.1% error rate through automation via a processing system that was implemented in 2015; reviewing our application forms with an eye toward providing greater clarity on pass-through options; continuing to engage stakeholders in RETC rulemaking process, with opportunities for participants to raise issues with the program, such as whether the uniform discount rate properly reflected present value of a tax credit; and providing accurate, timely, and useful information to the public, a task that will be supported by an effort currently underway to redesign our website.

Sincerely,

Michael Kaplan
Director, Oregon Department of Energy