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Oregon

## **State lowballed cost of green tax breaks**

State officials deliberately underestimated the cost of Gov. Ted Kulongoski's plan to lure green energy companies to Oregon with big taxpayer subsidies, resulting in a program that cost 40 times more than unsuspecting lawmakers were told, an investigation by The Oregonian shows.

Records also show that the program, a favorite of Kulongoski's known as the Business Energy Tax Credit, has given millions of dollars to failed companies while voters are being asked to raise income taxes because the state budget doesn't have enough to pay for schools and other programs.

The incentives are now under intense scrutiny at the Oregon Department of Energy, which is scrambling to curb their skyrocketing costs.

Energy officials were worried about the impact on the state budget in 2006, when Kulongoski and his staff proposed a dramatic boost in tax breaks to woo wind and solar companies to Oregon — upping the subsidies from a high of \$3.5 million per project to as much as \$20 million.

According to documents obtained under Oregon's public records law, agency officials estimated in a Nov. 16, 2006, spreadsheet that expanding the tax credits would cost taxpayers an additional \$13 million in 2007-09. But after a series of scratch-outs and scribbled notes, a new spreadsheet pared the cost to \$1.8 million. And when energy officials handed their final estimate to the Legislature in February 2007, they pegged the added cost at just \$1.2 million for the first two years and \$4.1 million for 2009-11.

The higher estimates were never shown to lawmakers. Current and former energy staffers acknowledged a clear attempt to minimize the cost of the subsidies.

"I remember that discussion. Everyone was saying, yes, this is going to be a huge (budget) hit," recalled Charles Stephens, a former analyst for the Energy Department who left in 2006. "The governor's office was saying, 'No, we need a smaller number.'"

Dave Barker, an analyst who is still with the agency, told The Oregonian that the initial cost estimates started high but got lower after he was told by his superiors to plug in smaller figures.

"What I would hear pretty consistently was, 'We want to keep it conservative,'" Barker said.

The official estimates turned out to be absurdly low. In 2007-09, the business tax credit cost the state \$68 million, of which about \$40 million can be attributed to the bigger subsidies. The latest estimate for 2009-11 puts the tab for subsidies at \$167 million in lost revenue, which is projected to grow to \$243 million for 2011-13 — about what Oregon spends now from its general fund on the entire state police budget.

The land rush is not surprising. Oregon's tax incentives are now among the nation's richest for wind, solar, biomass and other renewable energy projects. In 2007 alone, the state granted \$33 million in tax credits to Klondike Wind Power for three projects in Wasco County.

No other state program has been allowed to grow at such a pace. The runaway cost increases result in part from loose regulations that allow nearly every business that seeks the lucrative tax credit to get one. Since 1979, when the tax credits were voted into law, the state has approved 97 percent of the applications for subsidies.

### **Governor denies pressure**

The program has become the centerpiece of Kulongoski's legacy-making effort to turn Oregon into a center for environmentally friendly industry.

Kulongoski staff members deny that the governor or anyone on his staff directed the Energy Department to lowball the costs and said the huge disparity between early cost projections and actual expenses was simply a bad guess. They say no one understood how popular the tax credit would become.

"I'm not aware of anybody having those kinds of conversations with the Energy Department," said Kulongoski spokeswoman Anna Richter Taylor. The governor didn't, she said, and his aides "wouldn't set him up that way."

Richter Taylor said Kulongoski considers the subsidies to be "wildly successful" in bringing new, clean companies to Oregon. He does, however, agree that rules should be tightened on who qualifies for the tax breaks.

Mike Graine, who was Energy Department director before being ousted by Kulongoski last spring, denied efforts to downplay the potential costs of the higher subsidies.

"The number of projects that came in after those changes were made were far beyond our expectations," he said.

Graine said he doesn't remember what his expectations were for luring new business.

Records show that his department came up with the \$1.2 million in additional costs by figuring that only one large renewable energy project would take advantage of the tax breaks in the first two years.

### **Cost worried legislators**

Rep. Phil Barnhart of Eugene, who was chairman of the House Revenue Committee in 2007, said he and his fellow Democrats were skeptical about handing out more tax breaks to businesses when other needs were going unmet. But they wanted to encourage what he calls the "green revolution" and Kulongoski's goal of providing jobs while boosting the state's energy independence.

An economist with the Legislative Revenue Office didn't trust the low estimates from the Energy Department and raised them to \$1.9 million in 2007-09 and \$12.6 million for 2009-11. The numbers were still small enough that the bill sailed through.

"This was not a difficult bill," Barnhart said. "It should have been a bit more difficult. Since then, I've learned it's not so straightforward."

Underestimating the cost of the subsidies was just the start. Records obtained by The Oregonian point to a program that hands out tax credits with little accountability. Some examples:

- A wind energy project received four separate \$10 million tax credits even though it will generate less electricity than projects getting one-tenth the \$40 million subsidy.

- A Clatskanie ethanol plant got \$12 million in tax subsidies plus a \$20 million state energy loan, then promptly went bankrupt and stopped operating. The plant, Cascade Grains, claims it's still owed \$10 million in tax credits, and it may sue to try to get them.
- A Boardman tire recycling plant got \$3.4 million even though, after more than two years, it has yet to recycle tires. Investors are suing founders of Reclaim Technologies, now known as McKinstry-Reclaim, alleging they were misled about the project's solvency.
- Thirty-five companies that had applied for smaller tax breaks under the old rules were granted the higher subsidies — essentially giving them windfalls that cost taxpayers \$2.1 million.

Sen. Ginny Burdick, who chairs the Senate Finance Committee, tried to put the brakes on what she viewed as an out-of-control subsidy program. Her bill to trim tax breaks for big wind farms was approved by the Senate and the House this year but vetoed by Kulongoski, a fellow Democrat.

“What I saw was a hemorrhage of money at a time when we really could not afford it,” said Burdick, D-Portland. “The subsidy is far richer than it needs to be.”

The case of Oregon Windfarms helps illustrate her point. The corporation, based in Piedmont, Calif., planned to build wind turbines in eastern Oregon. But instead of applying for a single tax credit, worth \$10 million, the firm broke the project into nine smaller ones and demanded nine credits, worth \$90 million.

Before the company got approval for any state tax credits, it broke ground on the project and began erecting turbines. Grainey, the former state energy director, balked at the multiple applications but eventually approved four credits worth \$40 million — less than half the \$90 million the company originally sought.

Company officials expressed their outrage in a May 6 e-mail. “This would be a financial disaster,” wrote Glenn Ikemoto, a principal of Oregon Windfarms. Yet, last month, according to Energy Department records, the company signed an agreement for the \$40 million subsidy.

“The prospect of a protracted, costly fight was not attractive,” said Len Bergstein, a prominent Portland lobbyist who represents Oregon Windfarms.

The project is on the books to generate 64.5 megawatts of power. Three years ago, a 100-megawatt wind project in Sherman County received a \$3.5 million subsidy.

### **Department in disarray**

This past spring, it was clear that the governor's office was frustrated with the way the Energy Department was managed. Kulongoski's staff haggled with Grainey over his handling of an employee the governor's office wanted fired. Tensions arose over Kulongoski's desire to use federal stimulus money to build a string of solar panels along Interstate 205, a project energy staffers argued didn't qualify under federal guidelines.

Only a few weeks after the dust-up with Oregon Windfarms, Kulongoski forced Grainey out of his 30-year career in the Energy Department. His replacement was Mark Long, who had been director of the state Building Codes Division.

Long's assignment was to tighten control over the agency and put limits on the energy tax credits. The change resulted in considerable turnover, as Long brought in new managers and longtime energy analysts quit, disheartened by what they saw as a radical change in direction.

“Me and the folks I brought in, we get it,” Long said in an interview. “We get the (tax credit) needs sideboards.”

Long is overseeing an extensive rewrite of rules that would give the department more authority to deny applications. The new rules also will try to rein in the practice of applying for multiple credits, and they may allow the state to retrieve money if the projects don't operate as billed.

Supporters of the tax credits say they have put Oregon on the map for renewable energy, making it one of the top states in the nation for green jobs. Renewable energy companies such as Solaicx and Iberdola employ scores of workers at good wages.

The results can be seen by anyone driving through the Columbia River Gorge into central and eastern Oregon. Once-empty plateaus now bristle with towering turbines, spinning out about 7 percent of the state's electricity production.

Critics of the program note that job gains are small and have made little difference in the state's stubbornly high unemployment rate. The typical wind project, once construction workers leave, hires only a handful of full-time people.

The huge sums of money at stake have changed the way the agency thinks about energy projects, said Christopher Dymond, a senior energy analyst who found new work after the regime change.

“Now, it's not based as much on technical merit,” Dymond said. “It's based on politics.”

### **What's the Business Energy Tax Credit?**

A renewable energy company can receive a credit on its Oregon taxes worth half the cost of building a new facility, up to a limit of \$10 million, or \$20 million for solar manufacturers.

The credits are better than tax deductions — \$1 of tax credit means \$1 less paid in taxes. If a company has little or no tax liability, the credits can be sold at a discount to another Oregon taxpayer.

### **Politics and energy policy**

Swirling events last spring, cataloged in state e-mails and public records, led Gov. Ted Kulongoski to oust Oregon Department of Energy Director Mike Graine:

March 13: Graine sends memo to Sen. Ginny Burdick outlining his proposal for major cuts to the Business Energy Tax Credit: “I believe these sets of measures will have a significant revenue reduction impact while maintaining the overall effectiveness of the tax credit program.”

April 15: Graine sends e-mail to Portland lobbyist Len Bergstein notifying him of the decision to reduce by more than half the \$90 million in state tax breaks Bergstein's client, Oregon Windfarms, had sought for an eastern Oregon wind energy project.

May 5: Oregon Windfarms principal Glenn Ikemoto sends angry response to Graine, saying the company would never have built the project if it thought it wouldn't get the entire subsidy. “This is simply unfair,” Ikemoto writes.

May 7: Jane Bacchieri, who works for Kulongoski on energy-related projects paid by federal stimulus money, writes an e-mail to Graine's chief deputy, Diana Enright, asking for more “flexibility” in how the money is

spent. Kulongoski wants to spend federal stimulus dollars on his pet project, a large bank of solar panels along Interstate 205. Energy staff members balk, saying the project does not meet federal guidelines.

May 12: Kulongoski's deputy chief of staff, Brian Shipley, writes a sharply worded e-mail to Graine's staff questioning why they nearly missed the deadline to apply for federal stimulus funds. Graine writes back, blaming the hang-up on "confusion with this process."

May 13: Graine writes to Ikemoto and says the department will start a formal process to "reconsider" the request for more tax breaks for Oregon Windfarms. Later, the company agreed to a compromise of \$40 million in subsidies.

May 15: Kulongoski announces Graine's transfer from the Energy Department to a new position in economic development. "It has been a lot of fun," Graine writes Kulongoski.

June 26: Legislature passes House Bill 2472, which trims state subsidies for large wind farms from \$10 million to \$3.5 million. The bill contains some of Graine's recommendations for cutting the tax breaks.

Aug. 7: Kulongoski vetoes HB2472 but orders new energy director Mark Long to tighten rules that determine who gets the tax breaks.

By Harry Esteve, The Oregonian

[www.oregonlive.com](http://www.oregonlive.com) <sup>[1]</sup>

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