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Why are New York Political and Business Leaders putting the interests of Spain-based Iberdrola ahead of the interests of New York's taxpayers and electric customers?

New York's taxpayers and electric customers are facing a serious threat:

- Iberdrola, the Spanish company that wishes to acquire Energy East and its electric and gas distribution subsidiaries[1] is insisting that it will “walk away from” the deal if it is not permitted to build “wind farms” in New York.[2]
- High-powered New York political, business, labor and media leaders (including Governor Paterson and Senator Schumer) are working to get members of the NY State Public Utility Commission (NYS PSC) to overturn the PSC Staff's recommendation and the Administrative Law Judge's conclusion that Iberdrola should not be permitted to own *both* electric generating capacity (including “wind farms”) and electric distribution companies in NY.
- These NY “leaders” are striving in favor of Iberdrola despite *the demonstrable negative impacts that Iberdrola's proposal would have on New York's taxpayers, electric customers, and state economy.*

This brief paper:

- Provides details on the financial reason that apparently underlies Iberdrola's insistence on the right to own “wind farms” in NY. That is, huge tax breaks available for “wind farms” could permit Iberdrola to sharply reduce or eliminate liability for paying federal or state tax income tax on profits from Energy East Companies' electricity and gas distribution operations.
- Speculates about the reasons why NY “leaders” are working so hard on behalf of Iberdrola – and against the interests of NY taxpayers and electric customers – and the state's economy.

Why is Iberdrola insisting on the right to build “wind farms” in New York?

Clearly, Iberdrola is taking advantage of popular wisdom[3] about wind energy, and working to give the company a “green” image. However, it is a virtual certainty that huge federal and state tax breaks and subsidies for wind energy explain the company's threat to “walk away” from the Energy East acquisition if it cannot own “wind farms.”

Specifically, a \$2 billion investment in “wind farms” in New York would permit Iberdrola's Energy East to avoid paying most if not all of the federal and New York state

corporate income tax that would otherwise be due on the profits from Energy East-owned electricity and gas distribution companies operating in New York. Profits from Energy East's New York operations (paid for by NY electric and gas customers) would flow out of New York.

When considering the huge tax breaks detailed below, keep in mind that, according to Energy East's 2007 Annual Report, the total amount of all income taxes – federal and all states in which Energy East operates – paid in 2007 was \$114,058,000.[4]

What is startling and disappointing is that NY political leaders – particularly Governor Paterson and Senator Schumer – apparently *do not understand* and/or *do not care* that:

- Federal and state government tax breaks and subsidies have made it so lucrative for organizations to “invest” in “wind farms” to avoid paying taxes that would otherwise be due.
- Tax burden that would be avoided by companies such as Iberdrola's Energy East would be shifted to ordinary taxpayers who do not have access to such tax shelters. (That is, a large transfer of wealth, exacerbated by higher costs of electricity for electric customers.)

Key Tax Breaks and Subsidies for proposed Iberdrola “wind farms.”

Wind industry lobbyists have been enormously successful in getting federal and state politicians to enact generous tax breaks and subsidies. Specifically, consider the financial benefits to Iberdrola's Energy East of only the following five tax breaks and subsidies if the company were to own “wind farms” with a total capital investment of \$2 billion:[5]

For simplicity and to be conservative, the following example assumes (i) a cost of \$2,000 per kilowatt (kW) of turbine capacity so that Iberdrola's \$2 billion would finance 1,000 MW of wind turbine capacity, and (ii) that all the capacity would be added in a single year. Actually, Iberdrola's public statements assume a lower cost per kW and, quite likely, the proposed investment would occur over 3 or 4 years[6] but that doesn't change the key facts.

1. Federal Production Tax Credit for electricity from wind (PTC). First, Iberdrola would receive the federal wind PTC, currently \$0.02 per kilowatt-hour (kWh) for electricity produced during the 1st 10 years of operation. Congress is expected to extend this tax shelter beyond its current December 31, 2008, expiration date. By itself, this tax credit would reduce Iberdrola's federal income tax liability over 10 years by \$525,600,000,[7] effectively shifting that amount of tax burden to taxpayers who don't enjoy such tax shelters.

2. Accelerated Depreciation. Second, a \$2 billion “wind farm” would qualify for the exceedingly generous 5-year, double declining balance accelerated depreciation for federal income tax purposes.[8] Assuming that \$2 billion is the full cost of

Iberdrola-owned “wind farms,” the following amounts would be deducted from Iberdrola’s otherwise taxable income and further reduce Iberdrola’s federal income tax liability; specifically:

federal income Tax Year to PTC)	Deduction from taxable income		Further reduction in tax liability (in addition
	% of Capital investment	Amount	
1 st \$140,000,000	20%	\$400,000,000	
2 nd \$224,000,000	32%	\$640,000,000	
3 rd \$134,400,000	19.2%	\$384,000,000	
4 th 80,640,000	11.52%	\$230,400,000	\$
5 th 80,640,000	11.52%	\$230,400,000	\$
6 th <u>40,320,000</u>	<u>5.76%</u>	<u>\$115,200,000</u>	<u>\$</u>
Totals \$700,000,000	100%	\$2,000,000,000	

Note that these deductions from otherwise taxable income and from federal income tax liability could be taken regardless of whether the “wind farm” investment is financed with debt or equity.^[9] So, if Iberdrola were to put up only \$2 billion and borrow another \$2 billion, the deductions from income and reduced tax liability would be double the amounts shown.

Note also that, in addition to the further reduction in tax liability, this generous accelerated depreciation deduction for federal income tax purposes has two other huge benefits; specifically:

- a. Prompt recovery of Iberdrola’s equity investment. The example above, conservatively assumes that the entire “wind farm” capital investment would be equity, rather than debt. If the equity investment was only half the capital cost and the remainder borrowed, (i.e., \$1 billion), the table above shows that Iberdrola would recover through depreciation deductions all of its equity investment in less than 2 years and in just over 1 year if the project(s) begin operation late in the first tax year. With no remaining *equity* investment, Iberdrola’s return on equity would be infinite.
- b. A large interest free loan. The depreciation deduction continues even though all equity has been recovered. Thus, Iberdrola would, in effect, be receiving an interest free loan, courtesy of US taxpayers for an amount equal to the debt financing.

If Iberdrola were unable to use all the tax deductions – which may be the case, schemes are available to “sell” tax credits to other firms that have tax liabilities that they wish to avoid.

3. Avoiding New York Corporate Franchise Taxes. Tax breaks for “wind farms” are not limited to those provided by the federal government. New York State also allows a corporation to take advantage of 5-year double declining balance accelerated depreciation deductions from otherwise taxable New York income. Therefore, Iberdrola would be able to take deductions like those shown above when calculating its New York corporate tax liability.^[10] Assuming a 6.5% tax rate the deductions from taxable income and reductions in Iberdrola’s New York tax liability would be as follows:

York Corporate Tax Year <u>6.5% rate)</u>	<u>Deduction from taxable income</u>		<u>Reduction in New tax liability (assuming</u>
	<u>% of Capital investment</u>	<u>Amount</u>	
1 st \$26,000,000	20%	\$400,000,000	
2 nd \$41,600,000	32%	\$640,000,000	
3 rd \$24,960,000	19.2%	\$384,000,000	
4 th 14,976,000	11.52%	\$230,400,000	\$
5 th 14,976,000	11.52%	\$230,400,000	\$
6 th <u>488,000</u>	<u>5.76%</u>	<u>\$115,200,000</u>	<u>\$ 7,</u>
Totals	100%	\$2,000,000,000	

\$130,000,000

4. Subsidy Payments from NYSERDA to “Wind Farm” owners. Under rules issued by the NYS Public Service Commission (NYS PSC), customers of New York’s investor owned utilities are assessed a charge (added to monthly electric bills) that provides the funds used by NYSERDA to provide subsidies to producers of electricity from “renewable” energy. In April 2007, NYS PSC and NYSERDA announced selection of 9 proposed “wind farms” owned by three companies to receive payments from NYSERDA over 10 years. The awards averaged \$15 per megawatt-hour (MWh) of electric produced – which is equal to \$0.015 cents per kWh. The awards are said to purchase the “environmental attributes” of the wind-generated electricity.

If Iberdrola’s propose “wind farms” were to receive similar NYSERDA subsidies, the potential income, based on the conservative assumptions outlined earlier, would be \$39,420,000 per year and \$394,420,000 over 10 years.^[11]

5. New York’s Renewable Portfolio Standard (RPS). In addition to the above tax breaks and subsidies, New York has virtually assured big profits for “wind farm” owners by requiring that a growing percentage of the electricity sold in New York must come from “renewable” energy, which, in New York is expected to be mostly from wind. By dictating that a large portion of electricity must be produced from “renewable” energy, owners of facilities that produce electricity from wind and other “renewables” are likely to be able to demand higher prices for their electricity than

would be paid under normal market conditions. The higher costs of electricity from renewables that electric distribution companies are forced to pay are passed along to electric customers in their monthly bills – along with the PSC’s “surcharge.”

6. Other Tax Breaks and Subsidies. “Wind Farms” enjoy a variety of other federal and state financial, market and regulatory subsidies. For example, in New York, “wind farms” are eligible for exemption from property taxes.

Why are NY political, business, labor and media leaders urging the NYS PSC to override the PSC Staff’s recommendations and the Administrative Law Judge’s Decision?

The list of political, business, labor and media officials that have publicly urged the members of the NYS PSC to override its staff and ALJ Rafael Epstein includes NY Governor David Paterson;^[12] US Senator Charles Schumer;^[13] NY State Senators Joe Bruno,^[14] James Alesi and George Maziarz, NY Assemblyman Joseph Morelle, Kenneth Adams, president and CEO of the Business Council of New York State, and Brian McMahan, executive director of the New York State Economic Development Council;^[15] leaders of Business organizations such as the Rochester Business Alliance,^[16] and officials of the Greater Rochester Enterprise;^[17] and NY newspaper editorial writers (e.g., Schenectady NY Daily Gazette^[18]); New York State Laborers’ Union.^[19]

When considering the serious implications of Iberdrola’s insistence on a right to own “wind farms,” the truly puzzling question is:

Why are New York “leaders” favoring the interests of Spain-based Iberdrola over the interests of New York’s taxpayers, electric customers, and economy?

Sadly, the most likely answers to the puzzling question do not reflect favorably on NY leaders who are working on behalf of Iberdrola. To illustrate, perhaps the answers are that:

1. **Leaders really don’t understand the extent or implication of available tax breaks and subsidies.** Those who follow the workings of federal and state governments now recognize that political leaders often do not understand the implications of the policies, tax breaks and subsidies that they enact. Apparently this is true for New York’s leaders in the case of the huge tax breaks and subsidies that wind industry lobbyists and other wind energy advocates have pushed through the federal and state legislatures and regulatory bodies.
2. **Leaders have been misled by false and misleading claims about wind energy.** For more than a decade the wind industry and other wind energy advocates have greatly overstated the environmental, energy and economic benefits of wind energy, and greatly under stated the adverse environmental, economic, scenic and

property value impacts. Clearly, the public, media and government officials have been misled about wind energy.

Only during the last 3 or 4 years have the facts about wind energy been uncovered. The media has only begun to understand and report these facts. Unfortunately, there is always a delay before the facts begin to penetrate the thinking and actions of legislators and other government officials so it is not unusual for political leaders to continue taking positions that are not in the public interest, and harmful to a state's taxpayers, consumers and economy long after the negative effects have been identified.

3. Campaign contributions, advertising revenue, and member dues for business associations are taking precedence over the interests of ordinary taxpayers and electric customers. Clearly, the wind industry has enormous financial capability to pay for intensive lobbying of federal, state and local officials, providing campaign contributions, paying for advertising in "friendly" newspapers, and paying dues to associations that lobby on behalf of wind industry interests. Also, it appears that some "environmental" advocacy groups receive substantial contributions from organizations in the wind industry and work to promote wind industry interests. It would be truly surprising if these factors did NOT explain the positions taken by *some* NY political and business leaders in the Iberdrola situation.

4. Exaggerated claims of economic benefits and jobs from "wind farms" are being believed. Wind industry officials and other advocates (including some New York State and federal agencies) often exaggerate the local and state economic benefits and jobs that would result from "wind farms."^[20] Exaggerated claims are often the result of failure to recognize or acknowledge that :

- a. The overwhelming share of capital costs of a "wind farm" are for turbines, blades and other equipment that is produced elsewhere, often outside the US, thus providing no local or state economic benefits.
- b. Few of the jobs during "wind farm" construction are filled from local sources. Instead, some 80% of the jobs (particularly the higher paying ones) are often filled by workers brought in temporarily. Also, failure to recognize (i) that "wind farm" construction time is only a few months, and (ii) the "imported" workers probably pay taxes in their home states, not in the state where the "wind farm" is located.
- c. Few of the materials and supplies for "wind farms" are purchased locally and, for those purchased locally, only the local "value added" locally will contribute local economic benefit – not the total price of the materials or supplies as wind advocates assume.
- d. Economic benefit from rental payments received by land owners are tiny compared to the higher costs of electricity that are borne by electric customers. Higher electric bills – including the portion added by the NYS PSC to pay for

NYSERDA subsidies to “wind farm” owners mean that electric customers have less money to spend locally; e.g., for food, shelter, clothing, health care, education, recreation and other things that help the local economy.

5. Leaders still do not understand that wind turbines cannot provide the reliable generating capacity that is needed in New York to satisfy growing in peak electricity demand or replace older generating units.[21] Because wind turbines produce electricity only when the wind is blowing within certain speed ranges (start up around 6 mph, reach rated capacity around 32 mph, and cut out around 56 mph), the electricity they produce is inherently intermittent, volatile and unreliable. Furthermore, wind turbines are most likely to produce electricity at night in colder months, not on hot weekday late afternoons in July and August when electricity demand reaches peak levels.

Experience in New York, California and Texas, for example, demonstrate that wind turbines may produce well under 10% and often 0% of their rated capacity when electricity demand is at its peak. Therefore, areas experiencing peak demand growth or needing to replace older generating plants will have to add reliable (“dispatchable”) generating capacity whether or not “wind farms” are built. In fact, wind turbines have little or no *real* capacity value.

6. Leaders do not understand the full, true costs of wind energy and believe, incorrectly, that wind energy is environmentally benign. Wind energy advocates greatly understate the true costs of electricity from wind energy. Typically they ignore the huge cost of tax breaks and subsidies (only a few have been mentioned above), the need to provide back-up generating capacity because electricity from wind is intermittent, volatile and unreliable, or the adverse environmental, economic, scenic and property value impacts. Evidence of these adverse effects continues to mount (e.g., bird and bat kills, habitat destruction, noise) and is even finding its way into the news media. Claims of environmental benefits are overstated.

Conclusion

The people of New York – particularly the taxpayers and electric customers who are already overburdened with high taxes and high electric bills – do not deserve to pay more while “wind farm” owners avoid taxation, add to electric bills or impair the environment. Those who would be forced to live with “wind farms” do not deserve to have scenic vistas or their property values impaired.

New York political, business, labor, and media leaders need to be more responsive to the people of New York and the state’s economy than to the desires of Spain-based Iberdrola.

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Endnotes:

[1] New York State Electric & Gas (NYSEG) and Rochester Gas & Electric (RG&E) in NY, Central Maine Power in ME, Berkshire Gas in MA, Southern Connecticut Gas Co. in CT, etc.

[2] Stinson, Jim, "Iberdrola releases earnings, repeats stance on Energy East bid," Rochester Democrat & Chronicle, July 24, 2008.

[3] Many of the facts about the true costs and benefits of wind energy that have been uncovered during the past 4 years have not yet found their way into the news media or into the perceptions of political leaders or the general public.

[4] http://library.corporate-ir.net/library/10/104/104038/items/285227/EAS_2007_annualreport.pdf - Energy East's 2007 Annual Report, page 16.

[5] Thus far, it isn't totally clear whether Iberdrola intends a TOTAL "wind farm" investment in NY of \$2 billion or whether the \$2 billion would be Iberdrola's equity and the remainder would be financed with debt (i.e., borrowing).

[6] http://www.iberdrolarenovables.es/wc/en/corporativa/iberdrola?IDPAG=ENMODULOPRENSA&URLPAG=/gc/en/comunicacion/notasprensa/080509_NP_General_Electric.html

[7] Assuming a 30% capacity factor, 1,000 MW of wind capacity would produce about 2,628,000,000 kWh of electricity per year or 26,280,000,000 kWh during the first 10 years of operation. At \$0.02 per kWh, the tax credit over 10 years would be \$525,600,000.

[8] Referred to by the IRS as Modified Accelerated Cost Recovery System (MACRS). See IRS Publication 946.

[9] Note also that the US Congress, in the Economic Stimulus Act of 2008, added a 50% 1st year "bonus" deduction from federal taxable income for 2008 investments. The effect of this additional "bonus" would permit "wind farm" owners to deduct 60% in the 1st, 16% in the 2nd, 9.6% in the 3rd, 5.76% in the 4th and 5th and 2.88% in the 6th tax years for federal corporate income tax purposes.

[10] See New York State instructions for corporate taxes, particularly Forms CT-3 and CT-399 http://www.tax.state.ny.us/forms/corp_genl_forms.htm

[11] As in previous calculations, this assumes that the capacity of the Iberdrola-owned "wind farms" would be 1,000 MW and that they would produce electricity at an annual capacity factor of 30%; i.e., 2,628,000,000 kWh per year or 26,280,000,000 kWh over 10 years.

[12] <http://timesunion.com/ASPStories/Story.asp?StoryID=706485&LinkFrom=RSS>

[13] http://www.syracuse.com/news/index.ssf/2008/06/judge_recommends_state_psc_rej.html

[14] <http://www.rochestercitynewspaper.com/news/articles/ENERGY:+Politicians+intervene+in+Iberdrola+merger/comments/>

[15] <http://jamesalesi.net/55/news.aspx?nid=17874>

[16] <http://www.rochestercitynewspaper.com/news/articles/ENERGY:+Politicians+intervene+in+Iberdrola+merger/comments/>

[17] <http://www.rochestercitynewspaper.com/news/articles/ENERGY:+Politicians+intervene+in+Iberdrola+merger/comments/>

[18] http://www.dailygazette.com/news/2008/jul/14/0714_edit2/

[19]

<http://www.democratandchronicle.com/apps/pbcs.dll/article?AID=/20080717/BUSINESS/807170331/1001>

[20] Details can be found in, "Errors and Excesses in the NREL's JEDI-WIM Model that Provides Estimates of the State or Local Economic Impact of "Wind Farms," April 28, 2004.

<http://www.windaction.org/documents/104>.

[21] For more information on this problem in NY, see <http://www.wind-watch.org/documents/evaluation-of-new-york-energy-plans-announced-april-2007/>