HUNTON& WILLIAMS

Client Alert

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Government Files Brief in Appeal of *Alta Wind* Section 1603 Grant Case

The Government has filed its opening brief in the US Court of Appeals for the Federal Circuit, in its appeal of the decision by the US Court of Federal Claims ("CFC") in *Alta Wind I Owner-Lessor C et al. v. United States*, 128 Fed. Cl. 702 (2016). The Government has asked the Federal Circuit to reverse that decision and remand the case to the CFC for further proceedings.

The case involves six windfarms. The owners applied for Section 1603 grants totaling over $700 million based on the purchase price for the windfarms (less the costs of certain ineligible property). Treasury awarded 1603 grants totaling nearly $495 million, a reduction of over $206 million, based only on the development and construction costs of certain property, plus a premium for the developer. The case is one of numerous cases in which Treasury reduced grant awards to applicants on the basis that the purchase price paid for renewable energy facilities involved "peculiar circumstances" and required allocation of project costs to nonqualified intangible assets. The owners of the windfarms filed suit in the CFC to recover the $206 million shortfall. The CFC rejected the Government's arguments and found in favor of the owners, entering judgment for the full $206 million shortfall. The Government then appealed.

On appeal, the Government has focused on three "legal errors" by the CFC.

First, the CFC held that basis for 1603 purposes is "the cost of property to its owner"—i.e., the purchase price paid for the windfarms. The CFC held that the residual allocation method under I.R.C. § 1060 was not applicable because the Court determined that there was no goodwill or going concern value *at the time* of the Alta transactions. The Government argues that the CFC focused incorrectly on whether goodwill could have attached *at the time* of the Alta transactions. Per the Government, the proper standard is whether "[the assets'] character is such that goodwill . . . could under any circumstances attach to such group." The upshot of the Government's argument is to force the valuation of each component of tangible property of the windfarms–the Government suggests that the residual method will result in a very substantial residual value that must be assigned to goodwill/going concern value, which is not eligible for the 1603 grant. If accepted, those arguments could have a significant impact on how the cost basis of acquired renewable energy facilities is determined for both 1603 and investment tax credit purposes.

The CFC determined that the PPAs for the windfarms and other elements of value (e.g., location and "turn-key value") did not represent separate intangible assets. The Government argues that under the residual method the PPAs for the windfarms would be treated as separate intangible assets and must be valued separately. The Government contends that "[t]he PPAs are a paradigm of Section 197 intangibles" and, thus, a portion of the purchase price for the windfarms must be allocated to those assets under the 1060 residual method. The Government asserts that the value associated with the location of the windfarms is an element of goodwill under the residual method. The Government argues that the CFC's relied too heavily on the concept of "turn-key value" to explain the difference between the purchase price of acquired windfarms, on the one hand, and the development/installation/profit costs, on the other hand. The Government suggests that "turn-key value" is limited only to the value associated with making sure the windfarms and equipment work mechanically and do not extend to other elements of value such as "a

customer contract, transmission rights, and various other arrangements in place that contribute to the expected cash flows of the Alta windfarms."

Second, the CFC held that the "peculiar circumstances" standard—an exception to the general rule that cost basis is equal to the purchase price paid in an arm's-length transaction—applies where "the parties appear to be unduly manipulating the purchase price by entering into separate agreements at or near the time of purchase, causing the purchase price to be highly inflated." The Government argues that the CFC applied the wrong legal standard. Whereas the CFC suggested that this standard is applied sparingly–where there is "undue manipulation" and circumstances resulting in a "highly inflated" purchase price–the Government argues that it applies broadly where a purchaser is influenced to agree to a purchase price in excess of the fair market value. The Government contends that the Alta transactions were "rife" with peculiar circumstances—namely, (1) the developer's agreements to indemnify the purchasers for any Section 1603 reductions, and (2) the sale-leasebacks and lease prepayments resulting in a "round-tripping of cash." The upshot here is that if the "peculiar circumstances" standard applies the way the Government says it does, and the Federal Circuit were to agree, the Government gets the opportunity to ignore an arm's length purchase price and force a valuation of the individual assets of the windfarms.

Third, the CFC found at trial that the Government's expert was not truthful about certain Marxist articles he had written in the 1980s and excluded his testimony. The Government contends that the CFC's excluding expert testimony on the basis of credibility concerns and refusing to allow the Government any redirect examination constituted reversible error. The Government also implies that Judge Wheeler pre-judged the issues because of the political viewpoints taken by the Government's expert – "there was no untangling of Parson's politics from his credibility." Even if the Government is correct, the Government does not explain how the expert's testimony would have overcome the Court's legal holdings discussed above. Those legal holdings reject the methodology that the Government's expert used to value the windfarms and to support the Government's counterclaims.

The plaintiffs' response brief is due in June. The Government will have an opportunity to reply. Oral argument before a 3-judge panel of the Federal Circuit is expected later this year. A copy of our prior alert regarding the *Alta Wind* decision can be found here and a copy of the CFC's decision can be found here.

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The tax controversy team at Hunton & Williams LLP consists of a cross-practice group with significant experience in energy tax credits and 1603 Grants, tax controversy and litigation. The tax controversy team handled the first 1603 Grant case to go to a full trial in the Court, resulting in a decision in favor of the applicant, and currently is handling other Treasury grant cases in the Court. Hunton & Williams LLP is well positioned to assist 1603 Grant applicants resolve disputes with Treasury. Please contact us if you require assistance with Treasury's denial or reduction of 1603 Grant amounts.

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