HUNTON& WILLIAMS

Client Alert

March 2017

Recent Developments in Section 1603 Grant Litigation

There have been a number of key developments in the Section 1603 grant litigation since our last update on 1603:

Filed/Decided Cases. About 25 cases involving the 1603 grant have been filed in the U.S. Court of Federal Claims. Since our last update, a number of cases have been decided and a number of opinions have been issued on discovery and procedural issues. While the 1603 program resulted and is still resulting in considerable reductions, applicants have held back filing their claims. A word of caution. Although claims are subject to a generous six-year statute of limitations in the Court of Federal Claims, applicants need to consider carefully when this statute of limitations begins and make sure that they do not inadvertently allow it to lapse. Given the positive direction many of the 1603 decisions have taken, and the potential for key institutional knowledge and personnel to be lost or diminished, applicants should give serious thought to filing their claims as soon as possible.

Purchase Price Challenges. The Government lost a number of its key positions with respect to 1603 awards in *Alta Wind I Owner-Lessor C et al. v. United States*, Nos. 13-402T et al. In *Alta Wind*, the Government argued that the purchase price paid for wind facilities could not be used as the cost basis for calculating the 1603 grant – asserting that basis must be allocated to non-qualifying intangible assets such as the power purchase agreement, favorable location premiums, goodwill, and going concern value. The Court of Federal Claims rejected the Government's arguments (i) that the residual accounting method prescribed by IRC § 1060 applied to a newly-constructed wind farm, and (ii) that sale-leaseback transactions represented "peculiar circumstances," *per se*, permitting the Court to look behind an arm's length purchase price negotiated by sophisticated and self-interested parties. The Court rejected the Government's argument that costs must be allocated to a power purchase agreement (PPA) as a separate and nonqualifying intangible asset. A more detailed discussion of the *Alta Wind* case and its implications for other cases can be found here and a copy of the *Alta Wind* opinion can be found here.

The Government noticed its appeal of the *Alta Wind* decision on December 22, 2016. The appeal is currently pending with the first brief scheduled to be filed on April 13, 2017. Argument is expected later this year with a decision expected sometime thereafter. Case No. 17-1410.

Residential Solar. One case involving residential solar systems has been ongoing since early 2013. *See Sequoia Pacific Solar I, LLC, et al. v. United States*, No. 13-139C. In June, the Government filed a motion to schedule a conference with the Court to discuss a matter that had arisen from the *Alta Wind* case. In the *Alta Wind* trial, the Court disqualified the Government's valuation expert – the same expert that the Government is using in the *Sequoia* litigation – after the Court determined the expert had failed to disclose and was untruthful about certain articles he had written. Expert discovery is closed. A similar disqualification in the *Sequoia* case may sink the Government's case, and the expert's credibility may be colored in any event. A copy of the Government's motion can be found here and a copy of the August 4, 2016 conference can be found here. The trial has been rescheduled several times. The trial schedule was vacated recently because of ongoing settlement discussions.

In *LCM Energy Solutions v. United States*, No. 12-321C, the Court of Federal Claims rejected the applicant's claims for alleged shortfalls in its grant awards but also rejected the Government's attempts to

reclaim Treasury's grant awards and apply false claims treble damages and penalties with respect to residential solar system installations. The Court determined that the cost basis which Treasury used for its awards – the installation costs for each system plus a 20% profit – was the "more reasonable approach" in that case. In rejecting the Government's false claims assertions, the Court pointed to the lack of sophistication by the applicant's principals, their reasonable efforts to understand the grant requirements, a prior award made by Treasury at a level consistent with the applied-for amounts, and Treasury's representations to the applicants. A copy of the *LCM* opinion can be found here.

Fuel Cell Facilities. In March 2015, the Court of Federal Claims decided in favor of applicants with respect to two fuel cell facilities using biogas from a wastewater treatment plant. *See RP1 Fuel Cell, LLC et al. v. United States*, No. 13-552C. The question involved whether gas conditioning equipment used to treat the biogas was qualified as part of a qualified fuel cell facility which the Court concluded it was qualified. In the alternative, the Court also held that the equipment could qualify as part of a trash facility. After the Government appealed, the Court of Appeals for the Federal Circuit affirmed *per curiam* the Court of Federal Claims decision in April 2016. A more detailed discussion and a copy of the *RP1 Fuel Cell* decision can be found here and here, respectively.

Biomass Facilities. In January 2015, the Court of Federal Claims granted the Government's motion for summary judgment with respect to an open loop biomass facility producing electrical power and also supplying steam to adjacent chicken rendering processes. *See W.E. Partners II, LLC v. United States*, No. 13-54. The Court agreed that the facility was a qualified facility and took a more expansive view of qualified property as all property "actually involved in making electricity, and without which the electrical production would be reduced." However, in according deference to Treasury's guidance, the Court held that a reasonable allocation of the facility's cost basis must be made between what it characterized as the qualifying electric activity and the nonqualifying steam activity. The Court upheld Treasury's award which allowed the cost basis of only one of the three boilers and the steam turbine generator in the facility. In February 2016, the Federal Circuit affirmed *per curiam* the Court of Federal Claims decision. A more detailed discussion and a copy of the *W.E. Partners* decision can be found here and here, respectively. The same judge of the Court of Federal Claims has issued two recent opinions on the same steam use issue in *Nippon Paper Industries USA Co., Ltd. v. United States*, No. 15-1535C, which can be found here, and in *GUSC Energy, Inc. v. United States*, No. 14-1228C, which can be found here with order on reconsideration here. Another case, *WestRock Virginia Corp. v. United States*, No. 15-355C, is pending before a different judge. According to recent filings, summary judgment motions are expected to be filed in *Nippon* and *WestRock*.

Discovery of Treasury. The Court of Federal Claims has sent mixed signals on discovery of Treasury records and personnel. In *W.E. Partners* and other cases, the Court of Federal Claims has held that 1603 claims are reviewed *de novo* similar to tax refund cases. As a result, the Government has argued that Treasury's review process and decision-making is not relevant and not discoverable. In *California Ridge Energy LLC v. United States*, No. 14-250C, the Court denied an applicant's motion to compel discovery of information relating to data collected by Treasury with respect to other wind energy facilities and the size of development fees paid by other wind facilities – a copy of the opinion in *California Ridge* can be found here.

On the other hand, an order issued in the SolarCity (*Sequoia*) litigation allowed limited discovery of Treasury's review process with respect to its use of certain "benchmarks" and reference of other applicants' information in the context of a valuation issue for residential solar systems – order can be found here. In *Nippon Paper Industries USA Co., Ltd. v. United States*, No. 15-1535C, linked above, the Court of Federal Claims concluded that Treasury's treatment of other biomass applicants was relevant and discoverable for evaluating the level of deference to give Treasury's guidance. In *Alta Wind*, the Court denied the Government's motion in limine attempting to exclude certain Treasury and NREL witnesses from testifying at trial – the plaintiffs in that case had identified those witnesses on the plaintiffs' witness list.

Counterclaims. The Government has filed counterclaims in a number of the 1603 cases. The Court of Federal Claims has been receptive to allowing the Government to amend its pleadings to raise a counterclaim. For example, in *Alta Wind*, the Court allowed the Government to amend its pleadings after the Government's expert filed his report. The Court stated in that case: "Here, in these *de novo* proceedings, Plaintiffs are faced with the rather obvious proposition that the Court's ultimate resolution of the cost basis issues could be greater than or less than the amount paid by the Treasury. If 30 percent of the cost basis is less than the Treasury's original determination, then Plaintiffs would be required to refund the amount of the overpayment." A copy of the opinion in *Alta Wind* with respect to this issue can be found here. Although the Court has allowed counterclaims to be filed, the Government generally has been unsuccessful in its counterclaims. The Government lost its counterclaims in *Alta Wind* and *LCM*, as noted above. The Government also lost in its attempt to recapture a grant award in *GUSC Energy* because of the temporary idling of a biomass facility.

Settlement. Three cases now have been settled (on undisclosed terms). *See Windpower Partners 1993, LLC v. United States*, No. 13-696C (cost basis and valuation issues); *Vasco Winds, LLC v. United States*, No. 13-697C (cost basis and valuation issues); *Fire Island Wind, LLC v. United States*, No. 14-403T (costs of navigational aid facility required by FAA).

Jurisdiction. In January 2011, in *ARRA Energy Co., I v. United States*, 97 Fed. Cl. 12 (2011), the Court of Federal Claims held that it had jurisdiction over 1603 cases under the Tucker Act. The Court of Federal Claims and the Government have accepted the *ARRA Energy* decision in subsequent cases. In *Desert Sunlight 250, LLC, et al. v. Lew*, 169 F. Supp. 3d 91 (2016), the U.S. District Court, District of Columbia, granted the Government's motion to dismiss and held that the Court of Federal Claims has exclusive jurisdiction over 1603 claims. The plaintiffs there had filed suit and filed a motion for summary judgment and seeking injunctive and mandamus relief to compel Treasury to pay the grant within the 60-day period prescribed by 1603.

Cases to watch:

Alta Wind: The Government has noticed its appeal to the Federal Circuit. Briefing is scheduled to begin in April 2017 with a decision expected later this year.

Sequoia: The most recent trial schedule has been vacated pending what appear to be serious settlement discussions. A decision on residential solar transactions may have to wait for another case to be filed.

California Ridge & *Bishop Hill Energy LLC*, No. 14-251C. Cases involve reductions to the grant awards of wind energy facilities based on Treasury's challenges to reported cost basis – specifically, the application of the notion of the basis being in excess of "open market expectations" and the level of permissible developer fees. Trial has not been scheduled in these cases. The Government has indicated its intention to file a motion for summary judgment.

Genesis Solar, LLC v. United States, No. 15-268C. *Genesis Solar* is the first 1603 case in the Court of Federal Claims involving a utility-scale solar farm. The issues in the case are similar to issues raised by Treasury with respect to other commercial solar facilities – issues with respect to whether certain items represent qualified property (e.g., heat transfer fluid (HTF) systems, wind fencing, water wells) and whether certain costs (e.g., land mitigation costs, permitting costs) may be capitalized to eligible basis. The case has been stayed pending settlement discussions.

Ampersand Chowchilla Biomass, LLC, et al. v. United States, No. 14-841C. Trial has been scheduled for June 12, 2017 through June 23, 2017. The issues in *Ampersand* involve whether two biomass facilities were placed into service prior to the 2009 effective date of 1603, as determined by Treasury, or within the timeframes prescribed by 1603, as alleged by the applicants in that case. The applicants have filed a motion for partial summary judgment.

* * *

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.

Contacts

Timothy L. Jacobs
tjacobs@hunton.com
202.955.1669

David S. Lowman, Jr.
dlowman@hunton.com
202.419.2070

Laura Ellen Jones
ljones@hunton.com
804.788.8746

Hilary B. Lefko
hlefko@hunton.com
202.955.1906