

Client Alert

July 2014

Government Gets Full Discovery and Avoids Summary Judgment in Section 1603 Case

As a number of cases involving Section 1603 renewable energy grants are making their way through the US Court of Federal Claims, the court issued an opinion offering a preview of the evidence that the court expects to be presented in those cases. Developers and investors will need to focus carefully on the court's analysis and structure their litigation strategies to meet it.

On July 16, 2014, in *Alta Wind I Owner-Lessor C et al. v. United States*, Nos. 13-402T et al., the US Court of Federal Claims granted the government's motion for discovery and stayed the plaintiffs' summary judgment motions. The case involved a number of transactions in which wind energy facilities were sold and then leased back by a developer. The dispute focuses on the proper cost basis for the wind energy property for grant purposes. Of particular note, the court questioned whether a sale-leaseback transaction is in and of itself a "peculiar circumstance" requiring heightened scrutiny by Treasury and the courts. A copy of the *Alta Wind* opinion is available [here](#).

In a prior case, [ARRA Energy Company I et al. v. United States, No. 10-84C \(Jan. 18, 2011\)](#), the Court of Federal Claims held that it had jurisdiction to hear claims relating to Treasury's denial or reduction of grants applied for under Treasury's Section 1603 program. For prior alert, click [here](#). The *Alta Wind* case is one of a number of Section 1603 cases filed after the *ARRA Energy* decision.

Procedural Posture

The *Alta Wind* case involves 20 plaintiffs and eight complaints with similar facts and issues. Each of the complaints involves the sale and leaseback of wind energy property. The developer was both the seller and lessee in the sale-leaseback transactions.

Prior to the litigation, the plaintiffs had applied to Treasury for payment of requested grant amounts based on their asserted cost basis for each property. In addition to other information and the relevant agreements, the plaintiffs submitted detailed asset schedules, appraisals and over 10,000 pages of information to Treasury as part of the application process. Treasury ultimately reduced the plaintiffs' grant awards because it determined the cost basis in each of the transactions was overstated. In all, over \$226 million is in issue in the Court of Federal Claims for these cases.

The plaintiffs filed their original complaint in June 2013, and then filed seven similar complaints through March 2014. After the complaints were consolidated, the plaintiffs filed motions for summary judgment in May and argued that the issues in the case were "purely questions of law" with respect to the plaintiffs' cost basis in each of the sale-leaseback transactions. The plaintiffs argued that " 'one of the verities of tax law' is that the buyer's cost basis equals the purchase price unless 'peculiar circumstances' surround the sale." The plaintiffs further argued that there were "no peculiarities" with respect to the sale-leaseback transactions and, therefore, they were entitled to judgment as a matter of law.

In response, the government filed a motion for discovery focusing on the potential for abuse in a sale-leaseback transaction: "Defendant is concerned that such an arrangement creates the opportunity to adjust terms across transactions to inflate the purchase price while preserving the buyer's targeted return

on investment.” The government requested that the court stay the plaintiffs’ motion for summary judgment and allow for full discovery. Among other things, the government asserted that it must analyze all the documentation underlying the plaintiffs’ asset schedules and investigate the appraisal and independent accountant certification.

Court’s Analysis

The Court of Federal Claims determined that the government had satisfied its burden with respect to its desired discovery. The court prefaced that “the legal standard for determining cost basis [under Section 1603] based on the purchase price is only appropriate if: (1) the purchase price actually reflects an arm’s-length transaction; and (2) the purchase price encompasses only eligible assets.” The court also stated that this determination depends on the facts surrounding the transactions, which “the Government has not fully explored at this stage.” Accordingly, the court granted the government’s motion for full discovery in the case. There are four main points in the court’s analysis.

First, the parties agreed that as a general rule the buyer’s cost basis is equal to the property’s purchase price. Likewise, it was undisputed that this general rule is not applicable “if the transaction in question was ‘not conducted at arm’s-length by two economically self-interested parties’ or was based upon ‘peculiar circumstances’ that contributed to a price inflated above the property’s fair market value,” citing *Lemmen v. Comm’r*, 77 T.C. 1326, 1347-48 (1981). The court further suggested that a sale-leaseback transaction may qualify as “‘peculiar circumstances.’” The court noted that “a sale-leaseback agreement’s potential for value transfers across transactions mirrors the value shifts found in *Lemmen*, where the US Tax Court found ‘peculiar circumstances’ were present.” The court agreed with the government that the sale-leaseback transaction “provides the opportunity to adjust terms to yield a higher purchase price without lowering the buyer’s targeted return on investment.”

Second, the court agreed with the government with respect to its entitlement to discovery on the appraisal. The court stated: “The facts strongly suggest that the appraisal values dictated purchase price amounts, as some purchase prices are exactly equal to the appraised values. Indeed, stilted appraisal methods that comport with other evidence of value shifting would engender a genuine issue of material fact, and this precludes a grant of summary judgment.”

Third, the court observed that even if no “peculiar circumstances” exist, “the Court cannot apply the general rule for determining cost basis unless the purchase price comprises only eligible assets. In accordance with the Recovery Act, Treasury issues cash grants to applicants only for their grant-eligible property, denoted as ‘specified energy property.’” Because the court found that it was unclear whether the plaintiffs purchased *only* eligible property, the court determined full discovery was permitted on that basis alone. This discovery would include the plaintiffs’ detailed work papers, accounting records and calculations used in developing its cost schedules. The court was not persuaded that discovery was not appropriate on the basis that Treasury had an opportunity to look into cost basis and was provided more than 10,000 pages in supporting documentation. The court stated: “In short, a claim of this size demands that both parties have access to the underlying calculations to ensure that the Court considers the correct valuations.”

Fourth, the court agreed with the government that any existing goodwill or going concern values must be subtracted from the purchase price because those items are not qualifying under Section 1603. For this reason, the court agreed that the government must have full discovery to identify the amount of the purchase price that constitutes goodwill and going concern value.

Key Takeaways

Alta Wind is the first opinion to be rendered by the Court of Federal Claims since the *ARRA Energy* case was decided in January 2011. The valuation and cost basis issues involved in that case are similar to a broader group of cases being litigated in the Court of Federal Claims. The plaintiffs in *Alta Wind* sought to avoid expensive discovery and trial by filing motions for summary judgment. If successful, the summary judgment template would have provided a vehicle for summarily resolving those cases.

However, the court's opinion suggests that Section 1603 litigants will have a difficult time securing summary judgment—at the least not until the government has had full discovery.

Although the court's opinion was directed at a procedural discovery motion, the opinion previewed some of the key issues to be decided and some of the government's and court's concerns. In particular, at the government's urging, the court bought into the notion that a sale-leaseback transaction may represent "peculiar circumstances" and, therefore, merit special scrutiny. In addition, again at the government's urging, the court suggested that parties to sale-leaseback transactions may be indifferent to the level of their agreed purchase price. Ultimately, it does not appear that these issues and concerns can be resolved by summary judgment. Rather, it is apparent that they will require trial and the presentation of expert valuation testimony.

Finally, once again at the government's urging, the court seemed to be persuaded that the wind energy properties sold in the sale-leaseback transactions may include goodwill and going concern value. It is hard to see how a wind facility would include any value attributable to goodwill or going concern value where, as here, the sale-leaseback transactions necessarily occurred shortly after construction of the facilities was completed. It is common knowledge that Treasury has attempted to limit grant awards on the basis that certain elements of the cost basis relate to separate intangibles. Treasury has attempted to do so with respect to power purchase agreements, lease arrangements and other items. The ruling in *Alta Wind* suggests that Treasury applicants and litigants will need to focus carefully on the components of cost basis and negate the existence of any intangible values.

The tax controversy team at Hunton & Williams LLP consists of a cross-practice group with significant experience in energy tax credits and Section 1603 Treasury grants, tax controversy and litigation. Hunton & Williams LLP is well positioned to assist Treasury grant applicants resolve disputes with Treasury. Please contact us if you require assistance with Treasury's denial or reduction of Section 1603 grant amounts.

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