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David Burton writes that the Court of Federal Claims in *Bishop Hill Energy LLC v. United States* appears to have fumbled its analysis of why Treasury shouldn't have to produce documents related to other cash grant awards for wind energy projects after dis-allowing part of the petitioner's claim. The court found the requested information irrel-evant, but it ''seems to have overlooked that in Treasury's public guidance regarding the calculation of eligible basis, it expressly acknowledged comparing applicants' projects to each other,'' he writes.

Court of Federal Claims Fumbles Section 1603 Discovery Dispute

By David Burton

The U.S. Court of Federal Claims in a recent opinion, *Bishop Hill Energy LLC v. United States*, ruled against a discovery request made to the U.S. Treasury Department. The court's opinion appeared to fumble the analysis of why Treasury shouldn't have to produce certain documents in conjunction with litigation over a shortfall in Treasury's cash grant award for a wind project.

The discovery dispute arose in an action in which Bishop Wind Energy LLC and Invenergy Wind LLC (collectively, Invenergy Wind) are seeking an additional $12.7 million in a cash grant award from the Treasury.[1]

Section 1603 of the American Recovery and Reinvestment Act of 2009 provided that Treasury was to award a cash grant equal to 30 percent of the eligible basis of a wind project.[2] In calculating its cash grant, Invenergy Wind included a $60 million ''development fee'' paid apparently to an affiliate for services such affiliate provided in connection with the development of the wind project. Such fees are appropriately capitalized into eligible basis if:

- the payor and payee aren't members of the same consolidated group[3]; and
- the fee is for services allocable to eligible property.

For instance, if the services related to obtaining a construction contract for the project, then a fee attributable to enabling that work would be included in eligible basis. In contrast, if the fee related to arranging long-term debt financing, then the fee wouldn't be includible in eligible basis.[4]

Determining a Reasonable Percentage

Based on the amount in dispute, it appears that the Treasury recognized approximately $18 million of the development fee and disallowed approximately $42 million (i.e., 30 percent of $42 million is equal to the approximately $12.7 million that is in dispute).

[1] *Bishop Hill Energy LLC v. United States*, 2015 BL 419637, Fed. Cl., No. 14-251, *unpublished* 12/21/15.

[2] Section 1603 of Division B of the American Recovery and Reinvestment Act, as amended. One of the requirements was that the wind project had to be placed in service by the end of 2012, so cash grants for wind projects are no longer available.

[3] See Treas. Reg. Section 1.1502-3(a)(2).

[4] For a detailed discussion of ''development fees'' see David Burton, ''Project Finance Developer Fees Explained,'' 227 DTR J-1, 11/25/14.

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Assuming the $60 million was equal to a 20 percent development fee (i.e., the high end of the 10 percent to 20 percent range suggested in Treasury's ''Basis Memo''[5]), then the $18 million allowed by Treasury equates to an approximately 6 percent development fee. That 6 percent is within the range of the 5 percent development fee reported as approved by Treasury in the cash grant application for a wind farm owned by Western Wind Energy Corp. that, before being acquired by Brookfield Renewable Energy Partners LP, was publicly traded on the Toronto Stock Exchange and over-the-counter in the U.S.[6]

Invenergy Wind's discovery request sought information pertaining to ''the size of 'development fees' that . . . other wind projects have paid, and the extent to which such development fees were determined by Treasury to be reasonable.''

The court denied this discovery request as it determined the requested information wasn't ''relevant'' to the dispute. The court wrote:

> Plaintiff has failed to show how Treasury's files regarding other Section 1603 applications are relevant or even potentially relevant to this inquiry . . . . The parties must necessarily focus on the specific facts of this case rather than on any alleged patterns in the disposition by Treasury of 108 Section 1603 grant applications.

Public Guidance Contemplates Comparison

However, the court seems to have overlooked that in Treasury's public guidance regarding the calculation of eligible basis, it expressly acknowledged comparing applicants' projects to each other:

> Benchmarks considered by the 1603 review team are continuously updated (as warranted) drawing on relevant publicly available information and analyses by various experts, data from existing 1603 applications and other confidential sources, and the 1603 review team's experience with solar [photovoltaic] property.[7]

Admittedly, the quoted language is referring to solar and the title of the Basis Memo provides it is specific to solar; however, this was the only guidance made public by the Treasury regarding the specifics of determining eligible basis. Therefore, unless Treasury is asserting that wind projects were analyzed using a completely different methodology than solar, it would appear that Treasury publicly acknowledged that part of the review of each project's cash grant application was comparing it to applications for other comparable projects.

Further, the court's opinion quotes the Basis Memo with no reference to the Basis Memo's principles being limited to solar.

Thus, Treasury's data with respect to other wind projects appears to meet the relatively low standard of ''relevance'' under the Federal Rules of Evidence. Evidence is relevant if:

- it has any tendency to make a fact more or less probable than it would be without the evidence; and
- the fact is of consequence in determining the action.[8]

It would appear that Invenergy Wind's $60 million development fee is ''more probable'' to be fair market value and property includible in eligible basis if:

- it was consistent with development fees paid in connection with other wind projects; and
- it was consistent with development fees recognized by Treasury in other wind project Section 1603 applications.

The behavior of other parties is relevant because, according to Treasury's Basis Memo, ''a stated cost [such as a $60 million development fee] may be inconsistent with the eligible property's true basis where a transaction is not conducted at arm's-length by two economically self-interested parties.''[9] Since the development fee paid for Invenergy Wind's project was between affiliates, it is probative as to whether such fee is properly includible in ''true basis'' if comparable fees were:

- paid in connection with other wind projects; or
- recognized in cash grants as determined by an independent expert party, such as the U.S. Treasury.

Treasury's data with respect to other wind projects appears to meet the relatively low standard of ''relevance'' under the Federal Rules of Evidence.

Such information would suggest the fee paid by Invenergy Wind to its affiliate may be consistent with arm's-length behavior, and that is Treasury's publicly stated standard for inclusion in eligible basis for Section 1603 purposes.

Learning Curve for Treasury?

In its opinion, the court quoted a large portion of the Basis Memo. The court then concluded: ''There is no indication that Treasury would attempt a meta-analysis of other Section 1603 applicants' development fee requested information in order to determine the fair market value of a particular energy property.''

It doesn't appear possible to reconcile that conclusion by the court with the Basis Memo's statement—''The first step of the review team is to compare the basis claimed to benchmarks . . . . Benchmarks considered by the 1603 review team are continuously updated . . . drawing on . . . data from existing 1603 applications.'' That process as described in the Basis Memo appears to be exactly the ''meta-analysis of other Section 1603 ap-

[5] U.S. Treasury, Evaluating Cost Basis for Solar Photovoltaic Property (June 30, 2011) (available at https://www.treasury.gov/initiatives/recovery/Documents/N%20Evaluating_Cost_Basis_for_Solar_PV_Properties%20final.pdf).

[6] Konrad, Tom, ''Western Wind Expects Full Cash Grant for Windstar,'' Alt Energy Stocks, July 29, 2012 (available at http://www.altenergystocks.com/archives/2012/07).

[7] Basis Memo.

[8] Rule 401 of Federal Rules of Evidence.

[9] Basis Memo (internal quotation marks and citation omitted).

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plicants' development fee request information'' that the court somehow concluded Treasury doesn't do.

We know from Western Wind's public statements that Treasury permitted a 15 percent development fee for its first Section 1603 application for a wind project.[10] It appears that Invenergy Wind (and for that matter Western Wind) is entitled to an explanation as to why a 15 percent development fee paid to an affiliate was appropriate in an application submitted in the early days of the 1603 program but as Treasury became more experienced the amount fell to 6 percent or less.

Is Treasury prepared to admit that with time and a larger sampling size it became more savvy so that different standards were applied to earlier and later applications? If that is Treasury's explanation, Invenergy Wind should be provided the data so it can examine Treasury's learning curve for itself.

Private Letter Ruling Comparison Flawed

The court also based its opinion on the rationale that ''decisions by Treasury on Section 1603 grant applications are analogous to private letter rulings issued by the Treasury to a particular taxpayer. The substance of such communications with an individual taxpayer unrelated to the plaintiff has no relevance to a case before this court.'' In their pleadings with respect to this discovery motion, neither side raised this line of analysis.

It isn't surprising neither party's pleadings discussed such a line of analysis: The analogy is quite weak, if not analytically flawed.

Specifically, in a private letter ruling, the taxpayer represents the facts to the Internal Revenue Service, and then the Service applies its view of the law to the facts to reach the conclusion contained in the ruling. The Service may comment on or suggest wording changes to the represented facts, but a private letter ruling isn't a fact-finding exercise.

In contrast, in this instance the applicant certified under penalty of perjury that a $60 million development fee was properly includible in ''eligible basis'' for purposes of its cash grant award. The Treasury rejected that certification and concluded that only an $18 million fee was properly includible. Effectively, the Treasury rejected the applicant's factual certification.

Therefore, this dispute isn't analogous to a private letter ruling because the Service would never issue a private letter ruling if it didn't accept the taxpayer's representations.

'Open Market Expectations'

Treasury awarded less than the requested amount because the ''cost basis was higher than the open market expectation for projects of this size and location,''[11] which is a question of fact. Thus Treasury, rather than adjusting the development fee based on legal principles, adjusted it based on ''open market expectations.'' Such a rationale by Treasury opened the door to what Treasury had determined were ''open market expectations'' with respect to other cash grant awards.

Although the cash grant program is over for wind projects and only applies to solar projects that started construction prior to 2012 and are in service by the end of 2016, the principles in dispute in Invenergy Wind's case are and continue to be relevant to renewable energy projects.

First, the Section 1603 rules were intended by Congress to mimic the investment tax credit principles of Section 48 of the Internal Revenue Code.[12] Wind projects that start construction before 2020 can qualify for an investment tax credit,[13] and solar projects qualify for an investment tax credit that ratchets down from 30 percent to a permanent 10 percent credit.[14]

Further, both wind and solar on a permanent statutory basis qualify for five-year accelerated depreciation.[15] That accelerated depreciation is itself a material tax benefit, and the determination of the amount of expenses that qualify for it follows basis calculation principles similar to those for the investment tax credit and accordingly the Section 1603 cash grant.

Therefore, renewable energy investors, developers and their tax advisers will be wrestling with issues akin to those raised in the Invenergy Wind case for years to come and must await the court's resolution of the case on the merits.

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[10] Konrad, Tom, ''Western Wind Expects Full Cash Grant for Windstar,'' Alt Energy Stocks, July 29, 2012 (available at http://www.altenergystocks.com/archives/2012/07).

[11] Complaint at 6, *Invenergy Wind v. United States*, No. 1:14-cv-00251 (March 31, 2014).

[12] Jt. Explanatory Statement of the Comm. Conf. to the American Recovery Reinvestment Act, at 115.

[13] I.R.C. Sections 48(a)(5)(C)(ii), (iii).

[14] I.R.C. Section 48(a)(2)(A).

[15] I.R.C. Section 168(e)(3)(b)(vi)(I).