

Client Alert

June 2019

Court of Federal Claims Issues 1603 Grant Opinions on Developer Fees

On June 20, 2019, the US Court of Federal Claims issued identical opinions in *Bishop Hill Energy, LLC v. United States*, No. 14-251C, and a companion case, *California Ridge Wind Energy, LLC v. United States*, No. 14-250C. After trial in July 2018, the court first issued its opinions, under seal, and judgments in January 2019, but the parties disputed redactions delaying publication of the opinions. The Court of Federal Claims held against the applicants on their claims for full payment of their Section 1603 grant awards and also held in favor of the government on its counterclaims. The opinions focus on the unique facts of the transactions in the two cases and address whether developer fees paid by an affiliate to a parent company, under the specific circumstances of the two cases, are includable in qualified cost basis for the Section 1603 grant. The Court of Federal Claims held that none of the developer fees were includable in the applicants' qualified grant basis because the fees had not been substantiated to the satisfaction of the court. The court applied as its legal basis for this disallowance, the so-called "sham" transaction doctrine applied under the tax law. A copy of each of the opinions are available at the following links: [Bishop Hill Opinion](#) and [California Ridge Opinion](#).

Background Facts

The Court of Federal Claims did not provide a full recitation of the facts in the two opinions. However, the court followed the theory and the factual findings requested by the government. The Defendant's Memorandum of Contentions of Fact and Law (June 14, 2018), filed for both cases, provides a more complete picture of the facts for both cases. For convenience, we discuss only the facts of the Bishop Hill case insofar as the key facts are virtually the same as the companion case.

Development of the Bishop Hill project began in 2005. The development was undertaken by Bishop Hill Energy, LLC (Bishop Hill) and involved a number of contractors hired by Bishop Hill. Six years later, it appears that Bishop Hill entered into a development agreement with Invenergy Wind North America LLC (IWNA), dated July 18, 2011. IWNA and Bishop Hill were affiliated companies. Both were disregarded entities for federal income tax purposes. The common parent entity was Invenergy Wind LLC (Invenergy Wind), and all tax information for the affiliated entities was reported together on Invenergy Wind's return.

The development agreement was a three-page document, according to the Court of Federal Claims, wherein Bishop Hill agreed to pay IWNA a \$60 million development fee. The government's requested findings suggest that the development agreement disclosed that this amount was intended to compensate IWNA for development services that it had already performed for Bishop Hill. The development agreement was signed by two officers of Invenergy Wind and was terminable by construction lenders if the exercise of their remedies resulted in Bishop Hill being no longer controlled by IWNA. According to the government, another single member disregarded entity of Invenergy Wind, Invenergy Wind Development North America LLC (IWDNA), transferred \$60 million to Bishop Hill's construction account in July 5, 2012. On the same day, the \$60 million amount was transferred to IWNA's operating account. And, on the same day, the \$60 million amount was transferred back to the same IWDNA account from which the amount originated. According to the government: "Thus, on July 5, 2012, \$60 million travelled through three bank accounts and in each account, the debit and credit of \$60 million cancelled each other out." Defendant's Memo. at 7.

After the development agreement was entered, on or around November 15, 2011, an entity owned by U.S. Bancorp (US Bank) entered into an Equity Capital Contribution Agreement with Bishop Hill. Under this agreement, US Bank agreed to make two contributions to a holding company, Bishop Hill Holdings (BH Holdings)—an initial contribution of approximately \$390,000 in January 2012 and a second contribution of approximately \$35 million in November 2012. BH Holdings was formed to hold all the interests in Bishop Hill after consummation of the transaction with US Bank.

Bishop Hill filed a Section 1603 grant application with Treasury, claiming a \$433 million eligible basis and requesting a \$130 million grant. Bishop Hill's basis included the \$60 million developer fee as an indirect cost. Treasury substantially reduced Bishop Hill's claimed basis on account of the \$60 million developer fee. Treasury awarded a \$117 million grant, which included \$4.4 million attributable to the reduced development fee. After Bishop Hill filed a claim in the Court of Federal Claims for the approximately \$13 million reduction in its award, the government counterclaimed for the \$4.4 million in grant proceeds attributable to the reduced development fee.

Court of Federal Claims

The Court of Federal Claims began by acknowledging that "Section 1603 permits an applicant to include a 'Development Fee' as a part of a wind energy project's cost basis" and "Development Fees may increase the cash grant awarded by Treasury" Although these two basic principles would appear well established under the tax law, the court's acknowledgment of development fees as part of the qualifying cost basis of wind (and presumably other) energy projects is helpful. The court's legal holdings, therefore, were consistent with the expectations of tax practitioners. However, the court found that the facts and circumstances of the two cases did not permit inclusion of the development fee in cost basis. Importantly, in two short opinions, the court concluded that the applicants failed to substantiate the development fees and, therefore, were not entitled to any basis for the development fees. As a consequence, the court declined any additional grant awards to the applicants and awarded the government its counterclaims for the small portion of the development fees previously allowed by Treasury.

The court focused its opinions on what it viewed as "round-trip wire transfer[s]" on the same day. The court stated: "Section 1603 reimburses an applicant for costs, not value, and an applicant is required to show real costs, defendant claims. Discovery resulting from plaintiff's lawsuit revealed information regarding the 'proof of payment', which Treasury did not have when it awarded the cash grant. Defendant contends that the transaction is a sham." After reciting the familiar rules for the "economic substance" and "sham transaction" doctrines, the court concluded that the development fees did not have any business purpose or economic substance, and that the "round-trip wire transfers" had the markings of a sham. The court was not persuaded by testimony from the chief development officer of the company or the independent accountant. The court concluded:

In sum, plaintiff proffered: an independent certification of the Development Fee that is based on information from Invenergy management; a development agreement without quantifiable services; and a round-trip wire transfer that began and ended in the same bank account, on the same day, none of which were corroborated by independent testimony. This falls well short of the burden under the sham transaction doctrine.

What remains is the uncontested fact that plaintiff benefitted from the round-trip transaction; a higher cost basis results in an increased Section 1603 payment. The sham transaction on which the \$60 million Development Fee is based lacks a business purpose or economic substance. Therefore, defendant is entitled to recapture the amount of the counterclaim.

Considering the facts and circumstances described above, the court then proceeded to dismiss the applicants' complaints and to award counterclaims to the government.

Key Takeaways

- The Court of Federal Claims expressly recognized that developer fees are includable in cost basis and are eligible for the Section 1603 grant. The same legal conclusion presumably follows with respect to the investment tax credits.
- The Court of Federal Claims expressed concern about the particular facts for Bishop Hill and California Ridge but did not express and seemingly recognized that properly substantiated developer fees paid to related parties or affiliates may be treated as part of cost basis for Section 1603 purposes.
- The Court of Federal Claims ultimately focused on what was described as “proof of payment” and substantiation issues. The “round-trip wire transfers” described in the opinions and in the background facts reminded the court of poorly structured tax shelter transactions—thus, the court’s resort to economic substance and sham principles.
- Considering the court’s reliance on “round-trip wire transfers” and lack of evidence, it is difficult to discern any major long-term impact from the court’s opinions. Specifically, it is often said that “bad facts make bad law” but, here, it appears that there are simply bad facts. The court was careful in not announcing a broader holding than necessary to support its factual and legal conclusions. The court’s legal holdings were consistent and favorable.

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