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Shearman & Sterling: Litigation Heats Up in Section 1603 Cash Grant Program for Renewable Energy Projects

Following the 2008 financial crisis, Congress enacted Section 1603 of the American Recovery and Reinvestment Act of 2009, which established a cash grant program for applicants with eligible energy properties. Energy industry participants relied upon the government to calculate the awards in a manner consistent with the calculation of tax credits under Internal Revenue Code section 48, but the government has, in some cases, awarded smaller grants after changing its formula for such calculations. Some energy participants, feeling shortchanged by the government's methodology, are now suing.

The Origins of the Section 1603 Program

Congress enacted Section 1603 of the American Recovery and Reinvestment Act of 2009 ("the Section 1603 Program") during the economic recession.¹ The 1603 Program reimburses eligible applicants for part of the cost of installing specified energy property used in a trade or business or for the production of income after the energy property is placed in service. An applicant who accepts a Section 1603 grant elects not to claim the energy tax credits under Internal Revenue Code section 48 or the renewable energy production tax credit under Internal Revenue Code section 45 for otherwise qualifying facilities placed into service on or after January 1, 2009.²

The Section 1603 Program created an investment incentive in the tax equity market in response to the reduced demand for investment tax credits that began during the recession. The program had several stated purposes, including preserving and creating jobs, promoting economic recovery, spurring technological advances, and investing in infrastructure and environmental protection. Originally set to expire at the end of 2010, the program was extended through the end of 2011.

Under the Section 1603 Program, the Treasury Department awarded more than 9,000 grants, totaling \$18.5 billion.³ Wind energy projects accounted for \$12.6 billion of grants awarded, and solar power projects accounted for \$4.4 billion.⁴ Geothermal heat pump, biomass, hydropower, landfill gas, and fuel cell energy properties constituted the other ten percent of grant awards.⁵

Program Participants and Government Dispute Grant Awards

Controversy has now arisen over certain of the grant awards, and during the past two years several participants in the Section 1603 program have filed suit against the United States alleging violation of the statutory and regulatory obligations of Section 1603. Generally, the plaintiffs in these cases claim that the government paid less than the program mandated because the government changed its basis calculation for the projects, thereby undermining the economic expectations of the participants. Although Treasury is allowing unsatisfied participants to pay back grant awards received under the Section 1603 Program and claim tax credits instead, some participants have chosen to litigate the issue instead.

Legal Basis for Suit

Section 1603(a) generally provides that the Secretary of the Treasury shall provide a grant for reimbursement to each person who applies for such grant and has placed in service specified energy property, subject to certain other conditions. Under section 1603(b), the amount of the grant is the applicable percentage of the basis of the property, which is either thirty or ten percent depending upon the type of property. Treasury promulgated cost basis rules to determine the basis for investment property that are different from the basic rules that apply under Internal Revenue Code section 48.

Blue Heron Properties v. US

On July 24, 2013, Blue Heron Properties, LLC (“BHP”), a company with multiple energy projects, brought suit against the United States in the Federal Court of Claims complaining that the government made grant payments substantially less than the amounts to which BHP was entitled under Section 1603.⁶ According to the complaint, BHP submitted an application for a grant payment in connection with its project First Brandon Oaks System.⁷ BHP claimed the full purchase price as a cost basis, and Treasury awarded the full amount requested, \$10.50 a watt.⁸ After BHP purchased three additional solar panel systems at prices between \$9.52 and \$10.50 a watt, BHP applied for grant payments under Section 1603 for those projects.⁹ The complaint alleges that BHP met all the program conditions and was therefore entitled to thirty percent of its basis in each project.¹⁰ Instead, Treasury only awarded one of the three projects the full grant amount and accepted only \$5.56 and \$5.43 a watt for the two reduced grant awards.¹¹ The complaint alleges that this is a violation of Section 1603.¹²

RP1 Fuel Cell LLC v. US

In RP1 Fuel Cell LLC v. US, another grant application that had placed in service two fuel cell power plants in California brought suit against the United States for reduced grant awards.¹³ The plaintiffs began construction of their fuel cells in 2011 and placed them into service in 2012, within the timeframes specified in Section 1603(a).¹⁴ According to the complaint, Treasury, without explanation, awarded a grant payment reduced by \$1.6 billion after removing all costs relating to gas conditioning equipment associated with the project.¹⁵

Other 1603 Litigation

The litigants in four other Section 1603 cases allege similar harms and focus on the government’s calculation of cost basis. In Vasco Winds, LLC v. US, the grant applicant filed a complaint after the government used a reduced cost basis to calculate the grant award for its wind farm in California.¹⁶ As a result the grant applicant received approximately \$6 million less than requested. After being denied a full grant award for their energy facilities, the plaintiffs in Sequoia Pacific Solar I, LLC, v. US¹⁷ and Mustang Hills, LLC v. US¹⁸ filed a complaint alleging, among other things, that Treasury improperly changed the rules of the Section 1603 Program, reduced grant payments by improperly changing the basis calculation, and undermined the economic assumptions of industry participants. Most recently, the plaintiff in Fire Island Wind LLC v. United States, alleged that the government improperly denied reimbursement to the plaintiff for construction costs associated with the construction of a Doppler Navigation System (“DNS”), in Anchorage Alaska.¹⁹ Construction of the DNS was required by the Federal Aviation Administration to obtain approval for the construction of a 17.6 megawatt wind turbine project on Fire Island.

All these cases are still in the early stages of litigation, and it is likely that more plaintiffs will come forward. Grant applications have six years after a grant is paid to file suit.

Report by the Treasury Inspector General for Tax Administration

Presently, the government is not appearing to back down from its tough stance on the Section 1603 Program grants either. On January 31, the Treasury Inspector General for Tax Administration (“TIGTA”) released a report finding significant compliance problems among participants in the energy grants in lieu of tax credits program in its first review of returns claiming Section 1603 grants.²⁰ After examining the returns of 83 taxpayers seeking Section 1603 grants, the IRS’s Small Business/Self-Employed Division found that changes were necessary to 51 of the returns.²¹ Large Business and International reviewed 16 returns and found significant issues resulting in changes for eight.²²

The review’s initial focus was on taxpayers’ 2009 tax returns but has been expanded to include 2010 and 2011 tax returns now, too.²³ The stage is set for more litigation.

Footnotes

1 Pub. L. No. 111-5, 123 Stat. 115 (2009).

2 See *id.*; see also Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 111th Congress at 109-110. JCS-2-11 No. 6 (I.R.S.), 2011 WL 940372.

3 Review of Section 1603 Grants in Lieu of Energy Investment Tax Credit, Memorandum for Deputy Commissioner for Services and Enforcement from R. David Holmgren, ref. no. 2014-IE-R006, Dec. 17, 2013, p. 1.

4 *Id.* at 2.

5 *Id.* at 2.

6 Compl. filed in *Blue Heron Properties, LLC v. United States*, No. 1:13-cv-00505 (Fed. Ct. Jul. 24, 2013).

7 *Id.* at 5-6.

8 *Id.* at 6.

9 *Id.* at 6-7.

10 *Id.* at 7-8.

11 *Id.* at 7-9.

12 *Id.* at 9.

13 Comp. No. 1:13-cv-00552 (Fed. Cl. Aug. 6, 2013).

14 *Id.* at 19.

15 *Id.* at 13, 19.

16 Compl. No. 1:13-cv-00697 (Fed. Cl. Sept. 18, 2013).

17 Compl. No. 1:13-cv-00139-ECH (Fed. Cl. Feb. 2, 2013).

18 Compl. No. 1:14-cv-00047-TCW (Fed. Cl. Jan. 22, 2014).

19 Compl. No. 1:14-cv-403T (Fed. Cl. May 12, 2014).

20 Eric Kroh, "IRS Compliance Review finds Problems with Energy Grants Program." Tax Analysts, Feb. 3, 2014.

21 Id.

22 Id.

23 Id.

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The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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