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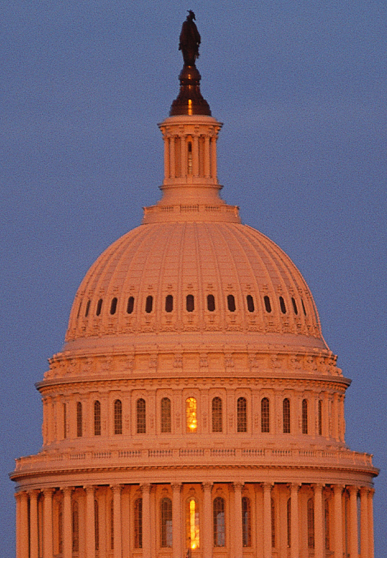

No. 2022-057
February 24, 2022

Federal Circuit: Request for Section 1603 grants denied; facilities not placed in service in 2009

The U.S. Court of Appeals for the Federal Circuit today affirmed findings of the federal claims court that the relevant biomass facilities did not meet the placed-in-service requirements of Section 1603 under the "American Recovery and Reinvestment Act of 2009," and denied a request for additional payments under Section 1603.

The case is: *Ampersand Chowchilla Biomass, LLC v. United States*, No. 2021-1385 (February 24, 2022). Read the Federal Circuit's **decision** [PDF 149 KB]

Background

In 2007, an entity acquired two defunct facilities and began restoring them and upgrading them to biomass facilities, expecting the facilities to be operational in 2008.

With the acquisition, the entity assumed certain power-purchase agreements (which were later amended to loosen their requirements). The parties also entered into interconnection agreements that required the facilities to pass pre-parallel testing to provide that the facilities could operate at the same frequency and in the same phase as the transmission grid so that the facilities did not damage the grid. While renovating in 2007, the entity secured "authority to construct" permits for the facilities. These permits allowed construction on the facilities and allowed the facilities to generate and sell electricity. The permits could be converted into "permits to operate" after the facilities met certain conditions, like emissions tests and environmental tests.

The subject facilities had their "initial fires" in April and July 2008, respectively. The facilities were labeled as being "in operation" as of May 2008 and August 2008. The facilities passed pre-parallel testing under interconnection agreements in June 2008 and August 24, 2008.

Following these events, the facilities began selling electricity on the spot market. In December 2008, one of the facilities met the requirements under its power-purchase agreement and accordingly started selling its electricity. The second facility did not start selling its electricity until February 2009, but the parties recognized that this facility had met the requirements under the power-purchase agreement based on data from the third and fourth quarters of 2008.

The facilities operated fairly continuously throughout 2009, during which the first facility operated at 53.9% capacity and the second facility operated at 51.2% capacity. The facilities occasionally were noncompliant with emissions regulations, but the facilities were allowed to continue operating and their authority to construct permits were never revoked.

The entity was experiencing financial difficulties when in 2009, Congress passed the "American Recovery and Reinvestment Act." The entity investigated whether it could apply for Section 1603 grants for the two facilities, but ultimately concluded that it could not apply for the Section 1603 grants because the facilities had been placed in service in 2008, outside of the statute's required period. Finding no resolution to its continuing financial problems, the entity suspended operations in June 2010 and decided to sell the facilities

In late 2010, the facilities were acquired by the applicant which spent nearly $15 million improving the facilities, and which passed emissions tests in August 2011. In October 2011, the applicant applied for Section 1603 grants, claiming that the facilities were placed in service when its emissions improvements were certified in August 2011. The applicant requested a $12 million grant under Section 1603 for each facility.

The U.S. Treasury Department largely rejected the claims for the Section 1603 grants because, according to Treasury, most of the property had been placed in service in 2008. Instead, Treasury granted only $1.1 million for each facility, awarded for the additional property that was eligible based on the date the applicant placed it in service.

The applicant (in fact, subsidiaries of the applicant and the direct owners of the two facilities) filed suit in the U.S. Court of Federal Claims for the remainder of the grants. The claims court held for the government, agreeing that the facilities were placed in service in 2008.

In its two-part analysis, the Court of Federal Claims first applied Treasury's regulatory definition of "placed in service," which required it to determine the "taxable year in which the property is . . . availabil[e] for a specifically assigned function."

Second, the Court of Federal Claims evaluated the five factor test—from IRS revenue rulings and *Oglethorpe Power Corp. v. Commissioner*, 60 T.C.M. (CCH) 850 (1990)—to determine when the facilities achieved their specifically assigned function and were therefore "placed in service."

The five factors are:

1. Whether the necessary permits for operation have been obtained
2. Whether critical preoperational testing has been completed
3. Whether the taxpayer has control of the facility
4. Whether the unit has been synchronized with the transmission grid
5. Whether daily or regular operation has begun

The Court of Federal Claims found that all five factors indicated that the facilities were placed in service in 2008. Therefore, the Court of Federal Claims concluded that the applicant was not owed Section 1603 grants claimed because its property was placed in service outside of the statute's designated time period.

This appeal followed.

Federal Circuit

The Federal Circuit today affirmed the decision of the Court of Federal Claims.

The Federal Circuit noted that neither the statute nor the regulations state or imply that the property must produce an anticipated or projected amount before it may be considered ready and available for a

specifically assigned function. The appeals court explained that the statute and regulation "simply do not require the strict construction" as asserted by the applicant. Thus, the Federal Circuit agreed with the Court of Federal Claims' statutory interpretation and held that a specifically assigned function need not require ideal or near-ideal production levels.

Further, the Federal Circuit noted that the Court of Federal Claims had found that all five factors under the five-factor test indicated that the facilities were placed in service in 2008—and thus the property was placed in service outside of the statute's designated time period. The Federal Circuit found that the claims court did not clearly err in its analysis of these five factors.

KPMG observation

Although the Section 1603 grant program is now expired, the placed-in-service date for a renewable power generating facility can be meaningful for the timing and amount of certain tax attributes, like investment and production tax credits and accelerated depreciation. The application of the relevant authority can be subject to different interpretations, especially because the facts can often involve, for example, multiple layers of permitting and varying durations of testing and preliminary operational phases. This case is an example of a relatively strict interpretation of the rules as applied to the facts and should be considered when evaluating similar fact patterns.