

Court Concludes on Cost Approach in *Alta Wind*, But It May Not Have Changed Status Quo

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KEY POINTS

- The U.S. Court of Federal Claims held that the cost approach, not the discounted cash flow approach, properly determines FMV of Section 1603 grant-eligible property for the *Alta Wind* projects.
- The court did not prohibit the income approach as a matter of law, finding the discounted cash flow method “not inherently defective” but insufficiently supported by evidence.
- Developer profits of 15%-20% under the cost approach were upheld, consistent with a conservative market benchmark for project valuations.
- The court’s exclusion of the Section 1603 grant from the income approach rests on its classification as a Section 197 intangible, potentially limiting the ruling’s broader impact.
- The order’s fact-specific reasoning and extensive record citations may allow taxpayers to distinguish it in future project valuation disputes.

On July 8, the U.S. Court of Federal Claims issued [an order](#) in *Alta Wind I Owner-Lessor C, et al. v. U.S.* (Nos. 13-402, 13-917, 13-935, 13-972, 14-47, 14-93, 14-174, 14-175, 17-997) finding that the government’s cost approach, with certain modifications, properly calculates the fair market value (FMV) of the Section 1603 grant-eligible property in the applicable projects. The court rejected plaintiffs’ contention that the FMV should be determined by a discounted cash flow approach and directs the parties to separately calculate the FMV of the grant-eligible property and the Section 1603 grants.

At issue in *Alta Wind* is the appropriate amount of the Section 1603 grant for several wind facilities. The *Alta Wind* plaintiffs purchased wind farms from a developer, placed them in service, and then applied to the Treasury Department for \$703 million in Section 1603 grants. The Treasury Department awarded Section 1603 grants of approximately \$495 million based on a determination that a portion of the purchase price for the wind facilities should be allocated to intangibles, potentially including going concern value and goodwill, using the residual method under Section 1060 of the Internal Revenue Code. Our analysis of previous *Alta Wind* proceedings is available [here](#).

Here are some key takeaways from the order, organized into the good, the bad, and the puzzling.

THE GOOD

- The court did not hold as a matter of law that the cost approach must be used. The court stated: “discounted cash flow for Section 1060 valuations is not inherently defective — rather, the record evidence here tilts in favor

of the cost approach over discounted cash flow.”

- In other words, the order does not foreclose the use of the income approach in appropriate cases.
- The order avoids deciding questions of law whenever possible and includes extensive citations to the record, perhaps to reduce the risks of the order being overturned on appeal. Taxpayers can argue that the fact-specific nature of the order narrows its potential impact.
- The holding that the grant should be excluded from the discounted cash flow approach appears to rely on the court’s conclusion that the grant is a Section 197 intangible. Taxpayers can argue that the court’s reasoning is specific to Section 1603 grants, which narrows the potential impact of the order.
- To address the Federal Circuit’s direction to distinguish turnkey value (which is part of grant-eligible basis) from going concern value (which is not), the plaintiffs’ expert applied a higher discount rate reflective of a merchant development-stage project.
- The court concluded that the appropriate developer profit under the cost approach was 15% for one project and 20% for the other projects.
 - The order therefore provides support for the conservative position in the market that a 15%-20% developer profit is reasonable.
 - The court did not agree with the government’s calculations of the appropriate developer profit under the cost approach and instead relied largely on the conclusions of plaintiffs’ appraiser.
- The court held that the cost approach should take into account interest and a development fee paid to prior owners of the project.
 - The conclusion that interest should be included is a welcome one.
 - The conclusion that the third-party development fee should be taken into account is surprising in light of the court’s holding with respect to the development profit paid by the plaintiffs.

THE BAD

- The court’s decision to determine FMV using the cost approach rather than the income approach is a disappointment to the energy industry. Among other things, it fails to reflect the reality that sophisticated industry participants value projects using discounted cash flow analyses.
 - The exclusion of the grant from the income approach is also a major disappointment; this is discussed below under “The Puzzling.”
- The court never really engages with the principle that a project’s value should reflect its location.
 - One striking example from the record includes testimony from one of the government’s experts, who apparently said that a turbine “sitting in a warehouse” has the same FMV as a turbine “placed in the most favorable location for production of electricity.”
- The court held that the cost approach did not include any turnkey premium over and above what was paid to the turbine suppliers and BOP contractors.
 - The turnkey premium is the value a buyer pays for the assurance that the plant and equipment will actually work together.
 - Here, the court held that the turnkey risks that are compensable with a turnkey premium were borne by the turbine suppliers and BOP contractors.
- The court held that certain amounts allocable to development rights were not included in the cost approach.
 - The court’s conclusion appears to have been driven by a lack of evidence from the plaintiffs.

THE PUZZLING

- It is hard to follow the reasoning underlying the court’s holding that the value of the grant should be excluded from the income approach’s calculations.
 - It ignores the directive that a discounted cash flow approach should include all the inflows and outflows with respect to an asset.
 - As in previous *Alta Wind* proceedings, the court was troubled by the apparent circularity that results from calculating the grant based on the income approach when the income approach takes into account the grant.

However, as discussed in [our analysis](#) of prior *Alta Wind* proceedings, the calculation can be done iteratively or, with some simplifying assumptions, with algebra. For instance, if a buyer is willing to pay \$70 for a project with no grant, it might be willing to pay \$100 for a project with a 30% grant ($\$70/(1-30\%)$).

- Absent the court's treatment of the grant as a Section 197 intangible, it would raise some truly extraordinary issues to exclude tax benefits from the income approach (e.g., a business that buys a copier is really buying two assets, the copier and a right to depreciate the copier).
 - Fortunately, the court's logic appears premised on the unusual features of the Section 1603 grant: "Whereas tax benefits such as exemptions, credits, deductions, or lower tax rates reduce tax liability associated with the income generated by an asset . . . the Section 1603 cash grant is a lump sum the government pays to reimburse the expense of the asset — regardless of income tax liability generated by the asset after it is purchased."

CONCLUSION

The *Alta Wind* saga has continued for well over a decade and, if either party appeals, it's conceivable it could extend further. In the meantime, the practical effect of the *Alta Wind* order remains to be seen. Given the centrality of the issues to the market, it's hard to ignore an unfavorable case. On the other hand, the more conservative segments of the market, which have already been enforcing a cap on development fees of 15-20%, may not be troubled by the order. The more aggressive segments of the market, which have transacted on fees above 20% when supported by an appraisal, may simply distinguish the order on the basis that its reasoning applied specifically to the Section 1603 grant and on the court's efforts to ground its conclusions in the specific facts in the record.

Please feel free to contact us with any questions about *Alta Wind*.

Gibson Odderstol also contributed to this article. He is not licensed to practice law in any jurisdiction; bar application pending in New York.

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