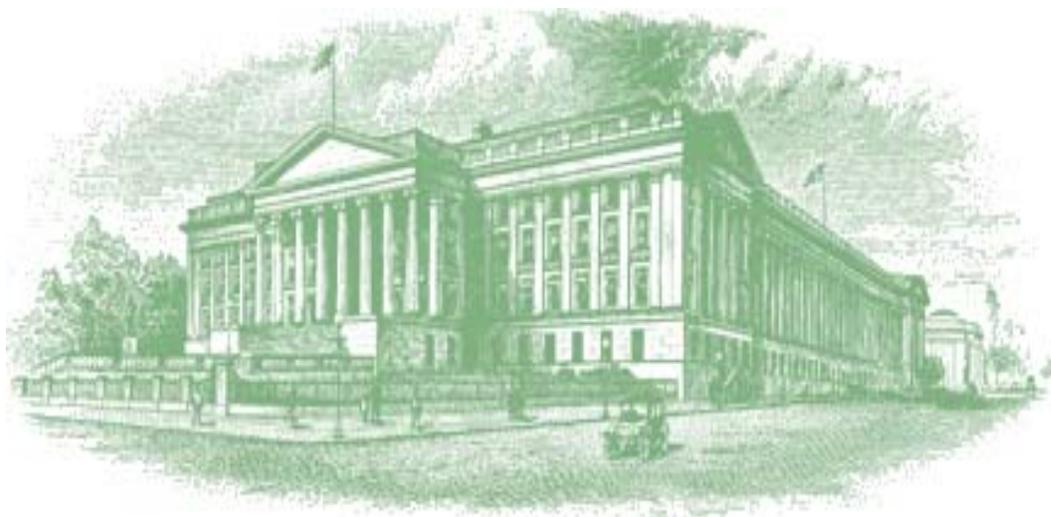




Audit Report



OIG-11-103

RECOVERY ACT: Audit of EcoGrove Wind LLC Payment
Under 1603 Program

September 19, 2011

Office of
Inspector General

DEPARTMENT OF THE TREASURY

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Abbreviations

AENA	Acciona Energy North America Corporation
AWE	Acciona Wind Energy USA, LLC
AWP	Acciona Windpower North America, LLC
EcoGrove	EcoGrove Wind, LLC
NREL	National Renewable Energy Laboratory
OFAS	Office of the Fiscal Assistant Secretary
OIG	Office of Inspector General
OMB	Office of Management and Budget
Recovery Act	American Recovery and Reinvestment Act of 2009
TD	Treasury Directive
Treasury	Department of the Treasury
Treas. Reg.	Treasury Regulation

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*The Department of the Treasury
Office of Inspector General*

September 19, 2011

Richard L. Gregg
Fiscal Assistant Secretary
Department of the Treasury

As part of our ongoing oversight of the Department of the Treasury's (Treasury) 1603 Program – Payments for Specified Energy Property in Lieu of Tax Credits (1603 Program)¹ authorized by the American Recovery and Reinvestment Act of 2009 (Recovery Act),² we are conducting audits of selected award recipients. In this regard, we have audited the award made to EcoGrove Wind, LLC (EcoGrove) for a wind energy facility in Stephenson County, Illinois. EcoGrove submitted its claim for payment in lieu of tax credit in the amount of \$67,868,807 on October 15, 2009, and was awarded that amount by Treasury on October 30, 2009. Our audit objectives were to assess the eligibility and accuracy of that award by determining whether (1) the property existed, (2) the property was placed into service during the eligible timeframe, and (3) the award amount was appropriate.

Results in Brief

We verified that the subject property described by EcoGrove in its 1603 Program application does exist and was placed in service on July 9, 2009, which was within the eligible timeframe. EcoGrove's reported cost basis of \$226,229,356 for the subject property included \$6,934,838 for costs that we believe do not comply with Treasury Regulation (Treas. Reg.)

¹ Treasury's Office of the Fiscal Assistant Secretary (OFAS) administers this program.

² Pub. L. No. 111-5, 123 Stat. 115 (Feb. 17, 2009). Under §1603 of the Recovery Act, Treasury makes grants (payments) to eligible persons who place in service specified energy property and apply for such payments. The purpose of the payments is to reimburse eligible applicants for a portion of the expense of such property and are made in lieu of tax credits that could potentially be claimed by the awardees.

§1.263A-1, EcoGrove's wind turbine supply agreement, or Treasury's Program Guidance. Ineligible costs are as follows:

- \$5,348,438 for interest for late payment
- \$831,160 for an extended warranty
- \$647,110 for spare parts
- \$79,000 for transmission lines
- \$29,130 for office furniture

As a result, we question \$2,080,452 of Treasury's 1603 Program award to EcoGrove (30 percent of \$6,934,838). We are recommending that OFAS (1) ensure that EcoGrove reimburse Treasury \$2,080,452 for the excessive 1603 Program payment received and (2) direct EcoGrove, Acciona Energy North America Corporation, and affiliated companies not to include in applications for 1603 Program awards inappropriate or otherwise ineligible costs in the claimed cost basis.

As part of our reporting process over 1603 Program awardees, we provided EcoGrove management an opportunity to comment on this draft report. In a written response, EcoGrove management did not concur with all of our questioned costs; instead, management agreed to \$118,263 of the questioned costs and plans to reimburse Treasury \$35,479 (30 percent of \$118,263). We have summarized and evaluated EcoGrove's response in the Audit Results section of this report. The response is provided as appendix 2.

Treasury management expressed partial concurrence with our recommendations and agreed that EcoGrove should reimburse Treasury \$35,479 for costs associated with transmission lines, office furniture, and expendable spare parts. However, management was unable to make a determination with respect to the remainder of the costs questioned. Management plans to seek guidance on the tax accounting issues and will take all appropriate action to seek reimbursement if warranted. The response is provided in appendix 3.

Background

Eligibility Under the 1603 Program

Applicants are eligible for a 1603 Program award if a specified energy property is placed in service during calendar years 2009, 2010, or 2011³ and the amount awarded is in accordance with provisions of the Internal Revenue Code of 1986 for determining the appropriate cost basis. Under the 1603 Program, applicants submit an application to Treasury that reports the total eligible cost basis of a specified energy property placed in service. If approved, award amounts are based on a percent of the eligible cost basis. For the type of property claimed by EcoGrove, the percentage of the cost basis eligible for award is 30 percent. According to OFAS program guidance, the cost basis of the subject property is determined in accordance with the general rules for determining the cost basis of property for federal income tax purposes. Specifically, for this type of property, applicants follow the capitalization procedures found in Treas. Reg. §1.263A-1, "Uniform Capitalization of Costs."⁴

³ Section 707 of the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," extended Treasury's 1603 Program for one year. To be eligible, a property must be placed in service in 2009, 2010, or 2011 or placed in service after 2011 but only if construction of the property began during 2009, 2010 or 2011. The application deadline was extended to September 30, 2012.

⁴ Treas. Reg. §1.263A-1(a)(3) (ii), Property produced: Taxpayers that produce real property and tangible personal property (producers) must capitalize all the direct costs of producing the property and the property's properly allocable share of indirect costs (described in paragraphs (e)(2)(i) and (3) of this section), regardless of whether the property is sold or used in the taxpayer's trade or business.

EcoGrove

EcoGrove is wholly owned by Acciona Wind Energy USA, LLC (AWE), and entered into a wind turbine supply agreement on December 30, 2008, with AWE's sister company, Acciona

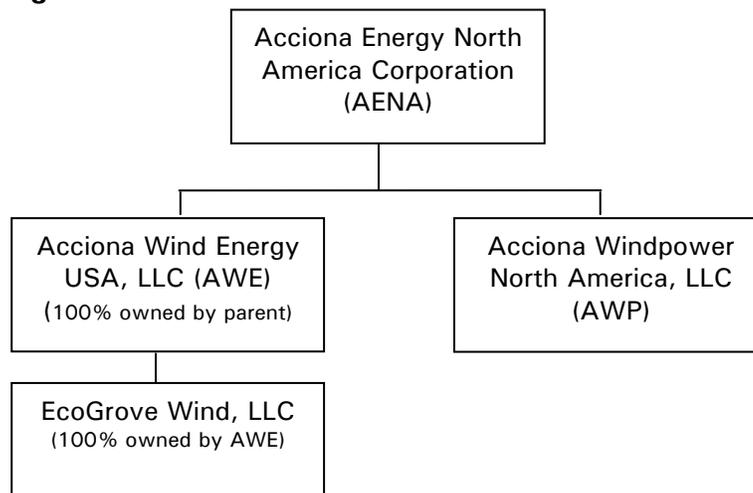


OIG Photograph (March 30, 2010)

Windpower North America, LLC (AWP), for the manufacture and supply of 67 Acciona 1.5 megawatt wind turbine generators that would generate 278.33 gigawatt hours of electricity annually. The parent

company of AWE and AWP is Acciona Energy North America Corporation (AENA). The parent company of AENA is Acciona, S.A., a foreign corporation headquartered in Spain. To date, AENA affiliates have received \$70 million in 1603 payments. The relationship of these entities is shown in figure 1.

Figure 1.



Objectives, Scope, and Methodology

To assess the eligibility and accuracy of the award made to EcoGrove under the 1603 Program, we determined whether (1) the property existed, (2) the property was placed into service during the eligible timeframe, and (3) the award amount was appropriate.

In performing our work, we visited EcoGrove's headquarters in Chicago, Illinois, and the subject property in Stephenson County, Illinois; interviewed key personnel of EcoGrove, AENA, AWP, and key personnel associated with its independent public accountant; reviewed the application and related documents used by the Department of Energy's National Renewable Energy Laboratory (NREL);⁵ and reviewed documentation used to support the costs claimed by EcoGrove. We also obtained clarification from OFAS and Internal Revenue Service personnel on eligible costs under the 1603 Program. We performed our work between March 2010 and February 2011.

Our audit was conducted in accordance with generally accepted government auditing standards for performance audits. Those standards require that we plan and perform an audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁵ NREL is a national laboratory of the Department of Energy. Under an interagency agreement between Treasury and Department of Energy, NREL performs the technical review of 1603 Program applications and advises Treasury on award decisions.

Audit Results

Questioned Costs⁶ in EcoGrove's Claimed Cost Basis

Cost Description	Claimed Cost Basis	Questioned Costs	Notes
Wind turbines	\$183,411,330	\$6,905,708	1,2,3,4
Transformers	5,248,568	0	
Substation	1,064,218	0	
Collection system	11,864,292	0	
Wind farm roads	8,892,563	0	
Weather-monitoring equipment	513,767	0	
Wind farm control and monitoring software	174,835	0	
Other	15,059,783	29,130	5
Total approved cost basis	\$226,229,356		
Total questioned costs		(\$6,934,838)	
Recalculated cost basis		\$219,294,518	
Recalculated award (30 percent of recalculated cost basis)		\$65,788,355	
Amount Awarded		<u>(\$67,868,807)</u>	
Overpayment resulting from questioned costs		(\$2,080,452)	

Note 1. Interest for Late Payment (\$5,348,438 questioned costs)

EcoGrove's wind turbine supply agreement with related party AWP provided for the manufacture and supply of 67 wind turbines at a cost of \$159,674,333. The claimed costs that EcoGrove used in making its application to Treasury under the 1603 Program include interest for late payment⁷ that was improperly charged by AWP, and therefore, should not be included in the subject property's cost basis. The details of these questioned costs are as follows:

Interest assessed prior to the contract	\$2,034,370 (a)
Unsupported interest penalty	<u>3,314,068 (b)</u>
Total interest assessed	\$5,348,438

(a) EcoGrove was assessed interest for nonpayment for the period April 2008 through December 2008, which was prior

⁶ See appendix 1 for the definition of questioned costs.

⁷ Late payment is referred to as interest in AWP's "Wind Turbine Supply Agreement §3.5".

to the date of the wind turbine supply agreement, December 30, 2008. Therefore, no amount was due in accordance with the agreement.

- (b) EcoGrove included an interest assessment for nonpayment in its 1603 claim that was unsupported. Specifically, EcoGrove was unable to provide us with documentation to show that this interest was paid in accordance with the terms of the wind turbine supply agreement. What was provided as support was an invoice from AWP for interest; however, that invoice did not have anything to do with this agreement. In fact, the invoice provided to us included an interest assessment based on the wrong principal due, the wrong interest rate, and the wrong time period.

EcoGrove Response

EcoGrove did not concur with our finding as follows.

- With respect to (a), Interest assessed prior to the contract, a common industry practice in the construction of wind farms is for the constructing company to incur costs at the beginning of a project and then charge interest to the company receiving the wind farm. Under the Second Restatement of Contracts, usage is defined as a habitual or customary practice. A “usage of trade” is a usage having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to a particular agreement. Unless otherwise agreed, a usage of [the vocation or] trade in the trade in which the parties are engaged or a usage of trade of which they know or have reason to know gives meaning to or supplements [or qualifies] their agreement.

In addition, the substance of a transaction governs its tax treatment not its form. Furthermore, every contract imposes a duty upon each party a duty of good faith; good faith can be described as faithfulness to an agreed common purposes and consistency with the justified expectation of the other party.

Even though a contract had not been signed until December 30, 2008, both AWP and EcoGrove were aware of the customary practice that AWP would incur costs and charge EcoGrove interest for those costs. Both were operating under the premise that an implied contract existed for the interest that AWP would be charging EcoGrove based on the industry practice.

- With respect to (b), Unsupported interest penalty, interest was calculated in accordance with the terms of the wind turbine supply agreement and properly included in the basis. The agreement required EcoGrove to make payments at typical industry milestones, such as substantial completion of each turbine. EcoGrove did not have the funds to pay the required installments due to AWP at the times called for by the contract. As such, EcoGrove incurred interest subject to provisions of the agreement.

OIG Comment

Based on the results of our audit and assessment of its response, we do not believe that EcoGrove has supported the questioned interest amounts included in the project's cost basis.

- (a) We considered EcoGrove's position that the wind turbine supply agreement should be interpreted not to restrict, but to include the terms regarding the payment of interest before the contract execution date as a trade usage. However, the wind turbine supply agreement clause 19.7 states that the agreement and the contract documents "supersede all prior discussions and agreements between the Parties" and contains "the sole and entire agreement between the Parties" and, more particularly, that "there are no agreements, understandings, representations, or warranties between the Parties other than those set forth herein or therein."

Therefore, the wind turbine supply agreement is, within the four corners of the document, complete and specific and must be considered an integrated agreement. Given the course of dealings of the parties, a pre-contractual interest expense is particularly unusual in this case since AWP never

made a demand upon default for payment. In short, the “trade usage” explanation is not persuasive because the terms are so significantly different than the written agreement between the parties who are both experienced in the wind energy generation field.

It should also be noted that in its response, EcoGrove stated that the amount of interest assessed prior to the contract was \$3,032,556. The amount claimed, however, was \$2,034,370.

We concluded that neither the original amount EcoGrove claimed for interest for nonpayment (\$2,034,370) nor the revised amount it included in its response to this report (\$3,032,556) should have been included in the cost basis of the subject property.

- (b) Interest of \$3,314,068 charged after the December 2008 contract date was not assessed in accordance with §3.5, Late Payments, of the wind turbine supply agreement. Section 3.5 states that when EcoGrove fails to make the appropriate payment, AWP would be entitled to accrued interest from the date that the payment was due until paid at the lesser of prime rate plus 150 basis points or the maximum rate permitted by applicable law. Based on the documentation provided by EcoGrove during our audit, the interest was not properly calculated using the method provided for in the agreement.

It should also be noted that in its response, EcoGrove stated that the amount of interest calculated in accordance with the agreement was \$2,315,882. The amount it claimed, however, was \$3,314,068. It did not, as part of the response, provide details or supporting documents of its calculation. The claimed amount of \$3,314,068 remains questioned.

Note 2. Extended Warranty (\$831,160 questioned cost)

EcoGrove included \$831,160 in the subject property’s cost basis for an extended warranty for the wind turbines. The extended

warranty, in this case, was not a cost of producing the subject property since it was not purchased in accordance with the wind turbine supply agreement between EcoGrove and related party AWP. This agreement required Ecogrove to provide written notice to AWP and make payment within 3 business days of such notice to extend the warranty. EcoGrove provided written notice to AWP in September 2009; however, payment was not made until April 2010.

Therefore, we concluded that the cost of the extended warranty was not a cost of producing the subject property in accordance with Treas. Reg. §1.263A-1 and should not be included in the subject property's cost basis.

EcoGrove Response

EcoGrove did not concur with our finding. In its response, EcoGrove agreed that the payment was not made until 2010; however, since the economic performance rules under IRC §461(h) were met, **for tax purposes**, EcoGrove capitalized the cost. EcoGrove also concluded that the extended warranty was an indirect cost of producing the subject property, as described under Treas. Reg. §1.263A-1.

OIG Comment

According to the wind turbine supply agreement, EcoGrove was to provide written notice and make payment to AWP within 3 business days of the notice to exercise the option to extend the warranty. EcoGrove provided written notice in September 2009 of its decision to exercise the option; however, it did not make payment until April 2010. Therefore, AWP was not obligated to provide the extended warranty services until both the notice and payment were received.

Furthermore, we concluded that the economic performance rule under IRC §461(h) was not met because no services were provided by AWP. Economic performance is met only when either services or properties are provided; in this case, neither one was provided.

Note 3. Spare Parts (\$647,110 questioned cost)

Under the original warranty included in the wind turbine supply agreement with related party AWP, EcoGrove was given the spare parts on AWP's Recommended Spare Parts List at no cost during the 2-year warranty period. The warranty, however, was amended on September 17, 2009, requiring EcoGrove to purchase all spare parts. Upon payment, EcoGrove would assume title to the spare parts and the risk of loss.⁸ However, title of the spare parts did not pass to EcoGrove until April 2010, 6 months after its 1603 Program claim. Therefore, since they did not own the spare parts at the time of the 1603 Program claim, we determined that the cost of the spare parts was not a cost of producing the subject property and should not be included in the cost basis.

EcoGrove Response

EcoGrove contested our determination that title and the risk of loss needed to pass in order for it to be considered the owner of the spare parts. EcoGrove considered itself the owner of the producing property, claiming that economic performance was met under IRC §461(h) since it had possession of the spare parts.

EcoGrove also stated, based on further review of the spare parts, \$10,133 of the amount originally claimed (\$647,110) should not have been included in the subject property's basis. However, it contended the amount of \$637,440 for the remaining spare parts was appropriate because the spare parts were considered to be placed in-service, in advance of actual use, at the time the subject property was placed in service. It cited Revenue Rulings (Rev. Rul.) 69-200, 69-201, 81-185, and 2003-37 as support for this position.

⁸ (c) Spare Parts. §2.9, "(b) Title to and risk of loss for the Spare Parts shall pass to Buyer at the time Buyer makes payment for the Spare Parts."

OIG Comment

EcoGrove, based on its original and amended warranty agreement with AWP, did not own the spare parts at the time of its 1603 Program claim. Accordingly, we believe the cost of the spare parts were not a cost of producing the subject property and should not have been included in the cost basis.

EcoGrove received the spare parts from its sister company AWP in April 2009 in accordance with §2.9 Stock of Spare Parts under the effective warranty agreement. The spare parts were to be provided to EcoGrove at no additional cost and were to be stored at the project site during the warranty period. The spare parts were to remain the property of AWP until they were installed or until the end of the warranty period. At the request of EcoGrove, the warranty agreement was amended in September 2009, 2 months after the July 9, 2009 in-service date of the subject property, requiring EcoGrove to purchase spare parts that it had already received in April 2009. The amendment stated that EcoGrove would pay the purchase price within 30 days of receipt of invoice. The amendment further stated that at the time of payment, the title to and risk of loss for the spare parts would pass to EcoGrove. EcoGrove received the invoice from AWP in October 2009 and did not make payment until April 2010, 6 months later.

In summary, based on our analysis and review of EcoGrove's original and amended warranty agreement with AWP, we concluded EcoGrove was not the owner of the spare parts since the terms and conditions of the amendment were not met at the time of its 1603 Program application; AWP was the owner. Additionally, economic performance was not met because EcoGrove only had possession of AWP's spare parts as delivery and storage were required in the original warranty agreement. We concur that the spare parts could be capitalized and depreciated; however, the subject property and the spare parts are two separate and distinct assets with separate cost basis and in-service dates.

Note 4. Transmission Lines (\$79,000 questioned cost)

EcoGrove included in the subject property's cost basis \$75,000 for structural steel and weatherization materials used for the transmission line towers plus \$4,000 of related indirect costs. According to Treasury's Program Guidance, transmission line costs are not eligible for the 1603 payment. Therefore, the transmission line materials and related indirect costs should not have been included in the subject property's cost basis. EcoGrove management agreed with this assessment.

EcoGrove Response

EcoGrove management concurred with our finding and noted that the cost basis should be adjusted by the amount questioned.

Note 5. Office Furniture (\$29,130 questioned cost)

EcoGrove included \$29,130 for office furniture in the cost basis of the subject property. Office furniture is neither a direct nor allocable indirect cost of producing the subject property, a wind energy facility, and therefore, should not be included in the subject property's cost basis.

EcoGrove Response

EcoGrove management concurred with our finding and noted that the cost basis should be adjusted by the amount questioned.

See appendix 2 for EcoGrove's response to this report.

Recommendations

We recommend that the Fiscal Assistant Secretary do the following:

1. Ensure that EcoGrove reimburse Treasury \$2,080,452 for the excessive 1603 Program award received for the subject property.

-
2. Direct EcoGrove, Acciona Energy North America Corporation, and any other affiliated companies not to include in applications for 1603 Program awards inappropriate or otherwise ineligible costs in the claimed cost basis.

Management Response

Management expressed partial concurrence with our recommendations and agreed that EcoGrove should reimburse Treasury \$35,479 for costs associated with transmission lines, office furniture, and expendable spare parts. However, management was unable to make a determination with respect to the remainder of the costs questioned. Management to seek guidance on the tax accounting issues and will take all appropriate action to seek reimbursement if warranted.

See appendix 3 for management's response to this report.

OIG Comment

Management's response partially meets the intent of our recommendations. We consider the cost questioned that requires further review to be an open recommendation, and, in accordance with Office of Management and Budget (OMB) Circular No. A-50 *Audit Follow-Up*⁹ and Treasury Directive (TD) 40-03, *Treasury Audit Resolution, Follow-Up, and Closure*¹⁰, a management decision must be made within 6 months of report issuance.

⁹ OMB Circular No. A-50, Action Requirements 8.a. (2) and (5)

¹⁰ TD 40-03, 5(j)

* * * * *

The information in this report should not be used for purposes other than what was originally intended without prior consultation with the Office of Inspector General regarding its applicability. Information contained in this report may be confidential. The restrictions of 18 U.S.C. §1905 should be considered before the information is released to the public. We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss this report, you may contact me at (202) 927-5400 or Donna Joseph, Audit Director, at (202) 927-5784. Appendix 4 lists the major contributors to this report.

/s/

Marla A. Freedman
Assistant Inspector General for Audit

A questioned cost is a cost that is questioned by the auditor because of an audit finding: (1) which resulted from an alleged violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances. Questioned costs are to be recorded in the Joint Audit Management Enterprise System (JAMES). The questioned costs will also be included in the next Office of Inspector General Semiannual Report to the Congress.

<u>Recommendation Number</u>	<u>Questioned Costs</u>
Recommendation 1	\$2,080,452

The questioned costs relate to excessive funds that Treasury awarded to EcoGrove under the 1603 Program. The amount questioned is 30 percent of the excessive costs included in EcoGrove's cost basis. As discussed in the audit report, the questioned costs in the cost basis consist of five components: (1) \$5,348,438 associated with interest for late payment, (2) \$831,160 associated with an extended warranty that was not a direct cost of producing the subject property or necessary to produce the subject property, (3) \$647,100 associated with recommended spare parts that was not owned by EcoGrove, (4) \$79,000 associated with ineligible transmission line costs, and (5) \$29,130 associated with furniture that is not a direct or indirect allocable cost to producing the subject property.

Appendix 2
EcoGrove's Response



ACCIONA Energy North America Corporation

331 West Wacker Drive, Suite 1500
Chicago, Illinois 60606

Tel: 312.673.3000
Fax: 312.673.3001
www.accion-na.com

May 10, 2011

Ms. Marla A. Freedman
Assistant Inspector General for Audit
Office of the Inspector General
Department of the Treasury
740 15th Street, N.W., Suite 600
Washington, D.C. 20220

Dear Ms. Freedman:

We are responding, on behalf of EcoGrove Wind, LLC to your audit report dated April 5, 2011, regarding the award made under the Department of the Treasury's 1603 Program- Payments for Specified Energy Property in Lieu of Tax Credits. The report questions \$2,080,452 of the \$67,868,807 award received October 30, 2009, by EcoGrove Wind, LLC.

We would like to express our appreciation for the chance to comment on the report and the additional time we were granted in order to research the cost items in question. The company's detailed response to each of the questioned items is attached. In summary, we agree with a reduction in the claimed basis of \$118,263 and a resulting adjustment in the award of \$35,479. Consistent with the terms and conditions of the 1603 Program, management is prepared to return the funds to the United States Department of Treasury ("Treasury") when provided repayment instructions. To the extent Treasury has additional questions or intends to rule adversely to our initial 1603 request in combination with the adjustment noted herein, we respectfully request a conference with Treasury.

Please feel free to contact me directly with any questions or concerns regarding this matter at 312-673-3045 or bfarrell@accion-na.com.

Kind Regards,

A handwritten signature in black ink, appearing to read "Brian M. Farrell".

Brian M. Farrell
Vice President Accounting
Acciona Energy North America

Enclosure

1. *General Statement of Facts.* The property in question is the 100.5 MW wind energy facility operated by EcoGrove Wind, LLC ("EcoGrove"), located in Stephenson County, Illinois. EcoGrove is wholly owned by Acciona Wind Energy USA LLC ("AWE"). AWE entered into a wind turbine supply agreement on December 30, 2008 with Acciona Windpower North America, LLC ("AWP"), for the manufacture and supply of 67 Acciona 1.5 megawatt wind turbine generators that would generate 278.33 gigawatt hours of electricity annually. The turbines are accessed by constructed project roads, and interconnected by communication and electric power collection cable within the wind farm. The collection system runs underground to the project substation where the voltage is increased and then sent via overhead transmission line to the point of interconnect. Approximately 176,000 tons of CO2 emissions will be avoided annually. EcoGrove represents AWE's first renewable-energy project in the state of Illinois. The EcoGrove Wind Farm will have the potential to deliver enough clean energy to power more than 25,000 U.S. homes. EcoGrove filed timely application for the Department of the Treasury's ("Treasury") 1603 Program – Payments for Specified Energy Property in Lieu of Tax Credit ("1603 Program") authorized by the America Recovery and Reinvestment Act of 2009 ("ARRA"). EcoGrove submitted its claim for payment in lieu of tax credit in the amount of \$67,686,807 on October 15, 2009 and was awarded that amount by the Treasury on October 30, 2009. The award was determined on an eligible project basis of \$226,229,357 or 93.5% of the total project costs of \$242,046,212. The audit report questions 3% of the award received or \$6,934,840 of the basis included in the award filing.

Grant Recipient maintains that all capitalized costs were characterized as such in good faith and through interpretation of Internal Revenue Code ("IRC") § 263A and the relating Treasury Regulations ("Treas. Regs.").

2. *Statement of Law – Principle Considerations* – The Program Guidance proffered by the Office of the Fiscal Assistance Secretary ("OFAS") of the Treasury regarding payments for specified energy property in lieu of tax credits under the ARRA specifically outlines the "Eligible Basis" for which a payment in lieu of tax credit is allowed. The guidance states that the basis of property is determined in accordance with the general rules for determining the basis of property for federal income tax purposes. Thus, the basis of property generally is its cost (IRC § 1012), unreduced by any other adjustment to basis...incurred in construction of the specified energy property. The guidance issued suggests that the taxpayer's basis in the property under the IRC is the taxpayer's eligible basis in the property under Section 1603 of the ARRA.
3. *Issues to Be Addressed*
 - A. *Interest for Late Payment (\$5,348,438 questioned costs)* – The Office of the Inspector General ("OIG") draft audit report states:

[1]

The claimed costs that EcoGrove used in making its application to Treasury under the 1603 Program include interest for late payment that was improperly charged by AWP, and therefore, should not be included in the subject property's cost basis.

- (a) EcoGrove was assessed interest for nonpayment for the period April 2008 through December 2008, which was prior to the date of the wind turbine supply agreement, December 30, 2008. Therefore, no amount was due in accordance with the agreement.
- (b) EcoGrove included an interest assessment for nonpayment in its 1603 claim that was unsupported. Specifically, EcoGrove was unable to provide us with documentation to show that this interest was paid in accordance with the terms of the wind turbine supply agreement. What was provided as support was an invoice from AWP for interest; however, that invoice did not have anything to do with this agreement. In fact, the invoice provided to us included an interest assessment based on the wrong principal due, the wrong interest rate, and the wrong time period.¹

Grant Recipient Position

During the time period between April 2008 and December 2008, AWP had begun incurring costs for the construction of the turbines for EcoGrove. While there was not a formal agreement in place, both parties were operating under the assumption that one would be reached. For the costs incurred during that time period, AWP charged EcoGrove interest.

- (a) *Interest Assessed from April 2008-December 2008* – A common industry practice in the construction of wind farms is for the constructing company to incur costs at the very beginning of the project and then to charge interest to the company receiving the wind farm. The Second Restatement of Contracts defines usage as a habitual or customary practice.² A usage of trade is a usage having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to a particular agreement.³ Unless otherwise agreed, a usage of trade in the trade in which the parties are engaged or a usage of trade of which they know or have reason to know gives meaning to or supplements their agreement.⁴ The substance of a transaction governs its tax treatment, not its form.⁵ In analyzing the doctrine of substance over form, the Supreme Court looks at the

¹ Treas. Dec. Int. Rev. Ins Gen. (Apr. 2011), 5-6.

² RESTATEMENT (SECOND) OF CONTRACTS § 219.

³ *Id.* § 222.

⁴ *Id.*

⁵ *Gregory v. Hoving*, 293 U.S. 465, 55 S. Ct. 266, 79 L. Ed. 596 (1935).

objective economic realities of the transaction rather than the form the parties employed.⁶

In addition, every contract imposes a duty upon each party a duty of good faith and fair dealing in its performance.⁷ Good faith can be described as faithfulness to an agreed common purposes and consistency with the justified expectations of the other party.⁸

Even though a contract had not been signed until December 30, 2008, both AWP and EcoGrove were aware of the customary practice that the builder, AWP, would incur costs and charge EcoGrove interest for those costs. They were both operating under the premise that an implied contract existed for the interest that AWP would be charging EcoGrove based on the industry practice.

Despite the lack of a written contract for the interest, the validity of the payment should still be respected. The substance of the transaction involves a buyer paying interest for costs incurred by a seller, which happens frequently in the wind farm construction business.

AWP did not act in bad faith when it charged EcoGrove interest because it was consistent with the justified expectations of both parties. EcoGrove was aware of the industry standard, so it anticipated having to pay interest on costs that AWP incurred before the turbine supply agreement ("TSA") was signed. The interest charged by AWP and included in basis for the period prior to December 30, 2008 was \$3,032,556.

- (b) EcoGrove entered into a wind turbine supply agreement and associated warranty agreement with AWP for the manufacture and supply of 67 wind turbines. The TSA contains language regarding late payment interest. The TSA states:

Any amount owed by Buyer hereunder beyond the date that such amount first becomes and due under this Agreement shall accrue interest from the date that it first became due and payable until the date that it is paid at the

⁶ *Frank Lyon Co. v. United States*, 435 U.S. 561, 573, 98 S. Ct. 1291, 55 L. Ed. 2d 550 (1978).

⁷ RESTATEMENT (SECOND) OF CONTRACTS § 205.

⁸ *See id.*

lesser of (i) Prime Rate plus 150 basis points or (ii) the maximum rate permitted by Applicable Law.⁹

Interest calculated in accordance with the terms of the TSA was \$2,315,882 and properly included in basis. The agreement stipulated that EcoGrove needed to make payments at typical industry milestones including downpayment, mechanical completion of each turbine, commissioning of each turbine, substantial completion of each turbine, and upon final completion. EcoGrove did not have the funds to pay the required installments due to AWP at times called for by the contract. All funds EcoGrove had available were already being used in the accumulated production expenditures for the qualifying project. As such, EcoGrove incurred interest subject to provisions of the TSA.

B. *Extended Warranty (\$831,160 questioned costs)* – The OIG draft audit report states:

The extended warranty, in this case, was not a cost of producing the subject property since it was not purchased in accordance with the wind turbine supply agreement between EcoGrove and related party AWP. This agreement required EcoGrove to provide written notice to AWP and make payment within 3 business days of such notice to extend the warranty. EcoGrove provided written notice to AWP in September 2009; however, payment was not made until April 2010.

Therefore, we concluded that the cost of the extended warranty was not a cost of producing the subject property in accordance with Treas. Reg. §1.263A-1 and should not be included in the subject property's cost basis.¹⁰

Grant Recipient Position

EcoGrove included costs in the subject property's cost basis for an extended warranty for the wind turbines. EcoGrove's TSA with AWP initially included a 2-year warranty for each wind turbine. By amendment dated September 17, 2009, the TSA was amended to provide EcoGrove with an option to purchase an extension of the warranty period. EcoGrove gave notice to AWP immediately after the amendment that they would purchase the extended warranty and incurred the warranty cost based on their accrual accounting method. The actual payment for the extended warranty was made in April of 2010.

Capitalization vs. Expense – Treatment of expenditures as currently deductible or subject to capitalization and depreciation poses considerable confusion for the IRS and courts alike. Although some items clearly represent either capital or expense expenditures, courts often struggle to distinguish items falling “between these two

⁹ Wind Turbine Supply Agreement between EcoGrove Wind LLC and Acciona Windpower North America, LLC for the EcoGrove Wind Project, (Dec. 30, 2008).

¹⁰ Treas. Dec. *supra* note 2, 6.

extremes [where] a point is approached at which it is difficult to determine whether the expenditure is capital or an expense."¹¹ Items properly characterized as capital in nature under some circumstances may warrant expense treatment in other situations.¹² No bright lines exist in characterizing these types of expenditures. Whether expenditures are currently deductible is a question of fact.¹³ Thus, taxpayers must apply the following statutorily and judicially announced principles of capitalization and deductibility to their unique factual circumstances to determine proper treatment of expenditures.¹⁴

IRC §162 allows a current deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.¹⁵ "Ordinary" in this context has been held to mean common and accepted means.¹⁶ "Necessary" has been defined as appropriate and helpful.¹⁷ Further, the regulations promulgated thereunder expand this allowance to include the costs of "management expenses ... labor, supplies, [and] incidental repairs."¹⁸ In the context of repairs, the regulations allow expense deductions for incidental repairs that "neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition."¹⁹ As indicated by the plain language of the regulations, repairs naturally may increase the value of or potentially prolong the useful life of the asset, and as such, the drafters of the regulation differentiate between allowable and prohibited expense deductions by proscribing *material* additions of value and *appreciable* extension of useful life. Additionally, some repairs require replacement items; however, the regulations limit expense treatment of repairs in the nature of replacements by requiring capitalization of replacements that both arrest deterioration and appreciably prolong the life of the subject property.²⁰

¹¹ Libby & Blouin v. Commissioner, 4 B.T.A. 910, 913 (1926).

¹² *Id.*

¹³ Tsakopoulos v. Commissioner, T.C. Memo 2002-8, 19 (2002) citing *INDOPCO v Commissioner*, 503 U.S. 79 at 86.

¹⁴ *Niagara Mohawk Power Corp. v. United States*, 214 Ct. Cl. 686; 558 F.2d 1379 (1977).

¹⁵ I.R.C. § 162.

¹⁶ *Welch v. Helvering*, 290 U.S. 111 (1933). "[w]hat is ordinary, though there must always be a strain of constancy within it, is none the less a variable affected by time and place and circumstance. Ordinary in this context does not mean that the payments must be habitual or normal in the sense that the same taxpayer will have to make them often. A lawsuit affecting the safety of a business may happen once in a lifetime. The counsel fees may be so heavy that repetition is unlikely. None the less, the expense is an ordinary one because we know from experience that payments for such purpose, whether the amount is large or small, are common and accepted means of defense against attack. Cf. *Kornhauser v. U.S.*, 276 U.S. 145. The situation is unique in the life of the individual affected, but not in the life of the group, the community, of which he is a part. At such times there are norms of conduct [industry practices] that help to stabilize our judgment, and make it certain and objective. The instance is not erratic, but is brought within a known type. . . . the decisive distinctions are those of degree and not of kind. One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle." *Id.* (question of fact)

¹⁷ *Welch v. Helvering* citing *McCulloch v. Maryland*, 4 Wheat. 316 (1819). In the context of deciding whether Congress, under the "necessary and proper" clause, was authorized to incorporate a bank of the United States, the U.S. Supreme Court also used the following terms to describe the term necessary: required, convenient, useful, essential, plainly adapted."

¹⁸ Treas. Reg. § 1.162-1(a).

¹⁹ *Id.* § 1.162-4.

²⁰ *Id.*

As stated above, the default rule for the classification of expenditures is capitalization. The IRC requires capitalization of expenditures on new property, permanent improvements, or betterments that increase the value of a property.²¹ Additionally, "amounts expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made" require capitalization.²² Capital expenditures generally include amounts paid or incurred: (1) to add to the value, or substantially prolong the useful life, of property owned by the taxpayer, such as plant and equipment; or, (2) to adapt property to a new or different use.²³ The cost of acquisition, construction, or erection of buildings, machinery, and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year is a capital expenditure.²⁴ Both direct and indirect costs attributed to a capital expenditure must be capitalized.²⁵

The capitalization provisions of IRC §263A take precedence over the deduction provisions in IRC §162.²⁶ Accordingly, the Supreme Court of the United States has noted that deductions pursuant to IRC §162 are exceptions to the norm of capitalization required under IRC §263A.²⁷ IRC §263A prevents a taxpayer from taking a current deduction for expenditures more properly attributable, through depreciation or an adjustment to basis, to income produced in future years.²⁸

Certain indirect costs have traditionally been capitalized under IRC §263 based on the Treas. Regs.²⁹ They include indirect labor costs, indirect material costs, storage costs, rent, insurance, utilities, repairs and maintenance, and many others. We are specifically concerned with indirect material costs, insurance, and repairs and maintenance costs. Indirect material costs consist of "materials that are not an integral part of specific property produced".³⁰ If the materials were not used in the production of property then they would be expensed as incurred.³¹ Insurance held on "plant or facility, machinery, equipment, materials, property produced, or property held for resale," is also a cost required to be capitalized.³² Repairs and maintenance

²¹ I.R.C. § 263(a)(1).

²² *Id.* § 263(a)(2). See *Evas*, 2 BTA 115 (1925) holding cost of replacing depreciable property not deductible expense; *Wilkes-Barre Lace Manufacturing Co.*, 1 BTA 467 (1925) holding repairs made in restoring property upon which depreciation has been deducted are not deductible (context of machines that slipped into disrepair due to lack of repair parts).

²³ Treas. Reg. § 1.263(a)-2(b).

²⁴ *Id.* § 1.263(a)-2(a).

²⁵ Taxpayers that produce real or tangible personal property must capitalize direct costs for materials and labor costs that become an integral part of an asset or are consumed in the ordinary course of business. Treas. Reg. § 1.263A-1(e)(2)(i). "Produce," as used in IRC §263A, includes construct, build, install, develop, and improve. *Id.* § 1.263A-1(g)(1).

²⁶ I.R.C. § 162.

²⁷ *INDOPCO v. Comm.*, 503 U.S. 79, 84, 112 (1992).

²⁸ *Comm. v. Idaho Power Co.*, 418 U.S. 1, 16 (1974).

²⁹ Treas. Reg. § 1.263A-1(e)(3).

³⁰ *Id.* § 1.263A-1(e)(3)(ii)(E).

³¹ *Id.* § 1.162-3.

³² *Id.* § 1.263A-1(e)(3)(ii)(M).

costs in the case of "repairing and maintaining equipment or facilities," are also defined to be a capitalized indirect cost.³³ These indirect costs when incurred for the production of property should be capitalized.

Paid vs. Incurred – The regulations state that production expenditures are taken into account under the taxpayer's method of accounting including the economic performance requirements under §461(h).³⁴ The economic performance requirements can be met when either services or properties are provided to the taxpayer.³⁵ Any production related property or services that are received and accrued for by an accrual basis taxpayer are therefore required to be capitalized by the taxpayer.

As discussed above, expenditures, often not easily distinguishable as deductible expenses or capital expenditures, frequently become the subject of debate.³⁶ We must apply the facts to the law stated in order to determine the correct classification of the cost, expense or capitalize.

Extended Warranty - The regulations and case law referenced previously show the default application of production costs is capitalization rather than expensing. In general the tax rules for capitalization under IRC §263A require items having a useful life substantially beyond the taxable year to be capital expenditures. The extended warranty is realized over the course of the contract term which in this case constitutes a multi-year agreement, longer than the normal 12-month period associated with expensing. The costs were incurred and property was received by an accrual basis taxpayer. Even though the actual payment was not made until 2010, the economic performance rules under §461(h) were met and for tax purposes EcoGrove was subject to capitalize the cost as the service of the extended warranty was received. AWP acknowledged the notice to extend the warranty during September 2009, and both parties recognized that payment was forthcoming. AWP was obligated to provide services under the extended warranty if necessary even though payment was not received until April 2010.

Grant Recipient contests this adjustment on that basis that claimed costs are an indirect cost of producing property, as described under Treas. Reg. § 1.263A-1.

C. *Spare Parts (\$647,110 questioned costs)* – The OIG draft audit report states:

Under the original warranty included in the wind turbine supply agreement with related party AWP, EcoGrove was given the option to obtain spare parts on AWP's

³³ *Id.* § 1.263A-1(e)(3)(ii)(O).

³⁴ Treas. Reg. § 1.263A-11(b)(1)

³⁵ IRC §461(h)(2)(A)

³⁶ The deduction versus capitalization classification issue was analyzed in *Zaninovich v. Comm.*, 616 F.2d 429 (CA-9, 1980). In *Zaninovich*, a calendar year taxpayer paid rent in 1973 for the period from December 1, 1973 through November 30, 1974. The court held that the payment was fully deductible in 1973 because the prepayment did not create an asset with a useful life that extended substantially beyond the close of the tax year. Additionally, in Revenue Ruling 73-357, 1973-2 CB 40, the Internal Revenue Service allowed a deduction in the year of purchase for the full cost of tires and tubes, since the useful life of these assets was less than a year.

Recommended Spare Parts List at no cost during the 2-year warranty period. The warranty, however, was amended on September 17, 2009, requiring EcoGrove to purchase all spare parts. Upon payment, EcoGrove would assume title to the spare parts and risk of loss. However, title of the spare parts did not pass to EcoGrove until April 2010, 6 months after its 1603 claim. Therefore, since they did not own the spare parts at the time of 1603 claim, we determined that the cost of the spare parts was not a cost of producing the subject property and should not be included in the cost basis.³⁷

Grant Recipient Position

As contemplated in the TSA and the associated Warranty Agreement, Eco Grove was invoiced for spare parts in the amount of \$647,110. The grant recipient purchased primarily emergency and rotatable spare parts. The parts are specific to the operation and repair of the wind turbines and will not be held for resale.

The spare parts are in service in advance of actual use. Treasury cash grants are paid only on property that is in service when the owner submits its application. Spare parts are in service in advance of actual use in two situations.

1) The parts are part of a pool of spare parts that a company keeps on hand to use in servicing its equipment. This only applies where the parts are "rotatable," meaning the company replaces a defective part using one from the pool and then puts the defective part into the pool, after it has been repaired, for reuse in another machine.

An example is where an airline keeps a pool of rotatable spares on hand for use in maintaining engines.

In Rev. Rul. 69-200, 1969-1 C.B. 60, the IRS said a pool of repairable and reusable parts that an airline kept on hand to avoid operational downtime for its aircraft were in service in advance of actual use. When the airline purchased new aircraft, it also bought "a substantial number of flight equipment rotatable parts and assemblies specifically for use on such aircraft. Even though these parts may not be immediately installed, they are, when purchased, necessary and essential to the profitable operation of the airline." The IRS said such parts are in service at the same time the aircraft for which they are purchased are put into service. It distinguished rotatable spares from "expendable spares" that, once installed, are not ordinarily repaired or reused.

In Rev. Rul. 69-201, standby replacement parts that a mining company kept on hand to repair "major items of machinery and equipment, including haulage trucks, conveyors, converters, drills, power shovels, crushers, and skip haulage systems" were in service in advance of actual use. The agency said the parts are generally repaired and reused three to four times after their original use in

³⁷ Treas. Dec. *supra* note 2, 6..

replacing a like part in a machine, are usually purchased as a parts pool when the original equipment is purchased and are difficult to obtain quickly on short notice.³⁸

2) Standby replacement parts are also in service in advance of actual use if they are "emergency spares."

In Rev. Rul. 81-185, an electric utility kept major parts on hand to deal with unexpected breakdowns in equipment. The Federal Energy Regulatory Commission treated the spares as in service for regulatory purposes. The IRS said they were also in service for tax purposes. The IRS described them as parts that are normally acquired at the same time machinery is purchased, kept at the site to avoid substantial operational downtime due to unexpected shutdowns, only available on special order, not subject to normal periodic replacement, and not repaired and reused. Examples are a bearing seal for a plant generator or a rotor support bearing for use in an air preheater. The IRS distinguished them from "expendable spares" that are not in service until actually used. Expendable spares do not require substantial special order lead times and are minor items that are subject to normal periodic replacement.³⁹

The turbine contract in this case required AWP to provide a recommended spare parts list for operation of the turbines and to deliver the spares on the list for storage at the site no later than the "Substantial Completion Date" for the project.

Revenue Ruling 2003-37 outlines the IRS position of capitalizing spare parts in which taxpayers are allowed to capitalize and depreciate rotatable spare parts. The parts are specific to the operation and repair of the wind turbines and will not be held for resale. Furthermore, indirect material costs are specifically capitalized under the regulations when used for production property. They are expected to be utilized over the usual life of the turbines as repairs are needed. The useful lives of the turbines are greater than a year and extend past the default 12 months associated with expensing costs. In addition, if the spare parts are considered to be repair and maintenance costs then they also would be considered capitalized indirect costs under the Treas. Regs.⁴⁰

Paid vs. Incurred – The regulations state that production expenditures are taken into account under the taxpayer's method of accounting including the economic performance requirements under §461(h).⁴¹ The economic performance requirements can be met when either services or properties are provided to the taxpayer.⁴² Any

³⁸ Rev. Rul. 69-201, 1969-1 C.B. 60. Cf. *Hewlett Packard, Inc. v. United States*, 71 F.3d 398 (Fed. Cir. 1995), rev'g *Apollo Computer, Inc. v. United States*, 32 Fed.Cl. 334 (1994) (investment credits allowed on rotatable spares kept by a computer company in a maintenance pool to replace broken parts in customer machines); *Honeywell, Inc. v. Commissioner*, 1992 T.C.M. 453 (1992), aff'd 27 F.3d 571 (8th Cir. 1994) (similar holding); Rev. Rul. 2003-37, 2003-1 C.B. 717 (IRS says it will follow the decisions in these cases).

³⁹ Rev. Rul. 81-185, 1981-2 C.B. 59.

⁴⁰ Treas. Reg. § 1.263A-1(e)(3)(ii)(O).

⁴¹ Treas. Reg. § 1.263A-11(b)(1)

⁴² IRC §461(h)(2)(A)

production related property or services that are received and accrued for by an accrual basis taxpayer are therefore required to be capitalized by the taxpayer.

Risk of Loss – The regulations provide that although in general “a taxpayer is not considered to be producing property unless the taxpayer is considered an owner of the property produced under federal income tax principles,” ownership is to be determined “based on all of the facts and circumstances.” A taxpayer “may be considered an owner of property produced, even though the taxpayer does not have legal title to the property.”⁴³ Furthermore, tax courts have specifically shown the, “identification of the owners of property for purposes of UNICAP rules does not necessarily rest on who bears the risk of loss when the product is fabricated, or, for that matter, on who actually turns the screws or hammers the nails.”⁴⁴

In this specific case while the risk of loss did not pass to EcoGrove until April 2010, the cost still would have been required to be capitalized for tax purposes since economic performance was met with the receipt of the spare parts in addition to the facts surrounding the situation. The spare parts were a necessary business expense in addition to the warranty provided in the TSA since previous project experiences have shown that orders under part warranties can be slow due to backorders. The cost of downtime for the property due to part failure can be significantly more than the cost of having spare parts on hand. This is common practice for affiliated projects and even third party projects.

Grant recipient performed a detail review of the spare parts list under this criteria and determined that \$10,133 of the previously claimed amount should not have been included in basis (See attached Schedule 1). The remaining balance of \$637,440 is appropriately included in basis as in service emergency or rotatable spares.

D. *Transmission Lines (\$79,000 questioned costs)* – The OIG draft audit report states:

According to Treasury's Program Guidance, transmission line costs are not eligible for the 1603 payment. Therefore, the transmission line materials and related indirect costs should not have been included in the subject property's cost basis.⁴⁵

Grant Recipient Position

Grant Recipient concedes. The inclusion of transmission line materials was an oversight and not an intentional misapplication of the rules. The basis should be adjusted by the \$79,000.

E. *Office Furniture (\$29,130 questioned costs)* – The OIG draft audit report states:

⁴³ Treas. Reg. § 1.263A-2(a)(1)(ii)(A).

⁴⁴ *Suzy's Zoo v. Commissioner*, 114 T.C. No. 1 (2000)

⁴⁵ Treas. Dec., *supra* note 2, 6.

Office furniture is neither a direct nor allocable indirect cost of producing the subject property, a wind energy facility, and therefore should not be included in the subject property's cost basis.⁴⁶

Grant Recipient Position

Grant Recipient concedes. The inclusion of office furniture was an oversight and not an intentional misapplication of the rules. The basis should be adjusted by the \$29,130.

⁴⁶ Treas. Dec., *supra* note 2, 6.

Appendix 3
Management's Response



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON

Marla Freedman
Assistant Inspector General for Audit
Department of the Treasury
Office of Inspector General
740 15th Street, N.W., Suite 600
Washington, D.C. 20220

Dear Ms. Freedman:

Thank you for the opportunity to comment on the draft audit report of the Section 1603 award made to EcoGrove Wind Farm, LLC (EcoGrove). We partially concur with the recommendations contained in the report.

The draft report recommends that the Office of the Fiscal Assistant Secretary (OFAS) ensure that EcoGrove reimburse Treasury in the amount of \$2,080,452 from a Section 1603 payment of \$67.9 million made in October, 2009 for a wind farm located in Stephenson County, Illinois. This recommendation is based on a finding that EcoGrove improperly included in their claimed cost basis costs for interest, an extended warranty, spare parts, transmission lines, and office furniture. OFAS concurs that costs associated with transmission lines, office furniture and expendable spare parts are not properly included in basis and therefore concurs that EcoGrove should reimburse Treasury in the amount of \$35,479 for such costs.

OFAS is not able at this time to make a determination with respect to the remainder of the costs questioned by the report. The report primarily bases its conclusions with respect to these costs on EcoGrove's failure to comply with the terms of its turbine supply agreement under which these costs arose. While the information contained in the report includes sufficient information to question these costs, we nevertheless are of the view that additional analysis of the tax accounting issues raised by EcoGrove is necessary before we can determine if reimbursement is appropriate. OFAS will therefore seek guidance on the tax accounting issues raised and will take all appropriate action to seek reimbursement if warranted.

Sincerely,

Richard L. Gregg
Fiscal Assistant Secretary

Appendix 4
Major Contributors To This Report

Donna Joseph, Director
Erica Wardley, Audit Manager
James Hodge, Auditor-in-Charge
Cheryl Sroufe, Auditor
Lisa Carter, Auditor
Roberta Wright, Auditor
Jenny Hu, Referencer

Department of the Treasury

Assistant Secretary for Management of the Treasury,
Chief Financial Officer, and Chief Performance Officer
Fiscal Assistant Secretary
Deputy Chief Financial Officer
Director, Office of Accounting and Internal Controls
Deputy Director, Office of Performance Budgeting
Program Manager, Office of Fiscal Assistant Secretary

Office of Management and Budget

OIG Budget Examiner

Acciona Energy North America Corporation

Chief Financial Officer
Vice President, Accounting