

DOE Loan Guarantee Program Developments

by Kenneth Hansen, in Washington

Recent days have seen a series of significant developments with respect to the deployment of the Department of Energy's Loan Guarantee Program under the Energy Policy Act of 2005. This memo reviews (i) the two solicitations issued July 29, (ii) the Cash-for-Clunkers \$2 billion raid on the Stimulus Act's \$6 billion credit subsidy cost appropriation, and (iii) the proposed revisions to the regulations governing the Loan Guarantee Program (the Final Rule).

The New Solicitations

First was the issuance on July 29 of two new project solicitations.

The Renewables (Etc.) Solicitation

One is for "Innovative Energy Efficiency, Renewable Energy, and Advanced Transmission and Distribution Technologies" issued jointly Section 1703 of the EPA, for projects embodying innovative technologies, and Section 1705, for renewable energy, manufacturing of components for renewable energy projects, transmission and leading edge biofuels projects as authorized under the American Reinvestment and Recovery Act, the so-called Stimulus Act.

This solicitation, which is projected to provide about \$30 billion in loan guarantees, rests on two distinct forms of financial authorizations provided to DOE. First is \$8.5 billion authorization for Section 1703 innovative project loan guarantees, along the lines of the several solicitations that DOE has previously issued. Second, it offers up to \$2.5 billion of the roughly \$6 billion credit subsidy cost appropriation under the Stimulus Act for projects that qualify under Section 1705 — i.e., renewable generation, manufacturing components for renewable generation, advanced transmission, and leading edge biofuels projects that are prepared to:

- (i) break ground by September 11, 2011;
- (ii) pay Davis-Bacon compliant "prevailing wages" to their construction workers;
- (iii) comply with certain reporting requirements; and
- (iv) for "public works," comply with certain "Buy American" requirements for iron, steel and manufactured components.

The consequences of being a Section 1703 project that cannot, or chooses not to, comply with Section 1705 are that

(i) the borrower will have to pay its credit subsidy cost as an additional closing cost (a significant amount that, absent further changes to the Final Rule, does not qualify as a financeable project cost), and (ii) something new in this solicitation, no other federal "funds," "property" or "personnel" can be "expected to be used (directly or indirectly)" to "support the project or to obtain goods or services from the project." This prohibition is, however, subject to several carve-outs. The carve-outs permit projects to receive Sec. 1603 ITC tax grants and to be erected on federal lands (so long as the leases comply with certain terms).

This federal double-dipping prohibition was imposed by the FY2009 Omnibus Appropriations Act that provided the \$8.5 billion being allocated under this solicitation for Section 1703 projects. Thus, it applies only to Section 1703 projects that do not also qualify under Section 1705 (such as energy efficiency projects). That is, another consequence of being a Section 1705-qualifying project under this solicitation is that, not only can the credit subsidy costs be paid for DOE, but also the federal double-dipping prohibition will not apply. It also does not affect projects that have applied, or will apply, under any other Section 1703 or Section 1705 solicitation (such as, for instance, the upcoming Section 1705 solicitation for commercial technology projects).

The \$30 billion estimate of supportable projects under this solicitation is probably conservative. Given the \$8.5 billion authorized under the FY2009 Omnibus Appropriations Act, \$21.5 billion in projects is impliedly estimated to be supportable from the \$2.5 billion in credit subsidy appropriation to be allocated to projects under this solicitation. That implies an average credit subsidy rate of 11.6%. The volume of guarantees supportable from this allocation depends on the project-by-project determination of credit subsidy cost requirements, but the implied 11.6% average seems high. If so, DOE will either be able to support more than \$30 billion in guarantees with the allocated credit subsidy cost appropriation or, when they reach \$30 billion, some portion of the allocated appropriation will remain to be deployed under future solicitations.

Applications under this solicitation are / *continued page 2*

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to be submitted in two parts, the first providing a broad overview of the project and a basis for the DOE to decide whether the project merits further consideration. If DOE decides to continue, a Part II application will be due approximately two months following the related Part I due date. The first Part I due date is September 14 with successive monthly due dates through August 24, 2010. DOE has also indicated that, upon notice to DOE, an applicant that requires more time to finalize its Part II application can take advantage of later Part II due dates.

Twenty-five percent of the application fee (\$75,000 for applications for up to \$150 million, \$100,000 for applications for \$150 million to \$500 million, and \$125,000 for applications for loan guarantees for more than \$500 million) is due with the Part I application. The 75% balance is due with the Part II application.

All projects supported under this solicitation will qualify for Federal Financing Bank funding expected to be offered at roughly 25 bps over Treasuries of a maturity comparable to that of the DOE-guaranteed loan.

The Transmission Solicitation

The second July 29 solicitation is for "Electric Power Transmission Infrastructure Investment Projects," was issued under Sec.1705 (i.e., no innovation requirement applies). \$750 million of the Stimulus Act's \$6 billion subsidy appropriation is allocated to support qualifying transmission projects.

The volume of transmission projects supportable from this allocation depends on the project-by-project determination of credit subsidy cost requirements. Some experts are arguing that, because of the rate-based support available for many such projects, the appropriate credit subsidy rate could be as low as 1%, which would permit this allocation to support a plentiful \$75 billion in projects. Rumors have surfaced, however, that OMB would favor a rate more like 10%, which would radically reduce (for instance to \$7.5 billion) the volume of available transmission guarantees. Further contraction could also result from the Cash-for-Clunkers raid. See below.

Applications under this solicitation are also to be submitted in two parts, the first providing a DOE a basis for deciding whether the project merits further consideration. If DOE decides to continue, a Part II application will be due. Unlike the renewables solicitation, there is only one Part I

due date, which is September 14, 2009. There are, however, a series of three optional Part II due dates: October 29, 2009, December 10, 2009, and January 25, 2010.

An application under the transmission solicitation is pricey: \$800,000, with 25% (\$200,000) due with the Part I application and the 75% balance (\$600,000) due with the Part II application.

Projects under this solicitation will also qualify for Federal Financing Bank funding.

Cash-for-Clunkers Raid on the Section 1705 Credit Subsidy Cost Appropriation.

Two days after DOE issued these solicitations, the House passed an emergency \$2 billion increase in funding for the Cash-for-Clunkers program, providing that the funds would be transferred from the DOE's \$6 billion Section 1705 appropriation because (according to OMB), "the DOE is not using it." The Senate passed it, and on Friday, August 7, the President signed it into law. The White House has, however, also indicated that the Administration will seek to have these funds restored.

In the event that were not to happen, the immediate impact of the raid is potentially to gut the upcoming commercial solicitation of resources. The credit subsidy appropriation originally available totaled \$5.965 billion (\$6 billion less \$25 million carved out for administrative expenses of the LGPO and \$10 million transferred to the advanced vehicle technology manufacturing program). As noted above, the DOE has already allocated up to \$3.25 billion of that appropriation (\$2.5 billion to the renewables solicitation and another \$0.75 billion to the transmission solicitation). This left \$2.715 billion available to be allocated in the solicitation for commercial technology projects, which is expected to be released by DOE within the next several weeks. With the Cash-for-Clunkers program taking \$2 billion, however, the credit subsidy cost appropriation remaining available to support commercial projects would be only \$0.715 billion or, using the popular conversion rate of 10%, enough to support \$7.15 billion in guarantees (of which a portion will be required for Section 1705-compliant projects already in the pipeline). This would be a drastic reduction of the \$25 billion to \$30 billion guarantee capacity that was expected to be available.

One thing that seems clear, however, is that, if these funds are not restored, this collapse of / *continued page 3*

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the commercial program will not stand. DOE is highly likely to amend the recent solicitations to spread the pain evenly, or in some fashion, across all project categories.

Revised Final Rule.

The DOE demonstrated this past week that they've been listening. The key revelation is in the preamble to the Notice of Proposed Rulemaking which states "DOE has concluded that section 1702 of Title XVII does not mandate that DOE receive a first lien position on project assets" [emphasis added]. That insight triggered a cascade of changes in the rule with respect to (i) flexibility in the scope of the required collateral package, (ii) flexibility in sharing liens in that collateral package, and (iii) cooperating and sharing control with co-lenders in the work-out process. Specifically, the revised rule authorizes the DOE to negotiate whatever collateral package it deems consistent with its underwriting requirements and its fundamental obligation to seek a "reasonable prospect of repayment," so long as it is not subordinated to other lenders. That collateral package, which might include non-project assets, can be shared on a pari passu basis with other project lenders. DOE is, under the proposed revised rule, free to enter into intercreditor arrangements that share control of decision-making in a default scenario.

The proposed revised rule is subject to a 30-day public comment period. There remain points in the Final Rule that could be improved, and these will doubtless receive attention during the public comment period. As to each of the key issues addressed in the proposed revised rule, however, the LGP is finally exactly where it ought to have been from the beginning. ☺

August 2009