

# Client Alert

Latham & Watkins Finance Department

## US Department of Energy Issues the First Two Title XVII Loan Guarantee Solicitations Since the Enactment of the Recovery Act

### Introduction

On July 29, 2009, the US Department of Energy (DOE) issued two solicitations under the loan guarantee program initially established by Congress in Title XVII of the Energy Policy Act of 2005 (Title XVII). These solicitations represent the sixth and seventh solicitations issued under Title XVII, and, importantly, the first solicitations issued since the enactment of the American Recovery and Reinvestment Act of 2009 (Recovery Act), which amended Title XVII.

The first solicitation offers \$8.5 billion in loan guarantees to applicants under the pre-Recovery Act loan guarantee program (Section 1703 Program) in support of eligible projects employing "New or Significantly Improved Technologies" (Innovative Technologies Solicitation). It also makes available an additional \$2.5 billion to pay the "Credit Subsidy Costs"<sup>1</sup> for applicants who, in addition to meeting the requirements of the Section 1703 Program, also meet the requirements of the temporary loan guarantee program established in the Recovery Act (Section 1705 Program). It is important to note that the Innovative Technologies Solicitation does not seek submissions from applicants who only meet the requirements of the Section 1705 Program. Rather, the threshold question under the Innovative

Technologies Solicitation is whether the applicant meets the requirements of the Section 1703 Program. If the applicant meets those requirements and also meets the requirements of the Section 1705 Program, then it is eligible to seek not only a loan guarantee, but also to have the Credit Subsidy Costs associated with that guarantee paid from funds appropriated under the Recovery Act.

The second solicitation (Transmission Infrastructure Solicitation) offers loan guarantees, supported by \$750 million to pay the Credit Subsidy Costs associated with such guarantees, for "Electric Power Transmission Infrastructure Investment Projects" under the Section 1705 Program.

DOE issued the Innovative Technologies Solicitation under the current regulations implementing the Section 1703 Program (Section 1703 Regulations). The Section 1703 Regulations will also apply to the subset of applicants under the Innovative Technologies Solicitation that, in addition to meeting the requirements of the Section 1703 Program, also meet the requirements of the Section 1705 Program and are therefore seeking to have their Credit Subsidy Cost paid from Recovery Act funds. For a detailed discussion of, and several key considerations regarding, the

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Section 1703 Regulations, please refer to Latham & Watkins Client Alert, Department of Energy Title XVII Loan Guarantee Program: Key Considerations, Mar. 24, 2009.<sup>2</sup>

The Transmission Infrastructure Solicitation is issued under slightly revised "Applicable Provisions," which themselves may offer insight into the possible structure and substance of forthcoming regulations to implement the Section 1705 Program.

This *Client Alert* describes the scope of these two solicitations, offers insight into the possible structure and substance of the Section 1705 Program regulations that are expected to be issued shortly, and highlights several key procedural changes.

## Background on Solicitations

### The Innovative Technologies Solicitation

The Innovative Technologies Solicitation<sup>3</sup> makes available up to \$8.5 billion in loan guarantees to applicants for eligible projects that employ one or more "New or Significantly Improved Technologies"<sup>4</sup> under the Section 1703 Program. In addition, the Innovative Technologies Solicitation offers an additional \$2.5 billion to pay the Credit Subsidy Costs for applicants who, in addition to meeting the requirements of the Section 1703 Program, also meet the requirements of the Section 1705 Program. Of the \$2.5 billion available for Credit Subsidy Costs, \$500 million is reserved for applicants seeking loan guarantees for "leading edge biofuel projects." As described in this *Alert*, the Innovative Technologies Solicitation is anticipated to result in loan guarantees to support debt financing for eligible projects in an amount in excess of \$30 billion.<sup>5</sup>

#### Eligible Projects

A project must qualify under the Section 1703 Program to qualify for a

loan guarantee under the Innovative Technologies Solicitation. Under the Section 1703 Program, a project must (a) avoid, reduce or sequester air pollutants or anthropogenic emissions of greenhouse gases and (b) employ one or more New or Significantly Improved Technologies. Given the criteria's broad scope, a wide range of projects may qualify, from manufacturing facilities to stand-alone projects in sectors including but not limited to the following: (i) alternative fuel vehicles; (ii) biomass; (iii) efficient electricity transmission, distribution and storage; (iv) energy efficient building technologies and applications; (v) geothermal; (vi) hydrogen and fuel cell technologies; (vii) energy efficiency projects; (viii) solar; and (ix) wind and hydropower. An illustrative list of eligible projects in each of these categories is provided at Attachment E to the Innovative Technologies Solicitation.

If a project applies under the Innovative Technologies Solicitation to have its Credit Subsidy Costs paid from Recovery Act funds, it must meet the requirements of the Section 1705 Program, in addition to the requirements of the Section 1703 Program. Under the Section 1705 Program, a project must fit within one of the following three categories: (a) renewable energy systems, including incremental hydropower, that generate electricity or thermal energy and facilities that manufacture related components; (b) electric power transmission systems, including upgrading and reconditioning projects; and (c) leading edge biofuel projects that will use technologies performing at the pilot or demonstration scale that DOE determines are likely to become commercial technologies and will produce transportation fuels that substantially reduce life-cycle greenhouse gas emissions compared to other transportation fuels.

While DOE has not yet defined “renewable energy systems,” it clarifies in the Innovative Technologies Solicitation that energy projects listed in the illustrative list of eligible projects (Attachment E) will be considered “renewable energy systems.”

Significantly, a project is eligible under the Section 1705 Program only if the project will “commence construction” no later than September 30, 2011. In the Innovative Technologies Solicitation (as well as in the Transmission Infrastructure Solicitation), DOE has clarified that construction will be deemed to have commenced once the applicant has (a) obtained all licenses, permits, and local and national environmental approvals required to proceed with the project; (b) completed all pre-construction design and prototype testing; and (c) engaged all contractors and ordered all pertinent equipment and supplies, so that physical construction of the project has or will begin prior to September 30, 2011.

#### **Additional Requirements for Section 1705 Program Applicants**

Applicants seeking to have their Credit Subsidy Costs paid from Recovery Act funds under the Innovative Technologies Solicitation (*i.e.*, applicants that meet the requirements of both the Section 1703 and 1705 Programs) must fulfill several additional obligations established in the Recovery Act:

- *Davis Bacon Act requirements:* An applicant will be required to comply with the prevailing wage requirements of the Davis Bacon Act;
- *Job Creation or Retention:* Eligible projects must either create or retain jobs. An applicant will be required to report quarterly to DOE regarding, among other things, the number and type of jobs created and retained by the project;
- *Buy American provisions:* If an applicant’s project involves the “construction, alteration,

maintenance, or repair of a public building or a public work,” then all iron, steel, and manufactured goods used in the project must be produced in the United States;

- *Commercialization Readiness:* An applicant must include in its application “a minimum of 6 months operating and performance data, including 1,000 to 2,000 hours of operation data” obtained from a demonstration project, to illustrate to DOE that the project is ready to proceed to commercialization. Moreover, an applicant must demonstrate that it has selected and obtained control of the site; and
- *Construction Commencement:* Project construction must commence by September 30, 2011. DOE plans to include this requirement as a condition precedent to closing a loan guarantee agreement, and DOE will retain the option either to terminate the loan guarantee agreement (or withdraw the conditional commitment) or require the applicant to pay the Credit Subsidy Cost for the project at closing (in such a case, the loan guarantee would be issued solely under the Section 1703 Program).

#### **The Transmission Infrastructure Solicitation**

The Transmission Infrastructure Solicitation<sup>6</sup> makes available loan guarantees to Section 1705 Program applicants for projects that (a) employ Commercial Technologies (defined later in this *Alert*); (b) are reasonably likely to commence construction no later than September 30, 2011; (c) cannot be “financed from private sources on standard commercial terms;” and (d) meet at least one of the following criteria:

- Involve new or upgraded lines of at least 100 miles of 500 kV or higher or 150 miles of 345 kV;
- Have at least 30 miles of transmission cable under water;

- Have a high voltage direct current component;
- Be a major interregional connector;
- Be designated as a National Interest Electric Transmission Corridor by DOE;
- Be associated with offshore renewable energy generation;
- Mitigate a substantial reliability risk for a major population center; or
- Involve a set of improvements to an integrated system within a state or region that together involve new or upgraded lines of at least 100 miles of 500 kV or higher or 150 of 345 kV.

The Transmission Infrastructure Solicitation further provides that projects that support the generation of power from renewable energy resources will receive special consideration. At the same time, the solicitation indicates that transmission projects that do not meet any of the criteria set forth above may be eligible to apply for a loan guarantee under separate future solicitations.

The Transmission Infrastructure Solicitation provides that DOE will make available up to \$750 million to pay Credit Subsidy Costs, which DOE has indicated will support several billion dollars in loan guarantees. DOE's authority to issue loan guarantees under this solicitation expires on September 30, 2011. Applicants under this solicitation are subject to the same Section 1705 Program requirements as applicants seeking to have their Credit Subsidy Costs paid under the Innovative Technologies Solicitation (see the earlier discussion). If a transmission project does not commence construction on or before September 16, 2011, DOE will terminate the project's loan guarantee or withdraw the project's conditional commitment. Finally, and as discussed in greater detail later in this *Alert*, Part I applications must be submitted by September 16, 2009.<sup>7</sup> Part II applications may be submitted on a number of dates, beginning on October 26, 2009 and ending on January 25, 2010.

## Solicitation Offers Insight Into Expected Forthcoming Section 1705 Program Regulations

As previously noted, applicants under the Innovative Technologies solicitation, including those applicants seeking to have their Credit Subsidy Costs paid from Recovery Act funds (*i.e.*, applicants that meet the requirements of both the Section 1703 and 1705 Programs), must comply with the Section 1703 Regulations. Applicants under the Transmission Infrastructure Solicitation are not required to comply with the Section 1703 Regulations, but rather are required to comply with "Certain Applicable Provisions for Eligible Projects Authorized Under Section 1705 of Title XVII," set forth in Attachment G to the solicitation (Applicable Provisions).

While DOE has not yet promulgated implementing regulations governing the issuance of loan guarantees under the Section 1705 Program, we currently anticipate that such regulations will be issued in August 2009. However, the regulations applicable to applicants under the Innovative Technologies and Transmission Infrastructure Solicitations may provide some insight into the structure and substance of the forthcoming Section 1705 Program regulations. Of particular significance, many critical aspects of the Applicable Provisions exactly parallel the current Section 1703 Regulations, suggesting that many of the concerns that plagued the Section 1703 Program prior to the enactment of the Recovery Act may still raise concerns for applicants in the forthcoming Section 1705 regulations.

For instance, the basic financing structure of projects under the Applicable Provisions remains the same as the structure set forth in the Section 1703 Regulations:

- Loan guarantees may only support loans in amounts up to 80 percent

of an eligible project's total "Project Costs," and the project sponsor is required to make a "significant" equity contribution to the project.

- The underlying loan to be supported by a guarantee must be made by the Federal Financing Bank or another "Eligible Lender" (as defined in the Section 1703 Regulations). If the applicant seeks a guarantee for 100 percent of its total debt obligation, the applicant must obtain the underlying loan from the Federal Financing Bank. We note that, as has been widely reported and is generally understood in the industry, DOE is likely to institute a "private financial partnership program" for certain types of projects under the Section 1705 Program (*e.g.*, renewable energy systems employing commercial technologies) under which private lending will be required and DOE guarantees will be limited to 80 percent of a project's total debt obligation. Therefore, we believe that the Federal Financing Bank will not likely be available for projects in this "private financial partnership program."
- The underlying loan must mature on the earlier of 30 years or 90 percent of the project's useful life.
- DOE must have a first priority security interest in all project assets. We note that this requirement has been a major point of contention with many in the industry, who have accurately argued that this requirement would practically preclude participation by private lenders. As a result, it is possible that this requirement may be modified in some fashion in any implementing regulations (*e.g.*, DOE could have *pari passu* rights generally as to private lenders while also having certain special control rights regarding the administration and disposition of project collateral).
- Applicants must obtain a preliminary credit assessment for the project from a nationally recognized rating agency

if the estimated "Project Costs" exceed \$25 million. We note that this requirement has also been a major point of contention with many in the industry and may be modified in some fashion in any future Section 1705 Program implementing regulations.

The Applicable Provisions also include two significant differences from the current Section 1703 Regulations. First, the Applicable Provisions no longer require DOE to issue solicitations in order to issue loan guarantees. If the forthcoming regulations governing the Section 1705 Program track the Applicable Provisions, the timing for applications could be determined by a project's development and financing schedule rather than by agency deadlines.

Second, the definition of "Commercial Technology" is revised from the current Section 1703 Regulations in two important ways that expand the allowable scope of eligible technologies under the Section 1705 Program. First, as noted previously, a technology is a "Commercial Technology" under the Section 1703 Regulations if it is "in general use in the commercial marketplace *in the United States* at the time the Term Sheet is issued." The Applicable Provisions broaden the scope of employment to technologies in general use "in *any commercial marketplace*." Second, under the Section 1703 Regulations, a technology is "in general use" if it "has been installed in and is being used in three or more commercial projects in the United States in the *same general application* as in the proposed project, and has been in operation in each such commercial project for a period of at least *five years*," measured for each project from the in-service date of such project. Under the Applicable Provisions, on the other hand, a technology is "in general use" if it "has been installed and is being used *anywhere* in three or more commercial projects in the *same or a*

*substantially similar general application* as in the proposed project, and has been in operation in each such commercial project for a period of at least *two years*." Because the employment of a "Commercial Technology" is an eligibility criterion rather than a bar to eligibility under the Section 1705 Program, the expanded definition opens eligibility to the Section 1705 Program to a broader range of applicants.

### Key Procedural Changes

In the Innovative Technologies and Transmission Infrastructure Solicitations, DOE has instituted several critical procedural changes that address various concerns that have been raised with respect to the Title XVII solicitations that were issued prior to the Recovery Act.

### Rolling Application Deadlines Offer a "First-Mover Advantage"

DOE has not eliminated the use of a solicitation process to issue loan guarantees. It has, however, revised its timeline to allow for review of applications on a rolling basis under both solicitations, as compared to the process it employed in earlier solicitations. Although the approach DOE takes under each solicitation differs, the accelerating effect should be similar under both approaches, and both approaches offer a distinct "first-mover" advantage.

### Innovative Technologies Solicitation

The Innovative Technologies Solicitation offers applicants seven rounds of review, and the submission deadlines for such rounds are in the chart below:

Round	Part I Submission Deadline	Part II Submission Deadline
1	September 14, 2009	November 13, 2009
2	October 22, 2009	January 15, 2010
3	December 23, 2009	March 12, 2010
4	February 18, 2010	May 14, 2010
5	April 22, 2010	July 19, 2010
6	June 24, 2010	September 17, 2010
7	August 24, 2010	December 31, 2010

An applicant is free to choose the round in which to submit its application, and Part II applications may be submitted at any time after an applicant receives notification from DOE that its Part I application is complete and its project is eligible under the relevant solicitation. DOE, however, will review applications on a continuous basis, giving those who apply in earlier rounds a distinct advantage over those who apply later in the process.

#### **Transmission Infrastructure Solicitation**

The deadline for submission of all Part I applications under the Transmission Infrastructure Solicitation is September 16, 2009. An applicant may choose to submit its Part II application on (a) October 26, 2009, (b) December 10, 2009, or (c) January 25, 2010. As is the case under the Innovative Technologies Solicitation, DOE will review applications under the Transmission Infrastructure Solicitation on a continuous basis and applicants who submit their Part II applications earlier will have a first-mover advantage.

#### **Easing of Fee Burdens for Applicants under the Innovative Technologies Solicitation**

The application fee structure under the pre-Recovery Act Title XVII solicitations was onerous in that fees were often required to be paid early in the application process, before the applicant had an opportunity to evaluate the potential success of obtaining a guarantee. For example, in previous solicitations, an applicant was required to pay 100 percent of such fees even before DOE began its technical and financial review of the project. Many applicants were overly burdened by this requirement, particularly since the loan guarantees were being used to support commercially untested technologies.

The application fee amounts under the Innovative Technologies Solicitation continue to be significant. However, applicants may now remit the majority

of the application fees later in the application process when they have more certainty regarding their potential for success. For instance, of the total \$1.25 million an applicant will be required to pay for a hypothetical \$100 million loan guarantee amount, only \$75,000 must be paid before DOE begins its technical and financial review of the project. Twenty percent of the remaining amount, or \$235,000, would be due upon the execution of a term sheet for a loan guarantee, and the remaining 80 percent, or \$940,000, would be due at closing of the loan guarantee agreement. Restructuring the fee requirements eases the significant burden on some applicants, while allowing other project sponsors, previously unable to afford the high application fees, to apply for a loan guarantee.

#### **Endnotes**

- <sup>1</sup> The Credit Subsidy Cost represents the net present value of the estimated cost of the loan guarantee. DOE is statutorily obligated to receive the Credit Subsidy Cost either from Congressional appropriation or from the applicant. Section 1703 Program applicants must pay the Credit Subsidy Cost, which can be significant, upon execution and closing of the loan guarantee agreement with DOE. The Recovery Act appropriated funds to cover the Credit Subsidy Cost for Section 1705 Program applicants.
- <sup>2</sup> See also J. Massouh et al., *Real Promise or False Hope: DOE's Title XVII Loan Guarantee Program*, 22 ELECTRICITY J. 4, 53-67 (2009).
- <sup>3</sup> The Innovative Technologies Solicitation is available at <http://www.lgprogram.energy.gov/2009-ren-energy-sol.pdf>.
- <sup>4</sup> "New or Significantly Improved Technologies" are technologies that:
  - (i) are concerned with the production, consumption or transportation of energy;
  - (ii) are not "Commercial Technologies";
  - (iii) either (A) have only recently been developed, discovered or learned or (B) involve or constitute one or more meaningful improvements in productivity or value as compared to Commercial Technologies in the US;

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- (iv) have the potential to be replicated in other commercial projects in the US; and
- (v) are or are likely to be available in the US for further commercial application.

The Section 1703 Regulations define a “Commercial Technology” as “a technology in general use in the commercial marketplace in the United States at the time the Term Sheet is issued by DOE.” A technology is “in general use” if “it has been installed in and is being used in three or more commercial projects in the United States in the same general application as in the proposed project for a period of at least five years,” which five-year period is measured from the in-service date of each such project.

<sup>5</sup> This estimated amount of more than \$30 billion in loan guarantee authority resulting from the Innovative Technologies Solicitation is derived by adding the \$8.5 billion in loan guarantee authority made available to support projects eligible under the Section 1703 program, and the loan guarantee authority that is anticipated to result from the additional \$2.5 billion that has been made available to pay the Credit Subsidy

Costs of applicants that meet the requirements of both the Section 1703 Program and the Section 1705 Program (the loan guarantee authority is calculated by applying a multiple to the Credit Subsidy Costs). However, the correlation between the funds that are available to pay the Credit Subsidy Costs and the resulting loan guarantee authority is unclear, so the final guarantee amounts that could potentially result from the Innovative Technologies Solicitation is open to interpretation.

<sup>6</sup> The Transmission Infrastructure Solicitation is available at <http://www.lgprogram.energy.gov/2009-CPLX-TRANS-sol.pdf>.

<sup>7</sup> DOE amended the Part I submission deadline from September 14 to September 16, 2009

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