



## The Stimulus Package News & Updates

[Stimulus Package](#)

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### Expansion of the Department of Energy's Loan Guarantee Program

The American Recovery and Reinvestment Act of 2009 (the "Stimulus Act") expands the existing Department of Energy ("DOE") loan guarantee program (the "Guarantee Program") for certain renewable energy and transmission projects.

Before the passage of the Stimulus Act, the Guarantee Program applied only to projects that employed New or Significantly Improved Technologies, and did *not* apply to any projects that implemented technology that was in general commercial use in the United States. Dubbed a "temporary program for [the] rapid deployment of renewable energy and electric power transmission projects," the Stimulus Act removes this restriction and appropriates an additional US\$6 billion [1] to three specific categories of projects [2] that begin construction on or before September 30, 2011, which include (i) renewable energy systems [3] used to generate electricity or thermal energy, (ii) electric power transmission systems, and (iii) leading edge biofuel projects (the "Eligible Projects"). Construction of all Eligible Projects is subject to the "prevailing wage" requirement, which may increase project development costs. There are additional statutory restrictions with respect to transmission and biofuel projects.[4]

The Guarantee Program largely will continue to operate under the DOE's current rules, regulations, and guidelines. The enabling legislation for the existing Guarantee Program was included within the Energy Policy Act of 2005. DOE issued its rules governing the Guarantee Program in October 2007. DOE has conducted three rounds of solicitations under the pre-existing Guarantee Program pursuant to which it has committed to guarantee approximately US\$40.5 billion. Despite these commitments, DOE has not closed any guarantees under the pre-existing Guarantee Program as of the date of this memo. Notably, the new Secretary of the DOE, Steven Chu, has committed to restructuring the way in which DOE processes loan guarantee applications. He expects DOE to offer its first solicitation with respect to the Eligible Projects (i.e. the newly appropriated US\$6 billion) in summer 2009 and to close US\$4 billion in guarantees for Eligible Projects by the end of 2010. Of course, to comply with the spirit of the Stimulus Act, DOE will need to process applications more efficiently, given that its authority to issue loan guarantees for Eligible Project terminates as of September 30, 2011.

As noted above, other than supplanting the definition of "Eligible Project" under the current Guarantee Program regime, the other parameters of the existing Guarantee Program are expected to remain. Some of the material requirements are as follows:

- The Eligible Project must be located in the United States, which expressly includes Puerto Rico, the Virgin Islands, Guam, American Samoa, and any other territory or possession of the United State of America. Foreign sponsorship of a project is permitted under the current Guarantee Program.
- The guaranteed loan cannot exceed 80% of the total project cost.
- The term of the guaranteed loan cannot exceed 30 years.
- The project sponsors must procure a credit rating of the project (without the guarantee) from a nationally recognized rating agency if the project costs total more than US\$25 million. This clearly poses a challenge in terms of time and cost, but the dollar threshold potentially could increase under the revised Guarantee Program given that proven and not only innovative technologies now will be permitted.
- If the DOE guarantees 100% of the project's debt, then the Treasury's Federal Financing Bank must be the lender.
- If the DOE guarantees more than 90% of the project's debt, then the guaranteed portion of the debt cannot be separated or "stripped" from the non-guaranteed portion of the debt for syndication or resale in the secondary market.
- **Credit Subsidy Cost:** This is the required fee that the Treasury must collect that is equal to the present value of estimated payments the government would make in the event of a default under the guaranteed loan (involves a default risk analysis on a project-by-project basis). Congress has appropriated US\$6 billion for loan guarantees with respect to Eligible Projects, but this is intended to cover only the credit subsidy cost. A conservative estimate (figures still are not public because no loans have closed under the current Guarantee Program) with respect to the current Guarantee Program is an average credit subsidy cost of 10%, but Eligible Projects now include proven (not only "innovative") technologies, which means this figure presumably will decrease. As such, if the average credit subsidy cost with respect to Eligible Projects is 6%, then there will be US\$100 billion in financing available.
- The borrower must grant to the United States a first priority security interest in the project's assets; provided, however, the DOE has determined that it has the authority to enter into intercreditor arrangements when it does not guarantee 100% of the project debt. The DOE may enter into a pari passu structure with holders of the non-guaranteed portion of the debt, but DOE must control the disposition of project assets. This means that the DOE will have sole authority to decide whether to liquidate the project assets in the event of the borrower's default.

The DOE awards Guarantee Program loan guarantees through a competitive process that compares one application against another, though this might change slightly given Secretary's Chu goal of streamlining the review process. He intends to evaluate applications on a rolling basis to expedite the review, which by necessity will reduce the extent to which the DOE can compare one application against another. We anticipate that making pre-application and application (see below) sooner rather than later would benefit an applicant, given that the Secretary presumably will set periodic deadlines by which his staff must make decisions. Finally, the DOE has stated expressly that, all other things being equal, it favors projects that require a smaller percentage of its debt to be guaranteed.

The application process generally involves the following steps:

- Pre-Application:*** Requires general information about the project, its sponsor(s), and the financing plan. The DOE likely will not require an application fee at this stage.

- ii. **Application:** Some of the pre-applicants will be invited to submit applications. The DOE received 143 pre-applications in its first solicitation (2006) under the Guarantee Program, but invited only 16 pre-applicants to submit applications. The "applications" require far greater detail as to the project and the financing plan. The DOE may require a fee at this point; however, to generate more applications, the DOE currently is considering making such fees contingent upon an award and including such fees in the closing.
- iii. **Term Sheet:** The successful applicant will receive a DOE-issued term sheet setting forth the material terms and conditions of a definitive loan guarantee agreement.
- iv. **Execution of a Conditional Commitment:** Once the applicant, DOE, and qualified lender agree on the material terms of the term sheet, the term sheet becomes a "conditional commitment."
- v. **Execution of the Loan Guarantee Agreement:** Once the conditions of the "conditional commitment" are met, the parties will execute an agreement incorporating the terms thereof. The DOE has no obligation until the parties execute the definitive agreement.

The extent to which the DOE weighs against an applicant its usage of the other incentives in the Stimulus Act, including the tax credits and grants, remains to be seen. The statutory provisions do not make claiming tax credits or grants mutually exclusive of obtaining a loan guarantee. On the other hand, the DOE's final rules for its existing Guarantee Program do note that the DOE will consider whether and to what extent a project relies on such financing, presumably because of the somewhat contingent nature of the same.

In considering whether to participate in the Guaranty Program, borrowers should consider a number of issues, including the following:

1. **Will the borrower know that it will receive a guarantee from DOE in a time frame that works for structuring the financing for the project in question?**
2. **Will the EA and/or EIS requirement for projects slow down project development?**
3. **For conventional renewable projects without unusual technologies, will the cost, time and potential difficulty of participating in the Guaranty Program be worth it, or will the potential interest rate benefit of the guaranty be insufficient to justify the potential costs and delays that may be required to get the guaranty?**
4. **How will projects that apply for the Guaranty Program be prioritized and chosen for funding? The existing Guaranty Program has both technological and financial criteria, including, most importantly, the requirement for New or Significantly Improved Technology. With that criteria eliminated, will financially viable projects be evaluated simply on a first-come, first-served basis, or on the basis of some other criteria?**

Secretary Chu has promised a more effective process at DOE for the new Guaranty Program, so the above concerns may not come to pass, but companies should consider them.

*For more information on this and related regulatory and business matters, please visit the McGuireWoods [Stimulus Package](#) section, or contact the members of our [Energy, Energy Regulatory & Utilities](#) industry group.*

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NOTES:

1. Though the appropriation is in the amount of US\$6 billion, this translates into US\$60-\$120 million in loan guarantees.
2. The existing Guarantee Program applies to ten different categories of projects, including, but not limited to, renewable energy systems, advanced nuclear facilities, pollution control equipment, and advanced fossil energy technology.
3. The Stimulus Act does not define "renewable energy systems," but DOE's first solicitation under the existing Guarantee Program (which had the "general-use" restriction) referenced biomass, wind, solar, and hydroelectric projects.
4. Notably, only \$500,000,000 may be used for biofuel projects, which means the bulk of the funds will go towards renewable energy and transmission projects.

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