David G. Frantz
Director
Loan Guarantee Program Office
Office of the Chief Financial Officer
1000 Independence Avenue, S.W.
Washington, D.C. 20585

September 21, 2009

Re: Taxpayers for Common Sense Comments on Department of Energy's Proposed Rule Regarding Loan Guarantees for Projects that Employ Innovative Technologies (RIN 1901-AB21) 74 Federal Register 39569 (August 7, 2009)

Dear Mr. Frantz:

Thank you for the opportunity to comment on the proposed amendments (74 Fed. Reg. 39569) to the Title XVII Department of Energy Loan Guarantee Program final regulations issued October 23, 2007. Taxpayers for Common Sense (TCS) is a non-partisan budget watchdog serving as an independent voice for American taxpayers. For more than a decade TCS has worked to achieve a government that spends taxpayer dollars responsibly and operates within its means.

Given the current fiscal climate, increasing reliance has been placed on federally backed loan guarantees as a vehicle to fund private enterprise. Because these types of loans mask the true cost of certain programs and create future financial liabilities for taxpayers, it is imperative that any loan guarantee program proceed with caution. To ensure the greatest level of protection for taxpayers, federal loan guarantee programs must operate with transparency, accountability and stringent oversight.

Over the next several years, the size and scope of federal credit programs are likely to increase. This is already clear with the existing Title XVII program. In 2007, the loan guarantee program had a budget cap of only $4 billion, but with the passage of the fiscal year 2009 Omnibus Appropriations bills, the program has increased to $51 billion. With this massive programmatic expansion, comes an associated increase in the risks to U.S. taxpayers.

The Department of Energy (DOE) has not run a loan guarantee program since the 1980's, and that program was riddled with problems and cost taxpayers billions of dollars. With billions more at stake this time, we urge DOE to not repeat the same mistakes. Yet the proposed rule puts taxpayers on the same old failed track by taking away key provisions that ensure taxpayers recoup assets in the event of project default.

In the following comments, TCS will discuss how the proposed changes jeopardize taxpayer funds followed by an outline how the existing program already puts taxpayers at enormous risk.

Concerns with DOE Proposed Rule

Taxpayers for Common Sense is gravely concerned that the proposed amendments to the existing loan guarantee program regulations will significantly jeopardize taxpayer funds. While DOE has found industry would like to employ a wide range of "ownership structures" in their proposed projects, it appears taxpayer interests have not been fully considered. The draft changes would accommodate the industry's ownership requests and allow these proposals to receive a loan guarantee, but at the cost of several taxpayer protections provided in the original statute. These changes are aimed at providing DOE the "flexibility" to determine collateral packages. But, in making these adaptations to accommodate industry, taxpayers are being asked to give up significant safeguards in the event of project default.

Specifically, the Proposed Rule raises several areas of concern described below:

Undermines First Right of Lien

The Proposed Rule claims the original Title XVII statute never required the first right of lien on project assets. This is contrary to what DOE first stated in the 2007 interpretation of the law. DOE now claims that, "A first lien on all projects is better understood as one element the Secretary may require for a particular project but is not compelled to by the statute to require."

Specifically, DOE has reinterpreted the legal meaning and intent of Section 1702 (d) and 1702 (g) and proposes to change the existing regulation. Adding to the problems with the existing regulations which allowed for non-guaranteed creditors to share in the proceeds, the claimed reinterpretation and proposed rule change would allow DOE to accept a *pari passu* position among project creditors, and subordinate DOE's rights to other project debt providers.

If the proposed change is implemented, DOE will seriously compromise and undermine its standing as first lien holder to project assets, especially in places where DOE provides the vast majority of the project debt. This scenario is highly likely because the loan guarantee program allows for up to 80% of the project cost to be guaranteed by DOE. In the event of a default by project sponsors, this change could lead to substantially increased loan losses to taxpayers.

DOE should not jeopardize the recovery of taxpayer provided loan funds where DOE provides the vast majority of project debt under Title XVII, by subordination of its loan in any form for such a project or agree to a *pari passu* sharing of project assets in the event of default with other creditors.

Jeopardizes Recovery of Taxpayer Assets

The Proposed Rule dramatically weakens taxpayers' ability to recover lost assets in the event of project default. In the 2007 Final rule DOE clearly stated "DOE retains--as superior right—the ability even over the objection of other parties, to decide against the liquidation of project assets and instead complete construction of the project, or to sell an incomplete project to an entity that will complete it." The Department is subrogated to the rights of the Holder, including the right to "complete, maintain, operate, lease or otherwise dispose of any property acquired pursuant to such agreement…"

The Proposed Rule now states "any guaranteed obligation is not subordinate to any loan or other debt obligation." This effectively strips taxpayers of any assurance they will be able to recoup lost assets in

the case of project default. Furthermore, this is clearly in conflict with the original statute and what DOE has made clear in their 2007 Final Rule.

This proposed change is likely to have significant consequences for taxpayers. In projects where DOE is the majority debt holder, if a project defaults, the other minor creditors are likely to demand and get full or near full repayment of their debt by DOE. In order for DOE to be able to pursue recovery of its loan without being hampered and delayed in the recovery process by minority creditors, DOE must maintain Subrogation rights as required by the original Title XVII statute. If the Proposed Rule moves forward other creditors can easily take advantage of the Agency and delay the recovery process.

This has occurred in federal loans made in the 1980s by the Rural Utility Service of the Department of Agriculture for new nuclear and coal fired power plants that defaulted. DOE should consult with the Civil Division attorneys of the Department of Justice familiar with these cases and get their specific advice on the proposed changes in the rule. In one case the final bankruptcy court decision required the write down of nearly $5 billion in outstanding RUS loan balances.

DOE Must Learn from other Failed Programs

In the 1980s the Rural Utility Service (RUS) made a number of power supply loans electric cooperatives either for a new power plant to be entirely owned by the sponsor cooperative or partially owned in a shared relationship with and investor owned utility. A large number of these loans defaulted and/or filed for bankruptcy or were restructured by RUS. The majority of RUS loans made for nuclear power plants failed. Taxpayers lost billions and it took over a decade to resolve all the loan repayment failures.

These failed RUS loans should serve as a warning to DOE that new technology power plant loans are very risky and have a high probability of loan default. In the event of default, assuming that DOE is the majority creditor, it must have a clear unencumbered first trust lien status on all project assets. If not, the loan losses to the taxpayer will be even higher and take far longer to resolve the default than if DOE had the essential first trust position. There are a number of GAO reports that document many of these losses and GAO report references can be provided upon request.

Taxpayer Risks with Existing Title XVII Program

The Proposed Rule further compounds the significant risks the existing Title XVII loan guarantee program already imposes on taxpayers. Below we briefly discuss our concerns with the existing program.

Scope of the Program

The current DOE loan guarantee program applies to a broad portfolio of technologies ranging from small-scale emerging renewable energy projects to large-scale coal and nuclear facilities. Taxpayers are already assuming great risks because the program has $51 billion in authority with $47 billion earmarked for nuclear energy, coal gasification, coal power generation with carbon capture and storage, and renewable energy and transmission projects. Of the $47 billion, $20.5 billion is allocated for nuclear facilities and uranium enrichment projects. The Congressional Budget Office considers the risk of default on nuclear loan guarantees to be well above 50%.

Program Costs

The Loan Guarantee Program has two main costs associated with it—the administrative expenses and the subsidy cost. As required by Title XVII, the administrative costs are recouped through the collection of

fees assessed by the Secretary. Under the statute these fees must be sufficient to “cover applicable administrative expenses.” However, in a February 2007 report, the Government Accountability Office concluded that appropriations will likely be needed to cover the expenses of the program. Furthermore, a 2008 report noted that DOE had not yet identified the program’s administrative costs that needed to be accounted for or developed a process to estimate them.

The other cost associated with the loan guarantee program is the subsidy cost or the net present value of the cost of the loan guarantee. Under Title XVII, the subsidy cost can be funded through a congressional appropriation or paid by the borrower. While a program paid for by loan guarantee recipients would appear to protect taxpayers, there are many risks involved with this approach. The method used to calculate market risk often results in substantial underestimation of the credit subsidy cost. The reason is the use of the Treasury discount rate to calculate net present value instead of the borrower’s private sector borrowing rate. Further, accurately forecasting these costs is extremely difficult and will likely lead to significant underestimations that will be paid for by the taxpayers. An accurately assessed subsidy cost should reflect the market risks of a project. In theory, the more “successful” the program (i.e. the more loan guarantees out the door), the more risk taxpayers assume and the more we lose on understated subsidy costs. Because of this, it is imperative the “success” of the program not be judged on the amount of loan guarantees that are distributed but whether the loans are repaid and whether the projects over the longer-term are commercially viable in the markets in which they operate.

Guarantee Percentage

Under the DOE regulations, guarantees can provide coverage for 100% of the loan for up to 80% of the project cost. These generous terms could easily lead to high risk projects that leave applicants with significantly less to lose than taxpayers in the event of default. OMB guidance for Federal Credit Programs suggests loan guarantees not guarantee more than 80% of the cost of the loan and the DOE Inspector General found that providing guarantees for up to 80% of the project cost will “result in significant risk to the Government and, therefore the American taxpayer.” To protect taxpayers the program should not move forward with such generous terms.

Default Risks

High-risk projects that have been unable to secure private financing will be the most likely recipients of Title XVII loan guarantees. Many, like those for nuclear reactors or large scale coal facilities, will also be extremely capital intensive. Loan guarantees for projects of this scale could carry a price tag easily reaching $6-$9 billion. The federal budget estimates loan guarantees issued under the Title XVII program will carry a 50% default rate for projects. Of these defaults they estimate that there will only be a 25% recovery rate.

Taxpayer Superiority of Rights

The Energy Policy Act of 2005 states that taxpayers “shall be superior to the rights of any other person with respect to the property.’’ This provides a significant taxpayer protection by ensuring that Treasury has the right to recover losses before other investors in the event of default. In interpreting the statute in the original 2007 rule, however, DOE has decided the loan guarantees should be issued without the full extent of this protection, allowing for the division of any money recovered with the holders of the non-guaranteed portion of the security. This provision, which is dramatically expanding in the Proposed Rule,

already leaves taxpayers extremely vulnerable, especially in cases where the majority of the financial backing for a project has been provided by DOE.

Additionally, the program as currently structured could lead to multiple defaults for the same technology, if any number or problems are encountered. This is a situation that occurred in the 1980's with the synthetic fuels program. Support for multiple projects was distributed quickly and market changes and administrative failures lead to taxpayers losing billions on defaulted projects. The current loan guarantee program is already well beyond the scale of the synfuels program, making the potential financial losses from defaults far greater. The original statue was intended to protect taxpayers with this provision and the final rule should not strip taxpayers' superior rights.

Transparency

To date, the public has received little information on the subsidy cost methodology and status of pending loan guarantee applicants. There has been no assurance that the subsidy cost will be calculated in a fair and transparent method that protects taxpayer interests above creating acceptable terms to industry. DOE has also stated that they will accept "non-cash" equity for payments. Additionally, it is unclear at this point how and when the subsidy cost will be collected in the conditional agreements that are currently moving forward. In order for taxpayer funds to be protected, these fees should be paid at the time of a conditional agreement or closing of the loan guarantee, whichever comes first.

Summary

Taxpayers for Common Sense believes there is substantial evidence that if the loan guarantee program issues guarantees with these proposed changes the fiscal consequences for federal taxpayers will be significant. The taxpayer risks of the existing loan guarantee program are already great. Further reducing the taxpayer's ability to recoup lost assets will only further jeopardize federal funds. We urge DOE to make significant changes before moving forward with the program.

To date, DOE has failed to:

- Maintain the original statute's taxpayer protections
- Ensure taxpayers will have the proper safeguards in place to recoup their losses in the event of default
- Provide sufficient time to review the Proposed Rule with a 60 or 90 day comment period
- Facilitate a transparent process with stakeholder involvement

As a result, TCS must seriously question the motives and decision-making process behind this Proposed Rule. The Loan Guarantee Program has been a largely closed door process with only leaks of information from overzealous applicants.

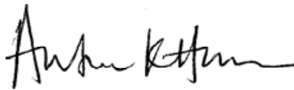
Under the Title XVII statute DOE is legally required to ensure taxpayers a "reasonable prospect of repayment" before issuing any loan guarantee. But chipping away at the few taxpayer protections that allow for the recouping of assets will only undermine this charge. If DOE fails, billions in taxpayer

dollars are at stake, as well as the public's faith in DOE's ability to properly manage its public trust obligation. DOE has been down this path before and this time the stakes are much higher.

We urge DOE to withdraw the Proposed Rule. Until the loan guarantee program has a transparent, accountable system that has adequate taxpayer safeguards in place, loan guarantees should not be distributed.

Thank you for taking our comments into consideration. If you have any questions, please contact me at (202) 546- 8500.

Respectfully submitted,



Autumn Hanna
Senior Program Director