HUNTON& WILLIAMS

CLIENT ALERT

July 2009

Contacts

[Ted J. Murphy]
1900 K Street NW
Washington, DC 20006
(202) 955-1588
tmurphy@hunton.com

[Enid L. Veron]
200 Park Avenue
New York, New York 10166
(212) 309-1331

1900 K Street NW
Washington, DC 20006
(202) 955-1675
everon@hunton.com

[Patrick J. McCormick III]
1900 K Street NW
Washington, DC 20006
(202) 778-2218
pmccormick@hunton.com

[Patrick T. Currier]
1900 K Street NW
Washington, DC 20006
(202) 419-2001
pcurrier@hunton.com

DOE Issues New Loan Guarantee Solicitations for Major Transmission and Advanced Renewable Energy Projects

On July 29, the Department of Energy ("DOE") issued two solicitations inviting applications for federal loan guarantees for transmission and "advanced" renewable energy projects. The first solicitation is open to major "Transmission Infrastructure Investment Projects," while the second is for "Projects that Employ Innovative Energy Efficiency, Renewable Energy, and Advanced Transmission and Distribution Technologies." DOE estimates that the solicitations will result in more than $30 billion worth of loan guarantees.

The new solicitations are part of the Obama administration's effort to promote renewable energy development, which is itself a component of a broader initiative to stimulate the U.S. economy. This means that DOE must act quickly, that application deadlines are fast approaching (preliminary applications are due on September 14), and that a substantial portion of the funding will be available only to projects that "commence construction" in the next two years. It also appears that applicants that file early will enjoy a "first mover" competitive advantage.

Renewable energy generation projects that employ established commercial technologies do not appear to be eligible for loan guarantees under these solicitations. DOE has indicated, however, that additional solicitations should be expected soon and it seems likely that "conventional" wind and solar projects will be addressed by a future issuance. DOE has also stated that there will be another solicitation for transmission projects that do not qualify as "Transmission Infrastructure Investment Projects."

The solicitations include more than two hundred pages of very detailed information on application requirements and evaluation criteria. For more information on these details please contact Hunton & Williams LLP, through one of the attorney contacts listed on this client alert.

Background

DOE's loan guarantee program was initially established under the Energy Policy Act of 2005 ("EPAct"). The purpose of the EPAct program is to incentivize "innovative" energy projects that use "new or significantly improved technologies"; that would "avoid, reduce, or sequester" air pollutants or greenhouse gas emissions; and that would otherwise face difficulty obtaining private-sector financing. "New or significantly improved technology" is defined in a manner that excludes "commercial technology" that is in general use.

Importantly, successful loan guarantee applicants under the EPAct program would be required to pay the "credit subsidy costs" of their loans, *i.e.*, the net present value of the loan's estimated long-term cost to the U.S. government. Such costs can be substantial and are difficult to predict. The credit subsidy requirement is often said to have discouraged participation in the program.

The American Recovery and Reinvestment Act of 2009 ("Recovery Act") introduced a significant, but temporary, expansion of the EPAct program. The temporary program is one of several major Recovery Act initiatives aimed at doubling domestic renewable energy capacity in the near future. Under the Recovery Act, "renewable energy systems," transmission projects, and "leading edge" biofuel projects are eligible for loan guarantees regardless of whether they employ "new or significantly improved technology." Another significant difference between the EPAct and Recovery Act programs is that Congress has appropriated approximately $6 billion to pay the credit subsidy costs of guarantees issued under the latter. Because of the Recovery Act's focus on economic stimulus, DOE's authority to enter into loan guarantees under the temporary program expires on September 30, 2011. Projects that obtain guarantees under the temporary program are subject to the special wage, "Buy American," and reporting requirements that apply to all recipients of Recovery Act funds.

The New Solicitations

A. "Transmission Infrastructure Investment Projects"

The first solicitation makes up to $750 million available to pay the credit subsidy costs of what DOE has defined as "Transmission Infrastructure Investment Projects." This is a new classification that encompasses a diverse range of large-scale projects. DOE defines a Transmission Infrastructure Investment Project as "complex electric transmission system projects in the United States" that:

- utilize a commercial technology;
- are reasonably likely, at the time that Part I of the application is submitted, to commence construction on or before September 30, 2011;
- "cannot be financed from private sources on standard commercial terms";
- satisfy all applicable EPAct, Recovery Act, and regulatory requirements; and
- meet at least one of the following criteria:
- consist of at least 100 miles of new or upgraded 500 kV lines or 150 miles of new or upgraded 345 kV lines (including projects that include a number of projects that meet this in the aggregate);
- have at least 30 miles of underwater transmission cables;
- include a high voltage DC component;
- act as a "major interregional connector";
- are designated "as" a National Interest Electric Transmission Corridor ("NIETC") by DOE under EPAct;
- are associated with offshore generation, such as open ocean wave energy, ocean thermal, or offshore wind; or
- mitigate a substantial reliability risk for a major metropolitan area.

Some of these requirements are ambiguous. In particular, it is not clear how DOE will interpret the requirement that Transmission Infrastructure Investment Projects "cannot be financed from private sources of standard financial terms." If read literally, such a requirement could exclude a number of major projects from receiving guarantees. There is other language in the solicitation, however, that implies that projects will not be automatically rejected if they are not financially viable without a loan guarantee.

The solicitation also says little about the meaning of other key terms and concepts, including "major interregional connector" or the mitigation of "substantial reliability risks" for "major metropolitan areas." In addition, the reference indicating that a project must be designated "as" a NIETC may be an error since, to date, geographic corridors, not individual lines, have been designated as NIETCs.

The solicitation does, however, shed light on how DOE will interpret the critical requirement that projects "commence construction" by September 30,

2011. A project must have: (i) "received all necessary licenses, permits and local and national environmental clearances necessary to proceed"; (ii) "completed all pre-construction design and prototype testing"; and (iii) "engaged all required contractors and ordered all necessary essential equipment and supplies so that physical construction of such project has commenced or may commence on or before September 30, 2011." This approach is in keeping with the notion that Recovery Act funding should be used only for "shovel ready" projects. It may prove problematic, however, for major transmission projects given the amount of time required for their development and the difficulty of predicting when needed permits will be granted. Regardless of how likely a project appears to be to commence construction by September 30, 2011 on the day an application is filed, it will not receive a loan guarantee if it misses the deadline.

The solicitation establishes a two-part application process. "Part I" submissions are due on September 14, 2009. There will then be up to three rounds of "Part II" submissions with the deadlines between October 2009 and January 2010. Applications submitted before the designated Part I due date will be reviewed on a rolling basis, meaning that "first movers" likely will be advantaged, particularly given that there is no assurance that funds will remain available for all three rounds. DOE will provide an assessment of Part I submissions that is intended to help applicants to decide whether they will proceed with the cost and effort of a more detailed Part II submission.

The solicitation provides detailed information on what must be included in submissions. Notably, the total, non-refundable application fee is $800,000; $200,000 of which must be included with the Part I submission. (Loan guarantee recipients will be subject to additional facility and maintenance fees.) It also includes detailed information regarding the criteria that DOE will use to evaluate applications.

B. "Projects that Employ Innovative Energy Efficiency, Renewable Energy, and Advanced Transmission and Distribution Technologies"

Under the second solicitation, DOE will make available up to $8.5 billion in loan guarantee authority to support projects under both the EPAct and the Recovery Act. In addition, the solicitation makes up to $2.5 billion of Recovery Act funds available to pay the credit subsidy costs of projects that qualify for funding under the Recovery Act and that also employ "new or significantly improved technology." The latter requirement is not mandated by the statute but reflects an apparent policy decision by DOE, which has broad statutory discretion regarding the deployment of Recovery Act funds, to support debt financing for projects that employ innovative, non-commercial technologies. Importantly, Recovery Act funds may not be used to pay the credit subsidy costs of projects that are not Recovery Act eligible (i.e., projects eligible only under the original EPAct program).

Of the $2.5 billion, $2 billion is available to pay the credit subsidy costs of advanced "renewable energy systems" and "electric power transmission systems." Renewable energy systems include renewable energy component manufacturing facilities, while the electric power transmission systems include upgrades and reconductoring projects. The remaining $500 million is designated for "leading edge biofuel projects." In addition to the general EPAct threshold requirements, projects under these categories must also create or retain jobs in the United States and commence construction by September 30, 2011, as mandated by the Recovery Act. Should a project fail to meet the 2011 deadline, however, the project may still be able to proceed under the original EPAct program, but without the benefit of Recovery Act funds to pay for the credit subsidy costs.

The solicitation seeks to support numerous manufacturing and stand-alone energy efficiency and renewable energy projects. However, eligible projects must meet the requisite EPAct program requirements, meaning they must be "new or significantly improved technologies" that will "avoid, reduce, or sequester" air pollutants or greenhouse gas emissions, and provide a reasonable prospect of repayment. The technology scope is broad, with potential eligible projects ranging from alternative fuel vehicles to energy-efficient building technologies to solar and wind.

The solicitation establishes seven rounds of application submissions, with each round consisting of a two-part application process. Part I submissions under the first round are due on September 14, 2009, but applications submitted before the due date will be reviewed on a rolling basis, so, again, early movers are encouraged and likely advantaged.

The last round closes in December 2010, if funds remain available.

The solicitation provides detailed information on what must be included in the submission and how they will be evaluated. The total, non-refundable application fee will range from $75,000 to $125,000 depending on the loan guarantee amount.

Observations

The two new solicitations represent the first step in DOE's implementation of the Recovery Act's loan guarantee provisions and a further step in the revitalization of the EPAct program. Given the administration's commitment to renewable energy development and to the broader economic stimulus program, it is likely that DOE will move ahead on schedule and begin to issue substantial loan guarantees in the near future. It is therefore imperative that entities interested in a loan guarantee move quickly to review the solicitations and prepare to submit applications. It remains to be seen whether the response to the solicitations will be strong or if potential applicants will be discouraged by the amount of effort required and the limited time available to prepare an application, the size of application fees, the potential difficulty of meeting the "commence construction" deadline, and the ultimate uncertainty of success. At the same time, the solicitations together account for only a little more than half of the approximately $6 billion that Congress has appropriated to pay credit subsidy costs. It seems likely that a significant portion of the remainder will be the subject of a future solicitation encompassing conventional renewable energy generation projects, including those employing commercial wind and solar technologies. Such a solicitation could support billions of dollars in new investments in wind and solar projects. Some of the remaining credit subsidy cost appropriation will also be used to support investments in transmission projects that do not fall under either of the two new solicitations.