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Global Project Finance Alert

House Oversight and Government Reform Committee Lambasts DOE Loan Guarantee Program

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On March 20, 2012, Darrell Issa, R-Calif., the chairman of the U.S. House of Representatives Committee on Oversight and Government Reform (the "Committee"), published a Staff Report entitled The Department of Energy's Disastrous Management of Loan Guarantee Programs (the "Staff Report"). The Staff Report is the first product of the Committee's ongoing investigation into the US Department of Energy loan guarantee programs (the "Program") authorized under title XVII of the Energy Policy Act of 2005 (the "EPAct"). Chairman Issa's conclusions are a scathing reprimand of DOE's management of the Program, asserting numerous examples of "dysfunction, negligence and mismanagement by DOE officials, raising troubling questions about the leadership at DOE and how it has administered its loan guarantee programs."

Key Conclusions in the Staff Report

The Staff Report asserts that the DOE has created a "high risk, speculative and undiversified loan portfolio" without requiring a commensurate risk premium in exchange. The key findings in the Staff Report include:

- Criticism of the DOE loan guarantee project portfolio, including deficient credit quality, risk factors to the portfolio (including exposure to conventional energy and sponsor concentration), harm to capital markets caused by inconsistent Program administration and general underwriting mismanagement;
- Violation of statutory, regulatory and prudential requirements, including relaxed innovativeness requirements, disregard for the requirement that projects commence construction by September 30, 2011 and violation of the statutory "superiority" requirement for DOE's interests vis-a-vis other project lenders;
- Artificial inflation of job creation statistics;
- Award process deficiencies, including exertion of improper influence on decision makers from former public servants, ignorance of credit quality evaluations, political meddling in the decision making process, misuse of guaranteed advances, support of projects that did not need Federal funding, as well as rushed and imprudent project approval; and
- Problems with the ATVM loan guarantee program.

Questions Raised by the Staff Report

In the eyes of some, there may be weaknesses in many of the Staff Report's allegations. Specifically, program supporters have noted:

- The Program mandated that taxpayer dollars be placed at risk, by guaranteeing loans for projects that, in many cases, required government support. One of the core purposes of the Program was to support the completion of such projects. Thus any comparison of the quality of the DOE loan guarantee portfolio to commercially underwritten portfolios is misguided;

- Each DOE loan guarantee was supported by a "credit subsidy fee," which, if calculated properly, should make DOE neutral to the outcome of any particular loan guarantee. It is true that the credit subsidies under the Program were funded by taxpayer dollars, but that feature of the Program was statutorily mandated. Thus criticism of the credit risk to taxpayers is attributable to the Program, rather than DOE underwriting;

- The Program's legal credit quality guidelines call for a reasonable assurance of repayment, not investment grade issuance. Thus criticism of the credit quality of the portfolio may be unfair;

- Much of the perceived risk to the DOE's Section 1703 loan guarantee portfolio is likely attributable to technology risk, as opposed to deficient underwriting;

- The Staff Report equates former government service or ties to the executive branch with the assertion of improper influence in the guarantee issuance process, a very serious and generally unsupported inference; and

- Policy objectives underlying the Program, including support for clean energy initiatives (which, at the time Congress funded the Program, faced a severe liquidity crisis) and economic stimulus, were largely ignored by the Staff Report.

Possible Effects of the Staff Report to Loan Guarantee Beneficiaries

The fallout from the Staff Report could be significant and may inject unanticipated and damaging political risk on DOE loan guarantee beneficiaries that have made significant equity investments in renewable energy projects, including:

- *As Congress continues to investigate the perceived problems with the Program, there will be increased scrutiny of projects that benefit from loan guarantees, including the possibility of congressional subpoenas, hearings and requests for information;*

- *Going forward, DOE's guaranteed loans may be administered more conservatively. Obtaining financing modifications and waivers that would otherwise be matters of ordinary course may be more difficult. Further, Borrowers may need to be wary of contractual bases for limitation or termination of financing commitments;*

- *Program opponents may undertake political, legislative or legal action in an attempt to invalidate, cut off or limit existing financing commitments; and*

- *The continuing performance and commitment of key non-sponsor project participants may be compromised if the availability of DOE financing is in doubt.*

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