I. INTRODUCTION


The Proposed Rule should be withdrawn because it is inconsistent with Section XVII of the Energy Policy Act of 2005 (P.L. 109-58, 119 Stat. 1117 (August 8, 2005), 42 U.S.C. § 16511-16514). And even assuming for purposes of argument that the relaxed standards could be deemed consistent with the Act, DOE has failed to provide any practical justification for repudiating its 2007 requirement for a priority lien on assets that are backed by any loan guarantee. Finally, the Proposed Rule fails to substitute any alternative provision that would give the DOE and taxpayers an equivalent level of protection as a first lien on a borrower’s

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assets. Instead, the Proposed Rule gives the Secretary unfettered discretion to fashion undefined “collateral packages.” With such a vague prescription for loan guarantee security, the DOE seems poised to repeat the disastrous experience of the 1980s Synfuels project, in which taxpayers were forced to pick up the tab on billions of dollars in defaulted loan guarantees. The DOE should withdraw the Proposed Rule.

II. DESCRIPTION OF COMMENTERS

Commenters are environmental and civic organizations whose offices and/or members are located in the vicinity of proposed new nuclear reactors that are unlikely to be built without the assistance of federal loan guarantees. These organizations and their members are concerned about the safety and environmental risks of the new nuclear reactors that are proposed in their communities. Commenters are also concerned about the potential adverse effects on the safety of nuclear reactor operation that may be caused by management disruptions and upheavals in the wake of defaults on nuclear reactor loan guarantees. Finally, as taxpayers, Commenters are concerned about the significant risk that DOE’s Proposed Rule would impose on them of incurring liability for billions of dollars in defaulted loans for new reactors.

III. STATUTORY AND REGULATORY BACKGROUND

In Section XVII of the 2005 Energy Policy Act, Congress established a U.S. DOE program to provide loan guarantees for projects that reduce greenhouse gas emissions and use “new or significantly improved technologies,” which is defined to include “advanced” nuclear energy facilities. As authorized in the Continuing Resolution for FY 2009, the total amount of loan guarantees that DOE may issue for nuclear reactors is $18.5 billion.

Section 1702 of the Act sets forth general terms and conditions for loan guarantee agreements, including the following:
- The amount of any loan guarantee may not exceed 80% of the cost of the proposed project (§ 1702(c), 42 U.S.C. § 16512(c));
- The DOE may not make a guarantee “unless the Secretary determines that there is reasonable prospect of repayment of the principal and interest on the obligation by the borrower” (§ 1702(d)(1), 42 U.S.C. 16512(d)(1));
- The borrower’s obligation “shall be subject to the condition that the obligation is not subordinate to other financing (§ 1702(d)(3), 42 U.S.C. § 16512(d)(3));
- If the DOE makes a payment on a defaulted loan guarantee, the DOE is subrogated to the rights of the recipient of the payment (§ 1702(g)(2)(A), 42 U.S.C. § 16512(g)(2)(A)); and
- The DOE’s rights “with respect to any property acquired pursuant to a guarantee or related agreements, shall be superior to the rights of any other person with respect to the property.” § 1702(g)(2)(B), 42 U.S.C. § 16512(g)(2)(B).

Section 1702(g)(2)(C)(i) of the Act also requires the Secretary to include, in every loan guarantee agreement, terms and conditions that the secretary deems “appropriate” to “protect the interests of the United States in the case of default.” 42 U.S.C. § 16512(g)(2)(C)(i).

In May 2007, DOE proposed a set of regulations to implement the Act. 72 Fed. Reg. 27,471 (May 16, 2007). In the Proposed Rule, the DOE noted that the Act does not “impose any specific limitations on the financial structure of proposed projects” other than limiting loan guarantees to 80% of the entire project cost; but that nevertheless, it does prohibit the DOE from issuing loan guarantees unless the DOE determines it has a “reasonable prospect” of recovering the principal and interest on the borrower’s obligation. 72 Fed. Reg. at 27,476 (citing 42 U.S.C. § 16512(d)(1)). Therefore, DOE reasoned, the agency “must make repayment of debt a very high priority of the loan guarantee program and DOE is authorized to adopt policies to ensure
that Borrowers and Eligible Lenders use their best efforts to ensure repayment of Guaranteed Obligations.” 72 Fed. Reg. at 27,476. DOE also observed that this obligation was reinforced by the “mandate” of Section 1702(g)(2)(B) that, with respect to any property acquired pursuant to a loan guarantee agreement, the rights of the DOE must be “superior to the rights of any other person.” Id. DOE interpreted this provision of the Act to “require that DOE possess a first lien priority in the assets of the project and other assets pledged as security.” Id.

In October 2007, after taking public comment, DOE issued the Final Rule. DOE reaffirmed its interpretation of the Act in the October 2007 Final Rule and adopted the first lien provision as a binding requirement. 72 Fed. Reg. at 60,124-25.

In August 2009, the DOE issued the Proposed Rule. Claiming that the first lien requirement would discourage investment in new reactors, the DOE offered a new interpretation of the Energy Policy Act that eliminated the requirement and even suggested that a “more modest” pledge of assets, combined with the “credit of the sponsor,” might constitute sufficient backing for a loan guarantee. 74 Fed.Reg. at 39,570.

IV. COMMENTS


In the Proposed Rule, DOE claims it has “critically reexamined” the 2005 Energy Policy Act and concluded that “the interpretation of the statute requiring receipt of a first lien on all project assets is not one that it was legally compelled to adopt, and was not correct.” 74 Fed. Reg. at 39,570. In support of its conclusion, DOE relies primarily on the fact that the statute does not specifically require a first lien. Id. But the DOE fails to explain why it was wrong in 2007 when it reached the opposite conclusion:
In the NOPR [notice of proposed rulemaking], DOE interpreted Title XVII’s requirement that DOE have a superior right to project assets pledged as collateral to prohibit pari passu structures, and as requiring all other lenders to be subordinate to DOE.

In the final rule, DOE has modified its regulations to provide that DOE and the Holders of the non-guaranteed portion of the Guaranteed Obligations may share the proceeds received from the sale of project assets. The Department interprets the Title XVII provision requiring DOE to have a superior right to project assets pledged as collateral to mean that DOE retains superior rights within the meaning of the statute even if the Department shares the proceeds from the sale of project assets with the Holders of the non-guaranteed debt as long as DOE controls the disposition of all project assets. Under this interpretation, it is solely within DOE’s authority to determine whether, and under what terms, the project assets will get sold at all. For example, DOE retains – as a superior right – the ability even over the objections of other parties, to decide against the liquidation of project assets and instead to complete construction of the project, submit to appropriations, or to sell an incomplete project to an entity that will complete the project.

The Department views this interpretation as being consistent with section 1702(g)(2)(A) of the Act, which provides that if DOE makes a payment on the guaranteed debt, 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 guaranteed or related agreements, or permit the borrower *** to continue to pursue the purposes of the project.” The Secretary cannot do any of those things unless the Secretary owns or controls the entire project. There is no provision, for example, for the Secretary to purchase the interest of the non-guaranteed lenders or holders of debt that is not supported by a title XVII guarantee. Furthermore, section 1702(g)(2)(B) provides that the rights of the Secretary, with respect to any property acquired pursuant to a guarantee or related agreements, shall be superior to the rights of any other person with respect to the property, and this provision limits DOE’s rights to the collateral to “property acquired pursuant to a guarantee.”

74 Fed. Reg. at 60,124 (emphasis added). Thus, as the DOE recognized in 2007, to interpret the 2005 Energy Policy Act as not requiring a first lien on a borrower’s assets would render some of the statute’s provisions impossible to carry out and thereby violate basic principles of statutory interpretation. *Milner v. U.S. Dept. of the Navy*, 2009 U.S. App. LEXIS 17387 at *14 (9th Cir. 2009) (a statute should not be interpreted in a manner that renders other provisions of the same statute “inconsistent, meaningless or superfluous”). The Proposed Rule does not resolve or even address that fundamental defect in the DOE’s reasoning. Nor does DOE mention in the Proposed Rule that its new interpretation of the 2005 Energy Policy Act is inconsistent with a nearly 30-

DOE also fails to address how, in the absence of a first lien on the borrower’s assets, it will still be able to meet § 1702(d)(1)’s requirement that its loan guarantees provide a “reasonable prospect of repayment of the principal and interest.” 42 U.S.C. § 1652(d)(1).

Instead, DOE states that:

The Department believes that having the flexibility to determine on a project by project basis the scope of the collateral package and whether pari passu lending is in the best interests of the United States, will enable the Department to reduce its exposure on individual projects, diversify its portfolio and maximize the benefits of the resources available for the loan guarantee program.

74 Fed. Reg. at 39,570. The Energy Policy Act does not set a standard that DOE must “reduce its exposure” or “maximize the benefits of the resources available for the loan guarantee program,” however. It requires the Secretary to establish terms and conditions of loan guarantee agreements that provide a “reasonable prospect of repayment of the principal and interest” on a loan. The Proposed Rule does not provide DOE with a basis for making that claim, and DOE does not even attempt to make it. 2 Therefore, the Proposed Rule should be withdrawn as inconsistent with the 2005 Energy Policy Act.

B. The DOE Has Failed to Demonstrate That the Rationale for the 2007 Final Rule was Erroneous.

According to DOE, the impetus for the Proposed Rule was DOE’s recognition, as a result of reviewing loan guarantee applications, that “its original reading of [Title XVII] was in tension

2 DOE also makes the vacuous argument that the structure of the statute “is suggestive” that provisions of Section 1702(g)(2)(B) are “designed to govern post-default rights of the Secretary, rather than to impose conditions that must be met at the time the Secretary determines to make a loan guarantee.” 74 Fed. Reg. 39,570. To the contrary, by operation of the Energy Policy Act and as a matter of fundamental contract law, DOE’s post-default property rights must be established in the initial loan guarantee agreement. DOE would have no means to acquire new contract rights to a borrower’s collateral after a default on a loan guarantee.
with the financing structure of many commercial transactions in the energy sector.” 74 Fed. Reg. at 39,570. As a result, DOE asserts that the final rule “effectively disqualifies from participation in Title XVII programs proposed energy production facilities that employ innovative technologies, particularly in the nuclear power industry, that are jointly owned through a tenants in common structure or where there are appropriate co-lenders or co-guarantors who require a *Pari passu* structure.” 74 Fed. Reg. at 39,570. In fact, however, DOE considered all of these issues in the 2007 rulemaking and addressed them. DOE has not explained, in the Proposed Rule, why the solutions and rationales provided in the 2007 Final Rule are no longer adequate or appropriate.

For example, DOE claims not to have realized that “tenancy in common, the mode of ownership for a third of proposed new nuclear reactors, does not lend itself to the unitary project ownership anticipated by the regulations.” In fact, however, the 2007 Final Rule does anticipate loan guarantee applications from applicants that own only a partial share of a proposed nuclear power plant, and addresses the issue by requiring a demonstration that the applicant must have a “substantial equity stake” in the project. 72 Fed. Reg. at 60,125. DOE does not explain in the Proposed Rule why it is no longer sufficient to require that borrowers who are partial owners of a nuclear power plant must have a substantial equity stake in the project.

Another reason that DOE claims that the Proposed Rule is needed is that DOE has received “expressions of interest” from Export Credit Agencies, who “will expect to share, on a *pari passu* basis, in collateral pledged to secure the borrower’s debt obligations.” 74 Fed. Reg. at 39,570. But DOE had already addressed this issue, in response to comments on the proposed version of the 2007 Final Rule. In fact, DOE first dealt with the same issue as far back as 1980. As summarized by DOE, the commenters argued:
the first lien requirement in the NOPR [notice of proposed rulemaking] is inconsistent with established norms in project lending and . . . the Export Import Bank of the United States, the Overseas Private Investment Corporation, and the Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA) program at the Department of Transportation treat any non-guaranteed debt as pari passu in terms of both payment and security.

72 Fed. Reg. at 60,112. DOE responded that:

It is customary and common practice in project financing for multiple lenders to enter into a pari passu structure with respect to assets pledged as collateral to secure debt. If such a structure were employed for the Title XVII program, DOE, pursuant to its Loan Guarantee Agreement, and lenders that held non-guaranteed debt, could share proportionately in the proceeds from the sale of project assets pledged as collateral if there were a default and the collateral was sold. In the NOPR, DOE interpreted Title XVII’s requirement that DOE have a superior right to project assets pledged as collateral to prohibit pari passu structures, and as requirement all other lenders to be subordinate to DOE.

In the final rule, DOE has modified its regulations to provide that DOE and the Holders of the non-guaranteed portion of the Guaranteed obligations may share the proceeds received from the sale of project assets. The Department interprets the Title XVII provision requiring DOE to have a superior right to project assets pledged as collateral to mean that DOE retains superior rights within the meaning of the statute even if the Department shares the proceeds from the sale of project assets with the Holders of the nonguaranteed debt as long as DOE controls the disposition of all project assets. Under this interpretation, it is solely within DOE’s authority to determine whether, and under what terms the project assets will be sold at all.

* * *

Insofar as it is applicable here, the Department reaffirms the view it expressed in 1980 in connection with the loan guarantee program for alternative fuels, that while DOE is required under section 1702(g)(2)(B) to have a first lien on all project assets, the Department is not prohibited from negotiating and agreeing with parties about how the proceeds from the sale of collateral will be shared.

72 Fed. Reg. at 60,124. Again, the Proposed Rule completely fails to explain why DOE now considers this approach to be inappropriate.
C. The Proposed Rule Unreasonably Gives the Secretary Unbridled Discretion in Establishing Substitutions for the Protection of a First Lien.

The Proposed Rule removes from 10 C.F.R § 609.10(d)(13) the clause which states that any guaranteed obligation “is in a first lien position on all assets of the project and all additional collateral pledged as security for the Guaranteed Obligations and other project debt.” Compare 74 Fed. Reg. at 39,577 with 72 Fed. Reg. at 60,142. But the Proposed Rule does not substitute any language that would set a standard for the determination of what constitutes an “appropriate collateral package,” i.e., a package that is adequate to reasonably ensure repayment of the loan guarantee. To give the Secretary such unbridled discretion is inconsistent with the Congress’ purpose in enacting Title XVII of ensuring that loan guarantees will be recoverable. It is also inconsistent with the Administrative Procedure Act and principles of administrative law. *FCC v. Fox Television Stations, Inc.*, 129 S. Ct. 1800, 1823 (2009) (Congress may not grant agencies unbridled discretion and federal courts have authority to set an aside agency action not based on neutral and rational principles).

The Proposed Rule should establish a standard for judging the adequacy of “collateral packages” devised by the DOE which addresses the following:

- The full subsidy cost must be paid by the borrower in advance of a conditional guarantee.
- The subsidy cost must not be calculated by breaking risk assessments into segments (i.e., prior to licensing, post-licensing, construction, post-construction) for the purpose of reducing the total subsidy cost for the borrower.
- DOE should outline the three or four most common deal structures that will be allowed, including mechanisms that DOE may use to secure loan guarantees. These sample deal
structures should include circumstances where one of the other major investors is a sovereign foreign state (e.g., France through Électricité de France).

- DOE should explain what limits it will place on its reliance on the “credit of a sponsor” (74 Fed. Reg. at 39,570), including provisions for piercing the corporate veil of limited liability corporations in the event of bankruptcy.

- DOE should clarify that loan guarantee commitments may not be sold to third parties unless the transaction ensures equivalent debt security for taxpayers.

- DOE should provide a detailed explanation of the process for establishing the contents of collateral packages, including what DOE staff will develop the packages, what criteria they will apply, and what process is in place for review of collateral packages.

- In compliance with the Freedom of Information Act and the Obama Administration’s commitment to transparency in government, DOE should publish all relevant information about the content of loan guarantee applications, its decision-making procedures, its criteria for issuing loan guarantees, and the contents of loan guarantee agreements on its website.

D. By Lowering the Requirements for Nuclear Reactor Loan Guarantees, DOE Encourages Risky Investments and Raises the Potential for Defaults.

As recognized in the 2007 Proposed Rule, Title XVII of the Energy Policy Act requires DOE to “harmonize and balance the twin goals of issuing loan guarantees to encourage use of new or significantly improved technologies in the Eligible Projects while limiting the financial exposure of the Federal Government.” 72 Fed. Reg. 27,467. By eliminating the first lien requirement and leaving the terms of loan guarantee packages to its own unfettered discretion,

the Proposed Rule will lower the cost of borrowing money for new reactors and make risky investments all the more attractive. But what makes them attractive is the government’s accommodation of private investors at the expense of taxpayers. This is not the balance that Congress sought to achieve.

The risk that U.S. taxpayers will get stuck with paying off defaulted loans is already acknowledged to be significant, even without the changes proposed by the DOE. According to the Congressional Budget Office (“CBO”), the likelihood of default for new reactors is “very high – well above 50 percent.” Congressional Budget Office, Cost Estimate – S. 14, Energy Policy Act of 2003 at 11 (May 7, 2003), http://www.cbo.gov/ftpdocs/42xx/doc4206/s14.pdf. Although the company receiving the guarantee is expected to pay the “subsidy cost” of the guarantee (the net present value of the anticipated cost of defaults), both CBO and the Government Accountability Office (“GAO”) have concluded that calculating a subsidy cost is extremely difficult. According to GAO, loan guarantees “could result in substantial financial costs to taxpayers if DOE underestimates total program costs.” Letter from James C. Cosgrove, et. al, to the Hon. Peter J. Visclosky, et. al, at 3 (Feb. 28, 2007), http://www.gao.gov/new.items/d07339r.pdf. CBO concluded that “the challenges and constraints involved in estimating the subsidy costs for such innovative projects make it more likely that DOE will underestimate than overestimate the fees paid by borrowers.” Congressional Budget Office, Cost Estimate – S. 1321, Energy Savings Act of 2007 at 8 (June 11, 2007), http://www.cbo.gov/ftpdocs/82xx/doc8206/s1321.pdf.

The already considerable risks to taxpayers from this program are magnified by the completely predictable risk of cost overruns on nuclear power projects. Indeed, the DOE’s own authoritative study on this subject (An Analysis of Nuclear Power Plant Construction Costs,
Technical Report DOE/EIA-0485 (January 1, 1986)) found an average cost overrun of the 75 nuclear reactors examined of 207%. Many reactors completed after this study suffered from even larger cost overruns. Current experience in other countries such as Finland, where an Areva EPR is now nearly 75% over budget and has missed its construction completion deadline by more than three years, provides evidence that the financial woes that plagued the first generation of nuclear reactors remain today.

Given that Congress deemed the loan guarantee program necessary because of the reluctance of the private investment sector to assume the economic risks associated with nuclear reactor construction, it is reasonable to assume there will be even less private sector interest in providing loans to nuclear projects to cover over-budget construction costs. Thus, a nuclear project using taxpayer loan guarantees that goes substantially over-budget could well become a nuclear project that is never completed—raising the likelihood of full default or only partial payment of loans.

DOE should have learned from experience the risks to taxpayers and the economy posed by lax regulation of loan guarantees. In the 1980s, DOE gave out billions of dollars in loan guarantees for synthetic fuel plants, only to have the borrowers default after oil prices dropped precipitously, rendering the synthetic fuels uncompetitive. Likewise, the Rural Electrification Administration (“REA”) loaned billions of dollars to municipal utilities and coops in the 1980s, only to have them default under the burden of skyrocketing costs.

In a recent interview, DOE’s Chief Financial Officer claimed that DOE would avoid the mistakes of the past by hiring “experts” to review loan guarantee applications. Technology Review (June 26, 2009), www.technologyreview.com/printer_friendly_article.aspx?id=22939&channel=energy. But as the recent spate of Wall Street debacles shows, hiring unnamed
“experts” for a wide-ranging review that has no clear or rigorous criteria for their decisions provides no basis for confidence in financial decisions. It is also a process that is totally without public accountability. This lack of accountability is exacerbated by the fact that DOE has refused to publish on its website any information about the loan guarantee program, including the contents of applications, the details of its review process, the criteria against which it judges applications, or its decisions.

Just as the DOE and REA underpriced the risk of their loan guarantees in the 1980s, so it promises to repeat the same mistake today, by making the attractiveness of nuclear reactor investments a much higher priority than the security of the government’s role in those investments. Given DOE’s previous experience, there is no excuse for a repeat performance. And in light of the fragility of the current economy, the DOE’s disregard of its own history is all the more egregious.

V. CONCLUSION

For the foregoing reasons, the DOE should withdraw the Proposed Rule.

Respectfully submitted,

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