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November 10, 2011

The Honorable Henry A. Waxman
Ranking Member
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515

Re: Energy Policy Act of 2005 Section 1702 Interpretation

Dear Congressman Waxman:

The letter responds to the request made by your staff to provide you with my views concerning the interpretation of Section 1702 of the Energy Policy Act of 2005, focusing specifically on the question of whether Section 1702 of the Act gives the Department of Energy ("DOE") the authority to subordinate a guaranteed loan to other debt incurred by a project in a post-default, restructuring situation. In particular, I was asked to comment on whether the February 15, 2011, opinion of Susan Richardson, Chief Counsel of the Loan Programs Office, entitled Solyndra Restructuring (hereafter referred to as the "Opinion") is supported by the statute.

As I explained to your staff in connection with responding to this request, I have no confidential information about the facts of the Solyndra loan guarantee, and I have not had access to the Solyndra loan guarantee documents. My knowledge of the matter comes from what has been publicly reported. In addition, while I have represented several clients in DOE loan and loan guarantee matters, I have not had occasion previously to consider the question of DOE's authority to subordinate a guaranteed loan in a restructuring. Finally, as I also explained to your staff, Susan Richardson is someone whom I know. I have not, however, discussed the Committee's request for my views or the substance of what follows with Ms. Richardson or anyone else at DOE.

I have concluded that the Opinion is supported both by the statute and by DOE's interpretation of Section 1702 as reflected in 10 CFR Part 609, the regulations governing the loan guarantee program, and the associated rulemaking proceedings. (It is noteworthy that the initial rulemaking was concluded during the prior Administration, and I believe that the subsequent amendments were also concluded before the Solyndra loan restructuring issues arose.) The Opinion is also supported by commercial practice with respect to the restructuring of loans that are in default.

Starting with the statute itself, Section 1702(d)(3) states: "The obligation shall be subject to the condition that the obligation is not subordinate to other financing." Had Congress sought to prohibit subordination of a guaranteed obligation at any time, under any circumstances, one might expect the provision to be phrased in more definitive terms, such as: "The obligation shall not be subordinated to other financing." Three aspects of Section 1702(d)(3) suggest that Congress had a more limited intent. First, Section

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1703(d)(3) is presented as one of three conditions that must be met prior to the issuance of a loan guarantee. The three conditions are presented as determinations the Secretary must make before issuing the loan guarantee. This is reinforced by the phrasing "the obligation is not subordinate to other financing." The use of the present tense "is" suggests a requirement at a particular point in time, i.e., the point at which the guarantee is issued. Finally, I agree with the Opinion that the use of the term "condition" as it appears in the context of Section 1702(d)(3) is reasonably understood to refer to a "condition precedent," that is a condition that must be met prior to issuance of the guarantee.

I find it significant that DOE plainly understood Section 1702(d)(3) in this light when it undertook the rulemaking to implement the loan guarantee program in 2007. In 10 CFR 609.10(d), DOE set out a long list of requirements that DOE must ensure are satisfied "[p]rior to the execution of a Loan Guarantee Agreement," that is, conditions precedent. Included in that list were the statutory requirements set out Section 1703(d)(1), (d)(2) and – of interest here – (d)(3). Following the structure of the statute, the rule used the present tense "is," describing the required condition as: "Any Guaranteed Obligation is not subordinate to any loan or other debt obligation. . . ." 10 CFR 609.10(d)(13).[1] A requirement that must be satisfied as a condition precedent to the issuance of a loan guarantee is not necessarily a requirement that must prevail regardless of what occurs thereafter, and neither the statute nor the regulations elsewhere state that the non-subordination requirement must be met at all times.

DOE repeated this understanding of the statute as distinguishing between what is required before a loan guarantee is issued and what requirements apply in the event of default in a 2009 rulemaking amending 10 CFR Part 609: "section 1702(d) addresses certain threshold requirements that must be met before the guaranty is made; and section 1702(g) addresses the Secretary's rights in the event of default of the loan." 74 Fed. Reg. 63544, 63545 (2009). DOE went on to note that the structure of the statute "key[ed] its particular provisions to the sequence of stages that are foreseeable in the loan guarantee relationship." Id. It is noteworthy that Section 1702(g), which deals with default, does not contain language prohibiting subordination.

Two other aspects of DOE's loan guarantee rulemaking provide indirect support for the conclusion that the non-subordination requirement, which clearly must be met before a loan guarantee is issued, does not prohibit DOE from agreeing to subordination if the borrower defaults and a loan must be restructured. The regulations provide that, where the loan guarantee agreement or any applicable intercreditor agreement so provides, in the event of default, a lender and the Secretary may agree to a workout strategy and/or a plan of liquidation. 10 CFR 609.15(h). There are no limitations in that provision on what a workout strategy might include. In particular, the rule does not preclude subordination of the guaranteed debt as a component of a workout strategy.

Finally, it is significant in my analysis that, in amending the loan guarantee rules in 2009, DOE eliminated a restriction that would have required it to hold a first lien position on all assets of a project receiving a loan guarantee. In making that change, DOE explained that its "original reading of the statue was in tension with the financing structure of many commercial transactions in the energy sector," involving for example ownership by tenancy-in-common or co-lenders or co-guarantors – commercial structures that some who had planned to apply for loan guarantees needed to employ if their projects were to go forward. DOE concluded that the statute did not strictly require the first lien requirement and that imposing a restriction that was not consistent with commercial practices would have had the effect of

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[1] As originally adopted in 2007, 10 CFR 609.10(d)(13) also required that DOE have a first lien on all project assets. That requirement was removed in 2009, as discussed below.

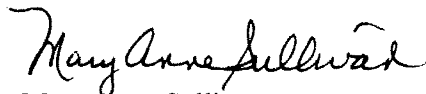
limiting the ability of the loan guarantee program to serve its intended purposes. 74 Fed. Reg. at 63545-46.

Likewise here, interpreting the statute to prohibit subordination of the guaranteed debt, even where additional new money is necessary as part of an effort to reduce the losses associated with a default, would not be consistent with commercial practice. A lender providing additional funding to a transaction already in default routinely insists that its debt be superior to earlier incurred debt because such later debt is being incurred at a point at which it has become apparent that the risk associated with a project is higher than anticipated at the time of the original financing and neither the existing lenders nor the equity has elected to provide the additional funds. Given this commercial expectation that, in a default situation, earlier incurred debt would expect to be subordinate to later incurred debt, had DOE reached any other conclusion about its authority under Section 1702, it would have sharply constrained DOE's ability to undertake any meaningful restructuring of guaranteed loans, a result that would likely increase taxpayer risk from projects that run into unexpected financial difficulties. While in the case of Solyndra, even the additional money injected into the project as a result of the restructuring proved to be insufficient to save the project, one would expect that in other cases, an infusion of additional debt could help to rescue a project and thereby protect taxpayer interests.

In short, I conclude from the statute, the loan guarantee regulations, and DOE's prior interpretations of Section 1702 that, had it expressly considered the question of its authority to subordinate its guaranteed debt in a post-default restructuring before the Solyndra default situation arose, DOE likely would have reached the same conclusion reflected in the Opinion, and that its conclusion is legally supported.

I hope the foregoing analysis is helpful to you in your deliberations.

Very truly yours,



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