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## **Testimony of Jeanine Hull**

### **Before the SENATE ENERGY AND NATURAL RESOURCES COMMITTEE**

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Good morning Mr. Chairman, Ranking Member Murkowski, and members of the Committee. I am honored to be invited back to convey my great respect for the work the Committee and Committee staff have done since the last time many on this panel were invited to give our thoughts on legislation establishing a federal clean energy funding entity.

I am currently 'of counsel' at Dykema Gossett, PLLC, a law firm based in Detroit, where I advise clients on energy infrastructure and project finance issues. My testimony today, however, reflects exclusively my personal opinions based upon more than 30 years in the energy infrastructure and finance sector.

The subject of my comments today is the Committee's Discussion Draft of the 21<sup>st</sup> Century Energy Technology Development Act which would create the Clean Energy Deployment Administration ("CEDA"). In my opinion, this Draft has brilliantly reconciled and updated bills introduced in the 110<sup>th</sup> Congress, S. 3233 and S. 2730, by Chairman Bingaman and Ranking Member Domenici respectively, which were the subject of the July 2008 hearing. Although similar to each other in most critical respects, those bills differed in two fundamental respects: S. 2730 was focused on rapid deployment of existing technology while S. 3233 focused on development of "breakthrough" technologies, and each bill authorized the use of different tools to achieve its respective purpose. As the Discussion Draft recognizes, both purposes and sets of tools will be required to achieve the scope and scale of low and zero carbon technology deployment necessary to meet the four challenges of reliable domestic energy supply, environmental protection and avoidance of climate change damages, economic growth and physical security.

Testimony last year focused primarily on the need for a clean energy funding facility, the seriousness of our energy related climate and security problems, and the need for a federal funding entity to facilitate the rapid deployment of not only existing energy efficiency and renewable energy technologies, but also of breakthrough technologies that have the potential to be 'game-changers' in a carbon-constrained economy.

There was significant discussion then about the crisis already developing in the credit markets which balked at financing novel energy technologies, and the decades of failure to achieve significant efficiencies in energy use. So many things have changed since that hearing in mid-July 2008: among many other things, the advent and collapse of \$4.50/gal. gasoline; the near total collapse of domestic credit markets which spread globally; alarming new findings about how much more quickly climate change is occurring than had been predicted just 2 years earlier; a change of Administration; failures in key domestic economic sectors, and the enactment of a nearly trillion dollar federal stimulus package to address some of these events. All this occurred in a matter of months!

The bright spot in this otherwise dreary litany is that now we are no longer debating *whether* to take action, but *how*. Evidence of the seriousness with which this Committee addressed the task of reconciling the two excellent bills from last year is before us in form of the Discussion Draft. The Committee clearly listened last year, not only to the formal witnesses, but also to those whose concerns about federal funding entities rose sharply with the trouble experienced last fall by Fannie Mae and Freddie Mac, resulting in their takeover by the federal government. The drafters of the Discussion Draft have taken great pains to tailor the authorities and responsibilities of CEDA, as well as the oversight functions of an independent Inspector General, the Government Accountability Office and Congress. The drafters also provided a focused and specific task, specific goals and the appropriate tools to accomplish those goals.

Last year the Committee was encouraged to leverage the Government's resources through the private capital markets and to provide credit support or risk transfer to encourage private capital markets to fill the gaps in existing lending practices. One specific lending gap discussed was the infamous 'valley of death,' that is, the difficulty of finding funding for projects attempting to pass from pilot scale demonstration to commercial deployment. The other gap identified was the lack of funding for widely available and proven, but small scale, efficiency and renewable projects which cannot support standard transaction costs. Witnesses testified that government funds were appropriately applied to offset technology risk in breakthrough or novel technologies, and financing/credit risk in small scale applications that when deployed in massive numbers can provide disproportionately large savings of carbon-based energy. Although it has long been recognized that funding of basic research and development is an important governmental function, justifying the expenditure of millions of dollars annually, we are now beginning to acknowledge the need and legitimacy for federal assistance to accomplish rapid and widespread commercialization and deployment of appropriate technologies.

Congress tested the waters for deployment support in the 2005 Energy Policy Act by creating the Loan Guaranty Program within the Department of Energy. The fact that as of April 2009, no loan has yet been guaranteed is not entirely the fault of the Department. The legislative changes to the loan program are ones that should substantially improve its ability to perform on a more timely basis. In part, the lack of speed of the loan program demonstrates the need for more than

a single tool to accomplish such a monumental task. This challenge has been met with the bill before you.

The draft 21<sup>st</sup> Century Energy Technology Deployment Act has resolved the tension between the difference in focus and authorities granted in S. 3233 and 2730. The new bill sets forth CEDA's mission in Section 2 as (in paraphrase) promoting the domestic development and deployment of clean energy technologies by creating an attractive investment environment through partnership with and support of the private capital market, with a priority on breakthrough technologies. In short, the goals of both earlier bills have been melded together while clearly putting the government in a limited, but critical support role with respect to private markets. This subordinate role is underscored by the fact that CEDA has a limited life of 20 years. It is to provide the foundation for capital market development and then terminate, not remain to compete in the markets it helps create. And quite soundly, the draft provides all of the tools that were included in last year's Bingaman and Domenici bills.

Those who are concerned about any similarity between CEDA and Fannie Mae or Freddie Mac should take significant comfort in the fact that CEDA is structured from the 'get-go' as a support facility for private capital markets, and is not intended to stay in existence long enough to compete in that market with the other for-profit participants. This limitation alone is in all likelihood, sufficient to prevent CEDA from following the paths of Fannie and Freddie.

However, CEDA can only succeed in its mission to manage technological and financial risks to promote commercialization of clean energy technologies if it is built on a solid foundation of prudence, transparency, accountability and competence. I believe such a foundation is established in this bill and want to specifically emphasize and support the need for the following provisions:

## **I. SAFETY AND SOUNDNESS**

### **a. PRUDENCE**

Numerous provisions of the draft require the CEDA Administrator or the Secretary of Energy to create a well-thought out plan of how to achieve the goals established by the bill. I shall address transparency in a moment, but of course, all final planning documents will be publicly available and subject to review. This approach carefully balances the need for speed and flexibility with the need for prudent consideration of various approaches and options.

Section 5 of the draft requires the Secretary of Energy to establish specific goals for CEDA with respect to ensuring adequacy of domestic energy supply, reducing reliance on foreign energy resources, developing clean manufacturing capabilities, improving and expanding energy infrastructure, and preventing energy waste, among other things.

These goals are further refined by an Energy Technology Advisory Council which will establish the assessment methodology to be applied by the Administration to all funding requests, and provide independent due diligence on specific technological approaches. I must note here that the requirement for technology due diligence by the Council will be one of CEDA's major contributions to the market. The Council will be composed of experts from a broad array of relevant fields, enabling the Council to develop a more accurate appraisal of a specific

technology than any investor or investor group is likely to be able to otherwise acquire. Private investors will be able to rely on the Council's assessment with confidence, providing a strong market signal of technical feasibility. The Council's imprimatur will give great credibility to CEDA's decision to fund a particular project or technology. This in itself should greatly facilitate private capital market funding.

The Administrator is required to establish and maintain an adequate loss reserve, an amount of cash or liquid securities set aside to protect the Administration against expected losses. This is consistent with safety practices required by the banking, credit union and savings and loan regulators, the Securities and Exchange Commission and the Commodity Futures Trading Commission in regard to entities subject to oversight.

In addition, the Administrator is explicitly tasked with the responsibility to ensure that the Administration operate in a 'safe and sound' manner. This is defined as including the establishment and review of internal controls, consistent with §404 of the Sarbanes-Oxley Act. (See §6(b)(2)(B) of the Draft).

Having been a compliance officer in a number of energy trading firms, I have come to believe that the only controls that are effective on a daily basis are internal "hard" controls, not licensing requirements or other external behavior prohibitions. Internal controls that separate deal initiation, or "front office activities," from accounting and other "back office" activities, by having different people perform those tasks who themselves report to different officers, are the best means to avoid "rogue bankers." In my experience, charges of "rogue bankers" or "rogue traders" are simply corporate-speak for a lack of adequate internal controls, both functional and behavioral. That this section is included in the Discussion Draft indicates the care taken to ensure the long-term success of this entity.

## b. TRANSPARENCY

As part of the US Department of Energy, CEDA is subject to oversight by the authorizing and appropriating committees of Congress and is required to report annually on its activities to Congress. It is subject to oversight by the Office of Management and Budget and it is subject to the provisions of the Administrative Procedures Act and the Freedom of Information Act, two laws, among others, which can provide a substantial level of transparency into CEDA's decision-making and activities. Moreover, the Administrator is required to develop policies and procedures that promote transparency and openness in CEDA operations.

## c. ACCOUNTABILITY

The Administrator, who also serves as chair of the Board of Directors, is appointed by the President, reports to the Secretary of Energy, and, along with other Directors, may be removed from office by the President for cause. The Administrator is responsible and accountable for meeting the goals established by the Secretary. In addition, the Secretary of the Treasury will have an independent responsibility to monitor the aggregate level of activity by the Administration.

The Government Accountability Office is required to audit CEDA on a regular basis, and is granted access to all personnel, records, property, etc. necessary to perform its audit. Further, the Administrator shall annually order an independent audit of CEDA's financial statements by an independent public accountant, to be conducted in accordance with generally accepted auditing standards. In addition, the Administrator shall prepare and submit annual and quarterly reports to the Secretary of Energy in the form prescribed by the Secretary.

Taking a page from recent securities legislation, the Administrator, as the Chief Executive Officer, and the Chief Financial Officer are required to personally certify the accuracy and completeness of these reports. Those reports will be made public after receipt by the Secretary. An Inspector General will be assigned to CEDA on a permanent basis.

#### d. COMPETENCE

The Draft recognizes the need for the types of specialized expertise and experience which does not normally reside in the federal workforce. The Administrator is granted significant flexibility to bring in personnel with necessary expertise where justified, subject to a limit on the total number of 'exempt' staff at any given time, and certain other limitations.

I believe that a careful review of the Committee Draft shows that the Committee has gone the extra mile to ensure that CEDA's mission is clear, achievable and focused; that CEDA is provided with the necessary tools, authorities and flexibility to achieve its mission; and that CEDA has been structured to ensure, as far as possible, that its resources are managed carefully and with strict accountability for its decisions, ensuring all the while the safety and soundness of the entity.

## II. RISK

After ensuring an appropriate mission and providing a structure for safety and soundness, the next important task is to allow CEDA to take on risky investments necessary for it to meet its mission of fostering breakthrough technologies, without fear that the failure of one or more supported technologies or projects will reduce or eliminate support for its risk-taking mission. Here again, I believe the Committee has done an outstanding job.

It is critical to be very clear that, if enacted, CEDA will support some projects that, despite best efforts and thorough due diligence, do not perform as expected, resulting in financial losses to CEDA. This will happen and only means that CEDA is doing its job. If there were little or no risk in CEDA's mission, there would be no need for it in the first place. It is very hard for any entity to acknowledge and accept losses or failures, but it is particularly difficult for an entity subject to public scrutiny and accountability to do so because of the potential for public humiliation in the wake of such loss, something CEDA's counterparts in private equity do not usually have to face.

That is why I believe the heart and soul of this bill is Section 7(a)(1)(C), a section simply titled "Risk." This section requires the establishment of a loss reserve, as discussed above, and even provides an initial loss reserve requirement, pending sufficient data to create a requirement more

tailored to its own risk experience. The selected loss reserve requirement is one common among private equity and other risk firms. This loss reserve level, appropriate for private firms, is probably too low for CEDA, since CEDA is tasked to facilitate the funding of higher risk projects than private equity is willing to fund. However, this goal is in tension with the need to preserve as much capital as possible to maximize the number of projects which receive funding. This is a perfect illustration of the perpetual tug of war between risk mitigation and potential payoffs, which is the defining characteristic of this space.

This section requires a portfolio or diversified approach, while other sections of the bill allow for the creation of multiple risk silos, with separate qualifications, fees and characteristics to accommodate a diversified portfolio. Most importantly, this section requires CEDA to provide the "maximum practicable percentage of support to promote breakthrough (i.e., the riskiest) technologies."

These provisions are critical to the achievement of CEDA's mission, which is nothing short of attempting to retool our economy to support a 'low-to-no-' carbon footprint. Only if CEDA knows that it is acceptable, in fact, expected to recognize losses, will it allow itself to take on the risks it must take to achieve its mission. I would argue that if it does not 'fail' enough, it is not taking the appropriate level of risk. Again, what is 'enough' failure and what is too much can be answered only by experience. We will not crash through the carbon-based economy barrier with timidity or by being risk averse. Courage and boldness are required on all frontiers-- and we are most definitely on a technology frontier.

### **III. NATIONAL ENVIRONMENTAL POLICY ACT ("NEPA")**

I encourage the Committee to consider narrowing the applicable scope of the National Environmental Policy Act to this program.

Most of CEDA's activities and support will be focused on leveraging private capital markets by providing some means of mitigating technology risk, either through loan guarantees, credit support, insurance, or by other means short of direct investment or lending. When acting in a purely credit support role, it would be beneficial if the project under consideration for such support could be subjected to significantly less than full NEPA assessment or review. Of course, if CEDA is considering investing equity or making a direct loan, a fuller evaluation would be appropriate. This is particularly important in view of the recognition by both the Department and the Committee that most applications should receive a final determination within 180 days of submission.



#### IV. CONCLUSION

In my testimony last year, I identified four primary challenges to our nation's future. I believe that, as proposed in the 21<sup>st</sup> Century Energy Technology Deployment Act, CEDA will address each of the four security challenges as follows:

**Energy Security** will be enhanced by the development of domestic, affordable, reliable and sustainable sources of energy to meet the demand for fuels and electricity while simultaneously making the system less vulnerable to intentional and unintentional disruption.

**Economic Security** will be enhanced through the increased ability of the United States to insulate itself from the inflationary pressures of dependence on a petroleum-based economy, as well as slow the imbalance of payments to oil- and gas-producing nations, many of which wish to do us harm. By retaining petro-dollars at home and refocusing them on a "greener" economy, the United States can maintain and enhance its manufacturing and intellectual competitiveness, create and maintain good jobs and support (and export) thriving new technologies.

**National (Physical) Security** will be enhanced by reducing our need to protect foreign oil and gas infrastructure and reducing our presence in unstable areas which harbor those who may wish to retaliate against the United States on its homeland as well as abroad.

**Environmental Security** will be enhanced by reducing the volume of emissions which contribute to climate change and otherwise pollute the air, water and soil.

Mr. Chairman, Ranking Member Murkowski, thank you for the opportunity to testify today in support of legislation that is so vital to our country. I urge this Committee to act on this bill and move legislation to the floor as quickly as possible. Time is truly of the essence.

This concludes my prepared remarks. I look forward to your questions.