STATEMENT FOR THE RECORD

by

Marvin S. Fertel
President and Chief Executive Officer
Nuclear Energy Institute

to the

Committee on Energy and Natural Resources
U.S. Senate

September 23, 2010

Chairman Bingaman and members of the committee, thank you for your interest in the loan guarantee program authorized by Title XVII of the 2005 Energy Policy Act, and your commitment to address the issues and challenges that have arisen in the course of implementing this important program.

My name is Marvin Fertel. I am the President and Chief Executive Officer of the Nuclear Energy Institute (NEI). NEI is responsible for establishing unified nuclear industry policy on regulatory, financial, technical and legislative issues affecting the industry. NEI members include all companies licensed to operate commercial nuclear power plants in the United States, nuclear plant designers, major architect/engineering firms, fuel fabrication facilities, materials licensees, labor organizations, universities and other organizations and individuals involved in the nuclear energy industry.

NEI recognizes the challenges associated with establishing a financing program of this magnitude. The nuclear energy industry is encouraged by the award of conditional commitments to the Vogtle nuclear power project and the Eagle Rock uranium enrichment facility, and the fact that three other nuclear power projects and one additional uranium enrichment project are well-advanced in the due diligence process. These projects, and many more like them, are essential if our nation is to meet our goals for clean energy and job creation.

Since taking office, the Obama Administration has demonstrated a willingness to address major challenges associated with implementing this program, including the president's proposal to authorize an additional $36 billion in loan guarantee volume in fiscal year 2011, and the revision to the final rule governing this program to allow sharing of collateral with other lenders, without which the program simply would not function.

Despite this progress, however, the Title XVII loan guarantee program faces significant challenges that will limit its effectiveness. For the nuclear energy industry, one of the most significant challenges involves determining the credit subsidy cost of Title XVII loan guarantees. Since borrowers receiving loan guarantees for nuclear energy projects are expected to pay the cost associated with those guarantees, the industry has a legitimate interest in the assumptions and methodology used to calculate credit subsidy cost.

Credit subsidy costs for the Department of Energy's loan guarantee program are calculated using a credit subsidy calculator developed by the Office of Management and Budget. Of the major inputs to the calculator, two of them (default probability and recovery rate in the event of default) have the greatest impact on results.

For the purposes of Title XVII, it is our understanding that the Executive Branch employs a recovery rate of 55 percent across the board for all energy technologies and projects being considered for Title XVII loan guarantees. The 55-percent recovery rate was set during the administration of President George W. Bush, prior to the submission deadline for detailed Part II loan guarantee applications . The use of a

standardized recovery rate does not satisfy the requirements of the Federal Credit Reform Act (FCRA) of 1990. In addition, the recovery rate chosen – 55 percent – is an arbitrary number and has no basis in actual market experience with financial structures like those supported under Title XVII. Nor did the decision to set an arbitrary 55 percent recovery rate have the benefit of the project-specific recovery information provided in the Part II applications for nuclear power loan guarantees.

We believe the methodology used by the Executive Branch inflates the credit subsidy cost well beyond the level required to compensate the federal government for the risk taken in providing the loan guarantee. At least one nuclear power project was quoted an unrealistically high credit subsidy cost, which ignored the project's strong credit metrics and the robust lender protections built into the transaction, and limited the estimate of recovery rate to 55 percent, significantly lower than the recovery estimate in the credit assessment of the project by an independent rating agency.

Consistent with FCRA, NEI believes that the most accurate and equitable process for calculating credit subsidy costs is a detailed, project-specific assessment. The current approach, which relies on standard assumptions applied to all technologies, with limited project-specific flexibility, cannot produce accurate results, and will not serve the loan guarantee program's objectives – to support deployment of clean energy technologies in such a manner that the risk to the federal government is fully offset by fees paid by the borrower.

In fact, a project-specific approach is explicitly required by the Federal Credit Reform Act (FCRA). FCRA requires the government to consider all of the cash flows over the term of the loan, including fees, defaults, recoveries and contractual and structural protections.[1] For large, customized transactions like those authorized by the Energy Policy Act of 2005, accurate estimates of recovery can only be derived from detailed project-specific analysis. Recovery values will vary from project to project, depending on the technology, nature and structure of the project, the project sponsors, contractual issues, and many other factors.

The vast majority of federal credit programs are characterized by high volumes and relatively low dollar amounts, concentrated in housing, education, rural development and small business. In calculating credit subsidy costs for these program, the Executive Branch makes a number of simplifying assumptions and, because the federal government pays for the credit subsidy costs of these transactions, borrowers are generally indifferent to the methodology by which credit subsidy costs are calculated. These simplifying assumptions should not be used in lieu of project-specific assessments in the case of a program involving multi-billion-dollar transactions, in which the borrower pays the credit subsidy cost.

Even if it were acceptable to use standardized, "one-size-fits-all" assumptions, the 55-percent recovery rate now used is well below the recovery rates observed historically for regulated utility debt and project finance debt. According to historical data from Moody's Investors Service and Standard and Poor's, ultimate recovery rates for regulated utility debt range from 87 percent to 99 percent. Recovery rates for project finance debt are comparable, in the range of 90 percent to 100 percent, because project finance transactions employ structural features designed specifically to maximize recoveries in the event of

[1] Section 502(5)(B) of the Federal Credit Reform Act of 1990 provides:

"The cost of a direct loan shall be the net present value, at the time when the direct loan is disbursed, of the following estimated cash flows:

(i) loan disbursements;

(ii) repayments of principal; and

(iii) payments of interest and other payments by or to the Government over the life of the loan after adjusting for estimated defaults, prepayments, fees, penalties, and other recoveries; including the effects of changes in loan terms resulting from the exercise by the borrower of an option included in the loan contract."

default. NEI has developed a detailed white paper that provides historical perspective on these issues, and I ask permission to have that white paper included in the record of this hearing.

It is vitally important that credit subsidy costs be calculated accurately. If current practices continue, the Executive Branch will continue to produce inflated credit subsidy costs. Project sponsors, in turn, will simply abandon otherwise creditworthy nuclear energy projects, and the nation will forego the clean energy and thousands of well-paying jobs represented by these facilities.

The difficulties encountered by the nuclear energy industry and the renewable energy community in implementing the Title XVII loan guarantee program cannot be laid entirely at the Department of Energy's doorstep. Other Executive Branch agencies and offices – including the Office of Management and Budget – play a significant, often governing, role in determining the rules and protocols governing this program. In our experience, the Department of Energy staff working on loan guarantees – from senior leadership to program management, from loan officers to the legal, financial and market advisers on the due diligence teams – are experienced, highly trained professionals committed to making the program work.

Mr. Chairman, we have reviewed the two pieces of legislation you introduced – S. 3746 and S. 3759 – which make a number of changes to the underlying statute to address some of the difficulties that have arisen during implementation. Although many of these changes are designed to address issues encountered by the renewable energy community, we fully support them. NEI believes this program must operate efficiently and effectively for all clean energy technologies that are eligible, not just a few.

We have identified a few additional statutory changes, largely designed to address the defects in the current process for developing credit subsidy costs. Among other items, these changes would:

- require the Executive Branch to use project-specific analysis in developing recovery values and other inputs to the credit subsidy calculator;
- allow project sponsors to pay the credit subsidy cost annually, based on the next year's anticipated draw;
- address the lack of transparency that characterizes the current process for determining credit subsidy cost, and
- vest final authority in determining credit subsidy cost with the Secretary of Energy, since it is the Department of Energy that is responsible and accountable for implementing the loan guarantee program, and since DOE is equipped with the corporate and project finance expertise necessary to make those determinations.

Mr. Chairman, we would appreciate the opportunity to work with committee staff in developing these proposals further, and we hope that you and other members of the committee would support such an initiative.

One other challenge deserves mention. The success of the clean energy loan guarantee program has been hampered by lack of certainty over loan volume. Project developers must have clear line of sight that financing will be available, if we expect them to continue spending millions of dollars – or, in the case of new nuclear power and fuel supply facilities, billions of dollars – necessary to maintain project schedules. If Congress chooses to impose limitations on loan volume – and we are not persuaded that such limitations are necessary in a program where project sponsors pay the credit subsidy cost – then those limitations should be commensurate with the size, number and financing needs of the projects. In the case of nuclear power, $18.5 billion is not sufficient. NEI continues to support the President's request for an additional $36 billion in loan volume.

Finally, Mr. Chairman, let me commend this committee for having recognized long ago that the scale of the energy and environmental challenges facing our nation – large-scale deployment of clean energy technologies, modernizing the U.S. electric power supply and delivery system, and reducing carbon emissions – requires a broader financing platform than the program envisioned by Title XVII. An effective, long-term financing platform is necessary to ensure deployment of clean energy technologies in the numbers required, and to accelerate the flow of private capital to clean technology deployment. For this reason, NEI continues to support creation of a Clean Energy Deployment Administration, as envisioned by S. 1462, the American Clean Energy Leadership Act, which was approved by this Committee in June 2009.

Thank you, Mr. Chairman. I would be pleased to answer questions.

■