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Before the

Senate Energy and Natural Resources Committee

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Mr. Chairman and Members of the Committee:

Thank you for the opportunity to discuss with you today the budgetary and financial management aspects of the Committee discussion draft bill, the "21st Century Energy Technology Deployment Act."

I served in several career executive positions at the Office of Management and Budget for a period of 18 years, the last 6 years as Deputy Associate Director for Energy and Science. While at OMB, I was responsible for oversight of energy technology R&D programs, including policies for technology demonstration and deployment.

I currently am a consultant and advisor to a number of companies participating in the DOE Title XVII loan guarantee program. I also advise several industry trade associations on loan guarantee program issues. My comments today are my own and reflect my cumulative government and private sector experience and do not represent the views of any particular company or organization.

My comments are focused on three topics:

- the proposed amendments to Title XVII of the Energy Policy Act of 2005;
- the financial management provisions of the proposed Clean Energy Deployment Administration (CEDA); and
- the transition process from the current DOE Title XVII program to the proposed new CEDA.

Amendments to Title XVII of the Energy Policy Act of 2005

The enactment of Title XVII of the Energy Policy Act of 2005 (EPACT 2005) posed a major challenge to the Department of Energy. Title XVII authorized not only a new program in DOE, but one that was of an entirely different character than any existing DOE program. Implementation of the Title XVII loan guarantee program for innovative technologies required the establishment of a new office, hiring of staff with expertise that did not exist within DOE, development of new regulations, and development of a new business model within DOE. Although the pace of implementation has not been as rapid as many observers would like, the DOE Loan Guarantee Program Office has made substantial progress and has now gained momentum that should become evident in decisions in the near future.

Title XVII of the EPACT 2005 established a relatively simple and flexible structure for the DOE Loan Guarantee Program. However, the absence of detailed and prescriptive direction in the original statute has contributed to delays and uncertainties.

New developments since the time of enactment, such as the potential for co-financing from foreign export credit agencies and the collapse of commercial lending and private equity markets, created issues that were not envisioned at the time of EPACT 2005.

The draft bill contains a set of amendments to Title XVII that provide much needed clarification and direction. In particular, the proposed amendments would:

- revise the definition of "commercial technologies" so that the criterion for eligibility for a loan guarantee would reflect the inability of a proposed clean energy technology project to obtain commercial financing, rather than simply the number of times that the technology was deployed in previous projects receiving DOE Title XVII loan guarantees;
- allow DOE to use a combination of fees and appropriations to pay for budget credit subsidy costs, providing DOE flexibility to adjust fees as needed to support smaller scale projects or projects with higher risk but greater technological breakthrough potential;
- clarify that appropriations Act authority is not necessary for the volume of loan guarantees that are supported through 100% self-pay fees. This amendment codifies an April 20, 2007 Government Accountability Office (GAO) Legal Opinion that the so-called self-pay authority in Section 1702 (b)(2) of EPACT 2005 was independent from the requirement of Section 504 (b) of the Federal Credit Reform Act of 1990. Section 1702 (b) of Title XVII provides clear DOE authority to issue loan guarantees through the self-pay mechanism, whereby DOE

can charge, collect and deposit in the Treasury such payments without the need for appropriations. This does not limit the ability of Congress to establish limits on self-pay guarantees; it merely clarifies that no further appropriations action is necessary in order for DOE to exercise the authority provided in Section 1702 (b).

- provide greater flexibility for DOE to enter into collateral-sharing agreements with other lenders, especially foreign export credit agencies, as well as allow multiple equity investors that hold undivided interests as joint tenants in project assets. EPACT 2005 and the DOE implementing regulations were premised on an assumption that Title XVII projects would have a single equity holder and a single lender. Financing structures, particularly for larger power generation projects, may involve multiple equity holders, using the ownership structure of joint tenancy, as well as several co-lenders. In some cases, equity holders with undivided interests may provide a corporate guarantee beyond their ownership interest in the project which would yield a significantly stronger credit position for DOE. The proposed amendment on subrogation, supplemented with changes in the DOE regulations, will enable DOE to:
    - hold collateral in undivided interest structures;
    - adopt parallel financing structures (including co-lending from Export Credit Agencies), and
    - more easily accept collateral other than project assets.

  These arrangements will lower the risk exposure to federal taxpayers and enable DOE in many cases to strengthen its collateral position;

- convert the current DOE Loan Guarantee appropriation account into a revolving fund, which is the customary type of federal budgetary account used for business-like transactions. This modification will provide greater funding certainty by enabling DOE to utilize fees immediately upon collection, without further appropriation, to pay for the continuing ramp-up in staff and support services. The proposed change in the budget accounting would reinforce the current requirement for DOE to recover 100% of administrative costs through fees; and
- provide clearer direction to DOE to complete its reviews of project applications within 180 days. This will help guide internal DOE program planning, while providing greater schedule certainty to project applicants.

In short, these amendments provide DOE greater clarity to overcome uncertainties in implementation, and provide greater flexibility to respond to the types of project applications received to date. These amendments are necessary to achieve expeditious implementation of both the original Title XVII program, as well as the new Section 1705 program authorized by the Recovery Act, without diminishing program effectiveness or accountability. However, it will be necessary for DOE to promptly make corresponding changes in its Title XVII regulations to reflect these changes.

The Proposed Clean Energy Deployment Administration (CEDA)

The proposed Clean Energy Deployment Administration (CEDA) builds upon and greatly strengthens the current DOE Loan Guarantee Program Office without the need to establish a new, wholly independent entity such as a government corporation. Placing the CEDA within the Department will enable the new organization to achieve operational status more quickly, while establishing its independence in the areas of personnel management, legal support, procurement and administrative services. This organizational placement also will foster better integration of CEDA activities with the proposed Energy Technology Deployment goals established by the Secretary of Energy.

The proposed CEDA will have two principal financing authorities:

- direct provision of credit enhancements in the form of loans, loan guarantees and related instruments; and
- indirect encouragement of commercial lending for clean energy technologies through the purchase and resale of commercially-originated loans for clean energy technologies.

The draft bill provides that, upon transfer of Title XVII functions to CEDA, an additional $10 billion in direct funding will be provided to CEDA from the Treasury. Assuming that the CEDA manages its portfolio with a loan loss target rate of 10 percent or less, the funding should be sufficient to support over $100 billion in loans, loan guarantees and other forms of credit enhancement. These amounts are in addition to the amounts made available in the Recovery Act and the Fiscal 2009 Omnibus Appropriations Act. In addition, CEDA is authorized to borrow $2 billion from Treasury for securitization of clean energy technology project loans originated by commercial lenders. The borrowing authority will provide the initial capital to “prime the pump” as CEDA develops a self-sustaining securitization program.

There are four aspects of the proposed CEDA financing authorities that I would like to highlight: (1) the design of the CEDA financing provisions based on the experience of other federal credit agencies, (2) application of the Federal Credit Reform Act, (3) provisions to encourage prudent risk management, and (4) transparency and accountability requirements.

First, it is important to note that the CEDA financing authorities are modeled after the successful business models of the U.S. Export-Import Bank (ExIm Bank) and the Overseas Private Investment Corporation (OPIC).

- The ExIm Bank provides loans and loan guarantees to international buyers for the purchases of U.S. goods and services. The Bank is authorized to issue loans and loan guarantees up to a statutory cap of $100 billion. The current portfolio has an outstanding balance of over $40 billion. The ExIm Bank makes credit decisions on the basis of a credit risk model that classifies prospective borrowers by host country and ownership structure. The country risk ratings are developed through an Interagency Country Risk Assessment System (ICRAS) that is applicable to all federal international assistance programs. ExIm Bank’s programs have been highly successful. It expects to earn revenues from fees in excess of loan loss reserves and administrative expenses.

- OPIC provides loans, loan guarantees and political risk insurance to encourage U.S. firms to invest in the economic and social development of developing countries and emerging market economies. OPIC also uses the ICRAS system in assessing host country risk. OPIC has a current portfolio of loans and loan guarantees of about $7 billion. OPIC earns net revenues from its political risk insurance program, and has a budget subsidy cost of only about 2 percent on its loan guarantee portfolio.

The financing authorities of the proposed CEDA are similar to those of ExIm Bank and OPIC, and should enable CEDA to manage a large and self-sustaining credit portfolio employing a disciplined risk management process.

Second, the proposed CEDA would be subject to the Federal Credit Reform Act of 1990 (FCRA), and would utilize the tools of FCRA to manage loans and loan guarantees. FCRA provides three benefits: (1) a rigorous methodology for evaluating project risk, (2) a disciplined process for periodic review and re-estimate of the risks associated with credit portfolios, and (3) reliance on permanent indefinite budget authority to liquidate any losses in excess of the budget credit subsidy cost (or loan loss reserve). The application of FCRA has had a beneficial impact on the performance of federal credit programs. At the end of fiscal year 2007, the last full fiscal year prior to the current economic recession, the federal government held a portfolio of $260 billion in direct federal loans and $1.2 trillion in loan guarantees. OMB budget data show that, on a government-wide basis, the budget subsidy cost for new loan guarantees issued during fiscal 2007 was 2.1 percent, and that losses from guaranteed loans terminated for defaults amounted to only 1.03 percent of the outstanding balance of the portfolio.

Third, the draft bill requires prudent risk management. The draft bill directs CEDA to adopt a portfolio approach, with a clear objective that the portfolio becomes self-sustaining. As part of this portfolio approach, the draft bill requires CEDA to establish a loan loss reserve, and further states that the Administrator of CEDA "…shall consider establishing an initial rate of up to 10 percent for the portfolio of investments under this Act." The draft bill also provides for an annual review of loan loss rates by the Board of Directors and an annual report to Congress on the results of that review. Establishing a clear, up-front policy on loan loss rates is critical to guide CEDA's risk appetite for clean energy technologies, especially breakthrough technologies. Regardless of the specific numerical target selected by CEDA, the portfolio will encompass a range of project risk, and it is likely (and desirable) that a significant portion of the portfolio will have loan loss risk that is substantially less than the average loss rate used to establish reserves.

Fourth, and finally, the draft bill provides a number of important provisions to ensure a level of transparency and accountability for CEDA that exceeds the current Title XVII program. Specific measures include:

- a separate, dedicated Inspector General;
- application of Sarbanes-Oxley standards for the maintenance of internal controls and capital adequacy;
- independently audited annual financial statements;

- quarterly and annual reports to the Secretary on CEDA's financial condition;
- annual loss rate review by the Board of Directors and reports to Congress; and
- oversight and audits by GAO at the discretion of the Comptroller General.

None of these requirements currently apply to the DOE Loan Guarantee Program Office. These measures will provide a high degree of openness and transparency, providing ample early warning of any emerging problems or issues.

In summary, the CEDA will not be risk free. Financing the deployment of clean energy technology projects, and potential breakthrough technologies, will entail risks. But the draft bill creates a rigorous framework to ensure prudent risk management.

Transition from the Current DOE Loan Guarantee Program Office to the Proposed CEDA

The draft bill contains special provisions to promote a seamless transition of the current DOE Title XVII program to the proposed CEDA. Currently, the Title XVII program is managed by the Loan Guarantee Program Office (LGPO) under the Chief Financial Officer. The LGPO is relatively small but has an exceptionally high workload. There may be 75 or more applications currently pending at the LGPO, and the implementation of the new Section 1705 loan guarantee program authorized in the Recovery Act will add substantially to that total.

While the early pace of LGPO has not been as rapid as many outside observers would like, it has been gaining momentum, and it is reasonable to assume that the Department will complete due diligence and take action on a large number of these applications prior to activation of the proposed CEDA. Thus, it is critical that the credit review activities currently underway within DOE be sustained without loss of momentum as the program transitions to the new CEDA.

Impact of the Fiscal Year 2009 Omnibus Appropriations Act

The Fiscal 2009 Omnibus Appropriations Act made significant changes to the funding resources of the DOE Title XVII program. The Act extended indefinitely the previous $38.5 billion in prior year loan guarantee volume, and provided for $8.5 billion in additional loan guarantee volume, for a total volume of $47 billion. These amounts are in addition to the $6 billion appropriated in the Recovery Act to cover approximately $60 billion in loan guarantee volume under the new Section 1705 loan guarantee program.

The Omnibus Act also contained new and extremely restrictive language regarding the issuance of new loan guarantees that qualify within the $47 billion loan guarantee volume limitation. Specifically, the Act prohibited DOE from issuance of loan guarantees to projects that have other federal contracts, leases or other forms of federal assistance. Further, the Act requires a certification by the Director of OMB for each loan guarantee issued under this authority. This provision unnecessarily restricts the ability of DOE to issue loan guarantees to projects that have other legal relationships with the federal government, and will inevitably slow the pace of the program due to the need for case-by-case OMB determinations.

The impacts of this provision need to be addressed in the consideration of the draft bill because, if left unchanged, the restrictions will carry over along with any unused authority that is transitioned to the proposed CEDA.

Conclusion

In conclusion, the draft bill:

- provides many needed clarifications and modifications to the existing Title XVII authorities. These amendments need to be accompanied by expeditious changes in the implementing regulations;
- creates a sound platform for an effective clean energy technology deployment financing program, with an emphasis on breakthrough technologies;
- provides a robust set of financing tools to accelerate the deployment of clean energy technologies, especially those with breakthrough potential;
- establishes checks and balances to ensure prudent risk management, promote transparency and establish strict accountability; and
- defines a transition mechanism that will sustain the growing momentum of the current Title XVII program.

This concludes my prepared statement. I would be pleased to answer any questions.