Wilson Sonsini Goodrich & Rosati
PROFESSIONAL CORPORATION

WSGR ALERT

APRIL 2010

U.S. DEPARTMENT OF AGRICULTURE LOAN GUARANTEE PROGRAMS AND UTILIZATION OF BOND FINANCING

On April 16, 2010, the United States Department of Agriculture (USDA) issued a proposed rule for its Biorefinery Assistance Loan Guarantee Program (the 9003 Program) and invited industry stakeholders to submit public comments on this proposed rule through June 15, 2010. Under the 9003 Program, USDA is authorized to guarantee loans of up to $250 million for the development and construction of commercial-scale biorefineries in rural areas that produce advanced biofuels.

Although USDA is authorized to provide a significant amount of financial assistance for the development of renewable energy projects under the 9003 Program, as well as the Rural Energy for America Loan Guarantee Program (REAP) and the Business and Industry Loan Guarantee Program (the B&I Program), illiquidity and risk aversion in the commercial bank lending market has precluded many project developers from accessing these programs. In contrast to the Department of Energy's (DOE's) Innovative Technology Loan Guarantee Program, in which a project developer may apply directly to DOE for a loan guarantee and request that the loan be issued by the Treasury Department's Federal Financing Bank, USDA Rural Development (USDA-RD) programs require project developers to partner with private lenders that will fund the loan and apply to USDA for a guarantee of that loan.

In anticipation of USDA reevaluating its program rules, on April 2, 2010, Wilson Sonsini Goodrich & Rosati participated in a meeting with USDA Rural Development Undersecretary Dallas Tonsager, a representative from USDA's Office of the General Counsel, senior staff members from USDA's Rural Development and other program offices, and a select group of industry stakeholders to discuss the potential for expanded use of bond financing within USDA loan guarantee programs. With a limited number of commercial lenders willing to provide loans, USDA-RD, financial institutions, and industry stakeholders are exploring new and innovative financing structures, including bond financings, that could increase participation in USDA-RD loan guarantee programs.

The following WSGR Alert summarizes the current use of bonds under USDA-RD programs and considers the possibility of reforms that could facilitate greater access to the relatively robust and flexible bond market in addition to the traditional commercial bank lending market for debt financing.

Current Use of Bonds under USDA-RD Loan Guarantee Program

As interpreted by USDA-RD in a 2007 guidance letter, the B&I Program rule, which serves as the model for the 9003 Program rule, allows USDA-RD to guarantee certain taxable corporate bonds, but the terms and conditions imposed by USDA-RD are inconsistent with standard practices in the bond market. For corporate bonds to be guaranteed by USDA-RD, among other things, (a) bondholders (who are treated as "lenders" for purposes of the regulations) must initially purchase all bonds, (b) there may be no more than eleven bonds issued (up to ten bonds for the guaranteed portion and one bond for the unguaranteed portion), and (c) each bondholder must retain a minimum percentage of the total bond amount. A trustee could service the bonds as if they were loans, but the trustee must be fully under control of the bondholders.

Importantly, only taxable bonds may be guaranteed under current USDA-RD rules, and municipal and government bonds may not be guaranteed due to the inability to identify an entity that would undertake the functions of a lender.

The proposed rule for the 9003 Program issued on April 16 would not modify USDA-RD's guidance letter or significantly alter program regulations so as to accommodate traditional bond financing structures.

Proposed Improvements to USDA-RD Programs

The purpose of the April 2 meeting was to suggest to USDA-RD that, with relatively minor amendments to program regulations, USDA-RD could support traditional bond financing structures through its loan guarantee programs in addition to commercial bank loans. The primary proposed modification to existing regulations would consist of revising USDA-RD's definition of "lender" to enable a bond trustee and an investment bank, solely for taxable corporate bond transactions, to collectively function as a lender under the 9003 and B&I Programs. With this modification, a single bond could be

Continued on page 2...

Continued from page 1...

issued to the trustee, who would act as a fiduciary for the bondholders. The trustee would hold 100 percent of legal title to the bond and therefore comply with minimum retention requirements. Furthermore, the bondholders could freely transfer their beneficial interests in the bond without executing USDA assignment guarantee agreements. The stakeholders argued that this type of modification would not alter the risk profile for a loan, nor would it negatively impact the loan servicing requirements outlined in the regulations.

USDA-RD reminded those present that the process for amending program rules can take up to 12 months, but USDA-RD welcomed suggested amendments to the 9003 Program rule through the public comment process. Upon receipt and review of comments that are submitted through June 15, 2010, USDA-RD will publish a final rule for the 9003 Program. USDA-RD plans to solicit comments for the B&I Program rule in 2011.

In the short term, USDA-RD indicated that it would like to keep an open dialogue with investment bank representatives and industry stakeholders to determine if there is a way for traditional bond financing structures to fit within the purview of current USDA-RD program rules.

With in excess of $1 billion of loan guarantee authority available under the 9003 Program alone, we encourage developers and financial institutions alike to participate in the public comment period for the 9003 Program and to begin considering bond financing strategies for eligible projects.

Conclusion

The April 2 meeting was very encouraging for the development of renewable energy projects seeking the assistance of USDA-RD programs. USDA-RD Undersecretary Tonsager and his staff clearly understand that innovative and flexible financing structures are essential to the success of USDA-RD programs and have committed to continuing to collaborate with industry stakeholders to improve access to these programs.

Wilson Sonsini Goodrich & Rosati is working with project developers, investment banks, and other industry stakeholders who are actively leading this dialogue with USDA-RD and we will continue to update our clients and contacts as USDA-RD programs become viable options for supporting renewable energy projects. In the interim, the firm recommends that companies seeking to utilize bond financing for the development of projects provide comments to the 9003 Program proposed rule. Our energy, clean technology, and government initiatives practices are at the forefront of these developments and are available to discuss these and other federal financing programs. Please contact Chris Groobey for more information.

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This WSGR Alert was sent to our clients and interested parties via email on April 26, 2010. To receive future WSGR Alerts and newsletters via email, please contact Marketing at wsgr_resource@wsgr.com and ask to be added to our mailing list.

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