Wilson Sonsini Goodrich & Rosati
PROFESSIONAL CORPORATION

# WSGR ALERT

MARCH 2011

## USDA ANNOUNCES AVAILABILITY OF FUNDING FOR THREE BIOENERGY PROGRAMS

**Overview**

On March 12, 2011, Agriculture Secretary Tom Vilsack announced the availability of fiscal year 2011 funding for three programs that were authorized under the Food, Conservation and Energy Act of 2008 (the "Farm Bill"):

(i) the Section 9003 Biorefinery Assistance Loan Guarantee Program (the 9003 program);

(ii) the Section 9004 Repowering Assistance Program (the 9004 program); and

(iii) the Section 9005 Bioenergy Program for Advanced Biofuels (the 9005 program).

To allocate the funding available through each of these programs for FY 2011, the U.S. Department of Agriculture (USDA) has issued Notices of Funding Availability (NOFA) for the 9003 and 9004 programs, and a Notice of Contract for Proposal (NOCP) for the 9005 program. As described in further detail below, each program provides a different mechanism for promoting the increased production of biofuels and bioenergy. Specifically, each program is designed to support a different stage of the biofuels and bioenergy supply chain, reinforcing USDA's objective of supporting the industry throughout all phases of growth and development.

**Biorefinery Assistance Loan Guarantee Program**

Section 9003 of the 2008 Farm Bill established a loan guarantee program within USDA Rural Development for the development and construction of commercial-scale biorefineries and the retrofitting of existing biorefineries to produce advanced biofuels. In February 2011, Wilson Sonsini Goodrich & Rosati's energy and clean technology practice published an alert on the interim final rule, which included background on the program's history and a brief summary of the primary changes to the rule. Below is a further analysis of these changes, including recommendations for interested applicants.

**Eligible Projects.** To be eligible to obtain financing from the 9003 program, a project must:

- be located in a state (the interim final rule eliminated the requirement from the proposed rule that a project must be located in a rural area, although this remains a selection factor);
- involve a commercial-scale biorefinery for the production of advanced biofuels (i.e., biofuels not derived from corn-kernel starch);
- use a technology that has been demonstrated to have technical and economic potential for commercial application in a biorefinery that produces an advanced biofuel;
- demonstrate that a majority of the biorefinery production is an advanced biofuel (the proposed rule required that projects derive more than 70 percent of revenues from the sale of advanced biofuels); and
- provide funds (such as cash equity, subordinated debt, and state grants) of at least 20 percent of eligible project costs (under the proposed rule, a 20 percent cash equity injection was required).

USDA gives preference to projects involving first-of-a-kind technology deployed on a commercial scale.

**Eligible Project Costs.** Guaranteed loans may be used for the following project costs:

- Purchase and installation of equipment (new, refurbished, or remanufactured), except agricultural tillage equipment, used equipment, and vehicles
- Construction or retrofitting, except residential
- Permit and license fees
- Professional service fees, except for application preparation
- Feasibility studies
- Business plans
- Working capital
- Land acquisition
- Cost of financing, excluding guarantee and renewal fees

**Eligible Borrowers.** A wide range of entities are eligible for the loan guarantee, including individuals, corporations, farm

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cooperatives, agricultural producer associations, rural electric cooperatives, public power entities, institutions of higher learning, national laboratories, Indian tribes, and units of state or local government. Under the interim final rule, entities may be controlled by U.S. or non-U.S. citizens (the proposed rule contained a requirement that entities must be controlled by U.S. citizens).

**Role of Eligible Lenders.** The 9003 program provides guarantees for loans made by eligible lenders. To be considered an eligible lender under the interim final rule, the entity extending the loan must (a) be a federal or state chartered bank, farm credit bank, other farm credit system institution with direct lending authority, or a bank for cooperatives; (b) satisfy specified minimum capital requirements; and (c) have adequate experience in making, securing, servicing, and collecting loans similar to those offered under the program. As is the case in USDA's Business and Industry and Rural Energy for America (REAP) loan guarantee programs, the relevant lender would have significant responsibility for developing the loan terms and evaluating the collateral package. In addition, under the interim final rule, the original lenders are required to retain at least 7.5 percent of the total loan amount throughout the term of the loan.

**Loan Guarantee Amounts.** USDA is authorized to guarantee loans of up to $250 million that represent no more than 80 percent of total project costs. There is no minimum loan size. The percentage of the loan that is guaranteed varies depending upon the size of the loan and, under the interim final rule, the maximum guarantee percentage is up to:

- 90 percent for loan amounts of up to $125 million for projects that satisfy the following conditions:
  - Equity of 40 percent;
  - Feedstock and off-take agreement with at least one-year terms; and
  - Collateral coverage ratio exceeding 1.5:1;
- 80 percent for loan amounts of up to $125 million for projects that do not satisfy the conditions above;
- 80 percent for loan amounts greater than $125 million and less than $150 million;
- 70 percent for loan amounts greater than $150 million but less than $200 million; and
- 60 percent for loan amounts from $200 million to $250 million.

**Effect of Other Federal Funding.** The amount of guaranteed loan will be reduced by the amount of other direct federal funding that the eligible borrower receives for the same project. Project financial assistance from state and local governments does not reduce the loan guarantee amount.

**Other Key Terms and Conditions.** The length of a guaranteed loan may be up to 20 years or the useful life of the project, whichever is shorter. The loan-to-value ratio may not exceed 1.0, and the debt coverage ratio must be 1.0 or higher. The interest rate of the guaranteed loan may be fixed or variable and is negotiated between the lender and the borrower. The guaranteed and unguaranteed portions of the loan may have different interest rates, but, under the interim final rule, the rate on the unguaranteed portion of the loan may not exceed the rate on the guaranteed portion by more than five percentage points.

Under the interim final rule, the entire loan must be secured by the same collateral, and USDA must be granted a first priority lien on all collateral necessary to run the project in the event of the borrower's default, except that USDA may consider a subordinate lien on inventory and accounts receivable for working capital loans.

Lenders are required to pay a guarantee fee of 3 percent of the guaranteed loan for loans receiving a 90 percent guarantee, or between 1 and 2 percent of the guaranteed loan amount for loans receiving less than a 90 percent guarantee, at the time the guarantee is requested. Lenders must also pay an annual renewal fee of between 0.5 and 1 percent of the unpaid principal balance for as long as the guaranteed loan is outstanding and payable during the construction period. Such fees may be passed on to the borrower.

**Application and Approval Process.** In previous years, loan guarantee applications have been accepted by USDA only during competitive application rounds lasting two to three months. The recently issued NOFA indicates the 2011 window for submitting applications is now open until May 10, 2011.

An application is submitted to USDA Rural Development by the lender with significant input from the borrower. Required elements of the application include, among other things:

- a feasibility study of the project;
- a business plan (if not incorporated into the feasibility study);
- appraisals, accompanied by a copy of a Phase I Environmental Site Assessment (ESA) in accordance with ASTM standards; and
- credit reports on the borrower and each partner, officer, director, key employee, and shareholder owning a 20 percent or more interest in the borrower, unless the borrower is listed on a major stock exchange. Under the interim final rule, loans of $125 million or more require an independent credit risk analysis from a nationally recognized rating agency.

Once submitted to USDA, an application is evaluated by a panel of reviewers, including Rural Development field staff (for eligibility and financial, technical, and environmental analysis) and U.S. Department of Energy (DOE) staff (for technical merit evaluation). Applications are also subject to NEPA review

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by USDA staff as a Class II Environmental Assessment (EA), unless the agency deems a different level of environmental review more appropriate for a given project. USDA advises prospective borrowers to contact the agency to determine environmental requirements as soon as practicable after the borrowers decide to pursue any form of financial assistance from the agency.

**Funding.** The NOFA announces the availability of approximately $129 million in mandatory budget authority in addition to any remaining program funds from fiscal year 2010. This budget authority will support approximately $463 million in new loans. Further, in light of USDA's geographically diverse approach to supporting biofuels, it is worth noting that five projects have already been announced under the 9003 program in Georgia (Range Fuels), New Mexico (Sapphire), Alabama (Coskata), Florida (Ineos Bio), and Mississippi (Enerkem).

The Farm Bill also provided additional discretionary authorization for the 9003 program of up to $150 million, to be appropriated by Congress during the annual budget cycle. To date, Congress has not utilized any discretionary budget authority to fund the 9003 program.

### Repowering Assistance Program

The purpose of the Repowering Assistance Program is to encourage the use of renewable biomass as a replacement fuel source for fossil fuels currently used to provide process heat or power in the operation of eligible biorefineries. The 9004 program provides for payments to biorefineries (that were in existence when the Farm Bill was passed) to replace the use of fossil fuels in their operations.

**Eligibility.** Applicants must be an eligible biorefinery, defined as a biorefinery in existence on or before June 18, 2008. Biorefineries must also be located in a rural area. If the applicant is an individual, the applicant must be a citizen or national of the United States, the Republic of Palau, the Federated States of Micronesia, the Republic of the Marshall Islands, or American Samoa, or must reside in the U.S. after legal admittance for permanent residence. If the applicant is an entity other than an individual, the applicant must be at least 51 percent owned by persons who are either citizens or nationals of the U.S., the Republic of Palau, the Federated States of Micronesia, the Republic of the Marshall Islands, or American Samoa, or legally admitted permanent residents residing in the U.S.

Eligible project costs will consist only of project-related construction costs for repowering improvements associated with the equipment, installation, engineering, design, site plans, associated professional fees, permits, and financing fees.

**Application and Approval Process**. Applicants must submit to USDA appropriate documentation regarding production of usable energy at the biorefinery during the relevant payment period. Further, all applications must be submitted through the Rural Development state office. Biorefineries interested in obtaining funding must apply by June 9, 2011.

USDA may make payments under this program to any biorefinery that meets the requirements of this notice for a period of up to three years. The agency will determine the amount of payments to be made to a biorefinery based on: (a) the quantity of fossil fuel a renewable biomass system is replacing; (b) the percentage reduction in fossil fuel used by the biorefinery; (c) the cost effectiveness of the renewable biomass system; and (d) the economic benefit to the community and the potential to improve the quality of life in rural America.

**Funding.** USDA is making available approximately $25 million to make payments to eligible biorefineries. The deadline to apply for funding under this program is June 9, 2011.

### Bioenergy Program for Advanced Biofuels

Section 9005 of the 2008 Farm Bill established a payment program for producers of advanced biofuels to support existing advanced biofuel production and to encourage new production of advanced biofuels. Proposed rules for the program were issued in June 2010 and an interim final rule was published in February 2011.

Under the program, USDA enters into contracts to provide payments to producers of biofuels produced at U.S. biorefineries from renewable biomass other than corn-kernel starch. This payment is in addition to the sales price received by the biofuel producer.

**Eligible Applicants.** Applicants must be individuals or legal entities, such as corporations, companies, foundations, associations, labor organizations, partnerships, and non-profit entities, that produce advanced biofuel. Applicants may be located in non-rural locations and may include foreign-owned producers.

**Eligible Advanced Biofuels.** Advanced biofuels eligible for payments include:

- biofuel derived from cellulose, hemicellulose, or lignin;
- biofuel derived from sugar or starch (other than corn-kernel starch);
- biofuel derived from waste material, including crop residue, other vegetative waste material, animal waste, food waste, and yard waste;
- diesel-equivalent fuel derived from renewable biomass such as vegetable oil and animal fat;
- biogas (including landfill gas and sewage waste treatment gas) produced through the conversion of organic matter from renewable biomass;
- butanol or other alcohols produced through the conversion of organic matter from renewable biomass; and
- other fuel derived from cellulosic biomass.

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**Application and Approval Process.** An advanced biofuel producer seeking to participate in the program must submit an application to the USDA Rural Energy Coordinator for the state where the eligible biorefinery is located during designated enrollment periods. The application requires information on:

- the applicant;
- the applicant's biorefineries at which the advanced biofuels are produced, including location, quantities produced, and a description of the business;
- the types and quantities of renewable biomass feedstock being used to produce the advanced biofuels; and
- the amount of eligible advanced biofuels produced at each biorefinery in the 12 months prior to the first day of the sign-up period for the fiscal year for which the annual application is being submitted.

The information contained in the application is used by USDA to determine whether the advanced biofuel producer is eligible to participate in the program and whether the advanced biofuel being produced is eligible for payments under the program. Before being accepted into the program, the producer must also furnish all required certifications, as applicable, and provide access to the producer's records required by USDA to verify compliance with program provisions.

The required certifications, which must be completed and provided by an accredited independent third party, depend on the type of biofuel produced. Once an advanced biofuel producer has been approved to participate in the program, the producer and USDA enter into a contractual agreement. All contracts are reviewed at least annually to ensure compliance with the contract and ensure the integrity of the program.

**Fiscal Year 2011 Funding.** The NCOP for Payments to Eligible Advanced Biofuel Producers makes available up to $85 million in fiscal year 2011 funds. Applications for fiscal year 2011 will be accepted through May 10, 2011.

Wilson Sonsini Goodrich & Rosati's energy and clean technology practice is tracking all of these developments and would be pleased to discuss them with you, as well as discuss other government financing programs. Please feel free to contact any member of the team, including Chris Groobey (202-973-8802; cgroobey@wsgr.com), Michael Klaus (202-973-8841; mklaus@wsgr.com), Sara Hochman (202-973-8882; shochman@wsgr.com), or Taite McDonald (202-973-8937; tmcdonald@wsgr.com).



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