



Statement of Doug Koplow

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January 30, 2013

Good afternoon. My name is Doug Koplow, and I'm the founder of Earth Track, Inc., a consulting firm in Cambridge, MA. My work focuses on government subsidies to energy, including those provided through government loan and loan guarantee programs.

Along with Max Chang of Synapse Energy Economics, we reviewed many hundreds of pages of released documents and e-mails related to the U.S. Department of Energy's (DOE's) pending loan guarantee to the Vogtle project. Our goal was to learn more about DOE's due diligence and risk assessment performed, the terms offered on the loan guarantees, and potential conflicts of interest among involved parties.

Using authority granted to it by Title XVII of the Energy Policy Act of 2005, DOE signed conditional commitment letters in February 2010 for \$8.33 billion in loan guarantees for the construction of the proposed Vogtle Units 3 & 4. The program subsidizes borrowing costs by accessing low interest government debt and by enabling borrowers to use more of that inexpensive debt in their capital structure than private markets would allow. Loan durations and principal repayment terms may also be more favorable.

There are five separate conditional commitment agreements on the Vogtle project: one each for Georgia Power and Oglethorpe Power; and three for the Municipal Electric Authority of Georgia (or MEAG), which set up three separate investment vehicles. Each agreement has somewhat differing terms, and final loan terms have not yet been signed. Two released documents related to Georgia Power indicate negotiations and changes continued at least through mid-2012.

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It is important to note that the more than \$8.33 billion on offer is not a “normal” government loan. It is by far the largest commitment DOE has made under its Title XVII loan program. Further, although the program has sometimes been compared to the US Export Import Bank (Eximbank), a main source of export credit, the Vogtle loan is far larger than the deals Eximbank does as well. Over the past five years and hundreds of deals, less than 15 Eximbank financings were for amounts in excess of even \$1 billion. A comparison of the Vogtle deal to venture capital funding of energy investment is even more striking. This single deal is \$3.5 billion larger than all venture capital funding to the energy and industry sector (370 investments) even during the peak funding year of 2008.

Under the best of circumstances, achieving a successful outcome for taxpayers from the Vogtle loan would be challenging. However, the released documents indicate a range of worrying problems.

Critical skills. Outsourcing key expertise is one. While some external input is useful in order to bolster DOE’s expertise (e.g., review by external credit rating agencies), the released documents suggest that virtually *all* key tools used to assess project risk by DOE were developed and held by private companies, and that individuals outside of the government were relied on for most tasks related to modifying and interpreting model runs.

Credit subsidy estimates. Credit subsidy estimates are a second issue of concern. A key taxpayer protection of the Title XVII program is an upfront credit subsidy fee borrowers must pay to the government before getting their loans. The payment is intended to compensate taxpayers for the expected risk of loss on the financing. Credit models were central in estimating the amount of these fees.

Disagreement between DOE and the U.S. Office of Management and Budget (OMB) on key model inputs was evident in the documents, though redactions precluded assessing both the range of disagreements and how they were resolved. Further, released emails show the credit models were

undergoing significant modifications even eight months after DOE signed conditional commitments and released the credit subsidy estimates to borrowers that those models were being used to generate.

Model results are also sensitive to assumed recovery rates should there be a default. The less one assumes defaulted assets are worth, the higher the upfront credit subsidy payment needed to protect taxpayers. Though actual inputs were redacted, there is clear disagreement on the appropriate values, with Georgia Power estimating them at 87%, whereas the US Congressional Budget Office pegged historical post-default recoveries on the type of debt they deemed most similar to the Vogtle loans (senior unsecured bonds) at only 37%. These different inputs would be expected to produce widely disparate credit subsidy values.

The actual credit subsidy range DOE provided to Georgia Power was a mere 0.5 to 1.5% of the authorized borrowing amount. Even assuming the high-end value (a payment of \$52 million), the credit subsidy payment would boost average interest rates over the life of the loan by only 1/8%, an astonishingly small risk premium for the first new nuclear reactor to be built in the US in decades.

Credit subsidy figures for MEAG and Oglethorpe are higher, ranging from 4.98% (MEAG SPV 3 low) to 11.1% (MEAG SPV2 high) of the loan amount. However, even the top-end of this range is still less than the *average* 12.5% credit subsidy that the Government Accountability Office estimated last year applied to other completed DOE loan guarantees.

DOE has confirmed recently that the 2010 credit subsidy values have not changed. This is despite changing loan terms, market conditions, and the emergence of delays and cost overruns in the first phase of Vogtle construction. Any losses from underestimating the credit subsidy payment will fall on taxpayers, not the borrowers.

Backloading principal repayment. Released documents indicate that payments of principal by Vogtle borrowers have also been back-loaded – a structure that increases the duration of taxpayer subsidies to the venture as well as the repayment risk to taxpayers. For Georgia Power, loan principal is not repaid at all until years 29 and 30 of the loan, a so-called “balloon” structure that OMB was not happy with and requested that DOE not repeat. Oglethorpe and MEAG are repaying principal during the loan term, but at a rate assuming a 40-year amortization on a 30-year loan. Residual debt in year 30 would need to be refinanced, potentially risky if the project has not gone as hoped.

Extending conditional commitment period. Another issue is that DOE has extended the conditional commitment letters multiple times, most recently into mid-2013. The Department’s continued willingness to extend the agreement period would be expected to weaken its ability to achieve stronger protections for taxpayers in the final loan agreement, since borrowers are able to retain their option on a subsidized loan at little cost or risk. Based on released documents pertaining to Georgia Power, many clauses of the conditional commitment letter appear to have been renegotiated over the ensuing two years. Material disagreements, such as on the amount and type of collateral, remain.

Redactions continue to make full analysis difficult, but there are multiple indications of political involvement with specific borrowers and specific aspects of the loan agreements as well. Many of the emails containing this information were actually fully redacted by DOE in initial responses to SACE; only subsequent litigation resulted in their disclosure. My colleague Max Chang will discuss these in more detail.

Thank you. This concludes my opening statement. I look forward to taking your questions after all speakers have spoken.