July 2, 2007

Mr. Howard G. Borgstrom
Director, Business Operations Center
Office of the Chief Financial Officer
U.S. Department of Energy
Mailstop CF-60, Room 4A-221
1000 Independence Avenue, S.W.
Washington, DC 20585

RE: Comments in response to Notice of Proposed Rulemaking on Loan Guarantees for Projects that Employ Innovative Technologies (RIN 1901-AB21), 72 *Federal Register* 27471 (May 16, 2007)

Dear Mr. Borgstrom:

Last March, five major U.S. banking institutions (Citigroup, Credit Suisse, Goldman Sachs, Lehman Brothers, and Morgan Stanley) provided Energy Secretary Samuel Bodman a consensus summary of the major structural elements necessary to implement the Title XVII loan guarantee program authorized by the Energy Policy Act of 2005. Since then we have met with officials at the Department of Energy, the Department of the Treasury and the Office of Management and Budget to discuss our views, and we are pleased to share our comments on the above-referenced Notice of Proposed Rulemaking (NOPR or Proposed Rule).

The six financial institutions below are convinced that loan guarantees are an important tool, along with supportive state government policies, to enable the financing in the credit markets of new nuclear power plants in the United States. We are concerned that the Proposed Rule is not workable, and are providing our perspective in the hope that it will assist the Department of Energy in developing final regulations to implement this essential program. We regard the attached comments as a set of minimum conditions necessary to secure project financing from lenders and from investors in the fixed income markets.

We remain committed to working with the Department of Energy in structuring a workable financing instrument to support construction of new nuclear power plants in the United States, while protecting the U.S. taxpayer.

Respectfully submitted,

Mini Roy, Managing Director
Export and Agency Finance Group
Citigroup Global Markets, Inc.

Steven Greenwald, Managing Director
Jonathan Baliff, Managing Director
Alex Kroner, Director
Credit Suisse Securities (USA) LLC

H. John Gilbertson Jr.
Managing Director
Goldman, Sachs & Co.

Joseph Sauvage
Managing Director
Lehman Brothers Inc.

Sylvia K. Barnes, Managing Director
Christopher Fink, Managing Director
Merrill Lynch & Co.

Ray Spitzley
Managing Director
Global Power and Utilities Group
Morgan Stanley & Co Incorporated

Loan Guarantees for Advanced Nuclear Energy Facilities

Bankers' Comments on DOE Notice of Proposed Rulemaking

(Developed by Citigroup, Credit Suisse, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley)

Summarized below are the consensus views of the six banks named above regarding the minimum conditions necessary for a workable loan guarantee program as authorized by Title XVII of the Energy Policy Act of 2005 that can achieve the twin goals of supporting the financing of new nuclear plants in the United States while adequately protecting the U.S. taxpayer.

We believe many new nuclear construction projects will have difficulty accessing the capital markets during construction and initial operation without the support of a federal government loan guarantee. Lenders and investors in the fixed income markets will be acutely concerned about a number of political, regulatory and litigation-related risks that are unique to nuclear power, including the possibility of delays in commercial operation of a completed plant or "another Shoreham". We believe these risks, combined with the higher capital costs and longer construction schedules of nuclear plants as compared to other generation facilities, will make lenders unwilling at present to extend long-term credit to such projects in a form that would be commercially viable.

We also believe that the standby support "insurance" (provided by Section 638 of the Energy Policy Act of 2005) is inadequate to address these risks and that a number of the conditions in DOE's Proposed Rule for the loan guarantee program, if carried forward into the final regulations, would make that program unworkable for purposes of financing new nuclear power projects. To be commercially viable, the loan guarantee program must address the following concerns at a minimum:

1. Partial Guarantee.

The Proposed Rule would limit the guarantee to 90% of any particular debt instrument. By requiring an unguaranteed, deeply subordinated debt tranche for the remaining 10%, and prohibiting "stripping" of the guaranteed debt from the unguaranteed debt, the Proposed Rule creates a hybrid debt instrument for which there is no natural market. There is a deep and highly efficient market for "AAA" government guaranteed paper. Investors in that market are distinctly different from those investors who participate in the sub-debt market. (In some cases, investors in the AAA government-guaranteed market are restricted, legally or otherwise, from investing in the sub-debt market.) Requiring investors to own interests through a mandated hybrid instrument in both AAA paper and deeply subordinated "quasi-equity" paper removes both of these financing instruments from their natural market. In addition, as the charts attached demonstrate, the size of the market for government-guaranteed paper has significantly more depth and liquidity than the project finance market.

Even if it was possible to place such a hybrid debt instrument, the higher cost associated with such financing would deter sponsors from moving forward and, for those projects that do move forward, would increase the risk of default. Both the government and project sponsors would be better off substituting additional equity if that is what is necessary to achieve a "reasonable prospect of repayment." The financing structure in the Proposed Rule compromises both of the government's key goals: construction of new nuclear plants and full repayment of the guaranteed loan.

For these reasons, we recommend that the final rule provide for 100% coverage of the debt of each project, up to the statutory limit of 80% of total project costs. The project sponsor should be left to decide upon the form of remaining capital to be invested. To the extent that commercial market for financing of new nuclear projects exists or will develop, the market will make that determination and such financing will be reflected in the applications for loan guarantees.

The government cannot, by regulation, mandate financing that does not exist.

2. Adequacy of Due Diligence.

We understand that the intent of the partial guarantee is to incorporate the due diligence and discipline of third-party lenders into the financing process. Experience with other Federal loan guarantee programs that provide 100% guarantee coverage demonstrates that the necessary due diligence and adequate assurance of repayment can be achieved without the mandate in the Proposed Rule.

Necessary due diligence and adequate assurance of repayment can be assured through:

- <u>Significant Equity Contribution</u>. The key to success of any project is not lender scrutiny, but the sponsor. Experienced, creditworthy sponsors with $1 billion or more in equity investment, in a first loss position, and with responsibilities to their Boards, shareholders and ratepayers provide the best due diligence and assurance of repayment.

- <u>Expert Financial and Legal Advisers</u>. DOE should follow the model of other successful Federal guarantee programs (such as Export-Import Bank and OPIC) and of project lenders in the commercial market, and engage third-party financial, technical and legal consultants to augment its resources and expertise. In the project finance market, lenders invariably retain (at the cost of the borrower) outside legal, financial, technical and other experts to perform the due diligence that the government is correctly focused on. Rather than relying on experts hired by others, the government can retain the same expertise directly.

- <u>Role of Agents, Arrangers and Lenders</u>. Agents, arrangers and lenders have a significant stake in the project and its success, even with a 100% guarantee, and are full participants in structuring the projects to ensure full repayment. First, the agents and arrangers will take the necessary measures to ensure that the project is properly structured in order to ensure a successful application and approval for the loan guarantee. In addition, agents, arrangers and lenders all have important interests in ensuring that a project is built and operated properly and that the loans are fully repaid. These interests include corporate reputation and a strong interest in remaining in good standing in order to be able to continue to participate in this program and in other Federal guarantee programs.

3. Guarantees must be 100% unconditional.

The guarantees must be 100% unconditional and viewed as "AAA" credit quality by the major rating agencies and lenders. The Proposed Rule includes several provisions that appear to weaken the unconditional nature of the guarantee. For example, the Proposed Rule seeks to impose on Eligible Lenders a duty of care and other duties that are significantly more onerous than is required in commercial markets and in other Federal loan guarantee programs. The effect of these provisions is to make the guarantee conditional and to put lenders at risk in disproportion to any potential returns, especially in the case of collateral agents or other agents who receive minimal fees for such functions. These provisions will further reduce interest in the lender community in this program and, therefore, the availability of financing. The Proposed Rule also allows for after-the-fact audits and exclusion or reduction of project costs based on such audits. This is inconsistent with standard practice in project finance transactions and also renders the guarantee conditional. Requests for funding of project costs should be reviewed by the independent engineer as part of the normal construction loan draw process and, once approved and drawn, should be definitive.

The mechanism that will allow lenders to receive payment under the irrevocable, unconditional guarantee in an event of default will also have to be well defined, market-based, and court tested, in order for it to be relied on by the capital markets. For the purposes of precedence, in addition to Ex-Im Bank and OPIC, we refer DOE to the monoline insurance market which provides credit enhancement to capital markets transactions and gives confidence to lenders that a monoline insured security will be paid in full and on time through a well established mechanism.

4. Term and scope of the guarantee.

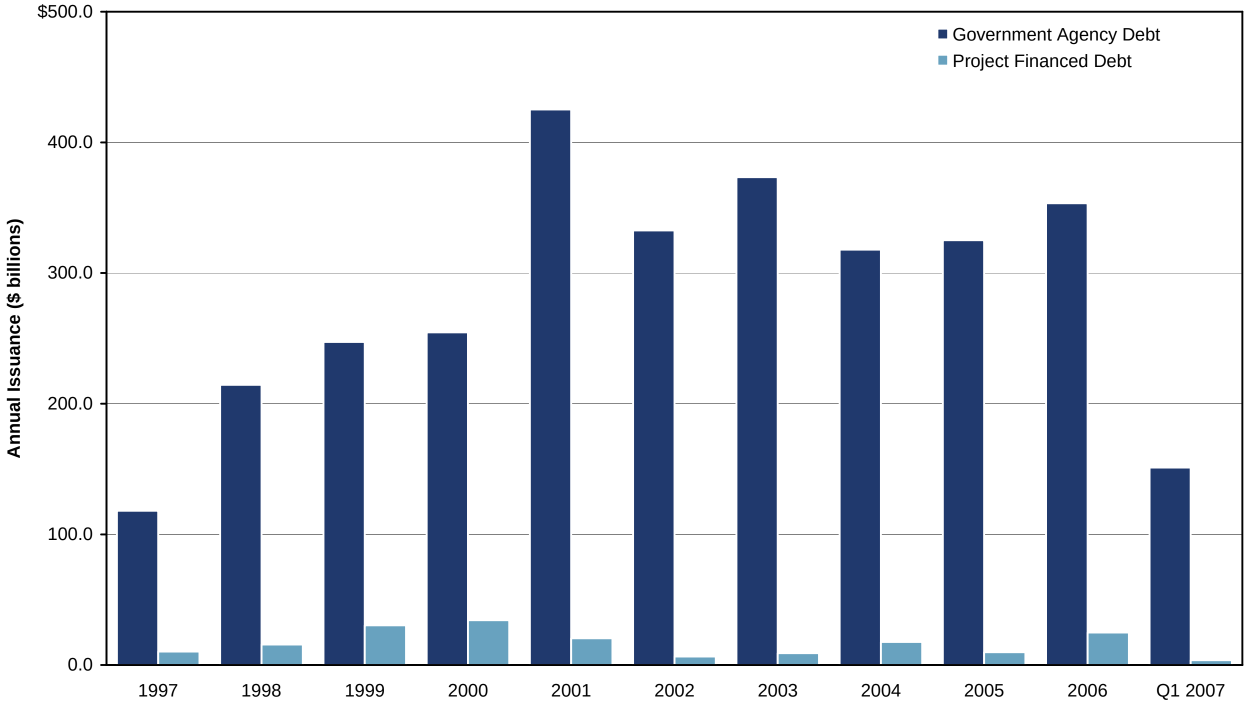
For new nuclear power projects, we believe that debt need not be guaranteed for the full 30 years (or 90% of project life) permitted by the Energy Policy Act. We believe a guarantee that covers the period of construction plus at least 5 years (and preferably up to 10 years to provide flexibility with respect to refinancing) of operation would be acceptable. Various structures could be used to achieve financing with a limited-term guarantee. We believe that limiting the term of the guarantee is preferable to the approach taken in the Proposed Rule as a way to achieve the goals of limiting the Federal government’s long-term program exposure and bring increased scrutiny and market discipline to the financing process. In addition, the final rule should clarify that the guarantee covers all principal, interest, obligations with respect to letters of credit, interest rate hedging obligations and other credit instruments which are senior secured obligations of the project, subject to the 80% of project cost limit noted above.

5. Subsidy cost and calculation.

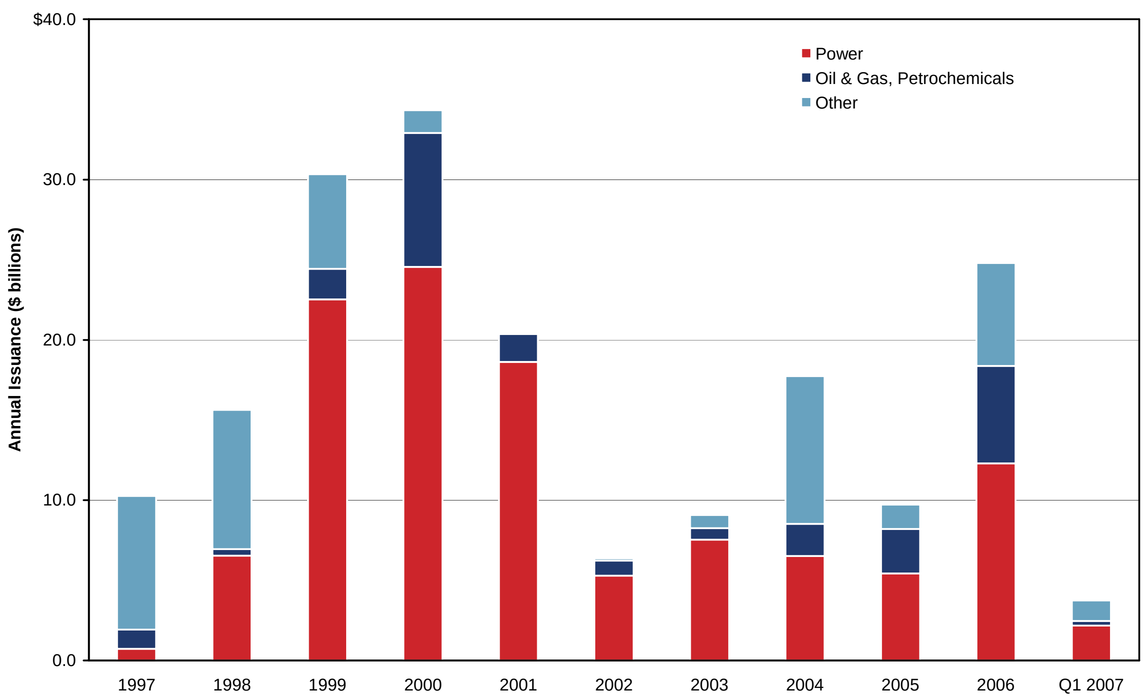
The Final Rule must include a transparent methodology to calculate the credit subsidy cost that will be paid by the project as a loan guarantee fee, and that credit subsidy cost should be reasonable and commercially viable (in line with those of other Federal loan guarantee programs). The methodology should stipulate (i) the conditions which might ultimately cause the guarantee to be called (e.g. construction cost overruns, revocation of permits, injunctions, etc.), (ii) the probability of such an event occurring, and (iii) the ultimate recovery which DOE might expect, e.g. "loss given default." In addition, the credit subsidy cost, and the fees paid for administrative costs, should be included in and financeable as part of the total “project cost.”

We find the requirement in the Proposed Rule for a rating of the project without the guarantee from one of the national rating agencies to be unnecessary and of limited value. A rating at the Application stage is very premature and to rate the project without the guarantee will provide little useful information. DOE should consider the approach taken by other Federal agencies that utilize outside technical, financial, and legal advisors to assist in assessing the credit risk of the project and then apply that assessment in determining the credit subsidy cost.

Government Agency Debt
U.S. since 1997, Annual Issuance (compared to Project Finance)



Project Financing
U.S. since 1997, Annual Issuance



Source: Securities Data Corporation, Securities Industry and Financial Markets Association