MEMORANDUM FOR THE GENERAL COUNSEL

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SUBJECT: SOLYNDRA RESTRUCTURING

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FACTS:

The Department of Energy ("DOE") has issued a guarantee (the "Guarantee") of repayment by Solyndra Fab 2, LLC (the "Borrower") of a $535 million loan (the "Guaranteed Loan") made by the Federal Financing Bank. The proceeds of the Guaranteed Loan are being used to finance the construction of a solar photovoltaic ("PV") panel fabrication facility located in Fremont California (the "Project"). Construction of the Project is scheduled to be complete on or about June 30, 2011.

The Guarantee and related documents obligate DOE to make scheduled payments of principal and interest on the Guaranteed Loan if the Borrower fails to make those payments. DOE and the Borrower have entered into a Common Agreement (the "Loan Guarantee Agreement") that contains the terms and conditions pursuant to which DOE issued the Guarantee and includes, among other things (a) the Borrower's contractual obligation to reimburse DOE for guarantee payments made by DOE, which obligation is secured by a first lien on the Borrower's assets and (b) customary remedies for default on the Borrower's obligations under the Loan Guarantee Agreement. These rights are in addition to DOE's rights of subrogation under applicable law.

A default relating to a financial requirement has occurred under the Loan Guarantee Agreement. When that default occurred, on December 1, 2010, $95 million of the Guaranteed Loan Commitment remained to be advanced. DOE has considered the circumstances leading to the Borrower's default and all reasonable responses to the default, including foreclosure on its collateral. Based on the analysis of the Director, Portfolio Management Division of the Loan Programs Office ("Director, PMD"), DOE has determined that a restructuring of the Borrower's obligations under the Loan Guarantee Agreement (the "Restructuring") will yield the highest probable net benefit to the Federal Government by minimizing the Federal Government's potential loss on the Guaranteed Loan. In light of the financial analysis, and the parties' agreement to negotiate in good faith the definitive Restructuring documentation, DOE has continued to permit advances under the Guaranteed Loan, enabling Project construction to continue pending closing of the Restructuring. Absent continued funding of the Guaranteed Loan,

the Borrower has indicated that it would file for reorganization under Chapter 11 of the Bankruptcy Code or liquidation under Chapter 7 of the Bankrupcty Code, impeding or preventing Project completion. Given the Borrower's limited operations in the PV space, the Director, PMD believes that a Chapter 11 filing would likely lead to a liquidation.

The Restructuring contains the following elements:

(a) DOE's collateral package will be enhanced, as all assets of the Borrower's parent and its affiliates will be transferred to the Borrower and thereafter secure the Borrower's obligations to DOE and Third Party Lenders (defined below);

(b) The Borrower will obtain additional funding under a $75 million note ("Tranche A") issued to third party lenders, and will issue a $175 million note ("Tranche E") to certain third-party lenders that previously funded that amount to the Borrower's parent (collectively with the holders of Tranche A, the "Third-Party Lenders");

(c) The Borrower's existing $535 million reimbursement obligation to DOE will be amended to comprise a $150 million reimbursement obligation ("Tranche B") and a $385 million reimbursement obligation ("Tranche D");

(d) The Borrower will have the right to borrow an additional $75 million ("Tranche C") from the Third-Party Lenders on specified terms and conditions;

(e) Tranches A, B and C (the "Senior Facilities"), will constitute senior secured facilities on a *pari passu* basis in lien and payment priority, except that, for the first 2 years after closing of the restructuring, Tranche A (a new $75 million loan) will have payment priority from the proceeds of a foreclosure (if any) on the collateral securing the Borrower's payment obligations;

(f) Tranches D and E (the "Subordinate Facilities") will constitute subordinate secured facilities, secured on a *pari passu* basis, but with DOE's Tranche D having payment priority;

(g) The Senior Facilities will have certain lien and payment priority over the Subordinate Facilities; and

(h) Interest on each of the Senior and Subordinate Facilities will be capitalized for limited periods.

Therefore, under the Restructuring (i) for the first two years following closing of the Restructuring, the Borrower's reimbursement obligations to DOE for Tranches B and D ($535 million principal amount, in aggregate) will be subordinate in payment priority to the Borrower's obligations to the Third-Party Lenders for Tranche A ($75 million principal amount) in a liquidation only, and (ii) the Borrower's reimbursement obligations to DOE for Tranche D ($385 million principal amount) will be subordinate in

lien and payment priority to the Borrower's obligations to the Third-Party Lenders for Tranches A and C ($150 million principal amount in new loans) until repayment in full.

ISSUE:

Whether the proposed subordination of certain of the Borrower's reimbursement obligations to DOE is consistent with Subsection 1702(d)(3) of Title XVII. Subsection 1702(d)(3) provides that "[t]he [guaranteed] obligation shall be subject to the condition that the obligation is not subordinate to other financing".

SHORT ANSWER:

The proposed subordination is permitted under Title XVII. The subordination condition contained in Subsection 1702(d)(3) is, by its terms, applicable only as a condition precedent to the issuance of a loan guarantee. It is not a continuing obligation or restriction on the authority of the Secretary; and subordination in the context of the proposed Restructuring will further the express statutory intent that the Secretary seek to maximize the prospects of repayment of borrowers' obligations (as well as the technology and job preservation goals of Title XVII).

ANALYSIS:

Title XVII

Title XVII of the Energy Policy Act of 2005, as amended, (42 U.S.C. 16511-16514) ("Title XVII") authorizes DOE to make loan guarantees for specified categories of energy projects in accordance with Section 1702 (Terms and Conditions). As set forth in the Preamble to the original Final Rule issued under Title XVII, one of the principal goals of the guarantee program authorized by Section 1703 of Title XVII is to encourage the commercial use in the United States of new or significantly improved energy-related technologies. (See "Summary".) One of the principal goals of the American Reinvestment and Recovery Act of 2009, P.L. 111-5, which added Section 1705 to Title XVII, is to preserve and create jobs and promote economic recovery. (Section 3(a)(1).)

The Guarantee qualified under both Sections 1705 and 1703. It was issued under Section 1705, but the Borrower was required, as a matter of policy and by contract, to comply with Section 1703 and the Final Rule. The policies of both 1703 and 1705 are furthered by the Guarantee transaction and the proposed Restructuring.

Section 1702

In setting out the terms and conditions for loan guarantees, Section 1702 is organized to reflect the life cycle of loan guarantees, from origination to default to foreclosure on collateral. More particularly, Section 1702 is subdivided roughly as follows:

- Subsections 1702(b) – (f) set forth threshold requirements for the issuance of loan guarantees;

- Subsection 1702(g) sets forth the rights and obligations of DOE and the holders of a guaranteed loan in the event of default; and
- Subsections 1702(h) and (i) relate to DOE's ongoing administration of the loan guarantee program.

Section 1702(b) – (f) - Loan Origination Provisions

Subsections 1702(b)-(f) relate to the issuance of loan guarantees. While only Section 1702(d)(3) is directly at issue, it is worth noting that each of Sections 1702(b) (Specific Appropriation or Contribution), (c) (Amount), (e) (Interest Rate) and (f) (Term) describe either predicates to the issuance of a loan guarantee or characteristics of the debt that must, expressly or implicitly, be satisfied at the time of issuance.

Section 1702(d) (Repayment) has three subparts, including subpart (3). Read together, they require the Secretary to determine, prior to issuance of a loan guarantee, that there is a reasonable prospect of repayment of the loan; that the aggregate available funding is sufficient to achieve project completion; and that the guaranteed obligation is not subordinate to other financing.

The requirements of these subsections reflect a Congressional intent that guaranteed loans be structured at the outset to maximize the probability that the project will reach completion and the debt will be repaid in accordance with its terms (as well as ensuring the funding of adequate reserves against default).

Section 1702(g) - Rights of DOE and the Holder of a Loan Guarantee After a Default

Subsection 1702(g) addresses events and circumstances that may occur after issuance of a loan guarantee, setting out the authority and obligations of DOE and the holder upon a default of the guaranteed loan. Read together, the provisions express an intention to afford to the Secretary, in a distressed situation, broad authority to take action that will protect and maximize the interests of the United States. That authority ranges from agreement to forbearance for the benefit of the borrower (Section 1702(g)(1)(C)) to the authority, after payment under the loan guarantee, to elect either to take control of the project or to permit the borrower to continue to pursue the purposes of the project if that is in the public interest (Section 1702(g)(2)(A)).

The Subordination Restriction in Section 1702(d)(3) Is a Condition Precedent to the Issuance of a Loan Guarantee and Not a Continuing Obligation Restricting Restructuring Options

Subsection 1702(d)(3) provides that"[t]he [guaranteed] obligation shall be subject to the condition that the obligation is not subordinate to other financing."

Both by reason of its placement within the statutory scheme, and the plain meaning of the words, we read Section 1702(d)(3) as a condition precedent to the issuance of the loan guarantee. We do not believe it can reasonably be read either as a requirement that the

guaranteed loan may never be subordinated, or as a restriction on the authority of the Secretary following the issuance of a loan guarantee. Commercial loans routinely are subject to conditions precedent that must be satisfied prior to the advance of funds by the lender. Once such a condition precedent has been satisfied (or waived), it has no continuing legal effect. By its plain meaning, and in the context of customary commercial practice, the word "condition" in Subsection 1702(d)(3) can logically be read as such a condition precedent to issuance of a guaranteed loan. This reading of the provision is reinforced by the use of the word "is," which we view as confirming the intent that the condition be satisfied at a single point in time.[1]

In addition to the plain meaning of the words, and their placement in the statute, we believe our reading is consistent with the policies embodied in the statute. Beyond the relatively few explicit terms and conditions that must be satisfied in connection with the issuance of a guarantee, Section 1702 gives the Secretary broad authority to determine the terms and conditions of loan guarantees. It also provides for rights and powers that are designed to ensure both flexibility and superior legal authority in the case of a distressed loan. Emphasizing the importance of Secretarial discretion, Subsection 1702(g)(2)(C) provides that the loan guarantee agreement "shall contain such detailed terms and conditions *as the Secretary determines appropriate* to protect the United States in a default." (Emphasis added.)

A continuing prohibition on subordination would, in our view, be inconsistent with the statutory scheme as it would preclude the use of a common restructuring strategy for a financially distressed borrower. Investors are unlikely to make an equity investment in a distressed company on commercially acceptable terms. Accordingly, a loan restructuring is the typical means of obtaining additional funding for a distressed company. A fundamental principle of restructuring is that new loans have payment and lien priority over existing loans – without such priority, few, if any, lenders would be willing to extend a loan in distressed circumstances. Accordingly, in a situation where a financially troubled borrower needs fresh capital to ensure its survival, a senior creditor typically is

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[1] It is worth noting that Section 19 of the Federal Nonnuclear Energy Research and Development Act of 1974 (42 USC 5919), which created a predecessor DOE loan guarantee program entitled "Loan Guarantees for Alternative Fuel Demonstration Facilities" contained similar, but not identical, subordination language. Section 19(c)(4) of that act provides that "(c) [t]he Administrator…shall guarantee or make a commitment to guarantee any obligation...only if ....(4) the obligation is subject to the condition that it not be subordinated to any other financing." In context (including the use of the word condition), we read the predecessor language as having the same effect as the Title XVII provision. However, the words "not be subordinated" arguably could be more susceptible to an interpretation that they have continuing effect. While not dispositive, the change to "is not subordinate" suggests an intent to clarify the language in a manner that reinforces our reading.

faced with a choice of providing an additional loan itself, subordinating to a lender that provides the needed capital and proceeding either to foreclosure or a bankruptcy filing.

CONCLUSION:

On the current facts, the Loan Programs Office has determined that the proposed restructuring offers the best prospect of eventual repayment in full of the Borrower's obligations under the Loan Guarantee Agreement, and is demonstrably preferable to a liquidation of the Borrower. In light of that determination, we conclude that the proposed subordination of the Borrower's obligations to DOE is consistent with both the text and the purposes of Title XVII. Indeed, a refusal to amend the Loan Guarantee Agreement to effect the proposed Restructuring, which likely would lead to a Chapter 11 filing by the Borrower and possible liquidation, could be considered inconsistent with both the specific mandate of Section 1702(g)(2)(C) (to include in the guarantee agreement terms and conditions appropriate to protect the interests of the United States in the case of default) and the overall scheme of Title XVII, which gives the Secretary the authority and tools necessary to protect the interests of the United States and to maximize the prospect of repayment of guaranteed loans. Moreover, by maximizing the prospect that the Borrower will complete the Project and continue as a going concern, the proposed Restructuring furthers the statutory policies of promoting the commercialization of innovative energy technologies and preserving jobs. [2]

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[2] A question has been raised as to where the line should be drawn between origination and financial default in determining whether subordination may be agreed to under under Title XVII. We do not believe it is necessary (or appropriate) to draw such a line in this memorandum. We do believe, however, that it is consistent with the statutory scheme to conclude that the Secretary has the authority to make such a determination in connection with specific loan guarantee transactions, consistent with the statutory purposes of fostering the commercialization of innovative energy technologies and preserving jobs, while protecting the interests of the United States and seeking to maximize the prospects of repayment of guaranteed obligations.