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USDA Made Substantial Changes To Its Section 9003 Biorefinery Assistance Loan Guarantee Program For Advanced Biofuels Including Qualifying Renewable Chemical And Biobased Manufacturing Projects

Solicits applications for loan guarantees due October 1, 2015 and April 1, 2016

by Mark J. Riedy and Ben Snowden

On June 24, 2015 the Rural Business Cooperative Service of the United States Department of Agriculture (“USDA”) issued an Interim Final Rule making changes to the USDA’s Biorefinery, Renewable Chemical, and Biobased Product Manufacturing Assistance Program (“the Program”). 80 Fed. Reg. 36410 (June 24, 2015) (“Interim Final Rule”) (see new rule at <http://www.gpo.gov/fdsys/pkg/FR-2015-06-24/pdf/2015-14989.pdf>). Formerly referred to as the Biorefinery Assistance Program, the Program provides loan guarantees of up to \$250 million of senior debt for the development, construction, and retrofitting of new and emerging technologies for the development of Advanced Biofuels, Renewable Chemicals, and Biobased Products. The Interim Final Rule expands the scope of projects eligible for loan guarantees and also implements significant changes intended to make the Program friendlier to large institutional Lenders and project-finance-oriented loan and collateral structures.

The Program was initially established under the Food, Conservation, and Energy Act of 2008, P.L. 110–234 (“2008 Farm Act”), and provided loan guarantees only for commercial-scale biorefineries using certain technologies and targeting the production of Advanced Biofuels. USDA has removed grants, which were authorized in 2008 Farm Bill, from the Program. Reauthorization of the 2014 Farm Act permitted changes to Section 9003 of the Agricultural Act of 2014, P.L. 113-79, 7 U.S.C. 8103 (“2014 Farm Act”), renewed funding for the Program, expanded it to cover renewable chemical and Biobased Products manufacturing facilities, and made certain other changes. The Interim Final Rule implements the changes required by the 2014 Farm Act and also addresses public comments received in a rulemaking under the prior interim final rule implementing the provisions of the 2008 Farm Act. 76 Fed. Reg. 8404 (Feb. 14, 2011). The Interim Final Rule also includes a finance framework and administrative improvements based on the USDA’s experience with the Program.

To date, the Program has obligated funds for three (3) loan guarantees and six (6) conditional commitments. According to USDA, these funding obligations will result in approximately 100 MMGY of Advanced Biofuels from approximately \$750 million of Program funding.

Major changes to the Program in the Interim Final Rule include:

- Expanding the Program to provide loan guarantees for Renewable Chemicals and Biobased Product Manufacturing, in addition to Advanced Biofuels;
- Removing the requirement that an eligible Biorefinery devote the majority (51 percent or more) of its production to Advanced Biofuels, in favor of a requirement that it produce only some Advanced Biofuels (which do not have to be sold as fuel, can be consumed at the manufacturing facility for other uses and are not restricted by volumes produced);
- Supplementing the Program to include a non-recourse “project finance”-based framework for loan evaluation and collateralization, in addition to the existing recourse “corporate finance”-based framework;
- Consolidating the applicable Business & Industry Loan Guarantee Rules into the new Interim Final Rule;
- Implementing a two-phased application process;
- Overhauling the scoring of applications;

- Changing the 20 percent and 40 percent sponsor cash equity requirements for 80 percent and 90 percent USDA loan guarantee coverage, respectively, to requiring significant sponsor cash equity as determined on a case-by-case basis by USDA. The 20 percent and 40 percent requirements now are that such funding percentages for such 80 percent or 90 percent respective loan guarantee coverage be from non-Federal sources;
- Basing various tests upon “Eligible Project Costs” and not “Total Project Costs,” such as with the calculation of the Guarantee Fee and Annual Renewal Fee;
- Eliminating the previous requirement that differences in the interest rate between the guaranteed and unguaranteed portions of the loan could not exceed 500 basis points;
- Providing 10 additional scoring points to ensure project diversity in the Program’s priority scoring analysis;
- Removing the previous credit rating requirement for applicants requesting loans at or above \$125 million and requiring an evaluation and rating of the project’s indebtedness, without considering a government guarantee, from a nationally recognized statistical rating organization (“NRSRO”), as defined by the U.S. Securities & Exchange Commission for all Phase 2 applicants with total Eligible Project Costs at or exceeding \$25 million;
- Allowing assets acquired with Federal funds to be included in the total value of collateral;
- Permitting the use of guaranteed loan or bond proceeds to fund a project’s debt service reserve account;
- Prohibiting the sale or assignment of the guaranteed loan to the Borrower, its parent, subsidiary or affiliate, or to officers, directors, stockholders, other owners including members of their immediate families;
- Requiring, as part of the evaluation of technical feasibility, evidence demonstrating 120 days of continuous (meaning generally without unscheduled shutdowns), steady state production from an integrated demonstration unit;
- Allowing the Lender to request a change in the standard for loan origination and servicing from “negligent” to “grossly negligent” on a case-by-case basis;
- Permitting the Lender to reduce its minimum 7.5 percent retention of senior debt on a case-by-case basis with the Secretary of Agriculture’s approval;
- Limiting the period of accrued interest being covered by the Loan Note Guarantee to the Lender to 90 days after the most recent delinquency date reported by the Lender to USDA. Holders of guaranteed loans are subject to limitation of the greater of 90 days after such a delinquency date or 30 days from the date the Lender or Agency sends a Holder an interest termination letter; and
- Permitting the Lender to rely on certain written documentation from qualified third parties (including independent engineers, appraisers, accountants and consultants).

Changes to the Program, according to USDA, are prospective and not retroactive. The Interim Final Rule, which revises 7 C.F.R. part 4279, subpart C, and 7 C.F.R. part 4287, subpart D, will remain in effect indefinitely, or until USDA promulgates a successor rule. Any comments to the Interim Final Rule are due to USDA on or before August 24, 2015.

On the heels of the Interim Final Rule, USDA also issued, on July 6, 2015, a Notice of Solicitation of Applications for the Program. 80 Fed. Reg. 38432 (“Notice of Solicitation”) (see notice at <http://www.gpo.gov/fdsys/pkg/FR-2015-07-06/pdf/2015-16480.pdf>). The Notice of Solicitation announced two (2) separate application cycles for the Program, with application deadlines of October 1, 2015, and April 1, 2016. The Notice of Solicitation specifically requests applications for qualified projects under the Program, and includes loan scoring criteria tailored to those projects.

Funds Available under the Program

The 2014 Farm Act provides \$100 million of mandatory funding for the Program for FY 2014 and \$50 million of mandatory funding for each of FY 2015 and FY 2016, potentially available to project applications submitted in response to the Notice of Solicitation. However, the 2015 Consolidated and Further Continuing Appropriations Act, P.L. 113–235, reduced the \$50 million for FY 2015 to \$30 million (with the \$20 million balance available for FY 2016 in addition to its \$50 million mandatory funding amount) or \$130 million of available mandatory funding for FY 2014 (\$100 million) and FY 2015 (\$30 million). FY 2016 funds could be as high as the additional \$20 million from FY 2015 plus the \$50 million mandatory 2014 Farm Act funds and any carry over from earlier rounds. Thus, available Program mandatory funds can be as high as \$200 million for FY 2014 – FY 2016.

Furthermore, the overall Program subsidy scoring by the Office of Management and Budget (“OMB”) could be from 3-to-1 to 4-to-1 of these amounts based on historical scoring. Additionally, since the USDA has had recent successes in its Program, the subsidy scoring could move to the higher level. Thus, available Program funding could be between \$600 million and \$800 million in loan guarantee authority from the aggregate FY 2014 – FY 2016 available mandatory funds of \$200 million for this Notice of Solicitation after subsidy scoring (the “Available Program Funding”). However, pending House legislation (H.R. 3049) could reduce this Available Program Funding, if ultimately enacted. (Available Program Funding also is affected by subsidy scoring on a project-by-project basis, as applicant awardees execute their respective conditional commitments).

USDA also requires up to 15% of the mandatory funding of \$130 million for FY 2014 and 2015 (when the restriction is effective) (or approximately \$19.5 million) to be set aside to provide loan guarantees to promote Biobased Product Manufacturing. With respect to credit subsidy-scored Available Program Funding of \$390 million (3 to 1) to \$520 million (4 to 1), this 15% funding would be in a range of \$58.5 million to \$78 million. This set-aside, however, is not provided expressly for FY 2016 mandatory funds.

The 2014 Farm Bill also enables Congress to approve an additional \$75 million of discretionary funding for FY 2014 through 2018. Nevertheless, Congress has never appropriated any of the identified discretionary funding since the 2008 Farm Act established the Program. Moreover, since the 2014 Farm Act provided no mandatory funds to the Program for FY 2017 and FY 2018, interested potential Program applicants must move quickly to participate in the current Notice of Solicitation.

Eligibility Criteria for Program Loan Guarantees

Types of Eligible Projects (7 C.F.R. § 4279.210)

Program funds may be used to fund the development, construction and retrofitting of the following types of projects:

- Commercial-Scale Biorefineries using Eligible Technology;
- Biobased Product Manufacturing facilities that use Technologically New Commercial-Scale processing and manufacturing equipment; and
- Facilities that convert Renewable Chemicals and other biobased outputs of Biorefineries into end-user products on a commercial scale.

These terms are defined (in 7 C.F.R. § 4279.202) as follows:

A *Biorefinery* is a facility that converts Renewable Biomass into Biofuels and Biobased Products. To be eligible to participate in the Program, a Biorefinery must produce some quantity of Advanced Biofuels (as defined below). However, this requirement need not be a majority of its production as under the previous Program rules. A Biorefinery also may produce electricity.

A *Biofuel* is any fuel derived from Renewable Biomass. An *Advanced Biofuel* is one derived from Renewable Biomass, other than corn kernel starch. This definition includes:

1. Biofuels derived from:
 - a. cellulose, hemicellulose, or lignin;
 - b. sugar and starch (other than ethanol derived from corn kernel starch); and
 - c. waste material, including crop residue, other vegetative waste material, animal waste, food waste, and yard waste;

2. Diesel-equivalent fuel derived from Renewable Biomass;
3. Biogas (including landfill gas and sewage waste treatment gas) produced through the conversion of organic matter from Renewable Biomass;
4. Butanol or other alcohols produced through the conversion of organic matter from Renewable Biomass; and
5. Other fuel derived from cellulosic biomass.

Biobased Products include commercial or industrial products, intermediate ingredients, or feedstocks composed, in whole or in significant part, of biological products, including renewable domestic agricultural materials and forestry materials. They do not include products intended for use as food which otherwise are aligned with the Section 9002 Biobased Purchasing Program. However, Renewable Chemicals that are food-grade are qualified Biobased Products.

Renewable Biomass is defined broadly to encompass renewable agricultural commodities including feed grains and other plant material grown on non-Federal or Indian lands, as well as certain vegetative materials removed from public lands, if that material would not otherwise be used for higher-value products. That said, as mentioned, while corn kernel starch may not be used as feedstock for Advanced Biofuels, it is available for use as feedstock for Renewable Chemicals and Biobased Products.

A *Renewable Chemical* is a monomer, polymer, plastic, formulated product, or chemical substance produced from Renewable Biomass.

Commercial Scale: To be considered “Commercial Scale”, a project must demonstrate that:

1. Its sole or chief emphasis is on saleability and profit;
2. Its revenue will be sufficient to recover the full cost of the project over its expected life and result in an anticipated annual rate of return sufficient to encourage investors or Lenders to provide funding for the project;
3. It will be able to operate profitably without public and private sector subsidies upon completion of construction;
4. Contracts for feedstock are adequate to address proposed off-take; and
5. It has the ability to achieve market entry, suitable infrastructure to transport product to its market is available, and the technology and related products are generally competitive in the market.

Eligible technology means:

1. A technology that is being adopted in a viable Commercial-Scale operation of a Biorefinery that produces an Advanced Biofuel; or
2. Any other technology that has been demonstrated to have Technical and Economic Potential for commercial application in a Biorefinery that produces an Advanced Biofuel.

A *Technologically New* technology consists of new or significantly improved equipment, process or production methods to deliver a product; or the adoption of equipment, process or production method to deliver a new or significantly improved product, of which the first commercial-scale use in the United States is within the last five (5) years and which is used in not more than three (3) commercial-scale facilities in the United States. This definition applies only Biobased Product Manufacturing and not to a Biorefinery. It is similar to that in the United States Department of Energy (“DOE”) Section 1703 Loan Guarantee Program.

Moreover, also similar to the DOE Section, 1703 Loan Guarantee Program, a Program applicant could apply for funding for more than one (i) stand-alone project at different sites under the same application or (ii) related facilities applicable to the main project facility and at different locations. In each instance, the overall application would be subject to Available Program Funding, specific Program funding limits and other requirements. Further, such an application is applicable for each of Biorefineries and Biobased Product Manufacturers.

Borrower Eligibility (7 C.F.R. § 4279.209)

The following types of Borrowers may be eligible for loan guarantees under the Program:

- Individuals;
- Public and private entities;
- State and local governments;
- Corporations;
- Indian tribes;
- Farm Cooperatives, and Farm Cooperative Organizations;
- Associations of Agricultural Producers;
- National Laboratories;
- Institutions of Higher Education; and
- Public Power entities.

Certain Borrowers, however, with outstanding Federal Court (non-Tax Court) judgments, delinquent Federal income tax or Federal debt payments, or debarred or suspended from Federal assistance are ineligible.

Lender Eligibility (7 C.F.R. § 4279.208)

The following types of Lenders may be eligible to participate in the Program, if they have sufficient expertise and experience as well as the legal authority to do so:

- A Federal or State chartered bank;
- Bank for Cooperatives;
- Farm Credit Bank, or other Farm Credit System institution with direct lending authority;
- Credit Unions subject to credit examination and supervision by a State agency or the National Credit Union Administration; and
- The National Rural Utilities Cooperative Finance Corporation.

To be eligible, a Lender must also meet the FDIC's definition of "well-capitalized" at the time of the application and note issuance. (12 C.F.R. § 325.103(b)(1).)

Savings and loan associations, mortgage companies, insurance companies and other Lenders not meeting the above eligible Lender criteria are not eligible.

Application Process

The Interim Final Rule establishes a two (2)-phase application process, which is similar, but not identical, to the DOE Section 1703 Loan Guarantee Program's Part 1 and Part 2 application process. In Phase 1, applicants provide information to determine Lender, Borrower, and project eligibility; preliminary economic and technical feasibility; and the priority score of the application, as determined by criteria discussed below. USDA will evaluate applications based on these scoring criteria and invite the highest-ranked Phase 1 applicants to submit Phase 2 applications. Phase 2 application materials will be submitted as the project planning and engineering are finalized and must include an environmental report, technical report, financial model, and the Lender's credit evaluation. Phase 2 materials are required for final approval of loan guarantees by USDA.

At least 30 days prior to submitting a Phase 1 application, a prospective applicant must submit a letter of intent to the USDA identifying the Borrower, the Lender, and project sponsors. The notice must also describe the project and project location, proposed feedstock, the primary technologies of the facility, the primary products to be produced, and total project cost estimate. In addition, applicants must be pre-registered with the System for Award Management ("SAM") and also have a Data Universal Number System ("DUNS") number. Information on SAM is available at <https://www.sam.gov/portal/SAM/##11>. DUNS may be accessed at <http://fedgov.dnb.com/webform>.

The July 6, 2015 Notice of Solicitation establishes the next two cycles of applications for the Program. Application deadlines for these cycles are October 1, 2015, and April 1, 2016. Applications are submitted on a rolling-basis and must be received by USDA at or before 4:30 p.m. EDT on each of those cut-off dates. A complete Phase 1 application must be received by the Agency on or before October 1 or April 1, respectively, to be considered for funding for that fiscal year.

Phase 1 Applications and Loan Scoring Criteria

Phase 1 application materials must include the following:

1. A project summary;
2. Application form (Form RD 4279-1);
3. Audited annual financial statements and current statements;
4. Financial model and supporting assumptions;
5. A feasibility study considering the project's economic, market, technical, and financial feasibility;
6. A business plan including information about the project and the Borrower's business;
7. Scoring information;
8. Intergovernmental consultation comments in accordance with 2 C.F.R. part 415, subpart C; and
9. The applicant's DUNS Number.

Applications must be submitted both electronically and in hard-copy. Application materials, an application guide, and other information are available on the Program's web site at <http://www.rd.usda.gov/programs-services/biorefinery-renewable-chemical-and-biobased-product-manufacturing-assistance>.

Phase 1 Scoring Criteria

Phase 1 applications are scored on a point system (on a scale of 125 possible points with a minimum score of 55 points necessary for loan guarantee consideration), with different criteria used to evaluate applications for Biorefineries and Biobased Product Manufacturing facilities. The criteria for Biorefineries are set forth in 7 C.F.R. § 4279.266. They include items such as the following:

- Whether the Borrower has established a market for its products, as determined primarily by the extent and duration of off-take agreements (up to 20 points);
- Whether the area in which the Borrower proposes to place the project has any other similar facilities (up to 5 points);
- Whether the Borrower is proposing to use a feedstock or biobased output of Biorefineries not previously used in the production of Advanced Biofuels or Biobased Products including Renewable Chemicals (up to 10 points);
- Whether the Borrower is proposing to work with producer associations or cooperatives to provide feedstocks (up to 5 points);
- The level of financial participation by the Borrower, including support from non-Federal government sources and private sources (up to 20 points);
- Whether the adoption of the process proposed in the application will have a positive effect on resource conservation, public health, and/or the environment (up to 10 points);
- Whether the technology proposed in the application will not have any economically significant negative impacts on existing manufacturing plants or other facilities that use similar feedstocks or biobased outputs of Biorefineries (up to 5 points);
- The project's potential to promote rural economic development (up to 20 points);
- The level of local ownership of the proposed facility(ies) (up to 5 points);

- Whether the project can be replicated (up to 10 points); and
- Whether the project uses a particular technology, system, or process that is not currently operating at Commercial Scale as of October 1 (or April 1) of the fiscal year for which the funding is available (5 points).

The USDA also has discretion to award up to 10 points to promote “diversity” among the types of technologies, products, and approaches embodied in the projects for which guarantees are approved. As part of its review, USDA seeks to select projects that promote partnerships and other activities which advance goals such as U.S. energy independence; promote resource conservation, public health, and the environment; diversify markets for agricultural and forestry products and agriculture waste material; and create jobs and enhance the economic development of the Rural economy. Such partnerships and other activities are identified in the *Federal Register* notices soliciting applications each year. (No additional information on such partnerships is included in the Notice of Solicitation.)

The criteria for evaluating applications for Biobased Product Manufacturing projects are similar to the criteria for Biorefineries, but are weighted somewhat differently. These criteria are set forth in the Notice of Solicitation. 80 Fed. Reg. 38433.

Phase 2 Applications and Loan Approval

In Phase 2, applicants selected by USDA submit more detailed project information to enable USDA to evaluate the loan for approval. Application materials required in Phase 2 include the following:

1. Technical assessment/technical report;
2. Environmental assessment;
3. Updates to application materials, as appropriate;
4. Other information requested by the Agency including contacts and agreements;
5. Lender’s analysis, credit evaluation, and supporting materials;
6. Appraisals;
7. Lender’s proposed loan agreement;
8. Estimated timing of loan closing and issuance of the Loan Note Guarantee (pre-construction or post-construction);
9. Credit rating (obtained under the direction of the Agency after loan terms and conditions have been established).

The Phase 2 loan approval criteria are changed significantly under the Interim Final Rule. Credit evaluation is more flexible, and allows more reliance on the Lender to exercise professional judgment (7 C.F.R. § 4279.215). Collateral evaluation is also more flexible, and allows the use of more project finance-oriented collateral (7 C.F.R. § 4279.235). In addition, Lenders are afforded more latitude to rely on third-party evaluations in discharging their own diligence obligations.

Applications for loan guarantees may be approved as their Phase 2 applications are completed and approved (7 C.F.R. § 4279.278).

Funding Availability and Requirements

The maximum principal amount of a loan guaranteed for up to 20 years under the Program is \$250 million. (7 C.F.R. § 4279.232(b)) There is no minimum loan amount. The total amount of Federal participation in a project (including the loan guarantee plus other Federal funding) may not exceed 80 percent of total Eligible Project Costs. However, USDA generally may guarantee senior debt: (i) between 60 percent and 80 percent with 20 percent of Eligible Project Costs funded from non-Federal sources including significant sponsor cash equity determined by USDA on a case-by-case basis, and (ii) 90 percent with at least 40 percent funded from non-Federal sources including significant sponsor cash equity determined by USDA on a case-by-case basis, with certain additional requirements for each percentage guarantee coverage. Interest rates on senior debt may be fixed, variable or a combination of both. Eligible Project Costs are listed in the Interim Final Rule, including as follows:

1. The purchase and installation of equipment;

2. New construction or retrofitting of existing facilities including reasonable contingency reserves, land acquisition, site improvements and development, and associated costs such as surveys, title insurance, title fees, and recording or transfer fees;
3. Permit and license fees and fees and charges for professional services;
4. Working capital;
5. Cost of necessary insurance and bonds;
6. Cost of financing, including capitalized interest;
7. Cash reserve accounts required by the Lender;
8. Engineering costs;
9. Projects expenses such as rail lines, roads and electric power lines; and
10. Any other items subsequently identified by the USDA in a *Federal Register* notice.

7 C.F.R. § 4279.210(d). Specifically ineligible costs include as follows:

1. Distribution or payment to an individual owner, partner, stockholder, or beneficiary of the Borrower or a close relative;
2. Any line of credit;
3. Any equipment, processes, and related costs of such equipment used for processing corn kernel starch into biofuel; and
4. Payment in excess of actual costs incurred by the contractor or other service provider on a contract or agreement that has been entered into at less than an arm's length transaction or with an appearance of or a potential for conflict of interest. (7 C.F.R. § 4279.210(e).)

In addition, the Program requires that the Borrower and other principals involved in the project have a "significant" equity investment in the project in the form of a cash contribution. The amount required is to be determined on a case-by-case basis as part of the credit evaluation of the project. (7 C.F.R. § 4279.210(c).)

Loan Terms

Loan terms other than interest must be the same for the guaranteed and unguaranteed portions of the loan.

Interest rates on guaranteed loans under the Interim Final Rule are negotiated between the Borrower and Lender, and may be fixed or variable. (7 C.F.R. § 4279.233). Interest rates may not exceed those customarily charged by the Lender for non-guaranteed loans.

Fees

Recipients of loan guarantees must pay guarantee fees of one (1) to three (3) percent, depending on the percentage of the loan guarantee. (7 C.F.R. § 4279.231(a).) Annual renewal fees of one-half (0.5) percent to one (1) percent are also owed, based on a percentage of outstanding principal and the percent of the guarantee. (7 C.F.R. § 4279.231(b).)

Practical Impacts of Interim Final Rule

The USDA anticipates that the Program changes required by the 2014 Farm Bill and implemented by the Interim Final Rule will have a number of practical impacts. It expects that the changes implemented by the Interim Final Rule will make the Program more attractive to larger, more sophisticated Lenders which are under more regulatory scrutiny than the Lenders that have historically participated in the USDA's guaranteed loan programs. USDA also expects that the Interim Final Rule will increase diversity in projects funded under the Program. Furthermore, the Agency expects these changes to improve the financial feasibility of the Biorefineries supplying Renewable Chemicals and other Biobased Products to manufacturing facilities because Renewable Chemicals and Biobased Products typically are of higher value than Advanced Biofuels.

Overall, USDA estimates that, based upon full Program funding and the higher percentage Program credit subsidy scoring by the OMB, it could receive approximately 95 applicants for Phase 1 applications. From this applicant pool, it projects approximately 34 such applicants could be invited to submit a Phase 2 application.

To learn more and discuss the parameters of this Notice of Solicitation, please contact the following Kilpatrick Townsend & Stockton LLP attorneys:

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