UNITED STATES GENERAL ACCOUNTING OFFICE
Washington, D.C. 20548

126993

FOR RELEASE ON DELIVERY
Expected at 10:00 a.m.
May 22, 1985

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STATEMENT OF F. KEVIN BOLAND
SENIOR ASSOCIATE DIRECTOR
RESOURCES, COMMUNITY, AND ECONOMIC
DEVELOPMENT DIVISION
BEFORE THE
SUBCOMMITTEE ON ENVIRONMENT, ENERGY, AND
NATURAL RESOURCES
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to participate in this hearing concerning the impact of the U.S. Synthetic Fuel Corporation's (SFC's) proposed assistance on the finances of the Great Plains coal gasification project in North Dakota. At your request, we previously reported on the financial status of the Great Plains project[1] and testified before this Subcommittee.

My prepared comments today will focus on the financial assistance awarded the project by the Department of Energy (DOE), the tentative terms of price guarantee assistance with SFC, an analysis of possible additional DOE assistance, and the government's options in the event of project abandonment.

BACKGROUND

In January 1982 DOE awarded a loan guarantee to Great Plains Gasification Associates--a partnership of five companies (Exhibit A lists the partners and their percent of ownership)--for up to \$2.02 billion of the originally estimated \$2.76 billion cost to build a plant to produce commercial quantities of synthetic gas

[1] Economics of the Great Plains Coal Gasification Project, (GAO/RCED-82-210, Aug. 24, 1983) and Financial Status of the Great Plains Coal Gasification Project, (GAO/RCED-85-70, Feb. 21, 1985)

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from coal. Great Plains agreed to finance the remaining with its own money or equity. As of May 1, 1985, Great Plains had borrowed about $1.46 billion under the loan guarantee agreement and had contributed about $490 million in equity.

The loan guarantee agreement requires Great Plains to annually submit an estimated cash-flow projection demonstrating its ability to repay the guaranteed loan and the project's profitability. The projection prepared in January 1982 when the loan guarantee agreement was signed indicated a favorable financial outlook for the project and showed that the plant would be in a positive cash-flow position after 3 years of operations.

The cash-flow projections prepared since January 1982 showed significant changes in the project's financial viability including losses in net income, less distribution of funds to the partners, and larger capital investment requirements by the partners through 1996--the last year covered in the January 1982 projection. The main reason for these changes was that the energy prices used to estimate the project's synthetic gas prices were lower than those used in January 1982. Previously, we reported that the project's finances are extremely sensitive to energy price changes.

In this regard, I would like to emphasize two important points. First, projections of future energy prices are very sensitive to economic conditions, international events, and domestic policy changes. Second, Great Plains' financial analyses extend through the year 2009. Using energy price projections 25 years into the future greatly increases the speculative nature of financial analyses related to this project.

As a result of deteriorating financial projections in the wake of declining energy prices, Great Plains applied to SFC for additional assistance. In April 1984, SFC tentatively agreed to provide Great Plains up to $790 million in price guarantee assistance. On April 22, 1985, representatives of SFC and Great Plains reached an understanding of revised tentative terms for financial assistance that included increasing the maximum price guarantee to $820 million. As of today, however, these tentative terms have not been approved either by SFC's board of directors or Great Plains management.

APRIL 1984 SFC PROPOSAL

Under the April 1984 SFC proposal, SFC agreed to guarantee Great Plains up to $790 million in assistance for up to 10 years. SFC agreed to guarantee gas prices of $10 per million Btu's for the first 3 years of the price guarantee period and $7.50 per million Btu's thereafter if the market price is less than the guaranteed price.

In exchange, the Great Plains partners agreed to contribute an additional $100 million in equity to the project and Great Plains agreed to repay the DOE-guaranteed loan faster and share profits with SFC (Exhibit B provides additional information on this assistance proposal).

SFC's assistance proposal would help to alleviate the impact of financial losses that could occur during the first 10 years of project operations (1985-94). The partners were concerned that the negative financial outlook during the first 10 years would affect their consolidated earnings, weaken their credit rating, increase their cost of capital, and drain capital from their other businesses. In February 1985 the Chairman, Great Plains Management Committee, reiterated that the partners gave more weight to these factors than to the speculative profits the project might generate in the future.

In the year since Great Plains and SFC signed the April 1984 tentative assistance agreement, several events have occurred that affected the final contract negotiations:

--Projections of future energy prices have been lowered.

--Estimates of sales for one of the [illegible] dioxide) have been reduced.

--Estimates of operating costs have been increased.

--The Internal Revenue Service (IRS) ruled favorably on the eligibility of the partners for production tax credits.

APRIL 1985 SFC PROPOSAL

On April 22, 1985, representatives of SFC and Great Plains tentatively agreed to revised financial assistance terms. Neither SFC's board of directors nor Great Plains management has approved these terms. The latest proposal increases the amount of price guarantee assistance and equity contributions from those set out in April 1984 but decreases the guaranteed gas price in the latter years. Under these terms, Great Plains could receive up to $820 million in price guarantee assistance for up to 10 years. SFC agreed to guarantee gas prices of $10 per million Btu's through March 31, 1988, and $6.50 per million Btu's thereafter if the market price is less than the guaranteed price.

In exchange, between April 1, 1985, and March 31, 1988, the Great Plains partners would invest $90 million more in equity than set out in the April 1984 proposal. (Exhibit C provides a comparison of the April 1984 and April 1985 terms.)

On the basis of SFC's analysis of the revised terms and the other changes cited above (for example, declining energy prices), price guarantees would be paid for 6 years (1985-1990), the same as expected in April 1984. Other impacts of the latest proposal, however, are less favorable than expected in April 1984. SFC's analysis shows that

--the DOE-guaranteed loan would be fully repaid in 1998--4 years later than expected in April 1984,

--profit sharing would begin 3 years later and net receipts would total about $1.3 billion compared to $2.6 billion previously projected, and

--about $813 million of the loan principal would be repaid during the price guarantee period compared to $1.3 billion projected in April 1984.

ANALYSIS OF POSSIBLE ADDITIONAL DOE ASSISTANCE

Of the $2.02 billion that DOE guaranteed, Great Plains expects to borrow about $1.54 billion leaving a balance of about $480 million. You asked that we provide information on (1) the impact of DOE's providing price guarantees to Great Plains assuming assistance levels of $480 million (the unused balance of loan guarantee funds) and $820 million (the amount proposed by SFC) and (2) the project's finances assuming continued operations with no assistance.

At our request DOE, using its energy price projections and computer model, conducted these analyses. Except for the price guarantee amount specified and DOE's energy price projections, the assumptions used are the same as the terms proposed by SFC in April 1985. The results of DOE's analyses for these assistance levels are shown for the project's cumulative after-tax cash flow, the amount of debt outstanding, and the parents' cumulative book income through the year 2009--the last year of expected plant operations. The estimates are presented in undiscounted dollars and do not recognize the time value of money.

Cumulative after-tax cash flow

After-tax cash flow represents the amount of cash generated (including price guarantees received) by the project plus tax benefits available to the parent companies of the Great Plains partners. DOE's analysis showed that:

--With $480 million in assistance, the cumulative after-tax cash flow would be negative from 1986 through the year 2005.

--With $820 million in assistance, the project would experience negative cumulative after-tax cash flows from 1986 through the year 2004 except for 1 year (1990).

--Without assistance Great Plains would have a positive cumulative after-tax cash flow during the first 5 years of plant operations (1985-89). After that and through 2007, however, the project would be in a negative cumulative after-tax cash flow position.

--Under all three assistance assumptions, the project would experience its maximum negative cumulative after-tax cash flow in the year 2001.

The reason the no assistance cumulative after-tax cash flow is positive during the first 5 years of operations but negative with either $480 million or $820 million (except for 1 year--1985) in assistance is because SFC's proposal states that all cumulative after-tax cash flow for the first 2 3/4 years would be used to accelerate repayment of the DOE-guaranteed debt. Without assistance, Great Plains would retain these monies rather than reinvesting them in the project.

Debt Outstanding

Outstanding debt reflects the amount of both principal and interest remaining on Great Plains' guaranteed loan. Under each assistance option, the total amount includes the $1.5 billion guaranteed by DOE and the rest represents interest. DOE's analyses showed that:

--With $480 million in assistance, the DOE-guaranteed debt would be fully repaid in 2005. Total principal and interest payments would total about $3.2 billion.

--With $820 million in assistance, the DOE-guaranteed debt would be fully repaid in 2005. Total principal and interest payments would total about $3.1 billion.

--With no assistance, the DOE-guaranteed debt would be fully repaid in 2005. Total principal and interest payments would total about $3.6 billion.

--From 1985 through 1989, about $694 million of loan principal would be repaid with $820 million in assistance, about $675 million with $480 million in assistance, and about $192 million with no assistance.

<u>Cumulative book income</u>

Book income is shown on the parent companies' income statement as either profits or losses that result from Great Plains' operations. DOE's analyses showed that:

--With $480 million in assistance, the cumulative book income is negative from 1985 through 2003.

--With $820 million in assistance, the cumulative book income is negative from 1985 through 2002.

--With no assistance, the cumulative book income is negative from 1985 through 2006.

--With or without assistance, the maximum losses would in 1995; however, the amount of these losses differ. With $480 million in assistance, the maximum loss would be $417 million; with $820 million, $241 million; and with no assistance, $843 million.

OPTIONS IN THE EVENT OF PROJECT ABANDONMENT

In the event the Great Plains partners abandon the project, the government could sell the plant or operate it under a contract with a private corporation. Both DOE and SFC have assessed the impact of these options using different dates and methodologies. Therefore, the results derived by DOE and SFC are not comparable.

DOE analyzed the government's net cash flows from selling the facility following abandonment in mid-1985 and December 1988, 1989, 1994, and 1999 assuming that (1) the gas pricing formula remained in effect and (2) the gas pricing formula was not enforceable if the partners abandon the project. In each case, DOE assumed the plant would be operated under contract with a private company for at least 1 year following abandonment to allow time to complete the procurement process. Further, DOE treated the $1.5 billion of guaranteed debt as sunk costs (costs incurred in the past that cannot be recouped). DOE's analysis of selling the plant after a mid-1985 or a December 1989 abandonment showed that the government's net cash flow would be $462 million and $419 million, respectively (assuming the gas pricing formula remained in effect). These cash flows improve for analyses conducted after 1989.

SFC--using its current energy prices--analyzed the cost to the government of selling the facility following a mid-1985 and a December 1988 abandonment assuming no assistance. SFC's analyses showed that the discounted cost to the government would be about $757 million and $680 million, respectively. Further, using two different energy price scenarios provided by Great Plains, SFC analyzed the cost of selling the facility following (1) m[illegible] and December 1988 abandonment assuming no SFC assistance and (2) abandonment in December 1989 with SFC assistance. SFC determined that the discounted cost to the government could range from $860 million to $1.5 billion depending on the energy price projection used and the time abandonment occurred. In each case, SFC assumed the gas pricing formula would remain in effect and that the plant would be operated under contract with a private company for 1 year following abandonment.

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Mr. Chairman, this concludes my prepared statement. I will be happy to respond to any questions.

GREAT PLAINS GASIFICATION ASSOCIATES

PARTNERS AND PERCENTAGE OF OWNERSHIP

	Percentage of equity
Tenneco SNG Inc. (an indirect subsidiary of Tenneco Inc.)	30
ANR Gasification Properties Company (a subsidiary of American Natural Resources Company)	25
Transco Coal Gas Company (a subsidiary of Transco Energy Company)	20
MCN Coal Gasification Company (a subsidiary of MidCon Corporation, formerly Peoples Energy Corporation)	15
Pacific Synthetic Fuel Company (a subsidiary of Pacific Lighting Corporation)	10
Total	100

 EXHIBIT B

ADDITIONAL INFORMATION CONCERNING

SFC'S APRIL 1984 PROPOSAL

--During the first 3 years of the price guarantee period, the Great Plains partners would contribute all project-related positive cumulative after-tax cash flow (including that generated by price guarantee receipts) for Great Plains' use in accelerating repayment of the DOE-guaranteed loan.

--After 3 years, Great Plains would use 90 percent of project-related positive cumulative after-tax cash flow to repay the remaining loan balance.

--After the DOE-guaranteed loan is repaid, Great Plains would pay SFC 70 percent of positive cumulative after-tax cash flow to a maximum of $1.58 billion (March 1984 dollars).

EXHIBIT C

COMPARISON OF SFC ASSISTANCE TO GREAT PLAINS

	April 1985 proposal	April 1984 proposal
Price guarantee amount	$820 million	$790 million
Guaranteed gas prices		
Committed equity period	$10.00 per MMBtu	$10.00 per MMBtu
Thereafter	$ 6.50 per MMBtu	$ 7.50 per MMBtu
Committed equity period	2 3/4 years (July 1, 1985 - March 31, 1988)	3 years from July 1, 1984
Equity requirements	$190 million plus positive cumulative after-tax cash from April 1, 1985 through March 31, 1988	$100 million plus positive cumulative after-tax cash through July 1, 1987
Profit sharing		
Accelerated repayment of DOE-guaranteed debt	90% of positive cumulative after-tax cash	90% of positive cumulative after-tax cash
After debt is repaid	75% of positive cumulative after-tax cash	70% of positive cumulative after-tax cash