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Fact Sheet for the Chairman, Subcommittee on Energy and Power, Committee on Energy and Commerce, House of Representatives

February 1987

SYNTHETIC FUELS

Status of the Great Plains Coal Gasification Project

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GAO/RCED-87-90FS

GAO

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Resources, Community, and
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February 27, 1987

The Honorable Philip R. Sharp
Chairman, Subcommittee on Energy
and Power
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

As requested in your August 5, 1985, letter and in related meetings with your office, we have obtained updated information on the Great Plains coal gasification project in North Dakota following the default of a $1.54 billion federal loan by the project's sponsors. Your office asked that we provide periodic briefing documents on the status of the project. We issued our last fact sheet to you on July 3, 1986 (GAO/RCED-86-190FS).

This fact sheet updates our previous fact sheet through December 23, 1986. Since our last fact sheet, the Department of Energy (DOE) has obtained title to the Great Plains project and is evaluating proposals from investment banking-type companies to assist it in selling the plant and its assets. DOE has also finalized a new operating agreement with the project administrator and has had tests conducted to determine the plant's optimum production level. New information in this fact sheet highlights recent legal action concerning gas purchase agreements and mortgage foreclosure; the status of the project sponsors' outstanding liability; DOE's progress in evaluating its options; revenue, expense, production, and plant employment data; capital improvement projects; and plant maintenance issues.

This fact sheet is organized into five sections. Section 1 provides background and information on our scope and methodology. Section 2 contains information on Great Plains loan and gas pricing formula, while section 3 discusses legal matters and agreements. Section 4 describes DOE's options and actions now that it has obtained title to the plant. Section 5 provides specific information on the plant operations.

The Department of Energy Act of 1978--Civilian Applications (Public Law 95-238) required our office to audit recipients of loan guarantees for alternative fuel demonstration projects every 6 months. In accordance with this requirement, we have issued eight reports on the status of the Great Plains project covering activities before the loan default. Our updated fact sheets on the status of the project since the loan default continued to satisfy this requirement. Because there is no outstanding loan guarantee commitment (since DOE now holds the title to the Great Plains project), no further audits are required under Public Law 95-238. This fact sheet, covering activities through December 23, 1986, reports the results of our final audit under Public Law 95-238. However, as requested in your November 14, 1986, letter, we will continue to provide your Subcommittee with periodic, updated fact sheets on the status of the project.

We obtained the information in this fact sheet from discussions with, and documents provided by, federal, state, local, and industry officials involved with or affected by the Great Plains project. We also discussed a draft of this fact sheet with DOE officials and project administration representatives. Based on these discussions, clarifications have been made where appropriate.

As agreed with your office, we are sending copies of this fact sheet to other interested congressional offices and committees, to the Secretary of Energy, and to other interested parties. Please call me at 275-8545 if you have any questions about this fact sheet.

Major contributors to this fact sheet are listed in appendix I.

Sincerely yours,

Flora H. Milans

Flora H. Milans
Associate Director

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ABBREVIATIONS

ANG	ANG Coal Gasification Company
Btu's	British thermal units
DOE	Department of Energy
FFB	Federal Financing Bank
GAO	General Accounting Office
GPGA	Great Plains Gasification Associates

SECTION 1

BACKGROUND AND SCOPE

The Federal Nonnuclear Energy Research and Development Act of 1974 (Public Law 93-577), as amended by the Department of Energy Act of 1978--Civilian Applications (Public Law 95-238), authorizes the Department of Energy (DOE) to provide loan guarantees for alternative fuel demonstration projects. The Secretary of Energy awarded a loan guarantee to the Great Plains Gasification Associates (GPGA) on January 29, 1982, for up to $2.02 billion of the estimated $2.76 billion cost to build and start up a plant in North Dakota, producing synthetic natural gas from coal. The federal government, through the Department of the Treasury's Federal Financing Bank (FFB), loaned GPGA 75 percent of project construction and start-up costs. GPGA financed the rest with its own equity. As of July 31, 1985, GPGA had borrowed about $1.54 billion from FFB, guaranteed by DOE, and had contributed about $493 million in equity to the project.

GREAT PLAINS SPONSORS DEFAULTED ON FEDERAL GUARANTEED LOAN

On August 1, 1985, the GPGA partners terminated their participation in the Great Plains coal gasification project, and the partnership defaulted on its $1.54 billion federal loan guaranteed by DOE. (The GPGA partnership includes subsidiaries of American Natural Resources Company, Tenneco Inc., Transco Energy Company, MidCon Corp., and Pacific Lighting Corp.) Their action followed a July 30, 1985, DOE decision that a proposed Synthetic Fuels Corporation's $720 million price support and debt-restructuring package for the Great Plains project would not support long-term operations at a reasonable cost to the taxpayer.

After GPGA defaulted, to maintain continuity, DOE directed the plant operator, ANG Coal Gasification Company (ANG), to continue operations temporarily while DOE completed a transition plan. The loan guarantee agreement provided that ANG could be required to operate the plant in the event of a loan default. ANG is continuing to operate the plant under DOE's direction while DOE determines the plant's future.

DOE BORROWED FROM THE TREASURY AND PAID OFF THE DEFAULTED LOAN

DOE acted to cover the defaulted loan.

- On August 6, 1985, DOE paid FFB the approximately $401 million principal and interest payment that was due at the time GPGA defaulted on the $1.54 billion DOE-guaranteed loan. The funds for the payment were obtained from the project's appropriated loan guarantee default reserve fund, which totaled about $673 million at the time of default, leaving a balance in the reserve of about $272 million.

- To protect the government's rights in foreclosure proceedings and to reduce the interest from the FFB rate of 11 percent to the Treasury rate of 8 percent, DOE borrowed $1.17 billion from the Treasury and paid the principal balance of the FFB note ($1.14 billion) plus accrued interest ($32 million) on September 30, 1985.

- DOE repaid $222 million of the Treasury loan on June 13, 1986, from the project default reserve fund, and repaid the balance of $1.02 billion on July 3, 1986, using a supplemental DOE appropriation. Of the $1.24 billion repaid, $1.17 billion represented principal and $72 million was accrued interest. This left a balance of about $50 million in the default reserve fund.

Thus, DOE's total expenditure resulting from its loan guarantee for the project was $1.64 billion ($401 million paid to FFB on the original loan plus $1.24 billion paid to the Treasury).

OBJECTIVES, SCOPE, AND METHODOLOGY

Congressman Philip Sharp, Chairman of the Subcommittee on Energy and Power, House Committee on Energy and Commerce, and former Senator Mark Andrews asked GAO to obtain information on the government's options, responsibilities, and potential costs in deciding what to do with the project. Senator Andrews also asked GAO to address the socioeconomic impact issues. In addition, both requesters' offices asked that we provide periodic briefing documents on the status of the project. Our first briefing paper was transmitted to their offices on September 18, 1985. We also issued fact sheets to the requesters on November 8, 1985 (GAO/RCED-86-49FS), February 28, 1986 (GAO/RCED-86-109FS), and July 3, 1986 (GAO/RCED-86-190FS). This fact sheet provides the requesters with information obtained as of December 23, 1986, on plant operations and the various issues, legal matters, and problems the government is facing or will be faced with in deciding Great Plains' future.

The scope of our work included interviewing and obtaining pertinent documents and information from federal, state, local, and industry officials involved in or affected by the Great Plains project. We spoke with officials at DOE headquarters in Washington, D.C.; DOE's Chicago Operations Office; ANG; the state of North Dakota; and local governments. DOE and ANG officials have reviewed a draft of this fact sheet, and their clarifications were incorporated where appropriate.

Our November 8, 1985, fact sheet included information on socioeconomic issues related to the uncertainty that then existed over the plant's future operation. Because the plant has continued to operate, we have not obtained any additional information concerning these issues and, therefore, have not included that subject in this fact sheet.

SECTION 2

GREAT PLAINS LOAN AND GAS PRICING FORMULA

Four pipeline companies, subsidiaries of four parent companies of the Great Plains partners, agreed to purchase all the gas produced by the Great Plains plant. (The plant's production is the equivalent of about 1 percent of the pipeline companies' average annual gas requirements.) The price of the gas is controlled by gas purchase agreements that contain a pricing formula. The pricing formula provided that the gas would be sold to the pipeline companies at a base price of $6.75 per million British thermal units (Btu's) in January 1, 1981, dollars. The price would vary quarterly on the basis of changes in the Bureau of Labor Statistics' Producer Price Index and changes in the price of No. 2 fuel oil. The $6.75 price was comparable to the 1980 prices paid by interstate pipelines for unregulated natural gas.

However, the pricing formula set various "caps" on the prices. Specifically:

-- For 5 years after the initial delivery of gas, the price could not exceed the price of unregulated No. 2 fuel oil.

-- From the 6th through the 10th year, the price would be the greater of the average prices paid by the pipeline affiliates for the highest 10 percent of domestic natural gas or for Canadian and Mexican gas. In neither case would it be higher than the unregulated price of No. 2 fuel oil.

-- After 10 years, the price would be based on the price of unregulated domestic natural gas. If gas prices were regulated at that time, then the price paid for Canadian and Mexican gas would set the ceiling.

Great Plains began producing gas in July 1984. From July 28 through December 31, 1984, the Great Plains synthetic gas sales price ranged from $5.69 to $6.10 per million Btu's--the equivalent price of No. 2 fuel oil, which controls the maximum sales price during the first 5 years of gas production. As of July 31, 1985, Great Plains had produced and sold about 28.3 billion cubic feet of gas, totaling about $153 million.

Actions not related to the Great Plains default have altered the gas pricing calculations. Effective July 1985, the Bureau of Labor Statistics ceased publishing the price of No. 2 fuel oil as a separate item. Because that published price had determined the cap under the gas pricing formula, it became necessary to devise an alternate approach. Pending the adoption of an alternative approach, ANG continued to bill for July through December 1985 gas deliveries at $5.37 per million Btu's (based on the June published price for No. 2 fuel oil).

On September 5, 1985, ANG presented a proposed substitute pricing formula to the four pipeline company purchasers for their approval. Under the proposed substitute formula, the last published price for No. 2 fuel oil would be adjusted monthly according to changes in the Bureau of Labor Statistics' Producer Price Index. Although only one of the pipeline companies has formally agreed to the proposed substitute formula, DOE directed ANG to begin billing for January 1986 and subsequent deliveries using the substitute rate. Since then, all four companies have paid for the delivered gas using the substitute formula rate. The companies also recomputed the gas prices for August through December 1985 deliveries using the substitute formula and adjusted payments as necessary.

Under the substitute formula, prices were highly variable. The gas price for July through December 1985 ranged from a low of \$5.02 per million Btu's for August deliveries to a high of \$6.27 per million Btu's for December deliveries. For January through November 1986, the price ranged from a high of \$5.71 per million Btu's for January deliveries to a low of \$2.56 per million Btu's for July deliveries.

SECTION 3

LEGAL MATTERS, AUTHORITY, AND AGREEMENTS

After GPGA defaulted on its loan, the Secretary of Energy directed his staff to review the status of Great Plains. Matters of concern included DOE's authority, foreclosure processes, ANG's operating agreement, coal and electric power supply contracts, gas purchase agreements, and the liability for expenses incurred during the June 24 to July 31, 1985, period (see p. 14). DOE believed it was necessary to obtain title to the project before making any final decisions concerning the future of the project.

DOE AUTHORITY

- Under the loan guarantee agreement and the Nonnuclear Act, DOE believed it had broad authority to protect the government's interests in the Great Plains project.

- Generally, DOE was authorized to "complete, maintain, operate, lease, or otherwise dispose of" the mortgaged property (42 U.S.C. 5919(g)(2); Loan Guarantee Agreement, 7.02(b)(iii)).

- DOE is of the opinion that, as a general matter, it needs no additional legislative authority to proceed with the sale of the project or to exercise other available management options.

FORECLOSURE

- To obtain title, DOE filed action in the federal district court in North Dakota on August 29, 1985, to foreclose on the property.

- DOE filed for summary judgment on October 16, 1985.

- On January 14, 1986, the federal district court for the district of North Dakota granted DOE's motion for summary judgment for foreclosure. The court ruled that North Dakota state law, which would have permitted GPGA to redeem the property within 1 year of foreclosure, was not applicable.

- On April 3, 1986, the Department of Justice, on behalf of DOE, filed a proposed foreclosure order with the North Dakota federal district court. The proposed order provided that the project assets were to be sold at a foreclosure sale at the Mercer County Courthouse in North Dakota on May 28, 1986. The order essentially provided for all assets held by GPGA to be sold as one unit to the highest bidder with no right of redemption by the former owners.

- On April 7, the federal district court signed the order.

- On April 18, GPGA filed a motion with the court to correct errors in the property descriptions and to defer the foreclosure sale date for at least 6 months in recognition of the partners "right of equitable redemption" under federal common law.

- On May 8, 1986, the court denied GPGA's motion for equitable redemption rights but granted its motion to correct certain property descriptions. The court also ordered the notice of the foreclosure sale to be republished with the corrected property descriptions and rescheduled the sale to be held on June 30, 1986.

- On June 30, 1986, ANR Gasification Properties Company, a partner of GPGA, filed a notice of appeal concerning the January 14, April 7, and May 8, 1986, federal district court foreclosure orders. The appeal is being heard in the U.S. Court of Appeals for the Eighth Circuit. The appeal argues that the North Dakota federal district court erred in (1) ruling that state foreclosure law did not apply and (2) denying GPGA's motion for equitable redemption rights. All routine written submissions from the parties involved were filed with the court, and oral arguments to the court were scheduled for January 14, 1987.

- On June 30, 1986, the foreclosure sale was held, and the Great Plains property was formally sold to the United States of America on behalf of DOE. DOE entered a bid of $1 billion, representing a portion of the loan DOE had guaranteed. The bid did not involve the expenditure of any additional federal dollars. No other bids were presented at the sale.

- On July 16, 1986, following confirmation of the sale by the court, a Marshal's Deed to the foreclosed property was issued to DOE. The deed was filed with the Mercer County Register of Deeds on July 17, 1986.

ANG PROJECT ADMINISTRATION AGREEMENT

- On December 16, 1986, DOE and ANG finalized a new agreement under which ANG will continue to operate the Great Plains project under DOE's direction. The basic agreement is for a 1-year period ending September 30, 1987. The agreement is renewable at DOE's option for 6-month periods with 30 days advance notice.

- Among other things, the agreement generally provides that:

  --ANG has no authority to act as an agent of DOE.

--ANG will be responsible for operating the plant, assuring supplies, and producing and marketing the plant's products.

--All routine actions taken by ANG as project administrator are subject to the exclusive direction and control of the Secretary of Energy.

--ANG will be reimbursed for actual operating costs allowed under the agreement, plus a fixed fee.

--ANG will incur no liability as a result of actions taken, or not taken, at the direction of DOE.

- The agreement provides that ANG will be paid a fixed fee for each 6-month period of its performance under the agreement, commencing on October 1, 1986. Under the fee schedule, ANG will receive $3 million for its services during the first year of the agreement. For each additional 6-month period that the agreement is renewed through March 1989, ANG will receive a fee slightly in excess of $1.5 million.

SUPPLY CONTRACTS

- The contract for supplying electric power to the plant is a 35-year contract between Basin Electric Power Cooperative and ANG that requires a 10-year advance written notification to terminate. The power is obtained from Basin Electric's Antelope Valley Station, which is located adjacent to the Great Plains gas plant.

  -- In June 1986, the Antelope Valley Station's second generating unit was placed in service, triggering a change in the rate paid by Great Plains. Under the new rate structure, the cost of power to the gas plant has been reduced.

  -- ANG had anticipated in its 1986 budget that the new rate structure would save about $9.7 million annually. However, billings received since the rate change indicate the savings will be about $8.1 million per year.

- The contracts for supplying coal to the project and Basin Electric's power plant are separate 25- to 35-year contracts between ANG and Coteau Properties Company, Basin Electric, and Great Plains.

- According to DOE officials, DOE has no liability under current supply contracts (e.g., coal purchase agreements, Basin Electric agreement) because it is not a party to any of those contracts.

GAS PURCHASE AGREEMENTS

- Following the August 1, 1985, default by the partners, DOE took the position that the separate 25-year gas purchase agreements with the affiliated pipeline companies remained valid and enforceable and that the pipelines were obligated to continue purchasing gas from the project.

- On August 19, 1985, Natural Gas Pipeline Company, a unit of MidCon Corporation, filed action in Washington, D.C., and Illinois asking the federal district court for the District of Columbia and the circuit court of Cook County, Illinois, to declare its gas purchase agreement void. The Illinois case was dismissed and the Washington case was transferred to the federal district court in North Dakota.

- As part of its August 29, 1985, foreclosure lawsuit in the federal district court in North Dakota, DOE asked the court to uphold the gas purchase agreements; the state of North Dakota intervened in the case on the side of DOE.

- On October 25, 1985, Tennessee Gas Pipeline Company, an affiliate of Tenneco, Inc., filed action in North Dakota asking the federal district court to either terminate its gas purchase agreement or approve its payment for Great Plains gas at the lower market value of other gas on its system.

- Since the August 1, 1985, loan default, all four pipeline companies have continued to accept their proportionate share of the synthetic natural gas produced at the plant. However, at varying points, three of the four companies discontinued payment at the formula price and began paying at a lower market price.

- On January 14, 1986, the federal district court in North Dakota upheld the validity of the gas purchase agreements. Since then, the four pipeline companies have paid the billed formula price. The pipeline companies have also paid all past due amounts for gas purchases since the August 1 loan default, plus interest.

- Transcontinental Gas Pipe Line Corporation (Transco), one of the four affiliated pipeline companies, still owes the project about $400,000, including interest for gas purchases before the August 1, 1985, loan default. This past due amount is still the subject of litigation in the North Dakota federal district court.

- On March 25, 1986, Transco, which purchases 25 percent of Great Plains gas, notified ANG that, due to a sharp decline in its gas markets, it might be unable to continue purchasing the gas. Transco cited the "force majeure" provision of its gas purchase agreement which, according to

Transco, provides for relief from performance under the agreement in the case of unforeseen events beyond the company's control that preclude the company from meeting its contractual obligations.

- On April 8, 1986, the Department of Justice, acting on behalf of DOE, responded to Transco's letter by stating that it did not agree that a decline in Transco's markets caused by market conditions constituted a force majeure under the agreement. The Department also stated its view that any attempt by Transco to refuse either to accept or to pay its share of Great Plains gas would violate the North Dakota federal district court's January 14, 1986, decision on the validity of the gas purchase agreements.

- On May 8, 1986, ANG notified DOE that the agreements between the four pipeline companies that purchase the Great Plains gas and the gas transportation pipeline (Northern Border Pipeline Company) would expire in July 1986. While DOE and ANG are not parties to those agreements, the continuation of the pipeline agreement is necessary to transport the Great Plains gas from the project's pipeline to the four pipeline companies. ANG told DOE that it may be necessary to discontinue gas production if new agreements were not executed and Federal Energy Regulatory Commission authorizations were not obtained before the existing agreements and authorizations terminated.

- In late May 1986, Northern Border Pipeline Company obtained signed agreements with each of the four pipeline companies that it would continue to transport Great Plains gas to them for 1 year. Northern Border Pipeline Company also applied for and received a temporary certificate from the Federal Energy Regulatory Commission to continue transporting Great Plains gas through July 27, 1987.

- On May 15, 1986, the judge of the North Dakota federal district court who had ruled in January on the validity of the gas purchase agreements, certified the decision to the U.S. Court of Appeals for the Eighth Circuit.

- In June 1986, three of the four pipeline companies filed notices of appeal of the federal district court's order upholding the gas purchase agreements. The appeals are being heard jointly in the eighth circuit court. All routine written submissions from the parties involved were filed with the court, and oral arguments to the court were scheduled for January 14, 1987.

EXPENSES INCURRED UNDER SPECIAL JUNE 24, 1985, OPERATING AGREEMENT

- Faced with the uncertainty of federal price supports and the financial impact of continuing operations, a special operating agreement was effected between DOE, GPGA, and the GPGA partners for the period from June 24 to July 31, 1985.

  -- The agreement was aimed at keeping the plant in operation through July 1985 while negotiations for federal price support were expected to be settled.

  -- The agreement enabled the Great Plains partnership to delay interest and guarantee fee payments and additional equity contributions until August 1, 1985.

- According to DOE, the Great Plains partners and their parent companies are liable for all expenses incurred during the period (including operational costs and capital and inventory costs).

- The partners' auditors (Arthur Andersen & Co.) stated in a September 10, 1985, report that GPGA's accounts payable and accrued liabilities were presented fairly as of July 31, 1985, and that they found no unrecorded liabilities.

- On September 23, 1985, GPGA made a cash payment of $441,000 as its final payment of costs under the special agreement with DOE. This was in addition to $13 million the partners paid in August 1985.

- DOE sent an October 2, 1985, letter to ANG stating that DOE does not consider GPGA's payments the final amounts due.

- On November 7, 1985, DOE requested its Inspector General to conduct an audit and render an advisory opinion on the GPGA partners' costs under the special agreement. On January 27, 1986, the Inspector General reported that the partners' and their parent companies' remaining liability totaled about $44.3 million.

- ANG billed GPGA for the $44.3 million on February 12, 1986, and sent copies of the billing to the partners and the partners' parent companies. GPGA and several of the partners' parent companies advised DOE in March that they disagreed with the scope of the liability. They also requested access to pertinent records. Certain Inspector General audit records were made available to GPGA in April.

- In a June 13, 1986, letter to DOE, GPGA cited three specific areas on which it disagreed with DOE's interpretation of provisions contained in the special agreement.

- In its July 30, 1986, response to GPGA, DOE generally rejected the issues raised but, based on a review of one of the issues, notified GPGA that the remaining liability would be reduced by about $8.1 million.

- On August 6, 1986, at DOE's direction, ANG sent a revised bill to GPGA for $36.2 million. As of December 23, 1986, ANG was continuing to carry the $36.2 million as an account receivable on the project's accounting records.

- DOE's Office of General Counsel is responsible for resolving the disputed GPGA liability.

SECTION 4

DOE'S OPTIONS FOR GREAT PLAINS

DOE is continuing to evaluate its options for the future of the Great Plains project. The options are to continue to operate the plant, sell it or lease it, shut down the plant until a buyer or lessee is found, mothball it, or scrap the plant. The pros and cons of each option are being considered in terms of the potential value or costs to the federal government and socioeconomic impact on the state of North Dakota. DOE told us it has not eliminated any of the options. Pending a final decision on the plant's future, DOE intends to continue operating the plant as long as additional taxpayer funds are not expended.

DOE'S PROGRESS IN EVALUATING OPTIONS

- In November 1985, DOE's Assistant Secretary for Management and Administration filed a deposition in the federal district court in North Dakota which stated, among other things, that, following foreclosure, DOE may sell or lease the Great Plains project to an appropriate buyer or lessee, who would be bound by the gas purchase agreements and would make a good faith effort to keep the facility in operation for the duration of the gas purchase agreements.

- On February 13, 1986, DOE placed an announcement in the Federal Register requesting any public and private sector organizations that may be interested in acquiring the plant to submit statements of interest and informational proposals by April 4, 1986. The announcement emphasized that DOE was not soliciting specific proposals for the purchase of the facility, but was seeking information to assist the Department in identifying qualified prospective offerors and determining which option for disposition of the facility would be the most appropriate and advantageous for both the citizens of North Dakota and the U.S. taxpayer. It also indicated that any submissions of interest must state the organization's commitment to operate the facility for the duration of the gas purchase agreements. A DOE news release concerning the announcement stated that DOE's objectives are to

  -- transfer ownership of the plant and remove the federal government as a direct competitor in the gas production business,

  -- recover as much of the federal funds provided to cover the loan default as possible, and

  -- assure continued long-term operation of the plant to avoid disruptions to the local economy and to capture the benefits associated with the extended plant operations.

- DOE received nine statements of interest in response to its Federal Register notice. According to DOE, the statements ranged from interest in purchasing the plant, to operating it for the government, to buying its gas or by-products.

- On May 21, 1986, DOE mailed requests for proposals to 51 investment banking-type companies to acquire services to assist it in the disposition of the plant and assets. Proposals were to be submitted by June 20, 1986.

- On August 8, 1986, DOE cancelled the May 21 request for proposals in order to broaden the solicitation to also include assistance in selling Naval Petroleum Reserves and an energy research facility.

- A revised request for proposals was issued on October 9, 1986, and distributed to 116 potential offerors. Under the revised request, in assisting with the sale of Great Plains, the successful bidder will

  -- submit a marketing plan for the divestiture of the plant and its assets (due 10 weeks after the contract award),

  -- prepare a sales prospectus,

  -- provide DOE with briefings of the project status and proposed sales arrangements,

  -- conduct a diligent search for acceptable purchasers and provide analyses of prospective buyers and financial arrangements to DOE, and

  -- perform all other activities necessary to assist DOE in completing the sale.

- The solicitation envisions that the firm selected will receive a percentage of the selling price as its fee. The firms responding were to specify in their proposals what percentage they would accept as their fee.

- DOE expects to complete its evaluation of the proposals received and award a contract by late February 1987.

SECTION 5

GREAT PLAINS OPERATIONS

The Great Plains plant is the nation's first commercial-scale facility producing synthetic natural gas from coal. Project construction began in August 1981 and was completed in December 1984, as scheduled. The plant has been producing and selling synthetic gas since July 1984 as part of the operational startup and testing process. During 1985, the plant met production performance standards for commercial operations. Some technical problems remain and modifications are needed to meet both design specifications and environmental control agreements.

GPGA appointed ANG as project administrator responsible for the plant's construction, startup, and operation. A management committee composed of representatives from each of the sponsoring partners provided overall direction to ANG. DOE's Office of Assistant Secretary for Fossil Energy was responsible for monitoring project construction and operations. The day-to-day monitoring of the project was delegated to DOE's Chicago Operations Office. When GPGA defaulted on its federally guaranteed loan on August 1, 1985, DOE directed ANG to continue plant operations until further notice.

According to DOE, any decision on plant operations will be made independently of the decision on the ultimate future of the project. Further, DOE does not believe that operating the project during the transition period will result in further costs or economic risk to the U.S. taxpayer as long as project revenues continue to exceed project expenses.

PROJECT MANAGEMENT

- Since the notice of default, DOE's Office of Assistant Secretary for Fossil Energy has been providing direction to ANG through DOE's Chicago Operations Office.

- DOE and ANG stated that they are continuing to work closely together to cut costs and increase operating efficiencies.

- DOE receives a number of reports from ANG to assist it in monitoring the project's operations. They include

  -- a new monthly report of project financial operations called "Statement of Operations and Related Estimates" (this report replaces the project cost report provided previously);

  -- weekly and monthly cash flow reports detailing actual and projected receipts and disbursements;

-- monthly project status reports that summarize the financial, operational, and administrative aspects of the project;

-- monthly capital project reports describing the engineering, procurement, construction, and cost expenditure status of each approved project; and

-- other reports, prepared as appropriate, to assist in the project's financial and operational management.

- Each month DOE and ANG managers conduct technical progress meetings to discuss plant operations and financial status review meetings to discuss the project's financial operations.

- ANG is proceeding with a program to dispose of surplus project property, which consists primarily of items left over from the plant construction period. As of December 23, 1986, the program had resulted in the sale of nine mobile homes, several residences, kitchen equipment, and various other surplus assets such as excess vehicles.

PLANT EMPLOYMENT

- Table 5.1 shows the month-end employment at the gas plant of both permanent and contract employees from July 1985 through November 1986.

Table 5.1: Great Plains Employment From July 1985 Through November 1986

	Permanent	Contract	Total
1985			
July	977	376	1,353
August	966	211	1,177
September	961	187	1,148
October	934	176	1,110
November	882	99	981
December	873	86	959
1986			
January	873	77	950
February	871	83	954
March	871	107	978
April	867	212	1,079
May	866	109	975
June	863	121	984
July	859	179	1,038
August	858	174	1,032
September	856	158	1,014
October	857	272	1,129
November	857	147	1,004

- From October 1985 through January 1986, 56 permanent employees were involuntarily terminated as part of a reduction-in-force to reduce operating costs. ANG told us that probably none of those employees would have been terminated at that time if it had not been for the need to reduce operating expenses. An additional 113 contract personnel were released during November and December 1985 to reduce costs further. Many of the released personnel were field and office technicians, and the others were building and equipment maintenance workers, supervisors, engineers, and support staff.

  -- ANG officials told us that personnel costs related to the contract personnel ceased immediately upon their termination.

  -- ANG also said that the termination of the permanent employees resulted in a monthly cost savings of about $100,000. Under company severance policies, the permanent employees generally continued to receive from 1 to 2 additional months of pay and benefits depending upon their length of employment.

- No reduction-in-force actions have been taken since January 1986, and we were told by ANG that none are planned.

- From August 1985 through November 1986, 92 permanent employees voluntarily terminated their employment at the plant. ANG estimated that about 65 percent were either highly skilled technically or were in key supervisory positions.

- The most seriously felt skill losses have involved electronic instrumentation technicians and certain key engineering positions. In certain cases, contract personnel were used to cover these areas while permanent staff were trained internally to fill the positions. ANG told us that these skill shortages have been corrected and that no critical skill shortages currently exist.

- ANG officials attributed much of the voluntary staff turnover to the uncertainties that existed regarding the plant's future operations. To minimize future losses of critical staff, DOE approved a temporary 3-point program to better protect employees in the event of a plant shutdown. The program generally increased severance pay benefits to a minimum of 6 months, extended the period of time that outplacement services are available, and increased ANG's contributions under its employee savings plan for a 3-year period.

- ANG believes these increased incentives for staying with the project have effectively countered the employee attrition that related to the uncertain plant future. Permanent employee levels were relatively stable in 1986.

- The number of contract employees increased significantly during April and October 1986, when about 100 were added temporarily to assist with scheduled routine annual maintenance. Contract employee levels were also higher in some months for work related to capital improvement projects.

- As of December 23, 1986, neither DOE nor ANG anticipated any significant changes in employment levels at the project. ANG planned to keep the permanent work force level steady and to bring contract employees in when needed.

PLANT PRODUCTION

- During 1985, Great Plains produced about 40.4 billion cubic feet of gas. Plant production averaged about 80.6 percent of the design capacity rating of 137.5 million cubic feet per day.

- During the first 11 months of 1986, Great Plains produced about 45.7 billion cubic feet of gas. Plant production averaged about 99 percent of the design capacity rating.

- Table 5.2 shows the average daily gas production since August 1, 1985.

Table 5.2: Average Daily Gas Production From August 1985 Through November 1986

	Average daily production (million cubic feet)	Average percent of design capacity rating
1985		
August	118.6	86.3
September	125.3	91.1
October	140.7	102.3
November	135.4	98.5
December	119.1	86.6
1986		
January	138.2	100.5
February	139.1	101.2
March	145.8	106.0
April	125.1	91.0
May	138.3	100.6
June	139.2	101.2
July	133.9	97.4
August	134.8	98.0
September	137.6	100.1
October	126.1	91.7
November	140.0	101.8

- The Great Plains project is designed to use a small amount of its own gas production for internal operating purposes. The gas production shown in table 5.2 was the amount delivered to the pipeline companies to generate project revenue.

- The 137.5 million-cubic-feet-per-day design capacity rating is based on an operating mode using 12 of the plant's 14 gasifiers. Based on an October 1985 test, ANG began running 13 of the 14 gasifiers as the normal operating mode in December 1985.

- The production drop in December 1985 was due to operational problems.

- -- The plant operated at about 50 percent of capacity for about 4 days early in the month when one gasification train (the plant has two rows of seven gasifiers called trains) was shut down for maintenance. During this shutdown, distillation equipment in the ammonia recovery unit also failed.

- -- A second production drop occurred later in the month when an electrical problem led to a loss of oxygen pressure in the power supply system at the oxygen plant, causing the plant to be unable to deliver gas to the pipeline for 13 hours.

- Production rates from January through November 1986 remained fairly stable.

  -- Except for a 6-day period from April 28 to May 3 and another short period in October when production rates were reduced for scheduled annual maintenance, the plant experienced only 8 days when production rates fell below the project's 1986 production goal of 91 percent of the design capacity rating. Four of the days occurred from April 9 to 12 when problems in an oxygen plant caused gasification train B to go down.

  -- The longest period during which the project did not deliver gas to the pipeline was 14 hours and 24 minutes on December 9, 1986, when both gasification trains tripped off due to low steam pressure.

- In a July 11, 1986, letter, ANG notified DOE that it would no longer operate the plant in excess of the original plant design capacity rating of 137.5 million cubic feet per day unless DOE (1) instructed it to exceed the rating and (2) provided assurance that ANG would be indemnified against all liabilities arising out of operating the plant.

- DOE told us that it has decided that the plant should not be operated to exceed the design capacity rating until studies to determine the plant's maximum and optimum operating levels are completed. As of December 23, 1986, ANG was continuing to maintain average monthly production levels at or near the design capacity rating.

- ANG performed a production capacity test in August 1986. The test did not detect any equipment limitations at production levels up to 156 million cubic feet per day. The test was ended when a mechanical problem occurred which required ANG to reduce production rates.

- In early October ANG requested DOE's approval to conduct a second plant capacity test. This test was begun on December 2, 1986; it addresses plant safety, equipment life, and sulfur emission concerns at various operating levels.

-- During the test, production is being increased gradually and plant equipment is being monitored at each of the operating levels.

-- The test is intended to determine the maximum operating rate (the highest production rate that can be achieved without exceeding the integrity and safety of the plant equipment). DOE told us that the maximum operating rate is expected to be about 160 million cubic feet per day.

-- After reaching the maximum operating rate, the production level will be reduced to an optimum operating rate (the most desirable and efficient production level), which DOE expects to be about 150 million to 155 million cubic feet per day. The plant will operate at or near the optimum level for a short period to collect technical and environmental emission data.

-- As of December 23, 1986, the second rating test was still underway.

- In addition to determining the existing plant's production capacity, DOE authorized ANG, on November 6, 1986, to proceed with a detailed study of specific plant modifications that would be needed to exceed the optimum operating rate by eliminating certain design bottlenecks that limit production. This study is underway by a private contractor and is expected to take about 4 months.

FINANCIAL OPERATIONS

- On June 17, 1986, DOE directed that, for the purpose of preparing financial statements, ANG should consider the plant as being "in-service" as of August 1, 1985. The declaration of in-service status caused certain changes in project financial reporting procedures. For example:

-- Operating revenues and expenses are reported on a profit or loss basis. During the startup phase that preceded in-service status, operating costs incurred in excess of revenues were capitalized as property, plant, and equipment.

-- Accumulated depreciation is recognized from the point in-service status began. For depreciation purposes, project assets are being valued at DOE's acquisition cost of about $1.6 billion. Plant depreciation is being computed on a straight-line basis, assuming a 25-year life and no salvage value.

-- Certain surplus project assets are recognized at estimated disposal value rather than acquisition cost.

-- Rental payment receipts from the mine operator for equipment furnished to the mine are treated as an offset to the cost of coal purchased, rather than as a separate revenue item.

- Arthur Andersen & Company audited the financial statements for the 11-month in-service period that ended June 30, 1986. In its October 6, 1986, report, Arthur Andersen expressed its opinion that the financial statements presented fairly the financial position of the Great Plains coal gasification project subject to future determination of the project's true market value, the outcome of ongoing litigation, and the uncertain collectibility of accounts receivable from GPGA.

- The Great Plains project has converted from a calendar business year to a fiscal business year ending each June 30th. DOE had previously approved an operating budget for the 1986 calendar year. Accordingly, the next operating budget that DOE approves will cover the 6-month period from January through June 1987.

Comparison of operating costs with selling prices

- Plant operating costs per million Btu's of gas sold have generally stabilized following cost improvement actions ANG implemented in late 1985, while gas selling prices have generally declined, as shown in table 5.3.

Table 5.3: Comparison of Monthly Operating Costs and Gas Selling Prices

	Operating cost	Selling price
	----(per million Btu's)----	
1985		
August	$4.71	$5.02
September	4.50	5.55
October	3.64	5.86
November	3.62	6.22
December	4.52	6.27
1986		
January	3.56	5.71
February	3.78	4.15
March	3.35	3.68
April	3.88	3.48
May	3.37	3.37
June	3.74	3.14
July	3.46	2.56
August	3.27	2.93
September	3.46	3.26
October	3.65	3.04
November	2.82[a]	3.04

[a]The reduced November operating cost is primarily due to lower November utilities charges. Basin Electric reduced the November utility billing to Great Plains to reflect a one-time credit adjustment of earlier Great Plains payments for shared facilities.

Cash flow from operations

- Since the August 1, 1985, loan default, the project cash position has improved substantially, as shown in table 5.4.

Table 5.4: Great Plains Cash Position

	Beginning cash balance	Receipts	Disbursements
	-----------(millions of dollars)------------		
1985			
August	$ 1.4	$ 32.5	$ 19.3
September	14.6	17.9	23.6
October	8.9	19.4	19.9
November	8.4	20.3	14.1
December	14.6	21.0	18.1
1986			
January	17.5	13.6	21.6
February	9.5	36.1	15.7
March	29.9	34.8	18.1
April	46.6	36.2	13.4
May	69.4	16.4	18.8
June	67.0	18.1	22.7
July	62.4	16.4	17.5
August	61.3	14.7	16.0
September	60.0	16.0	17.2
October	58.8	17.0	17.0
November	58.8	15.5	12.2
December	62.1	a	a
Total		$345.9	$285.2
Monthly average		$ 21.6	$ 17.8

[a]Data not available as of December 23, 1986.

Receipts

- Monthly cash receipts have varied for the following reasons.

  -- Under terms of the June 24 to July 31, 1985, special operating agreement, the GPGA partner companies contributed $13 million in August and an additional $441,000 in September.

  -- At varying points from August through December 1985, three of the pipeline companies began paying the market price rather than the formula price for the gas.

-- One of the four companies initially withheld all payments from August through October before making catch-up payments in November based partly on the market price of gas.

-- The increased receipts during February through April 1986 were due primarily to the receipt of about $40 million in past-due payments and interest from the gas pipeline companies.

Disbursements

- Certain cyclical-type payments are made either annually, quarterly, or at other times during the year (to fund the employee retirement plan, for insurance premium payments, for capital improvement expenditures, etc.).

- On June 30, 1986, ANG paid about $7 million owed to Basin Electric for shared facilities. Under agreements with Basin Electric, Great Plains is required to pay depreciation and maintenance costs for shared facilities.

Revenues earned and expenses incurred

- From August 1985 through November 1986, monthly revenues earned from the sale of synthetic natural gas and by-products (ammonia, tar oil, sulfur, and nitrogen) and from other sources ranged from $11.6 million to $26.3 million and averaged $18 million. Monthly project expenses during that period ranged from $11.5 million to $19.3 million and averaged $14.7 million.

- The monthly revenues earned and expenses incurred by the project from August 1985 through November 1986 are shown in table 5.5.

Table 5.5: Monthly Revenues and Expenses From August 1985 Through November 1986

	Total revenue earned	Total expenses incurred
	--------(millions of dollars)--------	
1985		
August	$ 19.0	$ 19.3
September	21.6	18.4
October	26.3	15.4
November	25.9	14.3
December	23.9	16.2
1986		
January	25.2	14.7
February	17.4	14.2
March	18.2	14.6
April	14.8	14.2
May	16.0	14.2
June	14.5	15.8
July	11.6	13.5
August	13.0	12.5
September	14.1	13.1
October	12.8	13.8
November	13.3	11.5
Total	$287.6	$235.7
Monthly average	$ 18.0	$ 14.7

- The revenues earned for August through December 1985 reflect ANG's recomputed gas prices using the substitute pricing formula discussed on page 8.
- The reduction in revenues earned since January 1986 reflects the drop in the price of No. 2 fuel oil, which is used to determine the maximum price the pipeline companies pay for Great Plains gas.
- The reduction in November 1986 operating costs resulted primarily from a one-time credit received from Basin Electric to adjust earlier Great Plains payments for shared facilities.
- ANG is recording accumulated project depreciation of about $5 million monthly from the August 1, 1985, in-service date.

- ANG has been conducting an internal cost improvement program to reduce project operating costs. According to ANG, reduced plant expenditures to date have resulted primarily from

  -- cancellation of all capital projects other than those essential to the continued operation of the plant,

  -- reduced personnel costs, and

  -- a rate reduction for power purchased from Basin Electric that became effective in June 1986 (see p. 11).

- An August 1985 payroll of about $1.6 million was paid from funds that had been transferred from the project's appropriated loan guarantee default reserve fund. At DOE's direction, ANG restored the $1.6 million to the default reserve fund in December 1985. All other operating expenses since August 1, 1985, have been paid from project revenues.

- Meridian Land and Mineral Co. owns two coal lease tracts containing about 35 million tons of coal within and around the Freedom Mine, which supplies Great Plains. On November 8, 1984, ANG approved an agreement whereby Meridian would sell all remaining unmined coal to Coteau Properties Company. Under the agreement, ANG and Basin Electric were to share in the cost on roughly a 50/50 basis. ANG did not make the approximately $2.3 million payment that was due on October 1, 1985, in order to preserve available funds for operating capital. ANG renegotiated to pay the $2.3 million plus interest in monthly installments through July 1986. All monthly payments under the renegotiated payment schedule were made on time.

CAPITAL IMPROVEMENTS/CRITICAL PROJECTS

- Prior to the loan default, the Great Plains budgets for 1985 and 1986 provided $81 million for 150 plant modification projects, including modifications to meet odor, air, and water quality standards.

- After the loan default, DOE instructed ANG not to make any capital improvements without its approval.

- In August 1985, ANG identified 50 capital improvement projects for further consideration. About $10 million had already been spent or committed for many of these projects. ANG estimated that an additional $15 million would be needed to complete all 50 projects.

- In September 1985, ANG reviewed capital improvement projects to identify those considered essential for plant operations and to assure workers' health and safety, or those that would increase operating efficiencies.

- Based on this review, ANG requested approval of three "urgently needed" capital improvement projects estimated to cost an additional $571,600.

  -- DOE approved two of these projects with combined estimated costs of $71,600. The projects, which were intended to provide cost-effective solutions to address environmental situations requiring immediate attention, have been completed.

  -- DOE rejected ANG's request for a cooling tower windwall project estimated to cost $500,000. This project would have provided for the erection of steel structures to prevent the wind from causing water losses and ice buildup in the plant's cooling tower.

- DOE determined that certain capital improvement projects started before August 1, 1985, would not be completed. These projects were cancelled and their related costs of about $6.8 million were charged to operations and written off the project books.

- ANG, in consultation with DOE, has continued to work with the North Dakota State Department of Health on specific projects aimed at reducing odor problems. Four capital improvement projects, completed as of November 30, 1986, achieved required odor compliance.

- According to DOE, sulfur emissions continue to be an environmental concern associated with the project. The plant's Stretford sulfur recovery process has not met its design specifications.

  -- The Stretford sulfur recovery unit was installed to remove hydrogen sulfide from the gas stream and to convert it to sulfur. Due to its first-of-a-kind application and to the unique process configuration, several adjustments to the process were made during and after the startup of the unit to achieve design specification performance. After a variety of modifications, the unit is still operating below design levels for sulfur removal.

  -- According to DOE officials, the unit has never operated for more than 12 consecutive days before plugging up. Minor modifications upstream of the unit and within the unit are being explored. A pilot plant is being used to analyze gas streams going into the unit. DOE officials told us that the installation of new, additional, or alternative systems is not likely at this time because they could be very costly--perhaps $40 million to $60 million--and there is no assurance that other systems would work any better.

- On July 29, 1986, the North Dakota State Department of Health notified ANG and DOE that the project was in violation of emission standards set forth in the Permit To Construct. In a preliminary response dated October 29, 1986, DOE notified the state that it planned to conduct additional facility testing. DOE expects ANG to complete testing to collect environmental emissions data that will form the basis for (1) the ANG/DOE response to the notice of violation for sulfur dioxide emissions and (2) the application of a new permit to operate. The ANG/DOE response to the North Dakota State Department of Health is expected to be prepared by mid-March 1987.

- DOE approved 12 of the capital improvement projects recommended by ANG for 1986. As of December 23, 1986, seven of these projects had been completed, two were underway, two were cancelled by ANG since they were not required at that time, and one had been postponed until 1987. DOE approved two additional capital improvement projects during 1986.

- Because certain projects were completed under budget and others were postponed, about $3 million of the $7.1 million budgeted for 1986 capital improvements will be carried over to 1987.

- ANG told us that its 1987 capital improvements budget will cover the 6-month period from January through June 1987 and is expected to include about four new environmental and health-related projects with an estimated total cost of about $1 million.

PLANT MAINTENANCE

- In accordance with DOE's instructions, ANG has continued to maintain plant equipment and facilities to assure efficient plant operations. According to both DOE and ANG, all routine maintenance has been performed on schedule.

- The principal scheduled, routine annual maintenance that is required is to replace spent catalyst material in methanation systems downstream from the gasifiers. The plant's gasification systems are configured into two equipment trains (trains A and B), allowing a portion of the plant to be shut down for the annual scheduled catalyst changes while the remainder of the plant continues to operate at or above 50 percent of the design capacity rating. Methanation train B was shut down for the catalyst change for 2 weeks in May 1985 and again for about 6 days beginning in April 1986. Train A was shut down for about 8 days in August 1985 and again for about 6 days in October 1986. The cost of this scheduled routine maintenance is about $2 million to $3 million annually.

OPERATIONAL ALTERNATIVES

- On the average, over 90 percent of the plant's earned revenues are from the production and sale of synthetic natural gas. The by-products that have been marketed (sulfur, ammonia, and coal tars) have accounted for only a small percent of revenues recorded. ANG is continuing to study the potential for increasing revenues by developing and marketing additional by-products.

- ANG indicated in February 1986 that carbon dioxide, a major by-product not now marketed, potentially could yield about $10 million or more annually in additional revenues if

  -- future increases in world oil prices make enhanced oil recovery techniques using carbon dioxide injection feasible for domestic oil reserves and

  -- an adequate supply could be guaranteed for a long period through assurances of the project's continued operation.

- ANG also told us that tar oil and other by-products could ultimately earn several million dollars annually with some additional capital investment and the development of new customer markets.

- During September 1986, ANG began selling a fourth by-product (nitrogen). At about that same time ANG lost its only active market for coal tar, which was being sold as a wood preservative, and sales of that by-product ceased for the remainder of 1986.

- ANG has also explored the potential for increasing revenues by reconfiguring the plant to produce other liquid products from the gas that have a higher market value. ANG's preliminary studies indicated that it may be feasible to reconfigure a portion of the plant's capacity to produce other principal products. In a September 3, 1985, letter to DOE, ANG recommended further investigation of seven such other products; its first preference was jet fuel, followed by a combination of jet fuel and gasoline. Ammonia and methanol were included among the other products recommended for study. DOE authorized an in-house study by ANG to evaluate the potential of those products further.

- ANG spent about 5 staff-months in reviewing operational alternatives and discussed the results with DOE on November 26, 1985. Citing the gas pricing agreement litigation and cash flow constraints, DOE instructed ANG in December 1985 to discontinue further work on the study.

- On October 16, 1986, DOE announced that it had initiated a study to (1) determine if Great Plains fine coal particles (coal fines), which are currently diverted for use in Basin

Electric's adjacent coal-fired power plant, could be more economically used to produce electricity at the gas plant and (2) investigate the potential for producing additional commercial liquid by-products.

- ANG told us that it expects to participate during 1987 in a Department of Defense program to test jet fuel derived from tar oil by providing technical support to the program contractor.

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