

GAO

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URANIUM ENRICHMENT

Observations on the
Privatization of the
United States Enrichment
Corporation

Statement of Victor S. Rezendes,
Director, Energy and Science Issues,
Resources, Community, and Economic
Development Division



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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to present our observations on the possible privatization of the U.S. Enrichment Corporation (USEC) which was established by the Energy Policy Act of 1992 (the act). For several years prior to the act's passage, we strongly supported the restructuring of the Department of Energy's (the Department) uranium enrichment program so that the program could be operated in a more business-like manner.

Our testimony will describe our responsibilities under the act to evaluate the privatization plan that USEC is required to develop by July 1995. We will also briefly discuss the criteria we think should be used to evaluate any proposed draft amendments to the act. We understand that the proposed amendments currently under review are directed toward facilitating the privatization of USEC and increasing the revenues gained by the federal government upon the eventual sale of USEC.

In summary, the act requires us to review the privatization plan developed by USEC before it is implemented. We are required to report to the Congress on whether the revenues expected to be received from the sale of USEC under the plan will meet or exceed USEC's net present value. Our report will also evaluate the extent to which the plan will result in any ongoing obligations or undue costs to the government.

With regard to the draft amendments, we believe each proposed amendment to the act should be carefully evaluated from two perspectives. First, do the proposed amendments properly balance efforts to increase the value of USEC with the need to foster open competition between the private corporation and its competitors? And second, would the increased liability or costs that the government assumes, if the proposed amendments are adopted, be worth the increased returns to the government? We believe that certain steps to transfer some risks and liabilities to the

government may be justifiable in terms of increasing the government's revenues from the eventual sale of USEC. However, these and the other proposed draft amendments, such as transferring all of USEC's liabilities to the government if it is privatized, need to be carefully evaluated.

GAO'S REQUIREMENT TO EVALUATE USEC'S PRIVATIZATION PLAN

The act requires USEC to prepare a strategic plan for transferring ownership of USEC from the government to private investors. The plan, which is to be submitted to the President and the Congress by July 1995, is to include an evaluation of alternative means for transferring ownership to the private sector, including a public stock offering or a merger. USEC may only implement the plan after the President approves it and if certain other conditions are met. For example, USEC must determine that the privatization will result in a return to the United States at least equal to USEC's net present value and that as a result of the sale, USEC will not be owned, controlled, or dominated by a foreign corporation or government.

If and when the corporation decides to privatize, USEC is required to notify the Congress of its intent to implement the plan. USEC may not implement the privatization plan less than 60 days after notifying the Congress. Within 30 days after that notification, we are required to submit a report to the Congress evaluating the extent to which

--the plan would result in any ongoing obligation or undue cost to the federal government; and

--the revenues gained by the federal government under the privatization plan would represent at least the net present value of USEC.

Our evaluation of the privatization plan will build on work that we did in 1992. At that time, to assist the Congress as it considered the act, we developed a cash flow model for the proposed government corporation and used the model to calculate the present value of the corporation's projected revenue streams.¹ To determine the present value of USEC if it is privatized, we will update that model to account for changes in the market since 1992, and other factors identified in USEC's privatization plan. In particular, we will focus on key factors that could materially affect the corporation's future revenue streams, such as its long-term contract with the Russian Federation to purchase enriched uranium extracted from dismantled nuclear weapons.

Another key factor affecting our determination of the net present value of USEC will be the selection of an appropriate discount rate to use in our calculation. Our previous work used a discount rate which assumed that the investment would have no risk; however, private companies would likely use a much higher discount rate to reflect their increased risk when analyzing their potential investment in the privatized corporation. Depending on the discount rate and other market assumptions used in our model, it is possible that our calculation of the net present value of USEC's revenues will be greater than the amount of money that could be realized through privatization. In that event, it may be in the government's best interest to retain ownership of USEC.

CRITERIA TO EVALUATE PROPOSED AMENDMENTS
TO THE ENERGY POLICY ACT OF 1992

We understand that the basic intent of the proposed amendments to the act is to facilitate the privatization of USEC by enhancing its value to potential investors, thereby increasing the return to the government if it is sold. Given this objective, we believe that

¹See UEC Net Present Value (GAO/RCED-92-294R, Sept. 23, 1992).

each proposed amendment to the act should be carefully evaluated from two perspectives. First, do the proposed amendments properly balance efforts to increase USEC's value with the need to foster open competition between the privatized corporation and its competitors? Second, would the increased liability or costs that the government assumes, if the proposed amendments are made, be worth the increased returns that the government is likely to receive upon privatization?

A complete evaluation of many of the proposed amendments would require a complex analysis of many legal and economic issues. Therefore, we will not be able to give you definitive answers today, since we have had little time to review the draft proposed amendments. We offer the following comments on the basis of our experience with uranium enrichment and nuclear issues.

Balancing Competitive and Investment Interests

Any proposed amendment should effectively balance competitive or free market interests with steps intended to maximize the potential return to the United States upon the sale of USEC. Several of the proposed amendments would apparently affect the competitiveness of the uranium enrichment market. For example, in the event of a nuclear accident, one proposed amendment would provide government-supported liability coverage² to an enrichment facility using the new atomic vapor laser isotope separation technology (AVLIS), that could be constructed by the new private corporation. Under current legislation, coverage under the Price-Anderson Act does not apply to uranium enrichment facilities constructed after November 1990. Should the Congress extend this coverage to an AVLIS plant, it could affect the competitiveness of other proposed enrichment

² Such government supported liability coverage is currently provided to commercial nuclear reactors under the Price-Anderson Act.

plants, such as the one proposed by Louisiana Energy Systems. On the other hand, providing such coverage may make USEC more attractive to private investors.

Another proposed amendment would require the government to turn over the exclusive commercial rights (or any other related rights) to gaseous diffusion membrane technology to USEC prior to the privatization date. The membrane technology is used in the operating enrichment plants to separate, or enrich, natural uranium into two streams, including one having a higher fissionable component that can be used as fuel in a nuclear reactor. Current law only allows USEC to apply to the Department for a patent license to use this technology. If enacted the proposed amendment may give the privatized corporation an unfair competitive advantage over other companies. The Department, which has been working on technology transfer issues related to the membrane technology for several years, may be in a better position to determine and evaluate potential uses for the technology and weigh them against obvious national security concerns. Again, these concerns need to be balanced with optimizing the investment potential of USEC.

Finally, when balancing the investment potential of USEC and competitive interests, we would ask the question of whether USEC, if it is privatized, should remain the exclusive marketing agent of the government's uranium. Under the act, USEC, which is a wholly owned government corporation, has the exclusive right to market the government's uranium, including any future sales of highly enriched uranium extracted from U.S. nuclear weapons. If privatization occurs, we believe it may be to the government's advantage to have access to a competitive market when trying to sell the extracted material.

Government Liabilities

We also believe that each of the proposed amendments should be carefully evaluated to determine if any increased liabilities the government assumes are warranted in terms of increased returns to the government upon the sale of USEC. For example, one amendment would authorize the Department, upon the request of the corporation, to accept, for treatment, disposal, and/or storage, low-level radioactive waste and mixed waste generated by the corporation as a result of the uranium enrichment operations. This amendment could alleviate investors' concerns about the potential large cost associated with waste disposal. Since the government already has large amounts of similar waste that it may need to dispose of, the amendment could be cost-effective for the government. However, we note that the proposed amendment would only require the corporation to reimburse the Department for any increase in direct costs actually incurred in dealing with the waste. It may be appropriate for the Department to be reimbursed for all costs (both direct and indirect) related to this transaction.

In other cases, the question of whether the government should assume new liabilities or continued liabilities may not be as easily answered. For example, under one of the proposed amendments the liabilities of USEC arising prior to the privatization date are treated as direct liabilities of the United States. Judgments based on USEC's operations before the privatization date are similarly treated under the proposed amendments as judgments against the United States. While this could enhance the value of USEC if it is privatized, it could expose the government to potentially large costs. For example, according to USEC officials, a group of utility customers have filed suit alleging that USEC has charged unfair prices. To date, we have not had time to fully evaluate whether the government's assumption of these liabilities is warranted.

This concludes our prepared statement, Mr. Chairman. We would be pleased to respond to any questions that you or other Members of the Subcommittee may have.

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