DIGEST - NO CIRCULATION (For 30 days: CONG.) - GGM

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

4250a

B-201035

February 15, 1984

The Honorable John D. Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives

Released by OCR, March 15, 1984.
~~DO NOT MAKE AVAILABLE TO PUBLIC READING UNTIL NOTIFIED~~ BY OCR

Dear Mr. Chairman:

By letter of October 29, 1982, you inquired whether the United States Synthetic Fuels Corporation (Corporation) is adhering to the restrictions on financial assistance placed on it by the Energy Security Act. You raise three series of questions concerning (1) the need for the Corporation to reserve funds for a proposed project which is the subject of a letter of intent or conditional commitment, and whether these monies may be reused if the project does not go forward; (2) the reuse of Federal assistance which is terminated because an assisted project is halted, either by the project sponsor or the Corporation; and (3) the right of the Corporation to reuse funds on the same project by sequentially converting one type of assistance (such as a loan guarantee) into another (such as a price guarantee).

As a general summary, we conclude that the Corporation should not reserve funds for projects merely the subject of a letter of intent, as this document has thus far been drafted and used. On the other hand, funds are required to be reserved under a certain kind of conditional commitment that the Corporation could use, but these monies may be reused for another project if the first project does not go forward.

In addition, the unused portion of a commitment of financial assistance provided to a project may be used for another project if the first project is halted. However, the portion of the financial assistance commitment already used for the cancelled project may not be reused. This standard applies to the now-terminated Colony Shale Oil Project, as well as projects assisted by the Corporation.

Moreover, the Corporation may provide for convertible assistance in a financial assistance award for a project without charging its obligational authority twice, but the form of each assistance, the dollar amount of each form of assistance, and

the terms of convertibility must be set forth in one financial assistance award. On the other hand, if subsequent to a Corporation award of assistance for a project, the project sponsor applies for another form of assistance to be available to the project dollar-for-dollar as the first assistance award is repaid, both awards must be charged against the Corporation's obligational authority.

Detailed analyses and more specific answers to each of the questions posed in the three areas of your interest follow.

Background

The United States Synthetic Fuels Corporation was created by the provisions of the United States Synthetic Fuels Corporation Act of 1980 (Corporation Act), which is Part B of Title I of the Energy Security Act, Pub. L. No. 96-294, approved June 30, 1980, 42 U.S.C. § 8702 et seq. (Supp. IV 1980). It was established as a Federal entity of limited duration formed to provide financial assistance for synthetic fuel projects of commercial size. 42 U.S.C. § 8701(b)(2)(C) (Supp. IV 1980). The Corporation is authorized to provide assistance in any of the following forms: loans; loan guarantees; price guarantees; purchase agreements; joint ventures; and acquisition and lease back of synthetic fuel projects. 42 U.S.C. § 8707(7) (Supp. IV 1980). All contracts and instruments of the Corporation to provide, or providing for, financial assistance are general obligations of the United States backed by its full faith and credit. 42 U.S.C. § 8731(c) (Supp. IV 1980). However, by the terms of the statute, the Corporation is neither an agency nor an instrumentality of the United States, except to the extent expressly provided in the Corporation Act. 42 U.S.C. § 8775(g) (Supp. IV 1980).

In part because of this ambiguous status of the Corporation, Congress provided both a special funding structure for the Corporation and a consequent special procedure which the Corporation must follow in awarding financial assistance.

Congress does not appropriate money to the Corporation. The Corporation obtains its primary funding by issuing notes or other obligations solely to the United States acting through the Secretary of the Treasury, 42 U.S.C. § 8751(a)(1) (Supp. IV 1980), when the Corporation needs funds for outlays. To purchase these notes and other obligations of the Corporation, funds are authorized to be appropriated without fiscal year limitation to the Secretary of the Treasury for deposit in an Energy Security Reserve, 42 U.S.C. § 8795(a)(1) (Supp. IV 1980). Thus far $19 billion has been appropriated into the

Energy Security Reserve. The Department of the Interior and Related Agencies Appropriations Act for Fiscal Year 1980, Pub. L. No. 96-126, approved November 27, 1979, 93 Stat. 954, 970-971. Up to $17.522 billion of this was specifically apportioned by statute for Department of the Treasury financing of Corporation activities. Supplemental Appropriations and Rescission Act, 1980, Pub. L. No. 97-304, approved July 8, 1980, 94 Stat. 857, 881-882; Department of the Interior and Related Agencies Appropriations Act for Fiscal Year 1981, Pub. L. No. 96-514, approved December 12, 1980, 94 Stat. 2957, 2974. Therefore, the monies for the synthetic fuels program are in the Energy Security Reserve in the Department of the Treasury and not in the Corporation. In essence, the Secretary of the Treasury can be viewed as a middleman between the Corporation and the Energy Security Reserve.[1]

To insure that the Corporation does not incur financial assistance liabilities or potential liabilities in excess of available appropriations in the Energy Security Reserve, the Corporation Act sets forth special procedures to be followed by the Corporation and the Treasury Department in the award of synthetic fuel financial assistance. The Corporation must specify in dollars in any contract for financial assistance the maximum liability of the Corporation under the contract, as computed in accordance with section 152 of the Corporation Act.[2] 42 U.S.C. § 8731(k)(1) (Supp. IV 1980). In addition, prior to the execution of any contract for financial assistance, the Corporation must notify the Secretary of the Treasury of its intention to enter into the contract. 42 U.S.C. § 8731(k)(2) (Supp. IV 1980). On the basis of each notification and assuming sufficient unencumbered appropriations are available in the Energy Security Reserve, the Secretary must reserve within the Energy Security Reserve an amount equal to the maximum liability of the Corporation under each proposed contract, again consistent with the provisions of section 152 of the Corporation Act. 42 U.S.C. § 8795(a)(2) (Supp. IV 1980). The Secretary must certify that he has reserved the monies for the proposed contract within 15 calendar days of his receipt of the notification from the Corporation. 42 U.S.C. § 8795(a)(3) (Supp. IV 1980). This certificate must accompany any Corporation contract for financial assistance. 42 U.S.C. § 8731(k)(3) (Supp. IV 1980).

1/ See the last portion of GAO legal opinion B-202463, March 24, 1981, for how Corporation activities are treated for budgetary purposes.

2/ Section 152 of the Corporation Act, 42 U.S.C. § 8752 (Supp. IV 1980), will be discussed in more detail below.

Thus both the Corporation and the Secretary of the Treasury have important roles in the accounting for funds available for Corporation financial assistance for synthetic fuels projects.

In addition to the special funding structure for the Corporation and the special procedure which the Corporation must follow in awarding financial assistance, section 152 of the Corporation Act, supra, establishes a ceiling on the right of the Corporation to incur obligations or make commitments, including administrative and operating expenses, of initially $20 billion plus an additional potential future authorization of $68 billion. See also, 42 U.S.C. § 8722 (Supp. IV 1980).

Specific questions

With this information as background, we now turn to the specific questions posed. In so doing, we note that we have obtained the formal views of both the Corporation and the Treasury Department on these issues. Even though in every instance we may not set forth or identify each's position on an issue, we have given all comments careful consideration before arriving at our conclusions.

Letters of Intent and Conditional Commitments

1. What is the status of the funds obligated in the letter of intent or the conditional commitment during the time given to the project sponsor to meet the conditions? Must the Treasury Department certify its availability under section 131(k) of the Corporation Act before such commitment is made?

2. Is a letter of intent less binding than a conditional commitment?

3. If a contract with the project sponsor does not result from the letter of intent or conditional commitment, does the amount promised revert to the unobligated fund category for reuse for another project?

This first series of questions concerns whether Treasury's certification process should be activated by, and the impact on the Corporation's obligational ceiling of, certain documents associated with the award of Corporation financial assistance. We find that the effect of the usual letter of intent differs substantially from that of a conditional commitment, although both are preliminary to a full Corporation commitment.

As indicated previously, the ceiling on the Corporation's obligational authority is a restraint on the right of the

Corporation to "incur obligations or make commitments." 42 U.S.C. § 8752(a) (Supp. IV 1980). In addition, Treasury's certification process is activated when the Corporation notifies the Treasury, prior to execution of a financial assistance contract, of the Corporation's intention to enter into the contract. 42 U.S.C. § 8731(k)(2) (Supp. IV 1980).

A letter of intent generally does not create any rights or obligations in the parties, and consequently is generally not a contract. Although signed by representatives of both parties, it is "rarely more than an agreement to agree." Wheat & Blackstone, Guideposts for a First Public Offering, 15 Bus. Law. 539, 554 (1960). A letter of intent is customarily employed to reduce to writing a preliminary understanding of parties who intend to enter into a contract. Garner v. Boyd, 330 F. Supp. 22 (N.D. Tex. 1970), aff'd, 447 F.2d 1373 (5th Cir. 1971); Dunhill Securities Corporation v. Microthermal Applications, Inc., 308 F. Supp. 195 (S.D.N.Y. 1969). Within the financial community, the letter of intent is a common device generally regarded as an expression of tentative intentions of the parties rather than as a binding agreement. George D. McCarthy, Acquisitions and Mergers 130 (1963).

Nevertheless, a letter of intent can be a binding agreement if the parties so intend. See Garner v. Boyd, supra. In determining the legal significance of a letter of intent, the critical question is whether the parties intended to be bound or whether either or both of them manifested an intent to the other not to be bound until a fully integrated contract has been executed. Saul Bass & Associates v. United States, 505 F.2d 1386 (Ct. Cl. 1974).

In the letters of intent involving the Corporation that we have seen, language is included expressly reflecting an intention of the parties not to be bound. For example, the letter of intent for the First Colony Project, signed by the chairman of the board of the Synthetic Fuels Corporation and the chief executive officers of the project sponsors, states:

> "We understand that this Letter of Intent * * * constitutes a statement of mutual understanding and intentions and neither this Letter, nor the Term Sheet [setting forth the details] constitutes or creates an obligation binding on any person or creates any right in favor of any person."

In addition, the letter of intent provides that before the project is recommended to the respective boards of directors, it is

subject to (1) negotiation of acceptable definitive agreements, (2) compliance with necessary legal requirements, and (3) the absence of changed circumstances which would adversely affect the financial prospects of the project.

We conclude that if the Corporation includes comparable language in all of its letters of intent, the Corporation does not intend to be bound by them, and such documents are therefore not contracts. Consequently, Treasury's certification process should not be initiated at this stage, no funds should yet be reserved for the projects covered, and they should have no effect on the Corporation's obligational authority.

It is difficult to be as definite with respect to the effect of Corporation use of conditional commitments. Conditional commitments can take many different forms, and we have been advised that the Corporation has not yet used this device. The degree to which a conditional commitment is or may become binding may well depend on its wording, and the subsequent discussion should be read with the understanding that we do not have a sample document before us for analysis.

Whether a particular conditional commitment constitutes a contract requiring the triggering of Treasury's certification procedure and the charging of the Corporation's obligational authority should be determined in light of the purpose of this statutory scheme. Congress chose these mechanisms as the means of assuring that the aggregate maximum liability of the Corporation for the duration of the program will not exceed the lesser of the Corporation's obligational ceiling or available unencumbered appropriations in the Energy Security Reserve. In order for this system to be effective, each instance of potential Corporation liability must be taken account of before the Corporation executes the document giving rise to the potential liability. Therefore, legally these procedures must be activated in every instance where the execution of the document by the Corporation could result in Corporation liability to provide financial assistance to the project sponsor.

Using this criterion, not all types of conditional commitments create circumstances which could result in Corporation liability to provide financial assistance to a project sponsor. Therefore, the Corporation would not be required to initiate Treasury's certification process, with resulting charge to its obligational authority, prior to the Corporation's signing every type of conditional commitment.

However, the Corporation is legally required to undertake these procedures before executing the following kind of conditional commitment: Where in the conditional commitment the

Corporation promises or commits itself to provide a stated form and amount of financial assistance to a project sponsor, if the project sponsor satisfies certain conditions and/or certain events occur or prevail.[3] Then, without any further action of the Corporation board of directors, when the conditions are satisfied and/or the events occur or prevail, the conditional commitment ripens into a full commitment of the Corporation to provide the financial assistance to the project sponsor. If the parties intend a conditional commitment to operate in this manner, it is not unlike a unilateral contract.[4]

The critical distinguishing element of this form of conditional commitment from those that may not be required to be charged against the Corporation's obligational authority is that the Corporation binds itself to provide financial assistance to a project sponsor conditioned upon elements outside the Corporation's control, without a reservation of any right to intervene in events to reconsider the project application and either confirm or reject it. If a conditional commitment can ripen into a full Corporation commitment without further action of the

---

3/ Examples of events that could reasonably be established as conditions are: (1) oil or natural gas prices must be within a specified range; or (2) estimated construction and/or operating costs (which are affected by inflation, labor costs, etc.) must be below a specified ceiling. If these circumstances do not prevail, the project might be judged not to be economically viable.

4/ This arrangement is not lacking mutuality.

> "Where one [here, the Corporation] makes a promise [to provide financial assistance] conditioned upon the doing of an act by another [project sponsor], and the latter does the act, the contract is not void for want of mutuality, and the promisor [the Corporation] is liable [to provide the financial assistance] though the promisee [project sponsor] did not at the time of the promise [execution of the conditional commitment] engage to do the act; upon the performance of the condition by the promisee [project sponsor], the contract becomes clothed with a valid consideration which renders the promise [to provide financial assistance] obligatory." 17 Am. Jur. 2d, Contracts § 12 (1964).

Corporation board of directors, potential liability of the Corporation arises at the time of execution of the conditional commitment agreement. Therefore, the Treasury certification procedure must be complied with before the execution of this kind of conditional commitment, and the maximum potential liability of the Corporation under the conditional commitment must be charged against the Corporation's obligational authority. In addition, the award of financial assistance is a nondelegable responsibility of the Corporation's board of directors. 42 U.S.C. §§ 8715(a) and 8731(b) (Supp. IV 1980). Since this conditional commitment could result in a Corporation obligation to award financial assistance, each of these conditional commitments must have the advance approval of the board of directors.

In response to your specific question, undoubtedly a conditional commitment that requires activation of Treasury's certification procedures and charging of the Corporation's obligational authority is more binding on the Corporation than are the kind of letters of intent that have thus far been signed. Nevertheless, whether the Corporation should use this kind of conditional commitment over another kind, or employ conditional commitments at all, is within the administrative discretion of the Corporation in the context of its needs and those of project sponsors. However, once a Corporation decision is made on the kind(s) of documents associated with the award of financial assistance that it wants to use, consistency of policy and application would be helpful in terms of accounting for funds in the Energy Security Reserve, particularly to the Treasury Department.

Moreover, for the reasons provided in detail below in conjunction with your second series of questions, monies reserved for projects, that were the subject of a conditional commitment but which do not progress to award of financial assistance, do revert to the unreserved portion of the Energy Security Reserve and are available for other projects.

Reuse of Reserved Funds If Project Is Cancelled

Your second series of questions concerns the portion, if any, of financial assistance awarded and reserved for a project that may be used for another project if the first project is halted, either by the project sponsor or the Corporation. Your questions are illustrated by the circumstances of the Colony Shale Oil Project, with a recognition that that Project was assisted by the Department of Energy pursuant to the Defense Production Act rather than by the Corporation. However, you correctly hypothesize that a similar situation could occur under

the Corporation Act. The Colony Shale Oil Project was halted after $78 million of a $1.2 billion loan guarantee commitment were drawn down. You ask:

1. If repaid, can the already drawn funds ($78 million for Colony) be reused for another project or for the later reactivation of the same project under the provisions of the Corporation Act?

2. Can the remainder of the loan guarantee obligation which has not yet been used ($1.1 billion for Colony) be reused for another project or for the later reactivation of the same project under the provisions of the Corporation Act?

Projects Assisted Under the Corporation Act

Subsection 152(c) of the Corporation Act, 42 U.S.C. § 8752(c) (Supp. IV 1980), addresses the impact on the Corporation's obligational authority of termination of Corporation financial assistance for a project. It provides:

> "Any commitment by the Corporation to provide financial assistance or make capital expenditures which is nullified or voided for any reason shall not be considered in the aggregate for the purpose of subsection (a)."

Subsection 152(a) establishes the limitation on the Corporation's total amount of obligational authority.

Subsection 152(c) makes special provision only for "commitments" by the Corporation to provide financial assistance or make expenditures. If these are nullified or voided for any reason (which could include the halting of a project by either the sponsor or the Corporation), the value of the commitments[5]

[5] For purposes of determining compliance with the Corporation's ceiling on obligational authority, commitments are to be valued in accordance with subsection 152(b)(1) of the Corporation Act, 42 U.S.C. § 8752(b)(1) (Supp. IV 1980), even though commitments are not explicitly referred to in that subsection. Commitments are covered by subsection 152(b)(1) by virtue of the inclusion of the term "commitment" in the definition of each of the forms of financial assistance. See, for example, the definitions of "loan," "loan guarantee," "price guarantee," and "purchase agreement." 42 U.S.C. §§ 8702(10), (11), (13) and (14) (Supp. IV 1980).

is not to be considered in computing the aggregate charge against the Corporation's obligational authority. No exception is made for any other impact on the Corporation's obligational authority when Corporation financial assistance for a project is terminated. Accordingly, if the general statutory scheme prohibits reuse of monies once they have been reserved for a given project, the answers to your specific questions are dependent on whether the circumstances described qualify as a "commitment" to provide financial assistance.

We conclude that the general statutory scheme does prohibit reuse of monies once they have been reserved for a given project. We reached this conclusion as a result of a composite of a number of Congressional actions, designed to retain Congressional control over (1) the maximum level of program activity authorized for the Corporation and (2) the maximum possible exposure of public funds. See 125 Cong. Rec. 30978 (1979) (statement of Sen. Jackson).

First, Congress set forth in the statute a ceiling on total Corporation obligational authority. The Corporation may not initially incur obligations or make commitments, including administrative and operating expenses, in excess of the aggregate principal amount of $20 billion. Subsection 152(a) of the Corporation Act, 42 U.S.C. § 8752(a) (Supp. IV 1980).

Secondly, repayments of financial assistance which are recycled into the program through the award of additional financial assistance must be charged against the $20 billion of obligational authority. See subsection 154(a) of the Corporation Act, 42 U.S.C. § 8754(a) (Supp. IV 1980), which makes receipts of the Corporation subject to the limitations contained in section 152, supra.

Thirdly, leveraging of Corporation funds in the making of loan guarantees and price guarantees was not authorized. In fact, an alternate version of the legislation reported by the Senate Committee on Banking, Housing, and Urban Affairs permitted $3 of guarantees to be made for each dollar appropriated. See proposed section 305(d)(12) of the Defense Production Act to be added by section 102 of S. 932, 96th Cong., 1st Sess. 21, as reported by the Senate Committee on Banking, Housing, and Urban Affairs (Oct. 30, 1979); and S. Rep. No. 387, 96th Cong., 1st Sess. 66 (Oct 30, 1979). The Banking Committee proposal was rejected on the Senate floor.

Fourthly, for purposes of compliance with the Corporation's obligational ceiling, contingent forms of financial assistance are to be charged against the ceiling from the beginning and

prior to the occurrence of the contingency. Loan guarantees are to be charged at the initial face value (plus interest and cost overruns).6/ Subsection 152(b)(1)(B) of the Corporation Act, 42 U.S.C. § 8752(b)(1)(B) (Supp. IV 1980). Price guarantees and purchase agreements are to be charged as of the date of each such contract, based upon the Corporation's estimate of its maximum potential liability. Subsection 152(b)(1)(C) of the Corporation Act, 42 U.S.C. § 8752(b)(1)(C) (Supp. IV 1980).

Thus the statutory scheme is not based upon outlays, repayments or anticipated default rates. Rather, as expressed by Congressman William Moorhead, Chairman of the Conference Committee:

> "The $20 billion authorization * * * really is a set-aside in the unlikely event the program is a total failure and we cannot even recover a nickel of our investment. * * * as each contract or guarantee is made, the amount of money is deducted from the total authorization dollar-for-dollar to the maximum liability and cannot be used again. In effect, it is a bookkeeping scorecard." 126 Cong. Rec. 16931 (1980).

These statutory provisions and expressions of Congressional intent are not consistent with the reuse of monies by the Corporation once they have been reserved for a given project, in the absence of a statutory exception.

6/ This is not the usual practice in accounting for funds within the Government. For example, the making of a loan guarantee does not involve an actual expenditure of Federal funds. The expenditure is made if and when the agency is required to pay on the guarantee, i.e., when the borrower defaults. When the original guarantee is made, the extent to which a liquidating appropriation may be needed cannot be known. A Federal loan guarantee, therefore, is treated as a contingent liability not requiring an immediate obligation of funds, and, as such, is not counted against an agency's available appropriations. 60 Comp. Gen. 700 (1981). When a loan is guaranteed, no obligation of funds occurs until the Federal Government becomes legally required to honor its guarantee, if ever, generally upon default by the borrower. Accordingly, unless specific statutory ceilings are imposed on an agency's guarantee authority, the amount of loans an agency can guarantee is not subject to legal restriction. See 58 Comp. Gen. 138 (1978).

One of these statutory exceptions to the general rule is subsection 152(c) of the Corporation Act, supra. As indicated previously, subsection 152(c) provides that if a commitment by the Corporation to provide financial assistance is nullified or voided for any reason, the value of the commitment is not to be considered in computing the aggregate charged against the Corporation's obligational authority. This, in essence, means that these monies that had been committed and reserved for a project are rendered unencumbered and available to the Corporation for other purposes, including other projects, whenever a commitment is nullified or voided.

A "commitment" has been defined as a pledge to carry out some action or to give support to some person. See Webster's Third New Unabridged Dictionary (1966). In the context here, it is a pledge or promise by the Corporation to provide financial assistance to a project sponsor on the terms and conditions specified in the agreement. However, to the extent the financial assistance is provided by the Corporation to a project sponsor in accordance with the agreement, the promise is absorbed into and extinguished by the actual providing of the financial assistance. In the context here, we conclude that this occurs when, and to the extent, that the pledged Corporation financial assets are actually placed "at risk." To the extent Corporation financial assets have once been placed "at risk," they cease to be the subject of a Corporation commitment to provide financial assistance and have become the actual provision of financial assistance. As a consequence, they cease to be covered by subsection 152(c) of the Corporation Act, supra.

The point at which Corporation financial assets are placed at risk varies depending upon the form of financial assistance. We find, for example, that:

1. In the case of a loan, Corporation financial assets are placed at risk upon the disbursement of the money.

2. In the case of a loan guarantee, as the loan that has been guaranteed is drawn down.

3. In the case of a price guarantee, at the time or upon the conditions specified in the price guarantee agreement, when the project sponsor first becomes eligible to receive a price guarantee, whether or not it is in fact entitled to a payment at that time in light of the then prevailing market price. At that point in time, the whole amount of price guarantees for which the project sponsor is eligible is placed at risk.

4. Similarly, in the case of a purchase agreement, at the time or upon the conditions specified in the purchase agreement, when the project sponsor first becomes eligible to benefit through Corporation purchases of project products, whether or not it is in fact entitled to require a Corporation purchase at that time in light of the then prevailing market circumstances. At that point in time, the whole amount of Corporation monies that could be available to the project sponsor at that time would be placed at risk.

In summary, therefore, once and to the extent that Corporation assets have been placed "at risk," whether or not they have been repaid, those monies may not be used again, even if the project has been terminated. However, to the extent the Corporation had made commitments of financial assistance to the terminated project that had not yet been placed "at risk" under the standards discussed above, subsection 152(c) of the Corporation Act, supra, renders these monies unencumbered and available to the Corporation for other purposes, including other projects. In addition, monies reserved for projects, that were the subject of a conditional commitment but which do not progress to award of financial assistance, clearly were never placed "at risk." Therefore, when the determination is made that the project will not receive an award of financial assistance, subsection 152(c) of the Corporation Act unencumbers the monies reserved for the project, and they revert to the unreserved portion of the Energy Security Reserve, where they will be available for other projects.

In the example you gave involving a loan guarantee, the $78 million that had already been drawn, even though repaid, may not be used for another project or for the later reactivation of the same project. However, the remaining $1.1 billion loan guarantee commitment, which had not been drawn down, may be used for another project or later reactivation of the same project, because it had never been placed at risk.

In addition, we understand that there is some concern over the standard established for when monies for price guarantees are placed at risk. We stated that the whole amount of price guarantees for which the project sponsor is eligible is placed at risk. To reduce potential forfeiture of Corporation obligational authority when providing price guarantees (and perhaps purchase agreements), the Corporation may, in the price guarantee agreement, provide for annual or biennial limits on the amount of price guarantees for which the project sponsor is eligible. Under this procedure, monies for future years would not be placed at risk at the beginning, and would remain mere

commitments for financial assistance until the particular designated year arrived. Consequently, in case of project termination, these portions, since they are still commitments, would be unencumbered and revert to the unreserved portion of the Energy Security Reserve. In the Corporation's discretion, to the extent that outlays for price guarantees in a given year do not reach the annual limit, the unused portion could still be available to the project sponsor in future years. Of course, the maximum potential liability of the Corporation under the whole price guarantee agreement would still have to be reserved as of the date of the execution of the agreement, in accordance with subsection 152(b)(1)(C) of the Corporation Act, 42 U.S.C. § 8752(b)(1)(C) (Supp. IV 1980).

Finally, the whole issue of terminated projects requires a coordinated effort between the Corporation and Treasury in properly accounting for Corporation obligational authority. How this coordination is achieved is in the administrative discretion of the two agencies. However, it seems logical that since the Corporation benefits whenever funds previously reserved for a project become unencumbered as a result of project termination, the Corporation should have the burden of formally notifying Treasury when a project has been terminated. This notification should be accompanied by sufficient facts so that Treasury can make a proper determination under the standards we indicated above of what portion of the monies reserved were never placed "at risk" and thus can revert to the unreserved portion of the Energy Security Reserve. Treasury need not then take any action until it receives this formal notification from the Corporation.

Colony Shale Oil Project

The Colony Shale Oil Project, although assisted by the Department of Energy (Energy) pursuant to the Defense Production Act rather than by the Corporation, does have an impact on the Corporation's obligational authority. The impact on the Corporation's obligational authority when the Project was terminated, although determined under different provisions of law, is the same as if the Project had been assisted by the Corporation under the Corporation Act. That is, once and to the extent that financial assistance was placed "at risk," whether or not repaid, those monies could not be used again. However, to the extent commitments of financial assistance had been made to Colony but not yet placed "at risk" before Project termination, these monies are available to the Corporation for other purposes, including other projects.

The basic facts are as follows: On August 6, 1981, Energy entered into a document entitled a "Commitment to Guarantee Obligations" with The Oil Shale Corporation (TOSCO) to cover loans involving up to $1,232,500,000 in principal and interest for the Colony Shale Oil Project (Colony) in Garfield County, Colorado. The loan guarantee was provided by Energy pursuant to section 305 of the Defense Production Act, as amended, 50 U.S.C. App. § 2095 (Supp. IV 1980).[7] Pursuant to the Defense Production Act, the $1.2325 billion was certified as available by the Office of Management and Budget and reserved within the Energy Security Reserve for the project. Subsequently, in February 1982 Energy's authorities and responsibilities in its agreement with TOSCO for the Colony Project transferred to the Synthetic Fuels Corporation, after board of director approval. See Supplemental Appropriations and Rescission Act, 1980, Pub. L. No. 96-304, approved July 8, 1980, 94 Stat. 857, 881; B-202463, January 19, 1984. In June 1982 TOSCO withdrew from the Colony Project, terminating the Project and nullifying and voiding any obligation of the Corporation to provide further assistance. Prior to termination, however, TOSCO had drawn on its Federal guarantee in an amount totalling approximately $78 million. All principal and interest on these obligations were repaid in June 1982 without loss to the Corporation. In excess of $1.1 billion in guarantee commitment had not been drawn upon. The issue is what impact this $78 million and $1.1 billion had on the Corporation's obligational authority.

Subsection 152(a)(2)(A) of the Corporation Act, 42 U.S.C. § 8752(a)(2)(A) (Supp. IV 1980), requires that certain Department of Energy assistance for synthetic fuels projects,

---

7/ Section 305 was added by the Defense Production Act Amendments of 1980, Part A of Title I of the Energy Security Act, Pub. L. No. 96-294, approved June 30, 1980, 94 Stat. 611, 619. It created in the President an interim synthetic fuels program for commercial-sized facilities until the Synthetic Fuels Corporation became operational. The President delegated his authority under this section to the Secretary of Energy by Executive Order No. 12242. 45 Fed. Reg. 65175 (October 2, 1980). Congress, anticipating the presidential delegation, had appropriated $3.31 billion to Energy from the Energy Security Reserve to stimulate domestic commercial production of alternative fuels under the Defense Production Act, supra, which could be used for purchase commitments, price guarantees and loan guarantees. Supplemental Appropriations and Rescission Act, 1980, Pub. L. No. 96-304, approved July 8, 1980, 94 Stat. 857, 880.

including that provided to TOSCO for the Colony Project, be charged to the Corporation's obligational authority. More specifically, it provides, in part, that the Corporation may not incur obligations or make commitments in excess of the aggregate principal amount of $20 billion--

"(2) less such sums--

"(A) as are obligated for purposes of carrying out section 305 of the Defense Production Act of 1950 before the date determined under section 305(k)(1) of the Defense Production Act of 1950 [the date on which the President determined that the Synthetic Fuels Corporation was established and fully operational] or are required to be retained as a reserve against a contingent obligation incurred before such date under such section, up to a maximum of $3,000,000,000; * * *."

The statutory provisions for accounting for monies under section 305 of the Defense Production Act, supra, are comparable to those contained in section 152 of the Corporation Act, supra, and for the issues of concern here, they are in substance identical. More specifically, subsection 305(g) of the Defense Production Act, 50 U.S.C. App. § 2095(g) (Supp. IV 1980), provides:

"(1) Any contract under this section including any amendment or other modification of such contract, shall, subject to the availability of unencumbered appropriations in advance, specify in dollars the maximum liability of the Federal Government under such contract as determined in accordance with paragraph (2).

"(2) For the purpose of determining the maximum liability under any contract under paragraph (1)--

"(A) loans shall be valued at the initial face value of the loan;

"(B) guarantees shall be valued at the initial face value of such guarantee (including any amount of interest which is guaranteed under such guarantee);

"(C) purchase agreements shall be valued as of the date of each such contract based upon the President's estimate of the maximum liability under such contract; and

"(D) any increase in the liability of the Government pursuant to any amendment or other modification to a contract for a loan, guarantee, or purchase agreement shall be valued in accordance with the applicable preceding subparagraph.

"(3) If more than one form of assistance is provided under this section to any synthetic fuel project, then the maximum liability under such contract for purposes of paragraphs (1) and (2) shall be valued at the maximum potential exposure on such project at any time during the life of such project.

"(4) Any such contract shall be accompanied by a certification by the Director of the Office of Management and Budget that the necessary appropriations have been made for the purpose of such contract and are available. The remaining available and unencumbered appropriations shall equal the total aggregate appropriations less the aggregate maximum liability of the Federal Government under all contracts pursuant to this section.

"(5) Any commitment made under this section which is nullified or voided for any reason shall not be considered in the aggregate maximum liability for the purposes of paragraph (4)." (Emphasis added.)

Again, there is an aggregate maximum liability under all contracts pursuant to the section, for which loan guarantees are to be valued at the initial face value of the guarantee (plus interest and amendments). Again, the only provision affecting the computation of the aggregate maximum liability in the case of project termination is that which provides that "commitments" for financial assistance that have been nullified or voided are not to be considered in the aggregate maximum liability. Again, we conclude here that once and to the extent that pledged financial assistance is put "at risk," it ceases to be a commitment and becomes the actual financial assistance. In the case of a loan guarantee, this occurs when the loan that has been guaranteed is drawn upon.

Under subsection 305(g) of the Defense Production Act, supra, the full $1.2325 billion in face value of the loan guarantee plus interest was encumbered and required to be set aside as a reserve against the contingent obligation that could arise if there were a default on the full amount and for which the Government had guaranteed payment. Of this amount, $78 million was placed at risk by TOSCO's drawing down this amount on the guaranteed loan. The $78 million would, therefore, have continued to be counted against the aggregate maximum liability and not available for other purposes, even though the Project was terminated. On the other hand, the remaining approximately $1.1 billion was still a commitment for financial assistance at the time of project termination. As a result, under subsection 305(g)(5) of the Defense Production Act, supra, this amount would not be considered in the aggregate maximum liability for the program. In addition, it was no longer "required to be retained as a reserve against a contingent obligation incurred." The contingent obligation would no longer be possible, because the commitment for financial assistance under which it could have arisen had been nullified or voided. Therefore, these monies would have been unencumbered and available for other projects. For these reasons, under subsection 152(a)(2)(A) of the Corporation Act, supra, the Corporation's obligational authority would have been reduced by the Colony Project only by the $78 million.

Subsection 152(a)(2)(A) of the Corporation Act, supra, is the determinative provision governing the impact on the Corporation's obligational authority (as opposed to the disposition of previously reserved funds recouped as a result of a termination) in the case of the termination of the Colony Project. Its meaning is not modified by the facts that (1) the Colony Project had been assisted by Energy prior to and at the time the Corporation had been declared operational, (2) responsibility for the assistance agreement for the Colony Project had transferred from Energy to the Corporation, and (3) the Project was subsequently terminated while it was under the jurisdiction of the Corporation. Nor is its meaning affected by other statutory provisions raised in the agency comments, including subsection 711(a)(2) of the Defense Production Act, as amended, 50 U.S.C. App. § 2161(a)(2) (Supp. IV 1980) because these provisions do not deal with the Corporation's obligational ceiling.

Roll-over Financing

In your third series of questions you describe roll-over financing as the sequential converting of one type of financial assistance, such as a loan guarantee, into another form of aid, such as a price guarantee. The example you give is a company

that receives a $1.3 billion loan guarantee that under the contract converts dollar-for-dollar as the loan is repaid into a $1.3 billion price guarantee. You further describe that the per-barrel price support is to be agreed upon either at the contract date or prior to the repayment of its loan. With this factual situation in mind you raised the following questions:

1. Does a roll-over as described above constitute an illegal reuse of already obligated funds?

2. What is the maximum liability which must be certified under the above roll-over contract?

3. If such an arrangement is not illegal and the maximum liability does not exceed the statutory limit, how many times during the life of the project can the same funds be rolled over from one form of assistance to another?

4. If roll-over assistance does not constitute a reuse of the $1.3 billion could the prohibition against cost-plus-price contracts in section 134 of the Corporation Act be violated if the amount of the per-barrel price support is negotiated after the plant is constructed?

As you are aware, the Act allows the Corporation to award combinations of forms of assistance. 42 U.S.C. § 8731(o) (Supp. IV 1980). The Act also provides for a different procedure to be used in calculating the amount of money to be charged against the Corporation's ceiling when combinations of assistance are awarded under one contract. 42 U.S.C. § 8752(b)(3) (Supp. IV 1980). In the absence of this special provision, the normal policy would be to count each type of assistance separately and charge the aggregate amount against the ceiling. 42 U.S.C. § 8752 (Supp. IV 1980). However, section 152(b)(3) changed this scheme and provides a statutory exception to the general prohibition on the reuse of funds.[8]

Section 152(b)(3) provides:

"(3) If more than one form of financial assistance is to be provided to any one synthetic fuel project or if the financial assistance agreement provides a right to the Corporation to

8/ See our previous discussion on the second series of questions.

> purchase the synthetic fuel project, then the obligations and commitments thereunder shall be valued at the maximum potential exposure on such project at any time during the life of such project." 42 U.S.C. § 8752(b)(3) (Supp. IV 1980). (Emphasis added.)

Under this provision it is the "maximum potential exposure at any time during the life of such project" and not the aggregate amount of liability for all forms of assistance provided that is charged against the Corporation's obligational ceiling. Therefore, the Corporation can provide one type of assistance to a project that sequentially converts into another form of aid without increasing the "maximum potential liability." Thus, under subsection 152(b)(3) roll-over financing is permissible and is calculated as the amount of potential liability at any time facing the Corporation. In terms of your example then, the maximum exposure of the Corporation "at any time" is $1.3 billion.

We would like to point out that section 152(b)(3), like section 152(c), is a limited exception to the general legislative scheme. Your own statement in explanation of the Conference Report on the Energy Security Act indicates that the provision applies only to combinations of assistance awarded simultaneously to a project. You stated:

> "[I]f the Corporation provides a loan guarantee of $2 billion, and then at the initiation of production, the recipient of the guarantee wishes to terminate the guarantee, that $2 billion can never be used for any other purpose. If the recipient wishes to obtain another form of financial assistance, such as a price support, then the extent of that assistance will be limited by the requirements of section 131(j)(1), and the funds for such assistance must be drawn from the unobligated balances available to the Corporation in the Energy Security Reserve established in section 195(B) and accounted for in accordance with the provisions in section 152(b)." 126 Cong. Rec. 16917 (1980).

Restricting the scope of section 152(b)(3) to combinations of assistance under one contract is in furtherance of the underlying objective of the Act that the Corporation have finite authority to provide assistance. Under this interpretation of subsection 152(b)(3), the reuse of monies is permissible only if convertible assistance is simultaneously awarded. On the other hand, both awards must be charged against the Corporation's

obligational authority, if, subsequent to the first Corporation award of assistance, a project sponsor applies for another form of assistance to be available to the project dollar-for-dollar as the first assistance award is repaid. Moreover, even when convertible assistance is provided for it must be made within the confines of the Act. Therefore, the award should be given in the hopes of promoting competition and encouraging and supplementing private capital investments in synthetic fuels projects. 42 U.S.C. § 8731(h) and (r). Additionally, even though the Corporation has discretion to provide for convertibility of forms of assistance, the Corporation is obliged to separately assess the need for and amount of each type of assistance under the statute's requirements. Consequently, a one-for-one convertibility may not always be appropriate.

Accordingly, we find that it is permissible to provide for roll-over financing if it is done within one financial assistance award, that the amount to be charged under such financing is the maximum amount of potential exposure at any time during the life of the project, and that the extent of such financing must be determined within the parameters of the Act.

The last part of your question deals with the prohibition against cost plus contracts. Section 134 of the Act provides:

> "Sec. 134. The Corporation is authorized, on such terms and conditions as the Board of Directors may prescribe, to commit to, or enter into, price guarantees providing that the price that a concern will receive for all or part of the production from a synthetic fuel project shall not be less than a specified sales price determined as of the date of execution of the commitment or the price guarantee: Provided, That no such price guarantee may be based upon a 'cost plus' arrangement or variant thereof which guarantees a profit to the concern, except that the use of a 'cost of service' pricing mechanism by a concern pursuant to law, or by a regulatory body establishing rates for a regulated concern, shall not be deemed to be a 'cost plus' arrangement or variant thereof: Provided further, That if the Corporation determines in its sole discretion that such project would not otherwise be satisfactorily completed or continued and that completion or continuation of such project would be necessary to achieve the purposes of this title, the sales price set forth in the price guarantee may be renegotiated. In awarding financial assistance under this section, the Corporation shall

> establish such specified sales price at the level which will provide the minimum subsidy determined by the Board of Directors to be necessary to provide an adequate incentive, in light of projected prices of competing fuels and the requirements for economic and financial viability of the synthetic fuel project." 42 U.S.C. § 8734 (Supp. IV 1980).

Under this provision the specified sales price is to be determined "as of the date of execution of the commitment or the price guarantee." However, if conditions warrant the Corporation may renegotiate the sales price. Therefore it may not constitute a violation if a price is agreed to upon completion of plant construction. However, as the Conference Report explains, the price agreed upon "shall assure that an appropriate risk will be borne by the recipient, that an appropriate level of price competition will be encouraged in the production and sale of synthetic fuels, that the price support will phase out if marketplace prices make such support unnecessary * * *." H.R. Rep. No. 1104, 96th Cong., 2nd Sess. 221 (1980). Thus, we find that while the timing of the agreement on the price is important, the critical element in determining if the Corporation has entered into a "cost plus" arrangement is whether the Corporation has committed itself to providing more than "the minimum subsidy * * * necessary to provide an adequate incentive" to the Project.

Sincerely yours,

Milton J. Socolar

for Comptroller General
of the United States