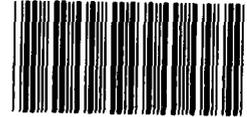


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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
Expected at 2:00 p.m.
Wednesday, July 29, 1981

STATEMENT OF
J. DEXTER PEACH
DIRECTOR
ENERGY AND MINERALS DIVISION
BEFORE THE
SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS
OF THE
HOUSE COMMITTEE ON ENERGY AND COMMERCE
ON
THE PROJECT SELECTION CRITERIA PROPOSED BY
THE SYNTHETIC FUELS CORPORATION



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Mr. Chairman and Members of the Subcommittee:

We welcome the opportunity to be here to discuss the Synthetic Fuels Corporation's (SFC's) proposed project selection guidelines. My testimony today is based on our preliminary review of the guidelines and our previous work concerning the Department of Energy's (DOE's) synthetic fuels programs; particularly, DOE's alternative fuels program. 1/ My remarks concern

- how the process will work,
- what additional information is needed, and
- how the integrity of the selection process will be ensured.

BACKGROUND

First, however, I would like to provide some background. On June 30, 1980, the Congress enacted the Energy Security Act, which authorizes the creation of the SFC. The SFC's

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1/"Special Care Needed in Selecting Projects for the Alternative Fuels Program" (EMD-81-36, Dec. 8, 1980).

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mission is to foster the commercial production of synthetic fuels by providing financial assistance to the private sector. The SFC received 63 proposals for synfuels projects by March 31, 1981, the close of the SFC's first and only solicitation to date.

On April 9, 1981, the SFC released initial project selection guidelines for public comment. The guidelines provide information on the SFC's process for evaluating proposals, the criteria to be used, and their relationship to the requirements of the Energy Security Act. These guidelines are currently being revised by the Corporation staff, based on public comments received. They cannot be finalized, however, until a Board of Directors is in place.

GUIDELINES VAGUE

With that background, I will now turn to our comments concerning the proposed guidelines. From our preliminary review, it appears that the guidelines are consistent with the requirements of the Energy Security Act. However, in reviewing the comments received on the guidelines we found that probably the principal criticism is that they are vague. There is concern that industry sponsors may not have enough guidance to adequately prepare their proposals. Also, EPA and environmental groups would like the environmental criteria to be clearer and more complete. Our comments similarly concern areas in need of clarification.

How will projects be selected?

The first area concerns the project selection process. According to the proposed guidelines, the process involves a two-level review. Projects will be evaluated for (1) their

intrinsic merit referred to by the SFC as project evaluation criteria, and (2) their conformance with the Energy Security Act's overall objectives, which the SFC calls program-level evaluation criteria.

The project evaluation criteria provide that (1) the project must be technically viable and properly managed; (2) the project must demonstrate good prospects for economic viability, and its financing must reflect an appropriate balancing of Corporation and sponsor interests; and (3) the project must be acceptable in terms of its environmental, regulatory, and socioeconomic aspects.

The program-level evaluation criteria correspond to the requirements of the Energy Security Act to

- encourage technological diversity in order to use domestic resources offering significant potential as a feedstock,
- assist projects that offer the potential to achieve the act's production goals of 500,000 barrels per day by 1987 and 2,000,000 barrels per day by 1992, and
- establish a comprehensive strategy by June 30, 1984, to achieve the act's production goals.

It is our understanding that the SFC will first evaluate projects based on project evaluation criteria and then apply the program-level criteria. However, it is unclear how the SFC will use the two levels of review to achieve the Energy Security Act's goals. For example, the guidelines are vague regarding the comparative process to be used in judging the

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relative merits of diverse processes. Of the 63 proposals received by the SFC, 17 coal gasification project sponsors applied for assistance. Conceivably, the projects could compete among themselves as a group, or they could compete within smaller groups, such as low-, medium-, and high-Btu gasification. Potential sponsors should know the ground rules under which they must compete. Also, it would help to ensure consistency in the review process once the proposals have been submitted.

What additional information is needed?

The proposed project selection guidelines state that, before the selection process begins, the SFC will assess whether a proposed project is mature and has a reasonable prospect of receiving financial assistance. Earlier this month, the SFC notified most of the 63 project sponsors that certain information must be submitted for their projects to be judged mature. The information includes design engineering, cost estimates, cash flow and internal rate of return projections, marketing information, and environmental and socioeconomic planning.

SFC officials told us that the 63 proposals are of mixed quality and completeness. They said that many of the sponsors would need to devote more than a year to their proposals before the SFC would consider their projects mature.

Because the proposals will become mature at different times, it is unclear how the SFC will address the Energy Security Act provision that, when it is practicable and provident to do

so, the SFC shall award financial assistance on the basis of competition. So far, the SFC has given no indication whether projects will be evaluated individually when they are judged mature or whether they will be held for concurrent review with other mature projects. It is questionable whether the SFC can adequately compare mature projects with projects in various stages of completeness. On the other hand, it would be unfair to those early sponsors of mature projects to require them to wait indefinitely until other project proposals become mature.

To ensure fairness to those projects which have been judged mature while allowing sufficient time for initial proposals to be supplemented sufficiently to be judged mature, we believe the SFC should establish a target date for beginning the review of mature projects. This could also help to ensure timely action by the SFC toward achieving its production and technological diversity goals. Those proposals, which were not judged mature by the initial target date, could then have the option of bringing their projects to maturity for competition with others at a later cut-off date.

In evaluating mature projects, the SFC must, among other things, assess the financial viability of a project by analyzing cost estimates and financial and market information. It is unclear how the SFC will make this economic comparison of projects since the guidelines do not provide sponsors with a uniform set of economic assumptions to use such as inflation rates, interest rates, and the price of oil and gas. These economic assumptions can make a substantial difference in

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a project's outlook and consequently in the SFC's evaluation.

To simplify comparisons between projects, the SFC could provide economic assumptions which all sponsors can use as a framework. Alternatively, if the SFC does not choose to dictate economic assumptions, the project sponsors should clearly identify their assumptions so that the SFC can make adjustments to ensure evaluation of the projects on a comparable basis.

How will the integrity of the selection process be ensured?

We believe that inherent with any two-level selection process, special care must be taken to ensure process integrity. In December 1980, we reported on DOE's alternative fuels program, specifically, the selection process used to award grants for feasibility studies and cooperative agreements for synthetic fuels projects. We found that it also uses a two-level review process.

DOE first evaluated and ranked each synthetic fuels project in terms of technical, economic, environmental, and socioeconomic merit. It then applied certain program policy factors, including discretionary factors such as geographical diversity, before selecting projects for funding. We found that the criteria used to evaluate the proposals initially were reasonable and appeared to be applied consistently. There was enough flexibility in the use of program policy factors in the second level of review, however, that DOE could justify an award to a number of projects, despite lower technical rankings. We stated that this is an area requiring close attention and one where special

care must be exercised to avoid any inferences of impropriety in future project selections.

Although the SFC has fewer program level criteria to use to override the technical evaluations of projects, we believe the same potential concern exists with the SFC's selection process. Consequently, the same note of caution to ensure integrity at each point of the selection process is applicable to the SFC. Detailed documentation at each level of the process could assist the SFC in resolving any questions in regard to future oversight of the SFC's selections.

That concludes my formal statement, Mr. Chairman.
My colleagues and I will be happy to respond to questions.

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NOTICE OF HEARING

COMMITTEE : Subcommittee on Fossil and Synthetic Fuels,
Committee on Energy and Commerce, H.R.

SUBJECT : Project Selection Criteria used by the Synthetic
Fuels Corporation

DATE : July 29, 1981

TIME : 2 p.m.

ROOM : 2123 Rayburn House Office Bldg.

MEMBERSHIP : Philip R. Sharp (IN), Chairman

Majority : Representatives Moffett (Conn.), Markey (Mass.),
Gore (Tenn.), Gramm (TX), Swift (Wash.), Leland (TX),
Shelby (Ala.), Collins (Ill.), Synar (Okla.), Tauzin (La.)
Hall (TX), Wirth (Colo.) and Dingell (Mich.)

Minority : Representatives Brown (OH), Collins (TX), Corcoran (Ill.)
Lee (NY), Dannemeyer (Calif.), Tauke (IA), Rogers (KY),
Benedict (W.VA), Coats (IND) and Broyhill (NC)

PRINCIPAL STAFF : Roger Staiger

GAO WITNESS : J. Dexter Peach, Director, Energy and Minerals Division

ACCOMPANIED BY : Kevin Boland, Associate Director, EMD
Dennis Matteotti, ^{Senior} Supervisory Evaluator, EMD
T. Vincent Griffith, Legislative Attorney, OCR

Car will leave G Street, 1st Basement at 1:45 p.m.

T. Vincent Griffith
Legislative Attorney
Office of Congressional
Relations

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PUBLIC HEARINGS

DATE AND TIME: Wednesday, July 29, 1981 at 2:00 p.m.
PLACE: 2123 Rayburn House Office Building
SUBJECT: Synthetic Fuels Policy--Project Selection
Criteria

WITNESSES:

PANEL 1

Representing: The National Governors' Association

The Honorable John D. Rockefeller, IV
Governor of West Virginia

The Honorable Richard D. Lamm
Governor of Colorado

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Mr. Robert W. Reed, Vice President
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