



Testimony

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DEPARTMENT OF ENERGY

Observations on Actions to Implement the New Loan Guarantee Program for Innovative Technologies

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Highlights of [GAO-07-798T](#), testimony before the Subcommittee on Energy and Air Quality, Committee on Energy and Commerce, House of Representatives

Why GAO Did This Study

The Energy Policy Act of 2005 (EPAct 05) authorized the Department of Energy (DOE) to establish a loan guarantee program (LGP) for energy-related projects that are intended to decrease air pollutants or man-made greenhouse gases and employ new or significantly improved technologies, and that have a reasonable prospect of repayment. Federal law requires appropriated budget authority for LGP costs before program can be implemented. In 2006, before it received appropriations for the program, DOE solicited preapplications to the LGP, stating it intended to issue up to \$2 billion in guarantees. It also issued guidelines for these proposals, stating that borrowers would ultimately pay for all costs. Questions were raised about DOE's authority to undertake these activities and whether the activities were based on sound policy.

This testimony is based on GAO's February 2007 report, *Department of Energy: Key Steps Needed to Help Ensure the Success of the New Loan Guarantee Program*, GAO-07-339R. GAO discusses (1) the sources and use of funds for the LGP in fiscal years 2006 and 2007; (2) extent to which the LGP could result in a financial risk to the taxpayer; and (3) steps DOE had taken to implement the LGP. The questions concerning DOE's legal authority were addressed in a recent GAO opinion, B-308715, April 20, 2007.

www.gao.gov/cgi-bin/getrpt?GAO-07-798T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact James C. Cosgrove at 202.512.7029.

DEPARTMENT OF ENERGY

Observations on Actions to Implement the New Loan Guarantee Program for Innovative Technologies

What GAO Found

In fiscal year 2006, and continuing through October 2006, DOE used about \$503,000 from three separate appropriation accounts to fund LGP activities. DOE used these funds for the salaries of three staff detailed to the LGP office and for contracts to support the program. DOE stopped most LGP development activities at the end of October, but according to the deputy general counsel for energy policy, he and others continued to work on the program by, for example, preparing a notice of proposed rulemaking and reviewing pre-applications for completeness. At the time of GAO's review, DOE officials said they were awaiting appropriations before taking additional implementation steps.

LGP guidelines call for borrowers to be charged fees to cover all program costs, but the program could result in substantial financial costs to the taxpayer if DOE underestimates these costs. Program costs are administrative costs and subsidy costs. While DOE must recover administrative costs, such as its costs for evaluating applications, it had not developed a plan for determining how to estimate costs or recover any shortfalls from borrowers at the time of GAO's review. Appropriated funds may be necessary to cover shortfalls. Subsidy costs are the estimated net present value of the long-term cost to the federal government of guaranteeing the loans over the entire period that the loans are outstanding, excluding administrative costs. Subsidy costs take into account estimated future loan performance, including defaults and delinquencies. DOE will have to estimate the subsidy cost to determine the fees to charge borrowers, but it had no policies or procedures for doing so at the time of our review. Estimating subsidy costs could be difficult because the program targets innovative energy technologies whose future success is uncertain, and loan performance could depend heavily on future economic conditions, including energy prices, which are hard to predict accurately. Under federal law, shortfalls in subsidy costs are funded automatically by a permanent indefinite appropriation, not through the annual appropriations process.

GAO identified five key steps that DOE should take to help ensure that the program will be well managed: issuing implementing regulations, establishing a credit review board to coordinate credit management and debt collection activities, setting policies and procedures for selecting and monitoring loans and lenders, setting policies and procedures for estimating program costs and accounting for loan guarantees, and setting program goals and objectives tied to outcome measures for determining program effectiveness. Rather than taking and completing these key steps, DOE initiated the LGP by soliciting pre-applications for proposed projects. The Revised Continuing Appropriations Resolution for Fiscal Year 2007 (Feb. 15, 2007) appropriated funds for implementing the program and directed DOE to implement most of GAO's recommendations within 6 months of the act.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the results of our February 2007 report on DOE's implementation of the new loan guarantee program for innovative technologies.¹ We prepared this report at the request of the Subcommittee on Energy and Water Development, House Committee on Appropriations.

As you know, the Energy Policy Act of 2005 (EPA05)² authorized the Department of Energy (DOE) to establish a loan guarantee program (LGP) to guarantee loans for projects that were intended to, among other things meet the following three conditions: (1) decrease air pollutants or man-made greenhouse gases by reducing their production or by sequestering them (storing them to prevent their release into the atmosphere), (2) employ new or significantly improved technologies compared with commercial technologies currently used, and (3) have a "reasonable prospect" of repayment. Such projects could include renewable energy systems, advanced fossil energy technologies, and production facilities for fuel-efficient vehicles.

In August 2006, DOE issued a solicitation for preapplications to the LGP, announcing its intention to issue up to \$2 billion in loan guarantees. At the same time, it issued guidelines for proposals submitted in response to this first solicitation, stating that the department expected borrowers to ultimately pay for all program costs, including DOE's

¹GAO, *Department of Energy: Key Steps Needed to Help Ensure the Success of the New Loan Guarantee Program for Innovative Technologies by Better Managing Its Financial Risk*, GAO-07-339R (Washington, D.C.: February 28, 2007). Last week, we issued a legal opinion on certain questions regarding DOE's implementation of the loan guarantee program (LGP) under § 1702 of the EPA05 and 42 U.S.C. § 7278—*Department of Energy—Title XVII Loan Guarantee Program*, B-308715, April 20, 2007. This opinion discusses DOE's authority to implement and fund the LGP before Congress had appropriated funding for the program in the continuing resolution. We concluded that § 1702(b)(2), confers upon DOE independent authority to make loan guarantees, notwithstanding Federal Credit Reform Act requirements. We also concluded that DOE engaged in activities to implement a LGP under title XVII of the act during a period when DOE was affirmatively prohibited from implementing the LGP. These activities violated § 7278; the purpose statute, 31 U.S.C. § 1301(a); and the Antideficiency Act, 31 U.S.C. § 1341(a). DOE must report the violations of the Antideficiency Act to Congress and the President, and submit a copy of that report to the Comptroller General of the United States under 31 U.S.C. § 1351, as amended.

²Pub. L. No. 109-58, Title XVII (August 8, 2005).

administrative costs.³ When it issued this solicitation, DOE had not yet received appropriated funds to carry out the LPG. After we had completed our audit work, Congress appropriated funds for the program.⁴

My testimony today discusses the (1) sources and use of funds for the LPG in fiscal years 2006 through October 2006, (2) extent to which the LPG could result in a financial risk to the taxpayer, and (3) steps DOE had taken at the time of our February report to implement the LPG.

To identify sources and use of funds for DOE's LPG, we interviewed DOE LPG and budget officials and reviewed and analyzed relevant DOE budget documentation as well as agency LPG guidance and planning documents. To examine the extent to which the LPG could result in financial risks to taxpayers, we analyzed DOE's plans and guidance for implementing the LPG and discussed these plans and the guidance with DOE and Office of Management and Budget (OMB) officials. To assess the steps DOE has taken to ensure the LPG will be well managed, we compared DOE's plan with OMB budget guidance, internal control and accounting standards, and practices used by other selected agencies that manage loan guarantee programs. We performed our work in accordance with generally accepted government auditing standards from October 2006 through February 2007.

In February 2007, we reported the following:

In fiscal year 2006, and continuing through October 2006, DOE used about \$503,000 from three separate appropriation accounts to fund LPG activities. DOE used these funds for the salaries of three staff detailed to the LPG office and for contracts to support program development, including the development of a LPG Web site. As of the end of October,

³For the first round of loan guarantees, the guidelines stated that DOE anticipated that borrowers would pay the subsidy costs and that those borrowers would be assessed fees to cover some administrative costs.

⁴Revised Continuing Appropriations Resolution for Fiscal Year 2007, Pub. L. No. 110-5, title II, ch. 3, §§ 20315, 20320 (February 15, 2007).

DOE had discontinued most funding, and the staff initially detailed to the LGP had returned to their home units. However, DOE continued to pay for task order support services to respond to program inquiries, and these payments were in addition to the \$503,000 already spent to initiate the program. At the same time, according to the deputy general counsel for energy policy, he and others in his office continued to work on the program by, for example, preparing a notice of proposed rulemaking and reviewing pre-applications for completeness. At the time of our review, DOE officials said they were awaiting appropriations before taking additional steps to implement the LGP.

Although LGP guidelines call for borrowers to be charged fees to cover all program costs, the program could result in substantial financial costs to the taxpayer if DOE underestimates total program costs and therefore does not charge fees sufficient to cover them. There are primarily two types of program costs: administrative and subsidy. Administrative costs include, for example, costs for evaluating applications; offering, negotiating and closing guarantees; and servicing and monitoring the guarantees. At the time of our review, DOE had not determined how it would estimate administrative costs, recover these costs from LGP borrowers, or fund shortfalls if the agency collected too little from borrowers.

The other type of program cost that poses financial risk to taxpayers is the LGP subsidy cost: the estimated net present value of the long-term cost to the federal government of guaranteeing the loans over the entire period that the loans are outstanding, excluding administrative costs. The subsidy cost takes into account (1) estimated federal payments to cover defaults, delinquencies, or other payments; and (2) estimated payments to the government, including origination and other fees, penalties, and recoveries on defaults. DOE will have to estimate the subsidy cost to determine the fees to charge borrowers, but it had no policies or procedures for doing so at the time of our review. Estimating the subsidy cost could be difficult because the program targets innovative energy technologies that have not been proven commercially viable and loan performance could depend the success of the unproven technologies and on future economic conditions, including energy prices, which are hard to predict accurately. Under the Federal Credit

Reform Act of 1990 (FCRA), shortfalls in subsidy costs are funded automatically by a permanent indefinite appropriation, not through the annual appropriations process.

DOE has taken some steps to implement the LGP, but these steps are not sufficient to help ensure the long-term success of the program. From OMB guidance, internal control and accounting standards, and the experience of other loan guarantee programs, we identified multiple steps that DOE needs to take to achieve reasonable assurance that the program will be well managed, including the following five key steps:

- *Issue regulations, which go through the public notice and comment process and thus are transparent; carry the force of law; and hold the agency implementing the program and program participants accountable to the terms specified in the regulations.* DOE had not issued regulations for implementing the LGP; instead it planned to rely on guidelines for awarding the first \$2 billion in loan guarantees. DOE officials told us that they would enforce the guidelines through the terms of the loan guarantee contracts and thus saw no need to issue regulations before issuing the first \$2 billion in loan guarantees. The officials also told us they would have regulations in place for later guarantees.⁵
- *Establish a credit review board to coordinate credit management and debt collection activities and ensure full consideration of credit management and debt collection issues.* DOE drafted a charter for a credit review board, but it had not yet provided the charter to the Secretary of Energy for approval at the time of our review.
- *Set policies and procedures for selecting and monitoring loans and lenders that protect the government's interests.* For example, these policies and procedures should establish mechanisms to screen and select applicants and lenders and to

⁵EPAAct 05 requires DOE to issue (1) regulations defining conditions for determining when a borrower has defaulted on a loan and (2) requirements for the documentation borrowers must make available for audits. At the time of our review, DOE officials told us that the department planned to include these requirements in its final regulations. If DOE issues guarantees before the regulations are final, officials said they would issue procedural rules covering these requirements before they issued the guarantees.

monitor loan and lender performance. DOE had taken some steps towards establishing such policies and procedures through its guidelines, but it had not completed them.

- *Set policies and procedures for adequately estimating administrative and subsidy costs and accounting for loan guarantees to help ensure funds are properly accounted for and that fees cover program costs.* DOE had not developed policies or procedures for estimating administrative or subsidy costs. In addition, it had not developed policies or procedures for accounting for loan guarantees. Instead, DOE asked potential borrowers—who have an incentive to underestimate the costs—to provide preliminary estimates of subsidy costs so that it could gain experience in developing these estimates. DOE expected the necessary accounting policies and procedures would be in place before guarantees were issued.
- *Set program goals and objectives tied to outcome measures for determining program effectiveness.* Rather than establishing outcome measurements, DOE set broad objectives of furthering the policy goals generally set forth in EPCA 05 and promoting the President’s Advanced Energy Initiative. This initiative supports clean energy technology research to reduce reliance on oil and address high natural gas and electricity prices.

In conclusion, Mr. Chairman and Members of the Subcommittee, at the time of our review, DOE had not taken steps to ensure that it had in place the critical policies, procedures, and mechanisms necessary to ensure the program’s success. In our report we recommended that the department take these steps: issuing regulations; establishing a credit review board, setting policies and procedures for selecting and monitoring loans and lenders, setting policies and procedures for estimating administrative and subsidy

costs and accounting for loan guarantees, and setting program goals and objectives tied to outcome measures for determining program effectiveness.

Since we completed our audit work, the Revised Continuing Appropriations Resolution for Fiscal Year 2007 directed DOE to implement most of our recommendations by issuing final regulations before awarding loan guarantees. These regulations are to include (1) programmatic, technical, and financial factors for selecting projects for loan guarantees; (2) policies and procedures for selecting and monitoring lenders and loan performance, and (3) any other policies or information necessary to implement the LGP. DOE was also instructed to complete these regulations within 6 months of the appropriations act.

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Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or Members of the Subcommittee may have.

Contacts and Staff Acknowledgements

Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. For further information about our review of the loan guarantee program, please contact James Cosgrove at 202-512-3841 or cosgrovej@gao.gov. Key contributors to this statement were Marcia Carlsen, Assistant Director; Doreen S. Feldman, Assistant General Counsel; Marcia Brouns McWreath; Karla Springer, Assistant Director; Carol Herrnstadt Shulman; and Barbara R. Timmerman, Senior Attorney.

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