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**DEPARTMENT OF
ENERGY**

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

Statement of James C. Cosgrove, Acting Director
Natural Resources and Environment





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 projects intended to, decrease air pollutants or man-made greenhouse gases, employ new or significantly better technologies, and have a reasonable prospect of repayment. The Federal Credit Reform Act requires appropriated budget authority for LGP costs before loans can be made. In 2006, 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, but funding was authorized.

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](#)) and its April 20, 2007 legal opinion (B-308715). GAO discusses the sources and use of funds for the LGP in fiscal years 2006 and 2007; DOE's authority to implement the LGP and to fund the program before Congress had appropriated funding; extent to which the LGP could result in a financial risk to the taxpayer; and steps DOE has taken to ensure that the LGP will be well managed.

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.

DOE should not have begun implementation of the LGP without a specific appropriation. Nevertheless, DOE did begin implementation, and its approach to the LGP raised serious questions about whether this program and its financial risks would be well managed.

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 administrative costs, such as evaluating applications. While DOE must recover these costs, it had not developed a plan to determine how it would do so at the time of GAO's review. Appropriated funds may be necessary to cover shortfalls. The other type of program cost is the 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. DOE will have to estimate this cost to determine the fees charged borrowers, but it had no policies or procedures for doing so. Estimating this cost could be difficult because the program targets innovative energy technologies, 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 by a permanent indefinite appropriation, not through the annual appropriations process.

GAO recommended key steps that DOE did not take but that would help ensure that the program is well managed. The Revised Continuing Appropriations Resolution for Fiscal Year 2007 directed DOE to implement most of GAO's 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.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the results of our February 2007 report, and Susan Poling is available to discuss our just-released legal opinion on the Department of Energy's loan guarantee program for innovative technologies,¹ both of which we prepared 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 May 2006, DOE proposed transferring appropriations from some DOE accounts to begin the program. In August 2006, DOE issued a solicitation for preapplications to the loan guarantee program, 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.³ After we had completed our audit work Congress appropriated amounts to cover the costs of loan guarantees. budget authority for the program.⁴

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); and B-308715, *Department of Energy—Title XVII Loan Guarantee Program*, April 20, 2007.

²Title XVII of EPA05—Incentives for Innovative Technologies.

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).

My testimony today discusses the (1) sources and use of funds for the LGP in fiscal years 2006 and 2007, (2) DOE's authority to implement the LGP under section 1702 of the EPAct 05 and section 301 of the Energy and Water Development Appropriations Act of 1993 and to finance the program before Congress had appropriated funds,⁵ (3) extent to which the LGP could result in a financial risk to the taxpayer, and (4) steps DOE has taken to ensure that the LGP will be well managed.

To identify sources and use of funds for DOE's LGP, we interviewed DOE LGP and budget officials and reviewed and analyzed relevant DOE budget documentation as well as agency LGP guidance and planning documents. To examine the extent to which the LGP could result in financial risks to taxpayers, we analyzed DOE's plans and guidance for implementing the LGP 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 LGP will be well managed, we compared DOE's plan with OMB budget and internal control guidance, federal 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. Consistent with our practice in rendering legal opinions, we contacted DOE to establish the factual record and elicit the agency's legal position on the subject matter of the request.⁶

In February 2007, we reported the following:

First, 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 program development, including the development of a LGP Web site. 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. However, DOE had discontinued other funding, and the staff on detail had returned to their home units. Nevertheless, according to the deputy general counsel for energy policy, he and others continued to work

⁵ 42. U.S.C. § 7278.

⁶ GAO, *Procedures and Practices for Legal Decisions and Opinions*, [GAO-06-1064SP](#) (Washington, D.C.: Sept. 2006), available at www.gao.gov/congress.html (last visited Apr. 16, 2007).

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.

Second, 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. These costs include, for example, administrative costs for evaluating applications; offering, negotiating and closing guarantees; and servicing and monitoring the guarantees. While DOE must recover applicable administrative costs, it had not developed a plan to determine how it would recover these costs at the time of our review. Appropriated funds may be necessary to cover shortfalls. The other type of program cost is the 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 charged borrowers, but it had no policies or procedures for doing so at the time of our review. Estimating this cost could be difficult because the program targets innovative energy technologies, and loan performance could depend heavily 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 by a permanent indefinite appropriation, not through the annual appropriations process.

Third, rather than taking and completing key steps to ensure that the LGP would be well managed and accomplish its objectives, we found that DOE had focused on initiating the LGP by soliciting pre-applications for proposed projects. From OMB guidance, internal control and accounting standards, and the experience of other loan guarantee programs, we identified the following key steps that can provide greater program accountability and reasonable assurance that program objectives will be met. For each step, we also describe the actions DOE had taken at the time of our review.

- *Issuing 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. Unlike guidelines, regulations (1) go through the

public notice and comment process and thus are transparent to the public, oversight agencies, and Congress and (2) carry the force of law and hold the agency implementing the program and program participants accountable to the terms specified in the regulations. 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.

- *Establishing a credit review board.* 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. This board is to coordinate credit management and debt collection activities and ensure full consideration of credit management and debt collection issues.
- *Setting policies and procedures for selecting and monitoring loans and lenders.* DOE had taken some steps towards establishing such policies and procedures through its guidelines, but it had not completed them. These policies and procedures should protect the government's interests by, among other things, establishing mechanisms to screen and select applicants and lenders and to monitor loan and lender performance.
- *Setting policies and procedures for estimating administrative and subsidy costs and accounting for loan guarantees.* As previously noted, 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. In the interim, DOE was asking 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.
- *Setting program goals and objectives tied to outcome measures for determining program effectiveness.* DOE had not established outcome measurements. Instead, it had set broad objectives of furthering the policy goals generally set forth in EAct 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.

EAct 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.

Finally, concerning DOE's authority to implement and fund the LGP before Congress had appropriated funding, we concluded in our April 20, 2007, opinion that EPL Act 05, section 1702(b)(2), confers upon DOE independent authority to make loan guarantees, notwithstanding the FCRA requirements. We also concluded that DOE engaged in activities to implement a loan guarantee program under title XVII of the act during a period when DOE was affirmatively prohibited from implementing that title by 42 U.S.C. § 7278. These activities violated section 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.⁷

In conclusion, Mr. Chairman and Members of the Subcommittee, DOE should not have begun implementation of the LGP without a specific appropriation. Nevertheless, DOE did begin implementation, and its approach to the LGP raised serious questions about whether this program and its financial risks would be well managed. 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.

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

⁷Office of Management and Budget Circular No. A-11 provides guidance on the information to include in Antideficiency Act reports. Agencies must report violations found by GAO, even if they disagree with the finding. OMB advises agencies, "If the agency does not agree that a violation has occurred, the report to the President, Congress, and the Comptroller General will explain the agency's position." OMB Cir. No. A-11, *Preparation, Submission, and Execution of the Budget*, § 145.8 (June 2006).

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.

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. For further information on our legal opinion, please contact Susan A. Poling, Managing Associate General Counsel at 202-512-2667 or polings@gao.gov. Key contributors to this statement were Thomas H. Armstrong, Assistant General Counsel for Appropriations; Marcia Carlsen, Assistant Director; Doreen S. Feldman, Assistant General Counsel; Marcia Brouns McWreath; Neill Martin-Rolsky, Senior Attorney; Karla Springer, Assistant Director; Carol Herrnstadt Shulman; and Barbara R. Timmerman, Senior Attorney.

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