Trouble at the Synfuels Bank

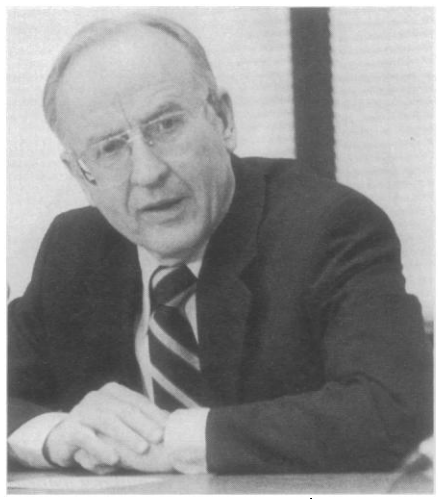
The $15-billion plan to finance a new fuels industry has bogged down in office politics and an adverse oil market; critics aim to cut back its funds

The Synthetic Fuels Corporation (SFC), set up in 1980 with $15 billion from the U.S. Treasury as an impartial banker of the synfuels industry, has become a political football. This is just what its creators hoped to avoid. In recent months, the SFC has been kicked from one end of Congress to the other, accused alternately of being too cautious and too spendthrift. The fact that the criticism comes from several directions might be taken as a sign that the SFC is making good progress on its own, offending some entrenched interests. But in reality it has made little progress.

The SFC's quarreling leadership and the deflated oil market have contributed to the disappointing record. It is likely, therefore, that proposals to abolish the SFC or tighten congressional controls will get attention when Congress reconvenes. Several bills are waiting, including a compromise abolition plan sponsored by Representative Tom Corcoran (R–Ill.) that would turn the SFC into a $3-billion research outfit. Already, the National Taxpayers' Union, a conservative group that helped kill the Clinch River breeder reactor, has decided that its next target will be the synfuels program. There is an irony here which is not lost on SFC staffers. The more the SFC cooperates with Congress to keep its confidence, the more pork barrel politics it may see.

The SFC's directors concede now that they will not meet the fuel production goals set out in the 1980 Energy Security Act that created the SFC. The objective was to hurry the birth of an industry whose natural gestation was taking too long. The stimuli were to be loan and price guarantees. In 1979 and 1980 congressmen argued plausibly that the guarantees would come almost cost-free. Oil prices were rising so rapidly that the figures the federal government would need to support looked conservative. The SFC was expected to deliver 500,000 barrels of synfuel a day in 1987 and 2 million in 1992.

In early 1981 the economy slowed and the oil market collapsed. Some of the biggest projects were canceled. The worst blow came in May 1982 when Exxon pulled out of a joint venture known as the Colony Oil Shale Project in Colorado. As of last July, when Congress went over the numbers in detail, the SFC said its awards to projects in construction would come up with no more than 35,300 barrels a day by 1989. However, in the coming months, the SFC hopes to launch enough new ventures to produce the equivalent of 160,000 barrels a day by 1989.



SFC chairman Ernest Noble

"There was no arm-twisting" in congressional lobbying for the Great Plains project.

In addition to lowering the production estimates, the SFC is asking that the deadline for its "comprehensive strategy" (due in July 1984) be postponed. Congress originally planned to give the SFC a second funding installment of $68 billion when the strategy paper was filed. Now there are rumors that the Administration will seek little or no additional money. It is not clear when the SFC will write its comprehensive plan.

Many legislators are watching these problems closely and urging the SFC to come home to Congress for guidance. A hint of what this might mean popped out during a public hearing in the House on 8 December. Representative Mike Synar (D–Okla.), chairman of the government operations subcommittee on environment, energy, and natural resources, had called the hearing to grill the SFC about its endorsement of a botched tar sands scheme in New Mexico known as the Santa Rosa project. (The $42-million endorsement has since been withdrawn.) In the middle of a tense interrogation on viscosity tests, fracture zones, and local mineral rights, a congressman to the chairman's left said he wanted to change the subject for a moment. A battery of SFC staffers and attorneys, headed by the SFC's board chairman, Ernest Noble, looked up at the questioner. Representative Joe Kolter (D–Pa.) smiled back beatifically and asked if anyone could explain what had happened to the application filed by a coal company in his district. Yes, came the answer, it was one of five finalists in competition for an SFC award, soon to be decided upon. "Thank you," said Kolter, and that was all.

This amounted to a nudge and a wink, nothing to compare with the serious lobbying being done on behalf of the Great Plains coal gasification project in Beulah, North Dakota. This project, financed primarily with a $2-billion loan guarantee from the Department of Energy (DOE) under the Carter Administration, is due to begin producing synthetic gas from coal next year. The problem is that in the 2 years since the Great Plains plant began construction, oil prices have dropped from around $35 to $29 a barrel, natural gas has become more plentiful, and energy use has failed to keep up with company forecasts.

Pipeline owners who signed contracts for high-priced gas during the inflationary period do not want to buy Great Plains' product any longer, or, in any case, not at the price it will cost. So the five owners of Great Plains (American Natural Resources, MidCon Corporation, Pacific Lighting, Tenneco, and Transco Energy), unwilling to absorb the price reductions that would be necessary, are asking the SFC for help. Specifically, they want a federal price guarantee that would pay them the difference between the price they can get for the gas and the price they would like to get (the equivalent of $45 for a barrel of oil). This emergency relief would come on top of special tax credits, waivers of price regulations, and loans already given by the federal government. If this request is not granted, the five companies say, they will abandon the nation's largest synthetic fuels project on the eve of its completion. This proposition has been likened to blackmail.

The SFC staff began bracing for the bailout request beginning last spring when the issue arose. Technologically, the project is adventurous only in its scale. The 16 gasifiers it uses are of the Lurgi type, invented by the Germans in the 1930's and incorporated more recently in coal-to-gasoline plants in South Africa. Politically, it may be tainted, having been a pet of the Carter Administration. But its failure would embarrass not just congressional backers of the synfuels program but the entire government. Representative Jim Wright (D–Texas), one of the most important of these backers, said in hearings last October: "It will be the first major proof that we as a country meant it; that Congress was serious; that we as a nation and as a people have the capacity for sustained urgency behind this drive to . . . be energy independent and allow us not to be at the mercy of the Arabs or any other combination of foreign nations."

The entire issue seems to turn on the credibility of the threat to abandon the plant. The SFC decided, as its financial officer Edward Miller told Synar's committee in October, that the threat did not seem credible. Using a computer model based on historic corporate decision-making, Miller concluded that there was little likelihood that the controlling partners would abandon Great Plains, although minor partners might want to. He mentioned that no physical preparations for abandonment had been made, and that the plant was virtually finished. In the worst-case analysis, the rate of return on equity would be 6 to 24 percent a year. Miller said this would be an acceptable income, although "book losses" would depress the value of the owners' stock. Caring for investors' stock was not something the SFC saw as one of its duties. Miller said in conclusion that the "SFC is not the only bank in town." He suggested that Congress or the DOE sponsor the bailout. (DOE's loan agreement permits Great Plains to delay repayment, if necessary.) Noble and the SFC's board decided on 21 October to let Great Plains fend for itself.

Five days later, Noble was called to what observers described as a "heated" meeting with congressmen who had pushed the SFC legislation to enactment: Wright, Senators James McClure (R–Idaho), Pete Domenici (R–N.M.), and others. Noble was chastised for being too tight with SFC funds. Then Noble went to see the President's right-hand aide, Edwin Meese III. He also urged the SFC to help Great Plains.

Thus on 1 December, the nonpolitical synfuels bank succumbed to politics: it invited the Great Plains investors to apply for a price guarantee, an amount to be negotiated next April. In announcing the board's decision, Noble said, "There wasn't any arm-twisting or any kind of pressure. We are not predisposed to make any decision. We're asking the staff to look at the facts, just look at the facts." Although the SFC solicitation was made in the form of a general invitation to coal gasification projects, the requirement that full commitment of capital be made by 2 March 1984 rules out most of Great Plains' potential competitors. Of course, the SFC, after signaling that it will bail out Great Plains, can

Robert A. G. Monks

An SFC board member who wants the agency to move more aggressively in making awards.

reverse itself again next year. But that seems unlikely.

This setback involved big politics. But some smaller and nastier differences that surfaced earlier this year were equally devastating for the SFC. For example, in July, the SFC endured a 2-day ordeal before the Senate governmental affairs subcommittee on oversight of government management. The meeting was chaired by Senator William Cohen, a 43-year-old liberal Republican from Maine and friend of a member of the SFC board, Robert Monks. Monks is a wealthy financier who has settled in Maine and takes an interest in national energy policy. He was once mentioned as a candidate for Reagan's secretary of energy. As an "outside" director of the SFC board, he was involved in policy-making only once a month, at board meetings. He wanted to be more involved and he considered Noble's appointees, who blocked Monks' path, to be disastrous for the agency.

Cohen's hearings on 27 and 29 July aimed to discredit the SFC management and promote the philosophy, and perhaps the career, of Monks. Their effect, in any case, was to reveal in detail the office rivalries and petty disputes that had been festering at the agency for 2 years.

Using documents and inside information supplied by Monks, Cohen revealed a division between an in-group and an out-group at the SFC. Authority was closely held by Noble and another director who served as the president and chief operating officer, Victor Schroeder. Noble and Schroeder were old friends and business partners; Schroeder's wife was Noble's secretary for 26 years. The committee's report on this investigation, issued in September, also charges that some of the SFC officials and consultants "had close ties to the management, giving rise to suggestions of cronyism."

Led by Monks, some of the outside directors objected to the SFC's slowness to make awards, the lack of a comprehensive plan, and the reluctance to keep outside directors informed of agency activities. The dispute came to a head in the spring of 1982 when the SFC board was asked to vote on a reorganization plan, drawn up in response to these complaints. Late one night before the critical vote, Schroeder persuaded a wavering board member to vote for an alternative plan which Schroeder liked. An SFC staffer who was present thought that Schroeder promised to do a business favor in return for the vote. The SFC investigated and then asked the Justice Department to take a look. Its conclusion, released in August, was that there was "insufficient evidence of criminal misconduct" to warrant further investigation.

Nevertheless, Schroeder resigned his position as president after the Cohen hearings but remained a member of the SFC board. Other staffers have left since the summer bloodletting, including the widely respected executive vice president, a man with 20 years' experience in the oil industry, Jimmie Bowden. When he left on 31 October, says James Moll, the president of Synthetic Fuels Associates, a California consulting firm, "They lost the best hope for a professional, goal-oriented, rather than politics-oriented, corporation." The shock waves are still reverberating through the SFC, which may now find it more difficult to attract good managers.

Another embarrassment that many SFC staffers trace to Monks' quarrel with Noble and Schroeder is a six-part investigative series on the corporation that appeared in *Newsday* starting on 28 November. It dissects the SFC from many angles, but is particularly detailed in tracing the business conflicts of SFC board members.

For example, Noble testified when he was confirmed as SFC chairman in 1981 that he would put his oil company holdings in a blind trust. However, *Newsday* discovered that Noble retains control of some oil stocks. He told reporters that the investments are managed by his daughter, who keeps him ignorant of her decisions. Noble Affiliates, run by Noble's brother, is a partner with or contractor for several of the big firms that seek subsidies from the SFC, among them Texaco, Chevron, Tenneco, and Phillips Petroleum. As *Newday* put it, "83 percent of the loan and price guarantees the SFC plans to issue have gone to companies involved in business deals with Noble's family oil company." Noble says there is no conflict.

Newsday also looked into several projects that have received tentative letters of commitment from the SFC, one of which has now been dropped from the list, the Santa Rosa project. Synar's subcommittee investigated it as well. Among the problems that cropped up are (i) the fact that the richest portion of the deposit lies under a lake, which is part of a popular state park dedicated in 1981; (ii) state park officials say they have been given so little information that they cannot guess whether or not the project will be environmentally acceptable; (iii) the Amoco and Getty oil companies, which control other important tar-sand reserves, say that the extraction method proposed by Santa Rosa's investors is of no commercial interest to them; and (iv) a geological investigation in August revealed that the site is so badly faulted that it may be unminable. The SFC withdrew its $42-million endorsement after a major company backed out of the deal, but told the other investors they were welcome to reapply for funding as soon as they had found a better deposit.

The policy conflict that divides the SFC board is essentially a split between those who agree with Noble's penny-pinching approach and those who side with Monks in thinking that the SFC should be moving much faster and on a bigger scale. Monks and another director, C. Howard Wilkins, Jr., spoke at Cohen's hearings about the SFC's slowness to act, saying that it may have killed industry's confidence in the corporation. Thus, when the SFC agreed on 1 December to consider bailing out Great Plains for political reasons, the Monks faction gained a victory.

In opposition to this point of view stand two very different political interests. One is the conservative, budget-conscious faction from which Noble himself comes. Noble was a major contributor to ther Heritage Foundation, which opposes government subsidies to private industry. During President Reagan's transition to office, Noble looked at the SFC and recommended doing away with it. But when President Reagan made him chairman, Noble says, he changed his mind. The country needs to build a technological base for turning its solid fuels to liquids and gases, he concluded, and the SFC could offer the incentive. His change of heart has never been fully convincing to the congressmen who conceived the program.

The only other regular criticism of the SFC comes from environmentalists, who see it as the creator of a new and unregulated generation of polluters. These critics are led by Robert Roach of the Environmental Policy Center. Cleverly, he bases his critiques substantially on economics so that the opponents stand on common ground and thus may speak with a louder voice.

Roach argues that the SFC, even moving at the pace set by Noble, has been hard-pressed to find good projects and has hastily endorsed some weak ones. When the major oil companies began to quit the scene, he says, the SFC was left with the ideas the big investors had discarded. Thus, he refers to the SFC's fourth general solicitation on 1 December as "the graveyard solicitation," because it invites all the projects that were killed in early SFC reviews to come back for another try. This approach attracts rank speculators and the other bane of the SFC, jobbing proposal writers. The latter, although competent, are not likely to carry a project beyond its federally guaranteed lifetime. The risk in encouraging such companies, Roach says, is that they will return later when the money runs low and threaten suicide, in the style of Great Plains. When that happens, as recent history shows, Congress finds it almost impossible to resist an appeal to save jobs.

"The SFC, by its own admission, has become an R & D outfit," Roach says. SFC and DOE officials are "always saying that the key is knowledge, that we need to learn more about the technology," even if it cannot be justified as a commercial investment. But the SFC is not equipped to manage research, he points out. It does not even have the capacity to collect and keep data. The agency regards itself as a bank, and does not really want to know anything about the projects it sponsors beyond what is required to make a funding decision. Roach thinks it is possible that the SFC could spend a great deal of money and 5 years from now have little to show for it in commercial or research experience.

—**ELIOT MARSHALL**

Another article will examine the technologies endorsed by the SFC thus far and its options for the future.

U.S. Synthetic Fuel Projects

Since the Synthetic Fuels Corporation (SFC) began to function in mid-1981, three government-backed projects have been built.

- The Great Plains gasification plant, in Beulah, N.D., was inherited from the Carter Administration. It had received $2 billion in loan guarantees and special tax credits but was still in trouble. The SFC's chairman did not want to bail it out, but under congressional pressure the SFC has agreed to consider giving it a price guarantee. The project is nearly complete and is due to produce the equivalent of 21,000 barrels of oil daily.
- Union Oil's shale project in Parachute Creek, Colorado, won a defense purchase commitment and $400-million price guarantee from the Carter Administration to produce 10,000 barrels of syncrude oil daily. In December the company won a new letter of intent from the SFC, promising up to $2.7 billion in price supports for an expansion to 42,000 barrels of daily production in the early 1990's.
- The Cool Water coal gasification plant in Daggett, California, won a $120-million price support from the SFC to continue an experiment in electricity generation. The project, sponsored by six companies and the Electric Power Research Institute, is to use the equivalent of 4,300 barrels of oil daily beginning in 1984.
- In addition to these commitments, the SFC has issued letters of intent to three other companies whose combined output is expected to be 23,000 barrels a day in the late 1980's.—**E.M.**