Industry Abandons Synfuels Project

The Administration says "no" to price guarantees for the Great Plains coal gasification plant, the only U.S. commercial-scale synfuels project

The nation's only commercial-scale synthetic fuels plant, the Great Plains Coal Gasification Project, is likely to be shut down by the federal government less than a year after beginning full-scale operation. The impending collapse of the $2.1-billion Beulah, North Dakota, project is tied to the Reagan Administration's refusal to provide the five industrial partners with $720 million in price guarantees to offset operating losses.

The lignite gasification project, which was built with $543 million in private capital and $1.5 billion in federal loan guarantees, began commercial operations in December 1984 after a 63-week start-up period. First conceived of in the mid-1970's, the plant, which produces 137.5 million cubic feet per day of high-Btu gas, was backed by the Ford, Carter, and Reagan Administrations. It was portrayed as a model project that would give the United States essential engineering, economic, health, and environmental data to assess the viability of a large domestic synthetic fuels industry.

But on 30 July, the Reagan Administration withdrew its backing for operating subsidies that have become necessary because of a drop in world petroleum prices. John Herrington, Secretary of the Department of Energy (DOE), justified the government's action on the grounds that there was "no assurance of long-term operation . . . at a reasonable cost to the taxpayers. . . ." Project sponsors, in response to Herrington's decree, notified DOE on 1 August that they were abandoning the plant.

Executives of Tenneco, Inc., American Natural Resources Company, Transco Energy Company, MidCon Corporation, and Pacific Lighting Corporation are understandably bitter about the government's decision. "The signal it sends is that it is very difficult to enter into a long-term business arrangement with the government," says Clifford W. Rackley, a senior vice president of Tenneco.

Two years ago, the industrial partners could have bailed out when their investment stood at $383 million, instead of $543 million. At that time they notified DOE that price guarantees would be required to avoid abandonment. DOE, in turn, urged the partners to seek financial aid from the U.S. Synthetic Fuels Corporation (SFC), which at that time had $14 billion in unobligated spending authority. And the SFC, after first balking at the idea, bowed to pressure from Congress and DOE to consider Great Plains' application for price supports.

Although construction of the complex was completed on schedule and under budget, the operating economics of the venture always have been a worry. Under the enacting legislation, the Energy Security Act of 1980, Great Plains can charge a premium price for gas produced from the plant. Instead of being pegged to market prices for natural gas, its price is based on home heating oil prices and the Producer Price Index. In 1981 the approach looked sound because oil prices were high. Gas from the plant would have sold at $6.75 per thousand cubic feet (MCF).

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The need for price supports developed as world oil prices plunged from $32 per barrel in 1981 to $29 per barrel in 1983. Since then world prices have dropped to less than $28 per barrel. This price slide has had a devastating effect on Great Plains' projected revenues, causing its gas prices to drop to $5.50 per MCF—still almost $3 higher than actual market rates for natural gas.

"This is not the fault of the project sponsors, or of the SFC. From a technical point of view, the project has gone well; oil and natural gas prices have simply not proved high enough to make the project economical," says DOE's Herrington in explaining his position.

"The Administration's decision," says Tenneco's Rackley, "reflects a different philosophy towards synfuels development than what has existed in the past." Indeed, proponents of synthetic fuels say economics should not be the litmus test for this frontier project. Edward E. Noble, chairman of the SFC, argues that the United States is passing up an opportunity to master this technology during a stable period, rather than during a time of crisis.

Still others argue that having come this far, the government ought to extract some knowledge from the facility. "It's an outrage that the people of the United States will be made to pay a $1.5-billion loan guarantee and not get anything for it, except a pile of welded pipe in Beulah," says Richard Olsen, who was involved in the writing of the Energy Security Act as a former staff director for House Majority Leader James Wright.

The fate of the sprawling 1-square-mile complex is uncertain. In the face of political pressure from state officials and supporters of the project on Capitol Hill, DOE is looking at options for keeping the plant operating under government ownership. However, sources say the Administration would prefer to mothball the plant or sell it—the latter being unlikely given current market prices for gas. Even at the premium prices Great Plains' gas now commands, revenues barely cover operating costs and are inadequate to meet debt service.

One-time costs for mothballing the plant range from $25 million to $50 million, depending on whether the government wants the capability of starting up the facility in 6 months or in less than 60 days. Annual maintenance expenses under each scenario are $5 million and $12 million, respectively.

Working in the Administration's favor is the effort in Congress to shut down the SFC, which has been rocked by scandal and charges of mismanagement. The House already has moved to strip $7.9 billion in remaining loan and price guarantee authority. The Senate is expected to take up the matter when it returns from the August recess.

With the last vestiges of the government-aided synfuel demonstration program about to be killed by the Congress, the United States' effort to understand the consequences of synfuel development will be confined to a few smaller industrial sites and to the laboratory. Commercial-scale demonstrations will have to wait until oil prices rise—or until the next energy crisis. Says Tenneco's Rackley, reflecting on synthetic fuels development in this country: "We have proceeded in a knee-jerk fashion in the past. We are acting in a knee-jerk fashion now. And I am sure we will proceed in a knee-jerk fashion in the future."

—**Mark Crawford**