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Report to Congressional Committees

July 2010

DEPARTMENT OF ENERGY

Further Actions Are Needed to Improve DOE's Ability to Evaluate and Implement the Loan Guarantee Program

GAO

Accountability * Integrity * Reliability

GAO-10-627

Highlights

Highlights of GAO-10-627, a report to congressional committees

July 2010

DEPARTMENT OF ENERGY

Further Actions Are Needed to Improve DOE's Ability to Evaluate and Implement the Loan Guarantee Program

Why GAO Did This Study

Since the Department of Energy's (DOE) loan guarantee program (LGP) for innovative energy projects was established in Title XVII of the Energy Policy Act of 2005, its scope has expanded both in the types of projects it can support and in the amount of loan guarantee authority available. DOE currently has loan guarantee authority estimated at about $77 billion and is seeking additional authority. As of April 2010, it had issued one loan guarantee for $535 million and made nine conditional commitments. In response to Congress' mandate to review DOE's execution of the LGP, GAO assessed (1) the extent to which DOE has identified what it intends to achieve through the LGP and is positioned to evaluate progress and (2) how DOE has implemented the program for applicants. GAO analyzed relevant legislation, prior GAO work, and DOE guidance and regulations. GAO also interviewed DOE officials, LGP applicants, and trade association representatives.

What GAO Recommends

GAO recommends that DOE develop performance goals reflecting the LGP's policy goals and activities; revise the loan guarantee process to treat applicants consistently unless there are clear, compelling grounds not to do so; and develop mechanisms for administrative appeals and for systematically obtaining and addressing applicant feedback. DOE said it is taking steps to address GAO's concerns but did not explicitly agree or disagree with the recommendations.

View GAO-10-627 or key components.
For more information, contact Frank Rusco at (202) 512-3841 or ruscof@gao.gov.

What GAO Found

DOE has broadly indicated the program's direction but has not developed all the tools necessary to assess progress. DOE officials have identified a number of broad policy goals that the LGP is intended to support, including helping to mitigate climate change and create jobs. DOE has also explained, through agency documents, that the program is intended to support early commercial production and use of new or significantly improved technologies in energy projects that abate emissions of air pollutants or of greenhouse gases and have a reasonable prospect of repaying the loans. GAO has found that to help operationalize such policy goals efficiently and effectively, agencies should develop associated performance goals that are objective and quantifiable and cover all program activities. DOE has linked the LGP to two departmentwide performance goals, namely to (1) double renewable energy generating capacity by 2012 and (2) commit conditionally to loan guarantees for two nuclear power facilities to add a specified minimum amount of capacity in 2010. However, the two performance goals are too few to reflect the full range of policy goals for the LGP. For example, there is no performance goal for the number of jobs that should be created. The performance goals also do not reflect the full scope of program activities; in particular, although the program has made conditional commitments to issue loan guarantees for energy efficiency projects, there is no performance goal that relates to such projects. Without comprehensive performance goals, DOE lacks the foundation to assess the program's progress and, more specifically, to determine whether the projects selected for loan guarantees help achieve the desired results.

DOE has taken steps to implement the LGP for applicants but has treated applicants inconsistently and lacks mechanisms to identify and address their concerns. Among other things, DOE increased the LGP's staff, expedited procurement of external reviews, and developed procedures for deciding which projects should receive loan guarantees. However, GAO found:

- DOE's implementation of the LGP has treated applicants inconsistently, favoring some and disadvantaging others. For example, DOE conditionally committed to issuing loan guarantees for some projects prior to completion of external reviews required under DOE procedures. Because applicants must pay for such reviews, this procedural deviation has allowed some applicants to receive conditional commitments before incurring expenses that other applicants had to pay. It is unclear how DOE could have sufficient information to negotiate conditional commitments without such reviews.
- DOE lacks systematic mechanisms for LGP applicants to administratively appeal its decisions or to provide feedback to DOE on its process for issuing loan guarantees. Instead, DOE rereviews rejected applications on an ad hoc basis and gathers feedback through public forums and other outreach efforts that do not ensure the views obtained are representative.

Until DOE develops implementation processes it can adhere to consistently, along with systematic approaches for rereviewing applications and obtaining and addressing applicant feedback, it may not fully realize the benefits envisioned for the LGP.

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Abbreviations

CRB	Credit Review Board
DOE	Department of Energy
EPAct	Energy Policy Act of 2005
FIPP	Financial Institution Partnership Program
GPRA	Government Performance and Results Act
LGP	Loan Guarantee Program
NETL	National Energy Technology Laboratory
Recovery Act	American Recovery and Reinvestment Act

United States Government Accountability Office
Washington, DC 20548

July 12, 2010

The Honorable Byron L. Dorgan
Chairman
The Honorable Robert F. Bennett
Ranking Member
Subcommittee on Energy and Water Development
Committee on Appropriations
United States Senate

The Honorable Peter J. Visclosky
Chairman
The Honorable Rodney P. Frelinghuysen
Ranking Member
Subcommittee on Energy and Water Development
Committee on Appropriations
House of Representatives

Through calendar year 2009, the Department of Energy's (DOE) Loan Guarantee Program (LGP) received more than 170 applications seeking over $175 billion in loan guarantees, generally to bring innovative energy technologies to market. Under normal economic conditions, companies can face obstacles in securing enough affordable financing to survive the "valley of death" between developing innovative technologies and commercializing them. Because the risks that lenders must assume to support new technologies can put private financing out of reach, companies may not be able to commercialize innovative technologies without government assistance. The financial crisis that emerged in late 2008, together with the associated economic decline, has further reduced access to capital markets for innovative energy technologies. In this constrained economic environment, even companies that might ordinarily rely on private financing are turning to the federal government for assistance.

Federal loan guarantee programs such as DOE's can help companies obtain affordable financing because the federal government agrees to reimburse lenders for the guaranteed amount if the borrowers default, which encourages lending by reducing the lenders' financial risks. In addition, to the extent that a federal loan guarantee signals confidence in a project, such guarantees can help companies raise capital from other sources, for example by selling equity. However, loan guarantee programs can also expose the government to substantial financial risks. In the past, problems with loan guarantee programs have occurred, in part, because agencies did not exercise due diligence during the loan origination and monitoring processes.

Since the LGP was authorized under Title XVII of the Energy Policy Act of 2005 (EPAct), its scope has expanded.[1] The act—specifically section 1703—originally authorized DOE to guarantee loans for projects that (1) use new or significantly improved technologies as compared with commercial technologies already in service in the United States and (2) avoid, reduce, or sequester emissions of air pollutants or man-made greenhouse gases. In February 2009, Congress passed the American Recovery and Reinvestment Act (Recovery Act), which amended Title XVII by adding section 1705.[2] Under section 1705, DOE may guarantee loans for projects using commercial technologies. Projects supported by the Recovery Act must employ renewable energy systems, electric power transmission systems, or leading-edge biofuels that meet certain criteria; begin construction by the end of fiscal year 2011; and pay wages at or above market rates.

The LGP's loan guarantee authority has also increased. In fiscal year 2007, Congress authorized up to $4 billion in loan guarantees for projects that meet the criteria in section 1703. By fiscal year 2009, Congress had authorized an additional $47 billion in loan guarantees for projects that meet these criteria.[3] Congress did not appropriate funds to cover the associated credit subsidy costs—that is, the government's estimated net long-term cost, in present value terms, of direct or guaranteed loans over the entire period the loans are outstanding (not including administrative costs). Consequently, borrowers who obtain loan guarantees under section 1703 must pay fees to cover these costs. Under the Recovery Act, Congress has provided nearly $4 billion to cover the credit subsidy costs

[1] Pub. L. No. 109-58, Title XVII (Aug. 8, 2005).

[2] Pub. L. No. 111-5 (Feb. 17, 2009).

[3] Omnibus Appropriations Act, 2009, Pub. L. No. 111-8, Div. C, Title III (Mar. 11, 2009). The act provided that of the authorized amount of $47 billion, $18.5 billion shall be for nuclear power. Further congressional direction about the allocation of loan guarantee authority among technology categories was contained in the explanatory statement accompanying the act. Use of the funds appropriated for the program was subject to certain conditions, such as a requirement for DOE to submit an implementation plan to the appropriations committees prior to issuing any new solicitations inviting applications for loan guarantees.

for projects that meet the criteria in section 1705.[4] While the Recovery Act appropriation did not specify the amount of new loan guarantee authority, DOE officials said that the department believes credit subsidy costs will average at least 15 percent of the value of loan guarantees. Accordingly, the nearly $4 billion Recovery Act appropriation to pay credit subsidy costs could increase the amount of loans that the LGP guarantees by about $26 billion, raising the program's total estimated loan guarantee capacity to about $77 billion.

As of April 2010, the department had issued eight solicitations inviting applications for projects using various categories of technologies (see table 1). It had also issued one loan guarantee for $535 million to Solyndra, one of the companies that responded to DOE's initial LGP solicitation issued in 2006, and had made nine conditional commitments to issue additional loan guarantees.[5] The one loan guarantee and four of the conditional commitments were made under the Recovery Act; the other five conditional commitments were made under section 1703.

[4]Pub. L. No. 111-5, Div. A, Title IV (Feb. 17, 2009). Congress originally appropriated nearly $6 billion to pay the credit subsidy costs of projects supported under section 1705, with the limitation that funding to pay the credit subsidy costs of leading-edge biofuel projects eligible under this section would not exceed $500 million. Congress later authorized the President to transfer up to $2 billion of the nearly $6 billion to expand the "Cash for Clunkers" program. Pub. L. No. 111-47 (Aug. 7, 2009). The $2 billion was transferred to the Department of Transportation, leaving nearly $4 billion to cover credit subsidy costs of projects supported under section 1705.

[5]A conditional commitment is a commitment by DOE to issue a loan guarantee if the applicant satisfies specific requirements. The Secretary of Energy has the discretion to cancel a conditional commitment at any time for any reason prior to the issuance of a loan guarantee.

Table 1: Technology Categories Targeted by Solicitations Issued for the LGP and Amounts Available under the Solicitations, as of April 2010

Dollars in billions

Targeted technology category	Solicitation issuance date	Amount available
Mixed[a]	Aug. 8, 2006	$4.0[b]
Nuclear power facilities	July 11, 2008	18.5
Front-end nuclear facilities[c]	July 11, 2008	2.0[b]
Coal-based power generation and industrial gasification facilities that incorporate carbon capture and sequestration or other beneficial uses of carbon and for advanced coal gasification facilities	Sept. 22, 2008	8.0
Energy efficiency, renewable energy, and advanced transmission and distribution technologies (EERE)	Oct. 29, 2008	10.0
EERE	July 29, 2009	8.5
Electric power transmission infrastructure projects	July 29, 2009	5.0[d]
Commercial technology renewable energy generation projects under the Financial Institution Partnership Program (FIPP)	Oct. 7, 2009	5.0[d]

Source: GAO presentation of DOE data.

[a]The 2006 mixed solicitation invited applications for all technologies eligible to receive loan guarantees according to the Energy Policy Act of 2005 except for nuclear facilities and oil refineries.

[b]DOE received authorization to guarantee up to $4 billion in loans in fiscal year 2007 and had planned to use this authority to support projects submitted in response to the 2006 mixed technology solicitation. On March 25, 2010, DOE informed Congress of its intention to use up to $2 billion of its fiscal year 2007 loan guarantee authority for projects submitted in response to the 2008 front-end nuclear facilities solicitation.

[c]Front-end nuclear facilities are to accelerate deployment of new uranium enrichment capacity and distribution.

[d]This amount is an estimate because the solicitation did not specify how much DOE would issue in loan guarantees. This estimate is based on the solicitation's stated plan to use $750 million to cover credit subsidy costs and assumes credit subsidy costs of 15 percent, which DOE has told us is consistent with credit subsidy estimates to date.

For fiscal year 2011, DOE is seeking an additional $36 billion in loan guarantee authority for nuclear power facilities and $500 million to cover the credit subsidy costs for energy efficiency and renewable energy projects eligible under section 1703.[6] DOE estimates that this $500 million will cover the credit subsidy costs for about $3 billion in loan guarantees.

[6]When asked if DOE plans to use the $500 million to cover the credit subsidy costs for projects that are currently under review or for projects that apply under a new solicitation, the department stated that the $500 million, if approved, will be used by the LGP at its discretion across the full spectrum of qualified energy efficiency and renewable energy projects.

We have an ongoing mandate under the 2007 Revised Continuing Appropriations Resolution to review DOE's execution of the LGP and to report our findings to the House and Senate Committees on Appropriations.[7] Our previous reviews focused on the department's efforts to establish the tools needed to evaluate the program's effectiveness and to process applications. In 2007 and 2008, we recommended that the department take steps to further develop and improve its capabilities in these areas.[8] In light of these recommendations and following discussions with your staffs, we assessed (1) the extent to which DOE has identified what it intends to achieve through the LGP and is positioned to evaluate progress and (2) how DOE has implemented the LGP for applicants.

To address these objectives, we analyzed Title XVII of EPAct, the Recovery Act, the Government Performance and Results Act (GPRA) and our prior work on GPRA, and DOE's program guidance and regulations. In addition, we interviewed relevant DOE officials and—to obtain a broad representation of views on DOE's implementation of the LGP—LGP applicants and trade association representatives. We selected the applicants and trade associations using a mix of criteria, including the amount of the loan guarantee requested and the relevant technology. Our review did not evaluate the technical or financial soundness of the projects that applied for DOE loan guarantees. In April 2010, we briefed your offices on the preliminary results of our review.

We conducted this performance audit from January 2009 through July 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. A further discussion of the scope of our review and the methods we used is presented in appendix I.

[7]Pub. L. No. 110-5 §20320(c) (Feb. 15, 2007).

[8]GAO, *The 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.: Feb. 28, 2007); GAO, *Department of Energy: New Loan Guarantee Program Should Complete Activities Necessary for Effective and Accountable Program Management*, GAO-08-750 (Washington, D.C.: July 7, 2008).

DOE Has Broadly Indicated the Program's Direction but Is Not Well Positioned to Evaluate Progress

DOE has broadly indicated the direction of the LGP but has not developed all the tools necessary to evaluate progress. DOE officials have identified a number of broad policy goals that the LGP is intended to support, including helping to ensure energy security, mitigate climate change, jumpstart the alternative energy sector, and create jobs. Additionally, through DOE's fiscal year 2011 budget request and a mission statement for the LGP, the department has explained that the program is intended to support the "early commercial production and use of new or significantly improved technologies in energy projects" that "avoid, reduce, or sequester air pollutants or anthropogenic emissions of greenhouse gases, and have a reasonable prospect of repaying the principal and interest on their debt obligations."

To help operationalize such policy goals efficiently and effectively, principles of good governance identified in our prior work on GPRA indicate that agencies should develop associated performance goals and measures that are objective and quantifiable.[9] These performance goals and measures are intended to allow comparison of programs' actual results with the desired results. Each program activity should be linked to a performance goal and measure unless such a linkage would be infeasible or impractical.

DOE has linked the LGP to two departmentwide performance goals:

- "Double renewable energy generating capacity (excluding conventional hydropower) by 2012."
- "Commit (conditionally) to loan guarantees for two nuclear power facilities to add new low-carbon emission capacity of at least 3,800 megawatts in 2010."

DOE has also established nine performance measures for the LGP (see app. II).

However, the departmentwide performance goals are too few to reflect the full range of policy goals for the LGP. For example, there is no measurable

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[9]GAO, *Agencies' Annual Performance Plans under the Results Act: An Assessment Guide to Facilitate Congressional Decisionmaking*, GAO/GGD/AIMD-10.1.18 (Washington, D.C.: February 1998, ver. 1.); GAO, *The Results Act: An Evaluator's Guide to Assessing Agency Annual Performance Plans*, GAO/GGD-10.1.20 (Washington, D.C.: April 1998, ver. 1).

performance goal for job creation. The performance goals also do not reflect the full scope of the program's authorized activities. For example, as of April 2010, DOE had issued two conditional commitments for energy efficiency projects—as authorized in legislation—but the energy efficiency projects do not address either of the performance goals because the projects are expected to generate little or no renewable energy and are not associated with nuclear power facilities. Given the lack of sufficient performance goals, DOE cannot be sure that the LGP's performance measures are appropriate. Thus, DOE lacks the foundation to assess the program's progress, and more specifically, to determine whether the projects it supports with loan guarantees contribute to achieving the desired results.

DOE Has Taken Steps to Implement the LGP but Has Treated Applicants Inconsistently and Lacks Mechanisms to Identify and Address Applicants' Concerns

As the LGP's scope and authority have increased, the department has taken a number of steps to implement the program for applicants. For example, DOE has substantially increased the LGP's staff and in-house expertise, and applicants we interviewed have commended the LGP staff's professionalism. DOE officials indicated that, prior to 2008, staffing was inadequate to review applications, but since June 2008, the LGP's staff has increased from 12 federal employees to more than 50, supported by over 40 full-time contractor staff. Also, the LGP now has in-house legal counsel and project finance expertise, which have increased the program's capacity to evaluate proposed projects. In addition, in November 2009, the Secretary named an Executive Director, reporting directly to the Secretary, to oversee the LGP and to accelerate the application review process.[10]

Other key steps that DOE has taken include the following:

- DOE has identified a list of external reviewers qualified to perform legal, engineering, financial, and marketing analyses of proposed projects. Identifying these external reviewers beforehand helps to ensure that DOE will have the necessary expertise readily available during the review process. DOE officials said that the department has also expedited the procurement process for hiring these external reviewers.
- DOE developed a credit policies and procedures manual for the LGP. Among other things, the manual contains detailed internal policies and

[10]The Executive Director also oversees DOE's Advanced Technology Vehicles Manufacturing Loan Program.

procedures that lay out requirements, criteria, and staff responsibilities for determining which proposed projects should receive loan guarantees.

- DOE revised the LGP's regulations after receiving information from industry concerning the wide variety of ownership and financing structures that applicants or potential applicants would like to employ in projects seeking loan guarantees. Among other things, the modifications allow for ownership structures that DOE found are typically employed in utility-grade power plants and are commonly proposed for the next generation of nuclear power generation facilities.
- DOE obtained OMB approval for its model to estimate credit subsidy costs. The model is a critical tool needed for the LGP to proceed with issuing loan guarantees because it will be used to calculate each loan guarantee's credit subsidy cost and the associated fee, if any, that must be collected from borrowers. (We are evaluating DOE's process and key inputs for estimating credit subsidy costs in other ongoing work.)

Notwithstanding these actions, the department is implementing the program in a way that treats applicants inconsistently, lacks systematic mechanisms for applicants to appeal its decisions or for applicants to provide feedback to DOE, and risks excluding some potential applicants unnecessarily. Specifically, we found the following:

DOE has treated applicants inconsistently. Although our past work has shown that agencies should process applications with the goals of treating applicants fairly and minimizing applicant confusion,[11] DOE's implementation of the program has favored some applicants and disadvantaged others in a number of ways. First, we found that, in at least five of the ten cases in which DOE made conditional commitments, it did so before obtaining all of the final reports from external reviewers, allowing these applicants to receive conditional commitments before incurring expenses that other applicants were required to pay. Before DOE makes a conditional commitment, LGP procedures call for engineering, financial, legal, and marketing reviews of proposed projects as part of the due diligence process for identifying and mitigating risk. If DOE lacks the in-house capability to conduct the reviews, external reviews are

[11]GAO, *Grants Management: Grants.gov Has Systemic Weaknesses That Require Attention*, GAO-09-589 (Washington, D.C.: July 15, 2009).

performed by contractors paid for by applicants.[12] In one of the cases we identified in which DOE deviated from its procedures, it made a conditional commitment before obtaining any of the external reports. DOE officials told us this project was fast-tracked because of its "strong business fundamentals" and because DOE determined that it had sufficient information to proceed. However, it is unclear how DOE could have had sufficient information to negotiate the terms of a conditional commitment without completing the types of reviews generally performed during due diligence, and proceeding without this information is contrary to the department's procedures for the LGP.

Second, DOE treats applicants with nuclear projects differently from applicants proposing projects that employ other types of technologies. For example, DOE allows applicants with nuclear projects that have not been selected to begin the due diligence process to remain in a queue in case the LGP receives additional loan guarantee authority, while applicants with projects involving other types of technologies that have not been selected to begin due diligence are rejected (see app. III). In order for applicants whose applications were rejected to receive further consideration, they must reapply and again pay application fees, which range from $75,000 to $800,000 (see app. IV). DOE also provided applicants with nuclear generation projects information on how their projects ranked in comparison with others before they submitted part II of the application and 75 percent of the application fees. DOE did not provide rankings to applicants with any other types of projects. DOE officials said that applicants with nuclear projects were allowed to remain in a queue because of the expectation that requests would substantially exceed available loan guarantee authority and that the applications would be of high quality. According to DOE officials, they based this expectation on information available about projects that are seeking licenses from the Nuclear Regulatory Commission. DOE officials also explained that they ranked nuclear generation projects for similar reasons—and also to give applicants with less competitive projects the chance to drop out of the process early, allowing them to avoid the expense involved in applying for a loan guarantee. However, all of the solicitations issued through 2008 initially received requests that exceeded the available loan guarantee authority (see app. V), so nuclear projects were not unique in that respect. In addition, applicants with coal-based power generation and industrial

[12]LGP staff have generally conducted the financial reviews for the projects that have received conditional commitments or a loan guarantee to date.

gasification facility projects paid application fees equivalent to those paid by applicants with nuclear generation projects but were not given rankings prior to paying the second application fee (see app. IV). To provide EERE applicants with earlier feedback on the competitiveness of their projects, DOE instituted a two-part application for the 2009 EERE solicitation—a change from the 2008 EERE solicitation. DOE officials stated that they made this change based on lessons learned from the 2008 EERE solicitation. While this change appears to reduce the disparity in treatment among applicants, it remains to be seen whether DOE will make similar changes for projects that employ other types of technologies.

Third, DOE has allowed one of the front-end nuclear facility applicants that we contacted additional time to meet technical and financial requirements, including requirements for evidence that the technology is ready to move to commercial-scale operations, but DOE has rejected applicants with other types of technologies for not meeting similar technical and financial criteria. DOE has not provided analysis or documentation explaining why additional time was appropriate for one project but not for others.

DOE lacks systematic mechanisms for applicants to appeal its decisions or provide feedback to DOE. In its solicitations, DOE states that a rejection is "final and non-appealable." Once a project has been rejected, the only administrative option left to an applicant under DOE's documented procedures is to reapply and incur all of the associated costs. Nevertheless, DOE said that, as a courtesy, it had rereviewed certain rejected applications. Some applicants did not know that DOE would provide such rereviews, which appear contrary to DOE's stated policy and have been conducted on an ad hoc basis.

DOE also lacks a systematic mechanism for soliciting, evaluating, and incorporating feedback from applicants about its implementation of the program. Our past work has shown that agencies should solicit, evaluate, and incorporate feedback from program users to improve programs.[13] Unless they do so, agencies may not attain the levels of user satisfaction that they otherwise could. For example, during our interviews with applicants, more than half said they received little information about the

[13]GAO, *Transportation Research: Opportunities for Improving the Oversight of DOT's Research Programs and User Satisfaction with Transportation Statistics*, GAO-06-917 (Washington, D.C.: Aug. 15, 2006).

timing or status of application reviews. Applicants expressed a desire for more information about the status of DOE's reviews and said that not knowing when a loan guarantee might be issued created difficulties in managing their projects—for example, in planning construction dates, knowing how much capital they would need to sustain operations, and maintaining support for their projects from internal stakeholders.

According to DOE officials, the department has reached out to stakeholders through its Web site, presentations to industry groups and policymakers, and other means. DOE has also indicated that it has changed the program to make it more user-friendly, based on lessons learned and applicant feedback. For example, unlike the 2008 EERE solicitation, the 2009 EERE solicitation includes rolling deadlines that give applicants greater latitude in when to submit their applications; a simplified part I application that provides a mechanism for DOE to give applicants early feedback on whether their projects are competitive; and delayed payment of the bulk of the "facility fee" that DOE charges applicants to cover certain program costs. While DOE said that these changes were based, in part, on feedback from applicants, because DOE has no systematic way of soliciting applicant feedback, the department has no assurance that the views obtained through its outreach efforts are representative, particularly since the means that DOE uses to obtain feedback do not guarantee anonymity. The department also has no assurance that the changes made in response to feedback are effectively addressing applicant concerns.

DOE risks excluding some potential applicants. Even though the Recovery Act requires that applicants begin construction by the end of fiscal year 2011 to qualify for Recovery Act funding, DOE has not yet issued solicitations for the full range of projects eligible for Recovery Act funding under section 1705. DOE has issued two solicitations specific to the Recovery Act for the LGP, but neither invites applications for commercial manufacturing projects, which are eligible under the act.[14] While DOE has announced that it will issue an LGP solicitation for commercial manufacturing projects, it has given no date for doing so. The 2009 EERE solicitation provided an opportunity for some manufacturing applicants to receive Recovery Act funding, but because DOE combined

[14]The solicitations specific to the Recovery Act are the 2009 solicitations targeting electric power transmission infrastructure projects and commercial technology renewable energy generation projects.

the Recovery Act's requirements with the original section 1703 requirements, applicants with commercial manufacturing projects were excluded. DOE officials told us that they combined the requirements to ensure that projects that are initially eligible under section 1705 but that fail to start construction by the deadline can remain in the LGP under section 1703.

Conclusions

DOE has made substantial progress in building a functional program for issuing loan guarantees under Title XVII of EPAct; however, it may not fully realize the benefits envisioned for the LGP until it further improves its ability to evaluate and implement the program. Since 2007, we have been reporting on DOE's lack of tools necessary to evaluate the program and process applications and recommending that the department take steps to address these areas. While DOE has identified broad policy goals and developed a mission statement for the program, it will lack the ability to implement the program efficiently and effectively and to evaluate progress in achieving these goals and mission until it develops corresponding performance goals. As a practical matter, without such goals, DOE will also lack a clear basis for determining whether the projects it decides to support with loan guarantees are helping achieve the desired results, potentially undermining applicants' and the public's confidence in the legitimacy of those decisions. Such confidence could also be undermined by implementation processes that do not treat applicants consistently—unless DOE has clear and compelling grounds for disparate treatment—particularly if DOE skips steps in its review process prior to issuing conditional commitments or rereviews rejected applications for some applicants without having an administrative appeal process. Furthermore, while DOE has taken steps to increase applicants' satisfaction with the program, it cannot determine the effectiveness of those efforts without systematic feedback from applicants that preserves their anonymity.

Recommendations for Executive Action

To improve DOE's ability to evaluate and implement the LGP, we recommend that the Secretary of Energy take the following four actions:

- Direct the program management to develop relevant performance goals that reflect the full range of policy goals and activities for the program, and to the extent necessary, revise the performance measures to align with these goals.

- Direct the program management to revise the process for issuing loan guarantees to clearly establish what circumstances warrant disparate treatment of applicants so that DOE's implementation of the program treats applicants consistently unless there are clear and compelling grounds for doing otherwise.

- Direct the program management to develop an administrative appeal process for applicants who believe their applications were rejected in error and document the basis for conclusions regarding appeals.

- Direct the program management to develop a mechanism to systematically obtain and address feedback from program applicants, and, in so doing, ensure that applicants' anonymity can be maintained, for example, by using an independent service to obtain the feedback.

Agency Comments

We provided a draft of this report to DOE for review and comment. In its written comments, DOE stated that it recognizes the need for continuous improvement to its Loan Guarantee Programs as those programs mature but neither explicitly agreed nor disagreed with our recommendations. In one instance, DOE specifically disagreed with our findings: the department maintained that applicants are treated consistently within solicitations.

Nevertheless, the department stated that it is taking steps to address concerns identified in our report. Specifically, DOE pointed to the following recent or planned actions:

- *Performance goals and measures.* DOE stated that, in the context of revisions to its strategic plan, the department is revisiting the performance goals and measures for the LGP to better align them with the department's policy goals of growing the green economy and reducing greenhouse gases from power generation.

- *Consistent treatment of applicants.* DOE recognized the need for greater transparency to avoid the perception of inconsistent treatment and stated that it will ensure that future solicitations explicitly describe circumstances that would allow streamlined consideration of loan guarantee applications.

- *Appeals.* DOE indicated that its process for rejected applications should be made more transparent and stated that the LGP continues to implement new strategies intended to reduce the need for any kind of appeals, such as enhanced communication with applicants including more frequent contact, and allowing applicants an opportunity to provide additional data at DOE's request to address deficiencies DOE has identified in applications.

While these actions are encouraging, they do not fully address our findings, especially in the areas of appeals and applicant feedback. We continue to believe that DOE needs systematic mechanisms for applicants to appeal its decisions and to provide anonymous feedback.

DOE's written comments on our findings and recommendations, along with our detailed responses, are contained in appendix VI. In addition to the written comments reproduced in that appendix, DOE provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to the appropriate congressional committees, the Secretary of Energy, and other interested parties. This report also is available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staffs have any questions concerning this report, please contact me at (202) 512-3841 or ruscof@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix VII.

Frank Rusco
Director, Natural Resources
and Environment

Appendix I: Scope and Methodology

To assess the extent to which the Department of Energy (DOE) has identified what it intends to achieve through the Loan Guarantee Program (LGP) and is positioned to evaluate progress, we reviewed and analyzed relevant provisions of Title XVII of the Energy Policy Act of 2005 (EPAct), the American Recovery and Reinvestment Act of 2009 (Recovery Act); DOE's budget request documents; and Recovery Act planning information, as well as other documentation provided by DOE. We discussed strategic planning and program evaluation with cognizant DOE officials from the LGP office, the Office of the Secretary of Energy, the Office of the Chief Financial Officer, and the Credit Review Board (CRB) that is charged with coordinating credit management and debt collection activities as well as overall policies and procedures for the LGP. As criteria, we used the Government Performance Results Act (GPRA), along with our prior work on GPRA.

To evaluate DOE's implementation of the LGP for applicants, we reviewed relevant legislation, such as EPAct and the Recovery Act; DOE's final regulations and concept of operations for the LGP; solicitations issued by DOE inviting applications for loan guarantees; DOE's internal project tracking reports; technical and financial review criteria for the application review process; minutes from CRB meetings held between February 2008 and November 2009; applications for loan guarantees; application rejection letters issued by DOE; and other various DOE guidance and procurement documents related to the process for issuing loan guarantees. We interviewed cognizant DOE officials from the LGP office, the Office of the Secretary of Energy, the Office of the Chief Financial Officer, the Office of Headquarters Procurement Services, and program offices that participated in the technical reviews of projects, including the Office of Electricity Delivery and Energy Reliability, the Office of Energy Efficiency and Renewable Energy, the Office of Nuclear Energy, and the National Energy Technology Laboratory (NETL). In addition, we interviewed 31 LGP applicants and 4 trade association representatives, using a standard list of questions for each group, to obtain a broad representation of views that we believe can provide insights to bolster other evidence supporting our findings. We selected the applicants and trade associations using a mix of criteria, including the amount of the loan guarantee requested and the relevant technology. As criteria, we used our prior work on customer service. We did not evaluate the financial or technical soundness of the projects for which applications were submitted.

We conducted this performance audit from January 2009 through July 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

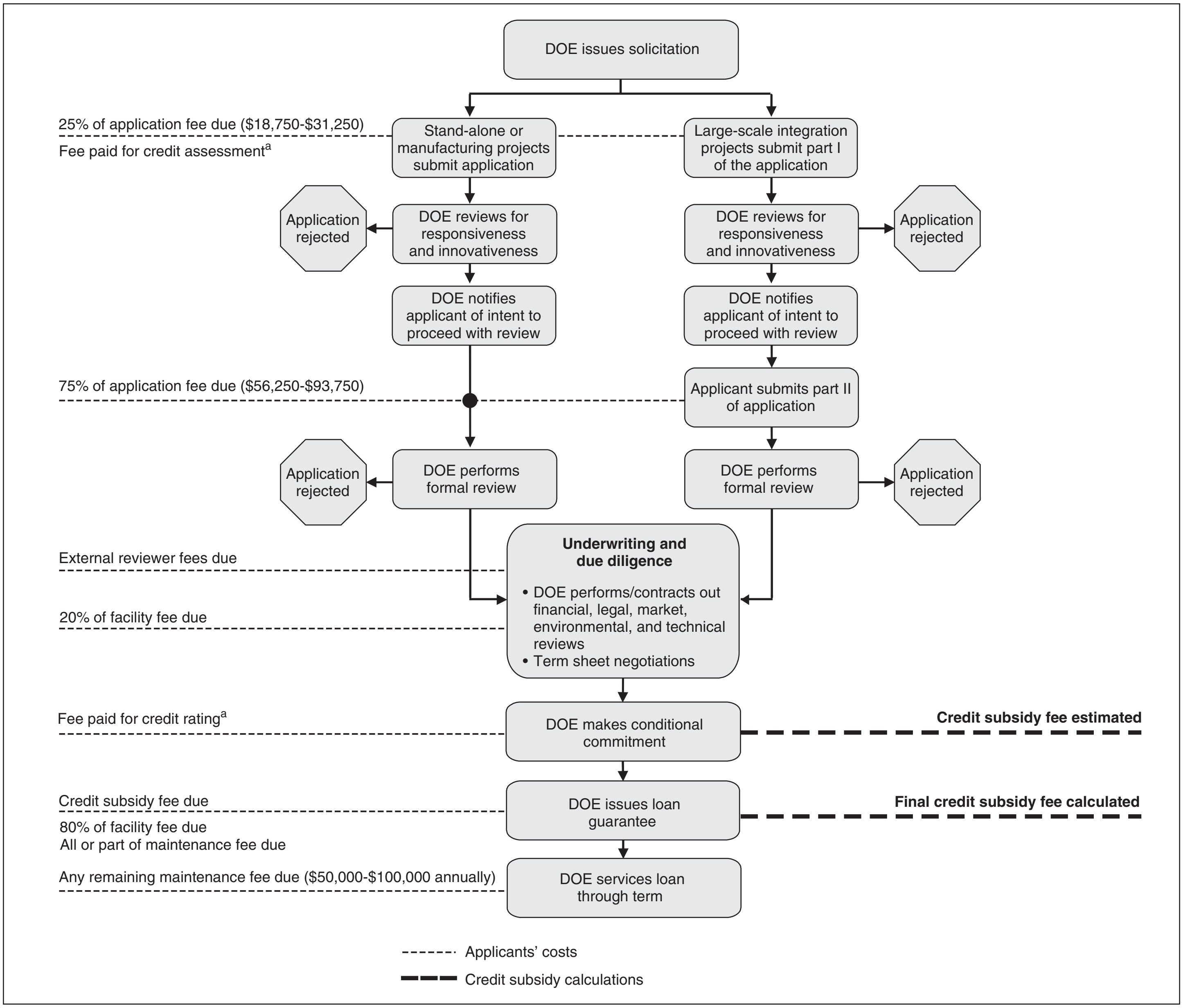
Appendix II: Performance Measures for the LGP

DOE has developed the following nine performance measures for the LGP:

- percentage of projects receiving DOE loan guarantees that have achieved and maintained commercial operations;
- contain the loss rate of guaranteed loans to less than 4 percent;
- contain the loss rate of guaranteed loans to less than 11.81 percent in fiscal year 2009 (11.85 percent for fiscal years 2010 and 2011) on a long-term portfolio basis;
- newly installed generation capacity from power generation projects receiving DOE loan guarantees;
- average cost per megawatthour for projects receiving DOE loan guarantees;
- forecasted greenhouse gas emissions reductions from projects receiving loan guarantees compared to ‘business as usual’ energy generation;
- forecasted air pollutant emissions (nitrogen oxides, sulfur oxides, and particulates) reductions from projects receiving loan guarantees compared to ‘business as usual’ energy generation;
- average review time of applications for Section 1705 guarantees; and
- percentage of conditional commitments issued to qualified applicants relative to plan.

Appendix III: Application Review Process

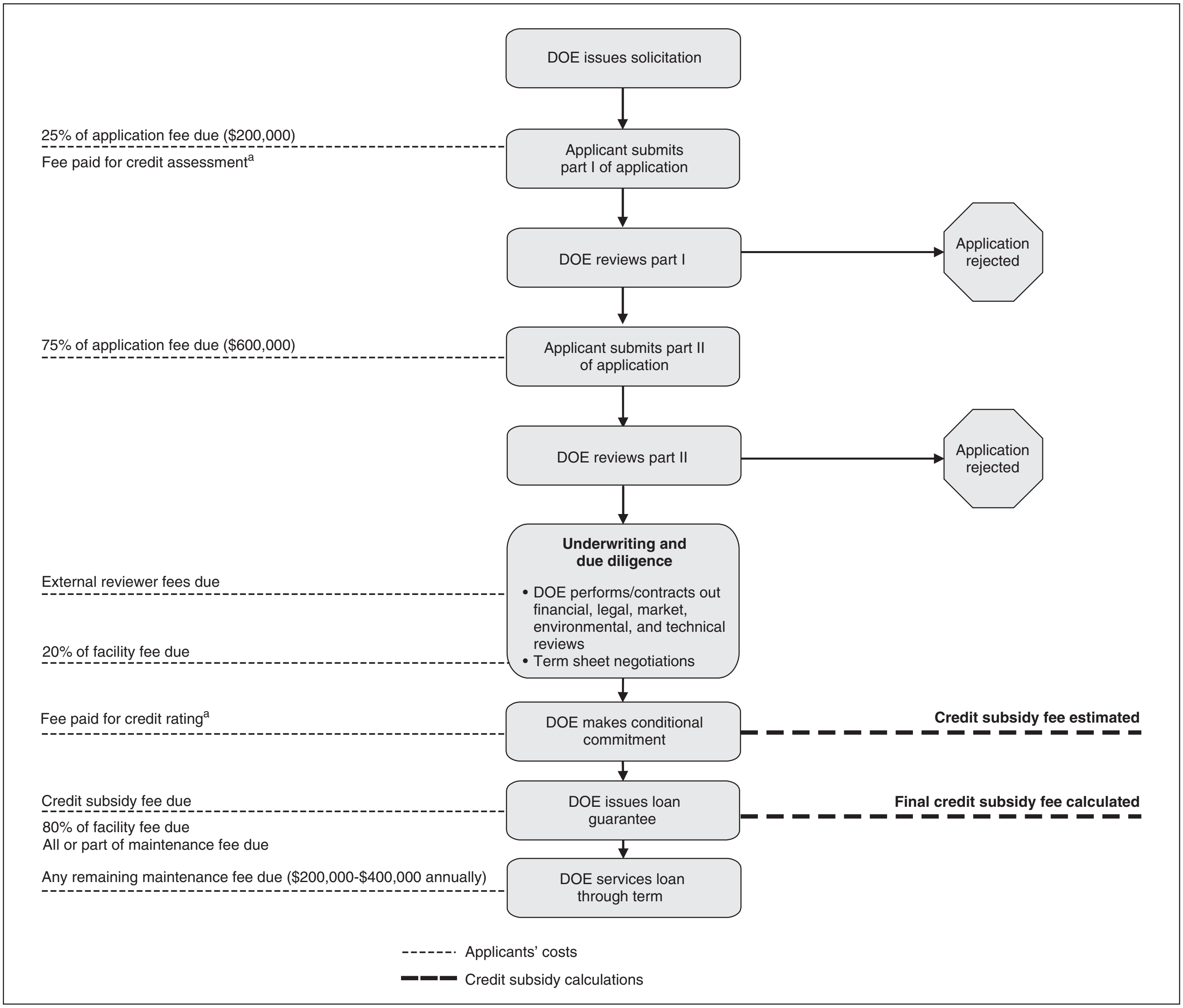
Figure 1: 2008 Solicitation for Energy Efficiency, Renewable Energy, and Advanced Transmission and Distribution Technologies



Source: GAO presentation of DOE data.

[a]Required for projects with estimated total costs exceeding $25 million.

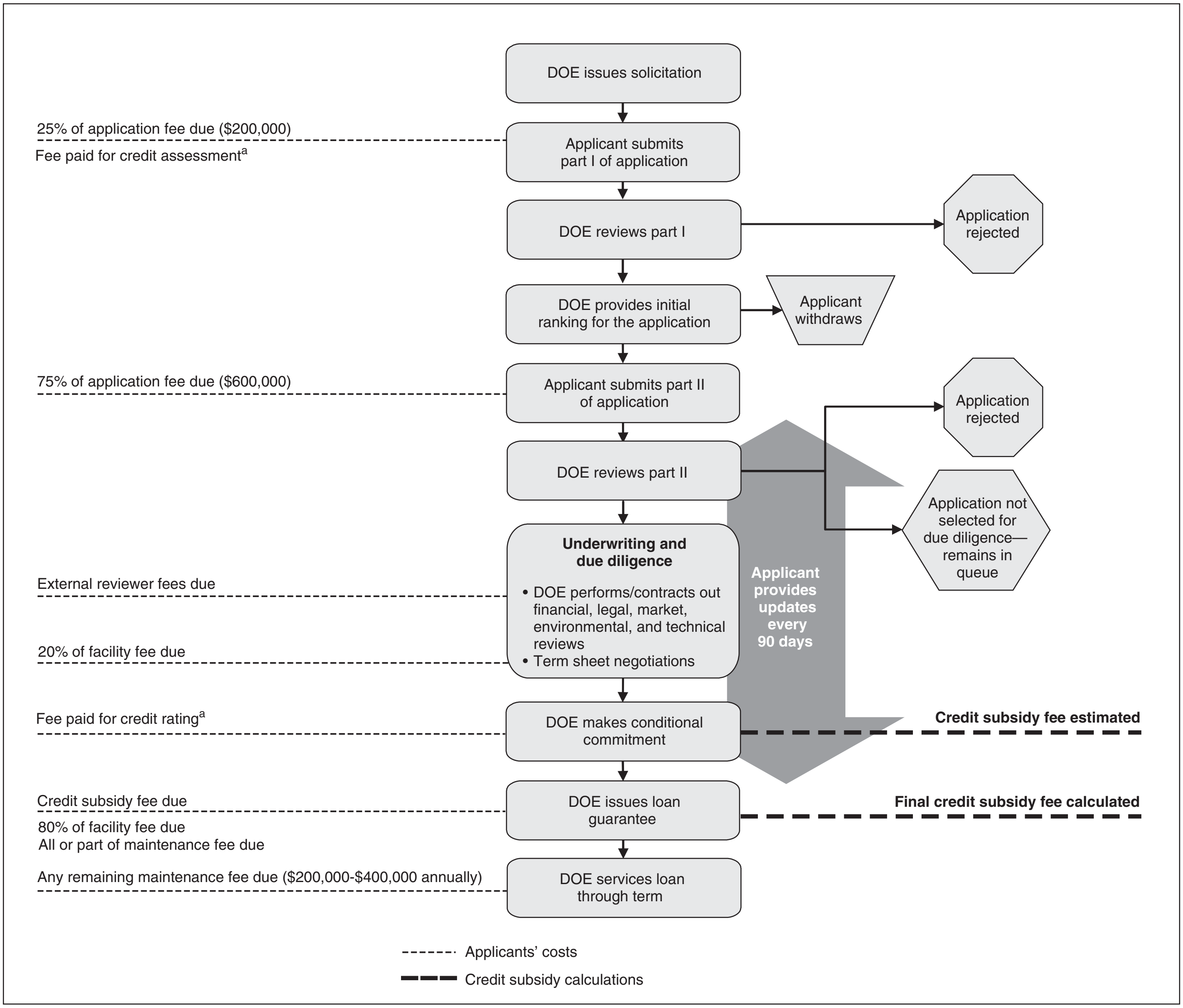
Figure 2: 2008 Solicitation for Coal-based Power Generation and Industrial Gasification Facilities That Incorporate Carbon Capture and Sequestration or Other Beneficial Uses of Carbon and for Advanced Coal Gasification Facilities



Source: GAO presentation of DOE data.

[a]Required for projects with estimated total costs exceeding $25 million.

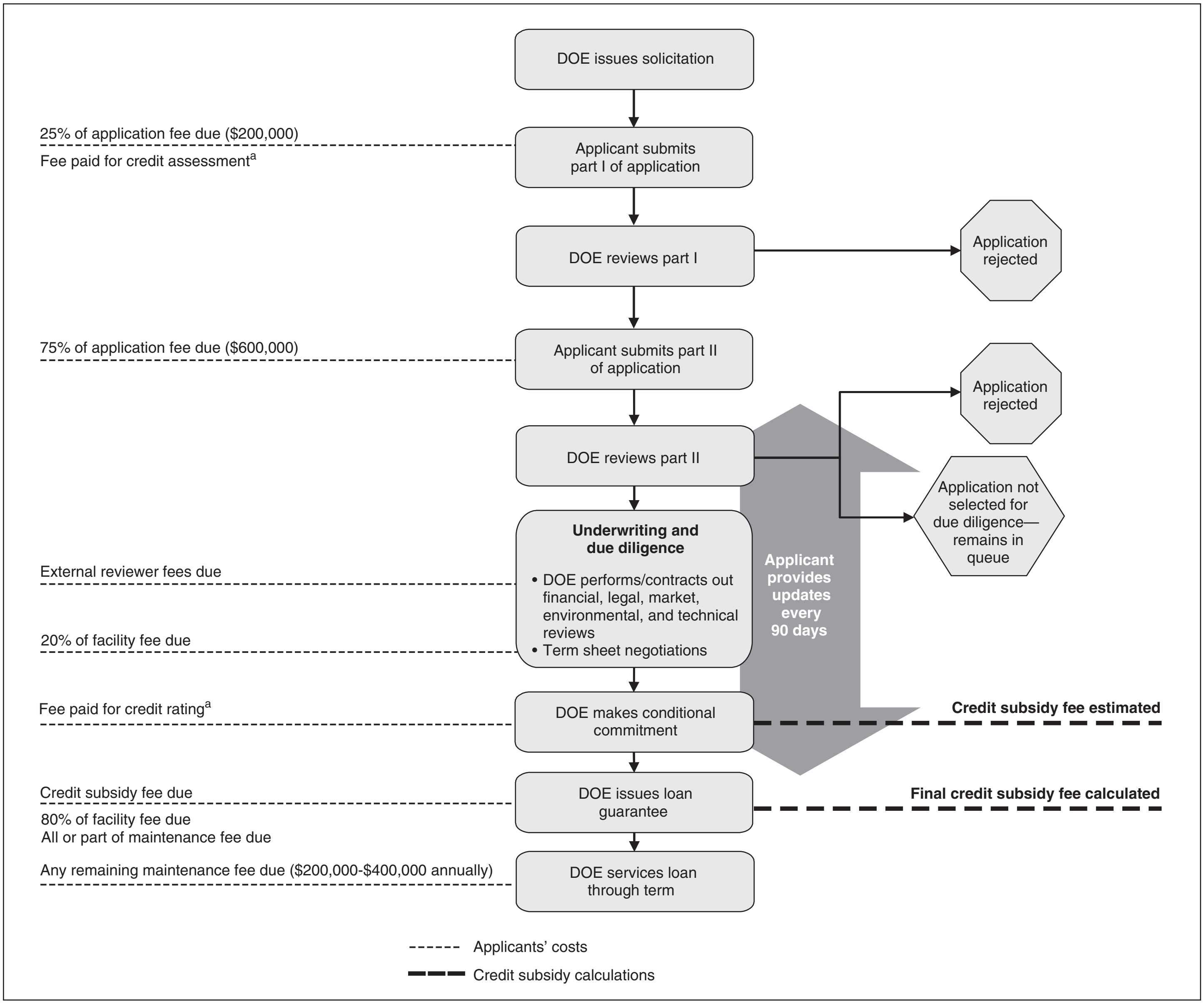
Figure 3: 2008 Solicitation for Nuclear Power Facilities



Source: GAO presentation of DOE data.

[a]Required for projects with estimated total costs exceeding $25 million.

Figure 4: 2008 Solicitation for Front-End Nuclear Facilities



Source: GAO presentation of DOE data.

[a]Required for projects with estimated total costs exceeding $25 million.

Appendix IV: Standardized Fees Associated with Obtaining a Loan Guarantee, by Solicitation

Solicitation	Application fee: 1st payment of 25%	Application fee: 2nd payment of 75%	Facility fee[a]	Annual loan maintenance fee
2008 Front-end nuclear facilities	$200,000	$600,000	½ of 1% of guaranteed amount	$200,000-400,000
2008 Nuclear power facilities	200,000	600,000	½ of 1% of guaranteed amount	200,000-400,000
2008 Coal-based power generation and industrial gasification facilities	200,000	600,000	½ of 1% of guaranteed amount	200,000-400,000
2008 Energy efficiency, renewable energy, and advanced transmission and distribution technologies (EERE)				
Loan guarantee amount:				
$0 - 150,000,000	18,750	56,250	1% of guaranteed amount	50,000-100,000
Above $150,000,000 - 500,000,000	25,000	75,000	$375,000 + 0.75% of guaranteed amount	50,000-100,000
Above $500,000,000	31,250	93,750	$1,625,000 + 0.50% of guaranteed amount	50,000-100,000
2009 EERE				
Loan guarantee amount:				
$0 - 150,000,000	18,750	56,250	1% of guaranteed amount	50,000-100,000
Above $150,000,000 - 500,000,000	25,000	75,000	$375,000 + 0.75% of guaranteed amount	50,000-100,000
Above $500,000,000	31,250	93,750	$1,625,000 + 0.50% of guaranteed amount	50,000-100,000
2009 Electric power transmission infrastructure projects	200,000	600,000	½ of 1% of guaranteed amount	200,000-400,000
2009 Commercial technology renewable energy generation projects under the Financial Institution Partnership Program (FIPP)	12,500	37,500	½ of 1% of guaranteed amount	10,000-25,000

Source: GAO presentation of DOE data.

[a]According to agency documentation, this fee is intended to cover the LGP's cost of loan setup and associated legal and finance fees.

Appendix V: Loan Guarantee Amounts Available and Amounts Applicants Sought for Technology Categories Targeted in Solicitations

Dollars in billions

Targeted technology category	Solicitation issuance date	Amount available	Amount applicants sought
Mixed[a]	Aug. 8, 2006	$4.0	$8.6
Nuclear power facilities	July 11, 2008	18.5	93.2
Front-end nuclear facilities	July 11, 2008	2.0	4.0
Coal-based power generation and industrial gasification facilities	Sept. 22, 2008	8.0	18.6
Energy efficiency, renewable energy, and advanced transmission and distribution technologies (EERE)	Oct. 29, 2008	10.0	20.1
EERE	July 29, 2009	8.5	22.8[b]
Electric power transmission infrastructure projects	July 29, 2009	5.0[c]	4.3
Commercial technology renewable energy generation projects under the Financial Institution Partnership Program (FIPP)	Oct. 7, 2009	5.0[c]	3.1

Source: GAO presentation of DOE data.

[a]The 2006 mixed solicitation invited applications for all technologies eligible to receive loan guarantees under the Energy Policy Act of 2005 except for nuclear facilities and oil refineries.

[b]DOE is still accepting applications in response to the 2009 EERE solicitation, so the final total amount that applicants will seek is not yet known. Through November 2009, applicants were seeking a total of $22.8 billion.

[c]This amount is an estimate because the solicitation did not specify how much would be issued in loan guarantees. This estimate is based on the solicitation's stated plan to use $750 million to cover credit subsidy costs and assumes credit subsidy costs of 15 percent, which DOE has told us is consistent with credit subsidy estimates to date.

Appendix VI: Comments from the Department of Energy

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Department of Energy
Washington, DC 20585

June 17, 2010

Mr. Frank Rusco
Director, Natural Resources and Environment
Government Accountability Office
Washington DC, 20548

Dear Mr. Rusco:

Thank you for the opportunity to comment on the Government Accountability Office's (GAO) draft report on the Department of Energy's (DOE or Department) Loan Guarantee Program (LGP), *Further Actions Are Needed to Improve DOE's Ability to Evaluate and Implement the Loan Guarantee Program.* The Department is committed to managing the LGP carefully and maintaining the integrity of the LGP as well as promoting the objectives of the Title XVII program. The Department's paramount concern is protecting the American taxpayer.

As noted in your report, the Department has made substantial progress in building a functional program for issuing loan guarantees under Title XVII of the Energy Policy Act of 2005. Significant achievements include:

- ***Leveraging external experts:*** DOE has identified external experts to assist with legal, engineering, financial, and marketing analyses of proposed projects. Identifying these external experts beforehand helps to ensure that DOE will have the necessary expertise readily available during the application review process. The Department has also expedited the procurement process for hiring these external experts.
- ***Revising LGP regulations:*** DOE has revised the LGP's regulations after receiving information from potential applicants, lenders, and other industry professionals concerning the wide variety of ownership and financing structures that applicants would like to employ in projects seeking loan guarantees. For example, LGP regulations were revised to allow for ownership structures that are typically employed in utility-grade power plants and are commonly proposed for the next generation of nuclear power generation facilities.
- ***Developing policies and procedures:*** DOE has developed a credit policies and procedures manual for the LGP. Among other things, the manual contains detailed internal policies and procedures that lay out requirements, criteria, and staff responsibilities for determining which proposed projects should receive loan guarantees.
- ***Approval for credit subsidy model:*** DOE obtained Office of Management and Budget approval for its model to estimate credit subsidy costs. The model is a

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critical tool needed for the LGP to proceed with issuing loan guarantees because it will be used to calculate the amount of each loan guarantee's credit subsidy and the associated fee, if applicable.

While the report recognizes key steps that DOE has taken to implement the LGP program, it also discusses opportunities for improvement in LGP's performance goals and measures, the transparency of its treatment of loan applicants, and mechanisms for systematic feedback from applicants. The Department recognizes the need for continuous improvement to its Loan Guarantee Programs as those programs mature, and is taking steps to address the concerns noted in the report.

Enclosed are the Department's detailed responses to GAO's specific recommendations and separate technical and factual comments on specific language in the draft report. We look forward to working with your team on future engagements.

Sincerely,

Jonathan M. Silver
Executive Director of the Loan Programs
Office of the Secretary

Enclosures

U. S. Department of Energy
GAO-10-627 – *"DEPARTMENT OF ENERGY: Further Actions Are Needed to Improve DOE's Ability to Evaluate and Implement the Loan Guarantee Program*

Response to GAO Recommendations for Executive Action

Technical and Factual Comments:

Recommendation 1: **The Secretary of Energy should direct the program management to develop relevant performance goals that reflect the full range of policy goals and activities for the program, and to the extent necessary, revise the performance measures to align with these goals.**

See comment 1.

DOE Response: The Department recognizes the need for relevant and targeted performance metrics and is working to ensure that appropriate metrics are identified for Loan Guarantee Programs. Currently, the program evaluates a project based on the ability to optimize multiple metrics that are consistent with overall program objectives, and there is no mandate from Congress regarding a specific target for the number of jobs created. In the context of preparing the LGP's contribution to the Department's Strategic Plan, which is still under development, the LGP is revisiting its performance goals and measures to better align with the Department's policy goals of growing the green economy and reducing green house gases in power generation.

Recommendation 2: **The Secretary should direct the program management to revise the process for issuing loan guarantees to clearly establish what circumstances warrant disparate treatment of applicants so that DOE's implementation of the program treats applicants consistently unless there are clear and compelling grounds for doing otherwise.**

See comment 2.

DOE Response: DOE disagrees with GAO's assertion that applicants are treated inconsistently but recognizes the need for greater transparency to avoid the perception of inconsistent treatment. Currently, each solicitation states the process for submitting applications and criteria for approving loan guarantees. The Department believes that within each solicitation, the rules have been applied consistently, and no applicants have been disadvantaged. The Department will ensure that future solicitations explicitly describe circumstances that would allow for streamlined consideration of loan guarantee applications.

See comment 3.

It is important to note that there is no one-size-fits-all approach across the various energy sectors, and processes may legitimately vary for the different energy sectors. One area highlighted by GAO was the ranking of the nuclear projects while not performing a similar ranking for other energy sectors. The LGP ranked nuclear generation projects because most nuclear power applications satisfied the requirements to proceed to due diligence, but the program did not have the loan authority to support all of the projects. A detailed analysis was required to differentiate those projects that had the strongest likelihood of readiness to proceed beyond the due diligence phase.

See comment 3.

The LGP does not provide a comparable ranking to applicants under the energy efficiency/renewable energy solicitations because the loan authority is adequate to support all viable projects. However, DOE provides applicants under the energy efficiency/renewable energy solicitations with early feedback on the viability of their application and the opportunity to avoid 75% of the application fee by using a Part I and Part II application process.

See comment 3.

In the case of the fossil energy solicitation, DOE met with all eight of the advanced fossil project sponsors who submitted Part I applications. The Part I applicants were informed that the solicitation was significantly over-subscribed and that there was a strong possibility that a loan guarantee approved by DOE for the selected projects could be substantially lower than the amount requested. Five applicants chose to proceed and submit Part II applications. Four of the five were invited to final due diligence. DOE had no reason to rank the four remaining projects because the $8.3 billion requested was in line with the authorized loan guarantee authority of $8 billion.

Recommendation 3: **The Secretary should direct the program management to develop an administrative appeal process for applicants who believe their applications were rejected in error and document the basis for conclusions regarding appeals.**

See comment 4.

DOE Response: The Department believes that the current process for rejected applicants is working, but agrees that the process should be made more transparent to loan applicants. As GAO pointed out, DOE has reconsidered some previously rejected applications. In these situations, applicants have demonstrated to DOE that there may have been an error made in the interpretation of their data.

See comment 4.

More importantly, LGP continues to implement new strategies to increase efficiencies and improve the loan guarantee application process that should reduce the need for any kind of appeals to the final loan decisions. These strategies include enhanced communication with applicants including more frequent contact and greater transparency. Applicants are allowed to improve their applications by providing additional data at DOE's request. Applicants with Part I submissions denied further review are provided with written notification detailing the reasons for this determination. Briefings on rejected applications are given when requested. Additionally, we are improving our intake procedures, allowing for a formal dialogue between DOE and the applicant and making decisions more quickly on applications and their readiness to move to Part II. On March 22, 2010, DOE instituted this new policy to allow applicants the opportunity to address deficiencies identified by DOE during the technical and financial review.

Recommendation 4: **The Secretary should direct the program management to develop a mechanism to systematically obtain and address feedback from program applicants, and, in so doing, ensure that applicants' anonymity can be maintained, for example, by using an independent service to obtain the feedback.**

See comment 5.

DOE Response: The Department agrees with the overall goal of this recommendation, but believes that use of a third-party to obtain feedback to preserve anonymity is not necessary. LGP stakeholders have not been reticent about expressing their views on the program. The Department believes that the LGP staff should be accountable for obtaining feedback from stakeholders. DOE has already implemented a variety of processes for soliciting, evaluating, and incorporating feedback from applicants about its administration of the program. DOE has proactively reached out to stakeholders using a myriad of venues. Program representatives have addressed renewable energy groups, banking and finance organizations, and state policy makers. In the process to update the LGP Final Rule, DOE received over 1,000 comments from stakeholders. DOE routinely meets with prospective and current applicants. Through Requests for Information, DOE seeks out opinions of the energy and finance industries on new solicitations. DOE also maintains the LGPO website which is a source for informing the public and potential applicants.

See comment 5.

DOE is constantly using information it gathers from lessons learned to improve procedures and increase efficiencies and effectiveness. For example, the Department shortened the intake and screening procedures, and is now in the process of automating and standardizing the application submission process.

The following are GAO's comments on the Department of Energy's (DOE) letter dated June 17, 2010.

GAO Comments

1. DOE appears to concur with the spirit of our recommendation. Best practices for program management indicate that DOE should have objective, quantifiable performance goals and targets for evaluating its progress in meeting policy goals DOE has identified for the LGP. Such goals and targets are important tools for ensuring public accountability and effective program management.

2. Our finding about inconsistent treatment of LGP applicants is based on information obtained from applicants corroborated by documents from DOE. In the instance we identified in which DOE made a conditional commitment before obtaining any of the required external reports, the external reviewers were not fully engaged until after DOE had negotiated the terms of the conditional commitment, which is contrary to DOE's stated procedures and provided an advantage to the applicant. Other applicants who received conditional commitments before completion of one or more of the reports called for by DOE's due diligence procedures also had a comparative advantage in that they were able to defer some review expenses until after DOE had publicly committed to their projects. We continue to believe that DOE should revise the process for issuing loan guarantees to treat applicants consistently unless there are clearly established and compelling grounds for making an exception.

3. We agree that there may be grounds for treating applicants differently depending on the type of technology they employ but do not believe that DOE has adequately explained the basis for the differences among the solicitations. For example, DOE's response does not address the possibility that lack of ranking information for fossil energy projects, combined with the knowledge that the solicitation was significantly oversubscribed, could have factored into applicants' decisions to drop out of the process, especially given the relatively high fees associated with submitting part II of the application.

4. We disagree that DOE's current process for rereviewing rejected applications is working. As we state in our report, some applicants did not know that DOE would provide rereviews. While we are encouraged by DOE's efforts to reduce the need for appeals, we believe that an administrative appeal process would allow DOE to better plan and manage its use of resources on rejected applications.

5. We applaud DOE's efforts to reach out to stakeholders and to use lessons learned to improve procedures and increase efficiencies and effectiveness. However, we continue to believe that DOE needs a systematic mechanism for applicants to provide anonymous feedback, whether through use of a third party or other means that preserves confidentiality. Several applicants we interviewed expressed concern that commenting on aspects of DOE's implementation of the LGP could adversely affect their current or future prospects for receiving a loan guarantee. Systematically obtaining and addressing anonymous feedback could enhance DOE's efforts to improve procedures and increase efficiencies and effectiveness.

Appendix VII: GAO Contact and Staff Acknowledgments

GAO Contact

Frank Rusco (202) 512-3841 or ruscof@gao.gov

Staff Acknowledgments

In addition to the individual named above, Karla Springer, Assistant Director; Marcia Carlsen; Nancy Crothers; Marissa Dondoe; Brandon Haller; Whitney Jennings; Cynthia Norris; Daniel Paepke; Madhav Panwar; Barbara Timmerman; and Jeremy Williams made key contributions to this report.

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