

Testimony of Robert C. Kelly Partner, DKRW Energy LLC

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Introduction

Thank you, Mr. Chairman, Distinguished Members and guests. I am Bob Kelly, a partner of DKRW Energy LLC. We are a privately held, Houston-based energy company currently developing one of the first major coal-to-liquids (“CTL”) facilities in the United States at Medicine Bow, Wyoming.

As the President outlined in the State of the Union Address, we are facing a serious energy crisis in the United States as our domestic production of oil declines and our domestic demand continues to grow.

We believe that CTL technology can have a major impact in helping to meet the future demand for energy in the United States in an environmentally acceptable way.

Our company’s, objective over the next ten years, is to finance and build CTL facilities in the United States totaling 110,000 barrels per day of capacity. Over a thirty year period, these facilities can produce over 1.2 billion barrels of liquid transport fuels from domestic US coal reserves. We believe that our efforts, along with those of others in our industry, are vital to achieving US energy independence and to keeping the price of fuels in the US at reasonable levels for American consumers.

The Medicine Bow Project

We have spent the last three years developing the Medicine Bow CTL project into what we believe will be one of the first major commercial coal to liquids facilities in the US. The initial phase of the project is designed to produce 11,000 barrels per day of ultra low sulfur diesel and naphtha transportation fuels.

The CTL technology we will employ at Medicine Bow is not new. The process was developed by German scientists in the early 1900s, was used in Germany during World War II to fuel their war economy, and is used today in South Africa to produce over 150,000 barrels per day of liquid transportation fuels.

The technology basically involves two key steps. In the first step, coal is converted in the gasification process to a synthetic gas. In the second step, the cleaned up synthetic gas, a mixture of hydrogen and carbon monoxide, is passed through a reactor, in what is called a Fischer Tropsch reaction, to produces diesel fuel and naphtha.

The key commercial elements of the Medicine Bow project include the following:

- We have an agreement with **Arch Coal**, one of the largest coal producers in the US, to acquire the Carbon Basin coal reserve. This reserve, currently owned by Arch, contains approximately 180mm tons of bituminous coal.
- We have an agreement with **General Electric** to enable the project to use the General Electric coal gasification technology.
- We have an agreement with **Rentech** to utilize the Rentech Fischer Tropsch technology. The Rentech technology employs an iron based catalyst, similar to that used by Sasol, to produce liquid hydrocarbons from coal.
- We have a preliminary agreement to sell all of the output of the facility over a multi-year period at market prices to a major refiner and marketer of diesel and naphtha in the Rocky Mountain region. These markets are currently importing liquid petroleum products from the US Gulf Coast so this project will have a direct impact on reducing US petroleum imports.
- Finally, we have a preliminary agreement with an oil and gas production company to sell all of the liquid carbon dioxide produced by the project. The carbon dioxide will be re-injected into the ground into oil wells to increase their productive capacity, thus effectively sequestering the CO2

What Congress Can Do

The cost of the Medicine Bow CTL project will be approximately \$1.4 billion dollars. We plan to complete the financing for the project in 2007. While we believe the equity side of the capital markets is prepared to participate in new CTL ventures, the unfamiliarity of major banks and EPC contractors with Fischer Tropsch technology will initially make project debt financing a challenge.

We therefore intend to immediately seek DOE loan guarantees as provided for in the EPACT 2005 legislation for the project. We urge the Department of Energy and the Secretary of Energy to move quickly to implement this program already authorized in the Energy Bill.

We do not believe that these loan guarantees need to be an ongoing program. After the first few project financings are complete the project debt market will stand ready to finance well developed projects like Medicine Bow without loan guarantees.

We also will apply for the industrial gasification investment tax credit ("ITC") provided by the Energy Bill. We do believe, however, that the cap imposed in EPACT 2005 on the ITC should be removed altogether in favor of a time deadline such as 2015.

Another key incentive we believe Congress should consider is making the 50 cent-per-gallon fuel excise tax credit provided in the Highway Bill available to CTL fuels. To do that, you could extend the expiration of the current credit from 2009, when no CTL plants will yet be operational in the U.S. to 2015.

Finally, we think Congress should consider Federal eminent domain legislation to assist in developing transportation corridors for pipelines carrying these fuels and CO₂ so that these products can get to market without significant delay due to right of way restrictions.

Conclusion

In the 2006 Annual Energy Outlook, the Department of Energy estimated that the CTL industry, given today's oil price outlook, could produce from 800,000 to 1,700,000 barrels per day of CTL transport fuels by 2030. I think this is a reasonable estimate.

DKRW is committed to helping make this forecast a reality. In addition to the Medicine Bow project, we have other projects in development in Montana and Illinois as well as in Wyoming.

We appreciate the efforts in Congress, in particular those of Representative Cubin and other members of the Wyoming congressional delegation in the Senate, as well as the state governmental officials in Wyoming and at the US Department of Energy in looking at ways to get this project and this industry moving. Every one in the room understands the risks involved and what is at stake. Our economy, foreign policy, and national security are vitally affected by what you will do here. Thank you for supporting our efforts and for giving me the opportunity to provide you with my views.