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RELEASED

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Langen

JUN 1 1970

Dear Mr. Langen:

This is in further response to your communication enclosing a copy of a letter dated March 19, 1970, from Mr. Carl R. Sullivan relative to Rural Electrification Administration (REA) cooperatives competing unfairly with independent fuel oil distributors and a privately owned gas utility company in Alaska.

Mr. Sullivan stated in his letter that four cooperatives--Golden Valley Electric Association, Inc., Fairbanks, Alaska; Chugach Electric Association, Inc., Anchorage, Alaska; Matanuska Electric Association, Inc., Palmer, Alaska, and Homer Electric Association, Inc., Homer, Alaska--(1) do not support local government since they are exempt from local property taxes, (2) have unlimited 2-percent Government financing available to them, (3) have electric-heating rates which are below their cost of supplying services to members and thus require standard service subscribers to pay extra to cover the electric-heating losses, and (4) are making loans to members for the installation of electric heat at interest rates much lower than commercial rates.

Mr. Sullivan is concerned also that the Chugach Electric Association, Inc., made two reductions in its electric rates during the period of a 4-year deferment on repayment of its REA loan and that the Homer Electric Association, Inc., is offering cash bonuses to individuals for switching to electric heat.

In examining into the issues raised by Mr. Sullivan, we reviewed pertinent legislation and policies and procedures under which REA makes rural electrification loans to cooperatives. We also reviewed loan records of the four cooperatives and interviewed officials of REA. Our review was made at REA headquarters in Washington, D.C.

General background information and our comments on each of the issues raised by Mr. Sullivan are presented in the following sections. This information and our comments were discussed with your legislative assistant on May 14, 1970, and he agreed that, if any further work on our part should be desired, you would advise us. As requested by your legislative assistant, we are not furnishing a copy of this report to the Department of Agriculture, nor are we advising the Department of its release.

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GENERAL BACKGROUND

Pursuant to section 4 of title I of the Rural Electrification Act of 1936, as amended (7 U.S.C. 904), the Administrator, REA, is authorized to make loans for rural electrification for financing the construction and operation of generating plants and electric transmission and distribution lines or systems for furnishing electric energy to persons in rural areas who are not receiving central station service. The loans are repayable over periods ranging up to 35 years and bear interest at a rate of 2 percent a year.

Section 5, title I, of the act, as amended, provides that the Administrator be authorized to make loans for financing the wiring of the premises of persons in rural areas and for the acquisition and installation of electrical and plumbing appliances and equipment. Such loans may be made to any of the borrowers of funds loaned under the provisions of section 4, or to any person, firm, or corporation supplying or installing the wiring, appliances, or equipment. The loans made pursuant to this section also bear interest at the rate of 2 percent a year. Current REA policy provides that such loans be repaid in 5 years or less.

The 2-percent interest rate for REA loans was established in 1944 pursuant to the provisions of the Department of Agriculture Organic Act of 1944 (58 Stat. 739), which amended the Rural Electrification Act of 1936. At that time less than one half of the farms in the United States were receiving central station electric service, and the rate was established, at least in part, to encourage the expansion of the rural electrification program.

A cooperative applying for a REA loan is required to certify that the amount of funds being requested is required for purposes designated in accordance with the provisions of the loan contract. The applicant also must certify that funds loaned under section 4 will be deposited in a construction fund account and that funds loaned under section 5 will be deposited in an installation loan fund account. REA auditors make periodic audits of these accounts to ascertain that all receipts and disbursements are properly accounted for and are for proper loan program purposes.

LOCAL PROPERTY TAXES

Section 10.25.540 of the Alaska Statutes provides that a cooperative pay to the State a percentage of its gross revenue earned during the preceding calendar year instead of paying State and local ad valorem, income, and excise taxes. The State statute provides further that the amount of gross revenue tax be (1) 1 percent of gross revenue for cooperatives which have furnished electric energy and power to consumers for less than 5 years and (2) 2 percent of the gross revenue for cooperatives which have furnished electric energy or power to consumers for 5 years or longer.

In view of the provisions set forth in the State statute, it appears that REA cooperatives do not pay local property taxes, but instead must pay a gross revenue tax to the State.

AVAILABILITY OF REA LOAN FUNDS

Section 3, title I, of the Rural Electrification Act of 1936, as amended, provides that the Congress appropriate funds to REA each year for rural electrification loans under sections 4 and 5 of the act. For fiscal years 1969 and 1970, the Congress appropriated \$329 million and \$340 million, respectively, for electrification loans.

Borrowers must meet the eligibility requirements set forth in the Rural Electrification Act and in REA's policies and procedures. REA, in reviewing an applicant's request for a loan, determines that

- in the case of section 4 loans, the facilities proposed are of the type set forth in section 4 of the act and are necessary to meet the applicant's growth and service requirements.
- in the case of section 5 loans, the wiring of premises and the acquisition and installation of electrical and plumbing appliances and equipment are of the type set forth in section 5 of the act and are necessary because credit is not available from other sources to finance such undertakings.

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Loan statistics for the four cooperatives as of December 31, 1969, are as follows

<u>Cooperative</u>	<u>Section 4 loans</u>		
	<u>Cumulative amount of loans approved</u>	<u>Cumulative amount of funds advanced</u>	<u>Amount of principal outstanding</u>
Chugach Electric Association, Inc.	\$ 65,796,000	\$ 54,440,575	\$50,220,626
Golden Valley Electric Association, Inc.	41,018,000	32,031,777	29,178,353
Homer Electric Association, Inc.	16,768,500	12,722,894	11,186,979
Matanuska Electric Association, Inc.	<u>9,363,000</u>	<u>8,095,308</u>	<u>6,361,322</u>
	<u>\$132,945,500</u>	<u>\$107,290,554</u>	<u>\$96,947,280</u>

<u>Cooperative</u>	<u>Section 5 loans</u>		
	<u>Cumulative amount of loans approved</u>	<u>Cumulative amount of funds advanced</u>	<u>Amount of principal outstanding</u>
Chugach Electric Association, Inc.	\$ 683,728	\$ 683,728	\$202,464
Golden Valley Electric Association, Inc.	96,785	96,785	-
Homer Electric Association, Inc.	130,000	130,000	30,000
Matanuska Electric Association, Inc.	<u>218,182</u>	<u>128,182</u>	<u>-</u>
	<u>\$1,128,695</u>	<u>\$1,038,695</u>	<u>\$232,464</u>

According to REA records, at April 1, 1970, REA had about 170 applications on hand for section 4 and section 5 loans totaling about \$377 million. REA records show that two of the 170 applications included requests for loan assistance from existing REA cooperatives in the State of Alaska. Of the two requests, one was from the Chugach Electric Association, Inc., in the amount of about \$10.5 million for constructing generator facilities.

RATES CHARGED BY COOPERATIVES
HAVING REA LOANS OUTSTANDING

REA's mortgage agreements provide that each borrower, subject to applicable laws and rules and orders of regulatory bodies, charge a rate for electric energy and other services furnished which shall be sufficient to (1) pay taxes, maintenance expenses, cost of electric energy, and other operating expenses of its system, (2) make all payments of principal and interest on its REA loan as they become due, and (3) provide a reasonable reserve for working capital.

To provide REA with assurance that rates are sufficient to accomplish these purposes, REA's policy requires its borrowers to obtain REA administrative approval of retail rate schedules before initial energization of a new system, thereafter, the borrowers are requested to inform REA of any proposed changes sufficiently in advance of their adoption to allow joint consideration of the effect of such changes. Borrowers desiring REA assistance with respect to retail rates are required to submit to REA documentation in support of their proposed rate increases or decreases. Using this information as a base, REA performs a study and forwards to the borrower for consideration recommended rates, together with an estimate of the change in revenues which will result from the rate change. The cooperatives, taking into consideration REA's recommendations, then make application for rate changes with the State regulatory agency.

In Alaska, the cognizant regulatory agency is the Alaska Public Service Commission. Final decisions on rate schedules are resolved between the cooperatives and the Commission.

The four REA cooperatives in question were current on their repayment of principal and interest through March 31, 1970. We noted, however,

that the Golden Valley Electric Association, Inc., was about 2 months delinquent on its September 1969 quarterly loan repayment. REA had previously made a study of this cooperative's operations and had recommended that the cooperative make certain changes in its operations and increase its rates. The cooperative subsequently requested a retail rate increase before the Alaska Public Service Commission, which rate, if approved, will be effective July 1, 1970.

LOANS MADE TO COOPERATIVE MEMBERS
FOR INSTALLATION OF ELECTRIC HEAT

As previously discussed in the general background section, REA is authorized to make 2-percent loans pursuant to section 5 of the Rural Electrification Act, as amended. As indicated on page 4, REA has approved a total of about \$1.1 million of section 5 loans to the four cooperatives in question. As of December 31, 1969, two of the cooperatives had loans outstanding which totaled about \$232,000.

With respect to the rates a cooperative can charge its members for loans made from funds borrowed under section 5, REA policy states that an interest rate of 4 percent a year is generally considered appropriate and that the use of a different interest rate must be justified. REA policy also requires the cooperatives applying for a section 5 loan to obtain written statements from two lending institutions as evidence that credit is not available in the area for purposes covered under section 5. Information submitted to REA by the two cooperatives having outstanding section 5 loans indicated that one was charging an interest rate of 4 percent and the other was charging an interest rate of 4-1/2 percent. REA records show that the required documentation concerning letters from lending institutions and the justification for charging an interest rate higher than 4 percent were provided by the cooperatives in question.

An REA official advised us that some cooperatives also use their own general funds, which do not include REA loan funds, for loans to their members to finance the installation of electric heat. REA does not have any specific control over how a borrower uses his general funds, however, REA policy statements recommend that, where a borrower's general funds exceed 8 percent of the value of the total utility plant or \$100,000, whichever is greater, the excess amount should be used for needed plant additions, advance payments on REA loans, or retirement of patronage capital.

DEFERMENT OF REA LOAN PAYMENTS

In October 1965 the Chugach Electric Association, Inc., was granted a 4-year loan repayment moratorium on a portion of its indebtedness to REA. The moratorium was granted pursuant to authority contained in section 12 of the Rural Electrification Act of 1936, as amended, which authorizes the Administrator, REA, to extend, subject to certain limitations, the period of payment of interest or principal on any loan made under the act.

The moratorium was granted to the cooperative after it suffered damages to its electrical facilities in the 1964 earthquake, in lieu of other benefits authorized by the Alaska Omnibus Act, as amended (78 Stat. 505). Under this act, the Secretary of Agriculture was authorized to compromise or release such portions of cooperatives' indebtednesses under the programs administered by REA as he found necessary because of loss, destruction, or damage by earthquake of property belonging to the cooperatives.

The moratorium applied to about \$29.8 million of the cooperative's \$47.3 million indebtedness to REA and applied only to principal payments and not to interest payments.

The moratorium expired on December 31, 1969, and the cooperative made its payment of principal and interest on its REA loan due March 31, 1970. REA records show that, during the 4-year moratorium, the Chugach Electric Association, Inc., had one rate reduction approved by the Alaska Public Service Commission. The request for the rate reduction followed a change by the cooperative in producing power from coal to natural gas, which decreased the cooperative's cost of producing power. Prior to approval of the rate reduction by the commission, REA reviewed the cooperative's rate study and advised the cooperative that the rates would not appear to endanger the financial position of the cooperative. Application for the rate reduction was made to the Alaska Public Service Commission in May 1968. The rate reduction was effective in June 1968. Consequently, the application for a rate reduction was not made until about 31 months after the loan moratorium was granted.

According to REA records, one other adjustment to the cooperative's rate schedule was approved by the Alaska Public Service Commission during the moratorium. REA officials advised us that the rate schedule had been adjusted to include rates for an area which was not previously served by the Chugach Electric Association, Inc.

INCENTIVES OFFERED TO OBTAIN CUSTOMERS

According to title I of the Rural Electrification Act of 1936, as amended, REA loan funds are not available for the purpose of offering incentives to promote the sale of power. An REA official advised us, however, that cooperatives could use their own general funds for such activities. As previously stated, REA has no control over how the cooperatives use their general funds.

REA does make annual audits of the borrowers' fund accounts for REA cooperatives in Alaska to determine, among other things, whether loan funds have been properly accounted for and disbursed for authorized loan program purposes. We reviewed the audit reports prepared by REA on the four borrowers in question, and we found no indication that loan funds had been used for the purpose of offering incentives to promote the sale of power.

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We trust that the foregoing information is responsive to your request. We shall be glad to discuss these matters further with you if you so desire.

As requested by your legislative assistant, the copy of the advertisement which you furnished to us with your request is attached.

Sincerely yours,



Comptroller General
of the United States

Enclosure

The Honorable Odin Langen
House of Representatives