An Agricultural Law Research Article

Reevaluating the Rural Electrification Administration: A New Deal for the Taxpayers

by

Richard P. Keck

Originally published in ENVIRONMENTAL LAW
16 ENVTL. L. 39 (1985)

REEVALUATING THE RURAL ELECTRIFICATION ADMINISTRATION: A NEW DEAL FOR THE TAXPAYER

BY
RICHARD P. KECK*

The Rural Electrification Administration (REA) has long been heralded as one of the New Deal's most successful and cost-effective programs. Supporters claim that REA loans have helped create jobs and make electricity affordable for rural customers at little or no cost to the taxpayer. However, recent defaults by two rural cooperatives on REA-assisted loans totalling billions of dollars, and the spectre of many similar defaults in the future, call the REA's past acclaim into question. This Article examines the rationale for and costs of REA assistance. Concluding that the REA is a costly government venture with little or no public policy justification remaining, the author recommends that recent proposals to phase out the REA be adopted.

---

*Associate with Kilpatrick & Cody, Atlanta, Georgia; J.D. 1985, Harvard Law School; B.S. 1982, Emory University. The author wishes to thank Ralph C. Cavanagh for the guidance he provided in preparing the paper from which this Article was adapted, and Rene W. Keck for her support.

I. INTRODUCTION

The Rural Electrification Administration (REA), a product of the New Deal, undoubtedly contributed to the electrification of rural America. From 1935 until 1960, the proportion of the rural population receiving central station electrical service increased from eleven to ninety-seven percent.[1] Since the early 1960's, however, the financial burden imposed by the REA on the American taxpayer has steadily increased from $4.68 billion in outstanding government loans in 1962[2] to an estimated $37.7 billion at the end of 1985.[3] While the burden has mushroomed, the need has become less apparent.

A hard look at the justifications for the REA's continued existence is long overdue.[4] This Article weighs the arguments for

---

1. J. GARWOOD & W. TUTHILL, THE RURAL ELECTRIFICATION ADMINISTRATION: AN EVALUATION 59 (1963).

2. *Id.* at 60.

3. OFFICE OF MANAGEMENT AND BUDGET, FISCAL YEAR 1986, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT 5-37 (1985) [hereinafter cited as 1986 FEDERAL BUDGET].

4. This assertion is not without opposition. Testifying before a congressional

and against the REA's present course in light of its history, its purposes, and the present needs of rural electric consumers.

The author finds that the large loan subsidies currently made available for rural power distribution, generation, and transmission facilities cannot be justified. The job program rationale has long been abandoned and discredited. The cost difference between electricity distribution in rural areas and nonrural areas is no longer so significant as to justify rural power distribution subsidies. And there is no cost difference with respect to generation and transmission facilities. The reasons which have been offered to justify REA financing of electricity generation projects are tenuous. In addition, many of the loans for generation facilities have been associated with cancellations, construction of excess capacity, and huge cost overruns, which have thus impaired the government's prospects of ever recouping the taxpayers' money. Moreover, the excessive volume of REA lending has displaced many other borrowers from the credit market. Yet, the current statutory framework limits congressional oversight of the REA by removing its loan programs from the federal budget process.

In 1984, Congress considered legislation which would maintain the solvency of the current programs but leave them relatively intact.[5] The Reagan Administration's proposed 1986 budget has taken the more radical position of proposing serious cutbacks

---

committee in 1984, a spokesman for the REA borrowers said:

> [T]he rural electrification program in general and REA financing program specifically have been the subject of numerous studies and reviews by various agencies of the government in recent years . . . . While we are confident that REA and the rural electric program will stand up to any reasonable and objective test or scrutiny, we note that these studies and investigations consume substantial time and expense for all involved. Some appear to be an attempt by the Administration to find fault with the program and to terminate or limit future activities. We oppose the use of auditing and review agencies of the federal government to subvert or frustrate the legislative intent of Congress.

Agriculture, Rural Development and Related Agencies Appropriations for 1985, Part 9: Hearings Before the Subcomm. on Agriculture, Rural Development and Related Agencies of the House Comm. on Appropriations, 98th Cong., 2d Sess. 311, 320 (1984) (84 C.I.S. H181-50.4) (statement of Robert D. Partridge, Executive Vice President, Nat'l Rural Elec. Coop. Ass'n).

To this author's knowledge, however, the only comprehensive study of the REA undertaken so far was by J. GARWOOD & W. TUTHILL, *supra* note 1.

5. *See* H.R. 3050, 98th Cong., 1st Sess. (1983); S. 1300, 98th Cong., 1st Sess. (1983).

in the REA's activities with the ultimate dismantling of the agency by 1990.[6]

II. BACKGROUND

A. *History of Rural Electrification*

Thomas Edison began operating the first centralized electrical power station in New York City in 1882.[7] Afterwards, electricity generation and distribution rapidly grew into a major industry.[8] As in any business, the most lucrative and secure markets were developed first. Hence, the higher costs in relation to revenues associated with distribution of electricity in sparsely populated areas[9] led the private utilities to concentrate their early efforts on urban areas.[10] Indeed, given the initial investment required to provide service to a rural customer and the uncertain demand for electricity from the land-poor farm population of the early 1900's,[11] studies conducted by the investor-owned utilities (IOUs) showed that the anticipated return on rural power lines would not even cover investment costs, let alone allow the utilities to turn a profit.[12]

Although it was becoming more profitable for electric utilities to expand into rural areas in the late 1920's, the Great Depression reversed the situation and brought private expansion into rural

---

6. *See* 1986 FEDERAL BUDGET, *supra* note 3, at 5-37 to 5-38.

7. P. FUNIGIELLO, TOWARD A NATIONAL POWER POLICY: THE NEW DEAL AND THE ELECTRIC UTILITY INDUSTRY, 1933-1941, at 122 (1973).

8. Garland & Phillips, *The Crisis in the Electric Utilities*, REFERENCE SHELF, Oct. 1936, at 3.

9. *Id.* at 171.

10. Manly, *Foreward to U.S. Fed. Power Comm'n, Rural Electric Service* (Rate Series No. 8, 1935), *reprinted in* Johnson, *Government Ownership of Electric Utilities*, REFERENCE SHELF, Oct. 1936, at 140-43.

11. J. BONBRIGHT, PUBLIC UTILITIES AND THE NATIONAL POWER POLICIES 51 (1940).

12. *See* P. FUNIGIELLO, *supra* note 7, at 123-24. Commenting on the results of a 1911 study:

> At this stage in the development of rural extensions, the industry's investment in lines, transformers, equipment, and manpower—including the inflationary cost of maintenance—was far greater than any anticipated return. This condition held true over the next two decades, and constituted the most serious obstacle in bringing electricity to every farmer.

Id.

areas to a standstill in the early 1930's.[13] The Depression left farmers unable to afford the luxuries of electric power[14] and the costly appliances which made it useful.[15] This dampening of the potential demand for rural electricity made expansion again unprofitable. Thus, the Depression acted as a catalyst for the decision to provide federal assistance in the electrification of rural America.[16]

Another concern which fueled arguments in favor of government assistance was that any rural expansion by the IOUs which did take place was "skim[ming] off the cream of the business."[17] The policy of the IOUs had been to construct only rural distribution lines which would produce revenues sufficient to cover their costs.[18] This policy resulted in "the stranding of considerable areas which [could not] be self-sustaining under [then] present conditions."[19] Critics of the private utilities within the Roosevelt Administration contended that "[t]he only effective way to electrify rural America [was] to construct within each rural area a network of lines to serve every possible customer."[20] For rates to be sufficient under such an "area coverage" scheme to cover the costs of electrical service, either there had to be enough profitable lines within an area for which customers would be overcharged to carry the burden of the unprofitable lines,[21] or there had to be a government subsidy for the unprofitable lines.[22] The private utilities were not willing to adopt the area coverage scheme where it involved construction of line extensions which could not be self-liquidating.[23] The area coverage debate ultimately led to a rift be-

---

13. P. FUNIGIELLO, *supra* note 7, at 129; *see also* TWENTIETH CENTURY FUND, ELECTRIC POWER AND GOVERNMENT POLICY 442 n.13 (1948).

14. TWENTIETH CENTURY FUND, *supra* note 13, at 442 n.13.

15. *See* SENATE COMM. ON AGRICULTURE & FORESTRY, RURAL ELECTRIFICATION, S. REP. No. 1581, 74th Cong., 2d Sess. 4 (1936).

16. P. FUNIGIELLO, *supra* note 7, at 129.

17. Letter from Morris L. Cooke, first REA Administrator, to Sen. Ellison D. Smith, Chairman Senate Comm. on Agriculture & Forestry (Feb. 3, 1936), *reprinted in* SENATE COMM. ON AGRICULTURE & FORESTRY, *supra* note 15, at 5.

18. J. BONBRIGHT, *supra* note 11, at 51.

19. Letter from Morris L. Cooke, *supra* note 17, at 5-6.

20. *Id.* at 5.

21. *See* L. NASH, PUBLIC UTILITY RATE STRUCTURES 14-15 (1933); P. MACAVOY, ENERGY POLICY: AN ECONOMIC ANALYSIS 141 (1983).

22. *See* Stewart, *Bringing Power to the Farm: Article III—"Boom" Expansion*, PUB. UTIL. FORT., June 19, 1941, at 786, 796-97.

23. *See id.* at 796.

tween private industry and government which prevented their cooperation in rural electrification.[24]

The first federal appropriations for rural electrification were made as part of an unemployment relief package in the Emergency Relief Appropriation Act of 1935.[25] Congress appropriated $100 million in funds to be available for loans or grants.[26] The selling pitch to the Roosevelt Administration by advocates of federal aid was the prospect of a self-liquidating program of unemployment relief,[27] which would secondarily make rural life more attractive and thereby slow the flight of rural inhabitants to the already overburdened cities.[28]

To administer the funds made available for rural electrification, President Roosevelt established the Rural Electrification Administration by Executive Order 7037 on May 11, 1935.[29] It quickly became apparent, however, that the REA could not succeed as an unemployment relief agency.[30] The requirement that workers be hired from unemployment relief rolls proved an unreasonable restraint given the need for skilled labor.[31] Thus, in August 1935 President Roosevelt "issued regulations which estab-

---

24. *See* P. FUNIGIELLO, *supra* note 7, at 141 (explaining how the REA flatly rejected a plan submitted by the IOUs in July 1935 which proposed that industry use government appropriated funds to extend rural service to those "regions which could afford the cost"); Stewart, *supra* note 22, at 787-88. Federal holding company legislation probably contributed to "the wall of distrust and hostility that divided the private-power companies and the government." P. FUNIGIELLO, *supra* note 7, at 142.

25. Ch. 48, 49 Stat. 115 (1935) (expired by its terms in 1937).

26. *Id.*; *see* SENATE COMM. ON AGRICULTURE, NUTRITION & FORESTRY, RURAL ELECTRIFICATION AND TELEPHONE REVOLVING FUND SELF-SUFFICIENCY ACT OF 1984, S. REP. No. 545, 98th Cong., 2d Sess. 5 (1984) (84 C.I.S. S163-9).

27. P. FUNIGIELLO, *supra* note 7, at 135.

28. *Id.* at 133. This rationale has been reiterated as recently as 1970. *See* HOUSE COMM. ON APPROPRIATIONS, DEP'T OF AGRICULTURE AND RELATED AGENCIES APPROP. BILL, 1971, H.R. REP. No. 1161, 91st Cong., 2d Sess. 41 (1970) (70 C.I.S. H183-15).

29. The REA's duties and functions were: "To initiate, formulate, administer, and supervise a program of approved projects with respect to the generation, transmission, and distribution of electric energy in rural areas." Exec. Order No. 7037, May 11, 1935.

30. P. FUNIGIELLO, *supra* note 7, at 145-48.

31. Exec. Order No. 7060, § 5, June 5, 1935, required that those employed come from public relief rolls. *See also* Exec. Order No. 7037, *supra* note 29, at 1 ("*Provided*, That in so far as practicable, the persons employed under the authority of this Executive Order shall be selected from those receiving relief.").

lished REA solely as a lending agency," in an attempt to overcome many of the "relief program restrictions."[32]

In May 1936, Congress passed the Rural Electrification Act,[33] establishing the REA as an independent agency authorized to make direct loans funded through REA borrowings from the Department of the Treasury. The Act was intended to extend for ten years the life of the temporary REA set up by President Roosevelt.[34] Interest on the loans was fixed at the Government's average cost of borrowing,[35] usually about two to three percent.[36] It was thought that rural incomes had been sufficiently augmented by other New Deal programs to make the provision of electric service by the REA economically viable.[37]

In the early months of the REA, when it became apparent that because of the demanding terms imposed on REA borrowers the private utilities would not take advantage of the availability of REA loans to extend their operations into rural areas,[38] the

---

32. Exec. Order No. 7130, §§ 2(a), 4, Aug. 7, 1935 (providing that allocated funds would be available for REA to make loans for rural electrification projects, requiring only 90 percent of workers on such projects to be persons from public relief rolls, and giving REA authority to relax even this requirement); *see also* SENATE COMM. ON AGRICULTURE, NUTRITION & FORESTRY, *supra* note 26, at 5.

33. Ch. 432, 49 Stat. 1363 (1936) (codified as amended at 7 U.S.C. §§ 901-950b (1982)).

34. SENATE COMM. ON AGRICULTURE & FORESTRY, *supra* note 15, at 3.

35. Rural Electrification Act, ch. 432, § 4, 49 Stat. 1363, 1365 (1936) (amended to a fixed rate in 1944).

36. TASK FORCE ON LENDING AGENCIES, U.S. COMM'N ON ORG. OF THE EXEC. BRANCH OF THE GOV'T, REPORT ON LENDING AGENCIES (1953-55), at 91, 203 (app.) (1955) (Price Waterhouse & Co., *Summary of the Government's Lending and Related Insurance and Guarantee Activities*) (interest rates on REA loans "averaged approximately 2.6 percent" from 1936 to 1944); P. FUNIGIELLO, *supra* note 7, at 152-53.

37. *See* Letter from H.A. Wallace, Sec. of Agriculture, to Sen. Ellison D. Smith (Feb. 4, 1936), *reprinted in* HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, RURAL ELECTRIFICATION, H.R. REP. No. 2219, 74th Cong., 2d Sess. 8 (1936) ("The partial restoration of farm incomes has already stimulated rural buying and spurred urban industry. Farm income has increased approximately 50 percent over 1932, and hundreds of thousands of farmers can now well afford the advantages of electric service.").

38. *See* P. FUNIGIELLO, *supra* note 7, at 152-53 (provision that REA loans would also be available to IOUs was "window dressing" because it was expected that the conditions on the loans "would discourage the private-power companies from heavy borrowing; later events demonstrated that [t]his analysis was correct.").

REA began to encourage the formation of cooperatives of rural residents to borrow REA funds and build distribution facilities.[39] The Rural Electric Cooperatives (RECs) thus became the principal REA borrowers.[40] The REA has continued to nurture the RECs, closely overseeing and regulating every aspect of their operations.[41]

The RECs are private, non-profit membership corporations formed under the laws of their resident states for the purpose of constructing and operating electric distribution systems and electric generation and transmission facilities. Most states passed the laws authorizing RECs specifically to accommodate the REA program.[42] However, there has been no uniformity from state to state regarding the regulation of RECs.[43] With respect to extensions of service and plant additions, some states require a certificate of convenience and necessity,[44] whereas other states do not.[45] Some states regulate the retail rates of RECs,[46] while still other states do not.[47] The REA's loan contracts also give the REA authority to

---

39. TWENTIETH CENTURY FUND, THE POWER INDUSTRY AND THE PUBLIC INTEREST 125 (1944); DEP'T OF AGRICULTURE TASK FORCE, EXECUTIVE COMM., PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL: REPORT ON THE DEP'T OF AGRICULTURE 276 (1983) (hereinafter cited as GRACE COMM'N REP.).

40. *See* TWENTIETH CENTURY FUND, *supra* note 39, at 125 ("[L]ess than 2 percent of [REA's] loans have been to private borrowers . . . . As of January 31, 1941, 721 of the 800 borrowers of REA funds were cooperatives, 54 were public power districts, municipalities and other public bodies and 25 were private companies . . . .").

41. *See* GRACE COMM'N REP., *supra* note 39, at 283-85 (criticizing the REA for overregulating its borrowers).

42. *See* H. SLATTERY, RURAL AMERICA LIGHTS UP 38-48 (1940) (the REA drafted the Rural Electric Cooperative Act to serve as a model for state legislatures); TWENTIETH CENTURY FUND, *supra* note 13, at 452. Indiana, for example, enacted statutory provisions in 1935 specifically for the purpose of authorizing RECs. *See* Rural Electric Membership Corporation Act, ch. 175, 1935 Ind. Acts 383 (codified as amended at IND. CODE ANN. §§ 8-1-13-1 to 8-1-13-27 (Burns 1982 & Supp. 1984)).

43. *See* H. SLATTERY, *supra* note 42, at 42.

44. *See, e.g.*, Southern Ind. Gas and Elec. Co. v. Indiana Statewide Rural Elec. Coop., 251 Ind. 459, 242 N.E.2d 361 (1968).

45. *See, e.g.*, Central La. Elec. Co. v. Louisiana Pub. Serv. Comm'n, 251 La. 532, 205 So.2d 389 (1967).

46. *See e.g.*, KY. REV. STAT. ANN. § 279.210 (Bobbs-Merrill 1981 & Supp. 1984).

47. *See, e.g.*, Ouachita Rural Elec. Coop. v. Garrett, 221 Ark. 189, 252 S.W.2d 545 (1952).

oversee retail rates.[48] Further, the retail rates of RECs which purchase federally generated power are subject to limitations on resale rates as specified by federal wholesale power sources.[49]

In short, the primary objective of the early REA became that of helping unsophisticated farmers put together financially sound electricity distribution cooperatives. The agency assured the success of these newly formed utilities by providing the requisite financing along with technical and legal advice. While the credit market of the 1930's was still recovering from the stock market collapse,[50] the government borrowed money and loaned it for relatively risky projects at its own cost. As Congress viewed the arrangement, however, "[n]o grant or subsidy [was] provided for" in the Rural Electrification Act.[51]

From its inception the REA has been authorized to make loans for generation and transmission facilities as well as for distribution facilities.[52] Although distribution was the only aspect of electrical service which was more costly to provide in rural areas than in nonrural areas,[53] Congress authorized the REA to fund generation and transmission projects in order to assist rural utilities in building their own power supply facilities where power could not be purchased at reasonable rates, or where no other source of power existed.[54] In the early years of the REA, however, REA borrowers purchased most of their power from private utilities or from federal power sources such as the Tennessee Valley Authority.[55] The situation changed in time. As the rural power

---

48. RESOURCES F R THE FUTURE, U.S. ENERGY POLICIES: AN AGENDA FOR RESEARCH 88 (1968).

49. *Id.*

50. *See* TWENTIETH CENTURY FUND, *supra* note 13, at 442 n.13 ("utilities lacked capital for even promising extensions" in the early 1930's).

51. HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, RURAL ELECTRIFICATION, H.R. REP. NO. 2219, 74th Cong., 2d Sess. 5 (1936).

52. *See* Exec. Order No. 7037 *supra* note 29 and accompanying text; *see also* Rural Electrification Act, ch. 432, § 4, 49 Stat. 1363, 1365 (1926) ("[T]o make loans . . . for the purpose of financing the construction and operation of generating plants, electric transmission and distribution lines or systems . . . .") (codified as amended at 7 U.S.C. § 904).

53. *See infra* text accompanying notes 229 and 230.

54. *See* J. GARWOOD & W. TUTHILL, *supra* note 1, at 16.

55. COMPTROLLER GENERAL, GENERAL ACCT. OFFICE, REPORT TO THE CONGRESS—FINANCING RURAL ELECTRIC GENERATING FACILITIES: A LARGE AND GROWING ACTIVITY 7 (1980) [hereinafter cited as COMPTROLLER GENERAL].

distribution network became more established, the emphasis of REA loan activity shifted to construction of power supply generation and transmission facilities.[56] Thus, while only three percent of all REA funds appropriated by 1941 had been used for power supply facilities,[57] twenty-seven percent of all REA loans appropriated by 1962 had been used for generation and transmission facilities.[58] As of 1982, roughly eighty-five percent of each year's REA-assisted financing was earmarked for generation and transmission facilities.[59] Of the $37.7 billion in rural electric loans from the federal government projected at the end of 1985,[60] $20 billion represents loans for generation and transmission facilities.[61] As a result of the emphasis shift in funding, the proportion of electric power used by REC consumers which was generated by REA cooperatives increased from 7.7% in 1941,[62] to 15.8% in 1958,[63] 26.4% in 1975,[64] and 38.2% in 1980.[65]

The cooperative has been the principal legal form employed to obtain generating and transmission assistance from the REA. Most REA distribution cooperatives have organized member-owned generation and transmission cooperatives which purchase or generate all of the power used by their member distribution cooperatives.[66] In 1982, 99.5% of new long term financing for projects undertaken by power supply cooperatives was obtained through loans from the federal government.[67]

---

56. *See* J. GARWOOD & W. TUTHILL, *supra* note 1, at 15, 46; COMPTROLLER GENERAL, *supra* note 55, at 7.

57. J. GARWOOD & W. TUTHILL, *supra* note 1, at 15.

58. *Id.* at 47.

59. *See* CONGRESSIONAL BUDGET OFFICE, NEW APPROACHES TO THE BUDGETARY TREATMENT OF FEDERAL CREDIT ASSISTANCE 34, 36 (1984).

60. *See supra* text accompanying note 3.

61. Louisville Courier-J., Jan. 20, 1985, at A1, col. 1, A8, col. 3.

62. J. GARWOOD & W. TUTHILL, *supra* note 1, at 15.

63. *Id.*

64. GRACE COMM'N REP., *supra* note 39, at 271.

65. Pace & Landon, *Introducing Competition into the Electric Utility Industry: An Economic Appraisal*, 3 ENERGY L. J. 1, 6 (1982) (*citing* U.S. DEP'T OF AGRICULTURE, RURAL ELECTRIFICATION ADMIN., 42D ANNUAL REP. OF ENERGY PURCHASED BY REA BORROWERS 5 (1980)).

66. *See* COMPTROLLER GENERAL, *supra* note 55, at 7 (noting that the principal distribution RECs which are not also members of power supply RECs "are those obtaining their total power needs from Federal power agencies").

67. Morrison, *Solvency of the Rural Electric Revolving Fund: An Economic Analysis of S. 1300 and H.R. 3050, 98th Congress* 10, 16 (Cong. Research Serv.

There were few significant statutory changes in the federal rural electrification program between 1936 and 1973. The REA lost its status as an independent agency and became part of the Department of Agriculture in 1939.[68] Five years later, the Pace Act[69] established a fixed two percent interest rate for REA loans and increased the maximum payment schedule from twenty-five years to thirty-five years.[70] The two percent interest rate reduced the rates on loans below the government's cost of borrowing[71] and thus created the first explicit interest subsidy to the RECs. In 1949, the Pace Act was expanded to authorize loans for furnishing and improving rural telephone service.[72] And, since 1950, all electric loan contracts have contained an "area coverage" agreement requiring the borrower to serve all customers in its area.[73] This requirement solidified the REA's longstanding policy of encouraging area coverage.[74]

The Nixon Administration precipitated the first major statutory change in the REA on December 29, 1972, when it suspended the making of direct loans to REA borrowers and refused to disburse funds already appropriated by Congress.[75] In an attempt to reduce the subsidy inherent in the fixed two percent interest rate, the Nixon Administration intended to discontinue making two

---

1983), *reprinted in* H.R. REP. No. 588, 98th Cong., 1st Sess. 84, 96, 102 (1983) (83 C.I.S. H163-24).

68. Reorg. Plan No. II of 1939, 5 U.S.C.A. app. at 145 (West 1967), § 5, 53 Stat. 1431, 1434 (1939) (subordinating the authority of the REA Administrator to the "general direction and supervision of the Secretary of Agriculture").

69. Ch. 412, § 502(a), 58 Stat. 739 (1944) (amending 7 U.S.C. §§ 903, 904 & 905).

70. *Id.*

71. Price Waterhouse & Co., *supra* note 36, at 203.

72. Act of Oct. 28, 1949, ch. 776, 63 Stat. 948 (1949) (codified at and amending scattered sections of 7 U.S.C.). The loans for rural telephones have not been as substantial as those for rural electrification, but may be subject to many of the comments in this Article. Nevertheless, the author has not treated telephone loans in this Article.

73. GARWOOD & W. TUTHILL, *supra* note 1, at 40.

74. *See supra* note 20 and accompanying text; Stewart, *Bringing Power to the Farm: Article II—National Development*, PUB. UTIL. FORT., June 5, 1941, at 651, 662 ("the area plan . . . was eventually made a tenet of the REA program"); *see also* REA Bull., Sept. 23, 1958, at 12, 13.

75. *See* H.R. REP. No. 91, 93d Cong., 1st Sess. (1973) (*quoting* U.S. Dep't of Agriculture, News: Rural Electric and Rural Telephone Program Change, Dec. 29, 1972 (press release)), *reprinted in* 1973 U.S. CODE CONG. & AD. NEWS 1365, 1366-67.

percent REA direct loans and instead to fund rural electrification with five percent insured loans and guaranteed loans under the Rural Development Act.[76] As the government's average cost of borrowing at the time was 5.099%, the five percent interest rate would have at least eliminated most of the explicit interest subsidy then inherent in the two percent REA direct loans.[77]

Congress reacted to the Nixon Administration's actions by passing several amendments to the Rural Electrification Act.[78] The changes established the current REA funding mechanisms, insured loans, and guaranteed loans.[79] These were modeled after the Rural Development Act's loan program in an attempt to accommodate the Nixon Administration.[80] The rate at which most future REA insured loans were to be made was thus fixed at five percent[81] which roughly represented the government's cost of borrowing at the time, whereas the rate at which guaranteed loans financed by the Federal Financing Bank (FFB) were to be made, was to float with the government's average cost of borrowing.[82]

The major emphasis of the congressional debate, however, concerned the issue of the President's constitutional authority to impound already appropriated REA funds,[83] and not the more important issue of whether the REA program needed to be reevaluated.[84] Since 1973, only minor amendments to the Rural

---

76. Note, *The Amended Rural Electrification Act: Congressional Response to Administration Impoundment*, 11 HARV. J. ON LEGIS. 205 (1974); *see also* GRACE COMM'N REP., *supra* note 39, at 276.

77. Morrison, *supra* note 67, at 97.

78. Act of May 11, 1973, Pub. L. No. 93-32, 87 Stat. 65 (codified as amended primarily at 7 U.S.C. §§ 930-940).

79. For a thorough legislative analysis of the changes see generally Note, *supra* note 76.

80. *See id.* at 219.

81. *See* Act of May 11, 1973, Pub. L. 93-32, § 2(b), 87 Stat. 65, 69 (codified as amended at 7 U.S.C. § 935(b)).

82. CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 36.

83. Note, *supra* note 76, at 217. The Nixon Administration's actions were indeed subsequently held to be unconstitutional. *See* Sioux Valley Empire Elec. Ass'n v. Butz, 504 F.2d 168 (8th Cir. 1974) (Congress did not grant the REA Administrator authority to terminate the two percent direct loan program).

84. *See, e.g.*, HOUSE COMM. ON AGRICULTURE, RURAL ELECTRIFICATION ACT, H.R. REP. No. 91, 93d Cong., 1st Sess. 9 (1973), *reprinted in* 1973 U.S. CODE CONG. & AD. NEWS 1365, 1373:

> During consideration of [the bill] by the Committee, it was suggested that the legislation be amended to exclude generation and transmission fa-

Electrification Act have been made in the Rural Electrification Administration Technical Amendments Act of 1976,[85] and the Omnibus Budget Reconciliation Act of 1981.[86]

B. Current Financing of Rural Electrification

1. Types of financing for REA-assisted borrowers

In the 1973 amendments to the Rural Electrification Act, Congress codified a policy of encouraging REA borrowers to become increasingly independent of REA assistance.[87] Nevertheless, as of 1982 the federal government still provided 99.5% of all financing for power supply borrowers and seventy-five percent of all financing for distribution borrowers.[88]

The REA is currently authorized to make direct loans from funds appropriated to the REA,[89] to make insured loans from the Rural Electrification and Telephone Revolving Fund,[90] and to

---

cilities from the purposes for which electric loans can be made and insured under Section 305; and to require that all loans for these facilities be of the guaranteed type and carry open market rates of interest.

It is the view of a majority of the Committee, however, that the fundamental purpose of the legislation is to reduce the adverse impact of the REA loan program on the federal budget in accordance with the announced objectives of the President rather than to change the purposes and objectives of the program.

A majority of the Committee believes, therefore, that the Administrator should continue to have the authority and the discretion to make loans for generation and transmission on the same terms [as other loans].

85. Pub. L. No. 94-570, 90 Stat. 2701 (codified as amended at 7 U.S.C. §§ 931(a)(4), 935(b)) (transfers previously appropriated but unobligated funds to the RETRF and changes the criteria for two percent "special rate" insured loans).

86. Pub. L. No. 97-35, § 165, 95 Stat. 379 (codified as amended at 7 U.S.C. §§ 935(b), 936, 937) (tightens the criteria for two percent "special rate" insured loans and requires FFB to make guaranteed loans on the request of the borrower).

87. Act of May 11, 1973, Pub. L. No. 93-32, 87 Stat. 65 (codified at 7 U.S.C. § 930).

88. Morrison, *supra* note 67, at 1.

89. Rural Electrification Act, §§ 2, 4, 5, 7 U.S.C. §§ 902, 904, 905.

90. Rural Electrification Act, § 305, 7 U.S.C. § 935. At least two sources, 1986 FEDERAL BUDGET, *supra* note 3, and CONGRESSIONAL BUDGET OFFICE, *supra* note 59, refer to these loans as "direct" loans; however, the statutory scheme refers to them as "insured" loans as distinct from the pre-1973 direct loans which were terminated under the Nixon Administration. When looking at the above two sources, the reader should note that the "direct" loans there discussed are the same thing as "insured" loans under the statute.

guarantee loans made by other lenders.[91] But no funds have been appropriated for REA direct loans since the Nixon Administration impounded the REA's funds in December 1972.[92] Although Congress did not repeal the REA Administrator's authority to make such direct loans when it passed the 1973 legislation,[93] the intention appears to have been to abandon the previous direct loan program.[94] The Administrator's authority to make direct loans is thus in effect a dead letter.

The practice of the REA has been to finance distribution borrowers with insured loans and to finance power supply borrowers with guaranteed loans.[95] In 1982, REA power supply borrowers obtained 0.6% of new long-term financing as REA insured loans, 98.9% as REA guaranteed loans made by the Federal Financing Bank (FFB), 0.4% as loans made by the National Rural Utilities Cooperative Finance Corporation (CFC), and 0.1% as loans from other sources.[96] Similar 1982 figures for REA distribution borrowers were 73.6% for REA insured loans, 1.5% for REA guaranteed loans made by the FFB, 23.9% for loans made by the CFC, and 1.0% for loans from other sources.[97] As of March 1984, insured loans accounted in dollar amount for about fifteen percent of REA credit activity and guaranteed loans accounted for the other eighty-five percent of REA credit.[98]

a. REA insured loans

The Administrator's authority to make insured loans is set out in section 305 of the Act.[99] The loans are made out of the assets of the Rural Electrification and Telephone Revolving Fund,[100] which is described below. The Administrator may make

---

91. Rural Electrification Act, § 306, 7 U.S.C. § 936.

92. *See* Morrison, *supra* note 67, at 95.

93. Indeed, 9 U.S.C. § 930, which was enacted as part of the legislation creating the insured and guaranteed loan programs, still treats direct loans as a viable method of REA lending.

94. *See* Note, *supra* note 76, at 223.

95. *See* CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 38; Morrison, *supra* note 67, at 102.

96. Morrison, *supra* note 67, at 102.

97. *Id.*

98. CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 34, 36.

99. 7 U.S.C. § 935.

100. *Id.*

insured loans "to the full extent of the assets available in the fund."[101] The loans and advances are excluded from federal budget totals and are not subject to "any general limitation imposed by statute on expenditures and net lending (budget outlays) of the United States," but they are subject to congressional limitations imposed specifically on the program.[102] It has been the practice of Congress to set floors as well as ceilings for the amount of insured loans which the Administrator may make in a given year.[103] These congressional "limitations" have been rather generous. "In every year since 1973, [the year in which the insured loan program was established,] Congress has mandated ceiling loan levels, and in many instances floor loan levels, that have exceeded income to the Revolving Fund."[104]

The Rural Electrification and Telephone Revolving Fund (revolving fund or RETRF) was established simultaneously with the enactment of the insured loan program,[105] and its main purpose is to finance insured and guaranteed loans.[106] The revolving fund consists primarily of the receipts from all past and future REA loan accounts as well as money obtained from the sale of insured loans.[107] The revolving fund also includes any money borrowed from the federal treasury.[108] The REA Administrator borrows money from the federal treasury by selling to the FFB certificates of beneficial ownership (CBOs) in the assets of the RETRF.[109] For accounting purposes, this allows the FFB to be treated as an equity holder rather than a creditor of the RETRF.[110]

In theory, the cash inflow from the collection of receipts and

---

101. *Id.*

102. *Id.*

103. Morrison, *supra* note 67, at 101.

104. *Id.*

105. *See* Act of May 11, 1973, Pub. L. No. 93-32, § 2, 87 Stat. 65 (relevant parts codified at 7 U.S.C. §§ 931-935).

106. *See* Rural Electrification Act § 302(b), 7 U.S.C. § 932(b); *see* Note, *supra* note 76, at 225.

107. Rural Electrification Act § 301(a)(1) & (3), 7 U.S.C. § 931 (a)(1) & (3); *see* Note, *supra* note 76, at 225.

108. Rural Electrification Act § 301(a)(5), 7 U.S.C. § 931(a)(5).

109. CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 39.

110. *See* MacLaury, *Federal Credit Programs—the Issues They Raise*, in FEDERAL RESERVE BANK OF BOSTON, CONF. SERIES ISSUES IN FEDERAL DEBT MANAGEMENT 205, 211-12 (1973).

sale of receivables was to be sufficient to cover loan needs.[111] The need for additional appropriations in the future was seen as unlikely "for some years to come."[112] As it turned out, the revolving fund has had to borrow increasingly larger amounts from the treasury.[113] By late 1985, the debt service on funds borrowed from the treasury is expected to exceed cash receipts from receivables.[114] The revolving fund is thus on a collision course with bankruptcy.

The problem arose because the interest rate charged borrowers for insured loans as provided by the Act is only five percent for regular borrowers and two percent for hardship borrowers,[115] whereas the interest rate which the revolving fund must pay to the FFB is one-eighth of one percent above FFB's cost of capital.[116] The subsidy to the RECs is the difference between the revolving fund's borrowing rate, which averaged 10.85% in 1983,[117] and its lending rate for a mixture of 5% and 2% loans, which was 4.90% in 1983.[118] It was inevitable that such subsidies would deplete the assets of the fund in time.

Of current significance is the status of the revolving fund's activities as statutorily off-budget.[119] This means that the interest subsidies are not viewed as annual expenditures and that the amounts which the fund borrows from the treasury to finance these subsidies are not subject to "budget cuts."

b. REA guaranteed loans

The authority for the REA Administrator to guarantee loans

---

111. *See* Note, *supra* note 76, at 226 ("The expectation of the draftsmen . . . was clearly that the need for replenishing the fund would be small.").

112. HOUSE COMM. ON AGRICULTURE, *supra* note 84, at 7.

113. *See* CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 36 (CBO sales financed almost half of all RETRF advances in 1982).

114. *Washington and the Utilities, 1984. The Year in Review. Rural Electrification Administration*, PUB. UTIL. FORT., Dec. 20, 1984, at 46.

115. Rural Electrification Act § 305(b), 7 U.S.C. § 935(b).

116. Congressional Budget Office, *supra* note 59, at 39.

117. SENATE COMM. ON AGRICULTURE, NUTRITION & FORESTRY, *supra* note 26, at 6.

118. *Id.*

119. Rural Electrification Act § 305(a), 7 U.S.C. § 935(a) (insured loans); CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 6 (guaranteed loans); *id.* at xi (sale of CBOs to FFB).

made by other lenders is provided in section 306 of the Act.[120] Although the loans may be obtained from "any legally organized lending agency,"[121] the usual source is the Federal Financing Bank.[122] Thus, the guaranteed loans, like the insured loans, are primarily government loans. The real differences between guaranteed loans and insured loans are that the guaranteed loans are made by the FFB rather than the REA, and that the interest rate is higher for guaranteed loans. The FFB makes REA guaranteed loans at an interest rate one-eighth of one percent above the treasury's borrowing rate.[123]

The Act does not spell out the loan guarantee process. The usual practice, however, is for the REA first to guarantee a specified loan amount, and then for the borrower to locate a lender.[124] Once approval for the guarantee is obtained, the borrower has no difficulty finding a willing lender because the FFB is required, when requested by the borrower, to make loans to borrowers with REA guarantees.[125] The interest rate the FFB may charge can be no more than the interest rate it charges on similar loans it makes or purchases.[126] Thus, the FFB has no statutory authority to charge higher interest rates for riskier projects.

A provision related to the REA guarantee of loans is the Administrator's authority to subordinate REA liens or mortgages in order to enable borrowers to obtain further financing from other lenders.[127] This provision was intended to allow the REA to accept a higher risk on its outstanding loans in order to enable a borrower to get a second loan at a favorable interest rate where

---

120. 7 U.S.C. § 936.

121. *Id.*

122. CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 36.

123. *Id.*

124. *Utility Financing: Hearings Before the Subcomm. on Energy Conservation and Power of the House Comm. on Energy and Commerce*, 97th Cong., 1st Sess. 290, 292 (1981) (82 C.I.S. H361-1) (statement of Charles A. Robinson, Jr., Executive Vice President and General Manager of Nat'l Rural Elec. Coop. Ass'n). This appears to have been the procedure anticipated by the Act. *See, e.g.*, the provision requiring the FFB to make loans, on request of the borrower, "with respect to guarantees *issued* by the Administrator." Rural Electrification Act § 306, 7 U.S.C. § 936 (emphasis added).

125. Rural Electrification Act, § 306, 7 U.S.C. § 936; *see supra* text accompanying notes 121 and 122.

126. *Id.*

127. *Id.*

the borrower's "needs are beyond the resources made available for REA loans."[128]

c. Supplemental financing by private lenders

Section 307 of the Act[129] authorizes the REA Administrator to request an insured loan applicant to apply for and accept a loan from another credit source concurrently with an insured loan. Power supply cooperatives, which obtain almost all of their REA-assisted financing through REA guaranteed loans,[130] are not required to seek supplemental financing in order to obtain REA credit assistance. As a result, power supply borrowers rely on REA financing for almost all of their credit needs.[131] Distribution borrowers, on the other hand, which obtain most of their REA-assisted financing through REA insured loans,[132] are subject to the "supplemental financing" requirement. In 1982, such borrowers obtained 23.9% of their long term financing needs from the National Rural Utilities Cooperative Finance Corporation (CFC), a supplemental financing lender.[133] The Administrator may make such a request "[w]hen it appears to the Administrator that the loan applicant is able to obtain a loan for part of his credit needs from a responsible cooperative or other credit source at reasonable rates and terms consistent with the loan applicant's ability to pay and the achievement of [the Rural Electrification Act's] objectives."[134] Although section 307 would allow the REA to aid such non-REA borrowing by guaranteeing loans from outside credit sources, the current REA Administrator has insisted that supplemental financing be obtained without REA guarantees.[135]

---

128. HOUSE COMM. ON AGRICULTURE, *supra* note 84, at 1374.

129. 7 U.S.C. § 937.

130. *See supra* text accompanying note 96.

131. *Id.* (99.5%); *see* Morrison, *supra* note 67, at 95-96 (guaranteed loans are made by the FFB "at the Treasury rate plus ⅛ of one percent—a rate no private lender, not even the [CFC], can match").

132. *See supra* text accompanying note 97.

133. *Id.*

134. Rural Electrification Act § 307, 7 U.S.C. § 937.

135. *See Agriculture, Rural Development, and Related Agencies Appropriations for 1985, Part 9: Hearings Before the Subcomm. on Agriculture, Rural Development, and Related Agencies of the House Comm. on Appropriations*, 98th Cong., 2d Sess. 311, 314 (1984) (84 C.I.S. H181-50.4) (statement of Robert D. Partridge, Executive Vice President of Nat'l Rural Elec. Coop. Ass'n) [hereinafter cited as Partridge Testimony] (contending that REA should guarantee "100 per-

Nevertheless, the REA's current financing policy requires the Administrator to fund a minimum of seventy percent of the financing needs of distribution borrowers to which it makes any loans.[136]

Congress anticipated that most supplemental financing would come from the National Rural Utilities Cooperative Finance Corporation.[137] The CFC was incorporated in 1969 with equity capital contributed by RECs.[138] The CFC had made loans of just under $2.2 billion to the RECs by the end of fiscal year 1982.[139] The funds for these loans came from a $610 million capital contribution by members and the remainder from sales of long-term bonds and short-term commercial paper.[140]

Congress was eager to ensure the success of the CFC as an alternative to REA financing. In considering federal appropriations for 1971, three congressional committees recommended that the REA Administrator defer for three years repayments of principal on both new and already outstanding REA loans "where desired by REA electrification borrowers to voluntarily invest amounts equivalent to the amounts of principal to be so deferred in securities of the National Rural Utilities Cooperative Finance Corporation."[141] In response to these recommendations, the REA

---

cent of these projects").

136. *See* REA Bulletin 20-14, Attachment A, *Supplemental Loan Criteria for Electric Distribution Borrowers* 3-4 (rev. July 1972) (REA will fund from 70 to 90 percent of a distribution borrower's needs depending on the borrower's "plant revenue ratio," which is a figure computed by dividing the value of total utility plant by revenues net of the cost of power); *see also* Morrison, *supra* note 67, at 101 n.13.

137. *See* HOUSE COMM. ON AGRICULTURE, *supra* note 84, at 1374-75.

138. CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 78.

139. *See id.* at 79.

140. *Id.*

141. HOUSE COMM. OF CONFERENCE, AGRICULTURE AND RELATED AGENCIES APPROPRIATION FISCAL YEAR 1971, H.R. REP. No. 1680, 91st Cong., 2d Sess. 10, 11 (1970) (70 C.I.S. S183-33); *see also* HOUSE COMM. ON APPROPRIATIONS, DEP'T OF AGRICULTURE AND RELATED AGENCIES APPROPRIATION BILL, 1971 H.R. REP. No. 1161, 91st Cong., 2d Sess. 42 (1970) (70 C.I.S. S133-15) ("[T]he Committee suggests that . . . the Administrator consider deferring repayment on outstanding loans for up to three years."); SENATE COMM. ON APPROPRIATIONS, DEP'T OF AGRICULTURE AND RELATED AGENCIES APPROPRIATION BILL, 1971, S. REP. No. 987, 91st Cong., 2d Sess. 38-39 (1970) (70 C.I.S. S183-8) ("The Committee recommends that . . . the REA Administrator grant up to a three year deferment on principal installments on new REA loans with the understanding that such deferred install-

Administrator issued a policy statement in January 1971, that set forth criteria for granting such deferrals to RECs.[142] However, a spokesman for the RECs reported to Congress later in 1971 that no such deferrals had been obtained by the RECs in contributing capital to the CFC.[143]

The CFC has not been as effective as was hoped in engendering the financial independence of the RECs. As already mentioned, the power supply cooperatives have had no incentive to obtain non-governmental financing.[144] Any power supply financing which is obtained from the CFC is "restricted largely to pollution control and leverage leasing guarantees and to front-ending loans prior to actual drawdown on REA guarantees."[145] Nor have the RECs been eager to improve the situation. An officer of the National Rural Electric Cooperatives Association recently testified before a House subcommittee that the RECs "continue to strongly oppose REA's arbitrary insistance that certain portions of a project—pollution control equipment, for example—must be financed separately and without REA guarantee, particularly when 100% of these projects could be guaranteed within the amount authorized by Congress for this purpose."[146]

The situation with respect to distribution cooperatives is better only to the extent that the REA requires them to finance part of their operations from private lenders.[147] However, even this non-governmental financing faces vigorous opposition from the RECs, which "are very much concerned by the Administrator's evident and continuing determination to reduce the role and function of REA by major increases in the percentage of non-

---

ments on principal will be invested by borrowers in the CFC.").

142. REA Bulletin 20-20, *Deferment of Principal Repayments for Investment in Supplemental Lending Institutions* (Jan. 14, 1971).

143. *See Agriculture-Environmental and Consumer Protection Appropriations for 1972, Part 2: Hearings Before the Subcomm. on Agriculture-Environmental and Consumer Protection Appropriations of the House Comm. on Appropriations,* 92d Cong., 1st Sess. 634 (1971) (71 C.I.S. H181-24.6) (statement of David A. Hamil, REA Administrator) ("To date no payments have been deferred to provide funds for investment in CFC. Since the issuance of our policy bulletin we have received one request for deferment in the amount of $96,748, and this request is under consideration.").

144. *See supra* note 131 and accompanying text.

145. GRACE COMM'N REP., *supra* note 39, at 273.

146. Partridge Testimony, *supra* note 135, at 314.

147. *See supra* note 136 and accompanying text.

REA financing borrowers must obtain in conjunction with their REA loans."[148] Such recalcitrance, coupled with charges that review of the REA by federal auditing agencies is an "attempt . . . to subvert or frustrate the legislative intent of Congress,"[149] stands in stark contrast to the declared legislative policy "that rural electric systems . . . should be encouraged and assisted to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources."[150] Moreover, although distribution borrowers do obtain more supplemental financing than power supply borrowers, the lower interest rates distribution borrowers pay on REA insured loans than power supply borrowers pay on REA guaranteed loans vitiates much of the ostensibly greater independence of the distribution borrowers.

2. Purposes for which REA loans are available

The purposes for which insured and guaranteed loans may be made are set out in three provisions of the Rural Electrification Act.[151] Under section 2 of the Act,[152] the REA Administrator is authorized and empowered to make loans "for rural electrification and the furnishing of electric energy to persons in rural areas who are not receiving central station service." Section 13 of the Act defines "rural area" as "any area of the United States not included within the boundaries of any city, village, or borough having a population in excess of fifteen hundred inhabitants. . . ."[153] Section 2 makes no further restrictions on the type of borrowers who can receive a loan or the purpose for which funds can be expended. Thus, this provision gives the REA Administrator vir-

148. Partridge Testimony, *supra* note 135, at 315.

149. *Id.* at 320.

150. Rural Electrification Act, 7 U.S.C. § 930.

151. Section 309 of the Act, 7 U.S.C. § 939, provides that insured loans "shall be [made] for the same purposes . . . as are provided for loans in [subchapter] I . . . of this [chapter,]" that is, sections 2, 4, and 5 of the Act. However, in carrying out its statutory authority, the REA has promulgated regulations which limit the making of insured loans for electrification to those purposes authorized by section 4 of the Act. *See* 7 C.F.R. § 1700.3b(a) (1985). Section 306 of the Act, 7 U.S.C. § 936, provides that loans may be guaranteed "for purposes provided in [this chapter,]" that is, sections 2, 4, and 5 of the Act. The REA has not limited guaranteed loans to Section 4 purposes as it has insured loans. *See* 7 C.F.R. § 1700.3c(a).

152. 7 U.S.C. § 902.

153. *Id.* § 913.

tually unlimited discretion in making loans for the electrification of rural areas.

A similar but narrower provision is section 4 of the Act.[154] Although section 2 seems broad enough to allow loans for all purposes provided in section 4, the provision is important because current regulations limit insured loans to section 4 purposes.[155] Section 4 of the Act authorizes the REA Administrator to "make loans for rural electrification . . . for the purpose of financing the construction and operation of generating plants, electric transmission and distribution lines or systems for the furnishing of electric energy to persons in rural areas who are not receiving central station service . . . ."[156] However, section 4 requires the Administrator, in making such loans, to "give preference to States, Territories, and subdivisions and agencies thereof, municipalities, peoples' utility districts, and cooperative, nonprofit, or limited-dividend associations . . . ."[157] Section 4 further provides that all loans be self-liquidating within a period of thirty-five years.[158] The two percent interest rate in section 4 was overridden by the provisions for insured loans and guaranteed loans, which provide that the former will be at either five percent or two percent[159] and that the latter will be at the rate negotiated between the borrower and the lender.[160] Section 4 further requires "the consent of the State authority having jurisdiction in the premises" before any generating plant loans may be made.[161] Although section 4 also imposes restrictions on type of borrower, the list of qualified borrowers covers almost every imaginable type of borrower.[162]

The third purpose for which REA insured or guaranteed loans may be made is set out in section 5 of the Act.[163] That provision authorizes the REA "to make loans for the purpose of fi-

154. *Id.* § 904.

155. 7 C.F.R. § 1700.3b(a); *see supra* note 151.

156. 7 U.S.C. § 904.

157. *Id.*

158. *Id.*

159. Rural Electrification Act § 305(b), 7 U.S.C. § 935(b).

160. Rural Electrification Act § 306, 7 U.S.C. § 936.

161. 7 U.S.C. § 904.

162. Section 4 authorizes loans "to persons, corporations, States, Territories, and subdivisions and agencies thereof, municipalities, peoples' utility districts and cooperative, nonprofit, or limited-dividend associations, organized under the laws of any State or Territory of the United States. . . ." 7 U.S.C. § 904.

163. *Id.* § 905.

nancing the wiring of the premises of persons in rural areas and the acquisition and installation of electrical and plumbing appliances and equipment."[164] The qualified borrowers for such loans are those listed in section 4 of the Act and "any person, firm, or corporation supplying or installing the said wiring, appliances, or equipment."[165] Even in the early years, the provision for electrical and plumbing equipment was not used excessively.[166] The REA usually made five year loans to cooperatives, who would relend to their members at six percent.[167] The legislative purpose was to make the availability of electricity financed by the REA meaningful by lending money to farmers at low interest rates so they could wire and plumb their houses and purchase electrical appliances with which to use the newly available electric power.[168]

Section 16 of the Act also requires the REA Administrator, in making or guaranteeing loans for generation and transmission facilities, to consider general criteria published by the Secretary of Energy to "insure coordination [with national energy policy] of electric generation and transmission financing" by the REA.[169] Although it has not been so used, this provision creates a present statutory authority for controlling overinvestment by power supply cooperatives in new generation facilities.[170]

III. THE DEBATE

A. The REA Goal To Create Jobs

The REA was established pursuant to a work relief appropriation bill and thus its original purpose was ostensibly to create jobs.[171] The job program rationale for REA subsidies for rural electrification has recurred throughout the REA's history. The ar-

---

164. *Id.* The loan authority under section 2 is broad enough that the loans authorized by section 5 would also seem to fall within section 2's authorization to make loans "for rural electrification." *Id.* § 902.

165. *Id.* § 905.

166. TWENTIETH CENTURY FUND, *supra* note 39, at 125 ("By January 31, 1941, 2 percent of the total allotments [of $358 million], or $7.3 million, had been made to cooperatives and other public agencies for wiring and plumbing.").

167. *Id.*

168. *See* HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, *supra* note 51, at 6.

169. 7 U.S.C. § 916.

170. *See infra* note 246 and accompanying text.

171. *See supra* text accompanying notes 25-28.

gument has taken three forms. Initially, REA supporters contended that the REA would increase employment directly by employing workers in the electric utility industry. It was also hoped that the REA would indirectly increase employment in the electric appliance industry. More recently, REA subsidies have also been advocated as a means to attract industrial employers to rural areas.

1. *Employment in the electric utility industry*

The prospect of employing jobless farmers to construct rural electric lines was a major impetus for the establishment of the Rural Electrification Administration.[172] Despite the REA's initial role as a work relief program,[173] however, the motive of its staunchest supporters was never to create jobs. Rather, the advocates of rural electrification saw the work relief measure as an avenue to get political support for their program.[174] Thus, when it became apparent that construction of electrical distribution facilities required such large amounts of capital investment and such highly skilled labor that the REA could not be very effective as an unemployment relief program,[175] it is no surprise that the supporters of REA were poised to transform the agency into one whose primary purpose was rural electrification. Indeed, the rationale that the REA creates employment in the electric utility industry seems to have long since been abandoned.

2. *Employment in the electric appliance industry*

In early support of the REA as a creator of jobs, some advocates also contended that the bringing of electric current to rural areas would create demand for electric appliances.[176] This, they

---

172. *See* P. FUNIGIELLO, *supra* note 7, at 135; HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, *supra* note 51, at 5 ("direct labor employed in line construction").

173. *See* Emergency Relief Appropriation Act of 1935, ch. 48, 49 Stat. 115 (expired by its terms in 1937).

174. *See* P. FUNIGIELLO, *supra* note 7, at 133 ("In the short run, it was this aspect . . . that had the strongest appeal.").

175. *See id.* at 145-48; *see also supra* note 31 and accompanying text.

176. *See* Letter from Morris L. Cooke, *supra* note 17, at 6; *see also* HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, *supra* note 51, at 5-6 ("[F]or every dollar spent upon line construction at least another dollar probably will be spent

argued, would require greater output from manufacturers and would create more jobs in such industries, thereby putting unemployed factory workers back to work.[177] The extent of this effect has never been documented.[178] However, providing farms with access to electricity probably did lead to greater spending on electric appliances.[179] Nevertheless, the argument would not justify continued REA credit assistance today. Because 99% of rural residents already have access to electrical service,[180] additional REA subsidies no longer increase access to electric power but instead only increase its use by those who already have access. In an era in which energy conservation is considered an important national priority, subsidizing the cost of power has the perverse effect of encouraging increased consumption of electricity.[181] For example, the goal of creating jobs has been served once the provision of

---

by consumers for wiring and appliances. . . . [This would] benefit industry engaged in manufacturing and distributing such appliances. Labor is doubly benefited in that direct labor employed in line construction is augmented by the increased work made possible in the manufacture of materials for line construction and in the manufacture of appliances and equipment used by consumers.").

177. *Id.*

178. To the extent that rural residents paid for such appliances out of their own pockets, the increased spending may merely have represented a shift in spending from other goods and services. The net effect on employment depended upon whether the increased demand for electric appliances created more or less jobs than were lost through the decreased demand for other goods and services. To the extent that the government subsidized such purchases of electric appliances, *see, e.g.*, Rural Electrification Act § 5, 7 U.S.C. § 905 (1982), the money used by the government, whether obtained by borrowing or by taxation, simply decreased the spending of somebody else, thereby reducing the demand for other goods and services. Again, it is not clear whether any employment gains exceeded employment losses.

There would have been an employment increase, however, if the use of electricity by farmers resulted in efficiency gains, for example, if certain electrical equipment might have increased the farmer's net income for a given amount of work and time. But there is no evidence of this. Electricity was not very useful for many farming operations, such as plowing, sowing, fertilizing, and harvesting, all of which use petroleum powered moveable machinery. Stewart, *Bringing Power to the Farm: Article I—Early Development Years*, PUB. UTIL. FORT., May 8, 1941, at 579, 580.

179. *See* TWENTIETH CENTURY FUND, *supra* note 13, at 472 n.132 (*citing* Rural Electrification News, Oct. 1940, at 10-11 (surveying the purchase of electric appliances by customers of REA financed systems)).

180. *See supra* note 1 and accompanying text.

181. *See* M. WEIDENBAUM, FINANCING THE ELECTRIC UTILITY INDUSTRY 117 (1974) (subsidizing energy prices "would run counter to the basic need to dampen down demand for scarce resources").

access to electric power encourages farmers to purchase washing machines; without creating any additional jobs, continued subsidies, which further reduce the price of electricity, lead to the wasteful result of farmers operating their washing machines with half loads rather than full loads.

3. *Attraction of industrial employers to rural areas*

Another argument which has been voiced regarding the claim that government assistance for rural electrification helps create jobs is that cheaper electricity helps attract industry into rural areas.[182] This should not be seen as an argument that cheaper electricity in rural areas creates jobs. Rather, it is best seen as an argument that cheaper power moves jobs from areas with higher power costs to areas with lower power costs by luring businesses away from areas with higher power costs. There is no reason for the federal government to favor some areas over others in such a way. Moreover, cheaper power may actually eliminate jobs because it makes machines relatively cheaper to operate and thus results in some substitution of machines for people.[183]

Even taking the attraction of industry argument on its own terms, cheap electricity is not very effective in shifting jobs to rural areas. The majority of industrial customers are "relatively insensitive to electricity rates when making locational decisions" because power costs are generally a trivial part of manufacturing costs.[184] Moreover, any attracted industry tends to be energy-intensive, and thus capital-intensive, and is not very effective in creating jobs.[185]

B. *The REA Goal to Provide Rural Residents with Access to Electricity*

The enduring rationale for federal involvement in rural elec-

---

182. *See* J. GARWOOD & W. TUTHILL, *supra* note 1, at 43-44 (quoting from 1958 Senate Agricultural Appropriations Hearings).

183. *See* R. LIPSEY & P. STEINER, ECONOMICS 190 (5th ed. 1978) ("Changes in relative factor prices will cause a partial replacement of factors that have become relatively more expensive by factors that have become relatively cheaper.").

184. Pace & Landon, *supra* note 65, at 51.

185. M. WEIDENBAUM, *supra* note 181, at 166; *see infra* text accompanying note 291 (70% of one REC's power is sold to two aluminum companies).

tric financing has been the goal of making power available to America's farms in order to improve the quality of rural life. The REA loans were intended to enable the construction of electrical distribution systems where costs were so prohibitive that the IOUs could not afford to extend their service.[186] Rural areas faced such cost barriers because of their low population density. Getting electricity from the generator to the consumer takes more wire and poles, and more energy is lost through line and transformer resistance when consumers are farther apart.[187]

1. *Subsidies for rural power*

Some have claimed that the first REA loans did not subsidize rural power because they were made at the government's cost of borrowing.[188] However, the loans still included a subsidy. The interest rate the government had to pay for money was only the return on a risk free investment.[189] Without federal assistance, the REA borrowers would have had to pay a higher rate of interest to obtain loans because of the non-zero risk involved.[190] The difference between the government's rate of interest and the rate the borrower would have otherwise had to pay was the subsidy.[191] The cost to the government was the risk of default.[192] Thus, even

---

186. Pace & Landon, *supra* note 65, at 6.

187. *See* Stewart, *supra* note 178, at 586.

188. *See supra* text accompanying note 51; SENATE COMM. ON AGRICULTURE & FORESTRY, *supra* note 15, at 4 ("Experience shows there is almost no loss on the kind of loans provided for in this bill, if they are carefully and honestly supervised. It is believed that the rate of 3 percent provided for will more than pay all the losses which may be sustained, and that in the end the Government will not lose any money, in carrying out the plan provided for in the bill.").

189. *See* CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 13.

190. *Id.*

191. *Id.* at 12.

192. *Id.* at 13. ("In private credit markets, interest rates and guarantee fees include a risk premium. This premium both induces lenders to bear the risk and assures that, on average, payments by borrowers are sufficient to cover default losses. In government lending, default risk exists in at least equal measure. The cost of this risk, now borne by taxpayers without compensation, is the fee that would be required to induce the bearing of these risks."); *cf.* Comment, *Allocation of the Risk of Constructing Electric Power Plants*, 1976 WASH. U.L.Q. 517 (criticizing a Michigan Public Service Commission decision which adopted a forseeability of loss standard in allocating loss from cancelled electric power generation construction projects between investors and consumers, rather than a standard which considers whether the rate of return allowed to investors "paid"

when the Act required all REA borrowers to pay a rate of interest similar to the government's cost of borrowing,[193] the rate paid by REA borrowers was substantially lower than on long-term borrowing by private companies.[194]

The present loan mechanisms contain similar subsidies. REA guaranteed loans provide a subsidy to borrowers in the form of interest rate savings and a cost to the government in the form of risk.[195] The RECs have adamantly denied that guaranteed loans provide any such subsidy.[196] Yet, in the face of a 1981 proposal to terminate FFB funding of REA loan guarantees, a measure which the Secretary of Agriculture had predicted would have raised the cost of guaranteed loan financing by 1.5%, an REC spokesman said "there is real doubt among experts as to the availability of adequate long term utility financing for rural electric cooperatives in the commercial money markets, because of their low equity ratios and lack of experience and history in attracting private lenders."[197] The RECs' position that guaranteed loans contain no subsidies is not only disputed by basic principles of corporate finance, it contradicts their own claim that they would have trouble raising money in commercial markets.

REA insured loans also contain the hidden interest subsidy represented by the difference between the interest rate the borrower could obtain without REA assistance and the interest rate the government must pay for money. Moreover, the insured loans

---

them for assuming the risk).

193. *See supra* text accompanying note 35.

194. TWENTIETH CENTURY FUND, *supra* note 13, at 477.

195. R. BREALEY & S. MYERS, PRINCIPLES OF CORPORATE FINANCE 473 (1981). ("The present value of a loan guarantee is the amount lenders would be willing to pay to relieve themselves of all risk of default on an otherwise equivalent unguaranteed loan . . . . A guarantee can clearly have substantial value on a large loan when the chance of default by the firm is high . . . . Members of Congress sponsoring loan guarantee programs do not, as far as we know, present careful estimates of the value of the program to business and the present value of the programs's cost to the public.").

196. *See, e.g.*, Partridge Testimony, *supra* note 135, at 313 ("REA guaranteed financing does not now, nor has it ever, involved any subsidy to borrowers or cost to the Government.").

197. *Utility Financing: Hearings Before the Subcomm. on Energy Conservation and Power of the House Comm. on Energy and Commerce*, 97th Cong., 1st Sess. 291 (1981) (82 C.I.S. H361-1) (statement of Charles A. Robinson, Jr. Executive Vice President and General Manager of Nat'l Rural Elec. Coop. Ass'n).

contain an explicit subsidy because the government makes insured loans at interest rates below its cost of borrowing.[198]

In addition, all REA loans contain a more latent subsidy. This lies in the amount of leverage that the REA allows its borrowers. "[T]he loans to cooperatives represent the entire investment in their property, while private companies must finance a large part of their investment through more costly classes of securities than bonds."[199] The more leveraged a firm is, the higher is the required return on the debt in order to attract capital.[200] Thus, the higher leverage of the RECs makes the interest rate they are charged even lower in proportion to what the market would charge.

Other subsidies present in the REA loans include administrative expense (the cost of REA lending administrative expenses), late payment costs (loss of the use of funds which are in arrears), and the costs of interest rate risk (which arise where the REA borrows at short maturities and lends at long maturities and thus runs a risk of increases in its interest spread).[201]

2. *Justifications for distribution subsidies*

The original rural electric distribution subsidies seem to have been justified on the grounds that the public return from investing government money in rural America was greater than the private return.[202] If so, the purpose of those subsidies has been ful-

---

198. CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 13.

199. TWENTIETH CENTURY FUND, *supra* note 13, at 477 (asserting that the IOUs could have reduced their capital costs if they had leveraged themselves more).

200. *See* J. VAN HORNE, FINANCIAL MANAGEMENT AND POLICY (4th ed. 1977) ("The greater the leverage, the lower the coverage of fixed charges and the more risky the loan."), *reprinted in* V. BRUDNEY & M. CHIRELSTEIN, CORPORATE FINANCE: CASES AND MATERIALS 395 (1979); *see also supra* text accompanying note 197.

201. *See* CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 13.

202. *See, e.g.*, Letter from H.A. Wallace, *supra* note 37, at 8 ("The concept of public responsibility for agricultural welfare has had broad acceptance in the past few years."); Stewart, *supra* note 22, at 795 ("[F]rom the strictly business standpoint of the lenders . . . the REA accomplishments as a whole are somewhat short of satisfactory . . . . But rural electrification . . . is a social as well as an economic matter. If farm living has been improved appreciably by the REA expansion perhaps the nation can afford to charge off a few hundred million dollars to progress.").

filled. Electric power has been made available to 99% of the rural population.[203] Yet, the subsidies have continued.[204] Moreover, the subsidies provided in the insured loans, which are the primary source of REA distribution assistance, have become more patent in time as the rate of interest at which RECs can borrow money from the REA has dropped substantially below the rate at which the government must borrow money.[205]

There appear to be two rationalizations for continued subsidies. The first is that the private return from maintaining rural electric distribution facilities is still insufficient to attract private investment and thus, government subsidies are needed to ensure that rural areas will have continued access to electricity in the future. The second is that even if demand for electricity is now sufficient to attract private investment because rural residents are now able to pay the full cost of the electricity they use, the government should nevertheless subsidize electric rates in order to keep the cost of power for rural residents comparable to the cost of power for urban residents.

a. Public benefit outweighs private benefit

The argument that the private return from maintaining rural

---

203. *See supra* text accompanying note 1.

204. This phenomenon is not unique to the REA. One observer, while acknowledging that the rapid expansion in federal credit programs might be attributed to an attempt to overcome imperfections in the credit market, contends that "the Congress has gone well beyond the 'market imperfections' rationale, to provide very substantial elements of subsidy in the form of debt service grants, below market interest rates, etc. not on a temporary but on a continuing basis." *See* MacLaury, *supra* note 110, at 211. A perceptive foreshadowing of today's problems was presented by one author in 1940. *See* J. BONBRIGHT, *supra* note 11:

> The problem here presented is an economic problem of far more importance than electrification. It concerns the whole economics of subsidies, as contrasted with the philosophy of individualism which calls upon individuals to assume the full costs of services performed for their benefit . . . [There is a] very wholesome fear that the practice of granting subsidies will be grievously abused under the influence of pressure groups . . . presenting . . . one of the most critical problems that our country will be called upon to face. Few problems of democracy call for a rarer combination of social vision and of hardheadedness than does the problem of meeting demands for subsidized services.

Id. at 54-55.

205. *See infra* text accompanying note 305; *see also* CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 13 (describing "explicit interest expense").

electric distribution systems is still insufficient to attract private investment is not credible. The National Rural Electric Cooperative Association, the trade association of the RECs, estimates the required investment in distribution plant as an average of $1337 per customer for RECs compared to $825 for IOUs.[206] Thus, the total economic cost difference between rural and nonrural electricity distribution is only an average of $512 per customer. Amortized over, say, a ten year period at a twelve percent annual rate of interest, this amounts to about $7.35 per month.[207] This cost difference is no longer sufficient to inhibit private investment in light of today's potent demand for electricity. The rural population has a much greater disposable income than in the 1930's and rural demand for electricity has increased significantly.[208] In addition, most areas served by RECs have experienced population growth which has reduced distribution costs by increasing population density.[209] Further, by the late 1930's, the REA had substantially reduced the costs of rural electric distribution through the use of lighter and cheaper equipment, together with more efficient construction techniques, as well as an easing of more costly construction standards which had previously been imposed by state public service commissions on the IOUs.[210]

The RECs do have continuing demands for capital, both for maintenance of existing lines and for expansion to meet growing demand.[211] However, there is no evidence that the continuing

---

206. NATIONAL RURAL ELEC. COOP. ASS'N, RURAL ELECTRIC FINANCING FOR THE FUTURE: FINAL REPORT AND RECOMMENDATION OF THE NRECA COMMITTEE ON FINANCING FOR THE FUTURE 18 (Jan. 1983). The statement in the foregoing publication that RECs have lower revenues per mile and fewer customers per mile of distribution line, *id.*, is not surprising at all because "the fewer customers per mile, the lower the cost of transformers and meters per mile of line." *See* TWENTIETH CENTURY FUND, *supra* note 13, at 453 & n.50. Moreover, the statement in NATIONAL RURAL ELECTRIC COOPERATIVE ASS'N, *supra*, at 18, that the RECs have lower equity than the IOUs only indicates that they are more leveraged but does not indicate any reason that their cost of service should be substantially higher.

207. This figure was derived by using standard loan amortization tables and calculating the monthly payment for a $512 loan with a 10 year payback in equal monthly installments at an annualized interest rate of 12 percent compounded monthly.

208. J. GARWOOD & W. TUTHILL, *supra* note 1, at 24-26.

209. *See* Morrison, *supra* note 67, at 22.

210. TWENTIETH CENTURY FUND, *supra* note 13, at 453-54 & n.52.

211. *See* Partridge Testimony, *supra* note 135, at 312, *see also* TASK FORCE, *supra* note 36, at 64. At first it was contended that the REA was merely a seed

need for capital cannot be satisfied by the sale of stocks and bonds on the private market. Indeed, the demand growth often acts to reduce average costs of distribution.[212] The only objection to such a move toward the RECs' independence from the federal government leads directly into the second explanation for the continuing government loans: rural consumers do not want to give up their subsidy.

b. Comparable rates for all consumers

The second explanation given for continuing REA loans is that rural consumers should not have to pay more for power than their urban counterparts.[213] Because of the REA's current lending programs, REC consumers actually pay less on average for their power than consumers of municipal and investor-owned utilities.[214] As indicated above, however, the actual amount more they would have to pay if subsidies were eliminated is $512 per con-

---

program to help rural utilities get started and then to launch them off on their own. As early as 1955, however, a federal task force commissioned to study federal lending agencies detailed the failure of the REA to fulfill this vision:

> The major volume of [REA] loans . . . have been made to REA cooperative associations organized without any initial ownership capital . . . . The financial plans developed for the cooperatives assumed that the physical plant once financed would require little if any further change and that earnings would be used to meet debt service charges.
>
> These plans have been found to be inadequate because an electric distribution system constantly requires replacements of parts of the system, and increased usage necessitates an increase in the capacity of the system. The additional demands for capital by the REA cooperatives have been met wholly from additional REA loans. The Congress has been generous in making funds available for this purpose without any requirement that the users of the system invest or induce others to invest private capital in the system.

Id.

212. *See supra* text accompanying note 209.

213. *See, e.g.*, HOUSE COMM. ON AGRICULTURE, *supra* note 84, at 1374 ("to provide reliable service at rates comparable to those charged for similar service by neighboring electric . . . systems"); Partridge Testimony, *supra* note 135, at 314 (RECs face "enormous challenges . . . keeping their rates at levels reasonably comparable to those charged in the cities and towns.").

214. *See* Morrison, *supra* note 67, at 117 (as of Jan. 1, 1981, typical monthly electric bills for 1000 killowatt-hours of power use were $51.26 for consumers of REA assisted borrowers and $58.16 for consumers of investor-owned and municipal utilities, or $6.90 less per month for consumers of REA assisted borrowers).

sumer,[215] which, when amortized over ten years at twelve percent, amounts to only $7.35 per month.[216] The government should not attempt to equalize such minor cost of living differences between rural and urban areas. Further, although electricity might cost more for rural residents, the overall cost of living for rural residents is generally lower than for their urban counterparts.[217] The cost of living difference is reflected in income differences. The median annual income for a farm family was $18,756 in 1982, whereas the median nonfarm family income for the same year was $23,585.[218] The relative cost of living differences are such that there is little or no real income difference. Even if there were a real income difference, however, that is something for people to take into account in deciding where to live. It is not something for which the government should compensate. Moreover, if any subsidies to either the rural or urban population are thought justified, subsidies for energy use, such as low interest REA loans, should be avoided in favor of general income supplements which "enable various groups of the population to buy the goods and services that they require, but without exempting them from the price pressures to conserve relatively scarce and hence relatively expensive resources."[219]

The federal government also provides other subsidies to rural electric power. The tax exempt status of the cooperatives reduces REC power costs.[220] In addition, the public power preference also provides cost advantages to RECs.[221]

---

215. *See supra* note 206 and accompanying text.

216. *See supra* note 207 and accompanying text.

217. *See generally* R. ELLICKSON & A. TARLOCK, LAND-USE CONTROLS 2-34 (1981) for a discussion of various cost of living components.

218. UNITED STATES BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 632, Table No. 1108 (105th ed. 1985).

219. M. WEIDENBAUM, *supra* note 181, at 117.

220. Davis, *Federal Tax Subsidies for Electric Utilities: An Energy Policy Perspective*, 4 HARV. ENVTL. L. REV. 311, 332 (1980); *see also* Pace & Landon, *supra* note 65, at 65 (contending that tax subsidies to cooperatives are an impediment to efficient operation of bulk power markets). NRECA misleadingly contends that certain deductions and exemptions provide subsidies to IOUs. *See, e.g.*, NATIONAL RURAL ELEC. COOP. ASS'N, *supra* note 206, at 22. However, the much greater subsidy, in tax expenditure form, is the completely tax exempt status for RECs.

221. *See* Morrison, *supra* note 67, at 115 & n.30; *see also* Larsen, *Public vs. Private Power Revisited: An Oregon Power Authority Proposal*, 7 ENVTL. L. 315 (1977) (principal benefit of public power is the preference for federal power); *cf.*

The idea of ensuring comparable electricity rates for rural and nonrural customers also goes beyond the purposes of the Act. The legislative intent of the drafters of the Rural Electrification Act was not to subsidize rural electricity so that its price was comparable to urban electricity. Early advocates saw the REA as a ten year plan to provide rural areas with *access* to electricity.[222] The projects were supposed to be "self-liquidating."[223] And, although the government's loans amounted to a subsidy, the interest rate was set at the government's cost of borrowing to give at least the appearance of not being a subsidy.[224]

3. *Justification for power supply subsidies*

Historically, the REA has been willing to finance generation and transmission projects in three situations.[225] First, the REA will make power supply loans where no adequate and dependable power source is currently available to the distribution cooperative.[226] Second, the REA will make such loans if rates offered by existing power sources would result in a higher cost of power for consumers than if the REA were to finance the proposed facility.[227] Third, the REA will make power supply loans where the future security of the distribution system is in jeopardy.[228] None of these three situations justifies government subsidies for generation and transmission facilities.

Comment, *Public Ownership of Public Utilities: Have Stockholders Outlived Their Useful Lives*, 43 OHIO ST. L. J. 821, 856-57 (1982) (low cost federal hydroelectric power sales to publicly owned utilities reduces rates for consumers of those utilities).

222. *See supra* text accompanying note 34; *see also* TWENTIETH CENTURY FUND, *supra* note 39, at 123-24 ("Legislation passed in 1936 provided for a ten-year program of rural electrification.").

223. *See* Rural Electrification Act, ch. 432, § 4, 49 Stat. 1363, 1365 (1936) (codified as amended at 7 U.S.C. § 904 (1982)).

224. *See id.* §§ 4, 5, 49 Stat. 1363, 1365 (1936) (amended to a fixed rate in 1944); *see supra* text accompanying note 51.

225. *See* REA Bulletin 20-6, *Loans for Generation and Transmission* (May 1969); REA Bulletin 20-2, *Electric Loan Policies and Application Procedures* 4-5 (June 13, 1977); *see also* J. GARWOOD & W. TUTHILL, *supra* note 1, at 47 (*quoting Department of Agriculture Appropriations for 1962: Hearings Before the Subcomm. on Agriculture of the House Comm. on Appropriations*, 87th Cong., 1st Sess. 4741-45 (1961) (testimony of REA Administrator Clapp)).

226. J. GARWOOD & W. TUTHILL, *supra* note 1, at 47.

227. *Id.*

228. *Id.*

The first criterion, that no adequate and dependable power source is currently available, might be a good reason for a rural utility to build its own generating and transmission facility. But it does not justify a federal subsidy for construction of such a facility. Although distribution of electricity does cost more in rural areas than in urban areas,[229] electricity generation costs are independent of population density.[230]

Advocates of the current REA generation and transmission loan guarantees point out that many power supply cooperatives are unable to borrow on private markets.[231] However, the inability of RECs to raise capital in private markets for proposed generating facilities does not reflect any special cost of generating power for rural customers, instead it reflects the potential inadequacy of the cooperative as a means of financing a generating and transmission facility.[232] In the absence of REA assistance, the capital structure of the power supply cooperatives may result in higher than necessary capital costs. The extremely high leverage of the power supply cooperatives[233] makes fixed payment debt issued by

---

229. *See* Pike, *Distribution Cost of Energy with Special Reference to Residence and Rural Customer*, in WHAT ELECTRICITY COSTS: A SYMPOSIUM ON THE COST OF DISTRIBUTION TO DOMESTIC AND RURAL CUSTOMERS 85-86 (M. Cooke ed. 1933) ("density—the number of customers per mile of street—tends to decrease [the cost of electricity distribution] since the length of wire needed to reach the customers is lessened and since the average size of line transformers is increased and hence their unit cost is lessened"); *see also supra* text accompanying note 9.

230. Transmission costs, that is, the costs of the high voltage lines which carry the power from the generator to the distribution network, would also appear to be independent of whether the consumer lives within a rural or an urban distribution system. *See generally* R. CAYWOOD, ELECTRIC UTILITY RATE ECONOMICS 26 (1st ed. 1956); M. FARRIS & R. SAMPSON, PUBLIC UTILITIES: REGULATION, MANAGEMENT, AND OWNERSHIP 229 (1973). Indeed, increasing concerns about radiation from nuclear plants and pollution from fossil fuel plants will likely lead to siting of future plants in more rural areas. If this has any effect on relative cost, it will make transmission costs cheaper for rural residents.

231. *See supra* text accompanying note 197.

232. In several recent joint ventures which will serve both rural and nonrural distribution networks, each utility has contributed capital in proportion to that part of the project's capacity which will be committed to that utility. Yet, the cooperatives have obtained REA assistance for their share. *See* RURAL ELECTRIFICATION AD., REA FINANCED GENERATING PLANTS 25 (1984) (New Hampshire Electric Coop., Inc., and Vermont Electric G & T Coop., Inc., received REA assistance for their shares of the Seabrook nuclear project; Wabash Valley Power Ass'n., Inc., received REA assistance for its share of the Wabash nuclear project).

233. *See supra* text accompanying note 199.

such cooperatives very risky for creditors and thus leads to unusually high interest rates.[234] Yet, the nonprofit status of the RECs prohibits them from soliciting private equity capital so that they can improve their capital structure.[235] Moreover, the rate structure policy of keeping capital contributions by cooperative member-ratepayers to a minimum also forecloses that avenue of improving the capital structure of the RECs.[236] The underlying cause of the inability of many rural power suppliers to function without REA assistance, therefore, may be the Rural Electrification Act's policy of giving cooperatives a borrower preference.[237] This policy encourages cooperatives to become the dominant power suppliers for rural power systems when in fact the cooperative form of ownership is least likely to result in eventual independence from REA assistance.[238]

The second situation in which the REA will make generation and transmission loans is where rates offered by existing power sources would result in higher power costs to consumers than if the REA financed the proposed facility. This rationale does not refer to the actual economic costs of providing power, but rather to the pricing of electric power. The theory is that the IOUs have a tendency to charge the distribution cooperatives an excessive rate for wholesale power, and that if the RECs build their own generation and transmission facilities they will not have to pay excessive rates to the IOUs.[239] A corollary to the theory is that the mere threat to build power supply facilities, given force by the availability of money to do so, may also deter the IOUs from overcharging the RECs.[240] Although these "competition" theories

---

234. *See* J. VAN HORNE, *supra* note 200, at 243 (arguing that excessive leverage increases overall capital costs).

235. *See supra* text accompanying note 42.

236. *See supra* note 211.

237. *See supra* text accompanying note 157.

238. *See supra* text accompanying note 56-65.

239. *See* Plotka, *The Changing Federal Role in Rural Area Bulk Power Supply Financing*, 52 N.D.L. REV. 685 (1976) (praising the 1973 amendments to the Rural Electrification Act for increasing the ability of RECs to finance generation and transmission facilities under the guaranteed loan program).

240. *See* HOUSE COMM. ON APPROPRIATIONS, DEP'T OF AGRICULTURE AND RELATED AGENCIES APPROPRIATIONS BILL, 1971, H.R. REP. No. 1161, 91st Cong., 2d Sess. 42 (1970) (70 C.I.S. H183-15) (power supply loans "strengthen borrowers' bargaining positions"); R. HELLMAN, GOVERNMENT COMPETITION IN THE ELECTRIC UTILITY INDUSTRY: A THEORETICAL AND EMPIRICAL STUDY 205-09 (1972).

are correct, it is not necessary for rural distribution systems to have subsidies in order to compete with other power suppliers. It is the absence of a natural monopoly over the generation of electricity rather than the subsidies which allows competition to work.[241] Moreover, the better approach for controlling excessive rates by the IOUs in wholesale power sales to the RECs is through the current regulatory framework which includes the state public service commissions and the Federal Energy Regulatory Commission. Subsidies are not the answer to controlling monopoly profits.[242]

The third rationale for REA power supply loans, protecting the future security of REA borrowers, focuses primarily on the future availability of power and the ability of the distribution cooperatives' customers to pay their power costs in the future.[243] The concern regarding future availability of power is merely a prospective version of the first criterion, that no adequate and dependable power source is currently available. Thus, meeting future rural power supply demand no more requires a subsidy than does meeting current rural power supply demand. The concern that customers of distribution cooperatives will not be able to pay their power costs in the future is a prospective version of the second criterion, that power supply rates offered by non-REA power sources will be higher than the rates which REA-assisted sources can provide. Again, the lack of monopoly power on the part of current power suppliers and the presence of rate regulatory authorities vitiate the need for power supply subsidies.

Beyond the rationales for current REA power supply loan guarantees, there is mounting evidence that the government is encouraging rural cooperatives to swim in water over their heads.[244] The loan guarantees make the already risky business of investing

---

241. *See* Essay, *Efficiency and Competition in the Electric-Power Industry*, 88 YALE L.J. 1511 (1979). Loan subsidies might reduce entry barriers for the RECs, however. This is especially true if the cooperative is an inefficient capital structure for a generation and transmission utility. *See supra* text accompanying notes 231-38.

242. *See* RESOURCES FOR THE FUTURE, INC., *supra* note 48, at 224.

243. J. GARWOOD & W. TUTHILL, *supra* note 1, at 53.

244. *See* Wall St. J., Feb. 9, 1984, at 29 (REA has financed over $9.75 billion in nuclear plant construction, much of which faces costly delays and cancellations).

in new generation facilities[245] even more risky by setting interest rates which are independent of risk and thereby reduce incentives for efficiency.[246]

C. *Crowding Others Out of the Credit Market*

Not only is government lending to RECs risky and without justification, REA guaranteed and insured loans also create very undesirable side effects in the credit market. The government homogenizes the credit market by converting various borrowing risk levels for various projects into risk free loans.[247] The REA "umbrella" thus reduces the ability of the credit market to differentiate between more and less secure investments.[248] This results in a

---

245. *See* Cavanagh, *Electrical Energy Futures*, 14 ENVTL. L. 133 (1983) (mistakes in demand growth projections make building new coal or nuclear generating facilities a costlier way than energy conservation to satisfy projected demand growth).

246. M. WEIDENBAUM, *supra* note 181, at 165-66 (criticizing early 1970's proposals for the federal government to guarantee loans to IOUs on the grounds that "the government guarantees would lessen whatever market forces are still operating in the government-regulated utility industry. There might be less pressure on utility managements for efficiency and cost reduction. The result might be the 'cost-plus' mentality that often characterize[s] government markets. Thus, the program could tend to be not only self-perpetuating but could lead to demands for larger Federal subsidies."); Note, *supra* note 76, at 228 (suggesting that RECs build unnecessary G & Ts because loan subsidies provide poor incentives).

247. MacLaury, *supra* note 110, at 217.

248. M. WEIDENBAUM, R. HARNISH & J. MCGOWAN, GOVERNMENT CREDIT SUBSIDIES FOR ENERGY DEVELOPMENT 13 (1976); *see also* MacLaury, *supra* note 110, at 217.

Weidenbaum and Harnish suggest that in theory "the federal agencies issuing or guaranteeing debt perform this role, charging as costs of the programs differing rates of insurance premiums," but say that "[i]n practice, all of the pressures are against such differential pricing of risks." M. WEIDENBAUM, R. HARNISH & J. MCGOWAN, *supra*, at 13. One might think that to charge an insurance premium for each risk would vitiate the value of the government loans by increasing their net cost to the market rate. This is not correct, however. If the premise for the government loans in the first place is that the social value of the investment in the project is greater than the private value to an individual investor so that the market tends to underinvest, then the government's fair price, what it is willing to pay for the investment, should be greater than the market's value. The net interest rate that the government is willing to charge for undertaking the risk associated with the loan is lower than the market's because the investment is worth more to the government than it is to the market. *Id.* at 9-10 ("In each government credit program, Congress has passed a law stating in effect that the national welfare requires designated groups to receive larger shares of the available supply of credit

reallocation of resources.[249] The increase in government assisted borrowing pushes up interest rates as the demand for borrowed funds increases.[250] The resulting higher interest rates make borrowing costs greater for those borrowers who were already in the credit market. These higher interest rates force some would-be borrowers out of the credit market and reduce the amount of borrowing by others.[251] The losers in this push-and-shove match are "consumers, homeowners, small businesses, school districts, and smaller counties, cities, and other units of local government."[252] The net effect is a shift of credit resources from these borrowers to the REA assisted borrowers.[253]

D. Inadequate Budgetary Oversight

The subsidies for REA assisted borrowers are currently subjected to minimal congressional oversight. The revolving fund has an annual inflow of $300 million in interest payments on outstanding loans,[254] $158 million of which represents interest on the pre-1973 loans on which the fund does not have to make interest payments to the FFB, and on which the first principal payments are not due until 1993.[255] The authority of Congress to restrict the loan levels has not impinged on the activities of the fund due to the practice of setting annual loan ceilings in excess of the annual income to the fund.[256] Moreover, under the Act, insured loans

---

than would result from the operation of market forces alone.").

249. MacLaury, *supra* note 110, at 211.

250. M. WEIDENBAUM, *supra* note 181, at 143. Weidenbaum argues that federal credit programs "do not increase the total flow of saving or investment," but rather only "exert upward pressures on interest rates as investment funds are bid away from other sectors." *Id.* at 142. This conclusion assumes that higher interest rates will not result in an increase in savings and investment. However, to the extent that higher interest rates do increase investment, *see* R. LIPSEY & P. STEINER, *supra* note 183, at 642-45 (describing how increases in the interest rate encourage people to buy bonds rather than hold their money), the borrowing generated by the federal credit programs may not entirely displace an equal amount of existing borrowing.

251. M. WEIDENBAUM, *supra* note 181, at 143, 145-46.

252. *Id.* at 145-46.

253. M. WEIDENBAUM, R. HARNISH & J. MCGOWAN, *supra* note 248, at 9-10.

254. *See* SENATE COMM. ON AGRICULTURE, NUTRITION & FORESTRY, *supra* note 26, at 7.

255. *Id.*

256. *See supra* text accompanying note 104.

made from the revolving fund may not be included in the unified federal budget totals,[257] and thus are not subject to being put on the table for comparative scrutiny along with other government programs which are included in the budget process. If such subsidies are justified on the grounds that they provide a "public" benefit, it is wise to put the agency to the test every year by convincing Congress that such benefit is still sufficient to justify the agency's costs.[258] In this case, the costs are in the form of the foregone revenue to the federal government from the interest payments on outstanding REA insured loans.[259] The off-budget feature of the insured loans is thus highly undesirable.

The guaranteed loans have similarly been omitted from the unified federal budget.[260] Current federal budget accounting excludes guarantees of debt because they are contingent liabilities which do not obligate a specified amount of funds in the future or at the time they are made.[261] Such subsidies, valued at the difference between the interest rate charged by the FFB and the interest rate the borrower could obtain on the market, should be subject to annual appropriation scrutiny. As recent defaults have demonstrated, the risk assumed by the government is not costless.[262]

---

257. Rural Electrification Act § 305, 7 U.S.C. § 935.

258. M. WEIDENBAUM, FEDERAL BUDGETING: THE CHOICE OF GOVERNMENT PROGRAMS 56 (1964) (criticizing a 1964 legislative proposal similar to the current REA insured loan program, which would have permitted the REA to use repayments it receives on old loans to make new loans without further congressional review and approval, because it would have "reduce[d] the controllable portion of future [federal] budgets" and thereby defeated the budgeting process's purpose of allocating scarce government revenues among competing demands.); *see also* Weidenbaum, *Government Expenditures and National Priorities,* in FISCAL RESPONSIBILITY—TAX INCREASES OR SPENDING CUTS? 47, 81-82 (Charles C. Moskowitz Lectures at the N.Y.U. School of Commerce 1973) (arguing that omitting uses of government credit and tax benefit expenditures from the federal budget process "substantially reduces the effectiveness of the entire budget process, particularly in the ability of both the President and the Congress to direct and influence the allocation of public resources in accordance with changing national priorities").

259. *See supra* text accompanying note 254.

260. CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 6.

261. *Id.*

262. The first major financial failure of an REC occurred when the REA forclosed on $1.1 billion in loans made to Big Rivers Electric Corp. in January 1985. *See infra*, Section IV for a discussion of the Big Rivers debate. Another REC filed for Chapter 11 bankruptcy protection in May 1985. *See* Debtor's Petition, *In re* Wabash Valley Power Ass'n, Inc., No. 1P85-2238 (U.S. Bankr. Ct. S.D. Ind., filed

IV. A Costly Mistake: The D.B. Wilson Project

The high risk associated with REA guaranteed loans made by the FFB to power supply cooperatives first materialized in the case of Big Rivers Electric Corporation, a small Kentucky power cooperative which serves four member distribution cooperatives,[263] which in turn serve 71,000 customers.[264] On January 18, 1985, the federal government filed a foreclosure suit in federal district court in Owensboro, Kentucky, against Big Rivers on its entire $1.1 billion in REA guaranteed loans issued by the FFB.[265] The government charged Big Rivers with defaulting on over $26 million in principal and interest on its REA guaranteed and insured loans between November 23, and December 31, 1984.[266] The defaults included Big Rivers' initial installment of over $19 million on an REA guaranteed loan made by FFB for the construction of a generation and transmission facility.[267]

Big Rivers' financial woes stem from its recent completion of that $756 million generating facility.[268] The coal-fired generator, called D.B. Wilson I, was one of two planned 400 MW units,[269] which Big Rivers was constructing to meet projected demand in-

---

May 23, 1985); *see also* Wall St. J., May 24, 1985, at 5, col. 1 (Wabash Valley Power Ass'n, a group of 24 RECs, filed for Chapter 11 bankruptcy protection on $500 million in debt used to fund a 17% share in two cancelled nuclear plants). Still more RECs are on the brink of financial failure. *See* Groundswell, May, 1985, at 16 (listing several other RECs that are on the verge of bankruptcy because of costly investments in nuclear plants facing cost overruns and cancellations).

263. Matter of Big Rivers Elec. Corp., Nos. 7990, 9006, slip op. at 1 (Ky. P.S.C. Oct. 18, 1984). The four member cooperatives are Green River Electric Corp., Henderson-Union Rural Electric Coop., Jackson Purchase Elec. Coop., and Meade County Rural Electric Coop. *Id.* at 1 n.1.

264. Application for Rate Increase, Matter of Big Rivers Electric Corp., No. 9163, slip op. at 2 (Ky. P.S.C. filed Nov. 16, 1984).

265. *See* Complaint of U.S. Dep't of Justice, United States v. Big Rivers Elec. Corp., No. C85-0012-0(J) (W.D. Ky. filed Jan. 18, 1985); *see also Washington and the Utilities—REA Initiates Foreclosure Action Against Cooperative,* Pub. Util. Fort., Feb. 7, 1985, at 47.

266. Complaint of U.S. Dep't of Justice, *supra* note 265, at 5, para. 12 ($404,826.01 on Nov. 23, 1984; $102,912.84 on Nov. 26, 1984; $1,546,497.30 on Nov. 30, 1984; $10,287.59 on Dec. 3, 1984; and $24,682,594.39 on Dec. 31, 1984).

267. Louisville Courier-J., Jan. 5, 1985, at B9, col. 1, 6.

268. *Id.* Oct. 11, 1984, at B17, col. 6.

269. Rural Electrification Ad., *supra* note 232, at 25.

creases.[270] When actual demand subsequent to the study projecting the demand growth, but prior to construction, showed the original load growth forecasts to be flawed,[271] construction of the second generator, D.B. Wilson II, was delayed indefinitely.[272] Nonetheless, D.B. Wilson I was begun in 1980 and completed in September 1984, but has turned out to be unneeded.[273]

Big Rivers first applied to the Kentucky Public Service Commission to have D.B. Wilson I included in its rate base in the Spring of 1984.[274] However, Big Rivers withdrew its application on October 16, 1984, when its largest consumer, an aluminum company, opposed the rate increase because the plant was not used and useful.[275] Subsequently, Big Rivers filed another rate increase application in November 1984.[276] The application purported not to include the D.B. Wilson plant.[277] In January 1985, however, one of Big Rivers' two major customers intervened in the rate case to oppose any rate increase sought on account of the D.B. Wilson plant on the grounds that excess capacity is not includible in the rate base.[278]

Meanwhile, Big Rivers has been unable to sell any of the power from the facility or sell the facility itself to other utilities.[279] One scheme by which Big Rivers had hoped to reduce the burden of its debt service on D.B. Wilson I was a proposed sale-leaseback negotiated between Big Rivers and General Electric Credit Corporation.[280] Such an arrangement would have enabled

---

270. *Washington and the Utilities*, *supra* note 265, at 47 ("A 1977 power requirement study showed that in the previous decade, demand had grown 10.36 percent annually; new capacity would be needed both in 1984 and in 1986, the study concluded.").

271. *Id.*

272. *Id.*

273. *Id.*

274. Application for Rate Increase, Matter of Big Rivers Elec. Corp., No. 9006 (Ky. P.S.C. filed April 11, 1984).

275. *See* Matter of Big Rivers Elec. Corp., Nos. 7990, 9006 (granting Big Rivers' motion to dismiss its rate increase application because Big Rivers could not "reach agreement with its principal users of electric power"); *see also* Louisville Courier-J., Oct. 24, 1984, at B9, col. 6.

276. *See* Application for Rate Increase, *supra* note 264.

277. *Id.*

278. Louisville Courier-J., Jan. 23, 1985, at B9, col. 4-6.

279. *See id.* (noting that Big Rivers has been negotiating the sale of 100 MW of its 400 MW in new generating capacity to utilities in Mississippi and Texas).

280. *See* Louisville Courier-J., Oct. 11, 1984, at B17, col. 6.

Big Rivers to save on its carrying charges for D.B. Wilson I, at the expense of the taxpayer, by "selling" the tax benefits to General Electric Credit Corporation.[281] The deal stalled, however, when the REA refused to guarantee Big Rivers' lease payments to General Electric Credit Corporation, a condition upon which the sale-leaseback was contingent.[282]

Big Rivers claims it defaulted on its payments because the REA, beginning in November 1984, " 'refused to advance loan funds which had been previously approved.' "[283] The REA had originally, on November 4, 1980, agreed to guarantee a $1.1 billion loan from the FFB for D.B. Wilson I and II[284] but had only advanced $565.6 million of the funding as of November 1984.[285] When the REA refused to advance any more funds, Big Rivers began diverting revenues it otherwise would have used to pay its already outstanding REA loans to pay the contractors on the D.B. Wilson project.[286] The REA's position was that "advancing the funds to Big Rivers in November would only have been 'throwing good money after bad.' "[287] The impact of the REA's refusal to advance additional funds to Big Rivers was particularly severe because ninety-seven percent of Big Rivers' net worth was debt.[288] Big Rivers' high leverage means that almost all of its capital costs are in the form of mandatory debt service payments, rather than member rebates which do not have to be paid when earnings are insufficient. Big Rivers' precarious position illustrates the risk assumed by the government in making such high leverage loans.[289] Since the Kentucky Public Service Commission is unlikely to approve a rate increase,[290] the REA faces little prospect of recover-

---

281 *See* Application for Rate Increase, *supra* note 274, at 9.

282. Louisville Courier-J., *supra* note 280; *see also* Matter of Big Rivers Elec. Corp., Nos. 7990, 9006, slip op. at 2 (granting Big Rivers' motion to withdraw its request for approval of sale-leaseback of D.B. Wilson I because it was "unable to obtain credit approval" from the REA).

283. *Washington and the Utilities*, *supra* note 265, at 47 (quoting Hayden Timmons, Vice General Manager of Public Relations at Big Rivers).

284. Complaint of U.S. Dep't of Justice, *supra* note 265, at 4, para. 10.

285. *Washington and the Utilities*, *supra* note 265, at 47.

286. *Id.*

287. *Id.* (quoting Jack Van Mark, REA Deputy Administrator).

288. Louisville Courier-J., *supra* note 267, at B9, col. 3. ("$1,073,846,976 in REA-guaranteed loans and about $143 million owed to other creditors").

289. *See supra* notes 199, 200 and accompanying text.

290. Louisville Courier-J., *supra* note 275, at B9, col. 6 ("P.S.C. officials have

ing the cost of the facility.

Moreover, a rate increase would not improve the situation anyway. The cooperative's two largest customers, two aluminum companies which use seventy percent of the power generated,[291] face plant closures if a rate increase is approved[292] because of the weak market for United States-produced aluminum.[293] If these two plants close, the rate increase will result in a significant revenue decrease.

The REA has put pressure on Big Rivers and East Kentucky Power Cooperative, another REA power supply borrower whose member distribution cooperatives serve 280,000 customers, to consider a merger.[294] The REA's position is that if the two aluminum companies shut down, a rate increase to pay for the D.B. Wilson plant would have "less impact" when spread over 350,000 customers rather than 71,000.[295] The merger would also relieve the REA from having to finance a generation facility currently under construction for East Kentucky Power[296] which is expected to cost $1 billion.[297] Big Rivers and East Kentucky Power have commissioned Bechtel Energy Corporation to study the feasibility of the merger and were expecting a report in June 1985.[298] Big Rivers has charged that the REA had withheld loan money which "it normally distributed to the utility each month, in an attempt to force Big Rivers to merge with East Kentucky Power."[299]

The D.B. Wilson project illustrates several of the problems with the current REA lending programs which were discussed in this Article. First, it shows that the risk associated with major power supply projects such as D.B. Wilson can and will materialize in some cases. Second, D.B. Wilson illustrates how the economic need for subsidies for generation facilities is tenuous at best. Two aluminum companies purchase the bulk of the power

---

said it is unlikely the utility can win any rate increase for the plant because Big Rivers cannot show it needs the extra power.").

291. *Washington and the Utilities*, *supra* note 265, at 47.

292. Louisville Courier-J., *supra* note 275, at B9, col. 6.

293. *Id.*, Mar. 20, 1985, at B9, col. 1.

294. *Washington and the Utilities*, *supra* note 265, at 47.

295. *Id.*

296. *See* Louisville Courier-J., Jan. 8, 1985, at A4, col. 1 (editorial).

297. *Washington and the Utilities*, *supra* note 265, at 47.

298. *Id.*

299. Louisville Courier-J., *supra* note 267, at B9, col. 5.

generated by Big Rivers. Third, Big Rivers' precarious financial state illustrates the even greater risk of default by the RECs due to their excessive leverageing.

V. PROPOSALS FOR CHANGE

A. The Revolving Fund Self-Sufficiency Act

The Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act was introduced into both the House and the Senate in 1983.[300] The proposal sought to redress the impending insolvency of the revolving fund.[301]

The problem arose because the fund loans money to borrowers at either five percent or two percent[302] but has to obtain the funds from the FFB at treasury's cost of money plus one-eighth of one percent.[303] Because of these subsidized rates the fund's net assets have been depleted so that the interest expenses paid by the revolving fund to the FFB are expected to exceed the interest income from all outstanding REA loans by the second half of fiscal year 1985.[304] In 1983, the average REA borrower's interest rate on new insured loans was 4.90% whereas the average interest rate paid by the RETRF to the FFB on certificates of beneficial ownership sold to the FFB in 1983 was 10.85%.[305]

The Self-Sufficiency Act would make four relevant changes. First, Congress would give the revolving fund a shot in the arm by forgiving the $7.9 billion in principal payments on REA's outstanding loans from the FFB.[306] The interest payments on these loans already had been forgiven in setting up the fund.[307] Under the Self-Sufficiency Act, the RETRF also would not have to repay the outstanding principal on pre-1973 loans to the FFB as it is currently obligated to do. This foregone federal revenue is the cost-equivalent of an appropriation of $7.9 billion to the RETRF

---

300. *Washington and the Utilities, supra* note 114, at 46.

301. *Id.*

302. *See supra* text accompanying note 115.

303. *See supra* text accompanying note 116.

304. *Washington and the Utilities, supra* note 114, at 46.

305. SENATE COMM. ON AGRICULTURE, NUTRITION & FORESTRY, *supra* note 26, at 6.

306. *Id.* at 7; *see* H.R. 3050, 98th Cong., 1st Sess. § 4, 3-4 (1984) and S. 1300, 98th Cong., 1st Sess. § 4, 3-4 (1983) (proposed changes in 7 U.S.C. § 932).

307. CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 39.

in obligations which would otherwise come due between 1993 and 2016.[308] The Senate Report accompanying the bill refers to this appropriation as converting the notes due to the United States Treasury into "equity capital" of the fund.[309] It is nothing more than an appropriation of funds in the form of foregone revenues.[310]

Second, Congress would authorize the Administrator to refinance the fund's obligations to FFB in order to take advantage of decreases in interest rates without paying an acceleration penalty.[311] The language of the bill characterizes the provision as allowing the Administrator "to repurchase" the certificate of beneficial ownership which was issued to the FFB.[312] However, since the RETRF would ordinarily have no liquid assets with which to repurchase the certificate of beneficial ownership,[313] the RETRF would have to sell a new certificate to the FFB in order to repurchase the old one. "This one-way, downward-only, penalty-free financing would benefit the Fund at the expense of Treasury [that is, the FFB], which does not have a similar refinancing option with investors in Treasury debt."[314] In other words, the bonds sold by the FFB to raise the funds with which the certificate of beneficial ownership was purchased by the FFB cannot be accelerated without penalty. The bill thus reduces the burden imposed on the RETRF by loan subsidies to REA borrowers by shifting some of it to the FFB. The bill would also authorize the FFB to grant a requested interest rate reduction by "[a]uthoriz[ing] the lender of a loan guaranteed by REA . . . to adjust without penalty the rate of interest on any advance having a remaining term of 7 or more years" if the current lending rate is more than one percent less than the lending rate on the outstanding loan.[315]

---

308. SENATE COMM. ON AGRICULTURE, NUTRITION & FORESTRY, *supra* note 26, at 6.

309. *Id.* at 2.

310. *See* WEIDENBAUM, *supra* note 258, at 81-82.

311. *Id.*; *see* H.R. 3050, 98th Cong., 1st Sess. § 5, 4-5 (1983) and S. 1300, 98th Cong., 1st Sess. § 5, 4 (1983) (proposed changes in 7 U.S.C. § 934).

312. *See* H.R. 3050, § 5, at 4-5; S. 1300, § 5, at 4.

313. First, that is why the CBO was issued in the first instance, to borrow funds from the FFB. Second, in every year since 1976, Congress has required the RETRF "to disburse more loan funds than have been available from receipts." *See* Morrison, *supra* note 67, at 104.

314. CONGRESSIONAL BUDGET OFFICE, *supra* note 59, at 39-40.

315. SENATE COMM. ON AGRICULTURE, NUTRITION & FORESTRY, *supra* note 26,

The third major change by the bill would be to abolish the fixed five percent "standard rate" of interest on insured loans and to vest the Administrator with the authority to fix a standard rate from time to time.[316] The calculated standard rate, which would not be allowed to fall below five percent, would be "that rate . . . that would produce, from loans (other than special rate loans) approved . . . during a given period, interest income equal to, but not greater than, the amount of anticipated interest expense on the . . . obligations . . . required to be issued or sold during such period to cover loan advances and interest expenses . . . "[317] The bill would expand "the eligibility criteria for 'special rate' loans,"[318] but would set interest rates at a range from two percent up to one-half the standard rate on such loans.[319] There is no justification articulated in the Senate Report on the bill for the retention of the arbitrary five percent floor on the standard rate, or the establishment of the arbitrary one-half-the-standard-rate ceiling on the special rate.[320] Nevertheless, this provision of the bill is laudable as an effort to reduce at least the explicit interest subsidies in REA insured loans.

The fourth major substantive change by the bill would be to make REA loan guarantees and lien subordination mandatory rather than permissive.[321] The loan guarantee provision would make guarantees mandatory "for any purpose provided in the Act and for refinancing assistance."[322] This, in effect, would insure the borrower against bankruptcy because the borrower could get a guaranteed loan to refinance any other loan on which it might

---

at 2; *see* H.R. 3050, § 7, at 11 and S. 1300, § 7, at 10 (proposed addition to 7 U.S.C. § 1936).

316. SENATE COMM. ON AGRICULTURE, NUTRITION & FORESTRY, *supra* note 26, at 2; *see* H.R. 3050, § 6, at 5 and S. 1300, § 6, at 4 (proposed change in 7 U.S.C. § 935).

317. H.R. 3050, § 6, at 5; S. 1300, § 6, at 5.

318. SENATE COMM. ON AGRICULTURE, NUTRITION & FORESTRY, *supra* note 26, at 2.

319. *Id.*; *see* H.R. 3050, § 6, at 6-7; S. 1300, § 6, at 5-6.

320. *See* SENATE COMM. ON AGRICULTURE, NUTRITION & FORESTRY, *supra* note 26.

321. H.R. 3050, § 7, at 8; S. 1300, § 7, at 8-9 (proposed change in 7 U.S.C. § 1936).

322. SENATE COMM. ON AGRICULTURE, NUTRITION & FORESTRY, *supra* note 26, at 2; *see also* H.R. 3050, § 7, at 8 ("for purposes provided in this Act and for purposes of providing refinancing assistance"); S. 1300, § 7, at 8.

otherwise default. Such a provision would only further reduce federal budgetary control over the guaranteed loan program and would hinder the goal of weaning the RECs from REA dependence.

The provision regarding lien subordination is equally overreaching. It would require the Administrator to subordinate government liens, upon the borrower's request, "for any purpose that would enhance the financial strength or revenue of the borrower or improve the efficiency, effectiveness, or financial stability of the borrower, upon a finding that the borrower has, or will have, the ability to repay its existing and proposed indebtedness."[323] The purposes for which an REA borrower could demand the REA to subordinate its liens are not clear. The requirement that the borrower have "the ability to repay" is vague in the sense that any loan has some risk involved and thus some probability that the borrower cannot repay. The bill does not define a threshold of risk above which loans would not be made. However, this is apparently the intended legal standard.

The proposed Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act passed the House of Representatives on March 1, 1984, by a vote of 283 to 111.[324] The bill did not reach a vote on the floor of the Senate in 1984.[325] In order to maintain the solvency of the fund in the interim, Congress approved funds in the continuing appropriations resolution, H.J. Res. 648.[326] This provided RETRF with $1.1 billion for insured loans for fiscal year 1985 and $216 million for losses incurred in fiscal year 1984.[327] To the author's knowledge, Congress did not taken any further action on the Self-Sufficiency Act in 1985.

B. The 1986 Reagan Budget Proposals

The Reagan Administration's Budget for fiscal year 1986 makes three proposals related to the REA. First, the Administration proposes that all federal activities which are statutorily "off-budget" be subjected to budgetary analysis on an annual basis by

---

323. H.R. 3050, § 7, at 10; S. 1300, § 7, at 8-9.
324. *Washington and the Utilities*, *supra* note 114, at 46.
325. *Id.*
326. *Id.*
327. *Id.*

having their statutory exemption repealed.[328] This proposal would subject the revolving fund's lending and borrowing activities, as well as guaranteed loans made by the FFB, to annual federal budget scrutiny.

The Administration's second proposal would aim to increase rural electric system reliance on private borrowing.[329] Without need for statutory changes, the Administration proposes to reduce new loan obligations from $2.4 billion in fiscal year 1985 to $0.9 billion in fiscal year 1986.[330] Proposed legislation would replace the current five percent insured loan "standard rate" with a rate equal to the cost of treasury borrowing plus one and one-eighth percent.[331] These changes would begin a needed transition from REA-assisted borrowing to independent borrowing.

The third part of the Administration's proposal with respect to the REA is the most significant. It would phase out all REA lending by 1990.[332] This is the aspect of the budget upon which public debate must focus. In light of the arguments discussed in this Article, this author believes the proposal to phase out the REA is a good one.

VI. SYNTHESIS

The Rural Electrification Administration has outgrown the justifications for federal subsidies for rural electrification. The burden on the federal taxpayer and on the American economy in this time of enormous budget deficits is intolerable in the absence of need. Several steps may be taken to rectify the situation.

First, Congress should embrace the Reagan Administration's proposal to amend the Rural Electrification Act and the Federal Financing Bank's authorizing statute to include all such activities in the unified federal budget. This would greatly improve the ability of lawmakers to weigh the costs and benefits of the REA against the costs and benefits of other federal programs in the fiscal battle to reduce the budget deficit. To make this process

---

328. 1986 FEDERAL BUDGET, *supra* note 3, at 6-8 to 6-17; Appendix to 1986 FEDERAL BUDGET, *supra* note 3, at III-2.

329. 1986 FEDERAL BUDGET, *supra* note 3, at 5-38.

330. *Id.*

331. *Id.*

332. *Id.*

more effective still, Congress should go beyond the Administration's budget proposal and change the accounting practices used in the federal budget process so that the cost of loan guarantees is given an actuarial value which is treated as an expenditure at the time a loan guarantee is made. This step has been endorsed by a recent Congressional Budget Office study.[333]

Second, Congress should enact a program to phase out all REA generation and transmission loans as soon as is practicable. As there is no basis for giving rural utilities any more subsidy in this regard than their urban counterparts, the only reason for continuing the loan program at this time is to avoid disruptive or wasteful effects of not continuing to fund projects which have already been undertaken. The Reagan Administration's proposal to end all funding by 1990 may be a workable approach. In the meantime, the President can use his authority under section 16 of the Rural Electrification Act to establish energy policy guidelines which regulate unnecessary expansion of generating capacity. In addition, the state public service commissions in those states which already require a certificate of public convenience and necessity should scrutinize more closely future proposals by power supply cooperatives to build additional generating capacity so that mistakes like the Big Rivers debacle are not repeated. Those states which do not require certificates of public convenience and necessity should consider enacting such a requirement.

Third, with respect to distribution borrowers, Congress should articulate and reassess the goals of the Rural Electrification Act. If Congress finds that rural electric rates should be the same for rural as for nonrural consumers, then some amount of continued subsidization will be necessary. However, this author would recommend a cessation of distribution subsidies. The roughly $7.35 per month average cost difference per consumer which would result after elimination of distribution subsidies[334] would not create such severe hardship as to justify the current prolific federal spending. Moreover, when all costs of living in rural areas, not just electricity costs, are compared to the costs of living in nonrural areas, rural residents may indeed be better off rather than worse off. Nevertheless, if Congress does want to provide financial assistance to rural residents, this is best done

333. *See generally* CONGRESSIONAL BUDGET OFFICE, *supra* note 59.

334. *See supra* text accompanying note 207.

through income supplements and not energy subsidies, which encourage increased energy consumption in a time when energy conservation is the desired policy.

Elimination of the distribution subsidies may require more than the five years proposed by the Reagan Administration. The excessive leverage which the RECs have been allowed to maintain must be reduced and their equity allowed to build over time so that they can become better able to borrow in private markets without the necessity of sudden rate increases which are larger than should be necessary to cover the cost of eliminating the subsidies.

It is time for Congress to nudge the rural cooperatives gently out of the federal nest. The taxpayer deserves a new deal.