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THE CHANGING FEDERAL ROLE IN RURAL AREA BULK POWER SUPPLY FINANCING

BY NORMAN L. PLOTKA*

INTRODUCTION

If, in the next decade, the Nation's rural areas do not experience the electric power supply shortages which have been so widely predicted to occur,¹ one of the reasons may be the slow, sometimes painful evolution of new, pragmatically developed relationships among several segments of the electric power industry. Recent federal legislative changes in rural electrification financing methods have assisted in accelerating the process. These new relationships are especially evident in the activities of rural electric power supply cooperatives (cooperatives) and investor owned companies (companies). This article will examine certain legal aspects of these changes as exemplified by recent arrangements between cooperatives and companies for joint ownership of bulk power supply facilities, some of which also illustrate the increased involvement of private sector funding in various ways in the field which, until a few years ago, was occupied exclusively by the federal government.

I. BACKGROUND

For many years before 1973, the cooperatives had been obtaining bulk power supply financing by Rural Electrification Administration (REA) thirty-five year direct loans bearing two percent interest, substantially in the same manner as their distribution cooperative members obtained REA financing for distribution facilities. These power supply loans were marked by long and hard-fought court and congressional battles in almost every geographic area of the country.² There were, of course, notable exceptions, even at the

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1. The scope of governmental concern over possible depletion or interruption of the Nation's energy supply generally is reflected in the numerous congressional discussions, e.g., 121 CONG. REC. No. XVI at 33, 34 (Index to daily ed. Sept. 25-Oct. 26, 1975), and executive statements, e.g., II EXEC. DOC. II (Index to weekly ed. Nov. 3, 1975), on the subject. See also findings and declarations of purpose in such legislation as Federal Energy Administration Act of 1974, Pub. L. No. 93-275, 88 Stat. 96; Emergency Petroleum Allocation Act of 1973, Pub. L. No. 93-159, 87 Stat. 627.

2. Alabama—Alagama Power Co. v. Alabama Elec. Coop., 249 F. Supp. 855 (M.D. Ala. 1965), *aff'd*, 394 F.2d 672 (5th Cir.), *cert. denied*, 393 U.S. 1000 (1968); Alabama Elec. Coop. v. Alabama Power Co., 278 Ala. 123, 176 S.2d 483 (1964);

time of the earliest REA loans to federated power cooperatives, some of which exhibited very close coordination of cooperative and company power supply activities.³ Fortunately for the rural areas served by the cooperatives as well as for the urban areas served by the companies, coordination has now become the rule. Increasingly, coordination is taking the form of projects jointly owned by cooperatives and companies, as well as other suppliers. Moreover, various forms of involvement of private funding have replaced the exclusively REA direct two percent loans of the past. The principal causes of these developments include, in addition to modernization of the REA legislation mentioned hereafter, such factors as the growth of environmentalism, inflation of construction costs, the growing expense and scarcity of fuels, declining availability of suitable plant sites and transmission rights of way, the economic and technologic advantages of scale, financing difficulties, and many other factors operating on all sectors of the electric industry.

REA policy for more than twenty-five years required special economic or service justification for electric power supply loans as compared to loans for distribution facilities to serve customers.⁴ In

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- Arkansas—Kansas City Power & Light Co. v. McKay, 115 F. Supp. 402 (D.D.C. 1953), *rev'd*, 225 F.2d 924 (D.C. Cir.), *cert. denied*, 350 U.S. 884 (1955);
- Colorado—Western Colo. Power Co. v. Pub. Utility Comm'n, 159 Colo. 1262, 411 P.2d 785 (1966); Tri-State Generation & Transmission Ass'n., Inc. v. Pub. Service Comm'n., 412 F.2d 115 (10th Cir. 1969), *cert. denied*, 397 U.S. 1043 (1970);
- Indiana—Public Service Co. v. Indiana Statewide Rural Elec. Coop., 247 Ind. 383, 216 N.E.2d 353 (1966); Southern Ind. Gas & Elec. Co. v. Indiana Statewide Rural Elec. Coop., 251 Ind. 459, 242 N.E.2d 361 (1968); Public Service Comm'n v. Hamil, 416 F.2d 648 (7th Cir. 1969).
- Kansas—Re Sunflower Elec. Coop., Inc., 77 P.U.R.3d 85 (Kan. Corp. Comm'n. 1968).
- Kentucky—Kentucky Utilities Co. v. Pub. Service Comm'n., 390 S.W.2d 885 (Ky. 1962); Kentucky Utilities Co. v. Public Service Comm'n., 390 S.W.2d 168 (Ky. 1965).
- Louisiana—Rural Elec. Admin. v. Central La. Elec. Co., 354 F.2d 859 (5th Cir.), *cert. denied*, 385 U.S. 815 (1966); Central La. Elec. Co. v. Louisiana Pub. Service Comm'n., 253 La. 553, 218 S.2d 592 (1969); Sibley v. Rural Elec. Admin., 419 F.2d 384 (5th Cir., 1969), *cert. denied*, 398 U.S. 937 (1970).
- Maryland—Re Southern Md. Elec. Coop., 49 P.U.R.3d 163 (Md. Pub. Service Comm'n. 1962);
- Mississippi—South Miss. Elec. Power Ass'n. v. Mississippi Pub. Service Comm'n., —Miss.—, 211 S.2d 827, *cert. denied*, 393 U.S. 998 (1968); Mississippi Power Co. v. South Miss. Elec. Power Ass'n., 254 Miss. 754, 183 S.2d 163, *cert. denied*, 385 U.S. 823 (1966);
- Missouri—Kansas City Power & Light Co. v. McKay, 115 F. Supp. 402 (D.D.C. 1953), *rev'd*, 225 F.2d 924 (D.C. Cir.), *cert. denied*, 350 U.S. 884 (1955);
- New Mexico—Re Plains Elec. Generating & Transmission Coop., 60 P.U.R.3d 538 (N.M. Pub. Service Comm'n 1965).
- South Dakota—Rural Elec. Admin. v. Northern States Power Co., 373 F.2d 686 (8th Cir.), *cert. denied*, 387 U.S. 945 (1967);
- Virginia—Re Old Dominion Elec. Coop., 86 P.U.R. (n.s.) 129 (Va. Pub. Service Comm'n 1950);
- West Virginia—Re Harrison Rural Elec., Inc. (W. Va. Pub. Service Comm'n 1938).
3. 1946—Iowa (Loan to Central Iowa Power Coop. for unit in generating plant of, and operated by, Iowa Elec. Light and Power Co.).
- 1949—North Dakota (Loan to Dakotas Elec. Coop. for joint transmission system with Montana-Dakotas Utilities Co.).
- 1950—North Dakota Loan to Rushmore Generating & Transmission Coop. for generating unit operated by Black Hills Power Co.).
- 1955—Colorado (Loan to Ark-Valley Elec. Coop. for unit in generating plant of, and operated by, Southern Colorado Power Co.).
4. REA Bulletin 20-6 and its forerunner, REA Administrative Order No. 61 (1950), have limited generation loans to situations where there was no available alternative

the past, even though these REA policy requirements were complied with, many REA loans were made to cooperatives before the full force of the factors just enumerated came to be appreciated by companies and cooperatives alike. This resulted in construction of isolated systems with little coordination, at least initially, with facilities of companies.⁵

With recognition by cooperatives and companies of the strength of these forces compelling common solutions to common problems, more recent REA loans reflected increased degrees of coordination of companies' and cooperatives' power supply facilities. The transition to greater degrees of coordination (including all forms of joint ownership) and to more involvement of private funding may not be readily accepted by the people who worked with their neighbors thirty or more years ago to get electric distribution lines built into their sparsely settled areas—which no company or cooperative, however willing or eager to do so, could economically serve without help from the federal government.⁶ Understanding the necessity for the transition comes more readily when it is realized that the bulk power supply projects needed in the immediate future to continue to provide adequate service in rural areas may each cost a billion dollars or more, and will require careful planning by all affected interests to minimize adverse environmental costs. In terms of time, each will require from five to ten years to complete. Such expenditures of money and time as well as the environmental costs are so vastly different from those to which rural people have in the past been accustomed that measures like increased coordination and new financing methods, which can keep these expenditures to their essential minimum, must receive the serious consideration of the cooperatives, the companies, and all other segments of the electric industry.

supply or where the loan would bring about savings in power cost. Pursuant to congressional committee requests, since 1964, under REA Bulletin 111-3, REA has been making power surveys of available alternatives and informing the Appropriation Committees in connection with power supply loans.

5. 1936—Iowa (Federated Coop. Power Assn).

1938—Wisconsin (Tri-State Power Coop.).

1939—Minnesota (Rural Coop. Power Ass'n).

1940—North Dakota (Minnkota Power Coop.).

In a number of the loans which were litigated, see note 2 *supra*, projects which involved little, if any, coordination with other suppliers were modified to provide increased degrees of coordination, e.g., Colorado Ute Elec. Ass'n; Indiana State wide REMC; Louisiana Elec. Coop.

6. Factors which made REA loans economically feasible to serve these areas include the two percent interest rate, exemption from federal income tax for electric cooperatives, and omission of any equity requirement. The nonprofit operation inherent in cooperative projects helped make sparse area service viable, since the capital contributed by the owner-consumers in excess of their cost of service does not earn dividends. An approximately fifteen-year cycle for revolving this capital contributed by the owner-consumers is maintained generally under the cooperatives' bylaw provisions for the "Capital Credits" plan of operation suggested by REA, whereby sums paid in by the patrons on their monthly power bills in excess of actual cost of service are credited to the account of each patron. See Re Union Elec. Coop., 73 P.U.R.3d 176 (Colo. Pub. Utilities Comm'n 1968), Re Vermont Elec. Coop., 97 P.U.R.3d 53 (Vt. Pub. Service Comm'n 1972).

Before describing the legal aspects of the joint arrangements developed in recent years by cooperatives and companies which give promise of providing adequate power for rural areas in the future, it is necessary to refer to the legislative modernization of REA by Congress in 1973. For many years before the 1973 Amendments (Amendments)⁷ of the Rural Electrification Act of 1936 (Act),⁸ REA financing was carried out by two percent loans made by REA directly from annual congressional authorizations which, for the largest annual program up to that time,⁹ aggregated approximately \$500 million for both distribution and power supply loan purposes. The Amendments established, outside the federal budget, a Rural Electric and Telephone Revolving Fund (Revolving Fund) which receives collections from past REA loans and from which new REA insured loans can be made. The Revolving Fund can also obtain resources for new loans by selling notes on which advances have been made and insuring them as to payment of principal and interest.¹⁰

In addition to the authority to make, sell and insure its own loans, REA is authorized to guarantee loans made by "legally organized lending agencies."¹¹ By published policy statements,¹² REA has, in general, reserved this guarantee authority for the larger dollar amount loans (bulk power supply loans and major telephone loans), because the amount available for insured loans is generally more limited¹³ and the essentially market interest rate of the guaranteed loans reduces to the point of insignificance the cost to the government.¹⁴

In the several years immediately preceding the Amendments, REA was receiving power supply loan applications for projects which

7. Act of May 11, 1973, Pub. L. No. 93-32, 87 Stat. 65 (codified at 7 U.S.C. §§ 930-40 (Supp. III 1973)).

8. 7 U.S.C. § 901-15 (1970).

9. Of the \$545 million authorized for fiscal year 1972 by the Agriculture-Environmental and Consumer Protection Appropriation Act of 1972, Pub. L. 92-73, 85 Stat. 183 (1971), loans aggregating \$438 million were made, of which distribution borrows accounted for almost ninety percent, including \$105 million to distribution cooperatives which made the funds available to power supply borrowers owned by them. Approximately \$46 million were loaned directly to other power supply borrowers.

10. 7 U.S.C. §§ 934, 935 (Supp. III 1973).

11. 7 U.S.C. § 936 (Supp. III 1973).

12. REA Bull. 20-22, 39 Fed. Reg. 814 (1974) (Bulk Power Supply); REA Bull. 320-22, 39 Fed. Reg. 33228 (1974) (Large Telephone Projects).

13. In the current appropriation, electric loans from the revolving fund shall not be less than \$750 million nor more than \$900 million, Agriculture-Environmental and Consumer Protection Appropriation Act 1976; Pub. L. 94-22 (89 Stat. 641 (1975)). Most of this insured loan authorization would appear to be required for distribution facilities, leaving the greater sums involved in the bulk power supply applications to be provided through the guarantee authority.

14. The cost to the government of Section 305 insured loans is must greater than of guarantees under Section 306, because the Section 305 interest rate is fixed by statute at the "standard" five percent rate and the "special" two percent rate (depending upon criteria in the statute), but both are well below the current market levels. Unlike the guaranteed notes, interest rates on the insured notes, to attract purchasers, have to be augmented to bring the return up to the market interest levels. Cost arising from losses through borrower default is almost nonexistent—approximately \$45,000 out of \$8.5 billion electric loan funds advanced in forty years of REA operation. REA Bull. 1-1, 1971 Ann. Stat. Rep. at 1.

each cost several hundred millions of dollars. It was evident that the annual amounts being made available under the then existing two percent direct loan program could not begin to cover the need of distribution borrowers (which alone required the major part of these annual amounts) and also those bulk power loan applications of several hundred million dollars each. This was particularly true because most of the forty existing cooperatives were engaged in preparing, or could be expected to submit, such bulk power supply applications to continue to meet the growing needs of their already connected distribution cooperative members. At this point, REA attempted to match the loan requests to the available funds by requiring that some distribution borrowers obtain from ten to thirty percent of their financing from non-REA sources,¹⁵ and that bulk power supply borrowers obtain approximately seventy percent of the major project cost from non-REA sources.¹⁶

From its establishment in the mid-thirties, REA made 100 percent loans because its cooperative borrowers did not have any equity capital beyond the five dollar fee from each of its member consumers.¹⁷ Assurance of repayment of the REA loans was essentially provided by the members' obligation to buy all of their electric requirements from the cooperative and to pay whatever the cooperative needed to meet its expenses, including repayment of the REA loan. REA loan security took the form of a first mortgage on all of the cooperative's property. When, in the forties, some of these distribution cooperatives joined to organize a federated power supply cooperative, the federated cooperative was in no better position to supply equity than the farmer members had been. Nevertheless, the REA loan could safely be made because repayment was assured by the distribution cooperatives' long-term contracts to buy all of

15. REA Bull. 20-14 establishes the criteria (based on borrowers debt service coverage, interest to earnings ratios, and plant to revenues ratios), on which the required percentage (10, 20, or 30) of non-REA "supplemental" financing is determined. The chief source of such supplemental financing is a cooperative organized by most of the nearly 1,000 electric cooperative REA borrowers—the National Rural Utilities Cooperative Finance Corporation (CFC). The Banks for Cooperatives of the Farm Credit System are also, but to a lesser degree, a source of supplemental financing. REA has developed a standard form of "common mortgage" to share pro rata its first mortgage lien with such supplemental lenders in connection with distribution facilities loans.

16. REA, REP. OF THE ADMINISTRATOR at 6-7 (1971). The seventy percent non-REA portion was expected to be divided—sixty percent from institutional investors or the public generally, in return for an exclusive first mortgage lien on the new facilities, and ten percent from CFC or other lender willing (like REA with its thirty percent) to provide the "equity" seed capital.

17. Typically, the borrower, in the programs' formative years, was a cooperative organized by a small group of consumers in a rural area who could not economically be served by existing suppliers. The equity problem was such that in Massachusetts no REA financed cooperative was able to get started because even the risk of loss of the five dollar membership fee was regarded by the state's utilities commission as too great to permit. Re Tri-County Electric Cooperative, 19 P.U.R. (n.s.) 113 (1937). The situation has changed greatly in this respect for most ultimate consumers served by distribution cooperatives, but the great sums needed for new bulk power supply projects are beyond the ability of the cooperatives to finance where lenders require the approximately forty percent equity capital customarily present in electric utility financing.

their requirements from the federated cooperative. REA security here too consisted of a first mortgage on all of the federated cooperative's property.

In the fifties and sixties, many distribution cooperatives and some power supply cooperatives prospered to the extent that by 1970 the REA Annual Statistical Report (REA Bulletin 1-1) showed that the distribution cooperatives' owner-consumers had approximately thirty percent equity in their systems on the average, and for power supply cooperatives the figure was less than ten percent. There were wide individual variations, particularly among the power supply cooperatives, some of the newer ones having had no opportunity to develop a significant net worth. Because of this and the increasingly large amounts needed for new facilities to match the rapid growth in the demand for power being encountered by the cooperatives, funds from the normal utility financing sources, in the years just preceding the 1973 Amendments, were generally unavailable to the cooperatives.¹⁸ Contributing to the difficulty was the fact that the cooperatives' existing facilities were already fully mortgaged to REA under security instruments containing the restrictive covenants and controls considered necessary in a no-equity, two percent loan program having a sparse retail consumer service area base.¹⁹

II. PRE-1973 RURAL ELECTRIFICATION ACT AMENDMENTS ATTEMPTS TO SOLVE LOW EQUITY, INADEQUATE SECURITY PROBLEMS

REA sought to overcome the cooperatives' lack of the equity capital which is customarily required by private investors for utility bond financing by announcing in 1971 that REA would help finance bulk power supply projects by making thirty percent of project cost available through REA loans at the only interest rate then permitted by statute—two percent.²⁰ A number of projects were then being studied by existing cooperatives, but only two proceeded to the point of REA loans being made. The financing plans worked out for these two projects temporarily solved the cooperatives' low equity problems and the REA and other lenders' security requirements in a manner adequate for the needs at the time, but

18. The organization of the National Rural Utilities Cooperative Finance Corporation (CFC) in 1970 was to a great degree prompted by this situation. While some distribution cooperatives had ample equity for borrowing, others did not. The marshalling of their resources to provide a vehicle for combined borrowing from the private market appeared to offer a means of meeting distribution cooperatives' needs in the future to the extent required to supplement REA funding. It was also thought CFC would greatly contribute to solution of the power supply financing problems.

19. REA, REPORT OF THE ADMINISTRATOR (1971), stated that REA financed distribution borrowers had an average consumer density of 3.8 per mile. The average for major non-REA financed electric utilities was nearly ten times greater.

20. REA, REP. OF THE ADMINISTRATOR at 6-7 (1971).

the solution was too limited to be useful for subsequent financing needs. As will be seen, however, this solution had built-in limitations which greatly restricted its usefulness for subsequent financing of the cooperatives' continually expanding capital needs. The more effective solution of these equity and security problems had to await the enactment of the 1973 Rural Electrification Act Amendments. A brief description of these two "seed capital" loans made prior to enactment of the Amendments and a comparison with several of the more recent arrangements made possible by the Amendments will illustrate the changing role of the federal government in this area.

A. THE "EAST KENTUCKY" PRE-AMENDMENTS LOAN

In June, 1972, REA loaned \$37.5 million to sixteen distribution cooperative members of East Kentucky Rural Electric Cooperative Corporation (East Kentucky) to help finance the construction of a 300 megawatt coal-fired electric generating plant and related transmission facilities, estimated to cost \$125 million, of which other lenders were to supply \$87.5 million, including \$12.5 million from National Rural Utilities Cooperative Financial Corporation (CFC).²¹ Since REA had previously financed generating and transmission facilities of East Kentucky by 100 percent loans secured by a first mortgage on the existing facilities, a loan plan had to be developed whereby the other lenders (except CFC) could acquire a first lien on the new facilities for which they were providing the major portion of the funds. Negotiations with the other lenders quickly established the need for a new corporation which could own the new facilities and give the necessary first lien security primarily because the existing REA mortgage lien on the East Kentucky facilities attached not only to existing but to all after-acquired property of East Kentucky. The new entity, Charleston Bottoms Rural Electric Cooperative Corporation (Charleston Bottoms) contracted with East Kentucky for construction and operation of the new plant and the sale of the electric output, thereby enabling East Kentucky to continue to perform its long-term, all-requirements wholesale power supply contracts with its sixteen member distribution cooperatives, which serve 188,000 farm and other rural consumers.

This somewhat cumbersome arrangement was necessary first in order to meet private lenders' requirements of first mortgage lien security on new facilities representing approximately 130 percent of the amount loaned by them, but even more cumbersome

21. See note 15 *supra* for the CFC general role.

arrangements were necessary to satisfy the REA statutory requirement of reasonably adequate security and the CFC need for security it could pledge to obtain its private market funds for relending for this project. The chief problem presented by the provisions of the first mortgage instrument on the new facilities proposed by institutional investors was that, in addition to subordination of the REA and CFC *liens* to the investors first mortgage lien on the new facilities, subordination of the REA and CFC *debts* was required as well. Foreclosure in case of default on the REA or CFC note would, in effect, have been precluded so long as the first mortgage debt was not in default. Since a thirty-five year loan term was involved, the prospect, in event of default to REA, for effective REA remedial action when needed could become very dim if the borrower merely kept current on the first mortgage debt. REA and CFC felt compelled at this stage of the negotiations to look for security elsewhere than in the new facilities. That solution, though cumbersome and of limited application for future project financing, was to obtain the equivalent of guarantees from the sixteen member distribution cooperatives of the REA and CFC portions of the financing. Those secondary liabilities of the member distribution cooperatives were in turn secured by additional mortgages to REA and CFC on the distribution cooperatives' properties which, though already mortgaged to REA and CFC for prior distribution facility loans, had values sufficiently in excess of the existing debt to provide reasonably adequate security for the new REA-CFC power supply financing.

The Rural Electrification Act feasibility requirement (assurance that the loan will be paid within the time agreed upon) was met by the series of power purchase contracts running from the ultimate consumers, through the sixteen member distribution cooperatives, to East Kentucky, and by the power sales contract from Charleston Bottoms to East Kentucky. Following compliance with the numerous conditions to the release of funds,²² advances have been made by the various lenders and construction is to be completed in 1976.

B. THE "ASSOCIATED" PRE-AMENDMENTS LOAN

Also in June, 1972, REA made a similar series of loans aggregating \$72.2 million to forty-three distribution cooperatives to enable Associated Electric Cooperative, Inc. (Associated) of Springfield, Missouri, to undertake construction of a 600 megawatt coal-fired

22. These conditions included obtaining state regulatory body approval, compliance with National Environmental Policy Act requirements, extending the distribution cooperatives' power purchase contracts with East Kentucky to cover the period necessary for amortization of the new loans, delivery of the various security instruments to the lenders, and execution of contracts for the construction, operation and sale of the output of the new facilities.

electric generating plant at New Madrid, Missouri, and related transmission facilities. The cost of this project was estimated at \$240.6 million, of which non-REA lenders were to furnish \$168.4 million, of which \$24 million would be from CFC. The basic financing plan resembled the East Kentucky arrangement just described, based upon REA furnishing thirty percent and CFC furnishing ten percent of project cost as a form of "seed capital," with institutional investors supplying the remaining sixty percent. The legal structures necessary for the Associated project were more complex than for East Kentucky, because there was already in existence an additional layer of six federated generation and transmission cooperatives between Associated and those forty-three distribution cooperatives that required the increased power capacity to serve their 300,000 farm and other rural consumers. A system agreement involving the six intermediate federated cooperatives as well as Associated and the distribution cooperatives together with a power sales agreement between Associated and a new entity, Federated Electric Cooperative Association (organized by Associated), satisfied the statutory feasibility requirement by providing assurance of repayment. The REA security requirements, as in East Kentucky, were met by the guarantees from the distribution cooperatives of the primary liability assumed by Associated, backed by first mortgage liens on the properties of the distribution cooperatives as well as of Associated.²³

The complexity of these East Kentucky and Associated Financing arrangements contrasted sharply with the usual REA loans,²⁴ involving either only a relatively simple REA mortgage, or if another lender like CFC participated, a standardized first mortgage shared pro rata with REA.²⁵

There was one other pre-Amendments agreement which involved private lenders in REA borrowers' efforts to construct bulk power supply projects to meet their growth needs.²⁶ In this case, Buckeye

23. Before funds were advanced, the institutional investors were replaced by CFC, which, in turn, following enactment of the Amendments, was replaced by FFB. See text accompanying note 40 *infra*.

24. In 1972, REA made 467 electric loans aggregating \$438 million. Most of the loans were effectuated by amending existing loan contracts and supplementing existing mortgages to cover existing borrowers' new financing. The few that did not follow the standard pattern required legal services on a scale that would have been prohibitive if there had been a substantial number of them or if the hundreds of standard pattern loans had required more legal attention.

25. The standard form of common mortgage was developed in 1970 by REA, with CFC assistance, to enable distribution cooperatives to comply with REA Bull. 20-14, which required borrowers meeting certain financial criteria to obtain non-REA (supplemental) financing for part of their needs. This common mortgage form follows relatively closely the standard form of that mortgage REA, as exclusive lender, used for many years. The common mortgage provides for a sharing of lien position and, to some extent, of mortgage controls by REA with the supplemental lender. In these two loans, the institutional investors' need for an unshared first lien on the new facilities prevented their use of the standard common mortgage form.

26. One smaller example of pre-Amendments involvement of private investment in cooperatives' bulk power supply occurred in Iowa, where CFC financed approximately ten

Power Cooperative of Columbus, Ohio, acquired two 615 megawatt generating units by selling its bonds to the public for ninety percent of the project cost. Buckeye obtained the remaining ten percent for its first unit by internally generated funds furnished by the member distribution cooperatives of Buckeye and ten percent "seed capital" for the other unit by an REA loan. The Buckeye departures from the East Kentucky and Associated pattern—shared first mortgage lien instead of subordination of REA security and REA participation of only ten percent instead of thirty percent—would appear to be unique to Buckeye because of its relationship with Ohio Power Company. The latter guarantees project feasibility by its surplus purchase contract obligation.

The most undesirable aspects of the pre-Amendments efforts of the Cooperatives to obtain private financing, despite the absence of customary equity to debt ratios, were not merely that they were complex, difficult to work out, and expensive in terms of cost to borrowers and time expended by their employees and consultants as well as REA staff—the most serious problem was that they have built-in, self-limiting features which reduce their availability for the future financing needed to keep up with predicted rural consumers' load growth.²⁷ The equity in the member cooperatives' distribution facilities which REA used for the member distribution cooperatives' guarantees to REA covering the REA portion of the East Kentucky and Associated financing would generally not be sufficient for the next needed facility increment. Thus, it would be difficult, if not impossible, to repeat the guarantee by member cooperatives in the East Kentucky and Associated cases which gave REA and CFC their needed security, and at the same time allow private lenders an exclusive first mortgage lien on the new facilities protected by an equity equivalent of thirty percent or more. The extremely large amounts needed for bulk power supply facilities as compared to the investment in distribution facilities quickly exhausts the available distribution cooperative equity. This would be true even if distribution cooperatives were able to continue to build up net worth, a difficult thing in this period of high operating costs and consumer rate resistance.²⁸

percent of a nuclear unit being constructed jointly by Iowa Electric Light and Power Company and two REA borrowers, Central Iowa Power Cooperative and Cornbelt Power Cooperative. The undivided ownership interests of the cooperatives aggregated thirty percent, with REA financing all of the cooperatives' share except for the CFC loan. Because of the small amount involved, it was possible to handle this substantially as a continuation of the supplemental financing arrangements previously developed for the distribution program.

27. REA borrowers' electric requirements are doubling every six or seven years as compared to every ten years for the electric industry generally. This trend is expected to continue, if not accelerate. (1972) REA, REP. OF THE ADMINISTRATOR at 6.

28. These financing difficulties have prompted numerous suggestions for relief: Energy Independence Authority proposed by President Ford, 121 CONG. REC. S. 18171 (daily ed.

III. THE 1973 RURAL ELECTRIFICATION ACT AMENDMENTS

A. FEDERAL GUARANTEE

On May 11, 1973, less than one year after the announcement of the East Kentucky and Associated power supply loans just described the Amendments provided REA with a new, more effective means of dealing with the growing backlog of bulk power supply project applications which was even then reaching into the billions of dollars. The new statutory authority for REA guarantees of loans made by "legally organized agencies"²⁹ resolved most of the difficulties which had produced the complex and limited solutions so painfully arrived at in the East Kentucky and Associated arrangements. The following are major features of the Amendments relating to guaranteed loans:

1. The two percent interest rate imposed by statute prior to the Amendments has been replaced by what is essentially a market rate—a rate agreed upon by lender and borrower and approved by REA.³⁰ While the risk of borrower default represents a potential cost to the government, the past credit record of REA borrowers would lead to the conclusion that this will not be a significant cost item.³¹ The change from the costly subsidy of the two percent interest rate tends to make more likely congressional authorizations of the use of the guarantee authority in amounts adequate to meet future rural area bulk power supply needs.

2. Unlike the REA pre-Amendments loan authority which depended upon normal federal budget procedures and annual congressional authorization, the guarantee authority of the Amendments is expressly stated by Congress to be outside the federal budget.³² Moreover, until borrowers default and the Revolving Fund established by the Amendments becomes

Oct. 20, 1975), S. 2532, H.R. 10267, 94th Cong., 1st Sess. (federal guarantee of company bonds); Rubin, *Get Electric Utilities Out of the Construction Business*, 95 PUB. UTIL. FOR. 35 (June 5, 1975) (federal guarantee of nonprofit construction association financing); *Mailbag*, 95 PUB. UTIL. FOR. 6 (February 27, 1975) (federal commitment to purchase new plant output); *Business Week*, November 3, 1975, at 31 (seeking termination of supply to wholesale customers).

29. Act of May 11, 1973, Pub. L. 92-32, § 12, 87 Stat. 69 (codified at 7 U.S.C. § 936 (Supp. III 1973)).

30. *Id.* There is a saving to the borrower in the interest rate as compared to other public market borrowing because of the existence of the statutory guarantee. Under present arrangements between REA and the Federal Financing Bank (FFB), 12 U.S.C. § 2281 (Supp. III 1973), the interest rate to borrowers is an amount equal to the rate paid by Treasury on comparable maturities plus an amount to cover FFB costs, which, in general, have been less than an additional 3/8 of one percent.

31. The REA credit record over a forty-year period shows a default loss of \$44,000, out of approximately \$8.5 billion advanced as of June 30, 1974, with the borrower's default in this one case having been caused by a hurricane that destroyed the borrower's small island system. See note 14 *supra*.

32. That any amount guaranteed hereunder shall not be included in the totals of the budget of the United States Government and shall be exempt from any general limitation imposed by statute on expenditures and net lending (budget outlays) of the United States.

7 U.S.C. § 936 (Supp. III 1973).

depleted,³³ this new source of financing does not need annual congressional appropriation. Congress can, however, if it chooses, limit the use of the guarantee authority by means of the annual appropriation acts.³⁴ Thus, like the two preceding aspects of the Amendments, this feature of nonbudget guarantee authority eases the availability of the increasing larger amounts required for financing rural area bulk power supply projects.

3. All of the elaborate structures developed in the pre-Amendments arrangements to give private lenders adequate security and protect the government's stake arising out of prior loans and the "seed capital" two percent financing are no longer required because the Amendments put the full faith and credit of the United States behind the full amount of the private lenders' financing. At the same time, REA can continue in the post-Amendments arrangements to obtain first mortgage lien security on the new facilities as well as on existing cooperative facilities. The properties of the member distribution cooperatives need not be burdened by liens arising from the power supply financing. Net worth can continue to develop in a normal way to enable the distribution cooperatives to meet the goal of financial stability set forth in the preamble to the Amendments.³⁵ The lack of equity capital which, before the Amendments, deterred private lenders accustomed in electric utility financing to thirty percent or more of equity to protect their loans was offset by the federal guarantee authority in the Amendments.

4. Under the Amendments, REA has been able to keep the legal structuring relatively simple because the existence of the government's guarantee permits the lender to dispense with restrictive covenants and controls on borrowers' actions which would otherwise be appropriate. REA at the same time is able to protect itself against the risk of liability under the guarantee by relatively simple amendments of existing loan and security instruments familiar to the cooperatives because they have been in use by REA in essentially the same form for many years. There are, of course, many substantive details to be resolved in the development of these complex pro-

33. The likelihood of depletion is remote since the Revolving Fund was established with assets of approximately \$7 billion. While the costly two percent and five percent insured loan programs also depend on the Revolving Fund, their cost is not of an order of magnitude which could, under present conditions, exhaust the Revolving Fund. Moreover, the Revolving Fund may be replenished not only by sales of the new insured loans, but also by collections on outstanding loans made during the preceding decades of REA operations, besides congressional appropriation. Defaults on loans under the insured as well as guaranteed loan program have to be met from the Revolving Fund, but this would not appear to represent a significant item. See note 14 *supra*.

34. 7 U.S.C. § 936 (Supp. III 1973). In fiscal years 1975 and 1976, Congress put no limit on the amount of guaranteed loans, but directed that the appropriation committees be given thirty days notice prior to the effective date of any guarantee. See, e.g., S. REP. No. 93-1296, 93d Cong., 2d Sess. 39 (1974).

35. [R]ural electric and telephone 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 at reasonable rates and terms consistent with the loan applicant's ability to pay and achievement of [the Act's] objectives.

7 U.S.C. § 930 (Supp. III 1973).

jects, but the legal work under the Amendments is relatively simple for a project of this magnitude, when compared to most long-term indenture-type financing. There is, of course, a consequent saving in time as well as money. The necessary delays imposed by such matters as meeting environmental requirements, obtaining regulatory body approvals, licenses and the like need not be compounded by legal drafting complexities such as were necessarily encountered in the pre-Amendments financing for East Kentucky and Associated.³⁶

B. IMPLEMENTATION OF THE AMENDMENTS

After two years of operation under the Amendments³⁷ financing of approximately ten bulk power supply projects has been effected by means of the REA guarantee authority, and many more are in various stages of development. Excluding those which have not reached the stage of Federal Register notice that REA is considering a guarantee commitment, the projects just mentioned represent approximately 4800 megawatts of generating capability and approximately 2000 miles of related transmission lines, estimated to cost approximately \$2 billion. While these figures may seem large in relation to past REA power supply financing, they are, in reality, very small compared to other sectors of the electric industry. Some understanding of the magnitude of the power supply financing needs of the Nation as a whole can be gleaned from the fact that REA-financed generation, which has accounted for only 1.6 percent of the Nation's supply,³⁸ will remain a very small part (at most, two percent) of the total, even with the REA-financed projects referred to herein and others planned which may or may not receive REA financing.³⁹

36. Under the Loan Commitment Agreement between REA and FFB dated August 14, 1974, the post-Amendments documentation for each borrower was reduced essentially to (i) a notice by REA to FFB and the borrower designating the amount to be loaned to that borrower by FFB and guaranteed by REA, (ii) a standard form of note to be executed by the borrower, and (iii) an REA guarantee endorsement on the note. Any special terms of the loan not contained in the standard provisions of the short REA-FFB Loan Commitment Agreement are provided for in the REA letter to the borrower transmitting a form of note and by the borrower's acceptance thereof when it delivers the executed note to REA, which acts as agent for FFB not only in the handling of the loan installments, but in all of the details of servicing the loan. The FFB statute, 12 U.S.C. § 2289(10) (Supp. III 1973) provides authority for both FFB and REA to utilize REA staff for these activities on a reimbursable basis. REA's documentation for security against the contingent liability it has assumed is almost as simple as the guarantee arrangements with FFB, since in most cases the security interest is effected by amendments of existing REA loans.

37. REA Bull. 20-22 (Dec. 21, 1973) related to the use of the guarantee authority for bulk power supply projects.

38. FPC News Release No. 21450 (Dec. 1, 1974).

39. *Electrical World*, 1975 REA ANN. STAT. REP. at 59. Lists planned additions for 1975 and thereafter by cooperatives of 9,352 MW out of a planned industry total for the same period of 364,433 MW, which when added to pre-1975 installed capacities of 7,530 MW for cooperatives and 474,574 MW for total industry pre-1975 installed capacity, would make the cooperatives' share amount to two percent. It is uncertain to what extent the planned cooperative additions would be REA financed in view of the fact that, as stated

The pattern emerging from the initial implementation of the Amendments for bulk power supply projects includes the following:

1. The borrower is a federated cooperative consisting of member distribution cooperatives without intervening corporate layers of extra entities such as were needed in the pre-Amendments projects to satisfy legitimate security concerns of both private investors and the government.

2. The existing first mortgage of the federated cooperative to REA is extended to cover the proposed power supply as security for REA's potential loss if the borrower defaults and REA is called upon to honor its guarantee to the lender.

3. To encourage cooperatives to obtain the best terms and interest rates in the market with the help of the REA guarantee, REA publishes a notice in the Federal Register that a guarantee commitment for a particular loan is under consideration. Cooperatives in turn are required to provide details of the project to any prospective lenders.

4. The credit and properties of the distribution cooperatives are not encumbered by the power supply financing, so as to create (as was likely in the pre-Amendments projects) difficulties for future financing of needed distribution facilities.

5. In keeping with assurance of economic power supply sources for future growth needs, the distribution cooperatives comprising the federated cooperative must extend their existing power purchase commitments appropriately, also thereby assuring feasibility of the new power supply loan through the furnishing of a market for the output of the new facilities.

6. The increased size and cost of the facilities needed for the projects financed under the Amendments resulted in a greater reliance upon joint ownership of facilities and closer integration of facilities than the degree of coordination generally found in the pre-Amendment projects.

7. The legal structures, document provisions and restrictions in the post-Amendments cases are closer to those customarily used for REA loans in the period before the East Kentucky and Associated loans. REA retains extensive controls over the borrowers' operations in the post-Amendment cases. In the East Kentucky and Associated cases, the borrower was obligated to the private lenders primarily with respect to the operation of the new facilities, while REA's rights, particularly with respect to enforcement of covenants leading to declaration of default, were limited, being subordinate to the private lenders' rights in these respects. REA, in the pre-Amendments cases, could assert only indirect control through the various cooperatives' contractual instruments and the REA mortgage rights against the distribution coopera-

In the text, the projects planned by cooperatives on which REA has announced it is considering a guarantee commitment amount only to approximately 4,800 MW, which would be substantially less than two percent of the total industry installed and planned generation.

tives' properties. Such remedies would appear to be less effective, because of their indirectness, than the security instrument remedies directly available to REA in the post-Amendments arrangements against the owner of the new facilities. To some extent, it must be recognized, these direct remedies are subject to being affected by the existence of other owners' undivided interests in the facilities. The success of the project as a whole in these cases depends also upon the sound financial position and operating abilities of these other owners to a great degree. Detailed participation, ownership and operation, as well as construction agreements, have been developed for these jointly-owned facilities. Care in drafting such agreements tends to preserve the advantages of scale and more efficient operation usually inherent in such joint arrangements and helps offset the effects of the dilution of control inherent in sharing ownership of a project with others.

8. The initial implementation of the Amendments coincided with implementation of the act⁴⁰ establishing the Federal Financing Bank (FFB). REA and FFB entered into a written lending and guarantee commitment agreement whereby projects designated by REA can be financed by the combination of FFB loan and REA guarantee. The interest rate payable to FFB under the general lending commitment is determined on the date of each advance of funds on the basis of Treasury new issue rates for comparable maturities plus an added amount of one-eighth of one percent per annum. This rate, in the present state of the utility financing market, has not been met by other "legally organized lending agencies," as the REA Act describes lenders eligible to obtain the guarantee. From the government's standpoint, apart from the replacement of five percent interest by a rate in excess of Treasury cost, there is the opportunity to realize the orderly and efficient marketing of government agency paper, which is one of the principal objectives of the act that made FFB the channel to the private market for such agency obligations.

Within nine months after enactment of the Amendments, the guarantee program for bulk power supply projects was initiated with REA guarantee commitments in February, 1974, to two Minnesota Cooperatives—Cooperative Power Association of Minneapolis and United Power Association of Elk River for a jointly-owned, lignite-fired 900 megawatt generating plant and related transmission facilities. The project (CU project) represented the largest REA-financed power supply project up to that time, the estimated cost being \$537 million⁴¹ and was financed under the terms of the REA-FFB commitment agreement described above.

40. 12 U.S.C. § 2281-86 (Supp. III 1973).

41. REA five percent insured loan funds to the extent of \$83 million were made available, with the remaining \$454 million to be provided by REA guarantee of non-REA loans. Generally in later guaranteed bulk power supply projects, the scarcity of the five percent

For security, the existing first mortgages of the cooperatives to REA were extended to cover the CU project and, to assure feasibility, the existing long-term power purchase contracts of the thirty-three distribution cooperatives serving 800,000 farm and rural residents were also extended. Construction, ownership and operating agreements between the two cooperatives and coordination contracts with other interconnected power suppliers established the basis for meeting REA policy requirements that the arrangement be the most effective and economical means of supplying the needs of the ultimate consumers served by the member distribution cooperatives. Among other conditions to the advance of funds under the REA commitments were compliance with environmental and site requirements, including the National Environmental Policy Act,⁴² the Clean Air Act,⁴³ the Water Quality Act,⁴⁴ and state and local requirements.

In June, 1974, REA made its first guarantee commitment involving joint ownership of electric generating facilities by REA-financed organizations and other power suppliers. The cooperative owners of the proposed project (Yampa) will be Colorado-Ute Electric Association, Inc., of Montrose, Colorado, the Tri-State Generation and Transmission Association, Inc., of Denver, Colorado, and will have REA financing aggregating \$227.5 million of REA guarantees and \$21.9 million of insured REA five percent loans. The other planned owners are four Colorado municipalities organized as the Platte River Power Authority of Ft. Collins, Colorado; the U. S. Bureau of Reclamation; and the Salt River Agricultural Improvement and Power District, an agency of the State of Arizona. The non-REA financed portion of Yampa will amount to approximately \$200 million of the total \$450 million estimated cost of the project. The REA-financed portion was financed under the terms of the REA-FFB commitment agreement described above.

The REA security for Yampa will be, as in the CU project, the existing mortgages of the cooperatives covering facilities previously financed by REA extended to cover the cooperatives' interests in the new facilities. The respective, undivided ownership interests and other relationships of the various owners of Yampa are established and governed by ownership, construction and operating agreements among the owners, the terms of which have been approved by REA. The portions of the Yampa capability to which the cooperatives are entitled are required to meet the power needs of the 500,000 farm and rural residents served by the thirty-nine member distri-

insured loan funds made it necessary to use the guarantee authority for the entire cost of the project.

42. 42 U.S.C. §§ 4321-47 (1970).

43. 42 U.S.C. § 1857 (1970).

44. 33 U.S.C. §§ 1251-1376 (Supp. II 1972).

bution cooperatives committed by long-term wholesale power contracts to take their requirements from the cooperatives.

The advantages of the pattern established by the post-Amendments projects heretofore considered have led not only to its use in a number of other areas of the country,⁴⁵ but have led the owner of the pre-Amendments project, Associated,⁴⁶ to restructure a part of its financing in order to utilize to the fullest extent possible the post-Amendments procedures.⁴⁷

Because of the size and long development period of the current power supply projects now being studied, there are many expenses requiring funding before the details of a loan and guarantee can be completed and all conditions satisfied which are prerequisite to the advance of funds. Accordingly, it has been necessary to develop a means of providing interim or so-called "front end" financing to the cooperatives. In large part, this has been supplied by CFC and to a lesser extent by the Banks for Cooperatives of the Farm Credit System. Where the amounts involved are not too great, and the term only one or two years, the interim financing has been on an unsecured basis.⁴⁸ Here, the post-Amendment procedures are particularly helpful, permitting the interim lender to proceed with reduced risk after a preliminary determination to provide a guarantee commitment for the permanent financing has been made by REA. Such determination, of course, does not assure the advance of funds under the permanent financing but does eliminate a number of the uncertainties which were present in the pre-Amendments projects at comparable stages of development.⁴⁹

45. Alabama Electric Cooperative—\$265.5 million commitment for 420 MW coal-fired generating plant and related facilities; Southern Illinois Power Cooperative—\$83 million commitment for 160 MW coal-fired generating plant; Western Farmers Electric Cooperative of Anadarko, Oklahoma—\$10.3 million commitment for transmission facilities (with a \$5 million five percent REA insured loan); Dairyland Power Cooperative of LaCrosse, Wisconsin—\$121.6 million commitment for seventy percent ownership (Northern States Power Company—thirty percent) of a 350 MW coal-fired generating plant and related facilities; Oglethorpe Electric Membership Corporation of Atlanta, Georgia—\$513 million for thirty percent undivided interest in four units aggregating 3,344 MW with Georgia Power Company.

46. See text accompanying note 23 *supra*.

47. In return for an amendment of the REA loan contract relieving the government of the obligation to advance previously unadvanced balances of the pre-Amendments two percent REA loan for the Associated project, the government agreed to guarantee an FFB loan of \$142 million to replace the unguaranteed loan commitment of CFC, which institution had replaced the original institutional investors in the meantime. While the financial results to Associated were estimated to be substantially unaffected, the simplification made possible by the post-Amendments procedures, including elimination of the corporate entity, Federated, were significant considerations in the change.

48. Because of feasibility requirements, in some cases extended maturity commitments for the interim financing have been necessary. In such cases, particularly in connection with CFC interim financing, REA has committed itself to extend for up to five years maturity dates on previous REA loans to enable payments to be made on the extended interim financing if necessary.

49. Generally, the interim lender is in a position to see that the project is receiving serious REA consideration for permanent financing under the guarantee program by reason of the REA procedures calling for Federal Register publication of notice of such consideration as well as the procedure for notice to the congressional committees. One of the advantages in this is the indication of the general availability of sufficient funds for

CONCLUSION

Rural area bulk power supply systems have been encountering many serious problems in this period of energy crisis. Generally, their difficulties are similar to those being encountered by the other sectors of the electric industry. However, the rural systems have greatly improved prospects for dealing with their financing problems as compared to their situation a few years ago. Before the 1973 Amendments, they could look forward only to inadequate amounts of capital, obtainable, if at all, only by complex financing arrangements requiring mortgaging of their limited equities in their distribution properties. Since 1973, this has changed so that they can look forward to meeting their consumers' expanding requirements with facilities constructed in close coordination and cooperation with other electric suppliers of all types, financed adequately and simply, with far less federal budgetary impact than would have been possible before the 1973 Amendments.