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REPORT BY THE U.S.

General Accounting Office

Bonneville Power Administration And Rural Electrification Administration Actions And Activities Affecting Utility Participation In Washington Public Power Supply System Plants 4 And 5

Congressman George Hansen asked GAO to examine the roles of the Bonneville Power Administration and the Rural Electrification Administration in development and termination of Washington Public Power Supply System Plants 4 and 5.

GAO found:

- --BPA provided electric demand forecasting help to small regional utilities, endorsed the need for additional generating units, supported utility participation in the plants, and acted to indirectly facilitate termination of the plants.
- --REA directed its borrowers to pay their debts to the Washington Public Power Supply System and implied their financial standing with REA could be affected if their obligations on plants 4 and 5 are not met.

UNITED STATES GENERAL ACCOUNTING OFFICE

119164

GAO/EMD-82-105
JULY 30, 1982

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

ENERGY AND MINERALS DIVISION

B-208409

The Honorable George Hansen
House of Representatives

Dear Mr. Hansen:

In your April 1 and 8, 1982, letters and in subsequent discussions with the General Accounting Office, you requested that we determine how activities of the Bonneville Power Administration (BPA) and the Rural Electrification Administration (REA) affected two incomplete nuclear powerplants (WNP-4 and 5) recently terminated by the Washington Public Power Supply System (Supply System). You expressed concern that BPA may have encouraged regional utilities to participate in these projects and that REA may be coercing rural cooperatives not to challenge the cooperatives' financial and legal responsibilities to the Supply System.

In an April 20, 1982, letter to you, we identified five concerns we would specifically examine in addressing your concerns. These areas are:

--BPA's involvement in regional demand forecasting.

--BPA's representation of the region's need for additional generating capacity to its customers during this time frame.

--BPA's involvement, if any, in its customers' decisions to participate in plants 4 and 5, and the respective levels of their participation.

--Recent BPA actions which directly or indirectly relate to termination of plants 4 and 5.

--Recent REA actions directed toward BPA customers which could affect the customers' approach to terminating plants 4 and 5.

We found that BPA

--played a role in providing electric demand forecast assistance to small customers and provided input to the region's forecast,

--endorsed the need for additional generating units to meet regional power needs by defending the validity of the regional forecast,

--supported the participation of its preference customers 1/ in plants 4 and 5, and

--took several actions indirectly facilitating attempts to mothball and then terminate plants 4 and 5.

We found that REA directed its borrowers to meet their Supply System obligations, and implied that their present and future financial standing with REA could be affected if they do not honor their obligations on plants 4 and 5.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to ascertain the facts and circumstances surrounding the five issues agreed to in our April 20, 1982, letter. To obtain information with respect to BPA's involvement in forecasting, representations on need for additional generating capacity, and involvement in customers' decisions to participate in the Supply System's nuclear plants 4 and 5, we reviewed BPA files and records pertaining to the subjects from the mid-1960s to the present. This included correspondence with various Pacific Northwest utility organizations, the Supply System, BPA studies and reports on the region's power supply and demand outlook, and regional forecasts.

To supplement this information and obtain a clear perspective of BPA's role, we identified and interviewed key BPA officials having major roles in the evolution and development of the region's power program. We specifically discussed with BPA's former Administrator, Deputy Administrator, Power Manager, and an Area Office Manager what role BPA played in forecasting the region's power needs, what pronouncements it made on the need for additional generating capacity, and whether the agency influenced its customers in deciding to participate in the construction of the Supply System plants. We also discussed the issues with present BPA officials including the Administrator and Deputy Administrator. In addition, we met and discussed these issues with representatives from the region's Public Power Council, public utility districts, municipalities, and REA cooperatives to

1/Under statute, BPA must give preference in selling Federal power to publicly owned systems e.g., the public utilities which purchase power from BPA have traditionally been labeled BPA preference customers.

obtain their views on the events and circumstances regarding BPA's involvement and role. The utilities we met with included those you identified, others identified by another member of the Northwest congressional delegation, and others selected outside this group to provide a broader based sample.

In examining recent BPA actions related to termination of plants 4 and 5, we reviewed recent BPA files and correspondence and discussed with key BPA officials the role BPA played in the termination.

Time constraints required that we limit our review to BPA's role. Consequently, we were unable to examine the roles of other organizations in the decision to pursue and eventually terminate these plants. These include the Supply System, the Public Power Council, Pacific Northwest Utilities Conference Committee, and large industry. In evaluating BPA's activities, it is important to keep in perspective their status as one of many key organizations.

With respect to recent REA actions, we met with REA headquarters officials in Washington, D.C., and interviewed REA field representatives in the Pacific Northwest to determine their interest and role in the termination of plants 4 and 5. We also discussed REA actions with cooperatives who are participants in plants 4 and 5 as well as with representatives of the National Utilities Cooperative Financial Corporation to obtain their comments and views. In addition, we reviewed REA's files and records including field activity reports, cooperatives' financial records, participant and loan agreements, and correspondence.

We performed our review in accordance with GAO's current "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions." Information on the five concerns and our findings follow. To understand the nature of these concerns and the history of electricity development in the Pacific Northwest, a detailed background is provided in appendix I.

BPA INVOLVEMENT IN REGIONAL DEMAND FORECASTING

Although BPA was not the primary organization for regional forecasting, it played a role in providing assistance to its small preference customers, and provided input for the region's forecasting. The official regional forecast, as recognized by the utilities, is published annually by the Pacific Northwest Utilities Conference Committee (PNUCC). This is a regional power planning organization with representation from BPA and the public and private utilities in the Pacific Northwest. The PNUCC regional forecast which is used for planning additional generation facilities is compiled from the individual utility forecasts of which BPA's input represented about 40 percent of the demand projections. During the 1970s, BPA's involvement in forecasting regional demand focused on providing technical assistance to its customers.

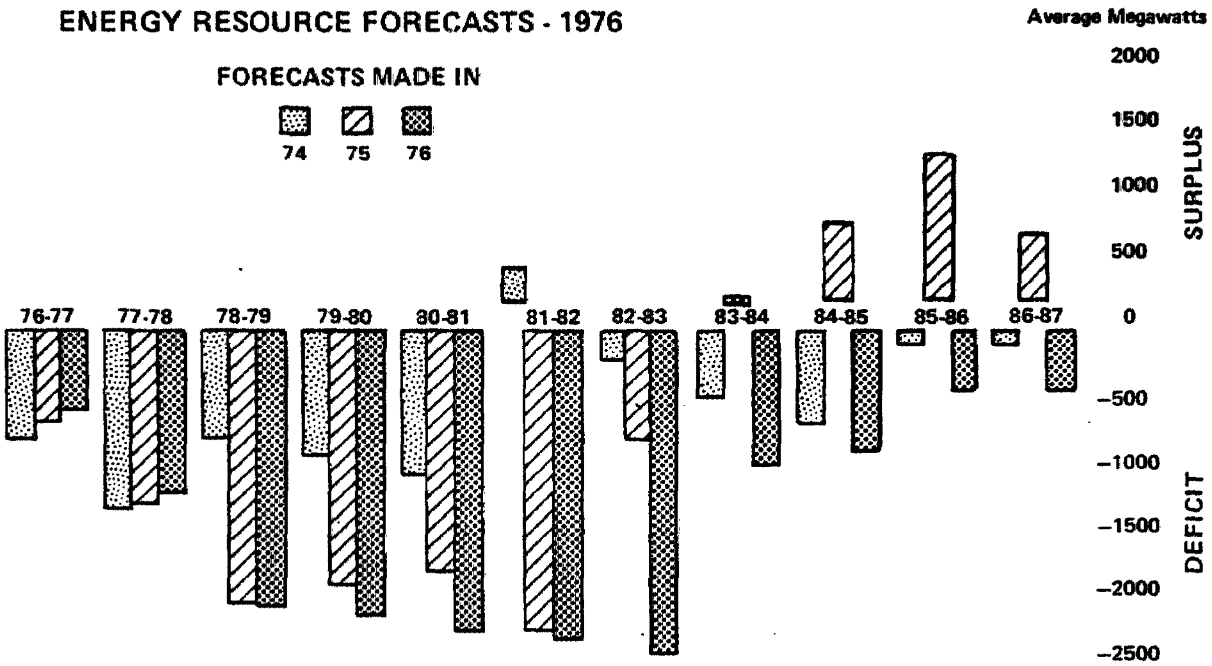
This assistance varied from providing minor help on technical issues in some instances to fully preparing the demand forecasts for smaller customers. BPA's forecasting assistance is provided by five economists or public utility specialists assigned to its Area and District offices who work with its customers in the preparation of their demand forecasts. The forecasts are then sent to BPA's headquarters office for review. Final approval of the forecast rests with the utility. However, BPA officials told us that many of their preference customers were small utilities with limited staffs and technical expertise in demand forecasting. Accordingly, utility officials acknowledged that they relied on BPA's expertise for assistance in such areas and accepted the forecast prepared by BPA.

Generally, the degree of BPA involvement was inversely proportional to the size of the customer utility--the smaller the customer the greater BPA's involvement. The approximately 100 utilities receiving assistance from BPA made up approximately 20 percent of the 1974 regional demand projections. BPA also did demand estimates for the Federal agencies and industries it serves directly. For the most part, these demands were set contractually and involved little forecasting per se. The Federal agencies and industry made up an additional 20 percent of the region's 1974 demand projections. The remaining 60 percent of projected demand was from the private utilities and large public utilities which developed their forecasts independently.

BPA'S REPRESENTATION OF THE REGION'S NEED FOR ADDITIONAL GENERATING CAPACITY TO ITS CUSTOMERS

BPA and utility officials as well as documents obtained from their files agree that BPA endorsed the need for additional generating units to meet regional power needs. BPA published an annual summary of the regional forecast during the mid-1970s entitled "Power Outlook." In these documents, BPA repeatedly cited the energy deficits which were being forecast and stated that additional delays in starting construction on new thermal plants would exacerbate an already serious energy supply situation.

Additionally, in May, 2 months following publication of its 1976 "Power Outlook" BPA published a special report entitled "The Electric Energy Picture in the Pacific Northwest." This report emphasized that greater deficits were projected in the 1976 forecast than in previous years. The following chart taken from BPA's special report demonstrates the increase of projected deficits. These deficits were projected through 1987 with Supply System plant 4 anticipated to come on line in 1983 and plant 5 in 1985.



SOURCE: Bonneville Power Administration, "The Electric Energy Picture in the Pacific Northwest," May 1976.

BPA not only endorsed the forecast calling for additional generating units but also publicly defended the forecast against critics. In response to a critique from the Washington State Thermal Power Plant Site Evaluation Council, BPA stated that the forecast was the "best available tool for projecting the future demand for electricity in the Pacific Northwest." BPA also expressed concern that the regional forecast might, in fact, be too low.

Although BPA endorsed the regional forecast and thereby the power deficits it projected, we found no indication that BPA made an independent evaluation of the methodology or assumptions used in the total forecast. A possible reason for this was that the demand growth predicted for the Pacific Northwest of about 6 to 7 percent was similar to projections for the rest of the Nation. To meet projected demand, utilities across the country were planning to start construction on new thermal plants to avoid deficits. For example, in 1978 the Tennessee Valley Authority had 17 nuclear units under construction to meet projected demand growth. Eight of those units are currently deferred because the forecasted demand growth did not materialize and TVA is now considering whether to cancel four units.

BPA'S INVOLVEMENT IN CUSTOMERS' DECISIONS TO PARTICIPATE IN PLANTS 4 AND 5

According to BPA's Administrator during the mid-1970s, BPA "actively supported" the participation of its preference customers in plants 4 and 5. This is further supported by BPA correspondence from the time period and by statements made by public utility officials we interviewed. A November 8, 1974, letter from the BPA Administrator to BPA's preference customers discussed the need for plants 4 and 5 and another nuclear plant. That letter stated in part:

> "These projects are scheduled * * * to meet Northwest utilities' load growth during the mid-1980s. Major financing will be needed in 1975 to maintain the construction schedules for these essential projects * * *.
>
> "Any utility which needs additional power resources in the mid-1980s will need to enter the Participant's Agreements with WPPSS at this time. Only by utilities signing these agreements can these generating projects be constructed on the schedule required to meet loads of Northwest utilities after July 1, 1983."

Another letter on June 11, 1975, from the BPA Power Manager to REA who was reviewing the option agreements for plants 4 and 5 on behalf of REA cooperatives stated:

> "Resources available to meet the estimated loads of BPA's preference customers, including REA borrowers, after July 1, 1983, would be inadequate without the capability of the projects. We know of no other projects, under construction or planned, available to the customers which would fulfill the need in the time frame that the projected need exists. While we cannot verify each utility's load estimate, our participation in load estimating procedures of the REA borrowers indicates that the estimates generally conform with current BPA load estimating standards. * * * Finally, a major strength of the proposed projects is that they have been planned to meet the region's preference agencies' load growth as a whole. These agencies through their participation in the Public Power Council have acted together to plan for their future power supply. By participating in the projects, the cooperatives have been given the opportunity to buy capability from the project at cost."

Later, at a March 17, 1976, BPA Regional Advisory Council meeting, the BPA Administrator made the following comments:

> "The first one that came to mind * * * was that we wanted to provide some certainty in the planning process for those who have a responsibility to their own local customers. The second objective we listed was that we wanted to meet the regional power requirements. In that regard we thought it was important, if possible, to find a way to keep the WPPSS plants 4 and 5 on schedule.
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> * * * * *
>
> "All of this boils down to the fact, * * * it would be desirable for public power to continue to try to keep plants 4 and 5 on schedule."

BPA continued to support its customers participation in plants 4 and 5. In April 1976, BPA met with its preference customers to inform them that BPA would not be able to meet all their future power requirements, and that they would soon be receiving the "notice of insufficiency." As a result of uncertainty created by the lack of a BPA power allocation policy, the preference customers were reluctant to sign up for plants 4 and 5, fearing that if they did so they would be later penalized by BPA in the allocation process. The Administrator told them he would be sending them a letter, which he later did, assuring them that they would not be penalized in any future BPA policy on power allocation for participating in the plants.

Information distributed at the BPA April 1976 Preference Customer Meeting showed that the estimated cost of Supply System plants 4 and 5 was about $2.4 billion. During the afternoon session of this meeting, representatives from the Supply System discussed the participants and ownership agreements for the two nuclear plants. A week after this meeting, the Supply System mailed participants agreements and related documents to prospective participants giving them 90 days to execute the agreements.

Further actions by BPA include meeting with preference customers in late May 1976 to discuss the deteriorating power supply picture and the importance of the region having adequate resources to meet projected demand requirements and participating in plants 4 and 5. Supply System representatives also attended the meeting to discuss the plants and answer questions of prospective participants. Also, BPA told its preference customers in the June 1976 notice of insufficiency that it would be unable to meet their future power requirements. Subsequently, in July 1976, 88 public utilities and 1 investor-owned utility signed agreements for plants 4 and 5.

Although it is not possible to quantify the impact BPA's statement had on the utilities' decision to participate, the notice of insufficiency, according to a number of participants, was a strong factor in their decision to participate in plants 4 and 5.

In addition to encouraging customer participation in the plants, BPA helped its customers determine their respective level of participation. According to a BPA official, a utility's percentage of participation in plants 4 and 5 was determined by using a formula developed by the Supply System. Each participant's share was aimed at 80 to 90 percent of their demand growth between 1983 and the late 1980s. In November 1974, BPA scheduled customers' meetings in each of its five service areas to explain the need for, and purpose of the proposed participant agreements. The BPA letter scheduling the meeting stated that its area power managers were to work with each utility to help determine the need for and amount of participation by each utility in projects 4 and 5.

BPA ACTIONS RELATED TO TERMINATION OF PLANTS 4 AND 5

Although it had no direct financial interest in plants 4 and 5, BPA management was concerned that an uncontrolled termination of the plants could impact on the three net billed plants. BPA, therefore, took several actions indirectly affecting attempts to mothball and terminate plants 4 and 5. In July 1981, as cash for the plants was running out, BPA reached an agreement with the Supply System to sell $100 million of nuclear fuel contracts and spare parts from plants 4 and 5 to one of BPA's net billed plants. The $100 million transferred to plants 4 and 5 allowed the Supply System to keep these plants financially alive until October 1981, an extension of 2 months, and provided additional time to find future funds for the plants. Between October 1981 and January 1982, BPA also assisted in attempts to develop a mothballing plan. At this time BPA was working with the Supply System and other regional power entities on alternatives to termination and encouraged the participation of various groups in the mothballing proposals including private utilities and large industry. For example, BPA agreed to act as an escrow agent for the participants during this period to collect the loan funds.

In October 1981, regional utilities and large industry agreed to loan the Supply System $60 million to fund plants 4 and 5 while attempts were being made to develop a mothballing plan. 1/ Between

1/The loans to the Supply System by 66 participants, 3 investor-owned utilities, and 12 direct service industry customers were made in equal amounts in Nov. and Dec. of 1981. The effective rate of interest on these loans is 15 percent, and the loans are due on July 1, 1984.

October 1981 and January 1982, the Supply System worked to obtain short-term loans from the 88 project participants. However, sufficient funds were not obtained, and the Supply System adopted a resolution terminating plants 4 and 5 on January 22, 1982.

REA ACTIONS DIRECTED
TOWARDS BPA CUSTOMERS

Subsequent to the Supply System's decision to terminate plants 4 and 5, REA has directed its borrowers (that are both customers of BPA and participants in the plants) to meet their Supply System obligations, and implied that their present and future financial standing with REA could be affected if they do not honor their obligations on plants 4 and 5. For example, after the Supply System's decision to cancel the plants, REA in a January 29, 1982, letter to its borrowers endorsing an orderly termination of the project stated

--each system is expected to honor Supply System obligations,

--steps should be taken to implement rate increases to meet Supply System obligations, and

--defaults by the Supply System could trigger actions and litigations accelerating the financial obligations of the participants.

REA also asked its borrowers to establish and submit plans for meeting Supply System obligations and requested that their boards pass a resolution agreeing to advance money for the termination costs of the plants.

On February 10 and March 22 and 23, 1982, REA and the National Rural Utilities Cooperative Financing Corporation 1/ held joint meetings with the participants to discuss their obligations and formulate a unified approach in addressing some issues raised about termination. Several REA borrowers who attended the meetings alleged that although REA did not prohibit borrowers from legally challenging their obligations to the Supply System, REA implied they would have difficulty obtaining REA financing if they did. REA officials, however, said they told the participants they appreciated their problems but still expected them to honor their commitments whether or not they were involved in lawsuits challenging the payments. Further, REA officials maintain that at the March meetings they assured

1/The National Rural Utilities Cooperative Finance Corporation is a private lending organization which provides financing to rural electric utilities and has made loans to 34 of the participants.

borrowers they would "work with those" that were unable to meet their Supply System debts. REA, however, kept no minutes of the meetings or elaborated on how it would work with its borrowers.

According to REA's files, their field staff warned several borrowers to honor their Supply System debts. For example, in a March 25, 1982, field report, an REA representative wrote in reference to one borrower and its questions on paying its Supply System obligation: "As the system is way past due to come in for a new loan application I felt it was only right to notify their manager as to the obligations of the system well before this goes any further." Another document in REA's files indicated that some borrowers may have been led to believe that the agency would not process future loan applications unless they agreed to pay the obligations. Further, the manager of one cooperative told us that an REA field representative had warned him that REA would replace him and the board if the cooperative challenged its Supply System commitments. The REA representative maintained that he did not make such a warning but only pointed out that REA has the authority to appoint a supervisor to conduct the cooperative's affairs if the borrower has difficulty meeting its obligations.

In an April 21, 1982, letter, REA also requested each borrower to develop and submit a financial forecast by June 30, 1982, indicating how it planned to meet its Supply System obligations, and stated that new loans and advances on previously approved loans would be withheld pending the receipt and review of the forecasts. REA stated that it could not continue approving loans or loan advances until it was assured that satisfactory plans to cover Supply System debts were developed. REA, however, did not specify what constitutes an acceptable financial forecast and advised us that they have no set criteria for reviewing the forecasts or determining whether they are satisfactory. With respect to advances on approved loans, REA advised us that they would continue to make advances if so required despite the letter.

In a May 1982 letter responding to an inquiry from one cooperative regarding the Supply System obligations, REA ignored the borrower's basic question. The cooperative wanted to determine if REA borrowers involved in legal action could withhold payment to the Supply System without objection or penalty from REA, provided that the utility had generated sufficient income to pay the obligation should the legal challenge be unsuccessful. REA's response did not directly answer the question, but stated only that the borrowers were expected to honor their obligations to the Supply System under the 1976 agreement. REA did not advise the cooperative whether or not it would be penalized if it chose to enter a lawsuit. An REA official in a May 1982 congressional hearing did, however, testify to the effect that REA would not penalize borrowers if they participated in lawsuits challenging the obligations.

In discussing the rationale for their recent actions, REA officials told us that they expect the borrowers to begin making their debt service payment to the Supply System beginning in January 1983 as required by contract. We were told that in REA's view, the cooperatives entered an agreement with the Supply System and have an obligation to honor this agreement although many of the borrowers may be faced with serious financial problems in meeting these payments. REA officials acknowledged that default on some of its direct loans to borrowers could increase if these borrowers are required to meet their Supply System obligations. 1/ REA, however, has not reached any conclusions on possible defaults because it has not completed its review of borrower financial plans.

Further, these officials maintained that nonpayment of the Supply System debts could have even more serious consequences for REA. REA has taken this position because it is concerned that failure of its borrowers to pay their Supply System obligations could adversely affect REA's $26 billion loan guarantee program and the ability of its rural electric cooperatives to obtain funds in the private capital markets. REA maintains that its loan guarantee program would be adversely impacted if the "take or pay" provision of the Supply System agreement (see appendix I) is not upheld by the courts in the pending lawsuit and the borrowers are not required to pay the debt. Currently, REA guarantees loans to finance construction of power plants from the Federal Financing Bank to generating and transmission cooperatives all over the Nation. To protect REA's interest, generating and transmission cooperatives are required to have similar "take or pay" contract provisions with their distribution cooperatives for selling the power. This assures that the generating and transmission cooperatives will be paid even if power is never delivered, thus assuring that they would have funds to repay the loans.

REA is also concerned that the situation could make it difficult for its rural electric cooperatives to obtain funds from private markets. REA officials expressed concern that failure of its borrowers to honor the Supply System obligations would be viewed negatively by the entire financial community. Such a development, REA officials contend, would affect the credibility of the entire rural electric cooperative sector because the financial markets would perceive more risks in funding cooperative activities.

The National Utilities Cooperative Finance Corporation is a case in point. It borrows money from private capital markets for relending to rural electric cooperatives. Because of the Corporation's financial structure, its credit worthiness is directly tied

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1/These loans amount to about $319 million.

to that of its member cooperatives. An adverse development with respect to the Supply System could make borrowing more difficult or costly for the National Utilities Cooperative Finance Corporation. Consequently, this could result in less private financing and lead to the necessity for more REA assistance.

AGENCY COMMENTS

A draft copy of this report was provided to BPA and REA for comment. Their detailed comments are included in appendixes II and III. BPA said the information regarding its activities was accurately stated. REA did not have any major objections to the report but did offer a number of specific comments expanding on REA's activities. We have evaluated REA's comments and incorporated them into the report where appropriate except for the following comment.

REA stated it has criteria for determining an acceptable financial forecast in REA Bulletin 105-5. We do not agree. The bulletin states that its purpose is "to provide electric distribution borrowers with suggested forms and techniques for preparing a financial forecast." It does not state what REA's policy is or what criteria must be met to qualify for a loan. In contrast to REA, the National Rural Utilities Cooperative Finance Corporation has an official statement "Policy and Procedures Memorandum-Loans-1" setting forth its specific loan policy and has a supplemental memorandum establishing additional loan conditions for Supply System participants.

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We trust this material answers your questions. As arranged with your office, we will not release this report to other interested parties for 7 days unless you publicly announce its contents earlier. At that time, copies will be sent to interested parties and will be made available to others on request. If we can be of any further assistance, please let us know.

Sincerely yours,

J. Dexter Peach

J. Dexter Peach
Director

BACKGROUND ON ELECTRIC POWER IN THE PACIFIC NORTHWEST

The diverse nature of regional power development in the Pacific Northwest 1/ has given rise to a myriad of regional power supply and power planning institutions consisting of a public, private, and Federal mix. BPA, the major power supplier in the Northwest, currently wholesales approximately 50 percent of the region's power. The remaining 50 percent is generated by a number of private and public utilities and publicly owned utility groups. About 100 public utilities are distributors only, buying their power requirements from BPA.

The Supply System and the Pacific Northwest Generating Company (PNGC) are two utility groups involved with generating power for the regional system. Formed in 1957 under the laws of the State of Washington, the Supply System (made up of 23 utility members) has the authority to acquire, construct, and operate generating plants and other related facilities. The Supply System was formed by the public utilities to enhance their ability to successfully undertake these activities. Formed in 1975, PNGC is currently a consortium of 20 rural electric cooperatives. PNGC activities to date have been primarily limited to purchase of shares in generating facilities owned and constructed by other utilities.

Until the 1960s, nearly all the region's electric energy needs were met by hydroelectric projects built on the Columbia River system. In the mid-1960s, projected future demand exceeded the projected baseload capability of the region's hydropower system. In response, in October 1966, BPA and the region's public and private utilities formed the Joint Power Planning Council, with the BPA Administrator as chairman, to study the region's future need for electric power and to develop a plan to meet that need.

As a result of this effort, the Hydro Thermal Power Program was developed in 1969 to meet forecasted electrical demand by incorporating new coal-fired and nuclear generating plants into the existing hydroelectric system. The initial activities of the program involved constructing seven large thermal plants, expansion of the generating capacity at hydroelectric projects, and further development of the Federal transmission system. The seven generating plants included the Supply System's nuclear units 1, 2, and 3; Portland General Electric's Trojan Nuclear Plant, and Boardman Coal Plant; and Pacific Power and Light's Centralia and Jim Bridger Coal Plants.

1/The term Pacific Northwest as used here means the States of Washington, Oregon, Idaho, and Montana west of the Continental Divide.

BPA agreed to participate in financing the Supply System's units 1, 2, and 3 construction through an arrangement with its preference customers called net billing. Under net-billing, BPA acquires its preference customers' share of the electric power generated by the new non-federally financed thermal plants. This thermal power is integrated into BPA's hydroelectric system and sold to BPA's customers at BPA's rates. In return for the power acquired, BPA assumes the preference customers' share of the construction, operation, and maintenance costs of these plants. BPA pays for these costs by offsetting them against the amounts due BPA for the sale and/or transmission of power or sale of services to the preference customers.

In 1972, BPA's ability to assist in the net-billing financing of additional generating units was halted by two developments. First, due to increases in the projected costs associated with the net-billed plants, the annual cost to BPA was projected to exceed the revenues received from power sales and other services to preference customers. Second, the Internal Revenue Service issued a tax ruling revoking the tax exempt status of municipal bonds sold to finance powerplants if more than 25 percent of the capability is assigned to a Federal agency. These events, coupled with delays in the construction of the net-billed plants, led Northwest power planners to believe they would not have adequate resources to meet projected regional demand growth beyond the early 1980s.

Under these circumstances, the Secretary of the Interior instructed BPA in March 1973 to informally notify its customers that it would be unable to meet their full power requirements beginning in 1982 unless the utilities and BPA could develop another plan. These "notices of insufficiency" were intended to allow time for the utilities to obtain additional resources outside of the Federal system and for BPA to develop a policy for allocating the Federal power available. In December 1973, BPA and regional utilities agreed to a "phase II" of the Hydro Thermal Power Program.

Under phase II, the utilities would continue to construct thermal generating units but without BPA participation in financing of the plants. Additional generation took on a new importance to the region after 1973 when energy shortages caused by low water in the region's reservoirs prompted pleas from utilities that their customers conserve energy. Large industry loads were interrupted and at least one State adopted an emergency power curtailment plan. Due to the oil embargo, the Nation's energy policies were also focused on alleviating energy shortages.

By 1974, the Supply System, with support of the Public Power Council, was pursuing the development of plants 4 and 5 as part of phase II. The Supply System financed the initial development of the two plants with a $17.5-million note issue. These funds began to run out in 1975, and 93 regional utilities interested in purchasing shares of the plants' capability signed option agreements. The option agreements were then used to back the issuance of additional debt. Under the option agreements, utilities gained the right to execute a future agreement to purchase a share of the project capability.

Problems developed, however, with finalizing the formal participants agreements. Utilities were hesitant to sign the agreements unless BPA agreed their participation in plants 4 and 5 would not cause them to lose access to or be penalized in Federal power allocations. In early 1976, BPA alleviated this concern by assuring their preference customers that their participation in the plants would not place them "in a less favorable position than non-participating customers with respect to future allocations of BPA power." Also in June 1976, BPA formally notified their preference customers it would be unable to meet their full requirements after 1983.

Subsequently, 88 preference customers and 1 investor-owned utility agreed to participate in plants 4 and 5. REA also became indirectly involved in the construction of plants 4 and 5 even though no Federal funding was involved because 41 of the participants were REA borrowers and could not participate in the projects without REA approval. 1/ In September 1976, REA authorized its borrowers to participate in the construction financing of the two plants.

Between 1976 and 1981, the Supply System continued the construction of plants 4 and 5. However, construction delays and dramatically increased projected costs ($2.4 to $7.8 billion) began to cause regional concern over the two units. A January 1981 report by the Energy and Utilities Committee of the Washington State Senate raised "serious questions" about whether the plants would be completed. The report questioned whether the Supply System could continue to find buyers for bonds to finance the plants. In March the committee recommended the Supply System consider a "temporary pause" in construction.

In June 1981, the Supply System board, on the recommendation of its managing director, voted to slow down construction of the plants. As the year progressed, financing for the plants appeared in jeopardy, and the Supply System worked on plans to "mothball" the units to avoid terminating them. However, the participants were unable to come to an agreement on mothballing, and on January 22, 1982, the Supply System decided to terminate the two plants.

1/The Rural Electrification Act as amended (7 U.S.C. 902) authorizes REA to make and guarantee loans to rural electric cooperatives for financing the construction of electric generating, transmission, and distribution facilities. Under REA loan agreements, borrowers may not undertake any new financial obligations unless they are approved by the REA.

The amount borrowed for these two plants was $2.25 billion and by the time this debt is retired, the principal and interest will amount to about $7.2 billion.

Because of the large financial costs to the participants and the fact that they will never receive power, several REA cooperatives have brought suit. 1/ They are arguing that the "take or pay" provision of their contract is invalid, and that they do not have to honor their obligation to the Supply System. The Supply System contends that under the "take or pay" provision of the agreement, the participants are required to make payments whether or not the plants are completed or operable.

1/Twelve REA borrowers filed a lawsuit on April 23, 1982, challenging the Supply System take or pay contracts.

APPENDIX II

Department of Energy
Bonneville Power Administration
P.O. Box 3621
Portland, Oregon 97208

OFFICE OF THE ADMINISTRATOR

In reply refer to: CE/BPA-A

JUL 22 1982

Mr. J. Dexter Peach
Director, Energy and Mineral Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

We appreciate the opportunity afforded us by the General Accounting Office to comment on your draft report regarding the roles of the Bonneville Power Administration (BPA) and the Rural Electrification Administration (REA) in the construction of Washington Public Power Supply System projects WNP-4 and WNP-5. We have reviewed the draft report and find the facts reported regarding BPA activities are accurately stated.

We do not feel competent to comment on those matters relating to REA activities.

I believe you and your staff are to be commended on the objectivity and evenhanded manner in which you approached this complex assignment.

Sincerely,

Peter T. Johnson
Administrator

United States Department of Agriculture

Rural Electrification Administration

Washington D.C. 20250

JUL 2 2 1982

Mr. Henry Eschwege
Director, Community and Economic
Development Division
U. S. General Accounting Office
Washington, D.C. 20508

Dear Mr. Eschwege:

This is in reply to your letter of July 13, 1982, to Mr. Harold V. Hunter, Administrator, Rural Electrification Administratin (REA) for comments on the draft of the proposed report to Congressman George Hansen, entitled "Bonneville Power Administration and the Rural Electrification Administration Actions and Activities Affecting Utility Participation in Washington Public Power Supply System Plants 4 and 5 (GAO/EMD - 82-105)." We appreciate the opportunity to review the draft and offer the following comments:

Page 9, first paragraph:

The letter written to all REA borrower/participants on January 29, 1982, was after the Washington Public Power Supply System (Supply System) had adopted a resolution to terminate Plants 4 and 5. Once the decision had been made by the Supply System to terminate, the participants' options were a "controlled" or "uncontrolled" termination of these plants. The earlier efforts to mothball the plants, which REA supported, had failed. It was REA's concern that possible actions arising from uncontrolled termination, including the possible acceleration of the debt on the outstanding bonds, would have an adverse effect on all participants. The acceleration of debt would seriously jeopardize the REA borrower/participants' ability to meet their obligations, including those to REA. Controlled termination, on the other hand, under which the participants were requested to advance funds to the Supply System as needed to provide the resources for an orderly termination of the plants, would forestall such acceleration and provide for repayment of outstanding debt over a much longer period of time. For this reason REA was of the opinion that support of the controlled termination program was the only viable alternative available to its borrowers.

See GAO note on page 8 of appendix III.

Page 8, second paragraph:

The meetings on February 10 and March 22-23 were not only to discuss REA's position regarding controlled termination but were also an effort to improve communications and formulate a unified approach in addressing some of the issues raised about the controlled termination plan. Basic to both of these meetings were REA concerns over its own security interests in the borrower/participants and that refusal to honor contractual obligations under the 1976 agreement could have an adverse impact on the rural electrification program.

Page 9, bottom of page
Page 10, top of page:

REA's position is that our borrower/participants should honor all commitments made under the 1976 agreement unless otherwise determined by a court of law. REA's concern is that the actions of the borrower/participants who have undertaken legal efforts to resolve any areas of ambiguity which they feel might exist in the 1976 agreement not place in jeopardy REA's first mortgage lien upon the assets of the borrowers. Any claim on the borrowers' assets which could result from these legal efforts would create problems in continuing to advance existing loan funds and in obtaining additional loans from REA by imposing a threat to REA's existing security interests.

At the March 22-23 meeting, REA requested that each borrower/participant prepare a financial forecast on how they would meet their obligations. REA indicated to the group that it shares the borrowers' concern over the impact on rates and would work with the borrowers in developing their financial plans.

Page 10, first paragraph:

REA has certain rights reserved to it under the loan and mortgage documents executed by its borrowers which provide, among other things, that REA may take possession of and manage, control and operate a borrower's system under certain specified conditions of default. A borrower's financial difficulties in itself is not an event of default.

Page 10, second paragraph:

REA does have established criteria for determining an acceptable financial forecast. The criteria is outlined in REA Bulletin 105-5, and is basically the same as that used in connection with preparation and review of forecasts prepared by all of its borrowers on a regular basis. REA field personnel have conducted workshops and worked individually with borrower/participants to develop the financial plans requested by REA. An interpretation of the proper accounting for the Supply System costs and obligations has also been sent to each borrower/participant. REA has agreed to extend the deadline for submission of the financial forecasts as may be needed and to date has received 19 of the expected 41 forecasts.

Page 10, third paragraph:

REA's May 17, 1982, response to an inquiry from Orcas Power & Light Co. states that the "board of Orcas is certainly free to follow the advice of its legal counsel in an effort to resolve those areas of ambiguity which counsel and the board might find to exist in the WPPSS 4 and 5 agreements, providing that in doing so the first security interest in the assets of Orcas held by REA will not be placed in jeopardy." Whether any legal action undertaken by Orcas will be a threat to REA's security interest or not, cannot be judged at this time.

Page 11, first paragraph:

Although some borrower/participants have stated that rate increases sufficient to meet the Supply System obligations, in addition to their other operating costs, would be impossible to implement. REA has not yet completed its review of the financial plans to reach any such conclusion. Depending upon the economic conditions of the borrower's area and the rate increases necessary for the borrower to meet its obligations, the possibility of future defaults will be considered in REA's evaluation of the borrowers' financial plans.

Page 11, second paragraph:

Although it could have an adverse effect on REA's guaranteed loan program, if the "take or pay" provisions of the Supply System agreement are not upheld, REA is not of the opinion that the program would be "destroyed".

REA would be happy to discuss any of the above comments with you or your staff.

Sincerely,

Joe S. Zoller

JOE S. ZOLLER
Acting Administrator

GAO note: Page numbers of the draft report were changed to correspond with those in this final report.

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