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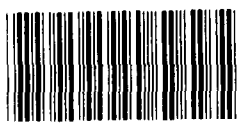
Report to the Honorable Howard M. Metzenbaum
United States Senate

March 1986

WATER RESOURCES

Bureau of Reclamation's Bonneville Unit: Future Repayment Arrangements



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GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-217826

March 7, 1986

The Honorable Howard M. Metzenbaum
United States Senate

Dear Senator Metzenbaum:

During our review of repayment arrangements for various reclamation projects that you requested, we asked the Department of the Interior's Assistant Secretary for Water and Science on April 22, 1985, to respond to several issues regarding the Bonneville Unit of the Central Utah Project. When we issued our report entitled Bureau of Reclamation's Central Utah and Central Valley Projects Repayment Arrangements, (GAO/RCED-85-158, Sept. 9, 1985), we had not yet received a response to our letter. At that time, we agreed with your office to provide you Interior's eventual response and our evaluation of it.

By letter dated November 22, 1985, the Assistant Secretary responded to our inquiry and disagreed with our conclusions on three major issues. A copy of the Assistant Secretary's response has been provided to your office. After evaluating his response, we remain convinced that

- the Bureau of Reclamation's use of the Water Supply Act of 1958 to defer a portion of municipal and industrial (M&I) costs of the Bonneville Unit was illegal,
- the Bureau's use of ad valorem (percentage of value) tax revenues from property owners to increase the Bonneville Unit's M&I customers repayment obligation under the 1965 contract was improper, and
- the Department of Energy Organization Act of 1977 requires congressional approval of the modified cost allocation of the Bonneville Unit initiated by the Bureau in 1984.

Our April 22, 1985, letter also contained specific questions concerning (1) the Bureau's assessment of irrigators' ability to pay, (2) the repayment of M&I water costs through electric power revenues, (3) the adequacy of the escalation factor included in the Bureau's supplemental contract with the Central Utah Water Conservancy District, (4) the impact of two additional supplemental contracts with the District's subcontractors, and (5) the impact of the potential resolution of a 1965 water rights agreement with the Ute Indian Tribe. The Assistant Secretary's response to these questions was adequate, therefore, we have nothing further to report on these issues.

Background

The Department of the Interior's Bureau of Reclamation undertook construction of the Central Utah Project as part of the Colorado River Storage Project of 1956. The Central Utah Project consists of six units—Jensen, Vernal, Uintah, Upalco, Ute Indian, and Bonneville. The Bonneville Unit—the largest of the six—develops water resources in two basins on either side of the Wasatch Mountains. The unit will divert water from the eastern side via a tunnel through the Wastach Mountains into the Bonneville Basin. The principal purposes of the unit are to supply water for irrigation and M&I users and to generate commercial electrical power. Construction of the unit began in 1966 and is currently almost one-third completed; completion is expected in 1996.

The unit's estimated total cost as of January 1985 was $2.1 billion, $1.9 billion of which is to be repaid to the federal government by the unit's beneficiaries[1] ($915 million for irrigation, $640 million for M&I water, and $296 million for electric power). The remaining costs are allocated to nonreimbursable purposes, such as fish and wildlife, flood control, and recreation.

Based on the Bureau's interpretation of reclamation law, Bureau policy requires a firm repayment contract with the users of M&I water before construction of M&I project facilities. Once a repayment contract has been executed, construction expenditures may not exceed the contractual repayment obligation. In 1965 the federal government and the Central Utah Water Conservancy District signed a contract which obligated the district to repay all of the costs allocated to M&I water supply. The district was to receive 79,000 acre-feet[2] of water annually for M&I use. At that time, the contract obligated the district to repay $102.4 million for M&I water.

In the late 1970's, the Bureau first recognized that the 1965 repayment contract would not recover all allocated M&I costs because of a lengthened construction period and inflation. The Bureau—aware that construction could be delayed unless the M&I repayment obligation of $102.4 million was increased—negotiated a supplemental contract with the district in 1980 that would have increased the district's repayment

[1]The Reclamation Project Act of 1939 requires the Bureau to recover all M&I costs, with interest, if the Secretary of the Interior determines that an interest charge is proper (as he did in this instance) and irrigation costs which are recovered without interest. Under the Colorado River Storage Project Act of 1956, electric power revenues may be used to pay irrigation costs which are beyond the irrigator's ability to pay.

[2]An acre-foot is 325,851 gallons, or the amount of water needed to submerge 1 acre of land under 1 foot of water.

ceiling. However, the Assistant Secretary of the Interior for Land and Water rejected this contract because it was legally questionable, contained several provisions which were not fiscally prudent, and did not adequately disclose the cost of the project to those responsible for repayment. The Bureau then took two actions that permitted construction to continue under the existing contract.

In 1981 the Bureau invoked the Water Supply Act of 1958. Under this act the Bureau is authorized to enlarge a project for storage of additional water to meet future demand, without a contract for repayment of the enlargement. Further, since there may not be a demand for the additional water on completion of construction, repayment of construction costs and of interest by future beneficiaries can be delayed for up to 10 years, or until water is delivered, if sooner. In this instance, the Bureau deferred to the future repayment of costs associated with 60,000 acre-feet[3] of M&I water which was covered in the 1965 repayment contract with the district. This deferral enabled the Bureau to continue construction because the district's repayment obligation was sufficient to cover the costs of the remaining 39,000 acre-feet of M&I water under contract. As a sign of good faith regarding its intent to purchase all of the M&I water, the district contributed $10 million in cash, increasing its M&I repayment obligation and the related construction ceiling to $112.4 million.

The Bureau also decided to use ad valorem tax revenues (percentage of value) from property owners within the district's boundaries only for M&I repayment. According to the 1964 Definite Plan Report, which provided the basis for the initial appropriation for construction and the 1965 repayment contract, repayment of irrigation costs would include $38 million in future ad valorem tax revenues. But in 1982, at the district's request, the Bureau reallocated this $38 million toward M&I repayment to increase the M&I repayment ceiling to $150.4 million.

Because of increasing costs and the attendant need for additional repayment obligation, the Bureau began negotiations again with the district in July 1984. The Bureau and the district have agreed to a supplemental repayment contract which adds $368.5 million to the M&I repayment obligation, including a 10-percent escalation factor. The Bureau has also

[3]The estimated M&I water yield of the project was increased from 79,000 to 99,000 acre-feet subsequent to the 1965 repayment contract. This increase did not result from additional construction under the Water Supply Act.

negotiated two other contracts with the district and its municipal subdistricts to repay the costs of a specific feature (Jordan Aqueduct) of the M&I system. These two contracts add another $35.3 million in repayment obligation. As a result of these negotiations, the district's total M&I repayment obligation is $554.2 million. Based on the Bureau's fiscal year 1986 budget data, this amount would be sufficient to recover the district's share of the M&I construction costs. This renegotiated M&I repayment obligation also includes the $38 million previously designated for irrigation repayment.

In 1984 the Bureau modified its procedure for allocating Bonneville Unit costs. According to the Bureau, this was done in an attempt to make a more equitable allocation of costs to project purposes. The allocation resulting from this change was used as the basis for repayment contract negotiations.

Use of 1958 Water Supply Act to Defer a Portion of M&I Costs Was Illegal

In 1981 the Bureau invoked the Water Supply Act of 1958, deferring repayment of the costs associated with 60,000 acre-feet of M&I water to be delivered by the Bonneville Unit. This deferral enabled the Bureau to continue construction, because the district's repayment obligation was sufficient to cover the costs of the remaining 39,000 acre-feet of M&I water under contract. In our opinion, the Bureau's use of the Water Supply Act for the Bonneville Unit was illegal.

The Assistant Secretary in his response to us said that the 1965 repayment contract with the water district allowed for the use of the Water Supply Act and provided that

> ". . . the act will be applicable to the repayment of allocated costs of project municipal and industrial water whenever the Contracting Officer determines that the facts and circumstances show a future anticipated demand . . .."

He also said that all of the requirements of the Water Supply Act had been met in its application to the Bonneville Unit costs. Further, in accordance with the provision of the Water Supply Act, he said the Department intends to allow a 10-year period of deferment of repayment of construction costs for facilities already completed and allocated to future use.

We found that the Water Supply Act, as indicated by its legislative history, allows the Bureau to enlarge a project for storage of additional water to meet an anticipated future demand, without a contract for

repayment of the enlargement. It does not, however, allow the Bureau to defer repayment obligations and thereby continue planned construction of facilities for M&I water supply already under contract, as it did in this case. The act provides for delayed repayment terms on the premise that the water supply will not be needed for some time after it becomes available. To permit optimum use of the limited number of good dam and reservoir sites, and because ordinarily it is less expensive to build a larger facility than to enlarge a completed facility, the law encourages construction for somewhat uncertain future needs. The Bureau, however, has used the provisions of the act for an entirely different purpose than the Congress intended.

For the Bonneville Unit, the M&I water supply which was contracted for and under construction was for current use under the Reclamation Project Act of 1939—not to meet future demand. Therefore, the authority governing this contract is the Reclamation Project Act of 1939, which requires a repayment obligation for construction to proceed.

Pursuant to the requirements of the Energy and Water Development Appropriation Act, 1986, on December 12, 1985, the Bureau submitted a copy of the supplemental repayment contract to the Congress to initiate the start of the 100-calendar day waiting period prior to obligating or expending funds made available by this act for the award of new construction contracts or for related land acquisition. This Act states that the supplemental repayment contract shall recover all costs allocated to M&I water supply, plus interest.

The supplemental repayment contract states that repayment of project construction costs allocated to supplying M&I water shall be governed by Federal Reclamation Law, by the 1965 Repayment Contract, and by the supplemental repayment contract, utilizing the provisions of the Water Supply Act. As stated previously, under the Water Supply Act, repayment of construction costs and of interest associated with deferred M&I water can be delayed up to 10 years. The Assistant Secretary has advised that the Department intends to allow a 10-year period of deferment. The allowance of such a deferment is inappropriate because the use of the Water Supply Act in this case was illegal. We estimate that such a deferment could result in the federal government losing up to $97 million in interest revenues.

The deferment under the supplemental repayment contract also does not satisfy the recovery requirements of the Energy and Water Development Appropriation Act, 1986. Accordingly, in our opinion, none of the

funds made available by this act should be used for the Bonneville Unit until such time as the supplemental repayment contract has been revised to eliminate the inappropriate deferment of repayment of construction costs and interest. On this matter, it should be recognized that because of the time needed to revise the contract, Interior and the district may face a situation where new construction contracts cannot be awarded and completion schedules are affected.

Recommendation to the Secretary of the Interior

We recommend that the Secretary of the Interior direct the Commissioner, Bureau of Reclamation, to (1) work with the Central Utah Water Conservancy District to revise the supplemental repayment contract between the Bureau and the district to eliminate any inappropriate deferment of the repayment of construction costs and of interest and (2) not use the funds made available for the Bonneville Unit by the Energy and Water Development Appropriation Act, 1986, until the supplemental repayment contract has been appropriately revised.

Reassignment of Ad Valorem Tax Revenues to Increase M&I Repayment Obligation Was Improper

According to the Bureau's 1964 Definite Plan Report on which the 1965 repayment contract was based, repayment of irrigation costs of $54.4 million would include $38 million in future ad valorem tax revenues. But in 1982 at the district's request, the Bureau reassigned this $38 million toward M&I repayment. This action increased the ceiling on M&I construction expenditures. We believe this action was improper, since the 1965 repayment contract dedicated the $38 million to irrigation repayment.

In taking exception to our conclusion, the Assistant Secretary said that the 1964 Definite Plan Report assigned the $38 million to repay irrigation costs only after M&I repayment is completed. Additionally, he said that the use of these tax revenues was a major issue during the recent negotiation of the proposed supplemental repayment contract. The Assistant Secretary indicated that the Bureau was able to successfully negotiate a major increase in the district's ad valorem tax pledge in exchange for continued application of the $38 million towards M&I repayment. He believes this was an appropriate trade-off, particularly since the balance of irrigation costs would be repaid from electric power revenues.

We believe that it is misleading to imply that the Definite Plan Report allowed all ad valorem tax revenues to be used for M&I repayment. Page 182 of the Definite Plan Report reads as follows:

"Ad valorem tax revenues collected by the Central Utah Water Conservancy District are expected to amount to $85,658,000 during the irrigation payout period. . .. The first $47,653,000 of this amount will be applied in repayment of municipal and industrial water costs and the remaining $38,005,000 will be used to repay costs allocated to irrigation."

The dedication of part of the ad valorem tax revenues to irrigation repayment is further demonstrated by the 1964 definite plan summary sheet which shows that the repayment of irrigation costs would include:

Table 1: Repayment of Irrigation Costs

Source	In thousands
Water Users	$16,400
Ad valorem tax revenues	38,005
Total	**$54,405**

To use the $38 million in ad valorem tax revenues for M&I repayment would in effect reduce the irrigation repayment obligation to $16.4 million from the $54.4 million required by the contract. Therefore, the Bureau's reassignment of $38 million to M&I repayment, to facilitate continued construction of the Bonneville Unit, was inconsistent with the contract.

The proposed supplemental contract redefines the 1965 contract repayment obligations for irrigation and M&I. It applies the $38 million toward M&I repayment and provides for irrigation repayment up to the irrigators' ability to pay, set at $16.4 million in the 1965 repayment contract. While the supplemental contract changes the future application of ad valorem taxes, we continue to believe, contrary to the Assistant Secretary's position, that the Bureau took an improper action in 1982 in order to continue construction of the Bonneville Unit.

Modified Cost Allocation Needs Congressional Approval

In 1984 the Bureau modified its procedure for allocating Bonneville Unit costs. According to the Bureau, this was done in an attempt to make a more equitable allocation of costs to project purposes. The allocation resulting from this change was used as the basis for negotiating the supplemental repayment contract. The Department of Energy Organization Act of 1977 requires congressional approval for the reallocation of the costs of multipurpose facilities, such as the Bonneville Unit. Although the law does not specify what is required in the way of congressional approval, it is our view that at the least full disclosure of the reasons for

and impact of changes in cost allocation should be made to the cognizant committees.

The Assistant Secretary in his response to us said that because the change in cost allocation is not a final one, the Department of Energy Organization Act does not require formal congressional approval of the change. He said, however, that the Congress is informed annually of such changes through the budget process. He also said that the modified procedure distributed costs equitably and reasonably.

We disagree with the Assistant Secretary's position that non-final changes are not subject to the congressional approval provision of the Department of Energy Organization Act. Section 302(a)(3) of the act makes no reference to a final cost allocation but only to "changes in cost allocation or project evaluation standards" which would "authorize the reallocation of joint costs of multipurpose facilities theretofore allocated . . .." Furthermore, statements made in debating the act do not refer to "final" cost allocations. For example

> "The amendment I am proposing today would make certain that cost allocations and project evaluations with respect to joint costs of multipurpose projects shall not be changed without the approval of the Congress."

(Remarks of Senator McGovern 123 Cong. Rec. 15300, 1977).

We believe that the Bureau's cost allocation modification has far-reaching effects on the costs to be allocated as well as on future repayment. Attachments to the Assistant Secretary's response show that the modification increased the allocation for irrigation from 9 percent to 54 percent and decreased the allocation for electric power from 40 percent to 2 percent of total joint costs.[4] This appears to be just the type of change that should be subject to approval under section 302(a)(3) of the act.

While we did not analyze the mechanics or equity of the reallocation, we did look at the effect the modified procedure had on allocated costs.

[4]Joint costs—such as those for dam construction—are that portion of total project costs which cannot be identified with any single project purpose and which are therefore allocated to all project purposes.

Table 2: Allocation of Total Project Costs Bonneville Unit

(000 omitted)

	Old procedures[a]	Modified procedure[a]	Increase (decrease)
Reimbursable costs:			
Irrigation	$534,100	$915,090	$380,990
M&I	616,665	640,882	24,217
Electric power	674,663	296,371	(378,292)
Total	**$1,825,428**	**$1,852,343**	**$26,915**
Nonreimbursable costs:	$355,635	$269,457	$(86,178)
Total	**$2,181,063**	**$2,121,800**	**$(59,263)**

[a]Cost from FY 1986 budget data.

This modification will reduce the interest the Bureau collects on repayment because the costs allocated to electric power is repaid with interest and irrigation is repaid without interest. Of the $915.1 million allocated to irrigation, $898.7 million will be beyond the irrigators' repayment ability of $16.4 million and thus will be repaid primarily by electric power revenues. However, electric power revenues will first be used to repay the costs allocated to Colorado River electric power development, before they are used to repay irrigation costs. In addition, since by law, irrigation cost repayment is not subject to interest, the value of the eventual repayment will be substantially less than the value of the government's expenditures.

To determine whether the Congress has been informed about the cost allocation changes through the annual budget process as stated by the Assistant Secretary, we examined the Bureau's project data sheets and appropriation hearings concerning the Bonneville Unit. Other than updated cost data reflecting the changes, we found no evidence that the Congress or cognizant committees were informed of a new allocation procedure. The record shows that the changes in cost allocations were attributed primarily to a change in the Bonneville Unit's physical facilities.

Recommendation to the Secretary of the Interior

To more fully inform the Congress, we recommend that the Secretary of the Interior direct the Commissioner, Bureau of Reclamation, to immediately provide the Congress with an explanation of why the modified procedure was developed, how it was developed, and what effect it will have on allocated costs and repayment. Further, to comply with the requirements of the Department of Energy Organization Act of 1977, we

recommend that the Secretary of the Interior seek congressional approval for this modification.

As arranged with your office, we are sending copies of this report to the Director, Office of Management and Budget; the Chairmen, House and Senate Committees on Authorization and Appropriations; the Secretary of the Interior; and other interested parties.

Sincerely yours,

Neal P. Curtin for

J. Dexter Peach
Director

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