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r Dear Senator Metcalf:

In accordance with your request of May 5, 1972, and as subsequently agreed upon with your office, we have obtained information on the controls exercised by the Rural Electrification Administration (REA), Department of Agriculture, over its borrowers. You indicated that you were particularly concerned about REA's actions with respect to a program by the Mid-Rivers Telephone Cooperative, Inc., Circle, Montana, to obtain financing for the construction of an Automatic Voice Network (AUTOVON) switch facility. You indicated that REA might need to initiate fiscal control programs to prevent future occurrence of difficulties similar to those encountered by Mid-Rivers.

Our work, done at the Department's headquarters in Washington, D.C., included a review of pertinent files and records and discussions with REA and other departmental officials. Also we obtained a statement from the REA Administrator on REA's controls over its borrowers and how such controls related to the Mid-Rivers situation. A copy of the Administrator's statement, dated June 14, 1972, is enclosed for your information.

The essence of the Administrator's statement, which confirms what we were told by other REA officials, is that:

- REA is not a regulatory agency but a lending agency having a lender-to-borrower relationship with each borrower.
- REA has considerable influence over a borrower's activities during the period when REA-financed facilities are being constructed, but its control thereafter over the activities and the decisions of the borrower is much more limited, as long as the borrower complies with REA's mortgage and loan terms.
- During the postconstruction period, REA monitors the borrower's operations, recommends improvements in its management and operations, and takes a strong stand on matters affecting the security of the REA loan. But REA recognizes that, in cases of differences of opinion, the borrower is independent and is responsible for its own operation and management.

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With respect to the Mid-Rivers situation, the Administrator and other REA officials told us, in essence, that:

- Mid-Rivers had financed the AUTOVON switch facility with funds obtained from commercial lending sources.
- REA's relationship with Mid-Rivers was that normally experienced during a postconstruction period, except that REA had, and was able to exercise, some control over the financing of the AUTOVON switch facility because the commercial lenders desired an accommodation in the REA mortgage to permit them to have a first lien on the facility. This control involved REA's review of the loan agreement for financing the facility for any objectionable features before arranging for the necessary mortgage accommodation.
- Mid-Rivers' board of directors and its manager considered themselves capable of handling the AUTOVON switch facility program and did not ask REA for advice or assistance.
- Mid-Rivers remained current in its payments on its REA loan, and otherwise complied with REA mortgage terms, until the final stages of construction of the facility. (An REA official told us in August 1972 that Mid-Rivers was current in its payments.)

It appears that the difficulties experienced by Mid-Rivers resulted from actions by its board of directors wherein the board agreed to a contract and to a related power of attorney between Mid-Rivers and its former manager that designated the former manager as its agent and granted him practical autonomy in handling all phases of the AUTOVON switch facility program. We believe that, under the circumstances, REA was not in a position to interpose itself in a manner to prevent the consequences of the actions taken by Mid-Rivers' board of directors.

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We did not obtain written comments from the Department on the information contained in this report; however, we obtained the information from REA and discussed it with REA officials.


We plan to make no further distribution of this report unless copies are specifically requested and then only after

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your approval has been obtained or public announcement has been made by you concerning the contents.

We trust that the foregoing information will satisfy your inquiry on this matter. We shall be pleased to supply further details you may desire.

Sincerely yours,



Deputy Comptroller General
of the United States

Enclosure

The Honorable Lee Metcalf
United States Senate