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December 18, 2015

The Honorable Jeff Denham
Chairman, Subcommittee on Railroads, Pipelines,
and Hazardous Materials
Committee on Transportation and Infrastructure
House of Representatives

The Honorable Mario Diaz-Balart
Chairman, Subcommittee on Transportation, Housing
and Urban Development, and Related Agencies
Committee on Appropriations,
House of Representatives

Subject: *Issues Arising under FRA's Implementation of California High-Speed Rail
Authority Grant Tapered Match Provision*

Dear Chairman Denham and Chairman Diaz-Balart:

This responds to your request for the Government Accountability Office's (GAO) legal opinion regarding issues arising under the Federal Railroad Administration's (FRA) ongoing implementation of a cooperative agreement with the California High-Speed Rail Authority (Authority). Federal funding for the agreement, totaling about \$2.5 billion, was appropriated by the American Recovery and Reinvestment Act of 2009 (Recovery Act)¹ and is being used primarily for construction of an initial Central Valley subsection of California's planned high-speed rail (HSR) system. In addition to this first agreement (Recovery Act Agreement or Agreement),² FRA has entered into a second cooperative agreement with the Authority, also for construction of the initial Central Valley subsection. Federal funding for this second agreement, totaling about \$928 million, was appropriated by the Fiscal Year 2010 Consolidated Appropriations Act (FY 2010 Agreement).³ We mention the FY 2010 Agreement in this opinion for context only.

We agreed to address:

(1) whether the Authority has failed to provide its matching share contributions consistent with Agreement payment deadlines and if so, whether that violates the Agreement and what remedies the federal government has to address such violations;

¹ Pub. L. No. 111-5, 123 Stat. 115 (2009).

² The Recovery Act Agreement, signed September 23, 2010, is No. FR-HSR-0009-10-01-00, as amended.

³ Pub. L. No. 111-117, 123 Stat. 3034 (2009). The FY 2010 Agreement, signed November 18, 2011, is No. FR-HSR-0118-12-01-00.

(2) whether, pursuant to a tapered match provision in the Agreement, FRA's ongoing disbursement of federal funds toward its 50 percent share of grant project costs, without the Authority concurrently paying its 50 percent matching share, violates the Antideficiency Act or other key federal financial management laws; and

(3) what responsibilities, if any, FRA has to re-evaluate the Agreement in light of developments in ongoing state court litigation, *Tos v. California High-Speed Rail Authority*.

Our practice when preparing legal opinions is to obtain the views of the relevant agencies in order to establish a factual record and obtain the agencies' legal positions on the subject matter of the request. GAO, *Procedures and Practices for Legal Decisions and Opinions*, GAO-06-1064SP (Washington, D.C.: September 2006), available at <http://www.gao.gov/products/GAO-06-1064SP>. In response to our requests, we received oral and written responses and documentation from U.S. Department of Transportation (DOT) and FRA officials (collectively DOT officials) and from Authority officials.⁴

I. SUMMARY OF CONCLUSIONS

For the reasons discussed below, we conclude that while the Authority has paid less than had been required under the original terms of the Agreement, the Authority has provided its matching share contributions to date consistent with the Agreement as amended, and thus is not in violation of the Agreement. The amended Agreement includes a legally-authorized tapered match provision, permitting changes to interim payment dates and amounts as specified in the Agreement's Funding Contribution Plan (FCP), and the Authority has made its contributions consistent with these revised dates and amounts. If the Authority fails to make its interim payments consistent with the FCP, or fails to pay its full matching share by the Agreement's final payment deadline (currently September 30, 2017, but FRA is considering an extension), FRA would have several remedies available. These include suspension or termination of further funding under the Agreement; use of the federal debt collection laws to seek recovery from the Authority or the State of California of up to the entire amount of federal funds already disbursed; and suspension or debarment of the Authority from further participation in DOT surface transportation assistance.

We further conclude that FRA's ongoing disbursement of federal funds pursuant to the Agreement's tapered match provision, without the Authority paying its matching share concurrently, does not violate the Antideficiency Act or other key federal financial management laws, specifically, the Federal Managers' Financial Integrity Act and the Cash Management Improvement Act.

Finally, we conclude that FRA has a number of responsibilities under federal internal control requirements, DOT grant regulations, and FRA grant management policies and procedures to monitor, assess, and mitigate risks under the Agreement. These risks include the possibility, due to the *Tos* litigation or otherwise, of the Authority's failure to provide its matching share consistent with the FCP interim payment dates or the final payment deadline.⁵

⁴ We received oral and written responses and documentation from DOT officials on May 23 and 27, July 3, 18, and 29, and September 12, 2014, and September 9 and 21, October 6, 9, 21, 26, and 28 and November 19, 24, and 25, 2015. We received information from Authority officials on October 27 and November 12, 15, and 17, 2015.

⁵ At Chairman Denham's request, the DOT Office of Inspector General (OIG) has conducted a related audit of FRA's grant amendment and grant oversight processes with respect to its High-Speed Intercity Passenger Rail grants,

II. BACKGROUND

As we reported in 2013, the California high-speed rail system is expected to be one of the most expensive transportation projects ever undertaken in the United States. GAO, *California High-Speed Passenger Rail: Project Estimates Could Be Improved to Better Inform Future Decisions*, GAO-13-304 (Washington, D.C.: Mar. 28, 2013) (GAO 2013 High-Speed Rail Report) at 1. Phase 1 of the system as currently planned will consist of a rail line approximately 520 miles long between San Francisco and Anaheim, currently projected to cost approximately \$68.5 billion and to be completed by 2029, with a travel time of less than 3 hours and a capability of operating at over 200 miles per hour. With the currently planned expansion of the system under Phase 2, the system would run between Sacramento and San Diego for a total of 800 miles.⁶ Key factual and legal background is provided below about federal funding and funding-related legal requirements for the planned system. Appendix I to this opinion provides additional information and context about state funding and funding-related requirements for the system and about the ongoing state court litigation in *Tos v. California High-Speed Rail Authority*.

Federal funding for the California high-speed rail system began in 2009, when Congress appropriated \$8 billion in the Recovery Act for high-speed rail corridors and intercity passenger rail service.⁷ The Recovery Act directed DOT to give priority to projects that support the development of intercity high-speed rail service, and FRA did so by using its High-Speed Intercity Passenger Rail (HSIPR) competitive grant program established under the Passenger Rail Investment and Improvement Act of 2008 (PRIIA).⁸ The Recovery Act required FRA to obligate funds no later than September 30, 2012,⁹ and in January 2010, FRA selected the Authority to receive an HSIPR grant ultimately totaling about \$2.5 billion.

The Recovery Act did not require high-speed rail grantees to contribute matching funds as a condition of the grant,¹⁰ but in its selection criteria, FRA provided a preference to applicants that committed to cost-sharing and whose documentation demonstrated the applicant's ability to fulfill any pledged contribution.¹¹ In its grant application, California offered to pay a 50 percent

including the Recovery Act Agreement, and reported the results of its audit on April 1, 2015. See DOT OIG, *FRA Improved Its Guidance on High Speed Rail Grant Agreements, but Policies and Procedures for Amending and Monitoring Grants Remain Incomplete*, ST-2015-038, April 1, 2015 (DOT OIG 2015 Report), available at <https://www.oig.dot.gov/library-item/32447>, last visited Dec. 1, 2015.

⁶ See California High-Speed Rail Authority, *Project Update Report to the California State Legislature* (Mar. 1, 2015) (CHSRA 2015 Legislative Update), at 2, 21; California High-Speed Rail Authority, *California High-Speed Rail Big Picture* (June 2015).

⁷ Pub. L. No. 111-5, Sec. 5, Div. A, tit. XII, 123 Stat. at 208.

⁸ See Pub. L. No. 110-432, Div. B, 122 Stat. 49907 (2008). The HSIPR program is authorized under PRIIA section 301 (Intercity Passenger Rail Service Corridor Capital Assistance), 49 U.S.C. §§ 24402-24406; section 501 (High-Speed Rail Corridor Development), 49 U.S.C. §§ 26101-26106; and section 302, 49 U.S.C. § 24105 (Congestion Grants).

⁹ Pub. L. No. 111-5, 123 Stat. at 208.

¹⁰ High-speed rail grantees usually are required to pay at least a 20 percent matching share, see PRIIA § 501, 49 U.S.C. § 26106(f), but the Recovery Act superseded this requirement.

¹¹ 74 Fed. Reg. 29900, 29904, 29909-10 (June 23, 2009).

matching share—it “pledge[d] to use [Proposition 1A bond proceeds] to match HSIPR funding dollar-for-dollar”¹²—and FRA selected the Authority based in part on this commitment.¹³ As discussed in Appendix I, the Authority planned to pay its matching share using proceeds from the sale of state general obligation bonds authorized by California’s Proposition 1A (Prop 1A).

FRA and the Authority signed the Recovery Act Agreement in September 2010, and since then, the parties have amended the Agreement five times.¹⁴ The Agreement now obligates \$2,552,556,231 in federal funds for preliminary engineering, environmental, and other early system work, and for design and construction of an initial Central Valley subsection of the system.¹⁵ Amendment No. 5 is the most significant for purposes of this opinion because it changed the requirements for the Authority’s matching share contributions from a concurrent proportionate match to a tapered match. Initially, as the Authority had committed in its grant application, the Agreement required the Authority to pay a minimum of about 50 percent of grant project costs and FRA to pay a maximum of about 50 percent.¹⁶ This 50/50 split has generally remained in place,¹⁷ meaning the Authority’s agreed matching share is, like FRA’s obligation, approximately \$2.5 billion. The Agreement also initially required the Authority to make its matching share payments concurrent with and proportionate to FRA’s payments; that is, each party had to pay about 50 percent of ongoing costs.¹⁸

In 2011, when the Authority had not obtained access to Prop 1A funds, it asked DOT about using federal grant funds first and postponing its matching share contributions, but DOT declined.¹⁹ In 2012, when the Authority still had not obtained access to most Prop 1A funds and

¹² Oct. 20, 2009 Letter from Governor, State of California, to Secretary, U.S. Department of Transportation, at 2.

¹³ May 25, 2011 Letter from DOT Under Secretary for Policy to Chief Executive Officer, California High-Speed Rail Authority.

¹⁴ The original Recovery Act Agreement obligated \$194 million in Recovery Act funds for certain preliminary, pre-construction work. Amendment No. 1 obligated an additional \$2.27 billion primarily for construction of the initial Central Valley subsection and extended both the federal funding and the project performance/grantee payment deadlines to September 30, 2017. Amendment No. 2 obligated an additional \$86.4 million in federal funds, bringing total maximum federal funding under the Agreement to about \$2.5 billion. Amendment Nos. 3-5 did not obligate additional funding. The Agreement and Amendment Nos. 1-5 are available on the Authority’s website at http://www.hsr.ca.gov/About/Funding_Finance/funding_agreements.html, last visited Dec. 1, 2015 (see FRA Grant/Cooperative Agreement for ARRA Funding).

¹⁵ FRA obligated an additional \$928,620,000 under the FY 2010 Agreement in November 2011, also for construction of the initial Central Valley subsection, and according to the Recovery Act Agreement, work under that agreement and the FY 2010 Agreement is “integral and interdependent.” Recovery Act Agreement, Amendment No. 5, Att. 1 at 80. For at least some purposes, FRA and the Authority have treated the federal funds available under the two grants as a single combined funding stream; see Part III.A.1. below (Authority-proposed tapered match funding scenarios) and Appendix II (summary of Recovery Act Agreement Funding Contribution Plan and updates).

¹⁶ Agreement, Amendment No. 0, Att. 1 at 2, Special Provisions, Para. 5.c.

¹⁷ There is one exception: the \$86.4 million in federal funding added by Amendment No. 2 is subject to an 80 percent FRA/20 percent Authority cost share.

¹⁸ Agreement, Amendment No. 0, Att. 2 at 12.

¹⁹ May 25, 2011 Letter from DOT Under Secretary for Policy to Chief Executive Officer, California High-Speed Rail Authority (postponing Authority’s matching share “not feasible” and would put project “in serious jeopardy”).

state court litigation had been filed against it in the *Tos* case (discussed in Appendix I) regarding Prop 1A and other matters, the Authority requested an amendment to the Agreement to add a tapered match provision. The Authority explained it had “no authority to spend any state monies aside from Prop. 1A bond proceeds” and issuance of those bonds was “unlikely to occur in a timely manner.”²⁰ The Authority therefore submitted a proposal consisting primarily of a “tapered match funding strategy,” which it explained “would . . . decoupl[e] the project schedule from the [Recovery Act funding] deadline” of September 30, 2017.”²¹

Pursuant to FRA policies and procedures as discussed below, FRA approved the Authority’s request and the parties executed Amendment No. 5 in December 2012.²² Under the tapered match provision,²³ FRA may pay its 50 percent funding up front and the Authority, with FRA’s approval, may pay its 50 percent matching share at varying times and in varying proportionate rates, potentially ranging from 0 percent (with FRA temporarily paying 100 percent of ongoing costs) to 100 percent (with FRA temporarily paying 0 percent of ongoing costs). FRA’s cumulative disbursements may not exceed its total 50 percent project share at any time and the Authority is still required to complete payment of its total 50 percent share no later than the project performance period deadline.²⁴ That deadline is currently September 30, 2017, but DOT officials told us this reflects a clerical oversight and may be extended.²⁵

To help implement the tapered match, Amendment No. 5 established a Funding Contribution Plan (FCP).²⁶ The FCP is a detailed schedule of projected monthly payment dates and amounts for FRA and the Authority through completion of the grant, and the Authority must update the FCP, and FRA must approve the update, every quarter.²⁷ DOT officials told us the

²⁰ Sept. 25, 2012 Letter from Chief Executive Officer, California High-Speed Rail Authority, to FRA Office of Passenger and Freight Programs (2012 Authority Tapered Match Request), enclosure at 4.

²¹ *Id.*, cover letter and enclosure at 1, 3, 4.

²² The Authority’s 2012 Tapered Match Request also proposed, and FRA agreed in Amendment No. 5, to change FRA’s short-term cash payment method under the Agreement from the reimbursement method to the advance payment method. FRA and the Authority’s implementation of the advance payment method is discussed in Part III.B.3. below.

²³ Agreement, Amendment No. 5, Att. 1 at 58 (tapered match for pre-construction), 93 (tapered match for construction).

²⁴ *Id.* See also FRA Office of Program Delivery, *Grants Management Manual v 7.0* (Aug. 2015) (FRA 2015 Grants Manual) at 80-81; May 24, 2014 Letter from DOT General Counsel to GAO Managing Associate General Counsel (DOT Letter) at 7, 9.

²⁵ July 3, 2014 e-mail from FRA Chief Counsel to GAO Managing Associate General Counsel, Att. at 2 (“Through a clerical oversight, the [Agreement’s] period of performance . . . remains September 2017 while the Funding Contribution Plan [FCP] assumes that the majority of construction work on the Project will be completed by 2018 . . . [and] 2019. FRA is aware of the difference between the FCP and the period of performance and is currently in discussions with the Authority to resolve the issue.”). See also Oct. 21, 2015 e-mail from FRA Attorney-Adviser to GAO Managing Associate General Counsel, Att. at 1; July 29, 2014 e-mail from FRA Assistant Chief Counsel to GAO Managing Associate General Counsel.

²⁶ Agreement, Amendment No. 5, adding Exhibit 3.

²⁷ Agreement, Amendment No. 5, Att. 1 at 58, 93.

FCP was created to provide an additional mechanism for monitoring progress and expenditures on this highly complex project, beyond FRA's standard suite of grant management tools such as requiring quarterly financial and progress reports and potentially conducting desk and on-site monitoring (tools FRA also uses for this grant, as discussed in Part III.C. below). According to DOT, the FCP is intended to be a dynamic and flexible document and to serve as a planning tool, rather than to create binding commitments, and thus the FCP's payment dates are forecasts rather than "deadlines" or requirements "set in stone."²⁸ Nevertheless, the Agreement requires both FRA's and the Authority's payments to be "consistent with" the FCP.²⁹ It also requires the Authority to certify with each payment request that it has completed all actions necessary to provide its matching contribution "as required by the terms of this Agreement and the [FCP]"³⁰ and, as discussed below, authorizes FRA to take action against the Authority if it fails to "adhere to" the FCP or to "secure and deliver its required match funding contribution pursuant to" the FCP.³¹ To date, there have been 10 FRA-approved versions of the FCP—the initial December 2012 FCP in Amendment No. 5 and 9 quarterly updates, the most recent being for the quarter ending March 31, 2015.³²

Finally, FRA added a number of risk mitigation measures in Amendment No. 5 in relation to the tapered match, in order to protect the government's interests.³³

III. DISCUSSION

A. Whether the Authority Has Failed to Pay its Matching Share in Violation of the Agreement and What Remedies FRA Has in the Event of Non-Compliance

In determining whether the Authority has paid its matching share contributions to date consistent with the Agreement payment dates, we first examine whether FRA had authority to include a tapered match in the Agreement, because FRA has used the tapered match to revise the interim payment dates. We then address whether the Authority has complied with the

²⁸ DOT letter at 3-5.

²⁹ Agreement, Amendment No. 5, Att. 1 at 58, 93.

³⁰ *Id.* at 4.

³¹ *Id.* at 37-38.

³² Appendix II to this opinion summarizes changes in projected payment periods and funding sources that FRA and the Authority have made through the FCP and its quarterly updates. The initial FCP and 6 of the 9 FRA-approved FCP quarterly updates to date are available at the Authority's website at http://www.hsr.ca.gov/About/Funding_Finance/funding_agreements.html, last visited Dec. 1, 2015 (see FRA Grant/Cooperative Agreement for ARRA Funding; Funding Contribution Plan).

³³ These risk mitigation measures include: (a) requiring the Authority to seek an alternative funding source if it cannot obtain Prop 1A funds; (b) requiring additional monitoring of the grant project's progress through the FCP quarterly updates; (c) requiring certification with each Authority payment request that there has been "no material adverse change in pending litigation" (such as the *Tos* litigation discussed in Appendix I) or other "change . . . that might prevent [the Authority] from securing and delivering its required matching fund contribution . . . consistent with the [FCP]"; (d) requiring immediate notification by the Authority of any decision pertaining to its conduct of litigation that may affect FRA's interests in the grant project; (e) providing explicit FRA remedies in the event of Authority non-compliance, as discussed in Part III.A.2. below; and (f) providing FRA the right, at its sole discretion, to require the Authority to revert back to concurrent, proportionate matching share payments rather than tapered match payments. Agreement, Amendment No. 5, Att. 1 at 3-4, 21, 58, 93.

revised dates and what remedies are available to the federal government in the event of the Authority's non-compliance.

1. FRA's Authority to Include the Tapered Match

It is common agency practice, as FRA acknowledges, for grantees paying a matching share to do so concurrent with the agency's disbursements and at a fixed proportionate rate.³⁴ This was the initial arrangement in the Recovery Act Agreement, as discussed above. Neither the Passenger Rail Investment and Improvement Act (PRIIA) nor the Recovery Act, under which the Agreement was awarded, requires this arrangement, however,³⁵ and DOT officials told us FRA relied on its general HSIPR program authority under PRIIA—section 301, 49 U.S.C. § 24402(a)(2), regarding intercity passenger rail service grants, for example—to add the tapered match.³⁶ That provision authorizes a grant to “be subject to the terms, conditions, requirements, and provisions the Secretary [of Transportation] decides are necessary or appropriate.” We agree this language provides FRA with general authority to approve a tapered match grant term under appropriate facts and circumstances, in the reasonable exercise of its discretion. The courts have found that similar language provides agencies with broad discretion to include grant conditions that fulfill the general congressional purposes of the statutory grant program.³⁷

We also agree it was within FRA's discretion to add a tapered match under the facts and circumstances of the Recovery Act Agreement in 2012. Under the Administrative Procedure Act (APA), agency actions, findings, and conclusions may not be “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . . .” 5 U.S.C. § 706(2)(A). This standard “is a highly deferential one. It presumes agency action to be valid. . . . [It] requires affirmance [by a court] if a rational basis exists for the agency's decision. . . . [Courts have a] narrowly defined duty of holding agencies to certain minimal standards of rationality.”³⁸ In deciding whether an agency has abused its discretion, courts look to “whether the decision was based on the

³⁴ See, e.g., FRA 2015 Grants Manual at 80.

³⁵ Cf. 23 U.S.C. § 121(a) (1997), *repealed by* Transportation Equity Act for the 21st Century, Pub. L. No. 105-178, § 1302, 112 Stat. 107, 226-27 (1998).

³⁶ July 3, 2014 e-mail from FRA Chief Counsel to GAO Managing Associate General Counsel, Att. at 1-2.

³⁷ See, e.g., *Pullman Inc. v. Volpe*, 337 F. Supp. 432, 438 (E.D. Pa. 1971) (upholding, as within DOT's discretion, grant condition requiring local applicant to use competitive bidding for subcontracts, under statute authorizing “such terms and conditions as [the Secretary] may prescribe”); *Illinois Environmental Protection Agency v. United States Environmental Protection Agency*, 947 F.2d 283, 291 (7th Cir.1991) (EPA's authority to make grants “upon such terms and conditions . . . necessary to carry out the purpose” of Clean Air Act provision should be read broadly); *Mass. Dep't of Correction v. Law Enforcement Assistance Administration*, 605 F.2d 21, 22, 27 (1st Cir.1979) (authority to make grants “according to the criteria and on the terms and conditions the Administration determines consistent with this chapter” provided “large discretion”).

³⁸ *Ethyl Corp. v. Environmental Protection Agency*, 541 F.2d 1, 34, 36 (D.C. Cir.), *cert. denied*, 426 U.S. 941 (1976) (citations and footnotes omitted) (upholding EPA finding of risk of harm from lead emissions). See also *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402 (1971) (remanding for further review DOT decision to provide grant funding for construction of expressway through city park); *Philadelphia Council of Neighborhoods v. Coleman*, 437 F. Supp. 1341 (E.D. Pa. 1977), *aff'd mem.*, 578 F.2d 1375 (3d Cir. 1978) (upholding DOT determination that city grantee was capable of paying matching share to fund tunnel construction because general obligation bond funding was reinforced by city's borrowing capacity and “unrestricted taxing power in a number of areas”).

relevant factors and whether there has been a clear error of judgment.”³⁹ Courts are “not empowered to substitute [their] judgment for that of the agency.”⁴⁰

In this case, as noted, DOT initially declined to postpone the Authority’s contributions, and DOT grants guidance had cautioned against approving a tapered match at least where the agency would pay its full share before the grantee “chipped in” its share.⁴¹ However, even when agency grants guidance discourages tapered matches, the agency can make an exception in the reasonable exercise of its discretion, paying some or all of its funding before the grantee pays some or all of its matching share. As we explained in 60 Comp. Gen. 208 (1981), regarding a grant by the Urban Mass Transportation Administration, this is permissible in part because the primary purpose of a grant is to provide assistance to the grantee to help further a public interest, not to purchase goods or services for the government.

We conclude FRA acted within its discretion in adding the tapered match. While the available documentation of FRA’s deliberations in 2012 is sparse,⁴² applying the APA and case law, we find FRA based its decision on relevant factors and there was a discernable rational basis for its decision.⁴³ First, the fact that the Recovery Act did not require any matching share from grantees underscores FRA’s discretion in determining how to secure the Authority’s matching share. Second, DOT officials told us that in evaluating the Authority’s September 2012 tapered match request, FRA followed its grant amendment policies and procedures⁴⁴ and newly developed FRA guidance modeled on guidance that had been in place for several years issued by DOT’s Federal Highway Administration.⁴⁵ The FRA guidance—*RPD-10 Tapered Match Request and Approval Procedure, Version 1* (Sept. 12, 2012) (FRA 2012 Tapered Match

³⁹ *Overton Park*, 401 U.S. at 416 (citations omitted). In evaluating whether agencies have abused their discretion in a particular case, courts must conduct a “searching and careful” and “thorough, probing, in-depth review” of the specific facts. *Id.*, 401 U.S. at 415, 416. See also *Ethyl Corp.*, 541 F. 2d at 34 (courts should not “rubber-stamp” agency decisions).

⁴⁰ *Overton Park*, 401 U.S. at 416. Courts sometimes must “affirm decisions with which [they] disagree . . .” *Ethyl Corp.*, 541 F. 2d at 3. See also *Philadelphia Council of Neighborhoods*, 437 F. Supp. at 1346 (“Whether [DOT’s] determination to build the Tunnel was a wise decision, or even a desirable one, is not for the Court to decide.”); *The Ark Initiative v. Tidwell*, 64 F.Supp. 3d 81, 86 (D.D.C. 2014) (agency decision not an abuse of discretion under APA although may reflect poor policy judgment).

⁴¹ The Federal Assistance Guidance Manual (2009), issued by DOT’s Office of the Senior Procurement Executive, directed that “[t]he recipient’s cost sharing should also be monitored to ensure that . . . cost sharing is appropriately distributed across project donors (that is, that the recipient isn’t spending all the Federal dollars before chipping in its ‘share’).” *Id.*, Chapter 9.b.2.

⁴² As the DOT OIG recently found in reviewing Amendment No. 5 and other FRA HSIPR grant amendments, “the files for all five grants we reviewed lacked documentation of significant decisions in the amendment process.” DOT OIG 2015 Report, *supra* note 5, at 6.

⁴³ As the Supreme Court has found, courts must “uphold a[n agency] decision of less than ideal clarity if the agency’s path may reasonably be discerned.” *Bowman Transp., Inc. v. Arkansas-Best Freight Sys., Inc.*, 419 U.S. 281, 286 (1974).

⁴⁴ See FRA Office of Railroad Policy and Development, *Grant Management Manual* (September 2012), Sec. 6.5 Grant Amendments (requiring grant manager to “validate the need” for grantee-requested amendments and “ensure the grantee is compliant will all other . . . requirements”).

⁴⁵ DOT Letter at 5.

Guidance or Guidance)—specified factors and procedures to be followed by grantees and by FRA in requesting and approving a tapered match.

We find that FRA examined the information provided by the Authority and considered relevant factors specified in its 2012 Tapered Match Guidance, and that there was a discernable rational basis for its decision to approve the tapered match. FRA therefore acted within its discretion under the APA and case law. The Authority's request included most of the information called for by the Guidance,⁴⁶ although the request did not, as the Guidance specified, include a risk mitigation plan. We also were unable to discern in the Authority's request a clear schedule for when its match would be paid under the Recovery Act Agreement, as the Guidance also specified: because the Authority's proposed funding scenarios were shown as a combined payment stream under both the Recovery Act and FY 2010 Agreements, it is not possible to identify when the Authority proposed to make its interim and final contributions toward its Recovery Act Agreement matching share.

Further, we find that FRA approved the Authority's request based on factors specified in the Guidance.⁴⁷ According to DOT officials, FRA determined a tapered match was "an accepted method that provides the Authority with flexibility in project delivery and can help reduce overall project costs. . . . [It also] does not diminish the Authority's obligation to provide its non-federal contribution."⁴⁸ FRA also added a number of measures to the Agreement to protect the government's interests in relation to the tapered match, as noted above. The Guidance required FRA to consider whether the grantee's "financial standing . . . indicates approval will be appropriate," but it is unclear how FRA assessed the Authority's financial standing in considering whether to approve its tapered match request.⁴⁹ Nevertheless, based on FRA's consideration of relevant factors and a discernable rational basis for its decision and in light of the high degree of deference and presumption of validity to be given to FRA's actions under the APA, we find FRA's addition of a tapered match in Amendment No. 5 was within its authority and discretion.

2. The Authority's Compliance with Payment Dates under the Tapered Match and FRA's Remedies in the Event of Non-Compliance

As noted, DOT officials told us the Authority's monthly payment dates in the FCP are not binding commitments; however, the Agreement requires the Authority's monthly contributions to be consistent with the FCP and authorizes FRA to take action against the Authority if it fails to

⁴⁶ Under the 2012 Tapered Match Guidance, grantees had to submit: (a) a justification why the arrangement is needed and should be approved, including the grantee's current financial status; (b) a "clear schedule" for when the match will be paid; (c) identification of the source of matching funds; and (d) a risk mitigation plan "to ensure that the project will be completed in a timely manner" and "assurances that the grantee will meet its match commitment and make provision for reconciliation and cost recovery, if necessary." *Id.* at 3.

⁴⁷ Under the 2012 Tapered Match Guidance, FRA was to consider whether: (a) use of a tapered match will result in earlier project completion; (b) project costs will be reduced; (c) use will allow additional non-federal funds to be leveraged for the project; (d) the financial standing of the grantee indicates approval will be appropriate; or (e) "any other factors deemed relevant." *Id.* at 2-3.

⁴⁸ DOT Letter at 3. See also Oct. 26, 2015 e-mail from FRA Attorney-Adviser to GAO Managing Associate General Counsel.

⁴⁹ Appendix I provides information about the Authority's financial challenges in paying its matching share under the Agreement, at the time FRA approved the tapered match in 2012 and currently.

adhere to the FCP. In our view, these terms clearly give legal significance to the FCP payment dates and amounts. The tapered match authorizes FRA and the Authority to change the FCP payment dates and amounts, however, and they have done so on multiple occasions.⁵⁰ The Authority has made its matching share contributions consistent with these revised dates and amounts, and thus is not in violation of the Agreement. As discussed in Appendix I, the Authority's matching share payments as of July 31, 2015, total about \$337 million, and FRA's disbursements as of that date are about \$647.032 million with an additional \$119 million in invoices under review for the period, for a total, if pending invoices are approved, of \$766.032 million. This represents a cumulative proportionate share of about 70 percent FRA/30 percent Authority, virtually identical to the 72 percent/28 percent proportionate share reflected in the most recent FCP.⁵¹

The Agreement's September 30, 2017, deadline remains for payment of the Authority's full matching share, but FRA has indicated this deadline reflects a clerical oversight, as mentioned above, and each of the 10 FCPs to date shows the Authority making payments for months or years beyond this date (see Appendix II). Whether the deadline remains as is or is extended, the Authority's failure to pay its full roughly \$2.5 billion matching share by the deadline would, as DOT acknowledges,⁵² constitute a violation of the Agreement by the Authority.⁵³ If that occurs, or if the Authority's interim monthly contributions are not consistent with the FCP, FRA would have the following specific remedies added by Amendment No. 5, in addition to FRA's general remedies to address grantee non-compliance.⁵⁴

⁵⁰ See Appendix II. Before the tapered match, the FCPs showed the Authority projected to make monthly contributions for two years using Prop 1A proceeds for non-construction and FRA projected to make disbursements in the same amounts, for a 50/50 share. See, e.g., FCP 2, 10. After the tapered match, the FCPs showed the Authority projected to make no payments for 2 years and FRA projected to make all payments, for a 100 percent FRA/0 percent Authority share. *Id.* The FCPs then showed the Authority resuming its contributions by April 1, 2014 (see FCP 1, using Prop 1A funds), then by May 2014 (see FCP 2-3, using Prop 1A funds), then back to April 2014 (see FCP 4, using Prop 1A funds), then July 2014 (see FCP 5-10, using Prop 1A and/or Cap-and-Trade funds). The amounts to be paid by FRA and the Authority after this restart date have changed in some cases; the most recent FCP, for example, shows FRA making no payments from July 2014 to March 2015 (see FCP 10), and DOT officials confirmed that FRA in fact paid only a small amount of expenses for that period.

⁵¹ The most recent FCP shows total projected FRA payments through July 2015 of \$1.004 billion and total projected Authority payments through that date of \$392.6 million, which would be a 72 percent/28 percent share. See FCP 10. We did not conduct an independent audit of the Authority's monthly contributions for this legal opinion but rather relied on information and documentation provided by DOT and Authority officials.

⁵² DOT Letter at 9.

⁵³ See, e.g., *Mayor and City Council of Baltimore v. Browner*, 866 F. Supp. 249 n. 10 (D. Md. 1994) ("The project completion date is a material term of the contract. Failure to timely complete is potentially a material breach, and a two-year delay is certainly so. The grantor would thus be allowed to choose restitution as a remedy, including reimbursement of funds already given to the grantee."). See *generally* B-130515, July 20, 1973 (once grant agreement requiring non-federal contribution is accepted, grantee is committed to providing its share if it wishes to continue with grant).

⁵⁴ FRA's general remedies for Authority non-compliance under the Recovery Act Agreement include temporary withholding of payments pending correction of the deficiency; disallowance of the costs of non-compliant action; partial or total suspension or termination of the grant; and withholding of further grants. See 49 C.F.R. § 18.43(a) (2014) (removed). (DOT agency grants awarded to state and local governments prior to December 26, 2014, such as the Recovery Act Agreement, remain governed by DOT's "common grants rule" previously codified at 49 C.F.R. Part 18. Grants awarded after that date are governed by 2 C.F.R. Part 200.)

- *Suspension or termination of grant funding:* FRA may notify the Authority that it intends to suspend or terminate its grant funding if the Authority has violated the Agreement or if FRA determines the purposes of the Recovery Act or the PRIIA HSIPR program would not be adequately served by continuation of funding. Any failure to make reasonable progress on the project, an FRA determination that the Authority may be unable to meet its 50 percent share and complete the project, or any other violation of the Agreement that significantly endangers substantial performance of the project provides explicit grounds for termination. If FRA suspends funding, it may amend the Agreement's scope of work to ensure responsible use of future federal funds in response to changed circumstances.⁵⁵
- *Repayment of FRA funds:* If FRA determines the Authority has misused federal grant funds by, among other things, failing to make adequate progress on the project or otherwise failing to adhere to the terms of the Agreement, FRA may require the Authority to repay up to the entire amount of FRA funds paid under the Agreement. FRA also may seek repayment if the Authority fails to complete the project or one of its tasks under the Agreement, or if it fails to adhere to the FCP, or if FRA determines the Authority will be unable to meet its 50 percent share and complete the project on schedule. FRA can seek repayment either from the Authority or from the State of California because FRA's repayment claim will constitute the collection of a claim of the U.S. Government under 31 U.S.C. Chapter 37,⁵⁶ the basic statutory framework for collection of U.S. Government claims. Under this statute, FRA can recover its disbursements via an administrative offset against any funds payable by the U.S. Government to, or held by the U.S. Government for, the State of California.
- *Suspension or debarment, consideration for future DOT funding:* If the Authority fails to, among other things, secure and deliver its matching share contributions pursuant to the FCP or fails to adhere to the Agreement terms, FRA may suspend or debar the Authority from further participation in DOT surface transportation program assistance and may consider the Authority's failures in awarding future funding under any DOT programs. In considering these remedies, FRA may allow the Authority to explain its failures and propose a solution and timeline to resolve the failures, which FRA may accept, reject, or modify.⁵⁷

Federal agencies have successfully used these types of remedies when faced with grantee non-payment of their matching share.⁵⁸ While both the Agreement and DOT's grant rules authorize FRA to use these remedies, FRA is not required to use these remedies. FRA generally would have discretion in deciding whether, when, and how to use these or other remedies, subject to the limitation discussed above that its response could not be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law as the courts have applied that APA standard. If FRA declares that it has a claim against the Authority for repayment of its disbursed grant funds under 31 U.S.C. Chapter 37, as referenced in the Agreement's remedies described above, FRA "shall try to collect a claim of the United States Government for money or property

⁵⁵ Agreement, Amendment No. 5, Att. 1 at 37-38.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ In *Cal. State Univ. Fullerton Foundation v. National Science Foundation*, 26 F. App'x 263, 2002 WL 80613 (4th Cir. 2002), for example, the U.S. Fourth Circuit Court of Appeals held that the National Science Foundation could terminate the grant and recover grant funds disbursed to a grantee that failed to pay its approximate 50 percent matching share and thus violated the grant agreement.

arising out of the activities of . . . the agency,” as DOT officials acknowledge.⁵⁹ See 31 U.S.C. § 3711(a) (emphasis added). Likewise, Treasury’s implementing regulations require that “Federal agencies *shall aggressively collect* all debts arising out of activities of . . . that agency.” 31 C.F.R. § 901.1(a) (emphasis added). A U.S. Government claim under the statute expressly includes unpaid matching share payments by non-federal partners,⁶⁰ such as the Authority. While FRA would have discretion in how it carried out this debt collection process if it asserts a claim against the Authority, it would have to exercise this discretion within the context of specific statutory and regulatory responsibilities. It is uncertain whether the federal debt collection process has been used to recover funds of the magnitude potentially at issue under the Recovery Act Agreement.

B. Whether FRA’s Disbursement of Funds under the Tapered Match Provision Violates the Antideficiency Act or Other Key Financial Management Laws

As GAO has reported, the federal government’s use of grants to achieve a variety of public purposes has been increasing, and in fiscal year 2013, the federal government obligated over \$555 billion for grants for a wide array of activities.⁶¹ Agencies must administer their grants in accordance with applicable laws and regulations,⁶² and you asked whether FRA’s ongoing disbursement of funds under the Recovery Act Agreement, without the Authority concurrently paying its 50 percent matching share pursuant to the tapered match provision, specifically violates the Antideficiency Act or other key federal financial management laws. Based on the information DOT officials provided us on the Department’s and FRA’s implementation of these requirements, we conclude FRA’s payments do not violate these laws.⁶³

1. Antideficiency Act

The Antideficiency Act prohibits federal officers and employees from, among other things, making or authorizing expenditures or obligations in advance or in excess of the amount

⁵⁹ See July 3, 2014 e-mail from FRA Chief Counsel to GAO Managing Associate General Counsel, Att. at 2 (“Situations where repayment of grant funds is required are discussed in the Principles of Federal Appropriations Law, Vol. II, Ch. 10, Sec. H.”; the situations discussed in this cited GAO treatise are collection of claims of the U.S. Government against grantees using 31 U.S.C. Chapter 37, as described in the text).

⁶⁰ A claim of the U.S. Government is “any amount of funds or property that has been determined by an appropriate official of the Federal Government to be owed to the United States by a person, organization, or entity other than another Federal agency,” including “*the unpaid share of any non-Federal partner in a program involving a Federal payment and a matching, or cost-sharing, payment by the non-Federal partner . . .*” 31 U.S.C. § 3701(b)(1) (emphasis added). For a general discussion of the duty of federal agencies to recover claims of the U.S. Government against a grantee, see GAO, *Principles of Federal Appropriations Law*, Vol. II, 3rd ed. Ch. 10, § H.1., GAO-06-382SP (Washington, D.C.: Feb. 2006).

⁶¹ GAO, *Federal Grants: Agencies Performed Internal Control Assessments Consistent with Guidance and Are Addressing Internal Control Deficiencies*, GAO-14-539 (Washington, D.C.: July 30, 2014).

⁶² As GAO has explained, such controls are fundamental to assuring the proper and effective use of federal funds to achieve program goals and ensure funds are used for their intended purposes. GAO, *Federal Grants: Improvements Needed in Oversight and Accountability Processes*, GAO-11-773T (Washington, D.C.: June 23, 2011).

⁶³ We did not audit or otherwise perform an independent evaluation of the factual information and statements that DOT provided, nor did we analyze the efficiency or effectiveness of FRA’s processes, procedures, policies, or decision-making regarding whether and when to make disbursements of Recovery Act-appropriated funds to the Authority pursuant to the Recovery Act Agreement.

available in an appropriation.⁶⁴ 31 U.S.C. § 1341. Simply put, FRA is prohibited from making payments, or committing to make payments at some future time, unless there is enough money available to cover the costs in full.

The federal government generally operates on an obligational basis, meaning it first takes an action obligating it to pay, such as entering into a grant agreement or a contract, and then it disburses the funds, usually at some later time. See, e.g., B-325526, July 16, 2014; B-300480, Apr. 9, 2003; B-289801, Dec. 30, 2002. Thus an agency must have budget authority available to cover the costs in full both at the time it incurs the obligation and when it disburses the funds. In the grant context, the time of obligation is when the agency signs the agreement committing federal funds, see B-300480, B-289801, and thus to evaluate FRA's compliance with the Antideficiency Act, we look to when it obligated and disbursed funds under the Recovery Act Agreement. The timing of the Authority's matching share contributions in relation to the timing of FRA's payments is not a factor under the Antideficiency Act,

As noted above, FRA incurred obligations under the Agreement against available Recovery Act appropriations when it initially executed the Agreement in September 2010 and when it added funding in December 2010 (Amendment No. 1) and August 2011 (Amendment No. 2). Because there were amounts available from the Recovery Act appropriation for capital high-speed rail and intercity passenger rail projects at the time FRA incurred these obligations, and we are unaware of information indicating these funds are no longer available as FRA is disbursing these funds under the Agreement, FRA's disbursements—regardless of when the Authority makes its payments—do not violate the Antideficiency Act.

2. Federal Managers' Financial Integrity Act

The Federal Managers' Financial Integrity Act (FMFIA)⁶⁵ was enacted to help improve the management of federal government programs and strengthen agencies' internal control systems, by requiring ongoing evaluations and reports on the adequacy of executive agencies' internal control systems. FMFIA requires agencies to establish internal control systems consistent with GAO's "Green Book" standards,⁶⁶ to provide reasonable assurance of their proper use of funds and resources, compliance with applicable laws and regulations, and preparation of reliable financial reports.

There is nothing in the Agreement's tapered match provision that is a *per se* violation of FMFIA. Rather, FMFIA requires DOT to have internal controls in place to provide reasonable assurance of the proper use of, in this case, grant funds. In particular, the DOT Secretary is required to assess and report on DOT's internal controls each year pursuant to Office of Management and Budget guidance,⁶⁷ including a separate assessment and documentation of internal control over

⁶⁴ An expenditure is the actual spending or outlay of money. An obligation is a definite commitment that creates a legal liability of the U.S. government for payment of goods and services ordered or received, or a legal duty on the part of the U.S. government that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States. GAO, *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP (Washington, D.C.: Sept. 2005), at 48, 70.

⁶⁵ The key provisions of FMFIA are at 31 U.S.C. §§ 3512(c), (d).

⁶⁶ Effective October 1, 2015, GAO's internal standards are contained in *Standards for Internal Control in the Federal Government*, GAO-14-704G (Sept. 2014). GAO's standards applicable prior to that date are contained in *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Nov. 1999).

⁶⁷ OMB Circular No. A-123, *Management's Responsibility for Internal Control* (Dec. 21, 2004).

financial reporting. DOT fulfills these requirements in the Secretary's annual FMFIA assurance letter included in its annual Agency Financial Report. The Secretary's letters for the two most recent fiscal years (2013 and 2014) report DOT's reasonable assurance that its internal controls and financial management systems met FMFIA objectives except for matters unrelated to FRA grants management.⁶⁸ DOT officials told us FRA also completes and submits its own annual assurance statement to DOT, evaluating its internal control processes consistent with OMB's guidance. FRA's evaluation includes a review of controls for FRA's HSIPR grants program and for HSIPR grants including the Recovery Act Agreement. DOT told us that for the two most recent fiscal years, FRA reported no internal control material weaknesses or financial systems material non-conformances. Based on this information, we have no evidence to conclude that FRA's disbursement of grant funds to the Authority under the tapered match violates FMFIA requirements.

3. Cash Management Improvement Act

When FRA added the tapered match amendment to the Agreement in Amendment No. 5, it also agreed to the Authority's request to change the sequence of FRA's short-term funding from the reimbursement method to the advance payment method, both authorized under DOT's general grant rules, in order to improve the Authority's cash flow.⁶⁹ These DOT rules implement the Cash Management Improvement Act (CMIA),⁷⁰ which requires agencies to minimize the time elapsing between their transfer of grant funds to grantees and grantees' payment of the funds to third parties, as well as Treasury's rules requiring agencies' advance payment method transfers to occur no more than 3 business days before the grantee disburses the funds to third parties.⁷¹ DOT officials told us the Authority has followed all CMIA requirements and regulations since the advance payment method was added to the Agreement by Amendment No. 5, including establishing and implementing appropriate procedures to minimize the time the Authority holds FRA funds. DOT also told us FRA monitors the Authority's compliance with these procedures through a regular and detailed verification process. Based on this information, we have no evidence to conclude that FRA's disbursement of its grant funding to the Authority under the tapered match violates CMIA requirements.

C. Whether FRA Has Responsibilities to Re-evaluate the Agreement Based on Risk to the Federal Government

The Recovery Act Agreement reflects risk to the federal government. The Authority has committed to paying 50 percent of the grant project costs, but as discussed in Appendix I, the Authority is facing financial and legal challenges in obtaining funding for this matching share.

⁶⁸ DOT, *Agency Financial Report, Fiscal Year 2013*, at 23-25; DOT, *Agency Financial Report, Fiscal Year 2014*, at 24-27.

⁶⁹ See note 22, *supra*. Under the reimbursement method, a grantee pays third parties all approved costs, after which the agency reimburses the grantee for the agency's proportionate share upon receipt and approval of proper invoices. Under the advance payment method, the agency disburses funds to the grantee after it approves proper invoices submitted by the grantee, but before the grantee has paid third parties. 49 C.F.R. §§18.21(c), (d) (2014).

⁷⁰ 31 U.S.C. § 6503(a).

⁷¹ 31 C.F.R. § 205.12(b).

These challenges include meeting remaining statutory conditions under Prop 1A, succeeding in the ongoing *Tos* litigation, and obtaining funding for other portions of Phase 1 construction, which in turn may affect funding availability for the Central Valley subsection being built under the Agreement. Tapered match funding under the Agreement increases risk to the federal government because it allows federal funds to be spent first, without securing the Authority's matching funds. If the Authority does not obtain these funds, there is a risk the federal government may pay for a partially built Central Valley subsection under the Recovery Act Agreement without the state funds needed to complete it. In that event, FRA may need to use federal debt collection laws to seek recovery of the grant funds it has paid to the Authority.

As FRA administers the Agreement, it has continuing responsibilities to try to mitigate such risks and to protect federal taxpayer dollars. As discussed below, under federal internal control requirements, DOT grant regulations, and FRA grant management policies and procedures, FRA must continually monitor and assess risks and seek to ensure that the government's money is not wasted and that projects achieve their intended results. FRA has substantial discretion in carrying out these fundamental grant management responsibilities, including managing the Authority's contributions under the tapered match provision, subject to the APA "abuse of discretion" standard discussed above.

First, as noted above, FRA has responsibilities under the Federal Managers' Financial Integrity Act—to use its funds and resources properly, comply with applicable laws and regulations, and prepare reliable financial reports—and under the Cash Management and Improvement Act—to minimize the time the Authority holds federal grant funds before paying them to third parties.

Second, FRA has risk management responsibilities under DOT grant regulations.⁷² Under 49 C.F.R. § 18.12 (2014) applicable to the Agreement, if FRA determines the Authority is a "high risk" grantee, it must add special terms to the grant to mitigate the risk. High-risk grantees include those who are financially unstable, have an unsatisfactory performance history, have a deficient management system, have not complied with previous grant terms, or are otherwise not responsible. While DOT officials told us FRA has not designated the Authority as a high-risk grantee because it is unaware of information warranting such designation under these standards,⁷³ FRA has, as noted, added a number of risk mitigation measures to the Agreement to address the risks it believes may flow from the tapered match.

Third, FRA has risk management responsibilities under its grants management manual, which is intended to integrate current grants management practices with existing regulatory requirements and best practices.⁷⁴ The FRA 2015 Grants Manual provides that the agency will conduct "routine monitoring" of all grantees' performance as well as, for select grants, more in-depth "scheduled monitoring."⁷⁵ In general, FRA monitoring is designed to verify the Authority's compliance with federal and FRA requirements; identify and address any instances of fraud waste, or abuse; and verify that FRA is administering programs as required. FRA routine

⁷² DOT grant regulations also impose responsibilities on the Authority—for managing day-to-day grant activities and for monitoring these activities to assure that it is complying with federal requirements and that performance goals are being achieved. 49 C.F.R. § 18.40(a) (2014).

⁷³ DOT Letter at 7-8.

⁷⁴ FRA 2015 Grants Manual, *supra* note 24, at 8.

⁷⁵ *Id.*, Chapter 7, Grant Monitoring and Oversight.

monitoring includes review of the grantee's quarterly financial reports (SF-425s) and quarterly progress reports, monthly portfolio reviews, and other reviews deemed necessary for the particular grant and grantee. The Grants Manual specifies particular steps and corrective actions to be taken.⁷⁶ DOT officials confirmed that FRA conducts such routine monitoring of the Authority's performance under the Recovery Act Agreement, using a Grant Manager, a Project Manager, and a matrixed team of experts. DOT also told us FRA and/or its contractors have daily interaction with the Authority, routinely attend project meetings to monitor the Authority's delivery of the project, and meet quarterly with Authority leadership.⁷⁷ FRA has added Sacramento-based Monitoring and Technical Assistance Contractors to assist with project oversight, which the agency believes will provide "another tool . . . to help proactively identify and mitigate risks, foster good solutions to challenges/issues, and ensure projects move successfully into revenue operations."⁷⁸

FRA's scheduled monitoring then consists of more comprehensive desk monitoring and/or on-site monitoring. Each year, the agency uses a numerical grant-risk monitoring risk model and its judgment to determine which grants are deemed the highest priority to receive this additional monitoring.⁷⁹ The Recovery Act Agreement has received the highest risk score under Fiscal Year 2015's 9-factor model and thus is Priority Rank # 1 of FRA's grants to receive this more comprehensive monitoring.⁸⁰ DOT officials explained it is also FRA's practice to conduct such monitoring on all major HSIPR-corridor projects, such as the Recovery Act Agreement project, regardless of their monitoring model score.⁸¹ If FRA's scheduled monitoring of the Agreement results in a significant finding—issues that jeopardize project completion or grant compliance—or an area of interest—issues that could lead to a future significant finding—specific FRA officials must conduct specific follow-up, including requiring a corrective action plan by the Authority to address any significant findings and documenting that corrective action has been taken.⁸²

IV. CONCLUSION

We conclude the Authority has made its matching share contributions to date consistent with the Agreement's Funding Contribution Plan interim payment dates and amounts, which have been revised as permitted under the tapered match. In the event the Authority fails to make its payments consistent with the FCP, or fails to pay its full matching share by the Agreement's final payment deadline, this would be a violation of the Agreement and FRA would have rights

⁷⁶ *Id.*, Chapter 7.8.

⁷⁷ DOT Letter at 8. FRA previously had a full-time Senior Project Manager stationed in Sacramento to help oversee work under the Agreement; this person has left the position and FRA is in the process of replacing him.

⁷⁸ Sept. 12, 2014 e-mail from FRA Assistant Chief Counsel to GAO Managing Associate General Counsel, Att. at 2.

⁷⁹ FRA 2015 Grants Manual, Chapter 7.1. FRA's Grants Manual now requires a 5-factor risk assessment as part of its consideration of requests for a tapered match grant amendment, because a tapered match is deemed to be a "significant modification" potentially affecting a grant's project scope, delivery, expected benefits, budget, or terms and conditions. *Id.* at 80-91.

⁸⁰ "FRA Grant Management and Risk Reduction," FRA Rail Program Delivery Conference, Oct. 13-15, 2015, at 21; Nov. 19, 2015, e-mail from FRA Attorney-Adviser to GAO Managing Associate General Counsel.

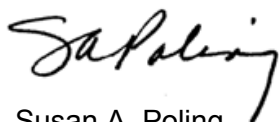
⁸¹ Nov. 19, 2015, e-mail from FRA Attorney-Adviser to GAO Managing Associate General Counsel.

⁸² FRA 2015 Grants Manual, Chapters 7.6, 7.7

and responsibilities under the Agreement, DOT grant rules, and federal debt collection laws to take a number of actions to protect the government's interests. We further conclude FRA's ongoing disbursement of federal funds in advance of the Authority's payment of its matching share, pursuant to the tapered match, does not violate the Antideficiency Act or other key federal financial management laws. Finally, we conclude FRA has a number of responsibilities under federal laws, regulations, and its grant management policies and procedures to monitor, assess, and mitigate risks under the Recovery Act Agreement, including the risk that the Authority may not pay its full matching share.

If there are questions concerning these matters, please contact Susan D. Sawtelle, Managing Associate General Counsel, at (202) 512-6417 or SawtelleS@gao.gov. Managing Associate General Counsel Edda Emmanuelli Perez, Assistant General Counsels Hannah Laufe, Julia Matta, and Gregory Marchand, Senior Attorneys Crystal Wesco and Lauren S. Fassler, Staff Attorney Shari Brewster, Assistant Director Paul Aussendorf, and Senior Analyst Richard A. Jorgenson also made key contributions to this opinion.

Sincerely,

A handwritten signature in black ink, appearing to read "S. Poling", written in a cursive style.

Susan A. Poling
General Counsel

Enclosures

APPENDIX I: California High-Speed Rail System: California Funding and Funding-Related Requirements, and the Ongoing *Tos* State Court Litigation

California's funding of its planned high-speed rail system essentially began in November 2008, when its voters approved Proposition 1A (Prop 1A), conditionally authorizing the issuance and sale of \$9.95 billion in state general obligation bonds primarily for initial work on the system. CAL. STS. & HIGH. CODE §§ 2704 *et seq.*, codifying the Safe, Reliable, High-Speed Passenger Train Bond Act for the 21st Century. Prop 1A limits the use of bond proceeds to 50 percent of construction costs for each "usable segment" of the rail line, requiring the California High-Speed Rail Authority to obtain the remaining funds from other sources. Prop 1A also does not permit construction of a usable segment to begin until those matching funds have been secured. In particular, for each usable segment, the Authority must meet two sets of conditions. First, it must submit a preliminary funding plan to the California Legislature identifying, among other things, the sources and anticipated timing of all "expected" funding and confirming that all pre-construction environmental clearances have been obtained. CAL. STS. & HIGH. CODE § 2704.08(c). Second, it must submit a final funding plan—identifying, among other things, the sources and anticipated timing of all segment funding based on actual (versus expected) governmental authorizations or assurances and/or actual offered private commitments—and an independent financial consultant's report—attesting, among other things, that construction of the segment can be completed as proposed in the plan, that the segment will be "suitable and ready for high-speed train operation," and that planned passenger service will not require an operating subsidy. CAL. STS. & HIGH. CODE § 2704.08(d). Only when the Authority has made this second set of submissions, and the Director of the California State Board of Finance finds the final funding plan "is likely to be successfully implemented," may the Authority spend Prop 1A proceeds for construction and most other purposes. *Id.*⁸³

The Authority has faced challenges in meeting these conditions and getting access to Prop 1A funds. Although some Prop 1A bonds have been sold and the Authority previously projected it would start using proceeds for construction of the Central Valley subsection under the Recovery Act Agreement in April 2014,⁸⁴ this has not yet occurred, according to DOT and Authority officials. One impediment has been state court litigation filed against the Authority in 2011 and still ongoing, *Tos v. California High-Speed Rail Authority*,⁸⁵ which is proceeding in two parts. Part I addressed plaintiffs' claim that Prop 1A bonds could not be issued and sold, nor could federal grant funds be used, for work on the rail line's first usable segment—a 300-mile line from Merced to the San Fernando Valley, including a 130-mile initial Central Valley subsection from Fresno to Bakersfield being funded primarily by the federal Recovery Act and FY 2010 Agreements—because the Authority's preliminary funding plan was deficient. In late 2013, the California trial court largely upheld these objections as to the Prop 1A bonds but not the federal grant funds. Because the court found there must be a valid preliminary funding plan before the Authority can submit its more detailed funding plan, approval of which is required before the

⁸³ Prop 1A allows the use of a limited amount of Prop 1A bond proceeds for environmental studies, planning, preliminary engineering activities, and certain other non-construction purposes. CAL. STS. & HIGH. CODE § 2704.08(g).

⁸⁴ See note 50, *supra* (summary of FRA-approved, Authority-submitted Funding Contribution Plan updates under Recovery Act Agreement).

⁸⁵ See *Tos v. Cal. High-Speed Rail Auth.*, No. 34-2011-00113919-CV (Cal. Super. Ct., Sacramento, filed Nov. 14, 2011). Additional federal and state court lawsuits have been filed against the Authority on a number of other matters not addressed here.

Authority may use Prop 1A funds for most purposes, the court's ruling effectively blocked the Authority from moving forward until it filed a revised plan.⁸⁶

The *Tos* trial court's Part I ruling was overturned on appeal in July 2014.⁸⁷ The appeals court ruled the Authority did not have to file a revised preliminary funding plan because the purpose of the plan was simply to provide guidance to the California Legislature in deciding whether to appropriate Prop 1A proceeds. That purpose was fulfilled in 2012, the court ruled, when the Legislature appropriated certain Prop 1A proceeds and approved use of the federal grant funds "based on the [Authority's] preliminary funding plan, however deficient," a legislative judgment requiring the court's deference.⁸⁸ The appeals court nonetheless stated, "there is merit to many of the *Tos* . . . parties' arguments" about Prop 1A's conditions, noting, for example, their assertion that "the voters insisted on an elaborate financial mechanism to ensure they would not be obligated to . . . pay for a stranded segment of the rail system." *Id.* at 709. To obtain access to the Prop 1A construction funds, the court stressed, the Authority still must satisfy the remaining Prop 1A conditions requiring the consultant's report and approval of the final funding plan. *Id.* at 452, 473-74. The California Supreme Court declined to review the appeals court's decision in late 2014,⁸⁹ clearing the way for Part II of the *Tos* lawsuit in the trial court. The *Tos* plaintiffs are currently asking the trial court to halt construction of the first usable segment as currently planned and to block the Authority's use of all "public" funds, both federal grant funds and state funds.⁹⁰ A bench trial is scheduled for February 11, 2016.⁹¹

The Authority is facing legal and financial challenges beyond the *Tos* litigation. In the short term, the Authority still must submit the Prop 1A-required final funding plan and consultant's report to obtain Prop 1A construction funds for the first usable segment, and for every subsequent usable segment. More broadly, the Authority's strategy for obtaining the estimated \$68.5 billion in Phase 1 construction funds is subject to uncertainty. As we reported in 2013, the Authority's strategy was to obtain most of that funding—61 percent—from the federal government, of which the Authority had obtained a small portion under the Recovery Act and FY 2010 Agreements. It planned to obtain the remaining 39 percent from current and future Prop 1A state appropriations (12 percent), locality funds (7 percent), and, after the first usable segment becomes operational, private investment and operating cash flow (19 percent).⁹² We found in our 2013 High-Speed Rail Report, however, that it is uncertain whether these additional

⁸⁶ See *Tos v. Cal. High Speed Rail Auth.*, 2013 WL 6578791 (Cal. Super. Ct., Sacramento, Aug. 16, 2013); 2013 WL 6184096 (Cal. Super. Ct., Sacramento, Nov. 25, 2013).

⁸⁷ *Cal. High-Speed Rail Auth. v. Cal. Super. Ct.*, 175 Cal. Rptr. 3d 448, 472 (App. 3 Dist. 2014).

⁸⁸ *Id.*, 175 Cal. Rptr. 3d at 476 (discussing CAL. SEN. BILL 1029 (July 18, 2012)).

⁸⁹ *Cal. High-Speed Rail Auth. v. Cal. Super. Ct.*, 2014 Cal. LEXIS 9825 (Cal. Oct. 15, 2014).

⁹⁰ Plaintiffs assert, among other things, that the project as planned violates Prop 1A because allegedly it is not "financially viable" as required and will not meet Prop 1A's high speed and other performance requirements. Plaintiffs also assert the Authority will be unable to pay its matching share under the Recovery Act Agreement. See *Tos*, *supra* note 85, Plaintiffs' Opening Brief (Nov. 2, 2015). The Authority's brief is to be filed January 15, 2016.

⁹¹ *Tos*, *supra* note 85, Stipulation and Order (Aug. 25, 2015).

⁹² GAO 2013 High-Speed Rail Report at 37-42. See also California High-Speed Rail Authority, *California High-Speed Rail Program Revised Business Plan, Building California's Future* (April 2012), at 7-1 to 7-25.

funds can be obtained in a tight budget environment.⁹³

The Authority's most recent biennial business plan in April 2014 reflects this same basic funding strategy,⁹⁴ but to date it has not received private funding or additional federal funding. The Authority has obtained certain state funding, however: in June 2014, the California Legislature appropriated \$250 million for high-speed rail from the state's Greenhouse Gas Reduction Fund, known as the "Cap-and-Trade" fund;⁹⁵ and appropriated, as of July 1, 2015, an additional \$400 million in one-time loan repayment funds plus continuing funding of 25 percent of annual Cap-and-Trade proceeds.⁹⁶ Authority officials currently estimate this "25 percent" appropriation will make about \$500 million per year available for the high-speed rail project.⁹⁷ To date, as of July 31, 2015, DOT and Authority officials indicate the Authority has contributed about \$235 million of its Fiscal Year 2014/2015 \$250 million Cap-and-Trade funds, plus about \$102 million in Prop 1A pre-construction proceeds, toward its \$2.5 billion matching share under the Recovery Act Agreement.

The Authority generally acknowledges the uncertainty of its project funding; recognizes this uncertainty poses risks; and is instituting measures to mitigate these risks.⁹⁸ Authority officials have stated that they do not have independent state financing vehicles from which to borrow or the ability to impose taxes,⁹⁹ and they have recently indicated that the state Prop 1A and Cap-and-Trade funds and the federal grant funds will not be sufficient to build Phase 1. They therefore are seeking expressions of interest from the private sector in financing Phase 1 construction in the nearer term, before the first usable segment becomes operational.¹⁰⁰ Such near-term private financing, if obtained, might provide non-federal funds for the Authority's matching share under the Recovery Act Agreement, but obtaining such financing for high-speed rail construction in the pre-operational stage is uncertain, as we explained in our 2013 report. GAO 2013 High-Speed Rail Report at 42-44.

⁹³ GAO 2013 High-Speed Rail Report at 37, 40.

⁹⁴ See California High-Speed Rail Authority, *Connecting California, 2014 Business Plan* (April 30, 2014) (CHSRA 2014 Business Plan), at 51-56.

⁹⁵ CAL. SEN. BILL 852, Items 2665-301-3228, 2665-306-3228 (June 20, 2014) (most proceeds available for encumbrance until June 30, 2018).

⁹⁶ CAL. SEN. BILL 862, Secs. 7, 8 (June 20, 2014).

⁹⁷ This is an internal planning estimate based on the California Department of Finance's estimate for the Governor's 2015-2016 Revised Budget; actual results could be higher or lower. See Nov. 12, 2015 e-mail from California High-Speed Rail Authority Chief Counsel to GAO Managing Associate General Counsel.

⁹⁸ See, e.g., CHSRA 2015 Legislative Update, *supra* note 6, at 41-42; CHSRA 2014 Business Plan, *supra* note 94, at 51-56, 68.

⁹⁹ See Authority 2012 Tapered Match Request, *supra* note 20.

¹⁰⁰ See Transcript, Authority Board of Directors Monthly Meeting, Oct. 6, 2015, at 102-03 (Board Chairman Richard), available at http://www.hsr.ca.gov/docs/brdmeetings/2015/brdmtg_100615_Transcript_for_Oct_6_2015_Meeting.pdf, last visited Dec. 1, 2015 ("[W]e've got the bond money, we've got the federal money, we've got the Cap and Trade money. All those things together are not enough to build a \$68 billion system.").

APPENDIX II: Summary of 2012-2015 Changes in Projected FRA and Authority Funding Periods and Sources under the Recovery Act Agreement's Tapered Match Provision and Funding Contribution Plan

FRA-approved FCPs (initial and quarterly updates)	For quarter ending	Projected FRA funding periods for Recovery Act Agreement	Projected Authority funding periods for Recovery Act Agreement or FY 2010 Agreement*
1 (initial FCP, Amendment No. 5, Exhibit 3)	(12/05/12)	July 2010-June 2017	July 2010-June 2012 No payments July 2012-March 2014 Resume April 2014-June 2019 <i>(Source: Prop 1A funds)</i>
2	03/31/13	July 2010-Dec. 2015	July 2010-June 2012 No payments July 2012-March 2014 Resume May 2014-June 2019 <i>(Source: Prop 1A funds)</i>
3	06/30/13	July 2010-Jan. 2016	July 2010-June 2012 No payments July 2012-April 2014 Resume May 2014-Dec. 2019 <i>(Source: Prop 1A funds)</i>
4	09/30/13	Aug. 2010-Jan. 2016	Aug. 2010-June 2012 No payments July 2012-March 2014 Resume April 2014-Aug. 2018 No payments Sept.-Nov. 2018 Resume Dec. 2018-Nov. 2019 <i>(Source: Prop 1A funds)</i>
5	12/31/13	Aug. 2010-March 2017	Aug. 2010-June 2012 No payments July 2012-June 2014 Resume July 2014-Nov. 2019 <i>(Source: Prop 1A funds 2010-2012, Cap-Trade funds starting July 2014, Prop 1A funds starting July 2015)</i>
6	03/31/14	Aug. 2010-March 2017	Aug. 2010-June 2012 No payments July 2012-June 2014 Resume July 2014-Dec. 2018 <i>(Source: Prop 1A funds 2010-2012, Cap-Trade funds starting July 2014, Prop 1A funds starting July 2015)</i>
7	06/30/14	Aug. 2010-Jan. 2016	Aug. 2010-June 2012 No payments July 2012-June 2014 Resume July 2014-Aug. 2018 <i>(Source: Prop 1A and/or Cap-Trade funds)</i>
8	09/30/14	Aug. 2010-June 2015 No payments July-Sept. 2015 Resume Oct. 2015-May 2016	Aug. 2010-June 2012 No payments July 2012-June 2014 Resume July 2014-July 2018 <i>(Source: Prop 1A and/or Cap-Trade funds)</i>
9	12/31/14	Aug. 2010-Sept.2014 No payment Oct. 2014 Resume Nov. 2014 No payment Dec. 2014 Resume Jan. 2015-July 2016	Aug. 2010-June 2012 No payments July 2012-June 2014 Resume July 2014-Aug. 2018 <i>(Source: Prop 1A and/or Cap-Trade funds)</i>
10	03/31/15	Aug. 2010-June 2014 No payments July 2014-March 2015 Resume April 2015-Feb. 2017	Aug. 2010-June 2012 No payments July 2012-June 2014 Resume July 2014-June 2018 <i>(Source: Prop 1A and/or Cap-Trade funds)</i>

Source: GAO analysis of FRA-approved Funding Contribution Plan and quarterly updates

* The Funding Contribution Plan and quarterly updates display a single combined funding stream for the Authority's matching share payments under the Recovery Act Agreement and the FY 2010 Agreement. Thus it is not possible to determine which agreement the Authority's payments correspond to and whether its projected payments would violate the Recovery Act Agreement's current September 30, 2017 final payment deadline.