COMPTROLLER GENERAL OF THE UNITED STATES

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RELEASED

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The Honorable Joe L. Evins, Chairman
Subcommittee on Public Works Appropriations
Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

In accordance with your request of December 18, 1972, and subsequent arrangements with your office, we have prepared this report on an alternative to the present requirements for repayment of the Federal investment in the Tennessee Valley Authority's (TVA) electric power system which would tend to reduce or postpone future power rate increases.

We estimate that use of this alternative repayment method from fiscal year 1974 through fiscal year 2014 could result in savings of about $287 million to TVA's power customers without any net interest cost to the Treasury.

TVA's repayment requirements are a policy matter for the Congress to decide and, in presenting this alternative approach, we do not intend to suggest that the present requirements are unreasonable. They have evolved over a period of years and give consideration to the unique history and changes in TVA's electric power operations and financing procedures. However, the alternative repayment approach, as we have described, could be adapted to TVA's repayment requirements if the Congress decides that a change is warranted.

INTRODUCTION

From TVA's inception in 1933 to June 30, 1960, the Government invested in TVA's power program through appropriations, bond purchases, and property transfers. TVA was not required to pay interest on the investment but was required to make some repayments to the Treasury on the investment. The status of the Federal investment in TVA's power program at June 30, 1960, is shown on the following page.

	Balance at June 30, 1960		
	Employed in power program	Construction in progress and investigations for future projects	Total
Appropriations, property transfers, and bonds issued			
Appropriations by the Congress	$1,365,267,726	$1,543,546	$1,366,811,272
Property transfers, net	19,535,008	-	19,535,008
Bonds issued to the Treasury and Reconstruction Finance Corporation	65,072,500	-	65,072,500
	1,449,875,234	1,543,546	1,451,418,780
Less:			
Payments into the general fund of the Treasury			
Through June 30, 1947--under provisions of section 26 of the TVA Act	15,059,020	-	15,059,020
After June 30, 1947--under provisions of section 26 of the TVA Act and title II of the Government Corporations Appropriation Act, 1948	170,000,000	-	170,000,000
Bonds redeemed ($56,500,000 under provisions of title II of the Government Corporations Appropriation Act, 1948)	65,072,500	-	65,072,500
	250,131,520	-	250,131,520
Net investment of Treasury funds	$1,199,743,714	$1,543,546	$1,201,287,260

Repayment requirements subsequent to fiscal year 1960

Section 15d of the TVA Act (16 U.S.C. ch. 12A) was added on August 6, 1959 (Public Law 86-137), to establish, starting in fiscal year 1961, new provisions applicable to the repayment of the Federal appropriation investment in TVA and to authorize TVA to finance its power program by selling revenue bonds to the public. Beginning with fiscal year 1961, TVA was required to make annual repayments of the appropriation investment in its power facilities in sums of not less than

--$10 million for each of the first 5 fiscal years,

--$15 million for each of the next 5 fiscal years, and

--$20 million for each fiscal year thereafter until a total of $1 billion shall have been repaid.

This repayment provision will result in repayment of $1 billion of the appropriation investment by June 30, 2014 (54 years after the starting date of July 1, 1960), but will not result in repayment of about $201 million of such appropriation investment which was outstanding at June 30, 1960, or of an additional appropriation investment of about $19 million since that date.

Under the repayment provisions added by the 1959 amendments, TVA must also make semiannual payments into the Treasury as a return (interest) on the unrepaid appropriation investment in its power facilities. The required payment is based on the average interest rate payable by the Treasury on its total marketable public obligations as of the beginning of each fiscal year, applied to the unrepaid appropriation investment as of that time. Therefore the interest rate increases or decreases each year in line with fluctuations in interest costs to the Treasury.

ALTERNATE REPAYMENT REQUIREMENT BASED ON CRITERIA APPLICABLE TO EQUITY CAPITAL INVESTMENTS

The legal requirements for repayment of the Federal appropriation investment in TVA and the return on that investment treat a large part of the investment as if it were equity capital. For example, although TVA is required to repay $1 billion of the appropriation investment, it is not required to repay about $201 million of the investment which was outstanding at June 30, 1960, or any of the appropriation investment made after that date.

The language of House bill 3460--which finally became Public Law 86-137--when it was passed by the House of Representatives, contained a provision (section 15d(e)) requiring repayment of the entire Federal appropriation investment in TVA. However, the Senate amended that provision to provide that only $1 billion of the investment would be repaid. In commenting on the reason for this amendment, Senate Report 470[1] stated

> "There would remain a relatively small amount of appropriation investment in the TVA power system, which would represent, together with the reinvestment of power revenues, the equity of the Federal Government in the System. The committee believed it advisable to retain some appropriation equity in the assets of the Corporation. The Government is the owner and sole stockholder of TVA, and will own the equity built up by the earnings of the Corporation. * * *"

In discussing the Senate amendment in the House of Representatives (p. 14115, Cong. Rec., July 23, 1959), Congressman Clifford Davis of Tennessee, who introduced the bill, pointed out that

> "* * * Everyone knows that if the owner, the Government, withdraws imprudent amounts of cash the proportion of debt to equity capital will grow too rapidly. At this time the Senate apparently concluded that $1 billion of the equity provided by appropriation could be safely withdrawn--in 54 years--and that $200 million should be left. It is a judgment figure."

In the Senate hearings[2] on the bill, the Chairman of the TVA Board of Directors had recommended that about $600 million of the appropriation investment be allowed to remain invested and not be repaid.

Based on the amount of debt financing being authorized at that time ($750 million), the ratio of debt to appropriation investment would have been about 1.25 to 1 if the $600 million had been allowed to remain as equity capital. This ratio approximated what a representative of the

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[1]Entitled "Revenue Bond Financing by TVA," dated July 2, 1959, from the Senate Committee on Public Works (86th Cong., 1st sess.), p. 11.

[2]Hearings before a subcommittee of the Senate Committee on Public Works, 86th Cong., 1st sess., on S. 931 and H.R. 3460, June 9 and 10, 1959 (p. 104).

Federal Power Commission told us was a reasonable capitalization ratio for investor-owned electric utilities. However, this ratio would not have been maintained because of subsequent increases authorized in debt financing (to $5 billion) without corresponding increases in the appropriation investment.

We made a computation to find out what the estimated financial effect would be on TVA if the entire unpaid appropriation investment estimated to be outstanding at June 30, 1973 ($1.035 billion), were treated as equity capital and thus not required to be repaid. We assumed that the rate of return on the investment would be determined the same as under present requirements.

Under our computation, which considers the appropriation investment outstanding at June 30, 1973, as equity capital, the $20 million annual repayment of the appropriation investment presently required would be available instead to reduce the amount of bonds TVA would otherwise issue to finance its power program. This procedure would result in net savings in interest costs because funds which TVA would use to repay the appropriation investment with an estimated interest rate of 5.75 percent would be used, instead, to reduce the amount of bonds which TVA would otherwise issue at an estimated interest rate of 7.5 percent. The resulting savings in interest costs would be available to reduce or postpone power rate increases.

We estimate that, from fiscal year 1974 through fiscal year 2014, the use of the alternative repayment method could result in TVA power customers realizing savings totaling about $287 million. Each year's annual benefit to TVA's power customers would increase by $350,000 to a total annual benefit of about $14 million in 2014. This estimated benefit to TVA's power customers is based on the assumption that the interest rates estimated by TVA as being applicable to its bond issues (7.5 percent) and repayment of its appropriation investment (5.75 percent) for fiscal year 1974 will remain the same in future years. Increases or decreases in the difference between these interest rates would result in increases or decreases in the savings in interest costs and correspondingly affect the savings to TVA's power customers.

It is important that the rate of return payable by TVA on the outstanding appropriation investment under this alternative method be the same as that payable by the Treasury on its total marketable public obligations at the beginning of each fiscal year. Therefore there would be no net interest cost to the Treasury if the total appropriation investment in TVA's electric power system were allowed to remain outstanding, rather than requiring that it be repaid.

In this connection, Senate Report 470 (86th Cong., 1st sess.), which reported on the present provisions in the law for payments to the Treasury, stated (p. 11):

> "Such payments [return on the investment] will insure that the Treasury will have no carrying charge on this [appropriation] investment since TVA's annual payments on it as a return will always be equal to the Treasury's current interest cost * * *."

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The alternative repayment method described above was discussed with TVA officials, and their views have been considered in preparing this report.

We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States