DECISION

THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D.C. 20548

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FILE: B-195437 DATE: February 15, 1980

MATTER OF: Big Rivers Electric Corporation-Rural Electrification Administration Guaranteed Loan - PLG039/5

DIGEST: Rural Electrification Administration has statutory authority of REA to finance construction and operation of electric generating plants to provide electrical service to people in rural areas not receiving central station service. This allows it to guarantee loan to electric cooperative to assure source of financing to pay certain initial expenditures associated with proposed coal-fired electric generating plant including cancellation charges required if contracts to supply steam turbine generator and coal-fired boiler are terminated. Without commitment to pay cancellation charges, contractors will not start work. Therefore, such charges are necessary and proper costs of contract to carry out statutory purposes.

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This decision is in response to a request from the Administrator of the Rural Electrification Administration (REA) for an opinion on whether he has authority, pursuant to section 306 of the Rural Electrification Act of 1936, as amended (7 U.S.C. § 936 (1976)), to approve an application from the Big Rivers Electric Corporation (Big Rivers) in Henderson, Kentucky, for a loan guarantee. The loan would be used to cover certain expenditures associated with construction of a proposed coal-fired electric generating plant, including cancellation charges if contracts for two components of the plant are terminated. It is our opinion, for the reasons set forth below, that the Administrator does have the authority to approve the loan guarantee for the purposes described in REA's submission.

As explained in the submission, Big Rivers is a generating and transmission cooperative responsible for meeting the wholesale power requirements of four member distribution systems. Big Rivers has wholesale power contracts with these member systems extending through January 1, 2017. The member systems distribute electricity to approximately 67,650 consumers in all or portions of 23 counties in Western Kentucky.

In July, 1977, Big Rivers initiated planning to determine and ultimately to satisfy future wholesale power needs of its member systems. Studies by Big Rivers, confirmed by REA, indicate a

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480 megawatt deficit between member systems' requirements in 1984 and the total of Big Rivers' current capacity and capacity under construction. Accordingly, Big Rivers determined that it was necessary to construct a new electric generating plant. Including expenditures to date, totalling approximately $1,500,000, Big Rivers and REA estimate that the preliminary expenditures associated with the project will be approximately $14,192,500 by December 31, 1980. These funds would be expended as follows:

"1. Approximately $5,428,700 for studies in conjunction with planning, licensing, and design of future generating capacity. * * *

"2. Approximately $6,000,000 for land purchases for a generating site. * * *

"3. Approximately $294,000 for legal fees and miscellaneous costs.

"4. Approximately $117,000 for an air quality monitoring station. * * *

"5. Approximately $171,500 for interest charges on borrowed funds.

"6. Approximately $1,181,300 for contingencies."

In addition to REA's guarantee of loans to Big Rivers for the above-stated expenditures, the application requests that REA also guarantee repayment of $17,430,000 for the "cancellation charges" associated with contracts to supply a steam turbine generator and a coal-fired boiler. Pursuant to a bid solicitation for the steam turbine generator that was initiated by Big Rivers in March, 1979, its board of directors approved award of a contract to the Westinghouse Corporation for a total contract price of $18,480,747. Under the terms of the Westinghouse offer, Big Rivers would be obligated to make payments to Westinghouse totalling $5,789,000 if the contract is cancelled no later than December 31, 1980. In addition, Big Rivers has estimated that cancellation charges which would be expected to be required by a supplier of a coal-fired boiler will total approximately $11,641,000 through December 1980. Based on REA's experience with contracts for similar items of equipment, involving other borrowers, REA believes that these amounts are reasonable.

REA has concluded, on the basis of information furnished by Big Rivers, that Big Rivers should award both these contracts as soon as possible in order to insure that the equipment will be in service in

1984. In the past, REA has provided financial assistance to electrical cooperatives only if the Administrator could realistically make the determination "that the expenditures for which he provides financial assistance will lead to the completion of facilities to serve RE Act beneficiaries * * *". However, with respect to the proposed loan guarantee to Big Rivers, REA states that:

> "the completion of contractual arrangements for fuel supply, the completion of contractual arrangements for transmission services and the environmental inquiry mandated by the National Environmental Policy Act of 1969 and other environmental statutes and directives all preclude such a determination by the Administrator."

To approve this loan guarantee, REA must assume "that the project may have to be aborted in December, 1980, the date through which this guarantee of funds by REA will sustain the project." Nevertheless, REA believes that the loan guarantee should be approved:

> " * * * It is essential that REA guarantee the loan to pay the cancellation charges associated with the turbine and the boiler, as without an assured source of financing for Big Rivers' obligation to pay the cancellation charges, the feasibility and security of REA's prior loans and guarantees to Big Rivers might be threatened. Because contracts for the turbine and boiler must be entered into in the very near future, before a final decision on the project can be reached, it is apparent that the potential guarantee of funds for cancellation charges is also essential to maintain for Big Rivers the viable option for additional generating plant by 1984.
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> " * * * All the expenditures for which the Administrator proposes to make REA guaranteed funds available to Big Rivers are essential to keep the option of constructing the generating plant to meet an in service date in 1984 viable for Big Rivers until such time as a final determination can be made on whether to proceed with this project."

As stated above, the proposed loan would be guaranteed pursuant to the Administrator's authority under section 306 of the Rural Electrification

Act of 1936, as amended, 7 U.S.C. § 936 (1976), which reads in pertinent part as follows:

> "The Administrator may provide financial assistance to borrowers for purposes provided in this chapter [the Rural Electrification Act of 1936, as amended] by guaranteeing loans, in the full amount thereof, made by the Rural Telephone Bank, National Utilities Cooperative Finance Corporation, and any other legally organized lending agency * * *".

The statutory purposes for which REA can make rural electrification loans are set forth in section 4 of the Rural Electrification Act of 1936, as amended, 7 U.S.C. § 904 (1976), which provides as follows:

> "The Administrator is authorized and empowered, from the sums hereinbefore authorized, to make loans for rural electrification to * * * peoples' utility districts and cooperative, non-profit, or limited dividend associations, organized under the laws of any State or Territory of the United States, for the purpose of financing the construction and operation of generating plants, electric transmission and distribution lines or systems for the furnishing of electric energy to persons in rural areas who are not receiving central station service * * *. Such loans shall be on such terms and conditions relating to the expenditure of the moneys loaned and the security therefor as the Administrator shall determine and may be made payable in whole or in part out of the income: * * * And provided further, That no loan for the construction, operation, or enlargement of any generating plant shall be made unless the consent of the State authority having jurisdiction in the premises is first obtained. Loans under this section and section 905 of this title shall not be made unless the Administrator finds and certifies that in his judgment the security therefor is reasonably adequate and such loans will be repaid within the time agreed."

The Administrator has determined that there is "reasonably adequate security" in the Big Rivers electric system to support the proposed loan guarantee of approximately $25,623,000. (This amount represents $14,172,500 in cash expenses as set forth above, plus $17,430,000 in estimated cancellation charges under the turbine and boiler contracts, less $6 million in expenditures associated with land

purchases which REA assumes would be recovered in the event the project is aborted.) The Administrator has also determined "that the proposed loan guarantee will be repaid by Big Rivers." Both of these determinations were made even on the assumption that the project would be aborted in December, 1980, and would never provide any revenue to Big Rivers.

The primary legal issue here is whether the purposes for which the loan is sought fall within a reasonable interpretation of section 4 of the Act, authorizing loans for rural electrification to finance

> "the construction and operation of generating plants, electric transmission and distribution lines or systems for the furnishing of electric energy to persons in rural areas who are not receiving central station service * * *."

In arguing that the proposed loan guarantee is consistent with REA's authority, REA, in its submission to our Office as well as during informal discussions with our staff, relies primarily on the language authorizing it to provide financial assistance for the construction and operation of "electric * * * systems." REA's submission reads in pertinent part as follows:

> "The issue, then, reduces itself to a question of what might be deemed to be appropriate expenditures associated with the construction and operation of a functioning electric system, involving generation, transmission, and distribution functions. Inasmuch as the RE Act and its legislative history are silent on the question of whether these 'front-end' type expenditures are to be considered as legitimate expenditures associated with the construction of an electric system the question is best answered by reference to precedents and practice involving the electric utility industry generally, including the proceedings of the various state commissions charged with the responsibility of approving the operating, financing, and rates of electric utility systems located in their respective states.
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> "The electric utility industry has long recognized that purposes such as license procurement, acquisition of future sites, surveys, and preliminary design and engineering work prior to the final determination of the viability of a prospective generating project are necessary purposes for expenditures by electric utilities as part of other construction of a system for providing electric service. * * *

> "Recognizing the need of electric utilities to make expenditures which may ultimately prove to be for purposes other than completed electric plant as part of the necessary expenses of constructing an electric system, commissions have permitted utilities to pass costs associated with abandoned generating projects on to consumers in the form of higher retail rates so long as the expenses were reasonably and prudently incurred. * * *
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> "The conclusion would appear inescapable that, in the opinion of utility commissions, the expenditures for which REA proposes to make a loan guarantee for Big Rivers, so long as reasonably and prudently incurred by electric utilities, all represent expenses associated with the construction of an electric system to service present and future consumers. In the event the project for which these expenditures are made is completed, the only persons who will benefit will be proper RE Act beneficiaries. In the event the project for which these expenditures are made is not completed the expenditures still must be deemed to have been those reasonable and prudent expenditures which Big Rivers must make in order to fulfill its obligation as a public utility to provide an adequate system to supply electric service to its consumers in the future.
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> "As repeatedly recognized throughout the history of the REA program, the RE Act vests broad discretionary powers in the Administrator in providing financial assistance to assure a healthy program of rural electrification. The words 'construction and operation . . . of electric . . . systems' establishes broad authority in the Administrator to use those specific tools for financial assistance available to him in sections 305 and 306 of the RE Act in a manner he deems most appropriate to further this end." (Emphasis omitted.)

Whether the proposed loan is considered a loan for the construction and operation of an "electric system" or for a "generating plant" is not important. It is necessary to focus on the underlying purpose of the loan and to determine whether that purpose is consistent with the objective of the Rural Electrification Act, as amended. Rural electrification loans are authorized only for the "furnishing of electric energy to persons in rural areas who are not receiving central station service."

The importance of this requirement has been repeatedly recognized in decisions of our Office. For example, in a letter to Congressman Lyle H. Boren dated December 1, 1942, B-29463, we said:

> "The specific power embodied in [section 4] * * * is the power 'to make loans' and, although the purposes for which a loan properly may be made necessarily are limited by the language appearing in the act, there would appear to be no doubt that the Congress contemplated that the extent of the Administrator's authority in this respect and any question as to whether the object of a loan in a particular case comes within his statutory power to make loans for the 'construction and operation of generating plants, electric transmission and distribution lines or systems' would be viewed in the light of the controlling intent of the Congress to provide electric service to persons in rural areas not receiving central station service."

As stated by REA in its submission, all of the proposed initial expenditures, including the cost of cancelling the contracts for the generator and boiler if the project is aborted, are essential to give Big Rivers the viable option of having the generating plant completed in time to be in service by 1984, if final approval of the project is given. According to REA, unless Big Rivers enters into the cancellation costs commitment giving rise to the need for the loan--and for REA's guarantee--at this time, it would not be able to meet the future projected power needs of its member systems since the contractors insisting on the commitment will not begin to build the generating plant components without it.

(We recognize that, to a large extent, Big Rivers only needs greater generating capacity in order to satisfy the increased electric power requirements of the same customers it is already supplying with electricity. However, the Rural Electrification Act has long been interpreted by REA, with the full knowledge and approval of Congress, to allow approval of generation and transmission loans to serve persons already receiving central station service who obtained such service initially through REA--financed facilities. Our Office has acquiesced in REA's interpretation of the Act. Also, see Kansas City Power & Light Company v. McKay, 115 F. Supp. 402 (D.D.C. 1953) 411, 412, judgment vacated on other grounds in 225 F. 2d 924 (D.C. Cir. 1955).)

The use of federal funds to pay contract termination charges--whether in the form of liquidated damages, as is the case here, or actual proven damages--is not uncommon. In all probability, no

doubt would have arisen here if Big Rivers had asked REA for a loan to cover the total cost of contracting for the generator and boiler, with a lesser included amount to be available to pay termination charges in the form of liquidated damages, if Big Rivers had to abort the project and terminate the contracts with the suppliers of the two pieces of equipment. We have informally been advised by REA, assuming a favorable decision from our Office and subsequent approval of the proposed loan guarantee, that REA would be willing to approve another loan guarantee to cover the actual cost to Big Rivers of acquiring the generator and boiler if the project is not cancelled. Admittedly, the procedure envisioned by REA here involving two loans and two loan guarantees--the first to cover initial expenditures including the contract cancellation charges and the second the actual cost of acquiring the equipment if the project is not aborted--is somewhat unusual. However, since the underlying purpose--to provide additional electricity to the intended beneficiaries of the Act--is consistent with the basic statutory objective, whichever loan mechanism is used, we do not believe that the manner in which the loan package is structured is of sufficient importance to justify a contrary legal result.

The rationale for allowing REA's loan guarantee to include an amount to cover items which in themselves would not provide service to Act beneficiaries but which are necessary and incidental to doing so has been recognized in prior decisions by our Office. For example, in B-42486, July 25, 1944, we considered whether REA could make a loan which was intended, in part, to allow the borrower to acquire an existing electric facility. In that decision we said:

> "But a different situation is presented where the Administrator desires to finance the construction of an electric transmission and distribution system designed to furnish electric energy to unserved persons in rural areas and which requires, for its effective operation, the erection of certain facilities and the acquisition of other facilities already providing service to persons in such areas; and since the acquisition of the existing facilities and the incorporation thereof into the larger, integrated system in such a case would merely constitute the incidental means by which the essential statutory purpose of providing electricity to unserved persons in rural areas would be accomplished, there would appear to be a substantial basis for the inclusion in the loan authorized by the Administrator of an amount to cover the acquisition of such facilities." (Emphasis added.)

(Also see B-29463, December 1, 1942, supra; B-32920, March 12, 1943; as well as B-48590, April 3, 1945.)

Thus, we upheld REA's authority to approve a loan for a purpose that was arguably beyond a strict construction of its statutory authority under the theory that the questionable activity was "incidental" to accomplishing REA's essential statutory objective. Similarly, we believe that REA's guarantee of this loan is incidental to its accomplishment of the statutory objective of providing electricity to Act beneficiaries.

Finally, we recognize that the basic authority to determine whether or not a loan is being made for the purpose of providing central station service to persons in rural areas and is therefore permissible under the Act rests with the Administrator of REA. In B-48510, April 3, 1945, supra, we said:

> "In other words, it appears that the inquiry as to whether a particular loan comes within the scope of the terms of section 4 of the Rural Electrification Act is, in the final analysis, whether the loan has for its basic object the furnishing of electricity to persons in unserved rural areas; and since that question is for the determination of the Administrator, his decision in the matter may not be challenged in the absence of evidence of an abuse of the discretion vested in him."

Also see B-32920, March 12, 1943, supra, and B-134138, October 15, 1958. The courts have also repeatedly recognized the Administrator's broad discretion. Kansas City Power and Light Co. v. McKay, 225 F. 2d 924, cert. denied, 350 U.S. 884 (1955); REA v. Central Louisiana Electric Co., 354 F. 2d 859 (5th Cir. 1966); Alabama Power Co. v. Alabama Electric Cooperative, Inc., 394 F. 2d 672 (5th Cir. 1968); Salt River Project Agricultural Improvement Dist. v. FPC, 391 F. 2d 470 (C.A.D.C. 1968); Sibley v. REA, 419 F. 2d 384 (5th Cir. 1969).

In the instant case, we cannot conclude that the Administrator's decision to guarantee a loan to Big Rivers would constitute an abuse of discretion.

In accordance with all of the foregoing, it is our view that the Administrator of REA has the authority to guarantee the proposed loan to Big Rivers for the purposes set forth in REA's submission.

R. F. Keller

Deputy Comptroller General
of the United States