

GAO

Report to the Honorable
John E. Porter, House of Representatives

July 1993

RURAL
ELECTRIFICATION

REA Borrowers'
Investments in Cable
and Satellite Television
Services





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

Resources, Community, and
Economic Development Division

B-253315

July 29, 1993

The Honorable John E. Porter
House of Representatives

Dear Mr. Porter:

This report responds to your request that we examine the cable and satellite television investments of Rural Electrification Administration (REA) borrowers. The report discusses, among other things, the extent to which (1) REA borrowers have invested in cable and satellite television businesses, (2) REA borrowers' cable and satellite television businesses compete with other businesses that provide these services, and (3) federal and state agencies regulate and control REA borrowers' nonutility investments.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies of this report to the appropriate congressional committees and to the Department of Agriculture. We will also make copies available to others upon request.

This work was performed under the direction of Victor S. Rezendes, Director, Energy and Science Issues, who can be reached at (202) 512-3841 if you or your staff have any questions. Other major contributors to this report are listed in appendix III.

Sincerely yours,

J. Dexter Peach
Assistant Comptroller General

Executive Summary

Purpose

Concerned about the potential for Rural Electrification Administration (REA) borrowers to use REA loans to subsidize their cable or satellite television services, Representative John Porter asked GAO to (1) examine the extent to which REA borrowers have invested in cable and satellite television, (2) determine whether REA borrowers or their affiliates compete with independent businesses to provide such services, and (3) provide information on the extent to which REA and other federal and state agencies oversee REA borrowers' cable and satellite businesses.

Background

Under the Rural Electrification Act of 1936, as amended, REA (an agency of the U.S. Department of Agriculture) provides loans and loan guarantees to rural electric and telephone utilities (called "electric borrowers" and "telephone borrowers," respectively). According to the most recently compiled data, as of May 31, 1993, REA had outstanding balances for its loans and guaranteed loans to electric and telephone utilities of about \$37 billion. The Federal Communications Commission (FCC) has authority to regulate interstate communication by wire or radio, including telephone, cable television, and satellite services. The Federal Energy Regulatory Commission (FERC), among other things, regulates the rates, terms, and conditions of wholesale electric power sales and transmission services.

To examine borrowers' cable and satellite investments, GAO surveyed all 1,863 current borrowers identified by REA and received 1,610 usable responses. The survey results, when reported as percentages in this report, are based on the number of responses received for each question; not all respondents answered every question. (See app. I for the survey results.)

Results in Brief

One-fourth of the REA borrowers that responded to GAO's survey provide either cable television or satellite television equipment and programming services (called "satellite television services") or both. Respondents reported investments of \$357 million in these businesses.¹

Borrowers that provide satellite television services compete with other satellite businesses ("independent businesses") that are not owned by REA borrowers. In GAO's survey, respondents with cable television businesses said that, before and after they established the cable business, they faced only limited competition from independent cable operators. Borrowers

¹The total is probably higher because about one-fifth of the borrowers reporting cable or satellite television investments did not report the amount of money they had invested in these businesses.

with cable businesses may compete with satellite businesses that serve the same areas; however, a House Committee report indicates that such competition largely has not materialized.² REA borrowers may have competitive advantages in their cable or satellite businesses; for example, they have access to credit sources established to help finance electric and telephone cooperatives' activities. Many share space, equipment, and staff used for their utility services with their cable or satellite activity.

Subject to statutory limits, REA restricts the amounts that borrowers may invest in nonutility activities. REA also has accounting and auditing controls intended to ensure that borrowers comply with their loan agreements and use REA loan funds for authorized purposes. These controls include annual audits of REA borrowers that can extend to the accounts of affiliates. For several reasons, FCC's and FERC's oversight of REA borrowers is limited. State regulation of borrowers and affiliates varies, depending in part on whether the borrower is a cooperative or is investor-owned. GAO did not assess whether federal and/or state oversight is adequate to prevent borrowers from cross-subsidizing their cable and satellite businesses.

Principal Findings

Many REA Borrowers Invest in Cable and Satellite Television Services

One-quarter (416) of the borrowers responding to GAO's survey provide cable and/or satellite television services: 152 provide only cable television services, 231 provide only satellite television services, and 33 provide both cable and satellite television services. Over 95 percent of the borrowers that provide only cable services are telephone utilities. About 77 percent of the borrowers that provide only satellite services are electric utilities. Respondents reported investments of about \$338 million in cable and about \$19 million in satellite businesses.

REA Borrowers' Businesses May Enjoy Competitive Advantages

About 15 percent of the survey respondents that provide cable television services said they compete with other cable systems, while 78 percent of the respondents that provide satellite television services said they compete with independent businesses. According to trade associations that represent REA borrowers, in many cases REA borrowers have entered cable or satellite television businesses because their rural areas lacked

²H.R. Rep. No. 628, 102d Cong., 2nd Sess. 30 (1992).

these services and/or did not have access to over-the-air television channels.

Borrowers with cable and/or satellite television businesses may have access to financial resources that independent businesses do not have. For example, many electric and telephone cooperatives are members of the Banks for Cooperatives (CoBank), National Rural Utilities Cooperative Finance Corporation (CFC), or Rural Telephone Finance Cooperative (RTFC). These institutions lend money to members to finance utility and nonutility projects. CoBank and CFC officials said these institutions are not available to most parties and have lower interest rates than commercial banks. Few respondents used these sources to directly finance cable or satellite businesses; however, the availability of these sources—as well as of REA loan funds—may have freed the borrowers' general funds (unrestricted funds available on demand) for these ventures: 56 percent of the respondents with cable businesses and 49 percent of those with satellite businesses used general funds to enter these businesses.

Many borrowers share nonfinancial resources with their cable and satellite businesses. About 94 percent of the respondents with cable services and about 77 percent of those with satellite services share resources—such as staff, offices, or service equipment used in providing utility services—with their cable and satellite businesses.

Government Oversight of Borrowers' Nonutility Activities Varies

To protect the security of its loans, REA has limited borrowers' nonutility investments. However, in 1987 the Congress amended the Rural Electrification Act to enable electric borrowers to invest their own funds without REA's approval if the investments do not exceed 15 percent of the value of a borrower's utility plant. Amendments passed in 1990 enable telephone borrowers to invest up to one-third of their net worth in rural development projects without REA's approval and prohibit REA from considering an applicant's balance of general funds when making decisions about loan applications.

REA requires electric and telephone borrowers, respectively, to follow the FERC and FCC Uniform Systems of Accounts, each of which provides a framework for recording utility and affiliate costs and transactions. REA employees audit borrowers at least every 3 years. Also, REA requires its borrowers to have annual audits by certified public accountants; these audits can detect improper cost allocations between utility and nonutility activities. GAO did not audit any borrowers or test these controls.

The Cable Communications Policy Act of 1984 generally prohibits common telephone carriers from providing cable television services in their service areas, but utilities that serve rural areas with 2,500 or fewer persons are exempt from this prohibition. Also, under certain conditions, FCC can waive this “cross-ownership” prohibition. In GAO’s survey, about 89 percent of the REA telephone borrowers that provide cable television services obtained exemptions or waivers from FCC. In order to minimize interference among signals, FCC approves and regulates transmissions by satellite operators; however, REA borrowers that provide satellite reception services are primarily “distributors,” or satellite equipment retailers, which are not regulated by FCC. Also, since 1967, FERC (formerly the Federal Power Commission) has concluded it has no jurisdiction under the Federal Power Act to regulate the wholesale rates of REA-financed electric cooperatives.

State regulation of borrowers’ cable and satellite businesses varies, depending in part on whether the borrower is a cooperative or is investor-owned. Almost all of REA’s electric borrowers are cooperatives. One-quarter of REA’s telephone borrowers are cooperatives, while the rest are investor-owned companies. Almost all states regulate the utility rates of investor-owned utilities and have procedures, frequently employed during rate cases, to address cross-subsidies that could arise from utilities’ relationships with their affiliates. However, many states do not regulate cooperatives. For instance, according to the association of state utility commissioners, only 21 of the 46 states with electric cooperatives regulate the rates of electric cooperatives, while only 23 of these states regulate cooperatives’ accounting and record-keeping.

Recommendations

This report contains no recommendations.

Agency Comments

REA provided written comments on a draft of this report. REA suggested minor clarifications and provided more current REA financial data. The suggested clarifications and financial data were incorporated where appropriate.

Contents

Executive Summary		2
Chapter 1		8
Introduction	REA Provides Loans, Loan Guarantees, and Grants to Rural Utilities	9
	Cable and Satellite Television Businesses Serve Millions of Customers	10
	Objectives, Scope, and Methodology	11
Chapter 2		13
Many REA Borrowers Invest in Cable and Satellite Television	REA Telephone Borrowers Are Likely to Provide Cable Television Services	14
	REA Electric Borrowers Are Likely to Provide Satellite Television Services	14
Chapter 3		16
REA Borrowers' Satellite and Cable Businesses May Enjoy Competitive Advantages	REA Borrowers' Cable and Satellite Businesses Compete With Independent Businesses	16
	REA Borrowers May Have Competitive Advantages	17
	REA Borrowers Have Access to Financial Resources	17
Chapter 4		25
Government Oversight of Borrowers' Cable and Satellite Investments Varies	Federal Utility Regulatory Agencies Play a Limited Role	25
	REA Has Controls Over Borrowers' Activities	27
	State Regulation of Borrowers and Their Investments Varies	30
Appendixes	Appendix I: Results of Survey of REA Borrowers	32
	Appendix II: Comments From the U.S. Department of Agriculture	43
	Appendix III: Major Contributors to This Report	45
Related GAO Products		48

Figures

Figure 1.1: REA Telephone and Electric Borrowers	8
Figure 2.1: REA Borrowers That Provide Cable and Satellite Television Services	13
Figure 3.1: Sources of Funding for REA Borrowers' Cable Television Investments	19
Figure 3.2: Sources of Funding for REA Borrowers' Satellite Television Investments	20
Figure 3.3: Sharing of Utility Resources Between REA Borrowers and Telecommunications Businesses	23
Figure 3.4: Sharing of Utility Services Between REA Borrowers and Telecommunications Businesses	24

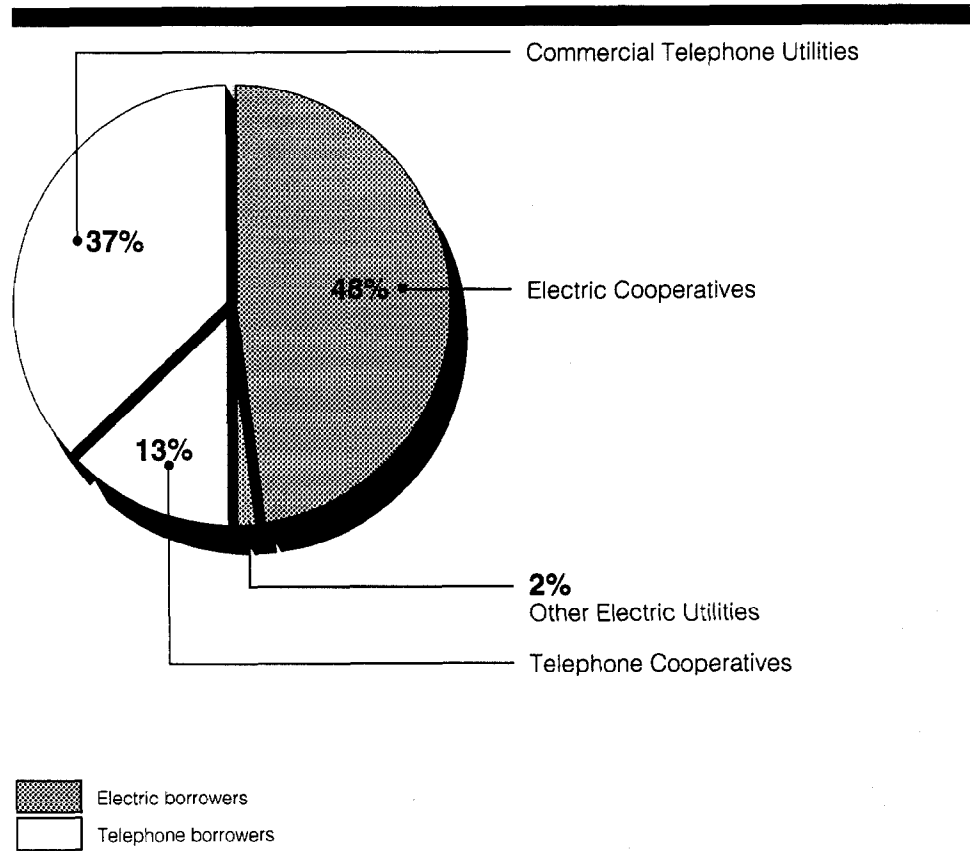
Abbreviations

CoBank	Banks for Cooperatives
CFC	National Rural Utilities Cooperative Finance Corporation
CPA	Certified Public Accountants
FCC	Federal Communications Commission
FERC	Federal Energy Regulatory Commission
GAO	General Accounting Office
NRTC	National Rural Telecommunications Cooperative
REA	Rural Electrification Administration
USDA	U.S. Department of Agriculture
RTFC	Rural Telephone Finance Cooperative

Introduction

The Rural Electrification Administration (REA), a credit agency of the U.S. Department of Agriculture (USDA), makes and guarantees loans to finance rural electric and telephone services and economic development projects. About one-half of the 1,863 borrowers are electric utilities (called "electric borrowers"), and the other half are telephone utilities (called "telephone borrowers"). (See fig. 1.1.)

Figure 1.1: REA Telephone and Electric Borrowers



Source: GAO presentation of REA data.

REA was established in May 1935 by presidential executive order and was accorded statutory authority by the Rural Electrification Act of 1936. This act established REA as a lender of funds that would promote the

electrification of rural areas. In 1949, the act was amended to allow REA to provide funds for the development of rural telephone service.

REA Provides Loans, Loan Guarantees, and Grants to Rural Utilities

To finance the development and maintenance of rural electric systems, REA makes and guarantees loans to 938 rural electric utilities, almost all of which are cooperatives. Sixty electric cooperatives are “generation and transmission” cooperatives that produce electricity and then transmit it over high-voltage power lines to central distribution stations. The remaining “distribution” electric borrowers buy and then transform the high-voltage power so that it can be used by households and businesses. These borrowers transmit the electricity to local customers.

Generation and transmission borrowers generally obtain funding through REA’s guaranteed loan program. After REA approves a loan application, these borrowers may obtain loans from the Federal Financing Bank or from private sector lenders; these loans are guaranteed against REA’s revolving fund.¹ Interest rates for the guaranteed loans are equal to the cost of money to the Treasury plus one-eighth of 1 percent. As of May 31, 1993, outstanding REA loan guarantees for electric borrowers totaled about \$21 billion.

Distribution electric borrowers generally use REA’s “insured loan” program. REA finances 70, 80, or 90 percent of a borrower’s financial needs, depending on the borrower’s financial condition. The remaining funds come from other sources, such as the Banks for Cooperatives (CoBank) or the National Rural Utilities Cooperative Finance Corporation (CFC).² The interest rate paid by the borrower is a “blend” (or weighted average) of REA and other interest rates. The REA portion of the insured loans comes from REA’s revolving fund and carries an interest rate of 5 percent. For example, if a utility needed to borrow \$100,000, it could receive an REA-insured loan for \$70,000 at the 5-percent interest rate and borrow the remaining \$30,000 from CFC at the prevailing market rates (for example, at about 9 percent in 1991). The “blended” interest rate for such a loan would be about 6.2 percent. As of May 31, 1993, outstanding REA insured loans to electric borrowers totaled over \$12 billion.

¹The Rural Electrification and Telephone Revolving Fund is primarily funded through repayments of REA loans and sales of certificates of beneficial ownership to the Federal Financing Bank.

²CoBank, which began lending in 1967, is a consortium of financial institutions that are owned by their borrowers. CFC was established by electric borrowers in 1969 to raise funds from commercial markets for lending to cooperatives.

About three-quarters of the 925 telephone utilities that borrow from REA are commercial telephone companies. The remaining borrowers are almost exclusively rural telephone cooperatives. Most rural telephone utilities can obtain financing through (1) direct REA loans at 5-percent interest, (2) Rural Telephone Bank loans,³ (3) "blended" REA and Rural Telephone Bank loans, and (4) Federal Financing Bank loans that are guaranteed by REA. The outstanding balance on REA loans to telephone borrowers totaled about \$3.3 billion in May 1993. The balance on REA loan guarantees to telephone borrowers was about \$340 million.

In general, REA loans and loan guarantees may not be used to finance nonutility investments.⁴ However, under 1987 amendments to the Rural Electrification Act, REA currently makes loans and grants in amounts of up to \$400,000 at no interest for general rural economic development purposes. Projects funded by these loans and by grants include community centers, sewer lines, recycling facilities, or other manufacturing or business activities in rural areas. According to REA officials, such loans and grants could be used to finance satellite or cable television investments by REA borrowers, but REA has approved no such requests thus far. Under 1990 amendments, REA makes grants to schools and hospitals in order to encourage and improve telecommunications, computer networks, and related advanced technologies used in rural areas.

Cable and Satellite Television Businesses Serve Millions of Customers

Over 60 percent of all U.S. households with televisions are served by either cable or satellite television services. According to trade association officials, cable television is concentrated in urban or suburban areas because it requires from 15 to 25 customers per mile of cable to be cost-effective. Cable television has grown from serving 37 percent of U.S. households with televisions in 1985 to serving 61 percent (or about 56 million) of these households in 1992. With few exceptions, cable television companies face no competition from other cable companies in their service areas.

Satellite television services mostly serve rural areas not reached by cable television services. The potential market for satellite television has been

³The Rural Telephone Bank, established in 1971, lends money to REA telephone borrowers that meet certain criteria. The Bank, whose governor is the REA Administrator, historically was funded by Treasury funds. Since its inception, the Bank has also issued class B and C stocks. The Bank is retiring its government class A stocks in preparation for becoming a private corporation.

⁴Nonutility activities for telephone companies are more commonly known as "nonregulated" activities. In this report, the term "nonutility" is used instead of "nonregulated."

estimated at about 20 million households, but only about 3.6 million households currently receive satellite programming.

Objectives, Scope, and Methodology

Many REA borrowers provide cable television or satellite equipment and programming services to their customers. Independent cable and satellite television businesses and others have expressed concern that these REA borrowers may enjoy unfair competitive advantages because they have access to low-cost financing and utility resources. Because of these concerns, Representative John E. Porter asked GAO to (1) examine the extent to which REA borrowers have invested in cable and satellite television, (2) determine whether REA borrowers or their affiliates compete with independent businesses to provide such services, and (3) provide information on the extent to which federal and state agencies oversee REA borrowers' cable and satellite television businesses.

To determine the extent to which REA borrowers invest in cable or satellite television services, we mailed questionnaires to all REA electric and telephone borrowers. We identified the universe of borrowers by obtaining a list of these entities from REA. REA borrowers completed and returned 1,610 questionnaires to us, responding at a rate of about 86 percent. The survey results are not adjusted in this report. Because different numbers of respondents chose to answer, or not to answer, specific questions in our questionnaire, percentages derived from the survey and contained in this report may be derived from different denominators. In this report, these percentages are reported without including the "missing" responses. (See app. I for the number of "missing" responses.)

To examine whether REA borrowers compete with independent businesses, we relied upon appropriate questions in our questionnaire that quantified the extent of competition between borrowers and independent businesses. To obtain the views of satellite equipment and broadcasting businesses and REA borrowers, we obtained and reviewed documents from, and interviewed officials of, the National Rural Telecommunications Cooperative, the National Telephone Cooperative Association, the National Rural Electric Cooperative Association, the Cable Antenna Television Association, and the Satellite Broadcasting and Communications Association.

To examine the extent to which federal and state authorities regulate and oversee the cable and satellite television activities of REA borrowers, we interviewed officials and/or reviewed documents obtained from REA, the

Federal Communications Commission (FCC), the Federal Energy Regulatory Commission (FERC), and the National Association of Regulatory Utility Commissioners—the national organization representing state utility regulators. We obtained and reviewed federal regulations and reports that pertained to regulating the nonutility investments of telephone and electric utilities. In addition, we included questions in our questionnaire about the extent to which REA borrowers are required to obtain authorizations to engage in cable or satellite television businesses.

Because REA has procedures and measures that are intended to ensure that its loan and loan guarantees are used for authorized purposes, we examined these controls to the extent that was appropriate for the objectives and scope of this review. Furthermore, we noted and reviewed USDA Office of Inspector General reports that addressed these controls. Because we did not examine the financial records of REA borrowers or conduct tests of REA's controls, we have no basis for making observations or drawing conclusions about the adequacy of these controls.

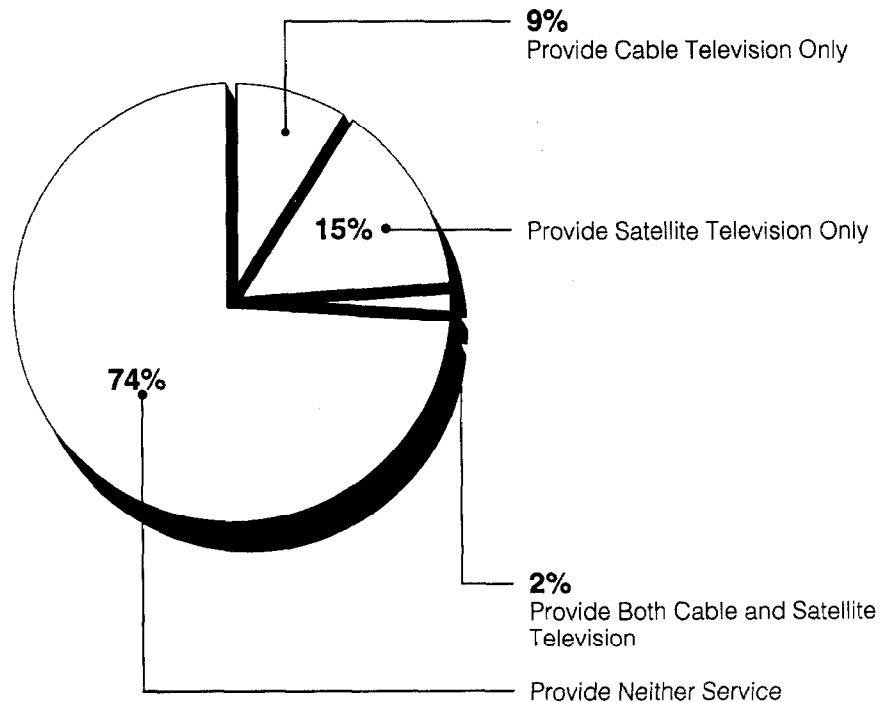
Most of our fieldwork was performed in the Washington, D.C., metropolitan area, except that our questionnaire was pretested on REA borrowers in Virginia and New Jersey. Our work was performed from July 1992 through April 1993 in accordance with generally accepted governmental auditing standards.

In providing written comments on a draft of this report, REA suggested minor clarifications and provided more current REA financial data. Specifically, REA provided us with recent data on the outstanding balances for its loans and loan guarantees. Moreover, REA clarified the kinds of stocks issued by the Rural Telephone Bank. REA also suggested that we explain why loans from such sources as CoBank and CFC are considered to be low cost and indicate how many households in rural communities have access to cable television. We incorporated these financial data and suggested clarifications into the report.

Many REA Borrowers Invest in Cable and Satellite Television

Many REA borrowers have invested in cable and satellite television businesses. Specifically, about one-quarter (416) of the 1,610 REA borrowers that responded to our survey said they provide cable or satellite television services to customers. One hundred fifty-two REA borrowers said they provide cable television services only, and 231 said they provide satellite television services only. Thirty-three REA borrowers said they provide both cable and satellite television services. (See fig. 2.1.)

Figure 2.1: REA Borrowers That Provide Cable and Satellite Television Services



Source: GAO survey of REA borrowers.

In our survey, about 56 percent of the borrowers with cable television services and about 49 percent of those with satellite television services

reported that they had spent their own moneys to finance the investments.¹ Respondents that provided cable television services reported that they had spent an average of \$2.3 million on each cable system established, for a reported total of \$338 million. Borrowers that provided satellite television services reported that they had spent an average of \$61,378 on each satellite business, for a reported total of about \$19 million. These reported investment totals are probably understated, since about one-fifth of the respondents in our survey that reported they had cable or satellite television businesses did not report the amounts of money they had invested.

REA Telephone Borrowers Are Likely to Provide Cable Television Services

According to our survey, 95 percent of the REA borrowers that provide cable television services are telephone utilities. Over one-half of the cable television businesses that are operated by REA borrowers began offering cable services between 1980 and 1983. Generally, borrowers that have cable television businesses organize these activities as profit-making business affiliates of the utility: 71 percent of our respondents that provide cable television services organize the business as an affiliate, and 85 percent operate the business for profit.

REA Electric Borrowers Are Likely to Provide Satellite Television Services

In our survey, 77 percent of the borrowers that provide satellite television services are electric utilities—almost exclusively electric cooperatives. Most satellite television businesses that are operated by REA borrowers began offering satellite television services between 1987 and 1989.

Of the 264 REA borrowers in our survey that said they provide satellite television services,² 41 percent provide satellite television programming and sell satellite reception equipment in their service areas. Fifty-five percent provide programming services only. Four percent sell satellite reception equipment only. Forty-nine percent of these respondents operate the satellite business for profit, and 51 percent operate the satellite business on a nonprofit basis.

REA borrowers have organized themselves to facilitate their entry into the telecommunications market. In 1986, REA borrowers formed the National Rural Telecommunications Cooperative (NRTC)—a joint venture of the National Rural Electric Cooperative Association and CFC, supported by the

¹Percentages in this report derived from our survey of REA borrowers exclude data from respondents that chose not to answer specific questions in the survey. (See app. I for details.)

²Including borrowers that provided both satellite and cable television services.

Chapter 2
Many REA Borrowers Invest in Cable and
Satellite Television

National Telephone Cooperative Association. Over 600 rural electric and telephone systems belong to NRTC. NRTC obtains and organizes satellite television programming packages from such sources as Home Box Office and Cable News Network.

When REA borrowers provide satellite television programming to their customers, they do not actually transmit satellite signals to viewers' satellite dishes. Rather, most REA borrowers market NRTC's "Rural TV" package to viewers and collect program revenues from viewers. The "Rural TV" package is available on the satellite C-band to homeowners with outdoor satellite dishes. Satellite dishes have prices of \$1,000 or more. Seventy-six percent of the REA borrowers in our survey that provide satellite programming are members of NRTC.

REA Borrowers' Satellite and Cable Businesses May Enjoy Competitive Advantages

In our survey, REA borrowers with satellite television services reported facing more competition from other providers than borrowers with cable television services. At the same time, independent¹ cable and satellite businesses are concerned that REA borrowers have access to resources that give the borrowers competitive advantages. For example, REA borrowers have access to sources of loans that other parties do not have access to. Moreover, REA borrowers have utility resources—such as equipment, office space, and personnel—that they share with their nonutility businesses, including cable and satellite television services.

REA Borrowers' Cable and Satellite Businesses Compete With Independent Businesses

According to our survey, when REA borrowers began to offer cable television services, only about 13 percent of these borrowers faced competition from other cable providers within their service areas. After the borrowers established their cable businesses, only about 15 percent faced competition from independent cable providers. In contrast, about 78 percent of the respondents that provide satellite equipment compete with independent satellite businesses. It is possible that borrowers with cable businesses compete with satellite businesses in areas where the two types of businesses exist; however, a House Committee report noted that through June 1992, competition between cable television and other telecommunications media, such as home satellite dishes, had not materialized.²

According to trade association officials, firms that provide satellite television services may face greater competition than cable television firms, in part because satellite equipment and programming are widely available and because satellite television services require relatively little capital. For example, dealers of satellite equipment range in size from a national department store to businesses that operate out of homes and garages.

Trade association officials said that, for a variety of reasons, only a few cable systems compete with each other. Reasons they cited included the high costs associated with starting and operating a cable system; for example, in our survey, borrowers with cable businesses spent an average of \$2.3 million on cable television, while borrowers with satellite television spent an average of \$61,378. Also, according to these officials, relatively high population densities are needed for cable systems to be profitable;

¹In this report, we refer to cable or satellite companies that are not affiliated with an REA borrower as "independent" companies.

²H.R. Rep. No. 628, 102d Cong., 2nd Sess. 30 (1992).

cable television systems may require 15 to 25 customers per mile of cable to be profitable, while satellite television businesses can operate successfully in less populous areas. In addition, trade association officials said, entry into the satellite television market is relatively unfettered by federal or state regulation, while many cable television providers are granted exclusive operating franchises by local governments.

REA Borrowers May Have Competitive Advantages

REA electric and telephone borrowers may enjoy competitive advantages over independent cable and satellite television businesses. We found that REA borrowers have access to financial, material, and human resources that may expedite the borrowers' entry into the cable and satellite television businesses. According to independent cable and satellite television businesses and their trade associations, rural electric cooperatives have access to loans from sources, such as the Banks for Cooperatives (CoBank) or the National Rural Utilities Cooperative Finance Corporation (CFC), that charge lower interest rates than many commercial banks, as well as to marketing and operating resources that may surpass those of many independent businesses.

REA electric and telephone borrowers and their national associations informed us that REA borrowers provide cable and/or satellite television services in sparsely populated areas that would not otherwise have access to these telecommunications services. For instance, these parties said that frequently only the local telephone utility had the financial and technical resources to provide cable television services in some remote areas. According to an FCC official, over 91 percent of U.S. households are served by cable television companies. However, according to the official, rural communities are generally not as well served by cable television as more densely populated communities.

REA Borrowers Have Access to Financial Resources

REA borrowers have access to financial resources to support their cable and satellite television enterprises. These include (1) exclusive sources of loans that REA borrowers established to finance their utility and nonutility projects and (2) the borrowers' general funds.³ (We neither looked for nor found evidence that REA borrowers were using the proceeds of REA loans or loan guarantees to directly subsidize their cable or satellite investments.)

³General funds are unrestricted funds that are derived from revenues and other sources; general funds are on deposit at banks and other institutions and are readily available on demand.

**Borrowers Have Access to
Exclusive Sources of Loans**

REA borrowers have access to their own sources of funds. According to our survey, REA borrowers have not used these resources extensively to directly finance their cable and satellite television businesses. However, the availability of these loan sources may free a borrower's own funds for cable and satellite investments.

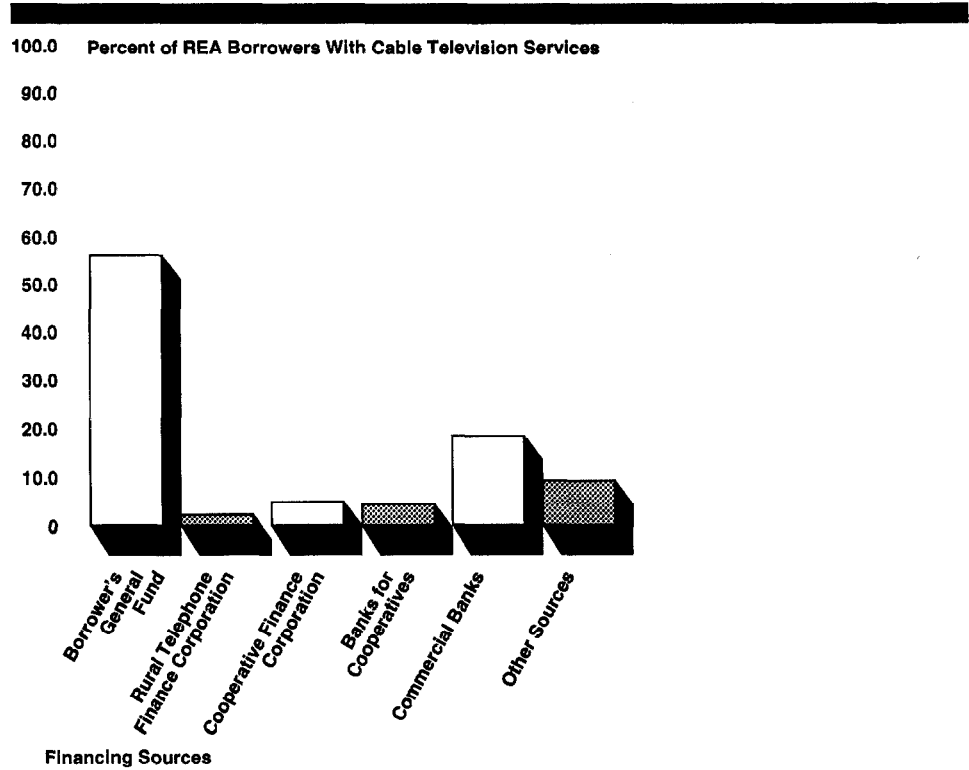
Specifically, many REA borrowers (such as electric and telephone cooperatives and public power agencies) are members of CoBank, CFC, or the Rural Telephone Finance Cooperative (RTFC). These institutions lend money to members to finance utility and nonutility activities. These sources of credit are generally available only to REA borrowers and their affiliates. Officials from these institutions said that loans from these sources would probably have lower interest rates than loans from commercial banks. A CFC official added that loans for cable and satellite investments might be easier for an REA borrower to obtain from CFC than from a commercial bank. In our survey, about 11 percent of the borrowers with cable television businesses said they had obtained loans from such sources as CoBank, CFC, and the RTFC to start these businesses. Also, about 7 percent of the borrowers with satellite television businesses said they had used these sources.

**Borrowers Use Their General
Funds**

REA borrowers also have money in their general funds to pay for their cable and satellite television businesses, which can be costly. For example, in our survey, the REA borrowers with cable businesses invested an average of over \$2 million in these businesses. Moreover, in our survey, 56 percent of the REA borrowers that provide cable television said they used their general funds to finance the cable television enterprise. (See fig. 3.1.)

Chapter 3
REA Borrowers' Satellite and Cable
Businesses May Enjoy Competitive
Advantages

Figure 3.1: Sources of Funding for REA Borrowers' Cable Television Investments



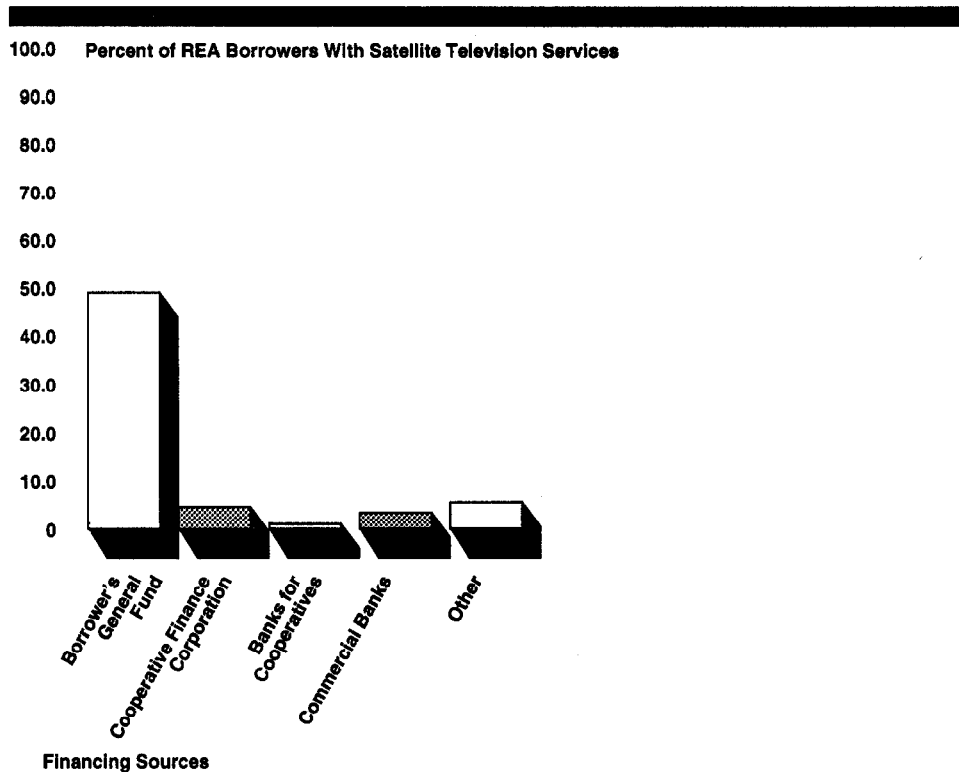
Note: Each borrower may have indicated more than one source of financing.

Source: GAO survey of REA borrowers.

According to our survey, 49 percent of the borrowers that invested in satellite businesses used their general funds. (See fig. 3.2.)

Chapter 3
REA Borrowers' Satellite and Cable
Businesses May Enjoy Competitive
Advantages

Figure 3.2: Sources of Funding for REA Borrowers' Satellite Television Investments



Note: Each REA borrower may have indicated more than one source of funding.

Source: GAO survey of REA borrowers.

In 1994, REA borrowers, through NRTC, look to expand and improve their satellite programming businesses. Specifically, in conjunction with Hughes Communications, Inc., NRTC plans to make available to its members a "Direct TV" satellite programming package that will have the advantage of being receivable by relatively small 18-inch-wide receivers. The "Direct TV" programming will use the "Ku-band" rather than "C-band." NRTC will pay up to \$250 million as a distribution fee to Hughes. Consumers will be charged an initial acquisition and installation charge of about \$700 for the new receivers. Independent satellite equipment retailers and satellite programmers that we contacted are concerned that the "Direct TV" venture will negatively affect their businesses. Some of these parties said that only an entity that had access to low-cost REA and other loans could afford to invest in such an expensive and, in their opinion, risky venture.

Our earlier work has documented that REA telephone borrowers have increased their cash reserves in recent years. In 1992, we testified before the Congress on the cash holdings and rural development investments of REA telephone borrowers.⁴ On the basis of work performed at 15 REA telephone borrowers, we found that in recent years these REA borrowers have increased their cash and investments. Telephone borrowers hold cash amounts for future purposes, such as upgrading their plant and equipment, providing contingencies for natural disasters and accidents, and expanding into related businesses, such as cellular telephone and cable television services.

A number of factors explain the increased cash holdings of REA telephone borrowers.

- REA telephone borrowers have received increased revenues from access charges—payments from long-distance companies to use the local telephone system—on an increased volume of long-distance telephone calls. When long-distance rates decreased during the 1980s, the number of long-distance calls increased, and rural telephone companies (including REA telephone borrowers) enjoyed more revenues, profits, and cash holdings.
- Access to low-cost REA loans tends to increase REA borrowers' cash flow. Some REA borrowers pay REA loan interest rates of 5 percent or less. At the same time, REA borrowers are sometimes reimbursed by the National Exchange Carriers Association for their interest costs at a rate that exceeds 5 percent.⁵
- Some REA borrowers have increased their revenues through income earned from investments in nonutility businesses, such as cellular telephone or cable television businesses.

REA electric borrowers also have substantial cash holdings that facilitate their entry into satellite television services. For example, according to the testimony of a former REA Administrator,⁶ in 1991 REA electric borrowers had "excess" liquid cash reserves of about \$475 million. At the time of the Administrator's testimony, REA defined "excess" reserves as funds that

⁴Rural Development: REA Telephone Borrowers' Cash Holdings and Rural Development Investments (GAO/TRCED-92-65, May 20, 1992).

⁵After the breakup of the Bell Telephone System in 1984, FCC ordered the establishment of the National Exchange Carriers Association to represent the interests of small telephone utilities. The Association works with FCC to determine long-distance telephone access charges and disburses access charge revenues to small telephone utilities.

⁶Statement of Gary Byrne, REA Administrator, before the Subcommittee on Conservation, Credit, and Rural Development, House Committee on Agriculture, June 20, 1991.

exceeded a borrower's utility plant and equipment requirements by more than 8 percent.

On the basis of our survey, we found that borrowers with cable or satellite television businesses account for no more than their proportionate share of REA's outstanding loans and loan guarantees. Borrowers in our survey that operate cable or satellite television businesses constitute 21 percent of all REA borrowers. As of December 31, 1991, these borrowers accounted for an outstanding balance in REA loans of \$5.2 billion—or 18.5 percent of the total outstanding balance for all REA loans at that time. Moreover, these borrowers collectively accounted for \$1.5 billion in outstanding loan guarantees—or 4.3 percent of the total REA balance for guaranteed loans at that time.

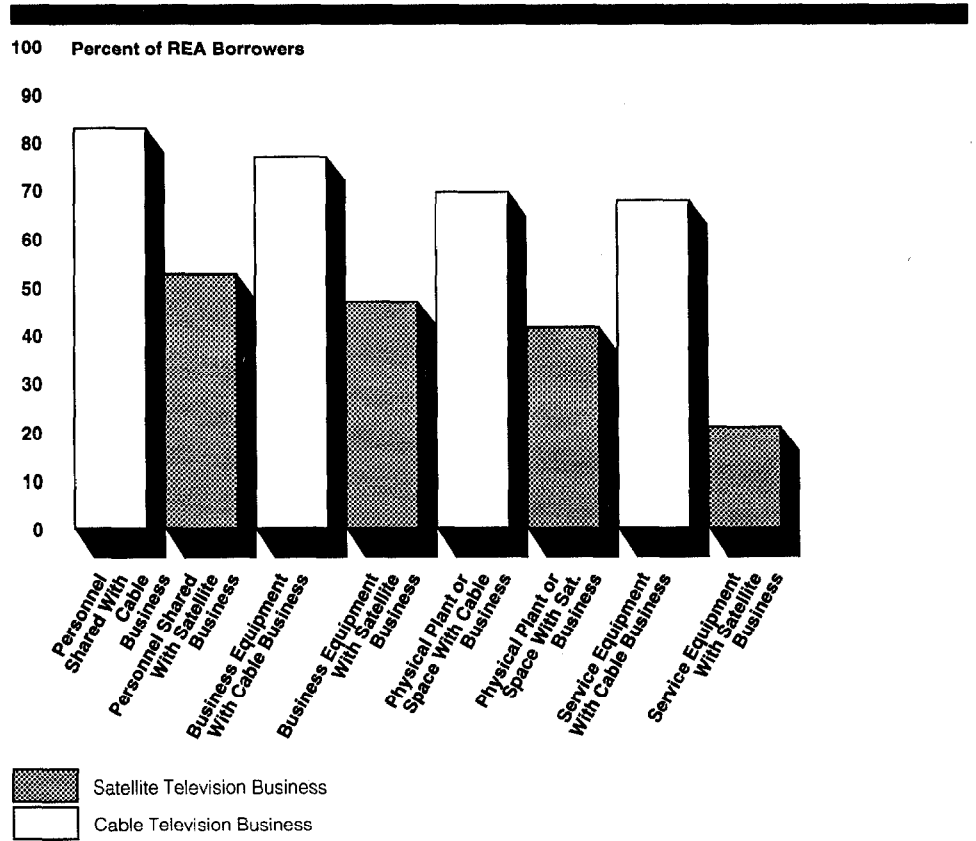
**REA Borrowers Share
Their Utility Resources
With Nonutility Businesses**

According to our survey, most REA borrowers shared utility resources and services with their cable or satellite television businesses. In general, REA borrowers shared resources and services with their cable businesses more than they shared resources and services with their satellite businesses. According to independent satellite businesses and associations that represent the cable and satellite broadcasting industries, this sharing of resources may give REA borrowers a competitive advantage over independent businesses. The sharing of utility resources and services with nonutility activities could result in REA borrowers' cross-subsidizing their nonutility activities if costs are not properly allocated between the utility and nonutility activities.

About 94 percent of the REA borrowers that provided cable television services and about 77 percent of those that provided satellite television services shared operating resources—such as personnel, business or office equipment, physical plant and office space, and service equipment (trucks and tools, for example)—with their satellite or cable business. Only 5 percent of the REA borrowers with cable businesses said they did not share utility resources with their cable business. In contrast, 19 percent of the REA borrowers with satellite television businesses said they did not share utility resources with the satellite business, and 25 percent said they did not share utility services. (See fig. 3.3.)

Chapter 3
REA Borrowers' Satellite and Cable
Businesses May Enjoy Competitive
Advantages

Figure 3.3: Sharing of Utility Resources Between REA Borrowers and Telecommunications Businesses



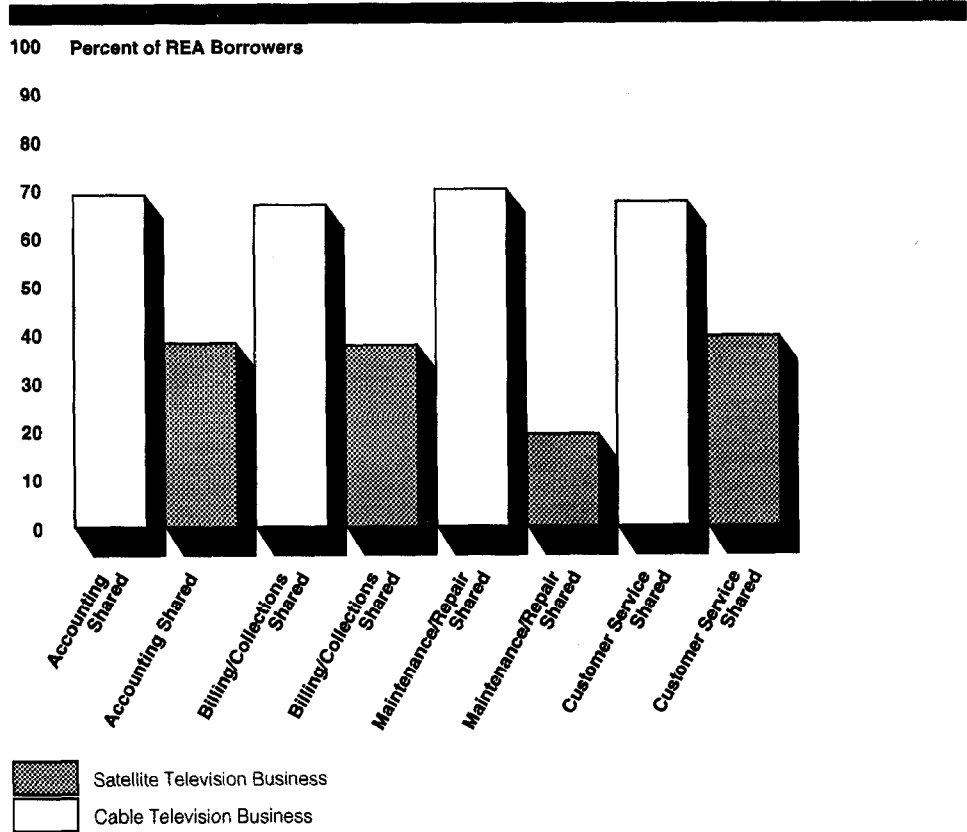
Note: Each borrower may have indicated more than one resource that was shared.

Source: Survey of REA borrowers.

In our survey, over 91 percent of the REA borrowers that provided cable television services and 72 percent of those that provided satellite television services shared services—such as accounting, billing, collections, maintenance, repair, and customer relations—with their cable or satellite businesses. (See fig. 3.4.)

Chapter 3
REA Borrowers' Satellite and Cable
Businesses May Enjoy Competitive
Advantages

Figure 3.4: Sharing of Utility Services
Between REA Borrowers and
Telecommunications Businesses



Note: Each borrower may have indicated more than one service that was shared.

Source: Survey of REA borrowers.

Government Oversight of Borrowers' Cable and Satellite Investments Varies

Federal and state government agencies are involved in regulating the business activities of electric and telephone utilities. At the federal level, utility regulatory agencies play a limited role, in part because many REA borrowers are relatively small. To protect the security of its loans and ensure that loan proceeds are used for authorized purposes, REA requires borrowers to follow certain accounting and audit procedures. Because we did not test these controls or audit any borrowers, we make no conclusions about the adequacy of these procedures. State regulation of borrowers and their affiliates varies widely among the states and depends in part on whether the borrower is a cooperative or is investor-owned.

Federal Utility Regulatory Agencies Play a Limited Role

The Federal Communications Commission (FCC) has authority to regulate interstate communications by wire and radio, including telephone, cable television, and satellite transmission services. The Federal Energy Regulatory Commission (FERC), among other things, regulates the rates, terms, and conditions of wholesale electric power sales and transmission services. However, for various reasons, these agencies' regulation of REA borrowers' activities is limited.

Telephone Borrowers Receive "Rural" Exemption to Provide Cable Television

Under the Cable Communications Policy Act of 1984, common carriers are generally prohibited from providing cable television services in their service areas. The act, however, provides that the "cross-ownership" prohibition does not apply to the extent that such carriers provide telephone exchange services in any rural area, as defined by FCC. FCC has adopted the Bureau of the Census's definition of "rural"—places populated by fewer than 2,500 persons not in "urbanized" areas. In addition, under certain circumstances, FCC can waive the cross-ownership prohibition. In our survey, about 89 percent of the REA telephone borrowers that provide cable television services stated that they are exempt or obtained an FCC waiver. FCC is currently considering increasing the population threshold for the rural exemption.¹

FCC Generally Does Not Regulate Borrowers' Satellite Businesses

REA borrowers that provide satellite broadcasting services are primarily programming "distributors," or satellite equipment retailers, which are generally not regulated by FCC. In our survey, about 73 percent of the REA borrowers that invested in satellite television services stated they did not have to obtain federal or state approval before beginning these businesses.

¹According to FCC, evidence suggests that there are still substantial areas that are wholly without cable service or are underserved by cable. Therefore, FCC has proposed increasing the population threshold for classifying an area as rural from fewer than 2,500 to fewer than 10,000 persons.

(In contrast, only about 9 percent of the borrowers that invested in cable businesses did not obtain regulators' approvals.)

Trade association officials explained that, when providing satellite programming services, REA borrowers generally purchase the rights to market the National Rural Telecommunications Cooperative's (NRTC) "Rural TV" programming package and encourage their ratepayers to buy this package. The borrowers also bill service subscribers and collect the revenues. REA borrowers arrange for ratepayers to view the satellite programming by obtaining the ratepayers' descrambler² codes and conveying the descrambler code to parties that transmit the satellite programming. However, REA borrowers do not physically receive or transmit satellite signals.

According to an FCC attorney, FCC does not regulate or license most entities that "distribute" satellite programming to viewers or to other "distributors."³ Neither does FCC regulate entities that sell satellite reception equipment, such as satellite dishes. The Cable Communications Policy Act of 1984 allowed owners of backyard satellite dishes to receive satellite-relayed, unscrambled programming free of charge until such time as the signals were scrambled by programming carriers and the carriers collected revenues to provide the programming. Today, many satellite programming signals are scrambled.

An FCC attorney explained that, to minimize interference among signals, FCC approves and regulates transmissions by satellite operators. FCC, however, does not license or regulate the activities of programming "distributors" or of entities, such as NRTC, that arrange for programming packages but do not actually transmit television broadcasting signals through satellites.

FERC Excludes REA Electric Cooperatives From Its Regulatory Jurisdiction

Under the Federal Power Act, FERC is responsible for (among other things) setting the rates, terms, and conditions for the sale and transmission of electricity sold at wholesale. While many REA borrowers purchase electricity from wholesale suppliers, relatively few sell power at wholesale. Rather, the borrowers primarily sell electricity at retail to their

²Satellite signals are scrambled to prevent unauthorized reception. Descramblers make it possible for satellite dish owners to receive satellite television programming.

³"Distributors" are entities that buy satellite programming packages to sell to viewers or to other distributors. Distributors do not originate the programming and are not responsible for transmitting the programming by satellite.

customers. Primary responsibility for setting retail electricity prices and regulating utility transactions, such as contracts between utilities and affiliated companies, lies with state utility commissions (although, as discussed below, not all states regulate electric cooperatives).

About 60 REA borrowers are "generation and transmission" cooperatives; that is, they produce and sell power at wholesale to their member retail cooperatives. As wholesale power transactions, such sales potentially fall within FERC's jurisdiction. However, in 1967, the Federal Power Commission (the predecessor of FERC) held that it had no jurisdiction under the Federal Power Act to regulate wholesale rates charged by rural electric cooperatives supervised by REA.⁴

REA Has Controls Over Borrowers' Activities

To protect the security of its loans, REA places certain restrictions on borrowers' nonutility investments; however, REA's authority in this area is limited by statute. REA has accounting and auditing controls that are intended to ensure that borrowers comply with their loan agreements and use REA loan funds for authorized purposes only.

REA Reviews Nonutility Investments as a Loan Security Measure

According to REA officials, REA attempts to prevent its borrowers from completing agreements with other organizations (such as agreements pertaining to the sharing of resources for cable and satellite television services) that could imperil the security of its loans. Specifically, REA regional office officials review and approve agreements between REA borrowers and other organizations. Before 1987, REA rules generally limited electric borrowers' nonutility investments to an amount not exceeding 3 percent of the value of a borrower's total utility plant. REA officials said that REA could also review and reject any nonutility investments planned by its telephone borrowers.

However, the ability of REA to control its borrowers' nonutility investments has been limited by law. In 1987, the Congress amended the Rural Electrification Act of 1936, as amended, to enable electric borrowers to invest their own funds without REA's approval, as long as the investments do not exceed 15 percent of the value of the borrowers' utility plant. In 1990, the Congress further amended the act to enable telephone borrowers to invest up to one-third of their net worth in rural development projects without REA's approval. The 1990 amendment also stated that REA could

⁴Dairyland Power Cooperative, 37 F.P.C. 12, 67 P.U.R.3d 340 (1967). See also, Salt River Project Agricultural Improvement & Power District v. FPC, 129 U.S. App. D.C. 117, 391 F.2d 470 (D.C. Cir. 1968).

not, on the basis of a borrower's level of general funds—the source, according to our survey, of many borrowers' financing for cable and satellite television businesses—deny or reduce any loan or loan advance made under the act.

Accounting and Auditing Controls Focus on Use of REA Loan Proceeds

Agency officials explained that, as a general policy, REA electric and telephone loan funds (with the exception of funds from rural economic development loans and grants) are to be used for utility purposes only. The loan agreement between REA and a borrower specifies the particular purposes of the loan—for example, to upgrade an electrical transmission substation. The accounting and auditing requirements for REA borrowers focus on ensuring that loan funds are used in accordance with the agreement. We did not audit any borrowers or test these controls.

REA Applies FCC's and FERC's Accounting Rules

REA requires that telephone and electric borrowers follow FCC's and FERC's Uniform Systems of Accounts, respectively. These systems of accounts are used by regulated utility companies and provide a framework for recording costs and transactions. In addition to its uniform system of accounts for telephone companies, FCC has established (1) joint cost rules, which specifically address how to allocate the costs of resources and/or services that are shared by regulated telephone utilities and nonregulated activities,⁵ and (2) affiliate transaction rules, which govern how transactions between a utility and its nonregulated affiliates are recorded. The joint cost rules are designed to ensure that utility costs are allocated to the utility activity and that nonutility costs are allocated to the nonutility activity.⁶ FERC's Uniform System of Accounts also addresses the recording of some nonutility and affiliate costs; however, according to FERC and REA officials, FERC's system of accounts is not as extensive or precise as FCC's.

REA requires its borrowers to follow these rules as supplemented by REA requirements. Requirements for telephone borrowers have been made part of REA's formal regulations (7 C.F.R. 1770), while requirements for electric borrowers are set forth in an REA bulletin. In 1990, REA issued a notice of proposed rulemaking to make the REA accounting requirements for electric borrowers a formal regulation. As of May 1993, the rulemaking had not been completed.

⁵In this report, the "nonutility" services or activities of a telephone utility refer to the nonregulated services offered by a telephone utility or its affiliates.

⁶Telephone Communications: Controlling Cross-Subsidy Between Regulated and Competitive Services (GAO/RCED-88-34, Oct. 30, 1987).

REA Requires Audits

REA officials review borrowers' expenditures for authorized loan purposes before approving fund withdrawals. Borrowers are required to establish special "trustee accounts," into which they must deposit the proceeds of REA loans. According to REA officials, borrowers cannot withdraw moneys from their trustee accounts and deposit these funds into their general funds without REA's approval. The REA officials said that, before this fund transfer can occur, they must review and approve the borrower's documentation showing that the work was performed for approved loan purposes.

According to REA officials, REA employees audit the accounts of REA borrowers at least every 3 years, and REA requires that its borrowers' accounts undergo annual audits by certified public accountants (CPA). The head of REA's Technical Accounting and Auditing Staff said that if an affiliate is deemed to have "material" assets, then a CPA can audit the accounts of the affiliate as well.

Controls May Deter
Cross-Subsidies

REA officials said that the agency's accounting and audit requirements are not intended primarily to identify or prevent potential cross-subsidies unless the cross-subsidies directly involve REA loan funds; however, they believe that REA's controls are sufficient to deter cross-subsidization. According to the head of REA's Technical Accounting and Auditing Staff, the required CPA audits may include a review of cost allocations between borrowers and their nonutility activities, which can identify improper cost allocations. REA officials review CPA audit reports. If a CPA notes a deficiency, REA officials may send a letter directing the borrower to correct the deficiency and implement any recommendations.

Potential cross-subsidization may come to light in other ways. For example, according to REA officials, a case in the 1980s was brought to REA's attention by several parties in the borrower's area. In this case, an electric borrower purchased all of its materials and supplies exclusively from one of its five subsidiaries from 1984 through 1987. The subsidiaries and the borrower shared common management, which arranged for the borrower to make the purchases at allegedly marked-up prices. REA documentation indicated that the alleged markups may have increased the borrower's (utility) expenses by about \$1.3 million. According to the documentation, before the case was discovered, REA had lent about \$1 million more to the borrower because of the inflated prices than REA would otherwise have lent. REA documentation further indicated that the borrower's ratepayers had paid for about \$300,000 of the increased utility

expenses through their electricity rates. REA referred the case to the USDA's Office of Inspector General. After an investigation, a settlement was agreed upon that included a payment to the government of \$2.5 million.⁷

The Director of REA's Borrower Accounting Division noted that REA auditors cannot examine the records of a borrower's affiliates unless there is a specific authorization in a loan agreement. REA officials said that currently no borrowers have loan agreements containing such provisions. According to the Director, access to affiliates' records could also help deter potential cross-subsidies. REA loan program officials, however, believe that existing procedures provide sufficient deterrence.

State Regulation of Borrowers and Their Investments Varies

The extent to which states regulate the cable or satellite businesses of REA borrowers varies among states. Almost all states regulate the utility rates of private electric and telephone utilities, and almost all states employ procedures, frequently during rate cases, to detect and prevent cross-subsidies that can arise from a utility's relationship with its affiliates.

However, many cooperatives (and REA borrowers) are not regulated by state regulators. For example, according to the 1992 study by the National Association of Regulatory Utility Commissioners,⁸ only 21 states (out of the 46 states with electric cooperatives) regulate the rates of electric cooperatives. Twenty-three states can interpret the prescribed uniform systems of accounts of electric cooperatives. Twenty-five states regulate some nonutility activities.

In addition, according to a survey conducted for the Small Business Administration,⁹ several states, including Maine, New Mexico, Ohio, Texas, Vermont, Virginia, and West Virginia, have laws that enable the public utility commissions to restrict or regulate the diversification investments of cooperatives. For instance, under Maine statutes, electric utilities (including rural electric cooperatives) may not extend or receive credit from an affiliate or make any contract or arrangement with an affiliate to provide management, construction, engineering, accounting, legal, or other services without the approval of the state public utility commission.

⁷The settlement agreement stated that the borrower's settlement did not constitute an admission of wrongdoing.

⁸National Association of Regulatory Utility Commissioners, Utility Regulatory Policy in the United States and Canada (Washington, D.C.: Dec. 31., 1992).

⁹SVL Associates, Competition Between Small Business and Rural Electric and Telephone Cooperatives in Non-Utility Business, National Technical Information Service (Springfield, Va.: May 1989).

The commission must find that the contract or arrangement is not adverse to the public interest and formally approve it.

Under Virginia state law, no contract or other arrangement providing for the furnishing of management, accounting, legal, or other services or for the sale, exchange, lease, or purchase of treasury bonds or stocks between a public service company (including a cooperative) and an affiliate may occur without the permission of the state. Virginia law also restricts the right of utilities to extend loans, credit, or obligations to an affiliate without the permission of the state commission. In addition, Virginia law specifies that rural electric cooperatives may engage in the distribution, servicing, and maintenance of television reception, satellite dishes, and encrypted programs and equipment.

Results of Survey of REA Borrowers

- 1. Which of the following most accurately describes this utility's business? (Check one.) (1,607 responses, 3 missing)**
- | | |
|--------------|------------------------------------|
| <u>49.3%</u> | Electric cooperative |
| <u>14.0</u> | Telephone cooperative |
| <u>0.1</u> | Commercial electric company |
| <u>34.7</u> | Commercial telephone company |
| <u>0.2</u> | Government owned telephone company |
| <u>1.5</u> | Government owned electric company |
| <u>0.2</u> | Other |
- 2. Has this utility or its affiliates ever provided cable television service? (Check one.) (1,609 responses, 1 missing)**
- | | |
|--------------|---------------------------|
| <u>15.8%</u> | Yes |
| <u>84.2</u> | No (Skip to question 19.) |
- 3. Does this utility or its affiliates currently provide cable television service? (Check one.) (254 responses)**
- | | |
|--------------|-----|
| <u>73.2%</u> | Yes |
| <u>26.8</u> | No |
- 4. Why does this utility or its affiliates no longer provide cable television service? (Check all that apply.) (68 responses)**
- | | |
|-------------|--|
| <u>4.4%</u> | Do not want to compete with another company in the area |
| <u>22.1</u> | Not economically feasible due to small number of consumers |
| <u>1.5</u> | Not economically feasible due to competition |
| <u>25.0</u> | Found other investments with greater return |
| <u>0</u> | Other |
- 5. As of December 1, 1992, how many subscribers does the cable system operated by this utility or its affiliates serve? (164 responses, 22 missing)**
- | | |
|----------------|-----------------|
| <u>2,727</u> | Mean response |
| <u>638</u> | Median response |
| <u>28</u> | Minimum |
| <u>221,000</u> | Maximum |

6. Does the cable television system operated by this utility or its affiliates serve consumers inside its utility service area, outside its utility service area, or both inside and outside its utility service area? (Check one.) (165 responses, 21 missing)

<u>53.3%</u>	Inside the utility service area
<u>1.8</u>	Outside the utility service area
<u>44.8</u>	Both inside and outside the utility service area

7. In what year did this utility or its affiliates first offer cable television service to the public? (Enter year.) (165 responses, 21 missing)

<u>1.2%</u>	1965
<u>1.2</u>	1966
<u>0.6</u>	1969
<u>0.6</u>	1970
<u>0.6</u>	1976
<u>0.6</u>	1977
<u> </u>	1978
<u>1.8</u>	1979
<u>4.8</u>	1980
<u>9.1</u>	1981
<u>19.4</u>	1982
<u>17.0</u>	1983
<u>6.1</u>	1984
<u>7.9</u>	1985
<u>4.2</u>	1986
<u>5.5</u>	1987
<u>4.2</u>	1988
<u>5.5</u>	1989
<u>2.4</u>	1990
<u>4.8</u>	1991
<u>2.4</u>	1992

8. Which of the following best describes how the cable television business is organized in this utility? (Check one.) (164 responses, 22 missing)

Appendix I
Results of Survey of REA Borrowers

<u>21.3%</u>	Cable television business is organized as a division of this utility
<u>70.7</u>	Cable television business is organized as an affiliate or subsidiary of this utility
<u>7.9</u>	Other

9. Is the cable business provided by this utility or its affiliates operated as a for-profit business or as a not-for-profit business? (Check one.) (164 responses, 22 missing)

<u>84.8%</u>	For-profit
<u>15.2</u>	Not-for-profit

10. Which of the following operating resources, if any, are shared under the terms of a management agreement or contract by this utility and the cable television business? (Check all that apply.) (186 responses)

<u>5.4%</u>	No resources are shared
<u>82.8</u>	Personnel (labor or management)
<u>76.9</u>	Business or office equipment (computers, telephones, etc.)
<u>69.4</u>	Physical plant or office space
<u>67.7</u>	Service equipment (trucks, tools, etc.)
<u>2.7</u>	Other (Please specify.)

11. Which of the following services, if any, are shared under the terms of a management contract or agreement by this utility and the cable television business? (Check all that apply.) (186 responses)

<u>7.5%</u>	No services are shared
<u>68.8</u>	Accounting
<u>66.7</u>	Billing and/or collections
<u>69.9</u>	Maintenance and/or repair
<u>67.2</u>	Customer service
<u>2.7</u>	Other (Please specify.)

12. From which of the following operating resources, if any, did this utility obtain financing for its initial expansion into

the cable television business? (Check all that apply.) (186 responses)

<u>11.8%</u>	Utility did not finance the cable television
<u>55.9</u>	This utility's general funds
<u>2.2</u>	Rural Telephone Finance Cooperative
<u>4.8</u>	National Rural Utilities Cooperative Finance Corporation
<u>4.3</u>	Banks for Cooperatives
<u>18.3</u>	Commercial banks
<u>9.1</u>	Other (Please specify.)

13. How much money has this utility invested or its affiliates invested in cable television through Dec. 31, 1991? (Enter the amount in dollars.)

(Statistics are based on 145 responses from the 186 entities that indicated they have offered cable television services to their clients.)

<u>\$2,337,186</u>	Mean
<u>\$360,000</u>	Median
<u>\$0</u>	Minimum
<u>\$200,000,000</u>	Maximum

14. From which of the following federal or state agencies, if any, did this utility obtain approval before offering cable television service? (Check all that apply.) (186 responses)

<u>8.6%</u>	Did not have to obtain approval from federal or state agencies.
<u>44.6</u>	Rural Electrification Administration
<u>17.2</u>	State regulatory authority
<u>66.7</u>	Local franchise authority
<u>71.0</u>	Federal Communications Commission
<u>1.6</u>	Other (Please specify.)

Question 15 is to be answered by telephone utilities. If this utility does not offer telephone service, please skip to question 16.

15. Did this telephone utility qualify for a rural exemption or obtain a cross ownership waiver from FCC for the purpose of

allowing the utility to provide cable television service within its telephone service area? (Check one.) (151 responses, 24 missing)

<u>88.7%</u>	Yes
<u>6.0</u>	No
<u>5.3</u>	Don't know

16. At the time this utility or its affiliates first began offering cable television service, was cable television service available to anyone in the service area from other sources? (Check one.) (165 responses, 21 missing)

<u>13.3%</u>	Yes
<u>86.7</u>	No

17. Do any other companies currently offer cable television service in the cable television service area of this utility or its affiliates? (Check one.) (163 responses, 23 missing)

<u>14.7%</u>	Yes
<u>85.3</u>	No

18. To the best of your knowledge, have any competitors or potential competitors of this utility's cable television business filed any complaints against this utility for having an unfair competitive advantage? (Check one.) (164 responses, 22 missing)

<u>1.8%</u>	Yes
<u>98.2</u>	No

19. Has this utility or its affiliates ever offered satellite dish equipment or satellite programming services to consumers? (Check one.) (1,606 responses, 4 missing)

<u>24.8%</u>	Yes
<u>75.2</u>	No

20. In what year did this utility or its affiliates first offer satellite television service to the public? (Data below are based on a total of 384 responses to question 19 that

indicated that the respondents had provided satellite services. Fifteen responses were missing.)

<u>0.5%</u>	1975
<u> </u>	1976
<u> </u>	1977
<u> </u>	1978
<u>2.6</u>	1979
<u>1.6</u>	1980
<u>1.8</u>	1981
<u>2.6</u>	1982
<u>2.3</u>	1983
<u>6.0</u>	1984
<u>10.4</u>	1985
<u>2.9</u>	1986
<u>24.7</u>	1987
<u>25.3</u>	1988
<u>11.7</u>	1989
<u>5.2</u>	1990
<u>1.3</u>	1991
<u>0.8</u>	1992
<u>0.3</u>	1993

21. Does this utility or its affiliates currently offer satellite equipment to consumers? (Check one.) (398 responses, 1 missing)

<u>29.9%</u>	Yes
<u>70.1</u>	No (Skip to question 24)

22. Has this utility or its affiliates ever offered satellite equipment to consumers? (Check one.) (268 responses, 11 missing)

<u>53.4%</u>	Yes
<u>46.6</u>	No

23. Why does this utility or its affiliates no longer provide satellite equipment to consumers? (Check all that apply.) (143 responses)

<u>32.9%</u>	Prefer to have another company provide satellite equipment
<u>53.8</u>	Not economically feasible due to small number of consumers
<u>18.9</u>	Not economically feasible due to competition
<u>7.7</u>	Found other investments with greater return
<u>18.2</u>	Other (Please specify.)

24. Does this utility or its affiliates currently offer satellite programming services to consumers? (Check one.) (399 responses)

<u>63.4%</u>	Yes
<u>36.6</u>	No

25. Has this utility or its affiliates ever offered satellite programming services to consumers? (Check one.) (143 responses, 3 missing)

<u>60.8%</u>	Yes
<u>39.2</u>	No (Skip to question 27.)

26. Why does this utility or its affiliates no longer provide satellite programming services to consumers? (Check all that apply.) (87 responses)

<u>29.9%</u>	Prefer to have another company provide satellite programming
<u>62.1</u>	Not economically feasible due to small number of consumers
<u>14.9</u>	Not economically feasible due to competition
<u>19.5</u>	Found other investments with greater return
<u>9.2</u>	Other (Please specify.)

27. Which of the following describes how the satellite equipment and/or programming business is organized in this utility? (Check one.) (368 responses, 31 missing)

<u>29.6%</u>	Satellite business is organized as a division of this utility
<u>36.4</u>	Satellite business is organized as an affiliate

34.0 or subsidiary of this utility
34.0 Other

28. Is the satellite equipment and/or programming business provided by this utility or its affiliates operated as a for-profit business or as a not-for-profit business? (Check one.) (322 responses, 77 missing)

49.4% For-profit
50.6 Not-for-profit

29. Which of the following operating resources, if any, are shared under the terms of a management agreement or contact by this utility and the satellite business? (Check all that apply.)(399 responses)

19.3% No resources are shared
52.6 Personnel (labor or management)
46.9 Business or office equipment (computers, telephones, etc.)
41.4 Physical plant or office space
20.8 Service equipment (trucks, tools, etc.)
9.8 Other (Please specify.)

30. Which of the following services, if any, are shared under the terms of a management agreement or contract by this utility and the satellite business? (Check all that apply.) (399 responses)

25.3% No services are shared
38.1 Accounting
37.6 Billing and/or collections
19.0 Maintenance and/or repair
39.3 Customer service
10.0 Other (Please specify.)

31. From which of the following sources, if any, did this utility obtain financing for its initial expansion into the satellite equipment and/or programming business? (Check all that apply.) (399 responses)

<u>36.8%</u>	Utility did not finance the satellite business
<u>48.9</u>	This utility's general funds
<u>0</u>	Rural Telephone Finance Cooperative
<u>4.5</u>	National Rural Utilities Cooperative Finance Corporation
<u>1.0</u>	Banks for Cooperatives
<u>3.3</u>	Commercial banks
<u>5.5</u>	Other (Please specify.)

32. How much money has this utility invested or its affiliates invested in satellite equipment and/or programming through Dec. 31, 1991? (Enter the amount in dollars.)

(Statistics are based on 315 responses from the 399 entities that indicated they have offered satellite equipment and/or programming services to their clients.)

<u>\$61,378</u>	Mean
<u>\$3,000</u>	Median
<u>\$0</u>	Minimum
<u>\$2,369,180</u>	Maximum

33. Is this utility or its satellite affiliates a member of the National Rural Telecommunications Cooperative (NRTC)? (Check one.) (377 responses, 22 missing)

<u>75.9%</u>	Yes
<u>23.1</u>	No (Skip to question 35.)
<u>1.1</u>	Don't know (Skip to question 35.)

34. Which one of the following satellite equipment or services, if any, does this utility or its affiliates acquire from NRTC for resale to consumers? (Check all that apply.) (286 responses)

<u>15.4%</u>	Acquire no equipment or services from NRTC
<u>14.0</u>	Satellite equipment such as dishes, decoders, or receivers.
<u>77.6</u>	"Rural TV" or other program packages
<u>2.8</u>	Other (Please specify.)

35. From which of the following federal or state agencies, if any, did this utility obtain approval before offering satellite dish services? (Check all that apply.) (399 responses)

<u>73.2%</u>	Did not have to obtain approval from federal or state agencies
<u>7.0</u>	Rural Electrification Administration
<u>6.0</u>	State regulatory authority
<u>7.5</u>	Other (Please specify.)

If this utility or its affiliates offer programming services only, please skip to question 39.

36. At the time this utility or its affiliates first offered satellite equipment, was any other organization or business selling or leasing satellite equipment on a walk-in basis (not mail order) in the local area? (Check one.) (100 responses, 19 missing)

<u>59.0%</u>	Yes
<u>25.0</u>	No
<u>16.0</u>	Don't know

37. Do any other organizations or businesses currently sell or lease satellite equipment on a walk-in basis (not mail order) in the local area? (Check one.) (99 responses, 20 missing)

<u>78.0%</u>	Yes
<u>22.0</u>	No

38. Under what terms does this utility or its affiliates offer satellite equipment to consumers? (Check all that apply.) (119 responses)

<u>74.8%</u>	Cash sales
<u>30.3</u>	Financing of sales
<u>37.0</u>	Leasing of equipment
<u>3.4</u>	Other (Please specify.)

39. To the best of your knowledge, have any competitors or potential competitors of this utility's satellite equipment

and/or programming business filed any complaints against this utility for having an unfair competitive advantage? (Check one.) (370 responses, 29 missing)

<u>1.1%</u>	Yes
<u>98.9</u>	No

- 40. If you would like to explain any of your answers or you have any comments on subjects covered in this questionnaire, please do so below.**

Comments From the U.S. Department of Agriculture



United States
Department
of Agriculture

Rural
Electrification
Administration

Washington
D.C.
20250

JUL 4 1993

SUBJECT: U.S. General Accounting Office Draft Report RCED-93-164, "RURAL ELECTRIFICATION: REA Borrowers' Investments in Cable and Satellite Television Services"

TO: Ernest Hazera
Evaluator
Resources, Conservation and Energy Division
General Accounting Office

FROM: THOMAS M. SCANLON
Director
Policy and Management Analysis Staff

Attached is a copy of the above mentioned draft report with our comments noted on the appropriate pages.

We have a few minor comments on this report in addition to some REA loan and guarantee dollar changes. On Page 12, the statement is made that the Rural Telephone Bank "... historically was funded by Treasury funds; however, it recently began issuing stocks in preparation for becoming a private corporation." This is a misleading statement. The Telephone Bank has been issuing Class B and C stock since its inception. Retirement of the Government's Class A stock is the requirement for privatization and is not dependent on stock sales except to determine the minimum amount of "A" stock that must be retired in a given year.

Now on p. 10.

On Page 22, the statement is made that, "According to independent cable and satellite television businesses and their trade associations, rural electric cooperatives have marketing resources, access to low-cost loans from such sources as the Bank for Cooperatives (CoBank) or the National Rural Utilities Cooperative Finance Corporation (CFC), and operating resources that may surpass those of many independent businesses." There is no definition of "low-cost loans" or how the determination was made that CFC and CoBank loans are low-cost. Perhaps this should be explained further. Also on Page 22, it is stated that about 70 percent of rural areas are served by cable television. This figure appears somewhat high to us, although we do not have an exact figure. We suggest that perhaps the source for this statistic be cited.

Now on p. 17.

On Page 23, in discussing borrower access to CoBank, CFC, and the Rural Telephone Finance Cooperative, the statement is made that, "... the availability of these loan sources may free a borrower's own funds for cable and satellite investments."

Now p. 18.

Appendix II
Comments From the U.S. Department of
Agriculture

Ernest Hazera

2

However, as the report points out "... only 9 percent or fewer of the borrowers with cable television businesses ...," and "... 5 percent or fewer of the borrowers with satellite television businesses said they used these sources." In any case, these particular institutions are not the only sources of funds that "... may free a borrower's own funds ..." The same would be true of a loan from a commercial bank.

If you have any questions, please call me on (202) 720-1946.

Attachment

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Related GAO Products

Telecommunications: FCC's Oversight Efforts to Control Cross-Subsidization (GAO/RCED-93-34, Feb. 3, 1993).

Telephone Communications: Controlling Cross-Subsidy Between Regulated and Competitive Services (GAO/RCED-88-34, Oct. 23, 1987).

Rural Development: REA Telephone Borrowers' Cash Holdings and Rural Development Investments (GAO/T-RCED-92-65, May 20, 1992).

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