

**FEDERAL POWER MARKETING ADMINISTRATION
ACCOUNTING PRACTICES**

OVERSIGHT HEARING
BEFORE THE
SUBCOMMITTEE ON WATER AND POWER
RESOURCES
COMMITTEE ON RESOURCES
HOUSE OF REPRESENTATIVES
ONE HUNDRED FOURTH CONGRESS
SECOND SESSION
ON
**ACCOUNTING PRACTICES FOR FEDERAL POWER
MARKETING ADMINISTRATIONS [PMAS]**

SEPTEMBER 19, 1996

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ACCOUNTING PRACTICES FOR FEDERAL POWER MARKETING ADMINISTRATIONS

THURSDAY, SEPTEMBER 19, 1996

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON WATER AND POWER RESOURCES,
COMMITTEE ON RESOURCES,
Washington, DC.

The subcommittee met, pursuant to call, at 2:55 p.m., in room 1334, Longworth House Office Building, Hon. John T. Doolittle (chairman of the subcommittee) presiding.

STATEMENT OF HON. JOHN T. DOOLITTLE, A U.S. REPRESENTATIVE FROM CALIFORNIA

Mr. DOOLITTLE. The Subcommittee on Water and Power Resources will come to order. The Chair apologizes for this delay—we have had several key votes, and it seemed prudent to get through them before we began.

The subcommittee is meeting today to hold an oversight hearing on the accounting practices for the Federal Power Marketing Administrations. We have several individual members who have asked to be with us on the dais, and I ask unanimous consent that the gentleman from New Jersey, Mr. Franks, the gentleman from Massachusetts, Mr. Meehan, and the gentleman from South Carolina, Mr. Spratt, be permitted to sit with the subcommittee and to participate in the hearing. Hearing no objection, the unanimous consent request is granted.

I want to welcome the witnesses who are here today to testify concerning the Accounting Practices for the Federal Power Marketing Administrations [PMAS] and whether the PMAS currently recover all of their costs as compared with other non-Federal utilities.

Last year, we were told by various witnesses who favor these programs that they were shining examples of self-sustaining, profitable government enterprises. We were told that these programs were in no way subsidized. Other evidence and testimony indicated that the picture was not so rosy.

Consequently, last December, I asked the General Accounting Office to determine [1] whether all power-related costs are being recovered through the PMAs' electricity rates; [2] if the financing for the PMAs and hydropower-related capital projects is subsidized by the Federal Government; and [3] how PMAs cost-recovery programs compare with similar investor-owned and public power operated electric utilities.

Through hearings by this subcommittee, we have already learned that the PMAs and the underlying Federal hydropower facilities

are often not maintained to industry standards and that decisions are made that would be financially unacceptable for non-Federal entities. I believe we will learn today from the GAO that the cost recovery practices used by the Federal Government would put a similarly run privately or publicly owned utility in deep financial trouble, if indeed not bankruptcy.

While the GAO will have ample opportunity to present details of their investigation, I believe it is safe to say that we are going to hear today that the unrecovered power-related costs and financing subsidies total nearly \$300 million for fiscal year 1995 alone and annually thereafter for the foreseeable future. In total, over the last 30 years, GAO estimates that these costs have been in the billions of dollars.

Under the Flood Control Act of 1944 and subsequent authorizing legislation, the PMAs are charged with marketing power at the lowest rate consistent with sound business principles. This report is an important contribution to the debate regarding the future of the PMAs and related hydropower production facilities. It should provide real insight into the question of whether there has been more emphasis on the lowest rate and less on the concept of sound business principles.

The subcommittee has learned that the Clinton Administration has known of this problem for several years but has failed to come forward to the Congress for consultation or to propose legislation to address it. The Inspector General for the Department of Energy within the Clinton Administration has, over the last several years, reached conclusions similar to those disclosed today by the GAO concerning cost-recovery shortfalls by the PMAs. In 1994 and 1995, as a result of financial audits of the PMAs, the Inspector General stated that the PMAs were not fully recovering the costs of operating these power projects.

Finally, I question the credibility of a letter I read a couple days ago that was written by an organization that has not read the GAO report, but was nonetheless critical of it. It is clear from reading the letter that it contained facts with inaccuracies. But perhaps more important is the thrust of the letter that the GAO is to be faulted because it has failed to find illegal activity by government employees.

They miss the whole point here. The GAO has been asked to investigate information which bears on policies adopted by prior Congresses. It is clearly time to review these policies and change them. You don't need illegal activity to justify a change in policy. Poor management will suffice.

In closing, let me reiterate that I look forward to the testimony of our witnesses. This issue is complex, and I do not believe we have gotten to the bottom of it. We have a responsibility to oversee these operations to ensure that the interests of the taxpayer are protected, and that the appropriate policies and laws are in force to make sure these programs are run using good business practices. At this point, I would like to recognize the ranking member, Mr. DeFazio, for his statement.

**STATEMENT OF HON. PETER DEFAZIO, A U.S.
REPRESENTATIVE FROM OREGON**

Mr. DEFAZIO. Thank you, Mr. Chairman. I appreciate the opportunity. I don't believe that the real motivation for this hearing is that, you know, we are here just to deal with the GAO report based on the problems identified because, in fact, there are a number of problems identified by the GAO report that I have advocated we should deal with for years, particularly, the huge subsidies which are mandated on ratepayers and taxpayers for the irrigation of private lands in the western United States.

I would certainly agree with the GAO on that area, and I would be happy to work with the Chairman for dramatic reforms in that area. You know, simply ratepayers have nothing to do with nor should they foot the bill nor should they subsidize irrigators. In the case of the pumping power at Grand Coulee on the Columbia, it is a loss of \$25 million a year for that one project if we were allowed by law to set a market rate for that power.

So, you know, I find that I find some merit there, and I find they are in other parts of the proposal; that is, in particular, that we should look at the interest subsidies in the Northwest. One power administration recently negotiated with the Federal Government, and we have set all of our repayment at market rate. So that has been dealt with and perhaps the other PMAs as you look at a refinancing of their debt in a similar manner.

I can't agree on the discussion of environmental costs. Some of the environmental recovery efforts are consequent to Federal treaties, treaties with tribes, treaties with foreign nations; Canada in the case of salmon in the Northwest. And I don't believe that the ratepayers of a small region of the country should have total responsibility of either carrying the lion's share or the burden of paying for those costs.

So, you know, I have a hard time finding that, you know, these should be considered as subsidies as opposed to a shared burden that is being paid for partially by ratepayers and partially in the national interest.

But the thing that I find most disturbing here is that, you know, the proposal, which is lurking in the background which drives this report and drives this hearing, is the Franks-Meehan bill. It is an extraordinary piece of legislation. We have just gone through the waiver of laws by the timber salvage rider of the Pacific Northwest, which I opposed.

And now we are confronted with, under the guise of privatization and save the taxpayers money, the second most extraordinary waiver of Federal environmental laws in the history of the United States in recent years. This bill does waive all environmental laws. It is clear the Clinton Administration says it waives all environmental laws. The analysis that I have conducted and others have conducted says it does. The authors say no.

Well, it does and it does for a simple reason. These projects, if they are not required to carry those environmental burdens, look pretty good to the private sector. If they have to carry public burdens, if they have to carry environmental burdens, if you have to pay for past debt, suddenly these projects don't look so attractive. In fact, some of them today are producing power after they meet

all their obligations at a cost which exceeds the market rate in the western United States in the current free market and the change that is going on in that market.

So it is not unintentional that the Franks-Meehan bill waives the environmental laws and sets basically the status quo, whatever that might be, in place for 10 years, whether it is adequate or not actually. It is intentional because, otherwise, the authors of the bill, whoever they might be, whether it is a private power interest or others intended that so that these projects would be more attractive.

If we are going to look fairly at the sale of Federal power marketing agencies, we have to look at a fair return to the taxpayers and a continuation of many burdens that today's private power is not being asked to carry. And, you know, under those conditions, I believe these projects would be a much less attractive target.

So, in any case, I would be happy to move ahead with a number of the reforms that are recommended. We have already adopted at least one of the major cost subsidy issues that has been reformed in the Pacific Northwest, and some other PMAs could come up to that. I would be happy to give the relief from the irrigation subsidies, which is the second largest cost identified.

The third largest cost identified is something that is a government mind problem; that is, you are not paying for Federal Government retirement and programs. The military pays about a penny, and other parts of the government are paying only a fraction of the costs of the retirement of their employees. And the PMAs are, unfortunately, not much of an exception in this area. It is something that warrants attention on a governmentwide basis. There is no reason to pick on the PMAs. Thank you, Mr. Chairman.

[The prepared statement of Hon. Peter A. DeFazio follows:]

PREPARED STATEMENT OF HON. PETER A. DEFAZIO

Mr. Chairman:

This hearing is not really about accounting and management problems at the federal power marketing administrations. I agree that there are problems with repayment of federal investments, but those problems can be fixed without huge increases in electric rates and without huge increases in electric rates and without gutting environmental restoration efforts at federally-owned dams across the nation, as the PMA sale proponents are proposing.

One of the problems identified in this GAO report is the fact that the law prevents the Pick-Sloan project from properly allocating the costs of irrigation investments. I'm not sure that these costs should ever be borne by power users, to be honest. The investments were made to benefit irrigators and under our very generous irrigation project laws, if the irrigators can't pay, power users and the U.S. taxpayers pick up the tab.

I'd like to point out to the Chairman that Northwest power users and the federal government are currently helping to subsidize irrigated agriculture in our region to the tune of hundreds of millions of dollars each year. For example—irrigation project pumping power at the huge Grand Coulee Dam on the Columbia River is set by law at less than one-tenth of one cent per kilowatt-hour. If the rate was set at market rates—let's say about 2.1 cents per kilowatt hour—the Bonneville Power Administration would collect at least \$25 million a year more than it now collects. According to the GAO, electric ratepayers are footing a large percentage of the bill for irrigation investments at a number of projects in the Northwest.

If we look across the West, we see much the same picture. Power users are all-too-often picking up the tab for subsidized irrigation. I'd like to work with Chairman Doolittle to reduce these subsidies and provide a fair return to the Treasury for the federal investments in irrigated agriculture. We could start with the legislation considered in the full committee yesterday that transfers federal assets at fire sale prices to the Calsbad Irrigation District in New Mexico.

And I'd be happy to work with the gentleman to address the other legitimate concerns raised in this GAO report.

But his hearing is not being held with the aim of improving management at the PMAs. It is being held for one reason and one reason only: the Chairman of the subcommittee and Senator Dole, his party's standard bearer in the presidential campaign, want to build a case for selling the PMAs to the highest bidder. Senator Dole wants to sell the PMAs to help finance his tax cuts. Chairman Doolittle wants to do it, I assume, because of his conviction that private enterprise would better manage these projects, notwithstanding the almost certain electric rate hikes for millions of residential electric ratepayers from Georgia to South Dakota to California and the Pacific Northwest.

I'm pleased to welcome to our committee the sponsors of a bill that would sell the PMAs to the highest bidder. I'm glad they're here today, because it makes the underlying agenda for this hearing quite clear.

A lot of the focus in the PMA sale debate has been the rate impacts for electric consumers—especially rural electric consumers—now served by the federal power marketing administrations. We know, for instance, that a PMA auction would probably increase wholesale electric rates for South Dakota residents by 146 percent. That would translate into a 40 percent rate hike at the retail level for residents of Pierre, South Dakota, for example. Average residential rate increases in Eastern Montana would be 27 percent. Texas, 10 percent. Utah, 12 percent. The list goes on.

Of course, these PMA sale proposals are nothing more than tax increases by another name. But that's really not the worst aspect of the proposals we have seen.

The Franks bill, the Dole plan, and the proposal that this committee approved last year to sell Southeastern would sell these federal dams—lock, stock and barrel—and exempt their future operations from all of the nation's environmental laws. I'm sure the sponsors of these proposals will insist that their bills do nothing of the kind. But just read the legislation.

Section 202 of the Franks-Meehan bill would require the Federal Energy Regulatory Commission—which regulates privately owned hydroelectric projects around the nation—to issue a ten year license for these federal projects once they are sold. Unlike every other FERC license for every other private hydropower project, these licenses would not be subject to the Clean Water Act, the Endangered Species Act, the National Environmental policy act, the Wild and Scenic Rivers Act or any other federal environmental law. According to this bill, these licenses could not be licenses would be the "sole and exclusive" regulations governing these newly privatized projects.

The Franks-Meehan bill—and the Dole proposal—would be an absolute disaster for salmon recovery efforts in the Pacific Northwest. This bill and the Dole plan would doom the once-magnificent salmon runs of the Columbia River basin to extinction.

The Franks-Meehan bill and the Dole proposal would be an equally devastating environmental disaster for every other federal hydropower project around the nation. That's one of the reasons the administration opposed the Southeast Power Administration sale proposal last year.

And one of the many reasons that this committee's efforts to auction federal hydropower projects without the associated environmental responsibilities is doomed to failure is simply that the public will not stand for it.

Mr. DOOLITTLE. Thank you. I would like to introduce our panel of witnesses. We have Linda Calbom, Director of the Accounting and Information Management Division, U.S. General Accounting Office. Let me ask you all to come forward and remain standing for the oath.

Greg Kutz, Assistant Director of the Accounting and Information Management Division, U.S. General Accounting Office; Thomas Armstrong, Assistant General Counsel of the same division of the General Accounting Office; and then J.M. Shafer, Administrator of the Western Area Power Administration. He will be accompanied by his counterparts, Mike Diehl from the Southwestern Power Administration and Charles Borchardt from the Southeastern Power Administration.

So if the three of you will also come forward? I realize Mr. Shafer is a witness, but the other gentlemen may be offering comments, so we would like to have you all take the oath.

[Witnesses sworn.]

Mr. DOOLITTLE. Thank you. Let the record reflect each answered in the affirmative. Please be seated. I would like to note for the record that some representatives of the public power community who had provided information to the GAO for this report and who had requested a letter from the subcommittee inviting them to testify declined after they received the letter.

Under our committee rules, witnesses are asked to limit their oral statements to 5 minutes, but their entire statements will appear in the record. In this case, I have agreed to allow 15 minutes for the GAO testimony, given the extensive nature of the GAO report.

I believe our witnesses are generally familiar with those lights. At the beginning of the fourth minute, that yellow light will go on, at the expiration or the end of the fifth minute, the red light will go on signaling that it will be time to wrap up. The Chair will recognize Ms. Calbom for her testimony.

STATEMENT OF LINDA CALBOM, DIRECTOR, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY GREG KUTZ, ASSISTANT DIRECTOR, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE; AND THOMAS H. ARMSTRONG, ASSISTANT GENERAL COUNSEL, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Ms. CALBOM. Thank you, Mr. Chairman. Mr. Chairman and members of the subcommittee, I am happy to testify on a report we are issuing today in response to a request from you and the ranking minority member of the full committee. As you mentioned, I am accompanied by Mr. Greg Kutz of our Accounting and Information Management Division, and Mr. Tom Armstrong of our Office of General Counsel.

You and the ranking minority member asked us to answer three questions about three power marketing administrations, Southeastern, Southwestern, and Western. As you mentioned, Mr. Chairman, you specifically asked us to determine (1) whether all power-related costs incurred through September 30, 1995, had been recovered through the PMAs' electricity rates, (2) if the financing for capital projects is subsidized by the Federal Government and, if so, to what extent, and (3) how these PMAs differ from non-Federal utilities and the impact of these differences on power production costs. We were not asked to and did not address whether any changes in PMA cost-recovery practices or financing should be made.

Before I get into the answers to these questions, let me provide some brief background information. Southeastern, Southwestern, and Western, sell power produced at 102 hydroelectric dams built and run primarily by the U.S. Army Corps of Engineers or the Department of Interior's Bureau of Reclamation. Most of these hydro-power facilities were originally designed for other purposes in addition to producing electricity.

The three PMAs receive annual appropriations to cover operating and maintenance expenses and capital expenditures. Federal law calls for PMAs to set power rates at levels that will repay these appropriations, as well as the power related operating and maintenance and capital appropriations expended by the operating agencies in generating the power.

Operating and maintenance expenses are to be repaid in the same year incurred, but appropriations for capital investments, which we refer to as appropriated debt, can be repaid over periods of up to 50 years with interest.

I think it would be worthwhile to spend just a few minutes discussing the way the funds actually flow between the Treasury, the PMAs, the operating agencies, and the ratepayers. With your permission, Mr. Chairman, if I could ask Mr. Kutz to walk us through this chart that demonstrates this flow of funds? And for the convenience of those who can't see the chart, it is included as attachment one to my prepared statement.

Mr. DOOLITTLE. Thank you. Please proceed.

Mr. KUTZ. This flowchart shows the flow of funds for Southeastern, Southwestern, and Western. Each of the PMAs receives appropriated funds, which are made available annually. In addition, the operating agencies, which are the Corps of Engineers and the Bureau of Reclamation, receive annual appropriations.

The power marketing administrations incur operating and maintenance and capital costs for the transmission systems, which would be Western and Southwestern, and for other power-related activities. In addition, the operating agencies incur capital and operating costs with multipurpose projects.

The operating agencies allocate the power-related costs to the power marketing administrations. The power marketing administrations set rates to recover costs including the direct costs incurred by the PMAs and the costs allocated from the operating agencies.

The power marketing administration rates also recover interest on the capital appropriations. The PMAs bill customers for the electricity charges and transmission charges incurred. The proceeds from those billings are remitted to the Treasury either directly or indirectly depending on which of the PMAs we are talking about, and the Treasury receives the funds. The funds are remitted to various Treasury accounts.

Two items we are going to talk about today are the financing subsidy and unrecovered costs. The financing subsidy is represented by the difference between the interest income received by the Treasury from the power marketing administrations and the interest expense paid by the Treasury on its bonds. What Linda is going to speak about now are unrecovered costs.

Ms. CALBOM. Thank you, Mr. Kutz. As Mr. Kutz mentioned, there are unrecovered costs related to the power generation activities, and we identified five of these main unrecovered costs that have not been fully recovered by one or more of the PMAs through their rates.

First, the three PMAs did not recover the full cost of power-related, post-retirement health benefits and civil service retirement system pensions for current PMA and operating agency employees. As

with other Federal agencies, the full cost of these pensions and health benefits is not charged to the PMAs or operating agencies.

For fiscal year 1995, we estimate that the unrecovered costs related to pensions and post-retirement health benefits for the three PMAs are about \$16 million. Cumulatively, we estimate these costs total about \$436 million.

Second, all three PMAs were not recovering the full cost of constructing certain projects in their regions. PMAs are not allowed to recover project costs until projects are put into operation. For example, at the Russell Project, which has been partially on line since 1985, excessive fish kills has kept four of the eight turbines from becoming operational.

As a result, about one-half of the project's construction costs have been excluded from Southeastern's rates. It is unclear whether these costs, totaling \$488 million as of September 30, 1995, will be recovered if the project never operates to the capacity designed.

Third, as GAO reported to you in May of this year, at the Pick-Sloan Program, about \$454 million of capital costs for hydropower facilities and water storage reservoirs have been allocated to irrigation facilities that are infeasible and, therefore, not expected to be completed.

Under current repayment criteria, it is unlikely that Western will be required to repay these costs. However, as we also reported in May, changing the terms of repayment to recover any of these costs would require congressional action.

Fourth, the Central Valley Project's Shasta Dam and the Colorado River Storage Project's Glen Canyon Dam have incurred power related environmental mitigation costs that are legislatively excluded from Western's rates. These excluded costs totaled \$23.6 million for fiscal year 1995 and about \$152 million cumulatively.

And, fifth, Western had deferred payments for operating and maintenance and interest expense relating to nine of its 15 projects, which totaled about \$196 million as of September 30, 1995. Western officials have told us they expect to recover the majority of these costs over time.

We estimate that these five unrecovered costs amounted to approximately \$83 million for fiscal year 1995 and that cumulatively they could be as much as \$1.8 billion. Table one, which is on page seven of my prepared statement, outlines these specific costs.

In answer to your second question, PMAs do receive Federal Government subsidies to finance their capital projects. Financing subsidies exist because, as Mr. Kutz mentioned, the Treasury's cost of funds is significantly greater than the interest rates on PMA-appropriated debt.

PMAs have low rates on appropriated debt for two primary reasons. First, DOE's policy generally requires PMAs to pay off outstanding debt with the highest interest rate first. Second, PMA projects prior to 1983 were generally financed at interest rates lower than the then prevailing comparable Treasury interest rates. Because repayment terms on appropriated debt are up to 50 years, some of this below-market debt could remain outstanding for several more decades.

We have another chart with us today that shows the interest differential between the PMAs and the Treasury. This chart is also

on page nine of my prepared statement. As you can see from the chart, for fiscal year 1995, on the right-hand side, the average interest rates on appropriated debt were 2.9 percent for Southwestern, 4.4 percent for Southeastern, and 5.5 percent for Western. This compares to 9.1 percent for Treasury's outstanding bond portfolio as of September 30, 1995.

The open space between the Treasury line, which is on the top, and the PMA lines represents the financing subsidy. You will notice from the chart that soon after 1983, when PMAs were no longer afforded below-market financing at the time of borrowing, the subsidy began to decline.

Over the next several decades, as the pre-1983 appropriated debt is repaid, the PMAs' financing subsidy should continue to decrease. However, the PMAs' ability to repay high interest debt first has been a factor and likely will continue to contribute to the difference between the PMA average interest rates and those of Treasury.

In addition, the nature of Treasury's borrowing practices contributes to the magnitude of this financing subsidy. Treasury's general inability to refinance or prepay outstanding debt in times of falling or low interest rates is part of the reason for its relatively high 9.1 percent average cost of funds for fiscal year 1995.

We estimate that the three PMAs received financing subsidies of about \$200 million in fiscal year 1995. Over time, we estimate that financing subsidies received by these three PMAs have been several billion dollars. Non-Federal utilities typically recover the types of costs I described earlier and generally pay higher interest rates on debt than do PMAs.

PMAs also have other inherent advantages over non-Federal utilities. One of the major inherent advantages is that nearly all of the power marketed by these three PMAs is hydropower primarily from projects built 30 to 60 years ago. These hydropower facilities are a low-cost means of generating electricity compared to coal and nuclear plants, which are primarily relied on by other utilities.

Another advantage is that PMAs, as Federal agencies, do not, for the most part, pay taxes. The unrecovered costs, financing subsidies, and other inherent advantages have resulted in low-cost power for the PMAs. In 1994, the PMAs' average revenue per kilowatt hour for wholesale sales, which we believe is a strong indicator of relative power production costs, was approximately 40 percent less than the average for non-Federal utilities.

Notwithstanding this, certain of the PMAs' higher-cost rate-setting systems currently face competitive pressures. Recent developments are projected to decrease average wholesale electricity rates which could further impact the competitiveness of these and other rate-setting systems.

PMAs also have disadvantages compared to non-Federal utilities. For example, Western is required to recover certain nonpower costs through rates, including the cost of the Hoover Dam Visitor Center totaling an estimated \$124 million. Under reclamation law, Western is also required to recover approximately \$1.5 billion related to construction costs on certain completed irrigation facilities.

In aggregate, we estimate that the unrecovered power-related costs and financing subsidy total about \$300 million for fiscal year 1995. Over the last 30 years, we estimate these costs have been in

the billions. It is important to emphasize that the PMAs are generally following applicable laws and regulations regarding recovery of these power related costs and financing of capital projects.

Mr. Chairman, this concludes my testimony. I would be happy to respond to any questions that you or members may have now or later.

[The prepared statement of Ms. Calbom may be found at the end of hearing.]

[Due to the high cost of printing the GAO report referred to can be found in the Committee files.]

Mr. DOOLITTLE. Thank you. Our next witness is Mr. Kutz. Mr. Kutz has explained the chart. Did you wish to add anything further to the presentation?

Mr. KUTZ. No.

Mr. DOOLITTLE. Mr. Shafer, the Administrator of WAPA, is our next witness. Mr. Shafer.

STATEMENT OF J.M. SHAFER, ADMINISTRATOR, WESTERN AREA POWER ADMINISTRATION, U.S. DEPARTMENT OF ENERGY; ACCOMPANIED BY CHARLES A. BORCHARDT, ADMINISTRATOR, SOUTHEASTERN POWER ADMINISTRATION; AND MICHAEL A. DIEHL, ADMINISTRATOR, SOUTHWESTERN POWER ADMINISTRATION

Mr. SHAFER. Thank you, Mr. Chairman. We appreciate the opportunity to testify before the subcommittee today. The Department has asked me to represent the Secretary at this hearing. Since I have submitted written testimony, I will limit my oral comments to a few major points.

The primary mission of all three of the power marketing administrations is to market the hydropower generated at Federal multipurpose projects that is surplus to the project's needs. These three PMAs, unlike other electric utilities, are not responsible for the load growth of their customers. Consequently, we do not construct new facilities for that purpose. Any new resource is a result of congressional-authorized projects whose feasibility is determined by the operating agency.

It is a policy of the Administration that the PMAs fully recover all power-related costs of the water projects from which they market power, as provided by law. The PMAs set their rates in accordance with DOE regulations and authorized statutes. Current payment practices follow the law and expressed congressional direction.

Rates are set to recover power-related operation and maintenance costs of the PMA and the generating agency in the year they occur, and to repay, with interest, the power-related investments of the PMA and generating agency within a defined time period. Power-related costs include a share of the project's multipurpose costs, in addition to costs directly attributable to the power features.

Western Area Power is additionally responsible to aid in repaying irrigation units in several projects by paying, without interest, capital investments that are beyond the irrigators' ability to repay.

All three PMAs are audited by independent auditors annually. The audits are conducted in accordance with generally accepted au-

ding standards, standards that are issued by the GAO Comptroller General, and requirements established by the Office of Management and Budget.

The accounts are maintained in accordance with Generally Accepted Accounting Principles and the Federal Energy Regulatory Commission's uniform system of accounts for electric utilities. All three PMAs received unqualified opinions from their independent auditors in past years.

The power available for marketing is dependent upon weather conditions, and can be greatly affected by both drought and flooding. In order to make this type of product marketable, and to maintain some price stability, Congress and the Department have provided flexibility in the repayment process.

In addition, within the limits of authorization, the Department and the PMAs have developed policies that allow operation in a more businesslike manner, all the while being responsible for repaying the investment in a specific timeframe with an assigned interest rate. Repayment studies are conducted every year to assure that adequate revenues are collected to repay the expenses and investment with interest.

The Administration recognizes that this program may need some adjustment in order to provide for changing needs and identify accomplished objectives. However, the Administration also realizes this program was established for far greater purposes than merely marketing surplus Federal hydropower. It was developed to build and strengthen the national infrastructure and economy.

It still serves that purpose. The PMAs' operational and business practices and procedures have been developed in an open public processes, and we believe that it will require a public process to decide what changes, if any, are required. The Department and the PMAs appreciate the opportunity to work with Congress in addressing these issues. That concludes my remarks, Mr. Chairman. I will be pleased to address any questions you or any other members might have.

[The prepared statement of Mr. Shafer may be found at the end of hearing.]

Mr. DOOLITTLE. Thank you very much. Ms. Calbom, by the way, I want to commend you and the GAO. This is a very well done study that's quite revealing, and I know you put a lot of effort into it. Would it be fair to say that when the PMAs exercise what they ultimately refer to as sound business principles, they are acting in the best interests of the customers?

Ms. CALBOM. I think that is probably a fair statement, Mr. Chairman. Of course, they follow the requirements of the Flood Control Act. Keeping electricity rates as low as possible is basically what that Act calls for.

Mr. DOOLITTLE. Following then, would it be fair to say that, in acting in the best interest of their customers, the PMAs could be increasing the cost to the taxpayers?

Ms. CALBOM. I think to the extent that the PMAs are maximizing the unrecovered costs that we reported on today that is not in the best interests of the taxpayers. To the extent that the PMAs are increasing their efficiencies in the way that power is generated and then marketed and sold, that it would be in the best interests

of their customers but would not necessarily be a detriment to the taxpayers.

Mr. DOOLITTLE. The GAO stated that PMAs would “generally” follow the law in the past with respect to capital financing. Could you elaborate upon the use of that word “generally”?

Ms. CALBOM. We use that word because we found that the PMAs’ policies were set according to the applicable laws and regulations. We did find a few instances of noncompliance with those policies. One instance related to the Truman Project where interest was not calculated or paid for fiscal year 1995. That amounted to, a little under \$1 million. That situation I understand is being corrected.

We also found based on our review of the external auditors’ working papers a few instances at Western where interest expense wasn’t being properly calculated. There is another situation with Western’s abandoned transmission line, where we have some unresolved questions about the treatment of that project. But it is those kinds of things that cause us to put that caveat in our report.

Mr. DOOLITTLE. In your previous answer, you referred to PMAs maximizing then unrecovery costs. Do you find a tendency for them to do that?

Ms. CALBOM. Well, I think they were utilizing the tools that were given them via the DOE order and the other types of laws and regulations under which they are operating. And, as I said, I think they are given a mission via the Flood Control Act to try to, provide the power at the cheapest rates they can, and it did appear that is what they were doing.

Mr. DOOLITTLE. But the other half of that mission is using sound business practices, isn’t it?

Ms. CALBOM. That is my understanding. Yes.

Mr. DOOLITTLE. Did you feel that there was more emphasis on the lower cost part of the mission than on sound business practices?

Ms. CALBOM. Well, I guess it depends on how you define sound business practices and whether or not it is the sound business practices that are in the best interest of the Federal Government or the ratepayer.

Mr. DOOLITTLE. Well, I think you referred to them in your report as generally accepted sound business practices or so-called financial standards of accounting. What represents a compendium of sound practices?

Ms. CALBOM. I think probably what you are referring to is Generally Accepted Accounting Principles, and that is a little bit of a different measurement stick I think than the sound business principle measurement stick. And we did find, again, and as Mr. Shafer mentioned, that they are audited by external auditors and that they are generally following these accepted accounting principles.

Mr. DOOLITTLE. Well, vis-a-vis say other utilities—nonPMAs—if we used their standards of sound business practices, how would the PMAs measure up?

Ms. CALBOM. Well, I think there are certain costs certainly, and this is what we were describing, that the PMAs do not recover, that those other non-Federal utilities do recover. And as we also mentioned, the non-Federal utilities generally do pay higher interest rates.

But probably what you are driving at is the recovery of costs at certain projects that have been under construction where there are unrecovered costs for the PMAs. We found instances where the non-Federal utilities generally would recover the costs of those types of projects or at least would make a decision as to what they were going to do with those projects in a more timely manner.

Mr. DOOLITTLE. What would you say about the ability of an entity to use a tool, shall we say, which will result in lower recovered costs? That is a very valuable tool that everyone would like to have, isn't it?

Ms. CALBOM. Well, it has certainly provided some benefits to the PMAs.

Mr. DOOLITTLE. OK. Mr. DeFazio.

Mr. DEFAZIO. Thank you, Mr. Chairman. Ms. Calbom, you said that generally the cost is 40 percent less than non-Federal. Where is that reflected ultimately in the rates to the consumers of the region, is that correct? I mean, one theoretically says today we maybe wave the magic wand and, you know, recover all the full Federal investment, all the costs, and unlike any other federally associated agency, pay all the retirement costs of his employees, the rates would have to go up. Is that correct?

Ms. CALBOM. Yes. That would be correct.

Mr. DEFAZIO. Then you also mentioned competitive prices. You are, obviously, perhaps familiar with it or tracking the open market prices unless some long term contract is being entered into—the whole concept of wholesale and retail dealing and probably try to escape from that answer, a decline in the price of wholesale power and using longer contracts.

And my question is one of the greatest problems that is being dealt with in attempts to move more into the competitive marketplace for all producers of electricity—so-called stranded investments, isn't there a real prospect here that as we move into more competitive markets that the power marketed by these agencies at the current advantage price or differential may not be competitive long term? I am certainly hearing that from my cases.

Ms. CALBOM. I think that is the case, and we mentioned several different rate-setting systems in our report where that is currently the case.

Mr. DEFAZIO. So then we would essentially be confronted with not stranded private sector investment but stranded Federal investments?

Ms. CALBOM. That could be the case in several of these systems.

Mr. DEFAZIO. Where market rates would not be able to meet current obligations?

Ms. CALBOM. Correct.

Mr. DEFAZIO. Now, that leads me to again get back to this section of the Franks-Meehan bill, and I will direct the question to Mr. Shafer because I understand he's perhaps qualified to speak to represent the Administration. I think there is an attempt here to try to undercut Federal laws.

When you read this Act in the applicable place it says, "The issuance of a license pursuant to Subsection E shall not be subject to provisions of the Federal Land Policy Management Act, Energy Policy Act of 1992, National Environmental Policy Act of 1969, the

Endangered Species Act of 1973, the Wild and Scenic Rivers Act, the Federal Environmental Pollution Control Act, the National Historic Preservation Act, the Coastal Zone Management Act, Fish and Wildlife Coordination Act, or any other Act." Are you aware of any power producer in the United States private or public to be exempt from those laws?

Mr. SHAFER. No, sir, I do not.

Mr. DEFAZIO. So this would be a pretty extraordinary deal, wouldn't it?

Mr. SHAFER. Yes, that is true.

Mr. DEFAZIO. Do you think that might drive up the—given the fact that we are dealing on the one hand with attempts to fully recover the Federal costs, obviously, at the point of sale we would try and fully recover Federal costs and perhaps even, you know, accrue a little profit for the taxpayers. Do you think that your agency today under competitive pressures could be sold for, you know, a price that would utilize a 100 percent return or more to the taxpayers without these exemptions?

Mr. SHAFER. No. I would state that it would be a very difficult proposition. Without the exemptions, did you say?

Mr. DEFAZIO. Yes, without these exemptions.

Mr. SHAFER. Without the exemptions it would be very—

Mr. DEFAZIO. What I am trying to point to is that I know the author of this bill says that this doesn't exempt us—these writers of the law so it is pretty clear on its face that it does. Is it the Administration's opinion that this is an exemption from these laws because it says it is an exemption from these laws?

Mr. SHAFER. The laws would not be applicable the same as in any other region.

Mr. DEFAZIO. Right. But this section, if this were in effect, would say that they would have—

Mr. SHAFER. Yes. That is the way we would—

Mr. DEFAZIO. And, again, this is something that no other utility in America is doing. In fact, one of my private power producers, when I asked their counsel to look at it, said to me how goof up at that power relicensing. So that, I think, causes a bit of a question or a problem here in terms of market's abilities.

Back to Ms. Calbom, couldn't we deal—short of a—you have any in the year of sale, Franks-Meehan bill. There are some reforms here. Are you familiar with the reforms adopted with the refinancing of the Bonneville Power Administration debt this year?

Ms. CALBOM. I am somewhat.

Mr. DEFAZIO. So do you feel comfortable in stating that, you know, such be reissued at a market rate and aggregated the net that does not represent ongoing subsidy unless interest rates go up, and someone wants to go back and say, "Well, hey, that is a subsidy. This is lower than today's market rates. It is not an adjustable rate. It is a fixed rate"?

Ms. CALBOM. On an ongoing basis my understanding is that it is at a market interest rate. Currently, my understanding also is that the outstanding principal was reduced in order to achieve that market rate.

Mr. DEFAZIO. Is that not a standard practice when one, you know, often would be a source of refinancings, review of present discounted value of money? That is, if I owe you \$2 million over— if I paid all my interest and made all my payments over 50 years but, you know, I would say I could pay you in full today, you wouldn't normally pay that full income stream. You would pay just added value?

Ms. CALBOM. If, in fact, the full amount was paid today, that wasn't my understanding of the terms of the agreement.

Mr. DEFAZIO. No, what I am saying—don't want me this company—I don't worry, its value's around \$100,000. Now, if I pay that off month by month, you can say, "Well, the income stream is going to be \$180,000." I wouldn't pay my \$180,000 to pay off the loan. I would pay the \$100,000. So we are not—you know, what we are dealing with here is the value of—you have got the value of the money, the value of the income stream, and a whole number of things to refute, so you don't—you know, there was a negotiation here. The Treasury says it got the full value. It got the use of the money now. You know, it doesn't seem an unreasonable sort of way to deal with this. Could the other power marketing agencies deal with this—it would depend.

Ms. CALBOM. I guess we would want to look more carefully at the complete terms of that agreement because as you are describing, it is slightly different than what was my understanding so—

Mr. DEFAZIO. OK. But at least it would be better than your current understanding of the situation of the PMAs?

Ms. CALBOM. To the extent that it would reduce that differential that we showed on the chart—which is simply the amount Treasury is paying out versus what the PMAs are paying in—

Mr. DEFAZIO. Right. But, of course, what the Treasury paid out at the time that they borrowed these funds?

Ms. CALBOM. Excuse me?

Mr. DEFAZIO. You also have to look at the bargain rates and the interest that the Treasury paid at that time and not today. That is like my bank saying, "Hey, I made a 10 percent today drawing 8.7." You don't have a variable-rate loan if you want 10.

Ms. CALBOM. And I think that in the banking environment the banks tend to have different types of abilities to manage their underlying debt which finances the borrowings.

Mr. DEFAZIO. Well, they sell it at that price. We could sell it at that price if someone wants to buy it.

Ms. CALBOM. As you know, we pointed out one of the important things to keep in mind in why there is this spread that we showed is the fact that Treasury doesn't have the ability to refinance its own debt or to prepay its own debt. So what you are looking at is Treasury's cost of funds, which is an average, of 9.1 percent compared to the PMAs' cost of funds, which is significantly lower.

Mr. DEFAZIO. Thank you.

Mr. DOOLITTLE. Mr. Pombo is recognized.

Mr. POMBO. Just to follow up on what Mr. DeFazio just asked you, that is kind of comparing apples and oranges on your chart there because what the current cost of funds is the U.S. Treasury

versus what this long-term debt is financed at by the PMAs is not—it is not the same thing.

Ms. CALBOM. It is the intent of our chart and of what we set out to look at is what is Treasury losing based on its financing agreements with the PMAs. And the way that we looked at this is we said, "OK. What does Treasury have to pay out on an annual basis on its portfolio versus what is it receiving in from the PMAs?" And as I was mentioning, there are several reasons for this interest differential. One is the fact that prior to 1983 much of the debt that the PMAs were issued was at below Treasury's interest rates.

Mr. POMBO. How much below Treasury's interest rates at the time that those loans were put out?

Ms. CALBOM. It differs significantly I think from a project-to-project basis. I don't know if we have got—with details on that here. As Mr. Kutz is looking at that, maybe I can just continue on with the other factors that impact this because it is important.

You have got that initial differential. But then as time has gone by, the PMAs, because they are required by DOE policy—and this isn't something that they can really manage—it is a requirement—they are required to pay off their highest interest rate debt first. So what that does, it allows them to maintain their lowest interest rate debt, and as Treasury is going along and, you know, their average rates are changing, the PMAs are able to maintain that lower interest rate debt.

The third piece of this is that the PMAs have a 50-year term. And, of course, Treasury's term is more along the lines of their 15 to 30-year term. Therefore, once you get past say, you know, that 15 or 30-year term, depending on, you know, the mix of Treasury's portfolio, well, then Treasury, in effect, has to take on new debt at the higher interest rates since rates have been increasing over this time period. And the PMAs, again, are still holding onto that debt that they incurred back in the 191950's by and large—was where the bulk was incurred.

Mr. KUTZ. Yes. On page 51 of the blue book, if you would look at that, up until about 1960, the Treasury's average cost of funds was about the same as the cost of funds that the three power marketing administrations were getting.

Starting a little after 1960, the spread between the solid line and the power marketing administration rates shows the difference between what Treasury is getting its money for at the time of the borrowing and the PMAs' rates at that time.

So back in the 1950's and early 1960's, the 2.5 to 3 percent rates that the power marketing administrations were getting were indeed market rates. After that time, there began to be a spread between Treasury's cost of funds and the PMAs' interest rates.

Mr. POMBO. But a lot of these projects were built during the 191950's and early 191960's, and that is when the money was loaned, not during this time period being shown to being spread?

Mr. KUTZ. That is true.

Mr. POMBO. So that it is not an accurate answer. What I was asking was were they subsidized? Were they averaged below what the cost of the Treasury funds were at the time that the loans were issued? I mean, you can have a mortgage that is 25 years old that

is at 6 percent and, you know, that are—or under. That doesn't mean that you did anything wrong 25 years ago.

Ms. CALBOM. And that is absolutely right. We are not trying to imply in any way, shape, or form that the PMAs did anything wrong. What we are trying to show here is that, in fact, this is a cost that Treasury does have today. It is funds that are going out the door to pay interest on Treasury's debt versus what they receive from the PMAs.

Mr. KUTZ. Well, keep in mind one other thing. Treasury only borrows for up to 30 years. So for a loan made in 1950, our subsidy calculation would reflect the Treasury having to go out in 1980 and having to refinance at that point in time. The power marketing administrations, if they got a loan in 1950, would have until the year 2000 to pay back the loan. So that is reflected in here. Your point—

Mr. POMBO. Did the Treasury know at the time that they were entering into a 50-year agreement with the PMAs that their Treasury notes were only for 30 years?

Mr. KUTZ. The Treasury does not borrow specifically for the power marketing administrations.

Mr. POMBO. So they knew that their notes were for 30 years?

Mr. KUTZ. Oh, yes. Sure.

Mr. POMBO. And they knew that they were entering into a 50-year agreement, and they knew full well that 20 years before this agreement was being paid back that they were going to have to refinance part of the debt? I mean, I have no problem here that we have got a spread, that we have to figure out a way to balance this because there is definitely a difference that exists, and there are a lot of problems with the PMAs. And I appreciate your report a great deal because it helps I think all of us understand exactly, you know, what we are up against in doing that. That I just—in following up with what Mr. DeFazio was just saying, I think we have to be careful with how we are seeing all of this because there are some real problems that exist with PMAs. But, you know, the difference in financing is a cost to the U.S. taxpayer, but it is not some special subsidy that was drawn in that it just happened.

I mean, it was a fact that we put the agreement together 40 years ago on a lot of these, and interest is higher now than it was then. That was not something specifically that was written in to benefit PMAs. And I am sure that if you look through a number of other projects, you would find very similar things that have nothing to do with PMAs. So—

Mr. KUTZ. No. They are taking full advantage of a 50-year loan at lower interest rates. It is good business practice.

Mr. POMBO. But I appreciate your report a great deal. I think it was well done, and I appreciate all you have put into it. Thank you.

Mr. DOOLITTLE. Mr. Meehan is recognized.

Mr. MEEHAN. Before I begin my questioning, I would like to first take this opportunity to thank the Chairman on behalf of myself and the Northeast-Midwest congressional coalition for calling this GAO report and two previous reports from the GAO. So I thank you for this opportunity.

I want to address a couple issues, one that my friend, Mr. DeFazio, mentioned relevant to the environmental considerations. The provision that I believe that Mr. DeFazio was referring to will not and I repeat will not waive any of the environmental laws relative to the operation of hydrofacilities under private management.

The waiver provision in the bill applies specifically to the actual transfer of title from a PMA to the current licensed private entities. Once title is transferred, the entity that markets the power will be held to all environmental standards.

Also, the Northeast-Midwest Congressional Coalition staff has been in contact with the Environmental Defense Fund and other conservation groups working with them to resolve the potential environmental problems with the bill. I can assure you that I am interested in maintaining my 100 percent pro-environment record.

So the aim is to have the EDF's endorsement, and we will reintroduce this bill in the 105th Congress. I should also point out that I don't think this hearing is really about the bill. In fact, I never had a conversation with the Chairman of this committee about my bill. So it was interesting, Mr. Shafer, that you had indicated that the Clinton Administration had a position on this provision of the bill?

Mr. SHAFER. We were reacting to the bill as we looked at it, and it appeared to present the facts to us. And it did look like, after the licenses are issued, the laws did not apply.

Mr. MEEHAN. The Clinton Administration doesn't have any legal opinion in writing, do they?

Mr. SHAFER. At this point, we are reacting to this bill as everyone else is. We are just looking at it and reviewing it.

Mr. MEEHAN. So there isn't an official position from the Administration?

Mr. SHAFER. Not at this point.

Mr. MEEHAN. I would like to address this question, if I could, to Ms. Calbom. I was at a public press conference recently where a public statement was made by Glen English of the NRECA on February 6 of 1995. I just want to ask you for a comment on it. How long did GAO work on this study?

Ms. CALBOM. Roughly 9 months.

Mr. MEEHAN. All right. And how many people of GAO worked on this?

Ms. CALBOM. Seven to ten people at various points in time.

Mr. MEEHAN. Over that whole period?

Ms. CALBOM. Correct.

Mr. MEEHAN. And the result of that analysis is this 117-page report?

Ms. CALBOM. That is correct.

Mr. MEEHAN. Well, based on the work the GAO did on this report, I wonder if you could comment on the statement that was made February 6, 1995, and it said—and this is by Glen English—“No one is getting a free ride or subsidized ride. In fact, the PMAs provide a long term revenue stream to the U.S. Treasury and pay their own way.”

If you could just refresh my memory, it seems to me in today's report that you are releasing, one of the conclusions—perhaps the

primary conclusion—is that PMAs failed to fully recover their costs by approximately 260 million a year. Is that correct?

Ms. CALBOM. Yes. It is a total of approximately 300 million a year. A large chunk of that relates to this financing subsidy that we have been talking about, as well as other things like the pensions and the other costs of the projects that we discussed.

Mr. MEEHAN. So is it accurate to say that no one is getting a free or subsidized ride; in fact, PMAs provide long term revenue streams to the U.S. Treasury and pay their own way? Is that based on your analysis over 9 months of the 10 or 12 people involved? Is that an accurate statement?

Ms. CALBOM. I don't think it is when you do consider these other factors that probably have not been considered in the other analyses that have been done in making those statements.

Mr. MEEHAN. In another news conference on April 27, 1995, a Larry O'Bright from the APPA has stated, "There may be Federal programs that don't work, but this," referring to PMAS, "isn't one of them. The Federal power programs pays all the investment with interest." Based on your analysis over a period of 9 months, is that an accurate statement?

Ms. CALBOM. No, I don't think it is.

Mr. MEEHAN. Further, I would refer to a public statement that was made April 27, 1995, again by Glen English from the NRECA, "PMA customers, not all Americans are paying for hydropower marketed by PMAs. The cost of Federal power facilities, unlike the Metro subway system, are being repaid in full with interest by those who directly benefit from them." Now, based on, again, your analysis over a period of 9 months, is that an accurate statement?

Ms. CALBOM. No, I don't think it is, particularly, as I said, when you consider the financing piece of this and that Treasury's costs are not being recovered.

Mr. MEEHAN. Now, just to get this straight, I want to examine the question of the interest rate subsidy. The U.S. Treasury borrows money at one rate and then loans the money to PMAs at a lower rate. Is that correct?

Ms. CALBOM. Well, back before 1983, that was correct to some extent. A lot of the problem here is not in the current borrowing situations. It is a problem that is more of a long-term nature, where the loans that were made to the PMAs back in the 1950's and 1960's were at very low rates. The PMAs have been able to hang onto those and keep their interest rates very low. And Treasury, on the other hand, has had their rates going increasingly higher and higher.

Mr. MEEHAN. Well, based on these deals on interest and your analysis, just based on the interest subsidy, it said the U.S. Treasury loses how much money?

Ms. CALBOM. We found that in 1995 about \$228 million of interest was not recovered.

Mr. MEEHAN. And in full how much did you find?

Ms. CALBOM. The cumulative financing subsidy is in the billions of dollars.

Mr. MEEHAN. Thank you.

Mr. DOOLITTLE. Thank you. Mr. Franks is recognized.

Mr. FRANKS. Mr. Chairman, I want to join Mr. Meehan in thanking you for the invitation to join in your hearing today. I also want to commend you and the members of the committee for providing some long overdue oversight in terms of the operation of these Federal power marketing facilities.

Mr. Chairman, if I may, I am going to start with Ms. Calbom. Ms. Calbom, I am not sophisticated in the ways of cost accounting. I am not an expert in power generation at all. And I want to be able to go home this weekend and try to distill what I am hearing today to my constituents who share with me a large degree of lack of knowledge about the operations of these very large and complicated facilities.

We have heard—all of us have heard over the years claims by PMA advocates and those who are beneficiaries of the PMAs who say time and time again that PMAs don't receive a subsidy from the Federal Treasury, and that they, in fact, recover all of their costs. Let me ask you this. In layman terms, if possible, if you could answer me, does the Federal Treasury provide a subsidy in power marketing administrations, and do they recover fully all their costs?

Ms. CALBOM. Yes, there is a subsidy provided, and, no, the costs are not fully recovered, as we have mentioned.

Mr. FRANKS. And could you reiterate for me the dollar figure that you believe the subsidy takes place at?

Ms. CALBOM. The total amount of the unrecovered costs and the financing subsidy is about \$300 million on an annual basis, at least that was the amount in 1995.

Mr. FRANKS. So many question the reasoning of your report as it applies to this CSRS pensions and post-retirement health care costs in terms of costs that need to be recovered by the PMAs. Can you share with us your reason for including your examination of those issues in your report?

Ms. CALBOM. Well, that is a cost, again, that the PMAs are not required to recover, and, you know, I want to make that clear. They are doing what they are required to do. But there are certain costs that do not get recovered in the formulas that are used, that the employees pay in a certain amount and the PMAs pay in a certain amount.

I believe it is about 14 percent that the PMAs and the employees pay for CSRS; whereas the cost to the Federal Government I believe, if I recall correctly, is about 25 percent. And, again, other agencies aren't required to pay this difference either, but we felt that this, in fact, is a cost of power generation and that it was something that we ought to report as such.

Mr. FRANKS. Can you tell me what Federal agency or what Federal entity oversees the repayment of debt with regard to the operation of PMAs?

Ms. CALBOM. There really isn't a lot of oversight. As we were doing our work, we had some preliminary discussions with the Treasury as far as their role in overseeing the repayment of this debt. Treasury, we found out, is not required really to monitor this debt in a way that they would for other types of borrowing situations. For instance, the Federal Financing Bank, which really is a

conduit for Treasury, monitors their debt similar to have a bank would.

But the Treasury doesn't really consider this PMA-appropriated debt to be debt technically. So whereas they do monitor the total gross payments that come into the general fund, they don't monitor the amounts that are paid in relative to what should be for interest expense principal, or deferred costs on some of the projects.

Mr. FRANKS. So Treasury looks at this debt as something with a unique nature, and, therefore, who has active responsibility over tracking the debt and helping us to collect money?

Ms. CALBOM. It is really up to the PMAs, and, again, they are being audited by external auditors but—

Mr. FRANKS. It is up to the PMAs to decide what is real indebtedness and what ought to be paid back?

Ms. CALBOM. Well, as far as any kind of—as you said, any kind of monitoring, it is just not taking place. And we have had discussions with the staff of this subcommittee about following up on that very issue, and we do intend to explore that further. We want to have some further discussions with Treasury on how they view their role in this area.

Mr. FRANKS. Thank you very much. Mr. Shafer, my yellow light is on so I will be as quick as I can. Can you tell me whether WAPA has a FERC hydroelectric license?

Mr. SHAFER. No, we do not. We are not required to obtain a license by them.

Mr. FRANKS. Can you tell me who, therefore, verifies compliance by WAPA with the litany of environmental laws that were mentioned earlier on?

Mr. SHAFER. Yes. Congress has extensive oversight. I would certainly disagree with the statement that we do not have extensive oversight. We receive oversight by the Department of Energy, and the Federal Energy Regulatory Commission. FERC concurs on our rates and evaluates them as far as being adequate to recover all costs that we need to recover. As Ms. Calbom mentioned, the PMA's have external auditors. We receive oversight through for our budgeting process, and Congress is very much aware of all of our happenings.

Mr. FRANKS. So the bottom line, all have oversight, and that PMAs are in total compliance with the provisions of the environmental laws that were delineated earlier?

Mr. SHAFER. We are held in—

Mr. FRANKS. That is not my question. I am not talking about a standard you are held to. I am talking about a level of compliance.

Mr. SHAFER. The level of compliance—yes, we are in compliance with environmental laws.

Mr. FRANKS. Thank you, Mr. Chairman.

Mr. DOOLITTLE. Mr. Shadegg is recognized.

Mr. SHADEGG. Thank you, Mr. Chairman. I apologize for being late, and I missed much of his testimony. But I may try to bring out some points that are interesting and get some questions answered. In essence, your report establishes that there is a significant amount of money not currently captured by the PMA structure, and that money is either coming out of or being lost by the Treasury. Would you agree, Ms. Calbom?

Ms. CALBOM. Yes. I think that to the extent that there are unrecovered costs, if they remain unrecovered, then they would be paid for by the Treasury, in essence.

Mr. SHADEGG. Well, under current law there is no prospect of going back and recovering these over the past decades, is there?

Ms. CALBOM. For certain of these costs, that would be the case. You wouldn't be able to go back and recover them. Certain of the costs that we have talked about in our report are unrecovered as of 9/30/95, but at least the PMAs have indicated to us that in some instances they do plan on recovering those costs in the future.

Mr. SHADEGG. Can they recover them under current law?

Ms. CALBOM. It depends on what you are talking about. There are certain projects, the Russell Project, for example, that have not come on line yet, and they are not allowed to start recovering those costs through rates until the project comes on line.

Mr. SHADEGG. Can you give me an estimate of how much of this might be recovered under current law?

Ms. CALBOM. I really—

Mr. SHADEGG. Percentage wise?

Ms. CALBOM. I really can't. That is not something that we tried to delve into. What we tried to say is what hasn't been recovered as of the date of our review.

Mr. SHADEGG. And clearly significant amounts haven't been recovered or aren't being recovered. Did you at any point, you know, look at the question of would these situations have occurred if market forces had been in play; that is, did you look at the issue of whether if this facility were already or this entity were operating within the competitive market whether or not the losses which were occurring would have continued to occur or alternatively whether any business could have run under that circumstance?

Ms. CALBOM. We really didn't look at it in that manner. We did look at whether or not the costs that we reported as being unrecovered were generally recovered by non-Federal utilities. And as I mentioned in my statement, we found that those costs generally would be recovered by non-Federal utilities.

Mr. SHADEGG. Generally are recovered?

Ms. CALBOM. Generally are. Correct.

Mr. SHADEGG. Did you look at the overall trend? Is there a trend that we are going to be recovering these costs, or is there a trend that we are going to continue not to recover these costs, and the subsidy is going to continue to exist, or is there no trend at all?

Ms. CALBOM. Well, I think that the fact of these costs not being recovered, a lot of it is driven by the laws and regulations that are currently in existence. And so until those laws and regulations change, you know, the trend will continue. Now, one of the things that we did mention as far as the interest subsidy, a lot of that is due to the pre-1983 low interest rate debt. As that matures and comes due, which won't be for several more decades, but as that debt matures, depending on the interest rate scenario at the time, it could change significantly.

Mr. SHADEGG. But is it fair to say that because a great deal of the laws are driven by the regulatory structure and statutory structure, unless Congress, the regulators, improve those laws and

manage these things dramatically better than we are remedying some of these policies?

Ms. CALBOM. I would say without changes in the current laws and regulations that these costs will continue to go unrecovered.

Mr. SHADEGG. Well, that leaves us the option of either do a much better job as a Congress and as a—having the regulatory function do a better job or you'll pay the—a lot of market forces you can play. Let me ask another question. There is an argument that's made that some kind of control of power machinery is necessary to test the marketplace. Do you accept that premise? Do you think that—

Ms. CALBOM. I am sorry. Could you repeat the question? We had a little—

Mr. SHADEGG. It is argued that without PMAs we would not have a yardstick of diversity to look at power production at—in pedum—utilities versus those that are owned in governmentship. Did you make any comparison of that, or do you have an opinion on that argument?

Ms. CALBOM. That is not something we really took into consideration in our report.

Mr. SHADEGG. Mr. Shafer, let me ask you one question. We have heard this issue of environmental burden. Is it not true that other industries which produce electricity are subjected to significant environmental restraints?

Mr. SHAFER. I think that is accurate to say.

Mr. SHADEGG. And if they can in a market environment sustain the environmental burden imposed upon them—I am thinking of various plants in the western United States—coal plants, for example, that are very heavily burdened with environmental regulation—if they can sustain the burden of environmental pressure, why would not the PMAs if they were independently operated or free market operated be able to do the same?

Mr. SHAFER. I think they could be operated in the same manner. The point is that they would be very difficult to sell these assets with those recognized environmental obligations already on the projects. This would reduce the value of the asset considerably.

Mr. SHADEGG. Why don't you move the power plants out in my part of the country. Thank you very much.

Mr. DOOLITTLE. I am going to ask Mr. Diehl a question, and, Mr. Shafer, you can jump in and answer or—

Mr. DEFAZIO. Could we identify—

Mr. DOOLITTLE. Mr. Shafer is the Administrator for WAPA, but Mr. Diehl is the Administrator of Southwestern. Mr. Diehl, in your experience, have you ever observed that power-generated facilities have been built against the recommendation of the PMA?

Mr. DIEHL. Well, first, Mr. Chairman, thank you for allowing me to testify here today. There is the case of Harry S. Truman Project in Missouri that the Corps of Engineers constructed and operates. There were several times during the preliminary stages of its design when the Southwestern Power Administration made some suggestions for them to consider on the final design. One of them was the number of units that the plant would have. The plant now consist of six units, but we asked them to consider five units.

Mr. DOOLITTLE. Did they follow your recommendation?

Mr. DIEHL. No, sir. The plant was built with six units.

Mr. DOOLITTLE. Oh, six. Mr. Shafer, are you aware of any such similar circumstance?

Mr. SHAFER. I can't give you a specific one, no.

Mr. DOOLITTLE. Is it possible that these may have occurred?

Mr. SHAFER. Yes, I am sure. The power marketing administrations previously were not consulted as far as feasibility. However, in the 1986 Water Resources Development Act, there is a provision that directs the Corps to do consult as to the marketability of Power projects with the power marketing administrations.

Mr. DOOLITTLE. But you mean as recently as 1986 it was possible for the entities that actually marketed the power not to be consulted by the entity that was building these hydropower facilities?

Mr. SHAFER. Yes. Usually, there was some input but it was evaluated from the perspective that they are multiple-use projects so power was not always the primary consideration, they made their decisions, I believe, based upon the value of the other benefits that were coming out of it, and power was a piece of it.

Mr. DOOLITTLE. I understand that, with many of these great dams, power is not the primary purpose or benefit. Nevertheless, as to that aspect of the facility, economics should be considered, shouldn't it?

Mr. SHAFER. Yes, if I understand what you are asking, the provision of power from many of these projects made them feasible. And I think if you look back in history probably why some of the assistance was provided in financing was so that there were some returns on the program.

Mr. DOOLITTLE. By feasible, you mean they were allocating a certain percentage of the total cost onto the power customers. Right?

Mr. SHAFER. That is correct.

Mr. DOOLITTLE. But that would not necessarily be economically feasible from the standpoint of power. Right?

Mr. SHAFER. From the pure power perspective, that would be true.

Mr. DOOLITTLE. I mean, as I listened to this testimony, this is one of the reasons this is such a bizarre situation. The PMAs are not—strictly speaking—utilities, because utilities have never acted this way. I guess that is why we are having these studies and hearings to learn what the differences are.

Mr. SHAFER. Congressman, I certainly would agree, and that's why we had some concern about making a comparison of the PMAs with investor-owned utilities. We certainly do have different purposes. Even the average of the power that is generated is a very distorted figure, or it is a distorted fact, because you have to look at the type of power that is being produced.

You have to look at whether it is firm power or nonfirm, and there are a lot of other factors. You have to look at the timing involved. You have to look at the fact that it is hydro versus maybe coal or gas-fired, and it is really a very difficult comparison to make.

Mr. DOOLITTLE. If we go to this issue in the report, maybe all of you can comment on it, if anyone wishes to. On page 27 of the blue GAO report, it talks about defining full costs associated with producing and marketing Federal hydropower. And the GAO used the

Office of Management and Budget's Circular A-25 dealing with user fees, which is not what guides the PMAs, but they were trying to come up with a definition of what the full costs were. Now, is that accurate, Ms. Calbom?

Ms. CALBOM. Yes. That is accurate.

Mr. DOOLITTLE. And, Ms. Calbom, as you looked at this, you said that that is not what governs, but instead DOE Order RA 6120.2 is what does govern. And they didn't adopt that standard. Do you know why they didn't adopt that standard?

Ms. CALBOM. You know, I think that it wasn't something that they even considered because they are following the DOE order, which would be their primary order that they would follow.

Mr. DOOLITTLE. Right, but why didn't DOE adopt that standard as ordered?

Ms. CALBOM. I don't know.

Mr. DOOLITTLE. Doesn't it seem logical to you as you studied this issue that would have been a pretty good standard to evaluate what full costs are?

Ms. CALBOM. Yes. In trying to do the study that we were asked to do, we considered what the private sector is required to do for reporting in financial statements. And then we came across this OMB circular as well. And we used all of those resources to develop our standard, as you say, of what full costs would be.

Mr. DOOLITTLE. Apparently, the DOE standard is more ambiguous in one part and then narrower in the other, so they apparently adjusted it under that standard and did not necessarily recognize full costs. Is that your understanding?

Ms. CALBOM. That is correct. And there are, in particular, certain things like the pension costs where I think there are some interpretations made by the PMAs which would indicate to them that they don't believe they could recover those costs. And we think that is subject to differing interpretations.

Mr. DOOLITTLE. Will you give me your interpretation of that?

Ms. CALBOM. Yes. Actually, I would like Mr. Armstrong of our Office of General Counsel to address that point.

Mr. DOOLITTLE. I was hoping Mr. Armstrong would have a chance to testify.

Mr. ARMSTRONG. Thank you, Mr. Chairman. Thank you, Ms. Calbom. Yes. We recognize that your position is a little bit different from Western's position on this. They had taken the position that the law will not permit them to recover those unfunded pension costs, that they are just like any other Federal agency and other Federal agency pays those costs. Those costs are appropriated by the Congress to the Office of Personnel Management.

We think that Western's interpretation of the law is a reasonable interpretation of the law. But we feel that the law could also be interpreted just as reasonably to permit them to recover those costs because, after all, they are a cost to the U.S. Government of providing this service to these power ratepayers.

Mr. DOOLITTLE. Could you tell us the basis for your belief?

Mr. ARMSTRONG. When you look at the Flood Control Act, which governs projects operated by the Corps of Engineers, and when you look at the Reclamation Project Act, which covers projects operated

by the Bureau of Reclamation, they speak in terms of recovering the costs for producing and transmitting electric power.

When we referred to these other sources to develop a definition of full costs, it seemed to us that these are costs of producing electric power or for transmitting electric power. And, as such, they seemed to us to be legitimate costs to the Federal Government providing this service.

Mr. DOOLITTLE. Mr. Shafer, do you believe that is a reasonable interpretation?

Mr. SHAFER. Well, I think we probably look at it a little bit differently.

Mr. DOOLITTLE. I understand you look at it differently. Do you believe that it is a reasonable interpretation of the law?

Mr. SHAFER. It is probably reasonable from their perspective. I can shed some light on the DOE Order RA6120.2 as to why it doesn't include OMB circular A-25 guidance. One thing, in the OMB Circular A-25, it acknowledges its guidance, and it is not to supersede any laws.

Prior to 1993, there was a specific exemption in OMB circular A-25 for certain resources, power, water, irrigation comes to mind, that this guidance didn't apply to. We don't argue with the fact that those pensions are not fully recovered. We'd agree also that we could, if directed, recover these costs in the rates. We don't argue with that.

Mr. DOOLITTLE. So you do acknowledge that these would be recovered costs?

Mr. SHAFER. The concern we have is putting in place a process of attributing those funds we have collected to the proper account without augmenting existing appropriations. There is really no place to put them. You can collect them, but where do they go? You could put them in the general fund of the Treasury, but it doesn't really get accredited to the appropriate accounts. Right now, OPM funds the retirement accounts.

Mr. DOOLITTLE. Ms. Calbom, do you concur with his conclusion that there is no place for them to go?

Ms. CALBOM. Well, I think, as Mr. Shafer said, you could put them in the general fund, which is similar to how the PMAs recover the costs of the operating agencies.

Mr. DOOLITTLE. So what is the matter with that?

Mr. SHAFER. Well, in consulting with our legal advisors, they said that this is really an augmentation of appropriations. And so what you do with that, you can book it, but you can't identify where you put it.

Mr. DOOLITTLE. But don't you have funds that are put into various accounts that aren't deemed to be augmentations of appropriations?

Mr. SHAFER. But they are identified specifically by law as to is where they should be accounted.

Mr. DOOLITTLE. Ms. Calbom of the GAO, do you believe there is a way that these PMAs could deal with the pension costs and not be in violation of the law?

Ms. CALBOM. Again, I will give Mr. Armstrong another chance to respond.

Mr. DOOLITTLE. Thank you. Mr. Armstrong.

Mr. ARMSTRONG. Yes. I think that it can be addressed without there being a legal issue here. I think that if the PMAs were to recover those costs, the recoveries could be deposited into the general fund of the Treasury where they would be available to the Congress to appropriate to OPM to cover what is currently referred to as the unfunded pension costs.

As Mr. Kutz was showing on the chart earlier, many of the PMA revenues go directly into the general fund of the Treasury. And they are available there to offset the costs that the Congress appropriates funds to cover. This would work similarly.

Mr. DOOLITTLE. Mr. Shafer, what do you think? Do you think you and your colleagues might be able to get together?

Mr. SHAFER. We are certainly willing to sit down and work to identify the process. If we can do that without financial obligation, we are certainly willing to pursue that.

Mr. DOOLITTLE. Would you and the other two gentlemen who are here, either in your capacities as PMA directors, or on behalf of the Clinton Administration, respond back to us as to whether you could find a way to make that work because that would be addressing one of these five key things about this subsidy? What do you think?

Mr. SHAFER. Yes. We will do that.

Mr. DOOLITTLE. Mr. DeFazio is recognized.

Mr. DEFAZIO. Mr. Armstrong, wouldn't it be a little cleaner if Congress were to specifically identify this and to set up a dedicated transfer fund? I mean, the money goes to the general fund. What else could we spend it on? Could we spend it on FATs?

Mr. ARMSTRONG. Of course it could. However, Congressman—

Mr. DEFAZIO. Because it's not appropriated. But how do we know it would go to the pensions?

Mr. ARMSTRONG. I agree with you that it would be much more direct and much cleaner for the Congress to—

Mr. DEFAZIO. Thank you. That is good. Thank you. I think that is the more proper way to deal with it. Back to the issue of contention. I mean, I find it extraordinary that Mr. Meehan believes that he is not waiving all environmental laws.

My understanding is that this section of the bill, authored by Mr. Franks and Mr. Meehan, is identical to the section of the bill in the CEFA sale and budget reconciliation, and that there is a letter from the Clinton Administration which particularly objected to that exception that section of the CEFA sale by reconciliation which says that this is a waiver of all environmental laws. Are you aware of that letter, Mr. Shafer?

Mr. SHAFER. I am now, Congressman, and I appreciate that.

Mr. DEFAZIO. And I would appreciate a copy being sent to Mr. Franks and Mr. Meehan since they want to do what is right, and they don't want to waive all environmental laws. And there was no intention of the author of the bill, whoever that was, whatever private interests they might represent, to, you know, make these things more marketable—then I'll look forward to that, you know, that communication then correct because it is pretty clear to me the license may not be revoked for any purpose in the first 10 years, shall constitute the sole and exclusive source for transfer of power-generated facilities, authorizations, requirements with respect to facilities, and additional waivers, and no flow restrictions.

Obviously, there isn't a lot of hydrogeneration in Mr. Meehan's district, and he wouldn't know what is going on with the EPA and Court orders and the 400 and some odd million dollars a year that are dedicated to salmon and Court orders which have to do with varying flow restrictions on a daily basis, let alone saying, "Somehow we have a license that says, well, if we decide what the flow restrictions are, those will be nine or 10 years."

Again, I have a private power company in my district that would take these nonexceptions to environmental laws tomorrow they've paid for—they'd be happy to pay tens of millions of dollars for these nonexceptions to environmental laws. Just give them this language, Mr. Meehan and Mr. Franks.

The—back to the irrigation subsidy, that is the second—this is the Chairman's bill for the intentions of something that concerns me across the entire bill. What is the unfunded liability to the entire Federal Government that isn't being done on an annual basis for pension retirement—for the total accumulated liability? Are you familiar with that number?

Ms. CALBOM. Not off the top of my head. I don't know that.

Mr. DEFAZIO. But is it tens or hundreds—

Ms. CALBOM. It is large.

Mr. DEFAZIO [continuing]. Of millions of dollars. Right?

Ms. CALBOM. Yes.

Mr. DEFAZIO. So this is not a meeting to get the PMAs, but I am pleased that we had some discussion on that. And I would like to go—the—and I've already dealt with the possibility of restructuring some of the debt and dealing with some of the supposed subsidies on that first line of questioning.

They were about the conditions under which the money was borrowed, when, and that—I mean, I have a 7-percent loan in my House Bank. They can't quote me and said that is a subsidy, we want to raise it, the Federal Government, you know, there are some questions here. But, OK, we can deal with that.

Let us go to the third big item and that is the irrigation subsidies. There are some conflicting GAO reports as far as I can tell on this. I would like a clarification, and perhaps we could do it today, from GAO on the amount of subsidies to the irrigators. There is a GAO report of September 1994 that says there is 3.4 billion in costs of irrigation not paid.

There is a July 1996 report saying Western is contributing 2.6 billion toward irrigation assistance, not 1.5. It seems to me that we need some clarification on the total amount of subsidy being provided to the irrigators in all forms by the power users and/or the taxpayers.

Ms. CALBOM. I think perhaps some of the difference might be related to projects that have been completed to date versus those that are planned. I know there is a larger number out there for planned projects, and once those projects are—

Mr. DEFAZIO. You mean we are still planning projects that gives subsidies to irrigators?

Ms. CALBOM. That is my understanding. Now, some of those projects—

Mr. DEFAZIO. You mean the government isn't acting like a business and doing this at a market rate for water for these irrigators?

Ms. CALBOM. There are certain projects—

Mr. DEFAZIO. We are not fully recovering every penny of taxpayer dollar with interest at bargain rates on current authorizations for irrigation projects we're not authorizing?

Ms. CALBOM. I don't know that they are now being authorized—

Mr. DEFAZIO. But they were proposed?

Ms. CALBOM. These are projects I think that were proposed sometime back but have not been completed.

Mr. DEFAZIO. Well, I guess we certainly want to look at, you know, if we revisit any of these, we appropriate them, that we get a 100 percent recovery from those subsidies from any forms only paid by the users. That would follow the GAO circular, wouldn't it, on the user fees or whatever—the OPM circular?

Ms. CALBOM. The OMB circular—

Mr. DEFAZIO. Would user fees apply in that manner to gauge the water their—some would use?

Ms. CALBOM. I would imagine they would in this case.

Mr. DEFAZIO. So it would apply equally to irrigators as it would to electric users?

Ms. CALBOM. I would imagine.

Mr. DEFAZIO. OK. Well, it would be a handy principle to look at across the board. I thank the gentlelady.

Mr. DOOLITTLE. Mr. Shadegg.

Mr. SHADEGG. Thank you, Mr. Chairman. That letter that was handed to Mr. Armstrong, the point you just went over was that with regard to recovery of pensions. The law says that you recover cost of producing and distributing electrical power, and there is this gray question as to whether or not that includes pension costs. Is that where the split is between you and—

Mr. ARMSTRONG. Yes. I think that is accurate. Yes.

Mr. SHADEGG. Oh, excuse me. I am sorry Mr. DeFazio is leaving. I would like to know if any normal business in America would not acknowledge that the pension costs for its employees which must openly be paid is going to cost the business—I mean, obviously, they would, would they not?

Mr. ARMSTRONG. I am a lawyer. I am going to have to kick this one back to Ms. Calbom when you start talking about business practice.

Mr. SHADEGG. OK, I went to Boston where they did told me I had to throw logic out—so it seems to me—I guess I would admit in all fairness to Mr. Shafer, I think WAPA is legitimately trying to interpret these laws and do it their way and say, "Well, these are the pension costs and actual costs of producing and distributing power. Gee, we are not sure and I don't really know where to put it."

I guess my point here is it just points out how the current government structure doesn't really work, and that is not a question that the president of any business in the world would ask himself. You would not say, Gee, someday I've got to pay pensions, and I have got to pay off on this, and I signed the contracts with employees to pay those, but I am not sure whether that is costing me business."

Mr. SHAFER. Yes. Congressman, we don't disagree with the fact that Pensions are a cost of providing power. What we think needs

to be sorted out is—and one of the issues is how do you make sure these funds get to where they should be. That is one issue.

The other one is the overall determination of what those costs actually are that are attributable to power. We would probably want to sit down and discuss and maybe argue with GAO on the amount of the costs that they show. Again, I haven't had an opportunity to really look at their final report only the draft report so I am responding to that. The total number that they present as unrecovered, we would probably have some disagreement. We don't disagree with the fact that pensions are a cost of producing power especially from the PMA perspective.

Mr. SHADEGG. So I guess what you are saying is there may be some employees more devoted to something—some function other than the production or distribution of power for—

Mr. SHAFER. Yes.

Mr. SHADEGG. Ms. Calbom, did you count employees in that category for whose pensions were being recovered—the cost of those pensions were being covered? Did you include in there people who were not either involved in production or distribution of power?

Ms. CALBOM. Our estimate tried to just capture the employees that were involved in the production of power. If I might just go back to the question that Mr. Armstrong was dodging to some degree, beginning in 1997, the PMAs will be required to record for financial statement purposes this cost. And so one way or another, the cost is going to have to be sorted out.

And in the private sector, I think it is since 1987 that cost has been something that has been recorded on the financial statements and has been a recovered cost of the non-Federal utilities. But I think as the new accounting standards for the Federal Government are implemented, this will be something that will have to be sorted out anyway.

Mr. KUTZ. With regards to the estimates, we got the full-time equivalents from the power marketing administrations, the Corps of Engineers, and the Bureau of Reclamation.

Mr. SHADEGG. I guess I am not so interested in the precise points of who was counted and who wasn't counted. The problem here is that as long as we manage this from the point of this Congress and from—and agencies of bureaucrats, things like this—legitimate, honest, level-headed people are going to look at the statutes to be right, and because the English language is vague, they are not going to know what to do with it because Congress didn't look forward and say, "Well, we have got to write out the response bill," we're not—we're going to get cheated out of problems like this. We can go on to the next one is—I think further clear.

The unrecovered costs are in. If you look at unrecovered costs for construction, it seems to me that any private investor-owned utility or a co-op that was truly owned by its individual shareholders would and could go dip into the Treasury. We have to figure out some way to cap budget costs for public construction projects before you even break it—either you have to go to the shareholders or you have to look to your rate—other rate cases making interest on that money. And because this is a government-run entity, you lose I guess under your report \$26.9 billion, and that is cost that they promised that it would go to shareholders and at this juncture it's

going to taxpayers. And my constituents who are not PMA customers have a legitimate right to ask me why should they be picking up that tab. I am sorry Mr. DeFazio left. I want to see this issue not get broken down in the environmental debate. I have a bill which does not grant specific exemption from environmental protection but does privatize PMAs in a way which makes the current PMA customers whole for their investment in the PMA or for their—divide in a power. And I think that this is useful information in moving toward that kind of solution. And I thank you for your testimony.

Mr. DOOLITTLE. I would like to go back to the Truman Project. The Truman Project apparently was built against the wishes of the PMA. That was done, we surmise from the testimony, because it made feasible a multipurpose project—in which they'd allocated a certain percentage of the cost of power. But it hasn't worked out that way, and we have, do we not, unrecovered costs. Is that what happened, Mr. Diehl?

Mr. DIEHL. Well, first, I would like to explain a little bit about the history of Truman. It might help shed some light on this. The project was constructed in 1982, and it was constructed in six units. In 1982, two of the units were placed on line, and all six units are compact generators.

When the two units were tested in the pumping mode, they experienced a fish kill. Right there they said, "Well, we have got a problem. We have got to work on a solution to this because we can't operate them in the pump mode. They kill fish."

Mr. DOOLITTLE. Let me ask you to stop there for a minute. Now, was this a pump-back project? Did pump generators produce fish kill? Isn't this also a problem in the Russell Project?

Mr. DIEHL. I believe so.

Mr. DOOLITTLE. I don't know which unit was built first. Was it the Truman that was built first, or the Russell?

Mr. DIEHL. Truman was built in 1982 and Russell—1985 Russell was completed.

Mr. DOOLITTLE. We are going to have to have Mr. Borchardt come up here and tell us why Russell didn't learn from Truman, so come on up. Let us talk about Russell. That amounts to about 400 and some million dollars in nonrecovery costs, doesn't it?

Mr. BORCHARDT. Yes. That is the cost associated with the project.

Mr. DOOLITTLE. When they saw these pump-back generators kill the fish in Truman, why didn't they learn from that before they built Russell?

Mr. BORCHARDT. Well, there was some concern, but, nevertheless, the pump-back units were constructed.

Mr. DOOLITTLE. Was that a Corps of Engineers decision?

Mr. BORCHARDT. Yes. Basically it was.

Mr. DOOLITTLE. So there is another instance where the way you want to build your project isn't necessarily binding on the ones who are in charge of construction?

Mr. BORCHARDT. Well, I don't want to leave you with a false impression.

Mr. DOOLITTLE. OK.

Mr. BORCHARDT. I know that—I am somewhat familiar with the Truman Project, and I know that the documentation on the Tru-

man Project was much clearer as to the limitations on what should—how that project should be constructed. There was some concern with Russell particularly from the customers—the power marketing customers regarding the pump-back units.

Mr. DOOLITTLE. It strikes me as amazing that we would be wasting these hundreds of millions of dollars. Do you ever expect that we will recover the—489—what is the figure?

Mr. BORCHARDT. I believe they have it at 448 if I am not mistaken.

Mr. DOOLITTLE. 448?

Ms. CALBOM. 488 as of September 30.

Mr. BORCHARDT. 488.

Mr. DOOLITTLE. Well, do you think we are ever going to recover those costs?

Mr. BORCHARDT. Yes, I do.

Mr. DOOLITTLE. And when do you think that will begin?

Mr. BORCHARDT. I think that the schedule for that to begin would be in June 1997.

Mr. DOOLITTLE. I interrupted Mr. Diehl, who was giving us the history. Let me jump ahead for a minute. Mr. Diehl, do you think we are ever going to recover the costs on Truman?

Mr. DIEHL. Right now at this point in time, we have no reason to believe it will not be recovered.

Mr. DOOLITTLE. No reason to believe it will not be recovered. When do you think it will be recovered?

Mr. DIEHL. Currently, like I said, there were two units placed on line. They have been mechanically repaired. There are at least three issues here I was leading up to.

Mr. DOOLITTLE. Go ahead.

Mr. DIEHL. One was the fish kill; one, there were mechanical problems with the units when they were installed. They are of a unique design. And the third one, there was some concerns downstream of possible environmental impacts due to high flow releases.

One of those issues has been fairly well addressed and that is the downstream issues. We have reached agreements with the Corps of Engineers, Southwestern Power, power customers, and the State of Missouri on an operating plan that would allow the plant to be used in such a manner that the downstream environmental concerns have pretty well been mitigated.

The issue of mechanical problems on the units—two of those units, like I said, were put on in 1982. Those units have been upgraded and repaired and are fully operational. They are not being used in the pump-back mode at this time. We also just completed or I should say the Corps has completed the repairs of two other units so there are now four out of six units that have been mechanically repaired. And the remaining two were scheduled to be completed by the year 1997.

That does leave the pump-back problem and the fish kill. The Corps of Engineers—the districts responsible for the Truman Project are working with the Corps district that is responsible for the Russell Project. And I understand there are some activities of research and testing of ideas being kicked around that are from the Russell Project and under test now. Based on the results of the tests some of those will be employed at Truman at a future point

in time, and hopefully the operating constraints that limit the operation of the facility would be lifted.

Mr. DOOLITTLE. Now, these units were completed, I think you said in 1982. Is that right?

Mr. DIEHL. Yes, sir.

Mr. DOOLITTLE. But some of them have never been put on line. Is that also right?

Mr. DIEHL. All the units have been on line at one time or another for testing purposes.

Mr. DOOLITTLE. Just for testing. The question in my mind is, since they appear to be essentially new units, at least new as in little used since they were first constructed, why are they having mechanical problems?

Mr. DIEHL. The units are slant-axis designed. There are not many hydro units that are constructed in that manner. Usually, they have a vertical-type shaft, where you have all your weights suspended on a bearing straight-down full force, or you have a complete horizontal unit.

This unit is on an angle, and it creates some unique situations when it comes to bearing stresses and shaft stresses. And I believe that this might have been one of the first slant-axis units to be designed and put in operation. So there was some prototype-type work I would guess done on these units.

Mr. DOOLITTLE. What agency was responsible for selecting these units?

Mr. DIEHL. The Corps of Engineers.

Mr. DOOLITTLE. All right. This isn't the first time I have heard of severe problems in the generator units operated by the Corps of Engineers. Are they known for doing this?

Mr. DIEHL. To the best of my knowledge, the Corps plants in the Southwest Power Administration region we serve are well maintained except for this one plant original design that appears to have some faults to it.

Mr. DOOLITTLE. Well, that is not the testimony we received in an earlier hearing. Excuse me. You said Southwest. We had testimony from Southeast. So your experiences are that the plants are well maintained in Southwest?

Mr. DIEHL. To date, yes, sir.

Mr. DOOLITTLE. OK. But now we're not talking about maintenance we're talking about—this is a problem at Southeast where they ordered some generators that were wrong right from the beginning. And then they took parts out to make them at least run, and that caused other problems which led to some very great expenses as a result of that.

I have not heard similar stories from nonPMAs, whether they are investor-owned or not. I mean, how do we get uniquely designed generators against the recommendation of the power entity in the first place, and then they have problems with them? And then basically they become an unrecovered cost, and the taxpayers pay for it. That is the result of unrecovered costs, isn't it?

Mr. DIEHL. Perhaps I misunderstood what you just said, but for clarification, the PMA makes no recommendation on the type of unit that is installed.

Mr. DOOLITTLE. No. I understand that, but you recommended Gansis build this facility in the way it was built. Right?

Mr. DIEHL. We did recommend that they consider some alternatives to their proposals.

Mr. DOOLITTLE. And your recommendation was disregarded?

Mr. DIEHL. To the best of my knowledge—I don't have personal knowledge of what is in the letters that were sent—but I understand that the PMAs recommended five units instead of six units.

Mr. DOOLITTLE. Six units. And now you have got a facility that is producing less than one-third of the power it was designed to produce. Ms. Calbom, didn't you find in your study it is likely that they will never recover these costs?

Ms. CALBOM. I think that certainly if this project isn't brought fully on line, that is highly questionable.

Mr. DOOLITTLE. Now, you are talking about the Russell Project, Ms. Calbom. You indicated if that were not a PMA but a normal utility, they would have to recover those costs. Wasn't that your indication? Aren't they carrying four of these units that have been completed since 1992, and they are still counted as construction and work in progress?

Ms. CALBOM. Yes. I think that generally would be the situation. And one of the things with the Russell Project is that interest is continuing to be accrued on this project so that the balance is growing and growing as time goes by. I think of the \$488 million, \$150 million of it was accrued interest. Today, I believe the cost is probably over half a billion dollars because this interest is continuing to increase the investment amount.

Mr. DOOLITTLE. Half a billion dollars. Let me ask you, other than \$300 million a year, Ms. Calbom, that you identified as the subsidy to the PMAs, did you form a conclusion realistically as to what portion of it might reasonably be recovered?

Ms. CALBOM. We didn't form any conclusion on that, no, but we certainly did have certain aspects of that that we think there is questions about whether or not it could be recovered. One of these was the Russell Project.

Mr. DOOLITTLE. Before you said it wasn't likely to be recovered?

Ms. CALBOM. We questioned whether if the project is never brought fully on line the costs could be recovered. However, when you are considering that you have got half a billion dollars of costs and it is a rate-setting system that I believe has about \$100 million in revenue annually, regardless of whether it is brought on line, I think there are some concerns there about the ability to recover that investment.

Mr. DOOLITTLE. That is so you can spread half a billion dollars over \$100 million a year. And this is going to continue to accrue interest, right, year by year and add it on?

Ms. CALBOM. Correct.

Mr. DOOLITTLE. And this compounds it?

Ms. CALBOM. Once the project is—if it is ever brought on line—once it is brought on line, then that interest would have to start being paid annually to the Treasury.

Mr. DOOLITTLE. Right. Well, Mr. Borchardt thinks it is going to come on line, and I certainly hope he is right. Mr. Shafer, the last time you were here before the committee, I think it was March, you

indicated you were optimistic about the prospects for the Mead-Phoenix Transmission Line. And you indicated that you would aggressively market its capacity, which I think at that point was woefully underutilized. Can you give us an update on the status of the Mead-Phoenix Transmission Line?

Mr. SHAFER. Well, I continue to be optimistic.

Mr. DOOLITTLE. Have you seen ascertainable progress?

Mr. SHAFER. At this point, we have not signed any firm capacity contracts for that line. The revenues that we are receiving are from short-term contracts.

Mr. DOOLITTLE. Why are you optimistic?

Mr. SHAFER. Well, we think that in the future this is going to be a valuable another asset, that as the industry begins to restructure itself and identify the direction its heading that this transmission line, is needed and will be needed even more so in the future.

Mr. DOOLITTLE. How far into the future though?

Mr. SHAFER. That is a good question.

Mr. DOOLITTLE. That is the difference between an economic and an uneconomic project.

Mr. SHAFER. I would like to point out the fact that this line is a portion of the overall Intertie project, and those costs will be recovered in one way or the other. Presently, it is the new portion of the Intertie project that is being marketed on its own. The old portion has a different marketing plan. Those repayment responsibilities could fold together. The cost will be recovered in one fashion or the other.

Mr. DOOLITTLE. Well, let me ask you another question. Do you meet with your customers on a regular basis?

Mr. SHAFER. Yes.

Mr. DOOLITTLE. And do you discuss rates with them?

Mr. SHAFER. Each year we make a study—we make them aware of what is being considered and what the indications are.

Mr. DOOLITTLE. So then rates would be a topic of discussion?

Mr. SHAFER. Yes. Our rate process is a very open process. We use a public process so that all of our customers are aware. It is really open to the public in general.

Mr. DOOLITTLE. Could a private utility have rate discussions with their customer?

Mr. SHAFER. They certainly can sit in on the public meetings.

Mr. DOOLITTLE. Is there any difference in the way that works versus the way it works in the PMAs?

Mr. SHAFER. You mean—excuse me—

Mr. DOOLITTLE. Is there any difference in the way that private utilities would have to interact with their customers vis-a-vis rate discussions?

Mr. SHAFER. I am not aware of the private utilities having public hearings in the rate process. They, of course, go through State Public Utility Commissions for approval.

Mr. DOOLITTLE. They come up with what they want and go to the Public Utility Commission, and that commission holds the hearings. Isn't that the way it works?

Mr. SHAFER. As I understand, it that is correct.

Mr. DOOLITTLE. So that is a lot more cumbersome process in terms of being able to sit down with your customers, and the customers are sometimes just a couple hundred or so.

Mr. SHAFER. The Public Process could be on a specific project.

Mr. DOOLITTLE. In the GAO report, didn't SWPA and SEPA each have about 250 customers—something like that?

Mr. SHAFER. Yes.

Mr. DOOLITTLE. And then WAPA I think had 500 and some. Is that correct?

Mr. SHAFER. Yes, close to 600.

Mr. DOOLITTLE. So you are dealing with a pretty small universe of wholesale customers, and you can actually get them in a room and talk about these things. It has a great advantage, doesn't it?

Mr. SHAFER. It could be a disadvantage. It might be looked at from that perspective, but we are very open with the costs, and we explain it to the customers.

Mr. DOOLITTLE. I mean, for the customers, it is a real advantage, isn't it? The ability to actually have a kind of give and take with the utilities?

Mr. SHAFER. Well, I think it is similar to the process that the customers have with the opportunities of the hearings held by the commissions; the opportunity when rates are finally referred to—

Mr. DOOLITTLE. Yes, but one big difference is that you can have private conversations with these people versus—

Mr. SHAFER. They are open. They are very open.

Mr. DOOLITTLE. Well, I mean, do you have the press there before you at the proceedings?

Mr. SHAFER. If they want to be.

Mr. DOOLITTLE. So the press is invited?

Mr. SHAFER. No, they are not specifically invited, it is an open public meeting.

Mr. DOOLITTLE. If they are not invited or the meetings are not advised, it is kind of hard to be there, isn't it? I mean, the Public Utility Commission is one of the most bureaucratic, cumbersome structures I have ever heard of.

Mr. SHAFER. Yes. While they are not personally notified, they are notified through the announcement of the public process.

Mr. DOOLITTLE. Does the announcement of the public process indicate the date and the room etcetera?

Mr. SHAFER. Yes.

Mr. DOOLITTLE. Regarding the issue Mr. DeFazio raised in the beginning, let us talk about the future now. In this GAO report on page 24, it states, "As a result of the increased competition, FERC expects wholesale and retail electricity rates to drop. Increased competition may impact the PMAs' status as a low cost supplier." Would you care to elaborate upon that, Ms. Calbom? Tell us how real this threat is anyway?

Ms. CALBOM. Well, I think that it is real when you think about the independent power producers that are starting to come into the picture that supply I think about 8 percent of the power across the country right now.

Mr. DOOLITTLE. Are they the driving force, in your opinion, of the downward pressure on electricity prices?

Ms. CALBOM. I think to a large degree they are probably influencing that.

Mr. DOOLITTLE. OK, you have these PMAs with unrecovered costs and so forth. Did you see the realistic prospect where they may be surpassed by some of these new energy-efficient projects in terms of being able to supply electricity at a lower cost and those sorts of things that PMAs themselves can do?

Ms. CALBOM. Well, I think it varies by rate-setting system. Certain of the rate-setting systems right now are actually very close to the IOUs, and so they are facing those competitive pressures currently. Certain of the other rate-setting systems have a significant amount of difference.

As we reported on the average, the PMAs compared to 40 percent below in their cost of generating the power non-Federal utilities. So that tells you that there are some systems that are very far below. But the IPPs certainly do seem to be one of the major driving forces.

Mr. DOOLITTLE. But PMAs, can lay off costs that are unrecovered. They don't pay taxes of any kind basically. And they don't pay presently at least for the pensions of a large class of their workers or for the health care of their retired workers. And you are saying that even with those tremendous advantages, in some cases their rates are about what the investor-owned utilities' rates are?

Ms. CALBOM. In some of the systems, that is true. I might have Mr. Kutz talk about an example of one or two of those.

Mr. DOOLITTLE. Sure. I would like to hear about those.

Mr. KUTZ. Well, the only one that that would probably be true for right now would be the Washoe Project, which is one of Western's projects that is selling electricity for two cents a kilowatt hour that is costing 11 cents. I think the market—

Mr. DOOLITTLE. Where is the Washoe Project?

Mr. KUTZ. This is Stampede Dam. Correct?

Mr. SHAFER. Washoe is in the States of California and Nevada.

Mr. DOOLITTLE. Now, is that in Southern Nevada?

Mr. SHAFER. By Lake Tahoe.

Mr. DOOLITTLE. Oh. I wondered if that was the one we would be talking about. OK. Great.

Mr. KUTZ. Aside from that, I think the one that would be in the most danger would be the Russell Project with the \$500 million of costs at this point that aren't even in a rate-base. At Southeastern, the Georgia-Alabama system has I would say a higher cost system than some of the other Southeastern systems and its rates are closer to some of the competitors than maybe some of the other southeastern projects. If that project was now operational or even not operational, again, with 6 percent interest on over \$500 million of capital cost, that could push that project closer to others in that area.

Mr. DOOLITTLE. Is this report like the earlier reports that talked about the sad state of repair on many of these facilities? In other words, when you give answers about the Stampede and then Russell, are you taking into account the maximum amounts of deferred maintenance that appear to be required? I mean, what do I do with that knowledge? How does that fit into this discussion of projects

that are referred to as being more expensive than investor-owned utilities right now?

Ms. CALBOM. The deferred maintenance issue is not something that we had included in this study here.

Mr. DOOLITTLE. I realize that. The committees had earlier meetings and hearings about that?

Ms. CALBOM. Correct. Yes. I guess we are not in a position to comment on that.

Mr. DOOLITTLE. OK. I would be interested, if we could elicit from you—maybe it will take a further study or something—what happens when you throw all of this in the same pot and you analyze it. Because if you are at the point with very many of these where they already are charging what investor-run utilities can charge, then investor-run utilities are paying taxes, and they have got to pay for their bad projects. They can't just say the costs are unrecovered.

And they pay for their pensions and their health care and they are still making a profit, and if the cost of electricity is being ever driven downward, what kind of liability are we going to be facing in trade with these PMAs that are free from many of these things and will be less competitive pricewise with the monster investor-owned utilities which are threatening every consumer in the country who is not presently within that structure? Do you see what I mean? Isn't that what—

Ms. CALBOM. I see what you are driving at. As I said, we haven't put those things all together. I think the operative thing to keep in mind is that I think we just found a couple of the rate-setting systems that were bumping up against this. But, as you say, that is a serious consideration when you think about all these other costs that haven't been recovered.

Mr. DOOLITTLE. I mean, aren't we dealing with dinosaurs from the early part of this century? I was struck by your report that said that at least in the case—I don't remember who WAPA's speaker was—but in the case of the SEPA and SWPA, the majority of their generated capacity was built since 1960. Is that correct? Is that your recollection of your report?

Ms. CALBOM. We will need to take a second to look at that.

Mr. DOOLITTLE. All right. Take a second to look at that. I mean, America was electrified by 1960, and, we hear the arguments that all these extra obligations they have such as recreation and environmental purposes, and you had to make special allowances.

But, nevertheless, they are in competition with private entities that can't do all these extraordinary things like not pay taxes, and defer (or just lay off) unrecovered costs whenever it becomes undesirable and not pay pension and the health benefits as part of the costs of producing the power or at least maybe they can account the cost but not be responsible for it.

And aren't we in real danger of a great run on the Treasury when people stop buying their power from PMAs, and the PMAs are supposed to pay for all of these power-generation facilities that have been authorized since 1960? And are not going to have people paying for this power because the people voted to go with some investor-owned utility or some municipal utility, whatever, for a

cheaper price. Isn't that a problem for the financial integrity of this whole vast system that has been erected?

Ms. CALBOM. And that is the reason that we brought in the competition issue in this report. We didn't delve extensively into that, as you can tell from the previous questions. But we did want to bring that up because it is important to note that if the PMAs are no longer low cost producers and don't attract customers, then there is some danger—there is a great danger that the Federal investment would not be able to be recovered.

Mr. DOOLITTLE. OK. Mr. Shadeegg, do you want to ask anything further? We will go to Mr. Shadeegg.

Mr. SHADEGG. Thank you, Mr. Chairman. Let me try to just clear up one point that I am confused about, and it really stems from page 24 of your report. If I understand the Energy Policy Act, FERC now under its rules compels investor-owned utilities to make their transmission lines available for wholesale power markets so that if someone wants to come in and sell wholesale power in a given service area, a local investor-owned utility, governed by the FERC regulations, must make those transmission lines available, thereby ending competition for that wholesale power.

In your report on page 24, you discuss this issue and acknowledge what I think I just described. And you say that the power marketing associations are now being directed to—I guess under the Department of Energy, DOE is now directing that PMAs comply with the intent of this Act. I take it at that point you were relying on their representation to you?

Mr. KUTZ. Yes. That is true.

Mr. SHADEGG. Do you know if each of the PMAs in your study is, in fact, currently allowing competitive utilization of their lines for wholesale power sales within certain area?

Mr. KUTZ. I can't answer that question.

Mr. SHADEGG. Mr. Shafer, do you know?

Mr. SHAFER. Yes. We have always had what we call an open-access policy on Federal transmission. The transmission is used primarily to deliver the Federal power to Customers. Anything over and above that is considered excess, and it is always marketed on a first-come, first-served wholesale basis with absolutely no preference given to type of utility ownership.

Mr. SHADEGG. I read the statement that at least SWPA has considered this—whatever you just said, which is also stated by the report. My question is is there today any utility utilizing that—utilizing WAPA lines for wholesale power marketing?

Mr. SHAFER. Yes. There very definitely is. As I indicated earlier, from the very beginning, the transmission line is available.

Mr. SHADEGG. And that is true as a matter of policy?

Mr. SHAFER. That is correct.

Mr. SHADEGG. So you don't have a problem with if nothing else happened if we put that in the statute remarks? I mean, I understand from what you described. There are extremely large power centers in my district or in my state who are in service areas serviced by PMAs who have said to me they can't get wholesale power because the PMA or the co-op power in their area won't make lines available, and that they are not making the lines available because they are not governed by this provision of FERC. And I believe that

competition is extremely important, and it is what is going to drive the market price down I believe in not only wholesale power but marketing discount at the retail level. So I guess my question is you said you are doing it and your lines are available, and when will it be available?

Mr. SHAFER. We are on record to provide wholesale transmission, and we don't accommodate retail wheeling because we are in the wholesale market. The Department has made it a policy saying that we will comply with the intent of the open-access transmission policy.

Mr. SHADEGG. Mr. Shafer, that sounds to me like the DOE has said on a voluntary basis you are going to comply with the intent of the law. It suggests to me that the law does not tell you to and to go along with the intent of the law?

Mr. SHAFER. That is correct.

Mr. SHADEGG. So if we change—if the government is sure of this, we can change the law require to comply with the FERC policy as a matter of law?

Mr. SHAFER. Yes. There could be some issues there as far as a matter of philosophy on the subject of regulation.

Mr. SHADEGG. Do you know if all of the PMAs are, in fact, also making their lines available for wholesale power sale?

Mr. SHAFER. Yes. I know for a fact that Southwestern is. Southwestern does not have any transmission. They have no physical facilities. They use—strictly use other utilities' transmission lines to deliver their resource. But I guess I know that Southwestern has the same policy. Bonneville, likewise, has allowed use of their lines for other utilities.

Mr. SHADEGG. I want to ask you one other question. You said you wouldn't be involved in a question of retail because you are in the wholesale business. If you sell wholesale to a city, you say DOE compelled you to make your lines available for other wholesale producers coming in to compete with that contract. Do you know if that city is required as a co-op—it is a private power area within or a public power ever been in that area—are they required to make, say, their distribution lines within the city itself?

Mr. SHAFER. No. Retail wheeling is not a Federal requirement at this point.

Mr. SHADEGG. OK. Let us say there is a large enough consumer in that city. They have to buy power. Are they required—your customer buys your power and then remarkets it to some retail household—let us say to a larger user in your area—

Mr. SHAFER. I think under today's definition of what you described as a large customer would be defined as a retail customer. And as of now, there is not a law that requires that the lines be opened up for that retail customer to access or for the utility companies to open up their lines for that retail customer to access the wholesale market.

Mr. SHADEGG. Well, which might mean that the practical difference is that for an investor-owned utility under FERC, which runs the line all the way to either my house and next door to that large producer—that large consumer, that large consumer can get the advantage of competition in the wholesale market because the line runs there to their house?

Mr. SHAFER. But that is not required in law at this point. As you know, FERC has not required retail access. Some companies have agreed to open up their system to that as a policy decision on their own. California's proposal does address this issue, but at this point, the FERC requirements do not mandate retail access.

Mr. SHADEGG. And you are saying retail access would by definition mean even in very, very large power consumer?

Mr. SHAFER. That is correct. They would be considered a retail customer.

Mr. SHADEGG. I have nothing further. Thank you.

Mr. DOOLITTLE. I just have a few questions left about this transmission line. Does Western plan on recovering the \$14.5 million in costs related to the ban that is discussed in the GAO report?

Mr. SHAFER. Yes. That is to be recovered.

Mr. DOOLITTLE. Is it?

Mr. SHAFER. Yes. Congressman, our numbers show that we have approximately \$11 million of costs. We are looking at that cost and how that would be dealt with. And, yes, we do plan on integrating that into the rates.

Mr. DOOLITTLE. Now, let me ask our GAO person, the 14.5 million, is that with interest?

Ms. CALBOM. Yes. The \$14.5 million does include capitalized interest.

Mr. DOOLITTLE. OK. And the GAO reported transmission lines abandoned in 1969. Is it true today that you have not recovered any of the original investment in this transmission project or any interest, Mr. Shafer?

Mr. SHAFER. The majority, yes. I would point out that this is a piece of the overall Pacific Northwest-Pacific Southwest Intertie Project. The total project cost was about \$206 million of which we are talking of \$11 million. And, yes, construction was stopped reportedly as due to lack of funding in 1969.

I think it is important to realize though that the project wasn't totally abandoned. The decision not to build was not made until as late as 1991 I believe it was when the Mead-Phoenix Project which we have talked about before, decision was made. That decision took it completely off the books. During the 70's and the 80's, there was still discussion as to whether it that might be a future line project.

Mr. DOOLITTLE. But you mean, you abandoned this one as you did with Mead-Phoenix, which has so far been used to capacity? One upper half of your capacity is sold under the Mead-Phoenix?

Mr. SHAFER. No. It was a different need. The project we are talking about is a DC line that was abandoned. It was a DC line versus an AC line. In the Interte project, there was one DC line built, and there was anticipated a second DC line.

As the system developed and as other utilities built lines in the area and over the period of time identified with the DC line, a fix was needed. The Mead-Phoenix is a piece. The line that was abandoned was actually north from Mead versus—Mead-Phoenix that runs, from Mead to Phoenix.

Mr. DOOLITTLE. So none of the 11 million that has been recovered since the line was abandoned?

Mr. SHAFER. The majority has not. We have taken some of the physical plant and used it in other projects. That we used the

right-of-way from some of the Phoenix line. And then some of the other facilities have been used. They were booked appropriately.

Mr. DOOLITTLE. So you are saying a small amount has been—

Mr. SHAFER. A small amount has been booked to project use, but it is a small amount.

Mr. DOOLITTLE. Roughly how much?

Mr. SHAFER. Less than \$1 million.

Mr. DOOLITTLE. Less than \$1 million?

Mr. SHAFER. Yes.

Mr. DOOLITTLE. And when will Western begin recovering the cost of this project?

Mr. SHAFER. We will include that in our next repayment study.

Mr. DOOLITTLE. OK. Will you recover the interest that should have been paid on this project from 1969 to 1996?

Mr. SHAFER. That is one thing we are working with our auditors right now to identify what that interest should be. And, yes, we would include what is identified as the appropriate number.

Mr. DOOLITTLE. And you know the interest rates that will be used to look at that?

Mr. SHAFER. Yes. I believe the interest rate was identified at the time of the project.

Mr. DOOLITTLE. And do you have any recollection of what that was?

Mr. SHAFER. I don't. I can certainly provide that to you.

Mr. DOOLITTLE. OK. Please do that. And the last payment on that project would be due what—35 to 45 years?

Mr. SHAFER. Yes. I don't know right offhand which that is, but it could easily be the 35 years.

Mr. DOOLITTLE. And would that run from 1969 or from 1996?

Mr. SHAFER. I think we have to decide that when the it would go into the rate base.

Mr. DOOLITTLE. OK. Well, let us know when you decide.

Mr. SHAFER. OK.

Mr. DOOLITTLE. I would like to thank our witnesses for a very good hearing; very informative. I appreciate your sticking with us. We will have some additional questions perhaps that we will wish to submit in writing. We ask you to answer those as soon as possible. And, again, I would like to commend the GAO for the excellent report. With that, the hearing is adjourned.

[Whereupon, at 5:17 p.m., the subcommittee was adjourned, and the following was submitted for the record:]

Mr. Chairman and Members of the Subcommittee:

Today, we are presenting testimony on a report¹ we prepared in response to a request from you and the Ranking Minority Member of the full committee. We were asked to answer specific questions about three power marketing administrations (PMA)-- Southeastern, Southwestern, and Western. You asked us to determine (1) whether all power-related costs incurred through September 30, 1995, had been recovered through the PMAs' electricity rates, (2) if the financing for power-related capital projects is subsidized by the federal government and, if so, to what extent, and (3) how PMAs differ from nonfederal utilities and the impact of these differences on power production costs. We were not asked to and did not address whether any changes in PMA cost recovery practices or financing should be made.

As members of this Subcommittee know, most of the hydropower facilities involved were originally designed for other purposes in addition to producing electricity. I would like to begin my testimony by providing a brief background on the history and purpose of the power marketing administrations as well as information about their operations. I will then discuss our findings on each of the questions.

BACKGROUND ON THE THREE PMAS

The three PMAs we studied (Southeastern, Southwestern, and Western) market primarily wholesale power in 30 states² produced at large, multiple-purpose water projects. Collectively, in fiscal year 1995, they had revenues of almost \$1 billion. Most of the power they sell is produced at 102 hydroelectric dams built and run primarily by the U.S.

¹Power Marketing Administrations: Cost Recovery, Financing, and Comparison to Nonfederal Utilities (GAO/AIMD-96-145, September 19, 1996).

²The wholesale power market for all five of the PMAs, including Bonneville and Alaska, encompasses 34 states.

Army Corps of Engineers or the Department of the Interior's Bureau of Reclamation, commonly referred to as "operating agencies." The operating agencies constructed these facilities as part of a larger effort in developing multipurpose water projects that have functions other than power generation, including flood control, irrigation, navigation, and recreation. To transmit this power, Southwestern and Western have their own transmission facilities. Southeastern relies on the transmission services of other utilities.

The three PMAs receive annual appropriations to cover operating and maintenance (O&M) expenses and, if applicable, the capital investment in transmission assets. Federal law calls for PMAs to set power rates at levels that will repay these appropriations as well as the power-related O&M and capital appropriations expended by the operating agencies generating the power. The Department of Energy's (DOE) implementing order specifies that unless otherwise prescribed by law, appropriations used for O&M expenses be recovered in the same year the expenses are incurred, but that appropriations used for capital investments (which we refer to as appropriated debt³) be recovered, with interest, over periods that can last up to 50 years.

At the end of fiscal year 1995, the three PMAs had about \$5.4 billion of appropriated debt outstanding. In addition, Western is required to recover about \$1.5 billion of capital costs related to assistance on completed irrigation facilities (which we refer to as irrigation debt), without interest, with repayment periods of up to 60 years.

Because PMAs and operating agencies generally receive financing from appropriations, Department of the Treasury checks are issued for their disbursements. Operating agencies allocate power-related costs to the PMAs for recovery. PMAs set rates to recover power-related costs, bill customers, and the resultant revenue is returned to

³We call this appropriated debt because PMAs are required to repay appropriations used for capital investments, with interest. However, these reimbursable appropriations are not technically considered lending by Treasury.

Treasury. The chart in attachment I demonstrates the flow of appropriated funds, costs to be recovered, and how repayment is made to Treasury from the revenues collected from power customers. It also outlines the costs that have not been recovered through this process, as well as the financing subsidy, that are discussed in detail in this testimony.

RATES DO NOT RECOVER ALL POWER-RELATED COSTS

The Reclamation Project Act of 1939 and the Flood Control Act of 1944 generally require that the PMAs recover through power rates the costs of producing and marketing federal hydropower. However, these acts do not define which costs are required to be recovered. In addition, DOE's implementing Order RA 6120.2, which was issued in 1979 and last revised in 1983, excludes certain costs associated with nonoperational facilities and is not specific about recovery of others. Where the order is not specific, PMAs have interpreted it to exclude certain costs from rates. To define the full cost of power production and marketing, we referred to Office of Management and Budget (OMB) Circular A-25, "User Charges," industry practice, and federal accounting standards. These criteria indicate that the full cost of producing and marketing federal hydropower would include all direct and indirect costs incurred by the PMAs, operating agencies, and other agencies involved in power-related activities. We identified five main power-related costs that meet these criteria that have not yet been fully recovered through electricity rates.⁴

First, the three PMAs do not recover the full cost of power-related postretirement health benefits and Civil Service Retirement System (CSRS) pensions for current PMA and

⁴We did not assess the reasonableness of the methodologies used by the operating agencies to allocate costs to power users and therefore could not determine whether these allocations result in recovery of all applicable operating agency power costs.

operating agency employees.⁵ For fiscal year 1995, we estimate that these unrecovered costs were about \$16 million for these three PMAs. The annual funding shortfall associated with CSRS pension benefits will be eliminated over time as CSRS employees leave the government and are replaced by employees covered by the Federal Employees Retirement System (FERS), for which pension benefits are fully funded. The annual funding shortfall associated with postretirement health benefits, however, will not be eliminated as a result of this transition, since it is an entirely separate benefit program. As of September 30, 1995, we estimate that the cumulative unrecovered costs associated with postretirement health benefits and CSRS pension benefits were about \$436 million for these three PMAs.

Second, all three PMAs had incurred costs and/or had costs allocated to them for projects that were completed or under construction for which full costs were not being recovered. In some cases, this was because the power-generating projects had never operated as designed. In accordance with DOE guidance, PMAs set rates that exclude the costs of nonoperational parts of power projects, including capitalized interest. For example, at the Russell Project, partially on line since 1985, litigation over excessive fish kills has kept four of the eight turbines from becoming operational. As a result, about one-half of the project's construction costs have been excluded from Southeastern's rates. It is unclear whether these costs, totalling \$488 million as of September 30, 1995, will be recovered if the project never operates to the capacity designed. In other cases, the tenuous financial condition of completed projects also raises questions about whether power-related costs will be recovered. For example, Western is currently selling electricity from the Washoe Project for less than 20 percent of what it costs to produce. According to Western, this situation is the result of relatively high construction costs and drought conditions. According to Western's 1995 annual report: "Based on current conditions, it is unlikely the project will be able to generate sufficient revenues to repay the Federal investment."

⁵We did not examine unrecovered costs for retired employees because relevant actuarial information was not available from the Office of Personnel Management (OPM).

For the same reasons, we believe that the Washoe Project is unlikely to generate sufficient revenue to repay all O&M and interest expenses.

Third, as we reported in May 1996,⁶ at the Pick-Sloan Missouri Basin Program (Pick-Sloan), about \$454 million of capital costs for hydropower facilities and water storage reservoirs has been allocated to authorized irrigation facilities that are infeasible and, therefore, not expected to be completed. Western is currently selling electricity to its power customers that would have been used by the irrigators had the irrigation facilities been completed. As long as the \$454 million is allocated to incomplete irrigation facilities, recovery by Western will not be required. If the facilities were completed but the capital costs were determined to be beyond the irrigators' ability to repay, then Western would be required to recover most of these irrigation costs without interest. If these costs had been allocated based on the actual use of the hydropower facilities and water storage reservoirs, they would have been allocated primarily to power production and recovered, with interest, through electricity rate charges within 50 years of completion. Under the current repayment criteria, it is unlikely that Western will be required to recover the principal or any interest on these capital costs. In addition, since 1987, \$13.7 million (\$15.3 million in constant 1995 dollars) of power-related O&M expenses incurred by the Army Corps of Engineers at Pick-Sloan have been allocated to incomplete irrigation facilities and thus are not being recovered through power rates.

The methodology that resulted in allocating power-related capital and O&M costs to the incomplete irrigation facilities was developed decades ago in anticipation of the completion of all planned irrigation facilities. This methodology is still being used and will continue to increase these unrecovered power costs. However, as we also reported in May 1996, changing the terms of repayment to cover any of the \$454 million investment would require congressional action. In addition, any changes between the program's

⁶Federal Power: Recovery of Federal Investment in Hydropower Facilities in the Pick-Sloan Program (GAO/T-RCED-96-142, May 2, 1996).

power and irrigation purposes may also necessitate reviewing other aspects of the agreements--specifically, the agreements involving areas that accepted permanent flooding from dams in anticipation of the construction of irrigation facilities that are now not likely to be constructed.

Fourth, the Central Valley Project's Shasta Dam and the Colorado River Storage Project's Glen Canyon Dam have incurred power-related environmental mitigation costs that are legislatively excluded from Western's rates. For the Shasta Dam, these costs totaled \$9.7 million in 1995 and \$5.4 million in 1994. For the Glen Canyon Dam, they totaled \$13.9 million and \$12.5 million for the same 2 years. The total cumulative legislatively excluded environmental costs for the two projects were \$134.3 million (\$152.5 million in constant 1995 dollars) as of September 30, 1995.

Fifth, as of September 30, 1995, Western had unrecovered O&M and interest expense payments relating to nine of its 15 projects. These "deferred payments" are to be repaid to Treasury, with interest. According to Western, these deferred payments are primarily due to drought conditions which reduced streamflow and hence the ability to generate electricity in the late 1980s and early 1990s. The balance of Western's deferred payments decreased from about \$250 million as of September 30, 1994, to about \$196 million as of September 30, 1995. Western officials have told us they expect to recover the majority of these costs over time.

In the aggregate, we estimate that the annual unrecovered costs for the three PMAs was about \$83 million for fiscal year 1995 for the five main power-related activities identified above. As of September 30, 1995, the cumulative unrecovered power costs could be as much as \$1.8 billion. Table 1 provides a summary of our estimates of these unrecovered costs.

Table 1: Estimated Total Unrecovered Annual and Cumulative Power-related Costs as of and for the Year Ending September 30, 1995

(Dollars in millions)

<i>Description</i>	<i>Annual - 1995</i>	<i>Cumulative</i>
Pension and postretirement health benefits	\$16.4	\$436.0
Russell Project (pumping units) Capitalized interest for fiscal year 1995 Construction-work-in-progress balance ^a	25.6	488.0
Truman Project	0.9	31.0
Washoe Project ^b	---	8.9
Abandoned Transmission Line Capital construction costs Unrecovered interest	0.4	14.5 6.4
Irrigation-related capital costs at Pick-Sloan	13.6 ^c	454.0 ^d
Deferred payments at Western	0.8	195.7
Irrigation-related O&M at Pick-Sloan	2.1	15.3 ^e
Environmental costs	23.6	152.5 ^e
Total	\$83.4	\$1,802.3 ^f

^aIncludes cumulative unrecovered principal and capitalized interest.

^bReflects the cumulative appropriated debt that might not be recovered. Annual deferred payments for O&M and interest expenses are included in the "Deferred payments at Western" line item.

^cThis amount represents unrecovered interest and was calculated based on the \$454 million.

^dThe \$454 million is as of September 30, 1994, because fiscal year 1995 data were not available.

^eThese amounts are converted to constant 1995 dollars to be comparable to the other cumulative dollars that are already reported in fiscal year 1995 dollars.

^fAmounts for the Mead-Phoenix Transmission Line are not included in this estimate because it did not become operational until fiscal year 1996. However, the project's ability to fully recover costs in the future is questionable.

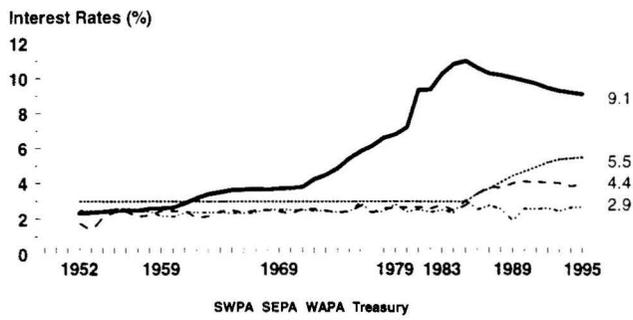
Source: GAO estimates based on information provided by the PMAs, operating agencies, and OPM.

FAVORABLE TERMS RESULT IN SUBSIDIZED FINANCING

Power-related capital projects are financed primarily with appropriated funds. Federal legislation and DOE policy enable PMAs to implement flexible financing terms that allow the accumulation of large amounts of appropriated debt at low interest rates. PMAs have low interest rates on appropriated debt for two primary reasons. First, DOE's policy generally requires PMAs to pay off outstanding debt with the highest interest rate first, regardless of maturity dates. (This does not apply to any appropriated debt due in a given fiscal year. Such debt must be paid first, regardless of interest rate.) Second, prior to 1983,⁷ capital projects were generally financed at interest rates lower than the then prevailing comparable Treasury interest rates. Because repayment terms on below market interest rate appropriated debt are up to 50 years, some of this debt could remain outstanding for several more decades. As shown in figure 1, for fiscal year 1995, the average interest rates on appropriated debt were 2.9 percent for Southwestern, 4.4 percent for Southeastern, and 5.5 percent for Western compared to 9.1 percent for Treasury's outstanding bond portfolio as of September 30, 1995.

⁷In 1983, DOE increased the interest rates at which new projects or replacements to old projects would be financed by modifying its Order RA 6120.2. This modification required that, in the absence of specific legislation to the contrary, new projects and additions and equipment replacements made after September 30, 1983, be financed at interest rates equal to the average yield during the preceding fiscal year on interest-bearing marketable securities of the United States, which, at the time the computation is made, have terms of 15 years or more remaining to maturity..

Figure 1: Average Interest Rates Paid by the PMAs on Appropriated Debt Compared to Rates Paid by Treasury on Its Outstanding Bond Portfolio--Fiscal Years 1952 to 1995



Note 1: Western was created in 1977. Pre-1977 interest rates are for appropriated debt transferred from the Bureau of Reclamation to Western in 1977. Sufficient data were not available to identify the weighted average interest rates in fiscal years 1952 to 1985 for projects in Western's service area. Western officials indicated that on a consolidated basis for all projects, 3 percent represents a reasonable weighted average interest rate on Western's appropriated debt for those years.

Note 2: Percentages shown at right represent percentages for 1995.

Sources: Data on PMAs developed by GAO from data provided by PMAs; Treasury interest rates determined based on Treasury summary information related to the public debt of the United States.

A financing subsidy exists because the interest expense incurred by Treasury on its debt is higher than the interest income Treasury receives from the PMAs for their appropriated

debt. As shown in table 2, we estimate that the PMA financing subsidy for fiscal year 1995 was about \$228 million.⁸

Table 2: Estimated PMA Financing Subsidy, 1995

PMA	Outstanding appropriated debt (dollars in millions)	Weighted average interest rate ^a (percent)	Treasury average interest rate ^b (percent)	Financing subsidy (dollars in millions)
Southeastern	\$1,491	4.4	9.1	\$70
Southwestern	686	2.9	9.1	43
Western ^c	3,184	5.5	9.1	115
Totals	\$5,361	4.9	9.1	\$228

^aWe calculated the weighted average interest rate for the PMAs by dividing interest costs by average appropriated debt outstanding for 1995.

^bThe 9.1 percent interest rate is the average interest rate paid on Treasury's outstanding bond portfolio at the end of fiscal year 1995.

^cExcludes irrigation assistance to be paid by Western; includes deferred payments.

Sources: PMA audited financial statements and other data, and Treasury summary information related to the public debt of the United States.

Over the next several decades, as the pre-1983 appropriated debt is repaid, the PMAs' financing subsidy should decrease. However, as shown in figure 1, the PMAs' ability to repay high interest debt first has been a factor and likely will continue to contribute to PMA average interest rates being below the effective Treasury average interest rate. In addition, the nature of Treasury's borrowing practices contributes to the magnitude of the

⁸See GAO/AIMD-96-145 for a detailed discussion of our methodology for calculating the financing subsidy.

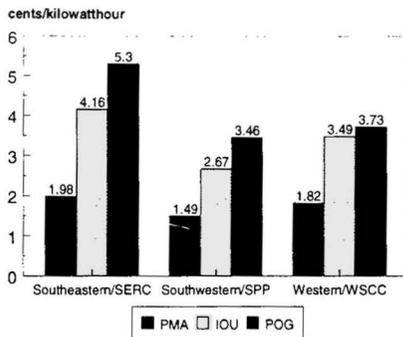
financing subsidy. Treasury's inability to refinance or prepay outstanding debt in times of falling or low interest rates is part of the reason for its relatively high 9.1 percent average cost of funds for fiscal year 1995.

FEDERAL SUBSIDIES AND INHERENT ADVANTAGES OF PMAs
RESULT IN LOW COST POWER

PMAs market low cost wholesale electricity. We believe that average revenue per kilowatt-hour (kWh) is a strong indicator of the relative power production costs and overall competitive position of the PMAs compared to other utilities.⁹ As shown in figure 2, in 1994 the PMAs' average revenue per kWh for wholesale sales was more than 40 percent lower than investor-owned utilities (IOUs) and publicly owned generating utilities (POGs) in the primary North American Electric Reliability Council¹⁰ (NERC) regions in which the PMAs operate.

⁹The average revenue per kilowatt-hour for wholesale sales (sales for resale) is referred to in this testimony as average revenue per kWh. This average is calculated by dividing total revenue from the sale of wholesale electricity by the total wholesale kilowatt-hours sold. Because PMAs and publicly owned generating utilities (POGs) generally recover costs through rates with no profit, average revenue per kWh should be reflective of PMAs' and POGs' full power production costs. For investor-owned utilities (IOUs), average revenue per kWh should represent cost plus the regulated rate of return. Given that a large portion of IOU rate of return (net income), 80 percent, is used to pay common stock dividends, which is a financing cost, average revenue per kWh also approximates power production costs for IOUs. The Energy Information Administration cautions that average revenue per unit of energy sold should not be used as a substitute for the price of power. The price that any one utility charges another for wholesale energy comprises numerous transaction-specific factors, including the fee charged for reserving a portion of capacity, the fee for the energy actually delivered, and the fee for the use of the facilities. These fees are influenced by factors such as time of delivery, quantity of energy, and reliability of supply.

¹⁰The North American Electric Reliability Council (NERC) was formed by the electric utility industry to promote the reliability and adequacy of the bulk power supply in the electric utility systems of North America. NERC consists of nine regional reliability councils and encompasses essentially all the power systems of the contiguous United States as well as parts of Canada and Mexico.

Figure 2: Average Revenue Per Kilowatthour of Wholesale Power Sold, 1994

Note: SERC - Southeastern Electric Reliability Council; SPP - Southwest Power Pool; WSCC - Western Systems Coordinating Council.

Source: Developed by GAO based on information from the PMAs' 1994 annual reports, Energy Information Administration, and American Public Power Association.

In 1994, the national wholesale average revenue per kWh was 3.5 cents for IOUs and 3.9 cents for POGs. This compares to 1.49 cents for Southwestern; 1.82 cents for Western; and 1.98 cents for Southeastern. To take into account the variability of PMA hydropower, we also compared the PMAs' average revenue per kWh to national averages for IOUs and POGs from 1990 through 1993. During that period, the PMAs' average revenue per kWh was consistently at least 40 percent less than that of IOUs and POGs. A detailed comparison of PMA, POG, and IOU average revenue per kWh for 1990 through 1994 and a comparison of each PMA's average revenue per kWh by rate-setting system¹¹ to the applicable NERC regions for 1994 is presented in our report issued today. Except for several rate-setting systems at Western, and one at Southeastern, the PMAs' power

¹¹Southeastern has 4 systems, Southwestern has 3 systems, and Western has 10 systems.

production costs appear to be stable and well below the costs for nonfederal utilities in their respective areas of the country.

Some of the difference in average revenue per kWh between the three PMAs and nonfederal utilities is attributable to the PMAs' unrecovered power-related costs and federally subsidized debt financing discussed earlier. PMAs also have other inherent advantages that contribute to their low-cost power. First, PMAs rely almost exclusively upon hydropower produced by projects built primarily 30 to 60 years ago, a low cost means of generating electricity. Unlike the PMAs and operating agencies, IOUs build new capacity to meet future customer needs and must rely on more expensive sources of electricity, such as coal and nuclear energy. To illustrate, during 1995, about 55 percent of the electricity generated in the United States by IOUs and POGs was fueled by coal, and another 25 percent by nuclear energy. Second, PMAs, as federal agencies, generally do not pay taxes, whereas other utilities pay federal and state income taxes, property taxes, and other taxes, or payments in lieu of taxes. In 1994, IOUs paid an average of about 14 percent of revenues for taxes, and POGs paid an average of 5.8 percent of revenues to state and local governments in lieu of taxes.

PMAs also have certain disadvantages compared to nonfederal utilities. For example, Western is required to recover through rates the cost of the Hoover Dam Visitor Center totalling an estimated \$124 million. Also, Western is required to recover approximately \$1.5 billion related to construction costs on completed irrigation facilities. Reclamation law provides for Western to repay certain portions of capital costs allocated to irrigation purposes which are determined to be beyond the ability of the irrigators to repay.

Recent developments are projected to decrease average wholesale electricity rates, which could impact the competitiveness of certain of the PMAs' higher-cost rate-setting systems. Competition in the wholesale electricity market is increasing due to legislation, such as the Energy Policy Act of 1992, which encouraged additional wholesale suppliers to enter the market and provided greater access to other utilities' transmission lines.

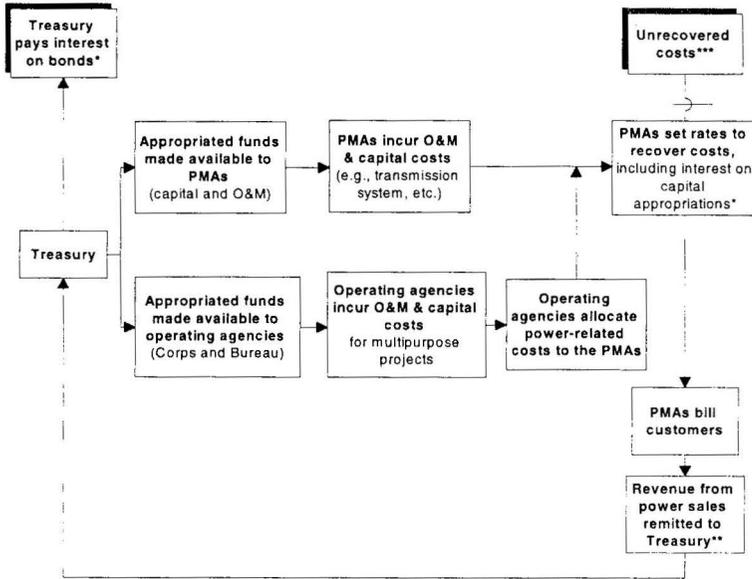
Another factor that could impact the PMAs is the increasing influence of low cost independent (nonutility) power producers (IPPs). Construction of increasingly efficient natural gas-fired combustion turbines by IPPs is driving the market price of wholesale electricity down.

In aggregate, we estimate that the unrecovered power-related costs and financing subsidy total about \$300 million for fiscal year 1995. Over the last 30 years, we estimate that these costs have been in the billions. It is important to emphasize that the PMAs are generally following applicable laws and regulations regarding recovery of these power-related costs and financing of capital projects.

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Mr. Chairman, this concludes my testimony. I would be happy to respond to any questions that you or Members of the Subcommittee may have.

Flow of Funds:
Southeastern, Southwestern, and Western



*The difference between interest paid by Treasury and interest received by Treasury from the PMAs on capital appropriations represents a financing subsidy.

**Southeastern and Southwestern customers generally remit funds directly to Treasury via lockboxes. For Western, there are various mechanisms for receiving and remitting funds to Treasury.

***Unrecovered costs:
 1. pension/postretirement health benefits,
 2. completed/in progress construction costs,
 3. Pick-Sloan irrigation,
 4. environmental costs, and
 5. deferred payments (interest on deferred payments is included in rates).

PREPARED STATEMENT OF MR. J.M. SHAFER,
ADMINISTRATOR, DEPARTMENT OF ENERGY

Mr. Chairman, thank you for inviting the Department of Energy (DOE) to testify before the Subcommittee today on the cost recovery and financing practices of the power marketing administrations (PMAs), which are separate and distinct agencies within DOE. My remarks focus on the practices of the Southeastern, Southwestern, and Western Area Power Administrations because these three PMAs are the subject of the recent U.S. General Accounting Office (GAO) report on this topic. I am accompanied by the Administrators of Southeastern and Southwestern power administrations, who are available to respond to specific questions you may have regarding their agencies. I will begin by providing the Subcommittee some background on these agencies.

BACKGROUND

The primary mission of these three PMAs is to market hydropower generated at Federal multipurpose (flood control, navigation, irrigation, power, recreation, etc.) water projects in their regions. By law, the PMAs are to market power that is "surplus" to the projects' own power needs (e.g. for water pumping) "in such manner as to encourage the most widespread use thereof at the lowest possible rates to consumers consistent with sound business principles," and in addition, "Rate schedules shall be drawn having regard to the recovery (upon the basis of the application of such rate schedules to the capacity of the electric facilities of the projects) of the cost of producing and transmitting such electric energy, including the amortization of the capital investment allocated to power over a reasonable period of years" (Flood Control Act of 1944). The PMAs primarily market such power at wholesale rates to municipalities, rural electric cooperatives, tribal governments, and other non-profit utilities who blend this power with other power resources and resell it, at cost, to millions of end-use consumers. In addition, the Southwestern and Western Area Power Administrations sell power to certain Federal and state agencies directly as end users. Unlike the Bonneville Power Administration and other utilities, these three PMAs do not have a responsibility to meet electric load growth or construct generation units.

The Southwestern and Western Area Power Administrations own and operate high-voltage power transmission lines, and also make use of other utilities' transmission systems, in order to deliver power from Federal dams to their customers' power grids. The Southeastern Power Administration owns no transmission facilities and depends entirely on other utilities' power transmission systems for power delivery. Power generation is the responsibility of the Federal agencies that manage the multipurpose water projects, primarily the U.S. Army Corps of Engineers and the Interior Department's Bureau of Reclamation.

Annual operating expenses and capital investments of the PMAs and the generating agencies are generally funded through annual appropriations and power portions of these expenses are reimbursed through revenues collected from power customers. In addition, the Western Area Power Administration markets power from three projects that are permanently financed through revolving funds in the U.S. Treasury. In addition, there have been occasions when PMA customers advanced funds for capital investments in Federal power facilities in return for credits on their power bills or other financial considerations.

The PMAs set their power rates by water project and in accordance with authorizing statutes and DOE regulation. As provided by law, rates are set to recover power-related operations and maintenance costs of the PMA and the generating agency in the year they are incurred, and to repay, with interest, power-related capital investments of the PMA and generating agency within a defined repayment period. Power-related costs include a share of the project's multipurpose costs, in addition to costs directly attributable to power features. The Western Area Power Administration is also responsible for collecting sufficient revenue to repay, without interest, the capital investment in certain Federal irrigation projects that are beyond the irrigators' ability to repay. Revenues from the sale of power are deposited into various U.S. Treasury accounts, pursuant to applicable legislation. Attached to this testimony is a table that presents statistical data on these three PMAs.

GENERAL COMMENTS

I have some general comments for the Subcommittee's consideration as it addresses PMA cost recovery and financing practices.

The PMAs receive independent auditors' reports annually on their financial statements from qualified auditing and accounting firms. The audits are conducted in accordance with generally accepted auditing standards, audit standards issued by the Comptroller General (GAO), and audit requirements established by the Office of Management and Budget. For FY 1994 and 1995, all three PMAs received "unqualified" opinions from their independent auditors, meaning the auditors found that the financial statements fairly reflected the financial condition of the agency. The auditors also found that each PMA's combined financial statements were "in conformity with generally accepted accounting principles" (GAAP). Accounts are maintained in accordance with GAAP and the Federal Energy Regulatory Commission's uniform system of accounts for electric utilities. In addition, the combined power system financial statements are generally presented in accordance with the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 71, "Accounting for the Effect of Certain Types of Regulation".

I believe that the PMAs' current repayment practices follow current law or expressed Congressional direction. Opinions may differ as to whether these practices are good public policy. However, if this Congress believes that certain practices should be changed, legislation will need to be enacted in most cases.

Also, I question the usefulness of comparing the PMAs against other, nonfederal utilities for the purposes of determining why PMA power costs are lower. The PMAs have unique characteristics that make certain comparisons against other utilities of limited value. Specifically, these three PMAs do not have responsibility to meet load growth in their regions nor do they have authority to build or acquire new firm power resources -- primary responsibilities of "traditional" utilities. The acquisition of new firm power resources to satisfy load growth, or to increase market share, has been a significant component of high power costs for many utilities. The three PMAs are able to avoid such expenses.

These PMAs have a different mission -- legislated by Congress. They were established to market "surplus" hydropower from Federal water projects. This major difference makes it inappropriate to compare the costs of PMA hydropower against the coal- and nuclear-based power generated by other utilities. To the extent the PMA resource base is comparable to any other, it is most similar to hydroelectricity produced at nonfederal dams built during the 1940s - 1960s, when construction costs were low.

Finally, when evaluating the adequacy of the cost recovery of generation investments associated with the PMAs, it is important to acknowledge that the PMAs do not decide which Federal power generating investments to make -- these decisions are the responsibility of Congress, and the Army Corps of Engineers or Bureau of Reclamation. The PMAs are only responsible for marketing whatever "surplus" power is produced once the projects are constructed.

ADMINISTRATION POSITION ON COST RECOVERY

It is the policy of the Administration for the PMAs to fully recover all power-related costs associated with water projects from which they market power, unless special circumstances exist for having certain costs borne by others. Just as with any utility, it is only fair that the beneficiaries of Federal power repay the government for the costs of providing this service.

The GAO's draft report on PMA cost recovery identified several examples of costs that the GAO staff believed are not being fully recovered:

- post-retirement pension and health benefits;
- construction expenses for certain nonoperating facilities;
- Pick-Sloan Missouri Basin Program investment allocated for repayment to irrigation features that will likely never be built;
- certain environmental costs mandated by law to be nonreimbursable; and
- Western Area Power Administration's deferred operating payments.
- The cost of Treasury borrowing that is not fully reflected in the interest paid by power users on the Federal investment.

I would like to comment on certain of these examples.

With regard to the underrecovery of retirement and post-retirement health benefits for power-related employees of the PMAs and generating agencies who are under the Civil Service Retirement System (CSRS), the Administration will work with this Subcommittee and other jurisdictional committees to address this issue.

As far as underrecovery of project construction costs addressed in the GAO draft report is concerned, the Richard B. Russell and Harry S. Truman Projects may eventually go into full operation and all power-related costs will be fully recovered through power rates. Therefore, we believe it is premature to conclude that the costs of the currently nonoperable generators will remain a taxpayer expense. If, in the future, this turns out not to be the case, the Administration

will work with the Congress, the affected power users, and other interested parties to develop an acceptable cost recovery arrangement. Western's Mead-Phoenix Transmission Line is already included in a power repayment study for cost recovery, and the Deputy Secretary has asked Western's Administrator to submit new interim rates as soon as possible if a significant deviation from planned revenues is observed.

The Pick-Sloan's suballocation of costs to irrigation projects that will likely never be built results from the cost allocation adopted by the Bureau of Reclamation. I believe GAO's May 1996 testimony on this subject (GAO/T-RCED-96-142, FEDERAL POWER: Recovery of Federal Investment in Hydropower Facilities in the Pick-Sloan Program) accurately summarized this issue. As the May GAO testimony noted, "Recognizing that the program incorporates agreements reached decades ago, any changes between the program's power and irrigation purposes may also necessitate reviewing other aspects of the agreements..." Furthermore, Congress has by law specifically barred the Bureau of Reclamation from administratively resolving this cost-allocation issue (DOE Organization Act of 1977).

The power-related environmental mitigation costs at two Western projects are nonreimbursable by power customers, as Congress specifically directed by statute (Energy and Water Development Appropriations Act of 1991, Reclamation Projects Authorization and Adjustment Act of 1992).

As the draft GAO report noted, certain Western projects incurred "deficits" in past years, due primarily to drought conditions that reduced hydroelectric generation and the fact that Western does not build up a contingency reserve to allow repayment to continue in poor water years. With the return of better water conditions, the deficits are being paid off with interest at Treasury's borrowing rate. During FY 1995, Western paid off \$54 million (over 21%) of its \$250 million in deferred liabilities outstanding at the beginning of the year. Western's current repayment studies project that by the end of FY 1998, the "deficit" total for Western should drop to \$17 million. Therefore, no administrative or legislative action appears warranted.

Finally, in the case of the interest rates paid on Federal investments, some investments are repaid at interest rates that are substantially below the Treasury's cost of money at the time the investments were made. However, administrative policy changes to implement full cost recovery prospectively were made in 1970 and 1983. All new investment going into service now is assigned an interest rate that is based on Treasury's cost of long-term borrowing, unless Congress specifically directed otherwise. I would note also that the PMAs are not able to refinance investments made at interest rates that are above the current Treasury borrowing rate. The Administration is willing to work with the Subcommittee to address this issue.

Mr. Chairman, this concludes my remarks. If you or members of the Subcommittee have any questions, I would be pleased to answer them.

Power Marketing Administration Statistics

	<u>Southeastern</u>	<u>Southwestern</u>	<u>Western Area</u>
Annual Energy Sales in FY 1995	6,829 GWH ¹	7,716 GWH	34,031 GWH
Number of Powerplants Whose Output is Marketed (as of September 30, 1995)	23	24	56
Installed Capacity of Powerplants (as of September 30, 1995)	3,092 MW ²	2,158 MW	10,581 MW
Circuit-miles of Transmission Line (as of September 30, 1995)	-0-	1,380	16,760
Total Operating Revenues in FY 1995	\$159 million	\$114 million	\$713 million
Federal Investment Repaid in FY 1995	\$33 million	\$37 million	\$40 million
Cumulative In-Service Investment that the PMAs are to Repay (as of September 30, 1995)	\$1.5 billion	\$1.0 billion	\$6.3 billion ³
Cumulative In-Service Investment that the PMAs Have Repaid (as of September 30, 1995)	\$ 0.5 billion (34%)	\$0.4 billion (36%)	\$2.3 billion (36%)
Unpaid Balance of In-Service Investment ⁴ (as of September 30, 1995)	\$1.0 billion	\$0.6 billion	\$4.0 billion
Cumulative Interest Paid to U.S. Treasury (as of September 30, 1995)	\$0.9 billion	\$0.6 billion	\$2.0 billion

¹ "GWH" stands for gigawatt hour, which is 1 billion watt-hours of electric energy.

² "MW" stands for megawatt, which is 1 million watts of electrical capacity.

³ Includes \$1.5 billion of Federal irrigation investment assigned to be repaid through power rates and \$0.2 billion of non-Federal power investment.

⁴ Does not include \$0.9 billion in construction work in progress as of September 30, 1995.

COMMITTEE: HOUSE RESOURCES
Water and Power Resources
Subcommittee

DATE: SEPTEMBER 19, 1996

WITNESS: J. M. Shafer
PAGE: 102, LINE: 2414

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INTEREST RATE

The original investment in the Pacific Northwest-Southwest Intertie Project that was placed in service in 1970 was assigned an interest rate of 3.0 percent.



American Public Power Association

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American Public Power Association
Statement for the Record of the Hearing Held September 19, 1996
House Resources Committee
Subcommittee on Water and Power Resources

Introduction

This statement is submitted by the American Public Power Association (APPA) for the record of the September 19, 1996 hearing of the House Resources Subcommittee on Water and Power Resources regarding the General Accounting Office (GAO) report entitled, *PMAs: Cost Recovery, Financing and Comparison to Nonfederal Utilities*.

The American Public Power Association (APPA) is the national service organization representing municipal and other state or local government-owned electric utilities throughout the United States. APPA member utilities serve some of the nation's largest cities, such as Los Angeles, Sacramento, Seattle, Phoenix, Jacksonville, Austin, San Antonio, Nashville, Memphis, Cleveland, Omaha and Orlando. Membership also includes several state public power agencies, such as the New York Power Authority, South Carolina Public Service Authority (Santee Cooper) and Lower Colorado River Authority in Texas. In addition, APPA members include joint action power supply agencies and public power distributors. The majority of APPA member utilities are located in small and medium-sized communities in every state except Hawaii. One in every seven electric customers in the United States is served by a public power utility.

The GAO was asked to examine the following three issues regarding the Southeastern Power Administration (SEPA), Southwestern Power Administration (SWPA) and the Western Area Power Administration (WAPA):

- 1) Have all power-related costs incurred through September 30, 1995, been recovered through the Power Marketing Administrations' electricity rates?
- 2) Is the financing for power-related capital projects subsidized by the federal government, and if so, to what extent?
- 3) How do PMAs differ from nonfederal utilities, and what is the impact of these differences on power production costs?

In responding to these questions, the GAO report provides a very misleading picture of the federal power marketing operations in several ways. For example:

- 1) GAO has selected an arbitrary methodology for calculating alleged "financing subsidies", and its conclusions regarding the magnitude of any subsidies are strictly hypothetical.
- 2) In determining "power-related costs", GAO substitutes its judgment for that of the U.S. Congress.
- 3) The report suggests that certain unrecovered costs are (or are likely to be) unrecoverable, when in fact most or all these costs will be recovered.
- 4) GAO engages in selective and misleading comparisons of the PMAs and nonfederal utilities.
- 5) The report omits key information related to the PMAs' rate review processes.

The cumulative effect of these problems is the creation of a highly inaccurate assessment of the PMAs.

GAO clearly states that it has found nothing illegal in its examination of the PMAs' operations. Indeed, the PMAs are not even alleged to be skating on the thin edge of the law. In GAO's own words, "...the PMAs are generally following applicable laws and regulations regarding recovery of power-related costs discussed in this report and financing of capital projects." Nevertheless,

the cumulative effect of GAO's conclusions regarding "subsidies" and "unrecovered costs " has apparently led Chairman Doolittle to conclude that there exists "poor management" problems that need to be addressed. However, GAO has not reached such a conclusion. Further, while GAO refers to cases of certain unrecovered costs, it generally does not attribute those to poor management. Indeed, in at least one case, it fails to explore the reasons behind certain unrecovered costs. Had it done so, it would have discovered that the situation arose as the result of anticompetitive activities of an investor-owned utility.

The starting point for GAO's inquiry into the recovery of power-related costs and the extent, if any, of subsidized financing, should have been the congressional directive regarding the sale of federal power. Specifically, Congress has directed that administrative agencies responsible for marketing federal power must, "transmit and dispose of such power and energy in such manner as to encourage the most widespread use thereof at the *lowest possible rates to consumers consistent with sound business principles.*" [16 USCA § 825S (West 1985)]. Nowhere in the report does GAO acknowledge this congressional directive. Indeed, GAO seems intent on finding ways for this power to be marketed at the highest possible rates.

In the end, the report has serious shortcomings in its characterization of the present and future status of the PMAs. Most importantly, highly questionable methodological assumptions underlie the report's alleged "financial subsidies" estimates as outlined below. In addition, GAO has based a large portion of its estimates on pure speculation regarding potential future scenarios -- much of which conflicts with available facts and information, and contradicts sworn testimony of the federal agencies with responsibility in these areas. Thus, the conclusions contained in the report are strictly hypothetical and speculative.

GAO's Estimate of "Financing Subsidies" is Strictly Hypothetical

In calculating the financing "subsidy", GAO compares the PMAs' overall interest rate on outstanding debt with the average interest rate paid on Treasury's outstanding bond portfolio at the end of fiscal year 1995. As pointed out by the PMAs themselves, this is in effect assuming

that the PMAs refinance their debt each year at the average Treasury bond rate. Sound businesses would never undertake such action when interest rates are rising, just as homeowners would not refinance their home loans to a higher rate. Moreover, the PMAs are prohibited from refinancing their debt.

The only accurate way to establish whether any interest rate gap in fact exists would be to engage in a comparison of PMA interest rates and the Treasury interest rates on a project by project basis. *GAO itself agrees this is the most accurate method, but dismisses it because records were not available for all WAPA projects.* This is inexcusable. Such information is available for SWPA, SEPA and the vast majority of WAPA facilities. Just because this method is more time-consuming is no reason to discard it in favor of an overly-simplistic and arbitrary method that leads to inaccurate conclusions. GAO is providing a report to the U.S. Congress on which future policy decisions might well be based. It has an obligation to undertake the most accurate analysis possible.

In contrast with the report's actual findings, comparing the PMAs' interest rate and the Treasury's interest rate at the time the PMA investments were put in place would have shown instances of the Treasury receiving a subsidy from the PMAs. For example, many PMA projects that came on-line in the 1940s and 1950s were charged interest rates at or above the U.S. government's long-term bond rate. The same is true for certain projects in the mid-1980s and 1990s. *For example, Southwestern Power Administration's additions to the Robert S. Kerr project came on-line in 1985, 1986, 1989 and 1990 at interest rates above the long-term bond rate.* GAO's Figure 3.2 (page 54 of report) illustrates this point, as the Department of Energy policy rates (those charged the PMAs) are above the Treasury rate for most of the 1983-1995 time period.

GAO justifies its comparison of the PMAs' interest rates covering the past several decades with the very recent 9.1% interest rate paid on Treasury's outstanding bonds in 1995 by stating that it captures costs in addition to the below-market financing benefits that the PMAs have received over the years. GAO says that these additional costs occur because the PMAs have flexible repayment terms for their debt, and the Treasury cannot refinance its debt in times of falling

interest rates. As outlined below, neither of these factors can be considered subsidies to the PMAs.

First, GAO simply posits that the 9.1% interest rate on the Treasury's bond portfolio captures the effects of the PMAs flexible repayment terms and the inflexible Treasury refinancing practices. There is no evidence to show any linkage between this particular rate and the effects that GAO says are being captured. The rate is one measure of costs to the Treasury. There are other legitimate measures of cost to the Treasury that GAO could just as easily have used. *For example, using the 1995 average interest rate on bonds with 15 or more years to maturity (8.7%) results in an estimate approximately 10% lower than GAO's \$228 million estimate of FY1995 "financing subsidies", and using the 1995 interest rate paid on public debt (7.0%) results in an estimate approximately 50% lower.*

GAO has apparently chosen the highest feasible interest rate and the most simplistic method to make its calculation. Further evidence that GAO did not take the time to determine exactly what it was capturing with its methodology can be found in the report's statement that "cumulatively, the financing subsidy for the three PMAs is several billion dollars." The only evidence for this statement is a graph showing that there has been a difference in PMA and Treasury interest rates over the years. And yet the "several billion dollars in subsidy" will be quoted by the congressional opponents of the PMAs as if it were based on rigorous analysis.

GAO's conclusion that there existed a \$200 million subsidy for the three PMAs in FY1995 could only have been reached through the assumption that the PMAs *should have* been setting power rates through application of current Treasury interest rates to all of the PMAs' outstanding debt. GAO's willingness to employ such an assumption as an underpinning of its "findings" indicates an implicit, if not explicit, endorsement of such a policy. Yet, utilization of this practice by the PMAs would have dramatically increased electric rates, and conflicted with the congressional directive to sell federal power at the lowest possible rates in accordance with sound business principles.

The problems with such a practice are demonstrated through the frequently-used analogy of a

fixed-rate home mortgage. It can hardly be argued that a fixed interest rate mortgage is not sufficient to cover the lender's cost of money. Nor can it be argued that the lender is free to convert that fixed-rate mortgage to a variable rate mortgage whenever it is to the lender's advantage to do so. Yet, that is precisely the basis for GAO's argument. GAO is saying that the government's failure to employ such a practice in the management of PMA debt is a "subsidy".

Moreover, the fact that the Treasury cannot refinance its own high-interest debt does not constitute a subsidy to the PMAs. Rather, it is a function of the Treasury's own business practices. GAO acknowledges in the report that, "Treasury's inflexible borrowing practices contribute to the magnitude of the financing subsidy. Treasury's general inability to refinance or prepay the federal government's outstanding debt in times of falling or low interest rates is part of the reason for its relatively high 9.1 percent average cost of funds for fiscal year 1995." While its inability to refinance its debt hurts the Treasury in times of falling interest rates, it is also of continuing benefit to the federal government. Bonds that cannot be called provide assurance of a fixed rate to the buyer of the bonds, and this added stability generally results in lower interest rates for Treasury debt. Whatever the reason for Treasury's inability to refinance debt -- be it a political decision to provide stability to bondholders, or a business decision to obtain lower interest rates -- it is a seriously flawed underpinning of the report's supposed "PMA financing subsidies."

According to GAO, an important component of the interest rate subsidy is the way in which the PMAs manage their debt. As would any prudent business, the PMAs manage their debt in order to minimize interest payments. To do this, they retire the highest interest bearing obligations first, except when lower interest bearing debt is at the end of its repayment period, in which case it would clearly have the higher priority. This is the only debt management practice available to the PMAs. Nonfederal utilities have this as well as many other alternatives available to them in this area. By characterizing this practice as an "advantage" enjoyed by the PMAs, GAO inaccurately implies this method is not available to nor employed by nonfederal utilities. Not only is this repayment principle consistent with applicable law, it is a sound business practice -- one that is also followed by private utilities and publicly-owned utilities

through calling bonds and refinancing.

In Determining "Power-Related Costs", GAO Substitutes its Judgment for That of Congress

Congress, not GAO nor any executive branch agency, is responsible for the cost allocation of multi-purpose water projects. Indeed, Congress felt so strongly about its responsibility in this regard that it prohibited any reallocation of reclamation costs when it created the Department of Energy (DOE), and transferred the marketing of Bureau of Reclamation power from the Department of the Interior to the new energy department. GAO ignores this. It takes a snapshot view of specific projects, and then provides its own interpretation of what should be defined as congressional directives. This is apparent in its treatment of Pick-Sloan and certain environmental enhancement costs at Glen Canyon and Shasta Dam.

GAO inaccurately includes among their unrecovered power-related cost estimates of \$454 million in unpaid irrigation-related costs, and \$13.5 million in estimated interest costs, related to the Pick-Sloan system. These costs are not a financial liability of the PMAs until such time as the underlying irrigation investments are completed and have been allocated. The PMAs, by law, can only repay the federal investment in accordance with repayment principles dictated by Congress. The unpaid portion of the Pick-Sloan system has resulted from a lack of congressional appropriations to complete the system's authorized irrigation projects -- projects which, under current law, must be completed to trigger repayment of the overall federal investment in the system. While Congress authorized and appropriated the funding for construction of the Pick-Sloan power functions, federal appropriations were never provided for construction of all of the irrigation projects.

The report reflects speculation regarding what would occur if the envisioned irrigation projects are never built, and the associated irrigation-related pumping power at Pick-Sloan is reallocated for power use. The report goes so far as to present financial estimates based upon the assumption that such a reallocation has in fact already occurred.

GAO even acknowledges the problems with arbitrarily adding these costs to the PMA side of the ledger by stating, "they [DOE] suggested that more emphasis be placed on the fact that the methodology for cost allocations cannot be changed without congressional approval. We concur with this suggestion and have revised our report accordingly." Despite this recognition, GAO proceeded to include Pick-Sloan irrigation costs as a line-item in its overall calculation of unrecovered power-related costs. This second-guessing of existing laws in an effort to inflate bottom-line estimates of unrecovered costs undermines the credibility of this report. These assumptions contributed another \$454 million to GAO's calculation of overall unrecovered "power-related" costs.

In pursuing this hypothetical premise, GAO explains that, should Congress choose to undertake a reallocation of costs for the Pick-Sloan system based upon current uses in the absence of the irrigation projects, the entirety of GAO's estimated \$454 million in "unrecovered power-related costs" at Pick-Sloan would be allocated to power for repayment. *What GAO has done is assume all of the estimated \$454 million of unpaid irrigation pumping power costs associated with Pick-Sloan, if reallocated, would automatically become power related costs. This is a significant assumption -- approximately \$277 million (or 61%) of this amount was originally allocated to power, but was then suballocated for irrigation pumping power costs. It is very likely that much of the remaining approximately \$177 million in irrigation-related costs would, under such a scenario, be reallocated to many other existing non-power-related uses of the system including flood control, fish and wildlife benefits and recreation. In fact, insufficient cost allocations currently exist for these other purposes in light of the current uses of the system.* Again, GAO is speculating about a potential outcome that is unlikely to occur. GAO was informed of this important distinction by DOE prior to release of the final report. For these reasons, the report's final estimate of \$454 million of "unrecovered power-related costs" for the Pick-Sloan system is extremely hypothetical and very likely inaccurate even under the scenario GAO has created.

GAO has also failed to credit the PMAs for already subsidizing many unanticipated non-power-related public uses of the Pick-Sloan system as mentioned above including recreation, flood control and environmental benefits. Such uses are the broad responsibility of the federal government, and under current law, federal investment in such purposes is non-reimbursable.

Nonetheless, power customers at Pick-Sloan are currently helping to fund these important benefits. GAO fails to account for the financial implications of this fact.

In addition, the report concludes there have been power-related environmental mitigation costs incurred at Shasta and Glen Canyon Dams that have not been repaid through the PMAs' rate structure. In both cases, the report's description of the purposes for these environmental enhancement projects, as well as its explanation of how the environmental activities have been funded, are inaccurate.

In the case of Shasta Dam, the environmental modifications to which GAO refers were undertaken to promote the greater public interest -- not solely to mitigate impacts of Shasta Dam as GAO relates. Contrary to the report's depiction, there is clear evidence that a declining salmon population in the Sacramento River was not specifically related to the existence or operation of Shasta Dam, but was brought about by the cumulative effect of multiple public use impacts and drought conditions. This fact compelled Congress to approve legislation to ensure power rates were not unfairly impacted by the cost of voluntary modifications made at the dam. As GAO states, these costs were, "legislatively excluded from Western's power rates". This congressional action was discontinued this year as construction of a new intake structure has restored the lost capacity. Even so, power customers contributed toward these improvements through their \$9 million in annual contributions for environmental purposes under the Central Valley Project Improvement Act -- a portion of which was utilized to cover the environmental modifications at Shasta Dam. Therefore, it is not correct to conclude that there has not been a power-related contribution toward the costs of environmental improvements at Shasta. In its treatment of this issue, GAO is second-guessing congressional action and legislative history which provides evidence that these costs were not attributable only to power generation at Shasta.

In the case of Glen Canyon Dam, the GAO report's financial estimates regarding environmental impact studies and other multi-year research conducted during 1994 and 1995 leave the impression that costs for these purposes will not in fact be repaid to the federal government. A decision regarding how these costs will be addressed is currently pending, and it is highly misleading to imply otherwise.

Under the Reclamation Projects Authorization and Adjustment Act of 1992, determinations about whether these costs should be borne entirely by power users or not hinges on a scoring test performed annually by the U.S. Department of the Interior, and presented to Congress as a formal report. The scoring process is designed to ensure that the costs of research and related studies do not exceed net revenues. The first of such reports was due in 1992. GAO notes that "The act includes a provision that the ...costs could become the responsibility of the power customers under certain circumstances."

However, it is clear that the report's classification of costs in this area -- totaling \$12.5 million in 1994 and \$13.9 million in 1995 -- as "unrecovered power-related costs" reflects an assumption that the Department of the Interior will determine these costs to be non-reimbursable. Such a determination has not been made, and it is very possible that some of these costs will be repaid by power users. Secondly, the reason Congress decided that, revenues permitting, a portion of the environmental impact process and other studies would be non-reimbursable, was that it found the benefits of these undertakings flowed to a wide range of interests other than power.

GAO also seems to be recommending that the PMAs find a way of avoiding what appears to be a direct prohibition that applies to all federal agencies regarding contributions to cover post-retirement benefits. As is the case with all federal agencies, the PMAs do not have authorization to make direct contributions into the Civil Service Retirement and Disability Trust Fund. In fact, the Western Area Power Administration (WAPA) collected what had been actuarially estimated to be their projected costs for these purposes through their electric rates between 1991-1994. However, the agency stopped collecting for these costs when it became clear that the PMAs were not authorized to make direct transfers into the Civil Service Retirement and Disability Trust Fund. Moreover, in 1994 the Southwestern Power Administration made formal inquiries with the Office of Personnel Management (OPM) in an effort to move toward collection for these costs. These inquiries have remained unanswered by OPM.

While GAO explains "We were not asked to and did not address whether any changes in PMA cost recovery practices of financing should be made", the report far exceeds this mandate by recommending that PMA collections for pensions and post-retirement benefits be deposited, "like many other PMA ratepayer collections, into the General Fund of the Treasury where the revenue would be available to the Congress to appropriate into the Fund to cover the full cost

to the government of CSRS pensions. Recovery of post-retirement health benefits could be handled the same way." APPA questions the wisdom of such an indirect approach, especially in light of the issues that have been raised by the subcommittee in the area of deferred maintenance at federal power projects. It has been clearly shown that ratepayer contributions toward maintenance of some federal facilities have historically been diverted to unrelated purposes. Drawing from this example, it can be concluded that contributions by the PMAs into the General Fund of the Treasury do not necessarily provide adequate assurances that funding will then be allocated for stated purposes.

The Report Creates Unfounded Scenarios to Suggest That Certain Costs Are Not Simply Unrecovered But Unrecoverable

GAO has seriously misrepresented the financial status of the PMAs by blending currently "unrecovered power-related costs" with "financing subsidies" to produce annual and cumulative estimates of uncollected costs related to the PMAs' operations. The presentation of data in this fashion blurs the distinction between these two different types of costs, and leaves readers with the inaccurate impression that the costs GAO characterizes as "unrecovered" are in fact a form of subsidy.

Another significant problem in this area is that GAO is willing to conclude that some costs "are not being recovered through power rates by the PMAs" while, at the same time, admitting its analysis in this regard is highly incomplete. Specifically, GAO acknowledges, "we did not assess the reasonableness of the methodologies used in developing the operating agency cost allocation formulas that are established for each project. To more fully assess whether PMA electricity rates include all power-related costs would require an analysis of the reasonableness of these allocations." Clearly, further examination of the specific allocation formulas on a project-by-project basis could lead to the conclusion that costs are in fact being over-recovered. Without this component of the analysis, the report's conclusions in this area are merely speculative.

In many cases where GAO has identified unrecovered costs, there is good reason to believe the costs will ultimately be recovered with interest. For example, the PMAs have testified that they believe the Russell and Truman Projects, which are partially operational, will ultimately be brought into full operation -- initiating repayment of the federal investment that has been made in the currently non-operational portions of these facilities. In addition, past experience shows the PMAs will continue to repay the Treasury for deferred payments that have occurred due to adverse weather conditions. In FY1995, WAPA paid \$54 million toward deferred liabilities amounting to 21% of its outstanding deferment. For GAO to imply these costs represent subsidies -- when they will likely be, or are in the process of being, repaid with interest -- is grossly misleading, and provides no sound policy guidance for future congressional action.

The report also discusses the insufficient amount of revenue that has been generated by the Washoe Project, and calculates the financial shortfalls from this project into its estimate of the PMA's overall unrecovered power-related costs. However, in describing why WAPA has been unable to find customers to purchase the power at a rate that would recover the project's costs, GAO has missed perhaps the most important fact -- that private utilities have largely created this dilemma.

When the Washoe Project went into service, Sierra Pacific Power Company refused to wheel the power from the project to two customers that had power allocations from the project -- Truckee-Donner Public Utility District and Plumas Sierra Cooperative. Without transmission services, WAPA was held captive by Sierra Pacific and was forced to sell the power to this private utility at a cost far below what was needed to recover costs. The monopolistic abuses of this private utility have threatened the \$8.9 million federal investment in this project. This highly relevant background on the Washoe Project is omitted from the report.

The report goes on to express doubt whether the Corps of Engineers' Russell Project will ever be fully operational, and includes among its "unrecovered power-related costs" an estimated \$488 million in federal investment associated with the four currently non-functioning pumping

units. However, as noted above, there is clear reason to believe this project will ultimately become operational, as SEPA has testified in this regard. The report also speculates about the potential for a loss on the \$94.1 million federal investment in WAPA's Mead-Phoenix Transmission line -- when the government's share of this project is being aggressively marketed, and the PMAs have explained they are confident that annual O&M and interest expenses on the appropriated debt for this project will be repaid. Moreover, there is no discussion in the report of the important contribution this project made toward overall system reliability during the recent electrical outages in the West. The existence of this line helped prevent the initiation of rolling blackouts which DOE explains would have almost certainly occurred in its absence.

GAO Engages In a Selective and Misleading Comparison of the PMAs and IOUs

The first question asked of GAO related to how the PMAs differ from non-federal utilities and the impact of these differences on power production costs. To answer this, GAO used a simplistic methodology of comparing revenue per kilowatt-hour (kWh) for the PMAs and non-federal entities. Such an "apples to oranges" comparison provides no meaningful measure of relative performance. However, having decided to compare the PMAs with non-federal utilities, there were certain comparisons in other areas that GAO might have made beyond just revenues per kWh that would have been illuminating. For example, federal law requires the PMAs to employ sound business practices. GAO apparently believes that annual debt refinancing regardless of interest rates and retention of high-interest debt as long as possible are sound business practices. It would have been useful had GAO reported on whether such practices are routinely employed by non-federal utilities.

Comparisons contained in the report regarding average revenue per kWh for PMA and non-federal utilities' wholesale sales are based upon a comparison of an entirely hydro-based federal system against mixed fuel source utilities. In its comments on the draft report, DOE informed GAO that such comparisons were problematic, and explained it is "inappropriate to compare the costs of PMA hydropower against the coal and nuclear-based power generated by other

utilities." Comparing a hydro system to a nuclear system, for example, does not shed light on the differences between federal and non-federal ownership, but instead reflects the variation in revenue income related to these types of generation systems. A more credible comparison would have been one between the federal hydro-based system and a private or publicly-owned utility that is primarily hydro-based.

To add perspective, the Energy Information Administration data for 1994 show that investor-owned utilities' average cost per kWh for hydro generation was 7.42 mills compared to 21.80 mills for steam generation and 20.85 mills for nuclear generation. Similarly, publicly owned utilities' cost per kWh for hydro generation was 3.80 mills compared to 22.19 mills for steam generation and 24.34 mills for nuclear generation. Thus, investor-owned utilities produced hydropower at costs approximately 65% lower than steam or nuclear power, and publicly owned systems produced hydropower at costs approximately 80% lower than steam or nuclear power. Clearly, this reliance on hydropower is by far the major factor behind the PMAs' lower revenue per kWh for wholesale power -- not the existence of a subsidy or undue advantages as GAO argues.

Also fundamental to this analysis is that GAO has made an error in its calculation of the PMAs' average annual revenue range per kWh. The report explains, "The PMAs' average revenue per kWh in 1994...ranged from a low of 0.66 cents per kWh for Southwestern's Robert D. Willis system to a high of 3.09 cents per kWh for Southeastern's Georgia-Alabama-South Carolina system...the PMAs' average revenue per kWh was consistently at least 40 percent less than those of IOUs and POGs." However, GAO was informed by DOE prior to the release of the report that, "Robert D. Willis is a small isolated, run-of-river project that has been totally financed by a non-federal entity. There is no investment to be repaid. The GAO statement is not a true reflection of revenue range for the PMAs." Yet, the report still utilizes this project as the basis for its estimate of the PMA's average revenue range despite this important clarification provided by DOE. As a result, the comparisons between average revenue per kWh costs for the PMAs and nonfederal utilities are based upon incorrect data regarding the average revenue range for the PMAs. Yet, this erroneous calculation is used to support the report's allegation

that "PMAs' average revenue per kWh for wholesale sales has historically been substantially lower than average revenue per kWh for nonfederal utilities." It goes on to serve as the premise for the report's conclusion that "Federal Subsidies and Inherent Advantages of PMAs Result in Low-cost Power." Despite its irrelevance, it is important to note that GAO's claim that revenues for the Willis project amounted to 0.66 cents per kWh is factually incorrect. The accurate rate is 0.50 cents per kWh.

In addition, the report states that the PMAs have an "advantage" over other utilities because they are hydro-based. This again demonstrates how inappropriate it is for GAO to compare the PMAs with nonfederal utilities. Across the board, hydropower enjoys a cost advantage when compared with most other means of generation.

This has not always been the case. When some federal power projects came on line decades ago, the cost of power exceeded the cost of power available from other sources. Preference customers, however, entered into long-term arrangements for this power that allowed the federal government to recover its investment while providing the customers with a reliable source of power. This historic fact which amounted to a competitive disadvantage in the early years of these projects is nowhere mentioned in the GAO report.

GAO then goes on to discuss additional "advantages" enjoyed by the PMAs. One such advantage is their tax-exempt status. Obviously, no taxes are paid on the sale of federal power. What possible sense would it make for the federal government to collect taxes from itself on the sale of a surplus federal product (hydropower) to its own citizens? However, GAO fails to point out that, while power sales are not subject to taxation, the operating agencies such as the Bureau of Reclamation, make annual contributions in lieu of taxes to the states or counties where federal water resource projects are located. The overall contributions made by the Department of the Interior for lands and projects administered by the agency as well as other federal holdings amounted to over \$113 million in FY 1996.

Again, the one-sided nature of the GAO report is evident. While GAO identifies PMA advantages, it fails to identify much less quantify the advantages enjoyed by investor-owned

utilities. The tax benefits available to the investor-owned utilities, such as their use of certain tax-exempt bonds, excess deferred taxes, and other tax breaks amounted to \$10.5 billion in 1993 alone that the U.S. Treasury did not collect.

Further, GAO fails to balance PMA advantages and disadvantages. The report does note that federal power rates must recover some non-power related costs such as the \$124 million Hoover Dam Visitor Center. Yet, power rates also overtly subsidize irrigation assistance, and other hidden subsidies from power go to recreation, environmental enhancement, navigation, and other purposes. GAO has also ignored a number of other PMA disadvantages as well, including: limited flexibility in financial management practices; the inability to ensure that funds collected from customers for operation, maintenance and rehabilitation of facilities are actually utilized for those purposes; the marketing restrictions imposed on the PMAs by law; and the close political oversight that is a common characteristic of public power but lacking with respect to activities of the investor-owned utilities.

Description of Rate Review Processes Is Incomplete

In its discussion of the formal PMA rate review process, GAO has omitted a description of the responsibilities the PMAs have, under the Administrative Procedures Act, to provide for extensive public involvement and accountability in rate-setting processes. In accordance with strict federal guidelines, the PMAs provide for significant public notice and input prior to Federal Energy Regulatory Commission (FERC) consideration. By the time proposed rate changes are presented to FERC for review, most of the information necessary for a final decision has been provided. Therefore, it is appropriate that FERC's role would then be to "...affirm, remand, or disapprove the PMAs' rates" based upon the extensive documentation which has been provided as the premise for their decision.

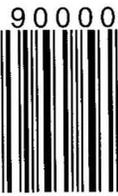
Through the omission of this important information regarding the public participation and accountability involved in the PMA rate-setting processes, GAO is leading readers to the inaccurate conclusion that FERC's oversight in this area is unduly limited. By choosing to

compare their incomplete description of the PMA process with FERC's "broad" jurisdiction over private-utilities, rather than drawing parallels with municipal utilities that are not subject to FERC jurisdiction in this area, GAO provides a distorted picture of the PMA rate processes.

Inaccurate Data Will Lead to Unsound Policies

Many of the topics addressed in the report are not new -- Congress created the laws which drive the PMAs' operations, and most of the issues addressed in the report have been previously debated and reviewed by national policymakers. However, never before have these issues been presented in such an inaccurate light. While such a presentation of information may further the agenda of private utilities seeking to increase their competitive position in a restructured electric marketplace, it does not serve the interests of national legislators seeking to promote sound public policies. APPA urges the Water and Power Subcommittee to proceed with caution where future use of this report is concerned.

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