THE RURAL LOCAL BROADCAST SIGNAL ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON TELECOMMUNICATIONS, TRADE, AND CONSUMER PROTECTION

OF THE

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HOUSE OF REPRESENTATIVES

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THE RURAL LOCAL BROADCAST SIGNAL ACT

THURSDAY, MARCH 16, 2000

HOUSE OF REPRESENTATIVES,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE ON TELECOMMUNICATIONS,
TRADE, AND CONSUMER PROTECTION,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2123, Rayburn House Office Building, Hon. W.J. "Billy" Tauzin (chairman) presiding.

Members present: Representatives Tauzin, Cox, Deal, Largent, Cubin, Shimkus, Wilson, Pickering, Bliley (ex officio), Markey, Boucher, Luther, and Sawyer.

Staff present: Justin Lilley, majority counsel; Cliff Riccio, legislative clerk; and Andy Levin, minority counsel.

Mr. TAUZIN. The committee will please come to order.

Today the subcommittee takes up the issue of loan guarantees. This important legislation almost made it to the finish line in the last session of Congress. It fell short, though, because of procedural objections, as you know, in the Senate.

Still, it was very clear at the time that broad support existed for the idea that Congress enact legislation that would provide loan guarantees to companies that carry local broadcast signals to those markets where satellite carriers currently do not and in many cases do not plan to do so.

We now have the opportunity to look at this matter in a deliberate and considered fashion, which frankly is a good thing. While many can agree that this is an important matter, it is equally important that we get it right. This includes asking some very precise and critical questions such as the prospects for actually providing universal access to subscription based systems that will carry local broadcast systems.

We also must ensure that we legislate in a technology neutral manner. We do not pick among the industry's potential winners and losers. We should be indifferent as to how many companies head the multi-channel video market, and concern ourselves more with companies who simply enter those markets.

Along these lines I would note that some claim that the version of the legislation in the House is not yet technology neutral, whereas the Senate version may be. I look forward to hearing from our dear friend Mr. Goodlatte and the others on this issue as to whether such is the case and we might be able to remedy it.

We must also take this opportunity to explore the existing loan programs administered by the Department of Agriculture. We have with us today Mr. Chris McLean, the Administrator of Rural Utilities Service, who can help the subcommittee better understand the issues raised by two very recent disturbing audits by the Inspector General.

Particularly we need to ensure that the legislation before this subcommittee doesn't invite more of the same problems pointed out in those audits, or whether the legislation's strict underwriting requirements can actually become a model for improving the existing programs that were so heavily criticized in those audits. We need to talk about that this morning as well.

In the end this matter deals not only with the Federal credit policy, but indeed with telecommunications policy. In particular, we are attempting to define the role of the Federal Government in ensuring that multi-channel video providers have affordable access to capital. Help us find the right balance, and we'll try to get it right.

Finally, let me also say that the National Telecommunications and Information Administration could not be with us today. I understand most of them are in Peru with the Chairman of the FCC. Legislation before the subcommittee this morning would assign the NTIA an important critical certification role.

And of course we will need and look forward to hearing the views of the NTIA at some point, and we will be communicating with the agency in writing on this matter. In the meantime I'm very interested in hearing from our distinguished witnesses, and of course my good friend Mr. Goodlatte.

The Chair will recognize the gentleman from Virginia, Mr. Boucher, for an opening statement.

Mr. BOUCHER. Thank you very much.

Mr. TAUZIN. Mr. Boucher of course is the cosponsor of Mr. Goodlatte's legislation.

Mr. Boucher.

Mr. BOUCHER. Thank you very much, Mr. Chairman. And I am indeed pleased to be a cosponsor with Mr. Goodlatte on the legislation that will provide this very much needed loan guarantee. The changes that this Congress made in 1999 to the Home Satellite Viewer Act enabled that important new service, and that new service is the ability of the direct broadcast companies to offer not just their national fare but also, for the first time, local television programs.

And the availability of those programs will produce an enormous benefit. Cable rates will for the first time be market based, because the direct broadcast satellite companies can now become a full and complete and viable competitor for local cable TV, offering exactly the same services that cable television provides.

The new service also provides a potentially tremendous benefit for millions of rural residents who live primarily in mountainous terrain and who because of that terrain do not have access at the present time to their local television programs. They're blocked by the mountain from receiving those signals over the air, and cable TV does not extend to where they reside. And so the new local into local service for the first time will offer to rural residents an opportunity to get their own local TV signals.

The business plans, however, of the major direct broadcast satellite companies do not extend into rural America. Those business plans in fact don't even extend to the small and medium sized cities across the United States. The DBS companies have announced the intention to serve initially 33 of the largest cities in the Nation with the new local into local service, and potentially over time to serve as many as 66 of the largest cities in the nation. But that still excludes the medium sized and small cities and virtually all of rural America.

Realizing this fact, Mr. Goodlatte and I, who both served as conferees on the Home Satellite Viewer Act last year, proposed to the Conference Committee an approach that would buy down the cost of capital sufficiently to enable this local into local service to be provided, not just in the largest cities, but in all 211 television markets across the United States.

Our approach is a loan guarantee of $1.25 billion, and a great deal of advice has been received of a technical and financial nature indicating that a loan guarantee of this level would be sufficient to enable the launch of enough satellites to provide this service to all 211 local television markets across the United States.

The conference committee adopted this proposal unanimously. The conference agreement that contained it was then approved in the House of Representatives by a vote, as I recall, of 418 to 11. But a single United States Senator suggested that his committee should have an opportunity to review this proposal, and as a consequence of his request the local guarantee provision was removed from the conference report.

But at the time that it was removed, the leadership in both the House and the Senate made a pledge that a freestanding bill introduced this year containing the loan guarantee would be considered on the floor of both Houses by no later than April 1, and in fact we are on track to meet that schedule.

A bill introduced by that Senator in the Senate has been approved unanimously by the Banking Committee in the Senate. Mr. Goodlatte's legislation has been approved unanimously by the Agriculture Committee in the House. And I want to commend Mr. Goodlatte on what is an absolutely extraordinary performance of legislative skill, in having a bill be introduced 1 week and then be approved unanimously in committee the next week. I've been in Congress for 18 years, and I don't recall that record having been surpassed in any instance. So Mr. Goodlatte has done a wonderful job in bringing this measure forward.

The legislation is in fact technology neutral. It is very much in the tradition that has been established in this Congress over decades of enabling people who do not get basic services, because the for-profit companies can't afford to provide it in their region, to receive that service as a consequence of government facilitation. This was done when electricity service was introduced into rural America. It was done again when telephone service was introduced into rural America.

And even today, rural telephone co-ops and rural electric co-ops receive government financial assistance in order to make that service affordable where it is not affordable for private companies to provide. And we are simply through our legislation extending that time honored tradition to the next generation of technology and making sure that rural Americans and people who reside in the small and medium sized cities around the country can receive the same benefits of this local into local service that the residents of the larger cities are going to receive.

I want to commend Mr. Goodlatte again. I'll look forward to his testimony and that of our other witnesses. And I thank you, Mr. Chairman, for scheduling this timely and very important discussion.

Mr. TAUZIN. I thank my friend. I might add that Mr. Goodlatte did such a remarkable job on that bill that Hollywood is looking at making a movie about him, "Looking for Mr. Goodlatte."

Mr. SAWYER. Will that be a short?

Mr. TAUZIN. We're extremely pleased now to welcome the Chairman of the full committee, Mr. Bliley, the gentleman from Virginia.

Chairman BLILEY. Thank you, Mr. Chairman.

Let me begin by welcoming my friend and colleague from Virginia, Mr. Goodlatte. It's been a pleasure working with him over the years. Virginia can count on him for his energy and enthusiasm for many years to come.

Today the subcommittee considers an issue that I know is very important to him, the issue of loan guarantees. Congressman Goodlatte has introduced legislation that would authorize the Federal Government to subsidize the construction of multi-channel video systems that could deliver broadcast signals to rural markets as well as other services such as high speed Internet access.

Congress has a strong and historical commitment to rural infrastructure development, and I commend Congressman Goodlatte for opening a dialog on whether we should expand this commitment to cover subscription based television services. I urge my colleagues today to examine closely the potential cost to the American taxpayer. CBO notes that providing local television service in rural areas is likely to prove financially and technically risky.

I suspect that this is true. For any multi-channel service provider to make money, millions of households will have to be willing to pay a premium to satellite or other service providers to receive local television stations, even though most Americans can view those stations today at no additional charge through their over-the-air antenna or existing cable subscription.

Let me also say a word about the proposed program. The proposed legislation would delegate responsibilities to the Rural Utilities Service which currently administers loan programs for the development of telephone networks and electric utilities in rural areas. It is noteworthy that unlike rural electrification or telephone services, there is immediate and intense competition in the video programming marketplace. I'm concerned about taxpayer risk in such a high stakes game.

The Wall Street Journal reported this morning that the Inspector General, who is with us today, has found that the telephone and electric utility programs are in need of serious review. The Inspector General found, for example, that many of the telephone companies that borrow from the RUS are financially strong and more than capable of obtaining financing from private lenders.

As for the electric utilities that borrow from the RUS, the Inspector General found that these utilities are playing the stock market, rather than investing in their communities as Congress had intended. I look forward to hearing from the RUS today on the Inspector General's finding. In the meantime, Congress needs to proceed very cautiously before expanding the RUS's authority. I look forward to working with my colleagues as matters proceed.

Thank you, Mr. Chairman. I yield back the balance of my time.

[The Wall Street Journal article follows:]

[March 16, 2000—The Wall Street Journal]

RURAL UTILITIES INVEST FUNDS IN MARKETS INSTEAD OF LOCAL PROJECTS, AUDIT SAYS

By Kathy Chen and Bruce Ingersoll, Staff Reporters of The Wall Street Journal

WASHINGTON—An Agriculture Department audit found that the nation's rural utilities are sinking billions of dollars into stocks, bonds and other investments instead of rural development, and the report is becoming fodder for a congressional battle over a rural television bill.

The audit shows hundreds of electricity cooperatives with low-interest government loans had nearly $11 billion of outside investments during 1997, the last year for which figures are available. But only $61 million, or about 0.5%, went into local business ventures or rural infrastructure.

Contrary to Congress's intent, the 787 borrowers on the roster of the department's Rural Utilities Service put most of their cash and other assets into a vast array of government securities, stocks, bonds, real estate and other nonrural investments. These findings by the department's inspector general are set to be released at a House Commerce Committee hearing today. The audit follows an inspector general's report in February that faulted the Rural Utilities Service for continuing to lend large sums of money at discount rates to rural telephone companies that no longer need government assistance.

The audit comes as Congress is considering legislation that would give the agency oversight for a third $1.25 billion loan guarantee program to help companies that want to beam local TV signals to rural and other underserved areas.

The House and Senate are working on different versions of the legislation, which would supplement the new law allowing satellite TV shows. However, satellite carriers have said they plan to roll out the service to only the top urban markets, leaving many of their rural customers without access to local TV shows.

Some members of Congress are pointing to the audits as a reason not to allow the agency to administer the rural TV plan—or not to approve the plan at all. Citing the agency's "somewhat lax oversight" of previous loan programs, Rep. Steve Largent (R., Okla.) is "somewhat skeptical of the need to hand out another $1.25 billion in loan guarantees," said bob Bolster, his telecommunications staffer. "He feels we should let the marketplace take care of itself."

But Rep. Bob Goodlatte (R., Va.), the sponsor of the House bill, said the measure is essential to bring local TV shows to tens of millions of satellite TV consumers. And the Rural Utilities Service has an "excellent reputation" for administering loan programs, he added.

A Rural Utilities Service spokesman said the agency's record is "pretty good" for administering loan programs. Regarding the audit of utilities' loans, he said there are no specific requirements on how co-ops should invest and "we followed the statute."

The audit singles out several examples of cash rich rural utilities that could afford to invest significant sums in their communities. The biggest utility in the audit, **Oglethorpe Power Corp.,** with $5.1 billion in assets, had $399 million of outside investments in 1997, but the Atlanta utility sunk no money into rural development.

Oglethorpe spokesman Gregory Jones said the auditors overlooked the fact that Oglethorpe's mission is to supply smaller electricity cooperatives with cheap power. "They, in turn, can afford to get involved in economic development and they can attract industry into their areas with their very competitive [electricity] rates," he said. Oglethorpe also runs an economic development program throughout Georgia.

In testimony today, Inspector General Roger Viadero is likely to question the investments of **Northern Virginia Electric Cooperative,** which serves a rapidly urbanizing part of the Washington metropolitan area. In 1997, the cooperative invested $100,000 in a marketing subsidiary and began selling two big companies' satellite TV dishes to northern Virginia and Washington residents. The money, Mr. Viadero contends, could be better spent on badly needed services for rural Americans.

A spokesman for the Manassas, Va., cooperative said its rural customers are being offered the same satellite TV service as city dwellers. In 1999, the cooperative had $128 million invested, including $27 million of stocks and bonds managed by a brokerage firm for "maximum return," the spokesman said. "The investment income helps us keep our rates as low as possible," he said, adding that the cooperative "never has been approached" for venture capital.

Mr. TAUZIN. I thank my friend the chairman.

Now the ranking minority member, the gentleman from Massachusetts, Mr. Markey, for an opening statement.

Mr. MARKEY. Thank you, Mr. Chairman. I want to commend you for holding this hearing on rural television issues. The legislative effort underway stems from the debate last fall concerning revisions in the Viewer Act and the advent of local to local service from direct to home satellite providers. Satellite provided local to local service promises to extend to millions of consumers much needed competition in the multi-channel video marketplace.

When Congress was considering legislation last year, it was clear that the two existing DBS companies would not be providing local to local service beyond the top markets in the most populated areas of the country. The legislation before us today was prompted by a desire to extend local to local service that urban America was going to receive to rural communities as well. This effort to do so is built upon America's experience in extending electricity and phone service to rural towns and hamlets.

I have long supported the universal concept. It ensures that the poor as well as rural Americans do not fall behind, and that they can receive the basic services that more affluent urban Americans do, at affordable prices. I know that my grandfather and grandmother would not have left the farm in Ireland if they had local into local direct broadcast service, coupled with a very strong price support system for the goods which they were raising on the farm. Unfortunately the New Deal had not arrived in the southeastern corner of Ireland by 1902, and so we came here to America.

But there's no question that we want to preserve those people in rural America with those price supports for their farm products and with additional programs to help them get local into local direct broadcast television service as well. These are critical programs to maintain that lifestyle.

The legislation before us, however, needs some additional analysis and clarifications. For instance, the legislation establishes a loan guarantee program to improve access to local television stations in unserved and underserved rural markets. From a universal service perspective I understand what an unserved market is. It is someone who doesn't get the service.

Yet in this context it isn't clear whether the service they are failing to receive is satellite delivered local to local service or the delivery of local television stations by any other means, such as provision of local TV stations from an incumbent cable operator. Depending on what the answer to that question is, then we have to delve into what an underserved market is.

Underserved could mean a rural community that in fact does receive local TV stations from the cable operator in town but doesn't get local to local from a DBS provider. If people can already get local TV stations from a cable operator, then the government doesn't need to get involved to extend service to that area in the same way that we extend electricity and phone service to areas that otherwise wouldn't get it. The cable guy is already there.

Consumers into that area, however, may understandably want an alternative to the cable operator, perhaps one they could use in conjunction with their satellite dish. If we are proposing to extend loan guarantees to provide alternatives to the local TV service rural consumers already receive from an incumbent, it makes zero sense in my view to permit incumbents to be eligible for loans.

If the incumbent monopoly already provides local TV stations to a community, then rural consumers in that community are choosing not to subscribe to that service for some reason. That reason is most likely price. Why would Congress ask these rural citizens for their taxpayer dollars to subsidize the only choice in town they don't want anyway? To do so would stand competitive telecommunications policy on its head, rather than addressing the lack of competition, our lingering concern about affordable cable rates.

We're proposing to allow the sole multi-channel provider in a rural area a chance to solidify their position with help from the United States taxpayer and without any obligation from the loan recipient to price the subsidized service to consumers affordably.

I hope before this bill leaves this committee we can make it crystal clear that incumbents are not to be eligible for subsidies, as well as clarifying other areas of the bill, so that we bring the benefits of competition and local TV service to rural America without extending the headaches of a monopoly era of telecommunications that this committee has time and again tried to end.

I thank you, Mr. Chairman. I yield back.

Mr. TAUZIN. I thank my friend. I point out to my dear Irish friend from Massachusetts, with St. Paddy's Day coming tomorrow, it's an absolute enlightenment to me to learn it was really the potato couch famine that sent your family to America.

I yield to my friend the gentlelady from New Mexico, Mrs. Wilson.

Mrs. WILSON. Thank you, Mr. Chairman. I'm tempted to just yield my time to Mr. Markey and Mr. Tauzin so we can be entertained more this morning. But I will yield my time and put any statement in the record.

Mr. TAUZIN. I thank the gentlelady.

The gentleman from Ohio, Mr. Sawyer.

Mr. SAWYER. Thank you very much, Mr. Chairman. I am inspired by the example of the gentlelady from New Mexico, and also insert my statement into the record.

Mr. TAUZIN. I thank the gentleman. The gentlelady, Mrs. Cubin from Wyoming.

Mrs. CUBIN. I'm going to inspire you with an opening statement, Mr. Chairman.

Mr. TAUZIN. The gentlelady may proceed.

Mrs. CUBIN. I thank you for bringing what I consider to be this very important bill before the subcommittee today. As an original cosponsor of the measure, I am pleased with this plan that will ensure that all consumers, specifically those in medium and small markets, have access to local broadcast signals by way of satellite.

The conference report to H.R. 1554, the Intellectual Property and Communications Omnibus Act, included this same $1.25 billion loan guarantee to help support the launch of certain systems dedicated to provide television service to hundreds of rural and underserved and unserved markets. Unfortunately the bill ran into some roadblocks in the Senate, not on the merits of the bill, I don't believe, but on supposed jurisdictional grounds.

I am pleased that we have this bill in front of us today, because without this plan only the largest television markets in America will be able to receive local into local service authorized by this legislation. The cities that will be served will only be those with millions of television households. As we all know, the largest TV markets are currently enjoying local into local service over their satellite systems, because of the hard work and dedication of this subcommittee.

Wyoming I think is a perfect example of why we need to enact the legislation that's before us today. The two largest television markets in Wyoming are Casper and Cheyenne. They rank 197 and 199 respectively. Even under the most optimistic local into local plans, I don't believe that Wyoming TV markets would ever receive local into local without the loan guarantee provision that's included in this bill.

So today's testimony from CBO Director Crippen details some of the financial pitfalls that may occur if we enact this legislation. And I can only say that in lieu of mandating that satellite providers serve rural areas, this is our only option. Some of our concerns I think can be alleviated with the recommendations that are put forth by the USDA's Inspector General to ensure that Rural Utilities Service the Rural Utilities Service makes better use of RUS loan funds and invest more wisely in rural America.

I am committed to moving this piece of legislation so rural satellite customers can enjoy the same television programming as our urban friends. And I truly appreciate Mr. Markey's support of the concept if not the words. And I would like to point out that when we live in a country like America, where we are so diverse geographically and socially, in places like where Mr. Markey lives, people are crowded more together than they are in places like where I live, but we're all one country.

There isn't one single kilowatt of electricity generated by nuclear power in the entire State of Wyoming and in some of the other Western States. And so I see the rural contribution in exchange for the contribution for universal service is that we take some of the—you know, we'll be storing maybe in New Mexico, maybe in Idaho, we'll be storing and treating some of the nuclear waste products that result from generating electricity.

And so it is one country. We all have to make sacrifices for one another. Sometimes we have to identify what those sacrifices we make actually are. I'm happy to do it for urban America, and I appreciate the folks in urban America being willing to do the same thing for rural America.

And I yield back the balance of my time, as if I had some, Mr. Chairman.

Mr. TAUZIN. I thank the gentlelady. The gentleman, Mr. Shimkus from Illinois, is recognized.

Mr. SHIMKUS. Thank you, Mr. Chairman. I want to thank Bob for his efforts and for joining us today. I want to thank you for calling this hearing. I want to mention our colleagues Joanne Emerson and Eva Clayton who have re-energized the Rural Caucus, which I am a member of. I look forward to following this legislation very closely and reporting back to them on how successful we will be in pushing something that everyone understands and realizes is very important.

I represent a large rural district, it covers 19 counties over 300 miles. Only one third is now receiving and will be finished receiving local into local St. Louis market, which should be the end of the month of April, we should have the full coverage of that area, which is a good sector of the district, but still leaves a lot of the areas still uncovered. And we've been through the drill before, talking about the benefits of local broadcast for community broadcast, emergency service broadcast warnings.

I harken back to the flood of 1993, when the levies broke and people had to get out of their towns and communities. So I've been a strong advocate of the importance of the local broadcasters in providing the service that we asked them to provide.

This ability to help rural Americans get access to their local stations and using any means possible is one that we want to make sure we do with respect to obviously the conservative ideology of this Congress, that it's not wasteful, but it's in a way that we encourage and empower those to provide services that we know are important for all citizens irrespective of whether they're from an urban area or rural area.

And I appreciate the hearing. I look forward to learning more, Mr. Chairman. I yield back my time.

Mr. TAUZIN. I thank the gentleman. The gentleman from Oklahoma, Mr. Largent, is recognized.

Mr. LARGENT. Thank you, Mr. Chairman. Only a few months ago Congress responded to the concerns of millions of American television viewers by enacting the Satellite Home Viewers Improvement Act. One of the primary reasons for the legislation was to offer consumers a complete alternative to cable by granting satellite carriers the ability to carry local broadcast signals back into their local markets, otherwise known as local into local.

To a large extent the Act appears to be working. The largest carriers appear to be providing local into local to 26 metropolitan markets. It's projected that ultimately satellite providers will be providing local into local service to 70 percent of American households. The question before us today is, what do we do about the remaining 30 percent of Americans who live in sparsely populated rural areas?

One option is H.R. 3165, the Rural Local Broadcast Signal Act introduced by our colleague Mr. Goodlatte. This legislation would authorize the Department of Agriculture through the Rural Utilities Service to provide $1.25 billion in loan guarantees to finance the delivery of local television programming to subscribers of satellite and cable and wireless delivery systems.

Frankly I've always had reservations about loan guarantee programs. And after reviewing the testimony submitted by the Congressional Budget Office and the Department of Agriculture's Inspector General, my concerns have grown. According to the testimony submitted by Mr. Crippen, Director of CBO, "Federal assistance for this venture would likely prove costly. Most of the proposals envision large capital investments. But the market for delivering local television signals would be most subject to competition and relatively small, making it difficult to ensure that large investments can be recovered, especially in the near term."

I also took note of CBO's analysis that, based upon its review, the default rate for companies that may qualify for this program could be as high as 44 percent. I hope all the taxpayers in America are listening to this testimony. The testimony submitted by Mr. Roger Viadero, the Department of Agriculture's Inspector General, raises even more serious questions about how the Rural Utilities Service administers its loan programs and its commitment to stimulate investment in rural America.

Recently the Inspector General's office conducted two RUS audits, one on the electric program and the other on the telephone program. What did the Inspector General's audit reveal? According to Mr. Viadero's testimony, the audit of the electric program "discovered that RUS electric borrowers have not become major players in financing America's rural infrastructure, despite the fact these borrowers hold almost $11 billion in total investments. Disappointingly, only one half of 1 percent of this $11 billion, about $61 million, is actually invested in rural America."

So where are these subsidized loans going? According to the audit, these loans are being invested in money market certificates, stocks, bonds, and mutual funds, not in rural America. The audit of the telephone program released on February 11 of this year discovered that more than half of the 815 RUS loans, totaling almost $1.9 billion, went to 434 companies that are strong enough financially not to need government assistance.

People living in rural America deserve a choice in video delivery systems. However, in light of the financial risk to the American taxpayer and the lack of oversight of existing loan programs, I'm extremely skeptical if now is the time to grant RUS an additional $1.25 billion in lending authority.

Thank you, Mr. Chairman. I look forward to the testimony of the panel.

Mr. TAUZIN. I thank the gentleman. The gentleman from Minnesota, Mr. Luther, is recognized.

Mr. LUTHER. I have no comment. Thank you, Mr. Chairman.

Mr. TAUZIN. I thank the gentleman. The gentleman from Georgia, Mr. Deal.

Mr. DEAL. Thank you, Mr. Chairman. I want to thank Mr. Goodlatte for bringing this legislation to the committee. I look forward to both his testimony and the panel that will follow him. I think there are some interesting questions to be asked and hopefully some interesting answers to be received.

As someone who represents a rural part of this country, the mountains of north Georgia, and a Congressional District that borders four states and is served by three media markets, two of which are out of my State and one of which is also out of my district, I do have gaps in this television service that is provided to the communities that make up my Congressional District.

And I think any effort to try and fill in those gaps in a financially sound method is certainly one that I am interested in, and I look forward to the testimony. Thank you, Mr. Chairman.

Mr. TAUZIN. I thank the gentleman. The Chair asks if there are any other opening statements. And all written statements by unanimous consent will be made a part of the record, including those of our witnesses, which are now indeed made part of our record.

And we will now welcome the first panel, which is a single panel represented by our good friend, Mr. Bob Goodlatte of the great State of Virginia. And Bob, I want to join your colleague from Virginia, Mr. Boucher, in commending you for your excellent work here in the Congress on this issue. And you heard from the members the great concerns they have about how this program as you propose it might work and how we might ensure that we don't have the problems that the audits recently came out seem to indicate exist in the current loan programs. And we welcome your testimony. We would urge you to address those concerns today.

Mr. Goodlatte.

STATEMENT OF HON. BOB GOODLATTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. GOODLATTE. Well, thank you, Mr. Chairman. I have a chart that I would like to put up for the members. First of all, let me thank you for holding this hearing and allowing me to testify; also for your cosponsorship of this legislation, as a great many other members of the committee have done, along with 110 other Members of the House. I also want to thank Chairman Bliley for his participation in this hearing and for the opportunity to work with him on the Satellite Home Viewer Act of 1999 and many other pieces of legislation that I've worked on with both of you.

I especially want to thank my colleague Rick Boucher, chief democratic cosponsor of the legislation, and who was very much involved with coming up with the proposal to put to the Conference Committee last fall, which you and other members of the committee have adequately described the history of how we got to this.

So I would like to devote my time to where we are now and why we're here, and address some of the matters that were raised here by the panel. I do have a statement which I would ask to be made a part of the record.

Mr. TAUZIN. Without objection, it is.

Mr. GOODLATTE. We have a chart over here which is a little dogeared, because it's been on the road quite a lot, to make the point about this issue, which we call another digital divide. If you look at the circles that are on the map, those show the cities served as of January 31 by local into local following the legislation that enabled the satellite companies to get into the local into local service.

And the yellow circles are the cities that are probably going to receive local into local service based upon the market plans of the existing satellite companies. There are some additional proposals, as mentioned by the gentleman from Oklahoma, that some new companies might reach as many as the top 67 markets in the country. But that is far from certain. And it is certain that the existing companies will not reach them.

And I would further point out there are 211 television markets in the country. And no plan, no plan by any existing or proposed private satellite company will reach more than 140 of those markets. So if you look at the map you'll see a stunning picture of the overwhelming majority of the geographic area of the country not being reached.

And it is important to note that while this legislation is geared to make sure that rural Americans share in local into local service, and in fact every square mile of rural America is covered by this legislation, it is also to be made clear that a great many urban areas in this country are also not served, including Tulsa, Oklahoma, and Oklahoma City, Oklahoma; Cheyenne, Wyoming; Albuquerque, New Mexico; most of Georgia, except for Atlanta; New Orleans, Louisiana; many parts of Ohio; Springfield, Illinois; for the gentleman from Massachusetts, Boston is covered, but my original hometown of Springfield, Massachusetts is not covered by this legislation. So it's important to consider that fact.

The legislation is designed to do two things; to solve the problem for rural Americans who cannot receive local into local service, but also to bring new competition to the urban areas not served on this map. The areas served on the map are getting that competition now. People who have the option of having cable or over the air broadcast will now also have the competitive option of choosing satellite service.

But no one else in America will have the opportunity to do that. Now, the issue has been raised this morning about whether the Rural Utilities Service is the best agency to administer this loan and whether they have done their job appropriately in the past. I am well aware of the article in the Wall Street Journal this morning, and I have also reviewed the testimony of my good friend Roger Viadero, who is the Inspector General of the Department of Agriculture, who testifies before my subcommittee, the Department Operations Subcommittee in Agriculture, many, many times, and I have a great deal of respect for his independence. And I very much agree with many of the observations in his testimony regarding where the money that is loaned is going and whether it should be going there.

But it's also important to note that that is a separate debate that this Congress should probably have about whether or not loan guarantees and the loan portfolio of the Rural Utilities Service should be going into some of the investments and some of the places that it is going. But this legislation is different in the respect that it is intended to reach more than all of rural America which it reaches.

It's intended to reach many, many urban areas and suburban areas and so on. And so I think it's important to draw a clear line between the criticism offered of the agency in terms of whether or not the loans that it is making now are going to where Congress intended them to go or whether or not it is possible to have—I've just been advised I have a vote in the Judiciary Committee. I think I would like to sum up here.

The point I want to make to you, Mr. Chairman, is this. The Rural Utilities Service is the successor of REA in administering these loans. For 60 years a loan portfolio of more than $42 billion, and never, never in the entire 60-year history has there been a default. So when you talk about the Rural Utilities Service administering loans, if the question is are they going to take care of the taxpayers' money and make sure it is not lost, I can't think of anyone better to administer this than an agency that has never experienced a default and has a loan portfolio of $42 billion, nearly 40 times the size of what we are proposing in this legislation.

So I would hope that the committee would keep that in mind. And while I share the concerns of Mr. Viadero regarding whether or not some of the loans they guaranteed are appropriate, I would also say that the rural electric cooperatives who have received many of these loan guarantees have also, because they've never defaulted on them, a very excellent record, and have invested the money soundly. Whether the money invested soundly is invested in the right place is I think a separate issue for another time and another place.

The issue before us today is, is this legislation important to ensure that more than 85 million Americans will have the opportunity to receive what the rest of the country in the urban areas is getting now, and will the country have it properly administered by the appropriate agency. And I think that, as you will hear from their testimony, they are very capable of administering these loans.

I thank you very much.

Mr. TAUZIN. I thank the gentleman. The gentleman does have a vote in his other committee. Mr. Goodlatte, if you would like to come back and join the other panel, you are more than welcome to do that. That's your call.

Mr. GOODLATTE. I thank you, Mr. Chairman.

Mr. TAUZIN. I'll call the second panel, which will include Mr. Dan Crippen, Director of the Congressional Budget Office; Mr. Roger Viadero, Inspector General, United States Department of Agriculture; Mr. Christopher McLean, Acting Administrator, Rural Utilities Service; and Mr. R. Kent Parsons, Vice President, National Translators Association.

We're pleased to welcome you all. You heard my earlier statement that your written testimony is a part of our record. We have copies of them before us. You needn't read them to us. We would appreciate if you would abide by our 5-minute rule, which means summarize your testimony within 5 minutes.

Mr. Crippen.

STATEMENTS OF DAN L. CRIPPEN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE; ROGER C. VIADERO, INSPECTOR GENERAL, UNITED STATES DEPARTMENT OF AGRICULTURE; CHRISTOPHER A. McLEAN, ACTING ADMINISTRATOR, RURAL UTILITIES SERVICE; AND R. KENT PARSONS, VICE PRESIDENT, NATIONAL TRANSLATORS ASSOCIATION

Mr. CRIPPEN. I'm pleased to be here with you this morning to discuss providing Federal loan guarantees to increase access to local television markets. We need to keep in mind there are at least two objectives of this legislation, and I think Mr. Markey's terminology went to exactly that. He talked about the unserved and the underserved.

So there are two differing objectives to this: providing broadcasts to folks not now receiving them, and providing competition to existing multi-channel providers. We often hear these objectives, Mr. Chairman, mixed together. And we need to keep them separate or clearly understood not so much as a matter of policy but in order to understand how we evaluate this legislation.

Our conclusion is that Federal assistance to this venture would likely prove to be costly. The market for delivering local television signals would be both subject to competition and relatively small, making it difficult to ensure that large investments could be recovered, especially in the near term. The cost to the taxpayers would depend on the size of the program and how much of the risk would be borne by the government.

The budgetary treatment of loan guarantee programs is governed by the Federal Credit Reform Act of 1990. That Act makes commitments of Federal loan guarantees contingent on the appropriation of enough funds to cover the estimated subsidy associated with the guarantees. Under credit reform, the subsidy cost of a loan guarantee is the estimated long term cost to taxpayers.

The subsidy cost of federally guaranteed loans depends primarily on expected defaults and the degree to which the losses can be offset by collateral and by income from fees or other charges. In CBO's view, providing local television service in rural areas is likely to prove financially and technically risky, with an attendant regulatory risk we have not attempted to assess.

For such services to be economically viable, millions of households have to be willing to pay a premium to satellite or other service providers to receive local television stations, even though most households can view those stations at no additional charge through their over-the-air antenna or existing cable. We have, I think, if David can put it up, a chart as well.

Let me say, Mr. Chairman, too, this should not be interpreted as a chart that discounts anything Mr. Goodlatte said. He was making the point about the desirability or the appropriateness of the policy. This chart I show you just to explain why we estimated what we did. You have undoubtedly seen this chart before. It's a mapping of areas currently receiving at least "Grade B" television broadcast signals.

Obviously most of the country and even more of the population can receive local broadcasts over the air. And many of the folks in the white areas or yellow areas can get local broadcasts through cable or MMDS or other alternatives. In fact, as you know, more than 97 percent of television households are covered by cable. For the remaining 3 percent, or roughly 3 million households, local signals may be available over the air or by other means. In other words, there are fewer than 3 million—more likely something like 2 million—television households that cannot currently receive local broadcasts in some fashion.

This is the primary market for any alternatives. This then is Mr. Markey's unserved. In addition, unlike companies that provide rural electrification or television service, these new entrants would immediately confront established competitors everywhere else. Thus, borrowers of the proposed guaranteed loans might have trouble achieving the necessary local market penetration to support a new television service.

They would also face numerous technical risks, including the risk that emerging technologies will allow local broadcast signals to be delivered through less costly methods. As I said, our analysis did not include regulatory risk, such as the availability of spectrum and appropriate satellite slots or the ability of any new entrant to gain licenses to those.

CBO has now completed estimates of both the House and Senate bills. The House bill—similar to the legislation included in last year's conference report on H.R. 1554—would provide a subsidy of 28 percent of the face value of the guarantee, a cost we estimate to be $350 million, therefore, based on $1.25 billion total. The Senate bill, because it would allow a guarantee for only 80 percent of any loan, would have a subsidy rate of approximately 20 percent, or $250 million.

To reiterate, the cost of a loan program to the taxpayer is determined by the riskiness of the venture and how much of that risk the government will bear. As is evident from our scoring of the Senate bill, one way to reduce the cost of the loan guarantee program significantly is to reduce its size, either by decreasing the total obligation level or by guaranteeing less than the full value of each loan.

About half of existing Federal loan guarantee programs guarantee less than 100 percent. Some guarantee as little as 50 percent. Guaranteeing less than full value can obviously reduce the cost to the taxpayers. First, it lowers the total amount of exposure.

Second, and perhaps more important, it can reduce the default risk by encouraging private lenders, who have more expertise in analyzing credit risk, to scrutinize their own exposure more carefully. Modifying the terms of the loan guarantees can also change the subsidy cost, but for the most part, such technical changes will have a relatively small effect on the cost of the program. Such other options include requiring borrowers to pay fees, enhancing the government's security in the event of default, and ensuring underwriting criteria.

It is possible to reduce the cost of proposals to guarantee loans for delivering additional television services to rural areas, but it is not possible to eliminate all of the risk or cost. The purpose of a Federal loan guarantee is to provide credit for activities that the private marketplace considers too costly or too risky to pursue. Such support comes at a cost.

Thank you, Mr. Chairman.

[The prepared statement of Dan L. Crippen follows:]

PREPARED STATEMENT OF DAN L. CRIPPEN, DIRECTOR, CBO

Mr. Chairman and Members of the Subcommittee, I am pleased to be with you this morning to discuss providing federal loan guarantees to increase access to local television services. The proposed loan guarantee program is designed to encourage investment in systems that deliver local television signals to mostly rural markets that are unlikely to receive those signals through existing direct broadcast satellite (DBS) companies. In my statement today, I will provide an overview of some of the factors that affect the budgetary cost of such loan guarantees. I will also discuss options that might reduce the cost of the proposed program to the federal government.

Federal assistance for this venture would be likely to prove costly. Most of the proposals envision large capital investments. But the market for delivering local television signals would be both subject to competition and relatively small, making it difficult to ensure that large investments could be recovered, especially in the near term. Federal credit programs can shift—but not eliminate—the risk of such projects. The cost to the federal government would depend largely on the size of the program and how much of the risk was borne by the government.

FACTORS THAT AFFECT THE BUDGETARY COST OF LOAN GUARANTEES

Many options to provide federal loan guarantees for rural television service are under consideration. The Congressional Budget Office (CBO) has estimated the cost of one proposal this session—H.R. 3615, as ordered reported by the House Agriculture Committee. My testimony this morning is based on our analysis of that program proposal.

H.R. 3615 envisions a $1.25 billion loan guarantee program. Up to half of that amount could be awarded to a single borrower, with the remainder divided among several smaller borrowers (each receiving no more than $100 million). The loans would be used to finance the infrastructure needed to deliver local television broadcast signals—whether through satellite facilities, cable systems, or other wired or wireless systems. Although the legislation was written to cover a variety of possible technologies, key supporters argued that the program should be used to finance satellite transmission of local television signals.

The budgetary treatment of loan guarantee programs is governed by the Federal Credit Reform Act of 1990 (as amended). That act makes commitments of federal loan guarantees contingent on the appropriation of enough funds to cover the estimated subsidy associated with the guarantees. Under credit reform, the subsidy cost of a loan guarantee is the estimated long-term cost to the government, calculated on a net present-value basis. Budget authority for the subsidy is recorded in the year it is provided; outlays are shown in the year in which the guaranteed loans are disbursed.

The subsidy cost of federally guaranteed loans typically depends on the extent of any defaults and the degree to which those losses are offset by proceeds from liquidating collateral and by income from fees or other charges. (Some loan guarantees also provide an explicit interest rate subsidy, which adds to the cost.) The credit risk of existing loan guarantee programs varies widely. Some programs have average default rates of less than 2 percent; others, between 10 percent and more than 20 percent, net of recoveries. Most existing programs guarantee a high volume of loans each year, effectively pooling the credit risk of many individual borrowers. In addition, fees—especially up-front fees—offset some of the subsidy cost of most loan guarantee programs.

In CBO's view, providing local television service in rural areas is likely to prove financially and technically risky. For such services to be economically viable, millions of households would have to be willing to pay a premium to satellite or other service providers to receive local television stations—even though most households can view those stations at no additional charge through their over-the-air antenna or existing cable subscription. Thus, borrowers of the proposed guaranteed loans might have trouble achieving the necessary level of market penetration for a new television service. In addition, unlike companies that provide rural electrification or telephone services, those borrowers would immediately confront competitors in the marketplace. They would also face numerous technical risks, including the risk that emerging technologies will allow local broadcast signals to be delivered to the home through less costly methods.

To estimate the subsidy cost of the loan guarantee program for rural television service, CBO consulted industry experts and investment analysts and examined the credit ratings of firms in the satellite television industry. That information is useful in estimating subsidy rates because the different credit ratings reflect analysts' expectations of defaults. For example, a January 2000 report by Standard & Poor's indicated that the cumulative default rate for investments with a "BBB" rating is less than 5 percent; for those with a single "B" rating, the default rate is 28 percent; and for those with a "CCC" rating, the rate is 44 percent. Based on our review of publicly available information about the ratings of companies in similar industries, we anticipate that the credit rating for rural television projects would be at the riskier end of that range.

We also examined the legislative terms and conditions that might mitigate such risk. For example, the loan guarantee program in H.R. 3615 would give the government a superior lien on the assets of a borrower in the event of default, but it would let the Administration decide how much collateral to require. Likewise, judgments about the reasonableness of borrowers' business plans and about the total amount of the loan guarantees would be made by the Secretary of Agriculture Administrator of the Rural Utilities Service. Finally, H.R. 3615 would authorize the Secretary Administrator to levy fees and accept a payment from a nonfederal source to fund all or part of the credit-risk premiums.

CBO estimated that the loan guarantee program authorized by H.R. 3615 would have a subsidy rate of about 28 percent of the total amount guaranteed. For a $1.25 billion loan guarantee program, that translates into an estimated subsidy cost of about $350 million (assuming that the optional fees would not be charged or collected). Because H.R. 3615 would make implementation of the program contingent on future appropriation action, those costs would be discretionary. (A copy of our letter to Congressman Goodlatte about cost estimate for H.R. 3615 is attached.)

OPTIONS TO REDUCE THE COST OF LOAN GUARANTEE PROGRAMS

As I noted earlier, the cost of a loan program is determined largely by the riskiness of the venture and how much of that risk the government will bear. One way to reduce the cost of a loan guarantee program significantly is to reduce its size—either by decreasing the total obligation level or by guaranteeing less than the full value of each loan. Modifying the terms of the loan guarantees can also change the subsidy cost, but for the most part, such technical changes would have a relatively small effect on the cost of the proposed program. Other options to reduce subsidy costs include requiring borrowers to pay fees, protecting the government's security in the event of default, and ensuring effective underwriting criteria.

Reduce the Obligation Level

The simplest way to decrease the size of the program is to reduce the amount of loans that the government is offering to guarantee. H.R. 3615 would authorize guarantees totaling $1.25 billion. Lowering the amount of obligations would cause a proportional reduction in the government's exposure and thus in the subsidy cost.

Guarantee Less Than the Full Value of the Loan

Another way to reduce the potential cost to taxpayers is for the government to guarantee less than 100 percent of the value of each loan. About half of existing federal loan guarantee programs guarantee less than 100 percent of insured loans; some guarantee as little as 50 percent of the value of their loans. Examples at the lower end of the range are the Development Credit Authority program at the Agency for International Development (AID) and the Section 7(a) General Business Guaranty program at the Small Business Administration (SBA).

Guaranteeing less than the full value can reduce the cost to the government in two ways. First, it can lessen the government's direct exposure for each loan by lowering the dollar amount of the guarantee. Although that would reduce the cost of the proposed program, it would run the risk that private lenders might be unwilling to lend enough funds to meet borrowers' needs. Second, it can reduce the default risk by encouraging private lenders to exercise more care in underwriting loans. The profit motive should push lenders to lend only to those borrowers most likely to repay the debt. Private lenders also have more expertise in analyzing business plans, industry trends, and financing options than their federal counterparts. However, having some degree of private financing is not a panacea for eliminating risk—both the AID and SBA programs mentioned above have default rates of about 15 percent.

Require Borrowers to Pay Fees

Most current loan guarantee programs require borrowers to pay either an up-front fee (when the loan is made) or an annual fee (collected as the borrower pays off the loan). Up-front fees are more common and typically range from less than 1 percent to more than 5 percent of the loan amount.

If properly designed, up-front fees can reduce the subsidy cost by a corresponding amount. Two caveats apply, however. First, there is a limit to the amount of fees that borrowers would be willing to pay—and that amount is likely to be far smaller than the subsidy cost of this program. Second, unless borrowers are prohibited from capitalizing the fee either directly (by adding it to the loan amount) or indirectly (by having third parties pay the fee, which would in turn be recovered through higher costs for equipment or services), their debt-service costs, and thus the risk of default, will increase. Capitalizing fees can also result in borrowers' having insufficient collateral to support the loans.

Many federal programs, especially those involving housing and business loans, impose annual fees. The fees typically range from about 0.5 percent to 0.75 percent of the outstanding balance of a loan. Such fees can significantly reduce subsidy costs for programs that are characterized by a low risk of default and long maturities (between 15 years and 30 years). However, annual fees cannot be collected if a loan is in default, so they may not significantly reduce subsidy costs for programs in which the expected default rate is high.

Protect the Government's Security in the Event of Default

H.R. 1554 would allow the government's guarantee to be subordinate to any private-sector financing. Subordination would reduce the incentive for lenders to assess the riskiness of the loan and would increase the likelihood that if a default occurred, the government's loss would be significant.

Recoveries from subordinated debt have been lower than recoveries from senior debt in federal credit programs and in the private debt market. For example, the SBA guarantees financing to businesses in the Section 504 Certified Development Company and the Section 7(a) General Business Guaranty programs. In the 504 program, the government's guarantee is subordinate to that of the lender; in the 7(a) program, the government's guarantee is equal in priority. Recoveries from defaulted loans have been significantly lower in the 504 program, even though it requires collateral in real estate and equipment and the 7(a) program does not. Making government liens superior to all other liens on the assets of the borrower could reduce the federal subsidy, relative to that of H.R. 3615.

Ensure Effective Underwriting Criteria

H.R. 3615 would direct the Secretary of Agriculture to develop underwriting criteria for the guaranteed loans in consultation with the Office of Management and Budget and an independent accounting firm. Although CBO expects the resulting standards to be consistent with current government practice, lawmakers may want to spell out some of the criteria in law. For example, legislation could require that the liquidation value of the collateral be equal to the outstanding principal balance of the loan. Even at that level, however, collateral alone would not eliminate the subsidy cost of a program because of the time and expenses associated with care and preservation, liquidation, and litigation of the collateral.

The criteria for evaluating loans could also be strengthened. H.R. 3615 would allow projections of an applicant's ability to repay a loan to include the value of collateral pledged to protect the government's interest. Collateral provides a basis for recoveries in the event of defaults; it is not a substitute for cash flow. As a result, it is not a useful basis for determining whether an applicant's project is viable.

CONCLUSION

It is possible to reduce the cost of proposals to guarantee loans for delivering additional television services to rural areas, but it is not possible to eliminate all of the risk or cost of making such guarantees. In theory, the purpose of a federal loan guarantee is to provide credit for activities that the private marketplace considers too risky to pursue on its own. Such support comes at a cost.

The surest way to reduce the cost of proposals like the one included in H.R. 3615 would be to reduce the size of the federal loan guarantee. Other modifications, such as charging fees or improving underwriting criteria, are unlikely to reduce the estimated subsidy appreciably because the activities being financed are fundamentally risky. Options designed to reduce the cost to the government could make the program less attractive to potential borrowers or lenders, which in turn could reduce the demand for the loan guarantees.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

March 1, 2000

H.R. 3615—Rural Local Broadcast Signal Act

As ordered reported by the House Committee on Agriculture on February 16, 2000

SUMMARY

H.R. 3615 would establish a loan guarantee program for certain companies to provide local television service to areas of the country that do not receive local television stations from satellite companies. The bill would authorize the Administrator of the Rural Utilities Service (RUS) at the Department of Agriculture to guarantee loans to qualified borrowers, totaling up to $1.25 billion. The bill would authorize the appropriation of amounts necessary for the costs of the loan guarantees and associated administrative expenses.

Under the bill, one guaranteed loan could be as much as $625 million, but all other loans would have to be $100 million or less. Qualifying loans would be payable in full within the lesser of 25 years or the useful life of the assets purchased. H.R. 3615 would allow the government's guarantee to be subordinate to any private-sector financing and would give RUS broad authority to modify the terms and conditions of loans. The authority to guarantee loans would be contingent upon future appropriation action and would expire on December 31, 2006.

CBO estimates that implementing H.R. 3615 would cost about $365 million for loan subsidy and administrative costs over the 2000-2005 period, assuming appropriation of the necessary amounts. H.R. 3615 would not affect direct spending or receipts; therefore, pay-as-you-go procedures would not apply. H.R. 3615 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

For the purpose of this estimate, CBO assumes that H.R. 3615 and related supplemental appropriations will be enacted in fiscal year 2000. The estimated budgetary impact of H.R. 3615 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

Spending Subject To Appropriation

By Fiscal Year, in Millions of Dollars

	2000	2001	2002	2003	2004	2005
Estimated Authorization Level	5	352	2	2	2	2
Estimated Outlays	2	233	124	2	2	2

BASIS OF ESTIMATE

Under procedures established by the Federal Credit Reform Act of 1990, the subsidy cost of a loan guarantee is the estimated long-term cost to the government, calculated on a net present value basis (excluding administrative costs). We estimate that the loan guarantees provided under the bill would cost about 28 percent of the total amount guaranteed—or $350 million, subject to the availability of appropriated funds. In addition, CBO estimates that administering the program would cost about $5 million in 2000 and about $2 million in each subsequent year. The bill would authorize the Secretary of Agriculture to charge fees, which could offset some of the subsidy or administrative costs, but this estimate assumes no fees would be charged.

To prepare this estimate, CBO consulted with industry experts and investment analysts and examined the credit ratings of firms in the satellite television and related industries. The information on credit ratings is useful because different credit ratings reflect analysts' expectations of defaults. Based on this information, we assume that the rural television loans likely to be guaranteed under this bill would have a credit risk comparable to debt rated as "B" or "CCC," which typically have default rates ranging from about 30 percent to 45 percent, respectively. We also estimate that provisions in H.R. 3615 allowing the government's guarantee to be subordinate to private-sector financing would increase the subsidy cost of such guarantees. Subordination would reduce the incentive for lenders to assess the riskiness of the loan and increase the likelihood that if a default occurred, the government's loss would be significant. Recoveries from subordinated debt have been lower than recoveries from senior debt in both federal credit programs and the private debt market.

PAY-AS-YOU-GO CONSIDERATIONS: None.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 3615 contains no intergovernmental or private-sector mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

ESTIMATE PREPARED BY: Mark Hadley (226-2860)

ESTIMATE APPROVED BY: Peter H. Fontaine, Deputy Assistant Director for Budget Analysis

Mr. TAUZIN. Thank you very much, sir. So we can understand your testimony, I just want to, before we move on, understand the charts you've given us. The red areas are the areas covering consumers with over-the-air broadcast local signals, is that correct?

Mr. CRIPPEN. Right.

Mr. TAUZIN. And that includes areas that receive good signals, bad signals, any kind, a signal intensity map?

Mr. CRIPPEN. Grade B contours.

Mr. TAUZIN. And the yellow areas do not receive over-the-air but may receive it through cable or some other means?

Mr. CRIPPEN. Precisely.

Mr. TAUZIN. Thank you, sir.

We will move on to Mr. Roger Viadero, Inspector General of the United States Department of Agriculture. And we'll appreciate your testimony, Mr. Viadero.

STATEMENT OF ROGER C. VIADERO

Mr. VIADERO. Thank you, Mr. Chairman, and members of the committee here today. I'm pleased to be here today to speak to you about the Office of Inspector General's recommendations to the Rural Utilities Service, RUS. With me today to my left is Mr. James R. Ebbitt, Assistant Inspector General for Audit. Before I begin my testimony, I would like to submit two recently issued audit reports for the record, sir.

Mr. TAUZIN. Without objection, they will be included.

[The report appears at pg. 63.]

Mr. VIADERO. Thank you, sir. I share your concern that rural America be made a full partner in the information age. To that end two reports issued by my office describe options for the RUS Administrator to stimulate rural investment and make better use of RUS loan funds. Funds made available through implementation of the report's recommendations could be used to better connect rural communities to rapidly developing information technologies.

Electric borrower investments. We audited RUS electric program borrowers to determine the extent of their investment activities and the degree to which borrowers invested in rural America. We discovered that RUS electric borrowers have not become major players in financing America's rural infrastructure, despite the fact that these borrowers had almost $11 billion in total investments.

Disappointingly, only one half of 1 percent of this amount or about $61 million is actually invested in rural America. The Northern Virginia Electric Cooperative provides a good example. NOVEC has borrowed about $129 million from RUS and holds $128 million in investments, none of which is classified as rural development.

Among the electric co-op's investment is a subsidiary called NOVASTAR, a company that is partnering with DISH Network and DIRECTTV to sell premium satellite services to the northern Virginia and metropolitan Washington, D.C. Areas.

I want to emphasize that NOVEC is not, I'll say again, is not violating any laws by investing in satellite TV for our metropolitan area. However, I believe encouraging RUS borrowers to invest more heavily in rural America just makes good sense. The same dollar that provides satellite TV to the area right here on Capitol Hill could be used to bring much needed services to the underserved communities in rural America.

Unfortunately RUS electric program borrowers on their own have not invested heavily in rural America. Instead, investment dollars are used for such things as money market certificates, stocks and bonds, and mutual funds. We recommended that RUS develop and implement a strategy to encourage electric borrowers to use some of their $11 billion portfolio to make discretionary investments in rural America.

RUS has agreed to develop and implement policies and procedures to strongly encourage borrowers to meet the intent of Congress. This new strategy could promote investment practices to ensure the delivery of local television programming to subscribers of satellite television in rural markets. Through increasing investments for rural access to telephones, computers, and the Internet, RUS electric borrowers would help close the digital divide.

Let's talk about telephone borrowers who do not need assistance. In another recent audit we identified 434 RUS telephone program borrowers with loan balances totaling $1.87 billion that appear to be in good enough financial condition to satisfy their credit needs from their own financial organizations or from other credit sources.

Our findings echo and expand on conclusions reported by the General Accounting Office in a January 1998 report that detailed options to make the RUS telephone program more effective and less costly. GAO reported that some borrowers may retain loans longer than needed and are therefore able to take advantage of the favorable terms provided by the government.

RUS continues to incur interest and other administrative costs in servicing the accounts of its financially healthy borrowers. The law requires RUS to encourage and assist rural telephone systems to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial sources.

Our trend analysis of key financial ratios showed steady improvement in the telephone loan portfolio, and that half of RUS borrowers are in strong financial condition. However, RUS does not have discretion to refuse a loan because a borrower is in strong financial condition. And the Rural Electrification Act is silent regarding loan graduation, that is, requiring borrowers to move to private credit when they're financially able. We recommended that RUS work with the Congress to clarify policy regarding loan graduation and requiring financially strong borrowers to obtain credit from commercial sources. RUS disagrees with our recommendation.

RUS should seek clarification about loans to borrowers who do not need government assistance. As decisions are made about funding rural America's move into the information age, it is important to remember that over half of the RUS telephone loan borrowers may not really need government assistance.

The money freed up could perhaps be used in other ways. For example, preserving and enhancing access to local and network television signals is important to rural America's economy. As enunciated in bill number 3615, local television, with its mix of crop reports, local news, weather reports, public service announcements, and advertisements from local businesses is vitally important for development efforts.

According to the National Telecommunications and Information Administration, Americans living in rural areas are lagging behind the national average in computer and Internet access regardless of income level. At some income levels those in urban areas are 50 percent more likely to have Internet access than those with similar earnings in rural areas. The $1.9 billion currently loaned to the telephone program borrowers who do not need Federal assistance could go much further in closing the digital divide.

In summary, my office has identified two potentially important options for increasing the effectiveness of RUS loans. Electric program borrowers hold about $11 billion in investments that could be used to build technological infrastructure for rural America. Telephone borrowers who could likely finance their operations privately owe the government $1.9 billion, money that could with appropriate authority be used to foster access to technology and electronic media.

We are currently working on another audit that will address additional opportunities for RUS to increase the sufficiency and thus its contribution to rural America.

Mr. Chairman, thank you for inviting me here today to talk about our recommendations on RUS.

[The prepared statement of Roger Viadero follows:]

PREPARED STATEMENT OF ROGER VIADERO, INSPECTOR GENERAL, U.S. DEPARTMENT OF AGRICULTURE

Thank you, Mr. Chairman and members of the committee. I am pleased to be here today to speak with you about the Office of Inspector General's recommendations to the Rural Utilities Service (RUS). With me today is James R. Ebbitt, Assistant Inspector General for Audit. Before I begin my testimony, I would like to submit two recently issued audit reports for the record.

I share your concern that rural America be made a full partner in the information age. To that end, two reports issued by my office describe options for the RUS Administrator to stimulate rural investment and make better use of RUS loan funds. Funds made available through implementation of the reports' recommendations could be used to better connect rural communities to rapidly developing information technologies.

ELECTRIC BORROWER INVESTMENTS

We audited RUS electric program borrowers to determine the extent of their investment activities and the degree to which the borrowers invested in rural America. We discovered that RUS electric borrowers have not become major players in financing America's rural infrastructure, despite the fact that these borrowers hold almost $11 billion in total investments. Disappointingly, only one-half of 1 percent of this amount—about $61 million—is actually invested in rural America.

The Northern Virginia Electric Cooperative (NOVEC) provides a good example. NOVEC has borrowed about $129 million from RUS and holds $128 million in investments, none of which is classified as rural development. Among the electric coop's investments is a subsidiary called NOVASTAR—a company that is partnering with DISH Network and DIRECTTV to sell premium satellite TV services to the Northern Virginia and Metropolitan Washington, DC areas. I want to emphasize that NOVEC is not violating any laws by investing in satellite TV for a metropolitan area. However, I believe that encouraging RUS borrowers to invest more heavily in rural America makes good sense. The same dollar that provides satellite TV to the area right here on Capitol Hill could be used to bring much needed services to underserved communities in rural areas.

Unfortunately, RUS electric program borrowers, on their own, have not invested heavily in rural America. Instead, investment dollars are used for such things as money market certificates, stocks and bonds, and mutual funds. We recommended that RUS develop and implement a strategy to encourage electric borrowers to use some of their $11 billion portfolio to make discretionary investments in rural America. RUS has agreed to develop and implement policies and procedures to strongly encourage borrowers to meet the intent of Congress. This new strategy could promote investment practices to ensure the delivery of local television programming to subscribers of satellite television in rural markets. Through increasing investments for rural access to telephones, computers and the Internet, RUS electric borrowers could help close the "digital divide."

TELEPHONE BORROWERS WHO DO NOT NEED ASSISTANCE

In another recent audit, we identified 434 RUS telephone program borrowers with loan balances totaling $1.9 billion that appear to be in good enough financial condition to satisfy their credit needs from their own financial organizations or from other credit sources. Our findings echo and expand on conclusions reported by the General Accounting Office in a January 1998 report that detailed options to make the RUS telephone loan program more effective and less costly. GAO reported that some borrowers may retain loans longer than needed, and are therefore able to take advantage of the favorable terms provided by the Government. RUS continues to incur interest and other administrative costs in servicing the accounts of its financially healthy borrowers.

The law requires RUS to encourage and assist rural telephone systems to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial resources or from other sources. Our trend analysis of key financial ratios showed steady improvement in the telephone loan portfolio, and that half of RUS telephone borrowers are in strong financial condition. However, RUS does not have discretion to refuse a loan because a borrower is in strong financial condition, and the Rural Electrification Act is silent regarding loan graduation—that is requiring borrowers to move to private credit when they are financially able.

We recommended that RUS work with Congress to clarify policy regarding loan graduation and requiring financially strong borrowers to obtain credit from commercial sources. RUS disagrees with our recommendation.

RUS should seek clarification about loans to borrowers who do not need Government assistance. As decisions are made about funding rural America's move into the information age, it is important to remember that over half the RUS telephone loan borrowers may not really need government assistance. The money freed up could, perhaps, be better used in other ways. For example, preserving and enhancing access to local and network television signals is important to rural America's economy. As enunciated in H.R. 3615, local television, with its mix of crop reports, local news, weather reports, public service announcements, and advertisements for local business, is vitally important for rural development efforts.

According to the National Telecommunications and Information Administration, Americans living in rural areas are lagging behind that national average in computer and Internet access, regardless of income level. At some income levels, those in urban areas are 50 percent more likely to have Internet access than those earning the same income in rural areas. The $1.9 billion currently loaned to telephone program borrowers who do not need federal assistance could go far in closing the "digital divide."

SUMMARY

My office has identified two potentially important options for increasing the effectiveness of RUS loan programs. Electric program borrowers hold about $11 billion in investments that could be used to build technological infrastructure for rural America. Telephone borrowers, who could likely finance their operations privately, owe the Government $1.9 billion—money that could, with appropriate authority, be used to foster access to technology and the electronic media.

We are currently working on another audit that will address additional opportunities for RUS to increase its efficiency and, thus, its contribution to rural America. Thank you for inviting me here today to talk about our recommendations to RUS.

Mr. TAUZIN. Thank you, Mr. Viadero. The chair is now pleased to welcome Christopher McLean, the Acting Administrator of the RUS.

STATEMENT OF CHRISTOPHER A. McLEAN

Mr. MCLEAN. Thank you very much, Mr. Chairman. Thank you very much, Mr. Markey. As a former staffer of Senator Exon, who spent so many hours at this table working on the Telecom Act, it is a very honoring and humbling experience to appear in this capacity at this table as a witness.

If I may have my statement on the satellite bill inserted into the record.

Mr. TAUZIN. Without objection.

Mr. McLEAN. I would appreciate it if I could use my time to comment on the comments of the Inspector General. The Rural Utilities Service administers a $22 billion portfolio, telephone, electric and water. In many cases people say we're all wet; water, electric, telecommunications. We also administer distance learning and telemedicine programs.

And our program is not to be a lender of last resort, in differentiation from other programs within the Department of Agriculture, perhaps like rural housing or rural business. The purpose of our program is to help roll out the most advanced, the best, highest quality, the most affordable service to rural America.

And we want telecommunications companies and co-ops to be in our program, because to be part of the RUS program you accept responsibilities to comply with State modernization; that you comply with RUS engineering standards; that you comply with civil rights obligations; that you limit your charging of high connection fees, one of the biggest barriers to service in rural America; that you commit to area wide coverage; and that you restrain yourselves from charging zone and mileage charges, in other words having a higher rural rate.

Now, since I left my position in the staff of the United States Senator, I have worked in the RUS as Deputy and now for the last several months as Acting Administrator. And as I traveled across this country I have not met a single customer of an RUS financed system who wishes they could be served by one of the large telecommunications companies that serves rural America.

Nobody wants to trade places the other way from an RUS. People come to us and say, how can we get that quality of service into my community that's not served by an RUS borrower? The same situation in the electric program. The RUS family of co-ops have higher reliability rates than their counterparts in the investor owned utilities.

The RUS program has encouraged economic development, and I accept the Inspector General's request that we redouble our efforts to encourage more investment in rural economic investment, although I think he went a bit too far in his statement that rural electrics are not investing in rural infrastructure.

Anybody who visits rural America and sees telecommunications, the distance learning, the water projects, that rural electrics and rural telephone companies are investing in their communities, and the scholarship programs that they've put together for their kids, they know that that's not a true statement.

Now, in the Northern Virginia example that Roger used, we at the RUS have been working very closely with the auditors of the Inspector General to try to explain the multi-layered system of cooperatives. Cooperatives are owned by their members. And in the $127 million of investments cited by the Office of Inspector General, and that was included in their exhibit, $56 million of those assets are patronage capital from the distribution co-op, from their generation of transmission capital, their generation of transmission cooperative.

This is not cash that's available to be invested. Five million dollars are the capital investments in the National Rural Utilities Cooperative Finance Corporation, a private sector cooperative owned lending institution that helps finance supplemental private sector lending to leverage RUS investment, to do exactly the kind of thing that Roger is asking us to do in our program. That is not cash that is available.

There's $12 million on the balance sheet of Northern Virginia Power for prepayment of their power bills. That was a very smart thing to do. They invested $12.7 million to prepay their power. Now, we're having a demonstration here on Capitol Hill from truckers who, if they could have prepaid $12 million of oil and energy, they would not be demonstrating today.

We want to work with the Office of Inspector General to make our program as good as it can be. But if you evaluate the fundamental criticism in both of these reports, it's that we are lending to institutions that are too financially strong.

Now, to make the record clear, in the telecommunications program, 50 years of experience, there has not been one writeoff in the telecommunications program. There have been writeoffs, I shall acknowledge, in our electric and water programs. The serious problems have been concentrated in nuclear investments that go back over 20 years. But the record of this agency and the record of this administration in running a program that fosters rural economic development is very good.

And I will work closely with Roger in my new position to make sure that we're making this program as good as it can be. But I do think that there is not one dollar of RUS loans that are not going toward rural electric infrastructure or rural telecommunications infrastructure or water infrastructure.

[The prepared statement of Christopher A. McLean follows:]

PREPARED STATEMENT OF CHRISTOPHER MCLEAN, ACTING ADMINISTRATOR, RURAL UTILITIES SERVICE, U.S. DEPARTMENT OF AGRICULTURE

Mr. Chairman, it is an honor to testify today on HR 3615, which authorizes a new loan guarantee program to finance the delivery of local television programming in rural and small markets. The United States Department of Agriculture (USDA) appreciates the Committee's concern, both in the existing coverage of rural access to local broadcasting and the possibility that developing technologies can broaden that problem.

The Rural Utilities Service (RUS) is a rural development agency of USDA. We administer a $42 billion loan portfolio of more than 9,000 loans for telecommunications, electric and water and wastewater infrastructure projects throughout rural America. Our agency also administers the Distance Learning and Telemedicine loan and grant program and is a leading advocate for rural consumers before federal and state regulatory bodies.

RUS RECORD OF SUCCESS

For nearly sixty-five years the REA and RUS have been empowering rural America. Just this last October, the RUS telecommunications program celebrated its 50 th anniversary. In those fifty years, the RUS telecommunications program has helped close the digital divide in rural areas. The telecommunications program has maintained an unprecedented level of loan security over the history of the program.

Since 1993, the RUS has financed more than $1 billion in fiber optic facilities and more than $725 million in digital switching for telecommunications companies and cooperatives serving rural areas. In 1999 alone, RUS provided nearly half a billion dollars in financing for rural telecommunications infrastructure. In addition, since its inception in 1993, the RUS Distance Learning and Telemedicine (DLT) program has provided $83 million in funding to 306 projects in 44 states and two territories.

The RUS is fortunate to have an accomplished corps of engineers, accountants, financial specialists and rural infrastructure experts. I am confident that the RUS has the necessary skills to administer new initiatives that will bring the benefits of the information revolution to all America.

THE NEED FOR LOCAL ACCESS

For America's rural residents, access to television signals has long been a challenge. Distance and geography have been significant impediments to the reception of consistently viewable broadcast signals. While cable television is available in many rural towns, it does not reach America's most rural citizens.

Since its inception, satellite delivered television and now direct broadcast satellite services have provided increased access for all communications services to rural residents. Satellite television gave America's many rural residents first time access to vital sources of news, information, educational programming, entertainment and sports. As good as these services were, satellite services did not connect rural residents to their local communities.

The 1999 amendments to the Satellite Home Viewers Act (SHVA) dramatically changed the dimensions of satellite service by giving carriers the right to deliver local television signals to viewers via satellite. However, that legislation limited the ability of these carriers to deliver distant network programming to consumers.

Since the enactment of the SHVA amendments, satellite broadcasters have announced significant new initiatives to provide local signals to viewers. Current satellite carriers are offering "local to local" service primarily to larger urban markets. There is little evidence that under current conditions significant "local to local" offerings will be made in the markets below the 40 largest markets. The smaller the market, the more rural residents will be affected.

Once the amendments to SHVA are fully implemented, many rural residents will likely lose their ability to purchase distant network signals. Many will still be unable to receive a suitable signal via antennae from their local broadcaster. Given the capacity limitations of current satellite providers, and the cost of nationwide local to local service, it is doubtful that current carriers will provide local signals to many smaller markets.

The availability of local programming will become more problematic as the television industry converts to a digital system of signal delivery. The propagation of digital signals is different from analog signals. Analog signals fade out with distance from the transmitters. Digital signals drop off suddenly. The likely result is that some current rural viewers of broadcast television may lose their ability to receive a viewable signal once the conversion to digital is complete.

Without the ability to retain and perhaps expand their viewer base, rural broadcasters may not have the financial ability to upgrade their systems. Once digital conversion is complete, the technology will make it likely that rural viewers will be able to receive fewer channels over a conventional TV antenna than currently available in analog mode.

ENSURING PUBLIC SAFETY

Access to a full range of news, weather, sports, entertainment and information is certainly important to maintaining and enhancing quality of rural life. But maintaining and expanding access to the most local sources of news, weather and information is critical to rural public safety. The 1999 violent tornado season, and recent weather events such as this year's back to back winter storms in the South and East, highlight the importance of local television as a means of disseminating life saving information.

Linking local residents to their communities of interest is also important to maintaining and enhancing the vitality of the local rural economy and civic life. From both an educational standpoint and one of public safety, it is in the public interest that rural citizens have access to local and network programming. Rural America should not fall into a new digital divide: either as a result of the amendments to SHVA or the coming conversion to digital television. The infrastructure necessary to deliver "local-to-local" programming can also be a platform for other needed services such as broadband internet access, weather radio signals, and educational programming.

LOAN GUARANTEES

The delivery of local signals to rural viewers will require significant infrastructure investment, regardless of the technology utilized. RUS loans, loan guarantees and grants have helped bring modern electric, telecommunications, and water infrastructure to the 80 percent of America that is rural. This public-private partnership has been the hallmark of rural infrastructure investment. RUS is capable of helping rural America meet this new infrastructure challenge.

We believe HR 3615 is a step in the right direction and look forward to working with the Committee to fully develop a loan guarantee program that is technologically neutral, includes eligibility for broadband investments, expands consumer choice, and is consistent with Federal credit policies, consistent with OMB Circular A-129.

CONCLUSION

Preserving and enhancing access to local and network television signals is important not only for rural quality of life, but is vital to rural public safety and community. Linking rural viewers to more local signals will also enhance the economics of rural broadcasting and their rural advertisers. In addition, the infrastructure necessary to deliver "local into local" services, regardless of mode, can bring new broadband capacity to rural areas. Just as the Rural Electrification Administration helped rural America become part of the national economy, the Rural Utilities Service can help rural America thrive in the information age. The Administration looks forward to submitting to you in writing at a later date more detailed comments.

Thank you Mr. Chairman.

Mr. TAUZIN. Thank you, Mr. McLean. And our final panelist, Mr. Kent Parsons, vice president of the National Translators Association.

Mr. PARSONS. If you'll pass him a mike, please. You've got two of them now. You've got a bigger loan than you needed there, Mr. Parsons.

STATEMENT OF R. KENT PARSONS

Mr. PARSONS. Thank you, Mr. Chairman. I hope this small voice from a farm boy in Utah has a different perspective here than what I have heard. By introduction, by way of introduction, my name is Rollo Kent Parsons. I am 67 years old and live in Monroe, a small, rural community of 1,600 people located in the south central mountain valley of Utah.

For 43 years I have been involved in the installation, repair, and engineering of television translators—in this hearing today I've never even heard that word mentioned—and am currently Vice President of the National Translator Association, a nonprofit volunteer organization dedicated to the preservation and extension of free over-the-air television and FM radio for all parts of the country.

I think I qualify in this position of being a rural person, as it takes me 3 hours of driving to get to Salt Lake City to the airport, or 4½ to Las Vegas.

Mr. TAUZIN. Mr. Parsons, we always say in this House that you live in the country if you have to drive toward town to go hunting.

Mr. PARSONS. We appreciate this opportunity to briefly outline the regulatory issues that have prevented broadcast translators from reaching their full potential in bringing a full measure of free over-the-air television to rural America. The issues of most concern to the NTA are the infrequency of filing opportunities or windows and the subsequent delay of approval bought on by the disproportionate number of applications that result; the impact of new technologies on this process; and the preservation of free over-the-air television to viewers in rural areas.

Since 1980 there have been five 5-day opportunities to file for permanent TV translator licenses, the most recent being in the spring of 1994. We believe that the implementation of a fast track authorization program would greatly simplify and expedite license applications for the underserved rural areas on an ongoing basis.

The NTA filed a request for such a rulemaking in March 1998, titled New Fast Track Authorization For Very Small Output Power Rural Translators. If this rulemaking could be expedited immediately, the burdens placed upon the regulatory agencies would be considerably lighter, and would give those agencies more time and resources to devote to the full range of issues related to the current technologies and their impact on the telecommunications industry as a whole.

The following chain of events has occurred that have significantly impacted the providing of free over-the-air television to rural communities. It began in 1955, when the FCC initiated a new television service to allow TV translators to provide television to rural areas located beyond the direct coverage of the primary stations. This service was called secondary service, to protect the primary stations from any interference which may be generated by the new translator stations. These stations were authorized to operate on channels 70 through 83.

In 1978 or thereabouts, the FCC initiated a rulemaking which assigned the channels 70 through 83 for a new cellular telephone service, which required TV translators operating on those channels to change to a different frequency in the range of the authorized channels of 55 to 69. At that time there were approximately 3,500 translator stations in operation providing local broadcast television to the Continental United States.

Within 2 years translators were assigned to operate on any vacant channel in the 2 to 69 range, subject to very stringent interference criteria. Low power television services, a plan to help TV translators provide some local programming to these underserved areas, was in development at this time, and licensing and administration of this new service was combined with the older translator licensing process. In 1980 the FCC declared a freeze on all applications for new and modified TV translator stations that lasted 6 years, until 1986.

In 1987, a 5-day filing opportunity was opened for filing new applications to include both services, LPTV and TV translators, which included modifications for existing licensed stations. After another 2-year freeze, additional opportunities for new translators were opened in 1989, 1991, 1992, 1994, and an additional window was opened in 1996 for modification to existing stations only.

Only five new filing operations have been available in the past 20 years. Many communities still do not have access to some of the major networks and local independent primary stations, even though there are 6,000 authorized TV translators now serving rural communities. New technological issues, such as digital television, the May 10, 2000 auction of channels 60 through 69, the proposed auction of channels 52 to 59, add to the pressures put on the regulatory agencies.

We are concerned that free over-the-air broadcast television will become increasingly lost to rural America as a result of the congressionally mandated transition to DTV. There has been no provision whatsoever to include translators in the DTV transition. These communities depend on translators for local weather bulletins such as tornado alerts, high wind warnings, fire information, floods, et cetera.

While it is certain that the new technologies will produce many new opportunities, a larger question looms. Can the small, rural communities afford it? The new satellite local to local has provided some local broadcast signals to those who can afford it. The rest of the rural viewing audience without translators must pay or go without. At this time translator stations are the only viable method to serve these people with free over-the-air television.

If Congress and the FCC are concerned about the people living in the rural areas relying on free over-the-air broadcast signals for critical local information, they must provide ways to help not only retain the present NTSC signals, but also ways to help in the transition to the new digital world. The NTA recommends a method to simplify and expedite license applications—is that my time?

Mr. TAUZIN. No, that goes off when Members of Congress need to go to the House and vote.

Mr. PARSONS. Okay—applications for rural underserved areas on an ongoing basis through their proposed rulemaking. The Fast Track Authorization For Very Small Output Translators specifically addresses the needs of the grassroots people. We believe free local over-the-air broadcasting must prevail in all parts of rural America through the continued expansion of TV translator stations. To require secondary service to go to auction is counterproductive to these communities.

I'm about through here. Personnel at the FCC have been extremely helpful and cordial in the processing of our TV translator applications, as far as policy allows. We extend our thanks to these individuals. And as I looked at the State of Utah on the panel there that was portrayed, I must say at this time 99 percent of the people of the State of Utah have access to at least five networks, free, over-the-air.

Thank you.

[The prepared statement of R. Kent Parsons follows:]

PREPARED STATEMENT OF R. KENT PARSONS, VICE-PRESIDENT, NATIONAL TRANSLATOR ASSOCIATION

INTRODUCTION

My name is Rollo Kent Parsons. I am 67 years old and live in Monroe a small, rural community of 1600 people located in a south-central mountain valley of Utah. For 43 years I have been involved in the installation, repair, and engineering of television translators, and am currently vice-president of the National Translator Association (NTA), a non-profit volunteer organization dedicated to the preservation, and extension, of free-over-the-air television and FM radio for all areas of the country.

We appreciate this opportunity to briefly outline the regulatory issues that have prevented rebroadcast translators from reaching their full potential in bringing a full measure of free-over-the-air TV to rural America.

The issues of most concern to the NTA are: (1) the infrequency of filing opportunities or "windows" and the subsequent delay of approval brought on by the disproportionate number of applications that result; (2), the impact of new technologies on this process; and (3), the preservation of free-over-the-air television to viewers in rural areas.

FILING OPPORTUNITIES OR "WINDOWS"

Since 1980, there have been five, five-day opportunities to file for permanent TV translator licenses, the most recent being the spring of 1994. We believe that the implementation of a "Fast-Track" authorization program would greatly simplify and expedite license applications for under-served rural areas on an ongoing basis. The NTA filed a request for such a rulemaking in March of 1998 titled "New Fast-Track Authorization for Very Small Output Power Rural TV Translators". If this rulemaking could be expedited immediately, the burdens placed upon the regulatory agencies would be considerably lighter, and would give those agencies more time and resources to devote to the full range of issues related to the current technologies and their impact on the telecommunications industry as a whole.

IMPACT OF NEW TECHNOLOGIES

The following chain of events has occurred that have had significant impact on providing free-over-the-air television to rural communities.

In 1955, the FCC initiated a new television service to allow TV translators to provide television to rural areas located beyond the direct coverage of the primary stations. This service was called "secondary service" to protect the primary stations from any interference which may be generated by the new translator stations. These stations were authorized to operate on channels 70-83.

In 1978, the FCC initiated a rulemaking which assigned channels 70-83 for a new cellular telephone service, which required TV translators operating on those channels to change to a different frequency in the new range of authorized channels, 55-69. At that time there were approximately 3500 translator stations in operation providing local broadcast television to rural areas in the continental United States. Within two years, translators were assigned to operate on any vacant channel in the 2-69 range, subject to very stringent interference criteria. Low Power Television (LPTV) Services, a plan to help TV translators provide some local programming to these under-served areas was in development at this time, and the licensing and administration of this new service (LPTV) was combined with the older translator licensing process. In 1980, the FCC declared a freeze on all applications for new or modified TV translator stations that lasted until 1986.

In 1987, a five-day filing opportunity was opened for filing new application s to include both services (LPTV and TV translators), including modifications for existing licensed TV translator stations.

After another two-year freeze, additional opportunities for new translators were opened in 1989, 1991, 1992, and 1994, and an opportunity for modifications to existing stations only was opened in 1996.

Only five new filing opportunities have been available during the past 20 years. Many communities still do not have access to some of the major networks and local independent primary stations even though there are approximately 6,000 authorized TV translators now serving rural communities.

New technological issues, such as digital television, the May 10, 2000, auction of channels 60-69, and the proposed auction of channels 52-59, add to the pressures put on regulatory agencies. We are concerned that Free-Over-The-Air broadcast television will become increasingly lost to rural America as a result of the congressionally mandated transition to DTV. These communities depend on the translators for local weather bulletins, such as tornado alerts, high-wind warnings, fire information, and floods, etc.

While it is certain that new technologies will produce many new opportunities, a larger question looms—Can the small, rural communities afford it? The new satellite "local to local" has provided some local broadcast signals to those who can afford it, the rest of the rural viewing audience without translators must pay or go without. At this time, translator stations are the only viable method to serve these people with free-over-the-air television.

RECOMMENDATIONS

If Congress and the FCC are concerned about the people living in rural areas, relying on free-over-the-air broadcasting signals for critical local information they must provide ways to help not only to retain the present NTSC signals, but also ways to help in the transition to the new digital world.

The NTA recommends a method to simplify and expedite license applications for rural under-served areas on an ongoing basis through their proposed rulemaking,—Fast-Track Authorization for Very Small Output Power Rural TV translators. This document specifically addresses these needs of the "grass roots people".

We believe local free-over-the-air broadcasting must prevail in all parts of rural America through the continued expansion of TV translator stations. To require secondary service to go to auction is counterproductive to the needs of these communities.

Personnel at the FCC have been extremely helpful and cordial in the processing of TV translator applications as far as policy allows. We extend our thanks to those individuals.

EXHIBIT E 1

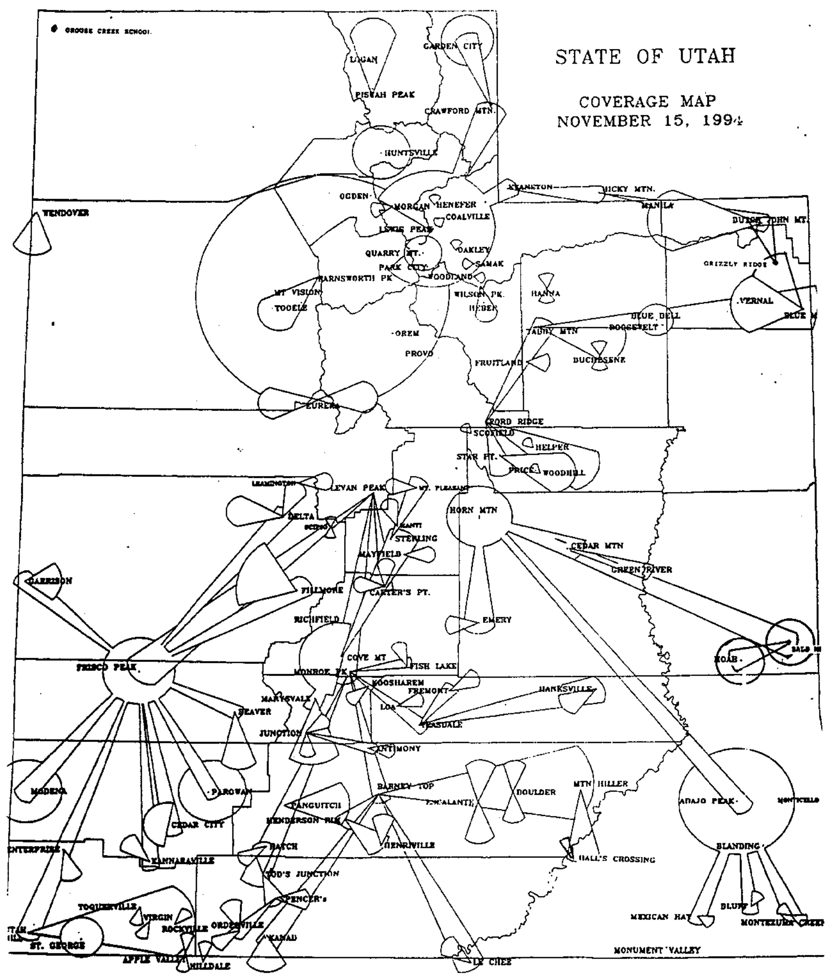
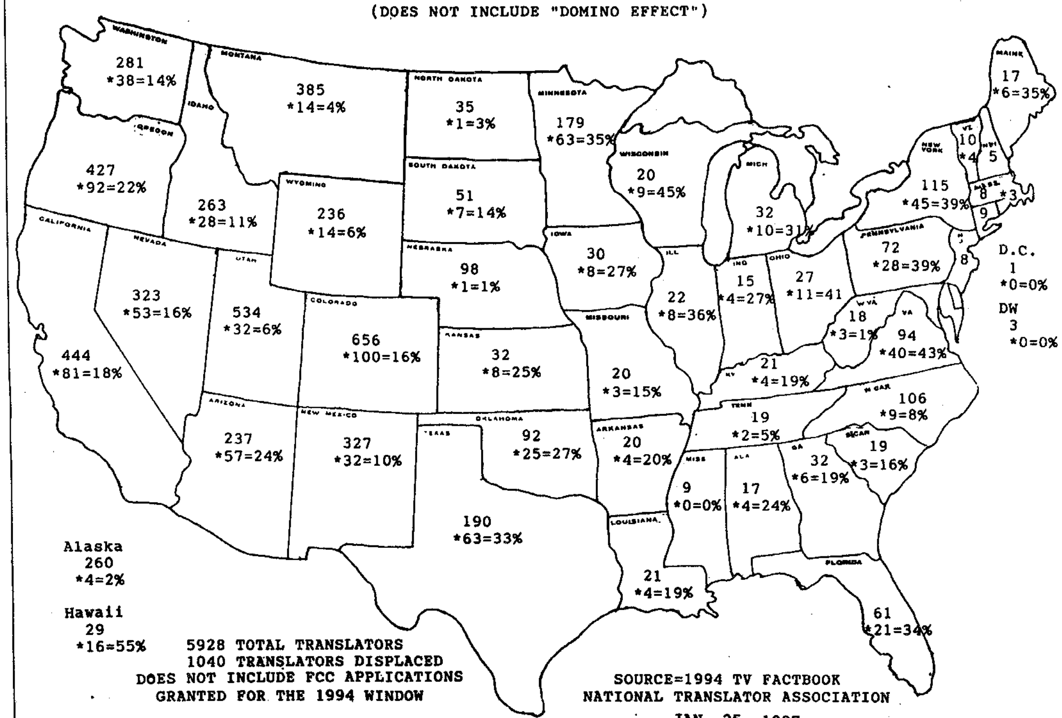


EXHIBIT E 2

LICENSED TV TRANSLATOR STATIONS IN THE U.S.
* CHANNELS DISPLACED ABOVE CHANNEL 59
(DOES NOT INCLUDE "DOMINO EFFECT")



Mr. TAUZIN. Mr. Parsons, thank you.

The Chair recognizes himself. I'll do a round of questions, and we'll try and get a second one in, then we'll take a break for the vote.

Let me first of all, Mr. Parsons, tell you that I think you put your finger on something, that while we're talking about getting local into local satellite service, one of the most important things I think we need to keep our eye on is whether or not people have the option of free over-the-air service as a first option, because the first choice for consumers ought to be whether they get a free signal or they want to buy a signal from a company that's carrying a cable or a satellite signal that wants to sell it to them as an option.

And so my first question is, why all these freezes? Why hasn't the FCC been more accommodating to the request of your members to put out more translators and deliver more on-the-air signal opportunities to rural Americans?

Mr. PARSONS. I'm not certain about that. We have made repeated requests. We met with the FCC commissioners 1 on 1 a year ago.

Mr. TAUZIN. What do they tell you when you meet with them?

Mr. PARSONS. That we provide a very special cause to the rural people, and it is something that should be done.

Mr. TAUZIN. So they blessed you on the way in and blessed you on the way out, but you got no relief?

Mr. PARSONS. I have no comment.

Mr. TAUZIN. Bottom line is that you offer us an opportunity that perhaps, Mr. Goodlatte, we need to look at, in terms of what we do in this bill, to ensure both elements, as you have correctly pointed out, not only those persons who have no access, the 1 remaining percent in Utah and others, but for the citizens in other states who are left out of any access to local signals because there is no choice for free signals.

Mr. PARSONS. Let me make a comment here, what's happening. We have some small communities—you talk about REA, I live in a community that happens to be an REA, and my son was on the City Council, and they talked about having their own local cable system, but this is starting to create a problem, because I'm thinking of a small community just north of me, that the community owns their own cable system because it's too small for the big players to come in.

As they drop off—there's five stations that come out of Salt Lake on the satellite now, five locals. But as people drop off, the number of members on that small cable system starts to deplete their revenue, and so now it's getting to the point whether the cable system will stay on or not.

Mr. TAUZIN. The second part of this bill is connected to cable programming. I mean, one part of it should be designed to make sure nobody is left out in the whole system of coverage. The second point is competition for the cable programming together with the local programming. Customers obviously do like cable programming. There's a growing number of Americans who choose to watch cable over network programming.

In that instance, now, Mr. Goodlatte, what we're hearing in terms of Mr. Viadero's testimony is that the co-ops that are serving America for telephone and electric do have apparently an awful lot of money loaned to them by the government from RUS in some cases that is in excess of their needs, apparently, because they're using it for other investments.

Can we get some comment from you on that criticism of the bill and the question that Mr. Largent and others asked, why should we loan them more money if they already have money they're investing in the stock market?

Mr. GOODLATTE. Mr. Chairman, first, if I might join you in observing that Mr. Parsons's comments are very apt.

It's our belief that the bill would allow the resources to be used for translators. But if for any reason there needs to be clarification put into the legislation that they could also avail themselves of this, we certainly would be supportive of that.

Mr. TAUZIN. Well, as I understand it, they're not a multi-channel system provider, so they may not qualify. Second, it looks like an FCC problem we may need to address in the legislation as well. But I like your comments on—this is one of the central tenets of the debate here. Should the government authorize another $1.25 billion of loans to provide this service to rural Americans, either to unserved or underserved areas? And we've seen audits saying, look, we're loaning money to the rural electrics and telephones and they don't need it, they're investing it in the stock market, so why don't you use that money to do this job.

What's your answer to that?

Mr. GOODLATTE. Well, the answer I think is that first of all, working with the CBO and later the Appropriations Committee in terms of coming up with whatever funding is necessary to fund the loan guarantee based upon what the risk may be, we will be looking to many sources for the purpose of doing that. And again, I think the question of whether or not the RUS is making loans and allowing loan guarantees in areas they may not be needed is something that we can certainly look at.

Mr. TAUZIN. It could be one of the offsets.

Mr. GOODLATTE. Absolutely. But one of the points that I think needs to be made is that this simply is not going to happen for a large portion of America, including some significant sized cities, unless Congress does get involved with this legislation. So I don't think you can simply say we'll sit back and watch money that is already out there flow into this area. It's going to require legislative authorization to do that.

Mr. TAUZIN. Before my time expires, your map indicating the places where local to local is going in identified the sites of the cities, but it did not outline the DMA, the service area of that local into local. It would be interesting to see that map, to see how much local into local coverage is going to occur from the cities in which the service will be provided. And we probably need to look at that.

Mr. Parsons.

Mr. GOODLATTE. Mr. Chairman, can I just comment on that? That is absolutely correct. Some of those circles would actually be smaller than they appear on the map, and some of them would be somewhat larger. But I think as a representation it is fairly accurate. But certainly some of those television markets are a bigger circle.

Mr. TAUZIN. The DMAs are pretty large. That's why I'm saying we probably ought to look at that in terms of getting a good picture at what local into local is going to provide under current law.

Mr. Parsons.

Mr. PARSONS. Yes, it might be well to note that the Salt Lake City market presently is number 36. If we remove the translators, it goes to 42.

Mr. TAUZIN. Mr. Markey is recognized.

Mr. MARKEY. Thank you very much. Mr. Goodlatte, do you believe incumbent cable operators should be eligible for the loan guarantee?

Mr. GOODLATTE. The way the bill is written now, we do not discriminate against any form of technology.

Mr. Markey. I'm only talking about where the cable companies—where it is already the incumbent. Where it's already providing service, would you give them subsidies, not where they're not providing services.

Mr. GOODLATTE. Where they're already located——

Mr. MARKEY. They also have a license in a community. Would you give them a subsidy?

Mr. GOODLATTE. I would think it would not be necessary to do that.

Mr. MARKEY. Okay. Good. The bill allows loans to entities to, quote—this is in the bill—finance the acquisition, improvement and enhancement, construction, deployment, launch, or rehabilitation of the means, including spectrum rights, by which local television broadcast signals will be delivered to an area. That's the end of the quote in the legislation.

When the bill says the loan can be used for the acquisition of spectrum rights, does that mean we would extend loans to people to bid at FCC auctions?

Mr. GOODLATTE. That's correct. The loan guarantees—in other words, we're not going to give a loan to anybody, we're going to make a loan guarantee to somebody to——

Mr. MARKEY. I appreciate that. But they——

Mr. GOODLATTE. They've got to require the spectrum. If an auction is the only way they can get the spectrum, this is not going to work unless you can put the whole package together, not just the physical plan, but also——

Mr. MARKEY. But we have auctions where some people have loan guarantees getting in and other people wouldn't have loan guarantees getting in. We just had a C block, I don't know if you're familiar with it, it was a debacle, people thought they could get in kind of a cheap money, bidding up the price because they had some longer period of time. Do you support loans that people—you do support loans that people can use at auctions.

Well, I think that, you know, in summary, Mr. Chairman, the argument made to immediately deregulate small cable systems in 1996 was that they need to be deregulated so that they could invest in the system upgrades. I think—I know that many of these cable companies would like us now to give them loan guarantees to help them to upgrade. I think that would be a bad policy. I don't think we should be doing that.

But I can work with something that, you know, again, dealt with the unserved areas of the country. But something that is more than that gets much more difficult. Thank you.

Mr. TAUZIN. Thank you. I'm going to put Mr. Shimkus in the chair. I'll go and vote. Mr. Shimkus will be in the chair, and we will have a round of questions with you, and John, if you can get the witnesses to talk until we get back. Thank you, sir.

Mr. SHIMKUS [presiding]. Thank you, Mr. Chairman. Give me a minute to get organized. Any time I get a chance to get into the seat of responsibility, I try to do that. Also accountability, sometimes. So you have to be careful. Let me go to—it was CBO that put up that map, that's correct? I'm sure you're going to hear this from a lot of my other colleagues, and I know your assistant was cringing when I made all these facial expressions, because, you know, the FCC is using the contour A and contour B as a protractor, correct? A delineation—do you know that?

Mr. CRIPPEN. Yes.

Mr. SHIMKUS. And the basic assumption is that we take a protractor, put it on the tower, spin it around, everybody within that grade A has perfect signals, everybody in the grade B has "should be able to receive" signals. Well, I'm going up tomorrow afternoon to Baylis, Illinois. Now, Baylis is situated definitely in that red area. I mean, the whole county is in that red area. It is probably 60 miles north of St. Louis, probably 35 miles southeast of Quincy, which has a local TV station, probably 65 miles southwest of Springfield.

Obviously they have no reception. I assume this would be—well, that's actually the Illinois River. I'm an old Army officer who trudged up a lot of hills. I understand contour and contour intervals. If you're using that as an—I just think that's a bad map to try to make your case, because what you'll find out is most of us who hear constantly from our constituents have areas based upon the contour that are not receiving signals.

And I would ask for you first if you would talk to me about if you did any consideration on the actual signal strength. And I'll follow up with, we have had numerous discussions with the FCC through this committee to talk about how do you really judge signal strength. And I think we've actually, in the bill, asked the FCC to assure how we can better identify those red areas.

And I think you would see, once they do that, a very different perspective about who is served and who is not served.

Mr. CRIPPEN. I think there are at least a couple of questions in there. One, I understand the problems in parts of the contours. In fact, the Chairman and I share an interest, if you will, in occasionally going out to Maryland's Eastern Shore, and it turns out that we are in a grade B contour and can't receive much over-the-air unless conditions are perfect.

Mr. SHIMKUS. Can I chime in? So those red areas are grade A and grade B combined?

Mr. CRIPPEN. Yes. I mean, they're on top of each other.

Mr. SHIMKUS. Grade B encompasses grade A.

Mr. CRIPPEN. Sure.

Mr. SHIMKUS. So you're saying they don't have a signal, although in the introduction you're making the claim that everyone but the red has no signal.

Mr. CRIPPEN. The point is not to speak to the desirability of the bill; rather, in our assessment of whether or not you're going to have a lot of people take this service, is it economically viable.

Mr. SHIMKUS. But you're making the assumption——

Mr. CRIPPEN. First, 97 percent of television households are served by cable. So they have available some form of local signal already by a multi-channel distributor. And most of the country, if not all, and some of the grade B contours don't get very good signals. But most of the country also has over-the-air.

So again, we're not speaking to the desirability of the policy. Rather, we're talking about the economics of the venture and about whether many of the people who get over-the-air will be willing to pay for satellite service. People who have cable, would they be willing to switch? That's the point we're trying to make, not that there's perfect coverage or that there's no need for the bill.

Mr. SHIMKUS. You're going to hear this today over and over again, because first of all, in my area, you go to Calvin County, there's no cable coverage there. And then if there is, there's no choice. And the whole emphasis of the satellite bill, the Satellite Home Viewer Act, was to make sure we had competition for cable and competition that would carry a local signal. So——

Mr. CRIPPEN. As I said, there are two objectives to the bill. One is to serve what would in Mr. Markey's terms be unserved, the places that don't get signals now, they may be in grade B, they may be in the red. The second is to instill competition, whatever multi-channel distributor is now there. The question, though, in terms of policy is, do you want to subsidize competitors through existing incumbents? I mean, that's up to you.

The point we're trying to make is not about the efficacy of the policy, but rather, if there's competition there, then trying to break into that market is going to be much harder. There's a limit on prices. You'll have to get people to convert from something they now use to something new.

The complaint that you're hearing from many of the constituents and that I've had some members show me in their mail—and I've had this experience myself—is that you can't get network programming over a satellite, because the local broadcaster won't give you a waiver, despite the fact that you're in a contour where you can't get it. I see what's happened to us in Wingate, Maryland.

Mr. SHIMKUS. My point is you discredit your argument by using that map, for those of us in rural areas who have constituents who are living inside the red area that have no choice and they have no signal.

Mr. McLean, do you want to add to this?

Mr. MCLEAN. Thank you. And the situation is going to get even more complicated as we proceed with digital conversion, because the propagation of a digital signal is that it drops off suddenly, whereas an analog signal fades out gracefully. One of the reasons that Congress enacted the Satellite Home Viewer Act improvement was that the grade B contour which was determined by a court in

Florida to be good enough was at that time of the legislation considered to be 50 percent of the signal 50 percent of the time.

And when you go to digital, you will either have a signal or no signal. So it's going to be even more complicated, looking 60 years into the future.

Mr. CRIPPEN. Mr. Chairman, that really doesn't have anything to do with our point. Our point is simply there is competition, and there are services available, cable in 97 percent of the households, large areas of the country, most of the viewers in the country can get over-the-air. And that's what drives our estimate; again, not whether or not you pass this bill, whether the policy is right or anything else, but it has to do with how we come up with the estimate.

Mr. SHIMKUS. Thank you. My time has expired.

Mr. Boucher, for your sake, I've gone over the map quite extensively. I'm sure you had concerns about that also. And so you are recognized for 5 minutes.

Mr. BOUCHER. Thank you. Mr. Crippen, welcome.

Mr. CRIPPEN. Thank you.

Mr. BOUCHER. I appreciate your testimony this morning. I do have some differences with your conclusions. I live in a mountainous region of the western part of Virginia, and my constituents in huge numbers cannot get any local signals. They may live within the grade B contour of the local stations, but they're blocked by the mountains from getting the signals at all.

And those who can get signals usually find that they're not viewable. And so one of the best things that happened in my region over the last decade in terms of the ability to get television programming of any kind was the advent of the 1988 Home Satellite Viewer Act. And in that, people who could not get adequate local TV signals from the station were able to subscribe to the network programming delivered by satellite.

I notice in your testimony you say that—and by the way, my district is not unique. The entire State of West Virginia is affected by the same concern. I don't see that highlighted on your map. Western North Carolina, eastern Kentucky, I daresay parts of the Ozarks, the Allegheny region, much of the eastern United States is in exactly the same condition.

That 1988 Satellite Home Viewer Act is instructive for a couple of reasons, one of which is that while some households subscribed to the distant network signals that clearly were not eligible to do so, there were millions of households around the country that subscribed to distant network signals over the satellite that were eligible and are eligible today. And these are the homes that live in rural areas.

I note in your testimony you say that for the services to be subject to this loan guarantee, to be viable, and for those programs to succeed and not wind up costing the government money, there would have to be millions of subscribers to the service.

And I would suggest to you that there are going to be millions of subscribers. You can start with these millions who are eligible to get network signals delivered by satellite under the Home Satellite Viewer Act. Given the choice of being able to get their local TV signals by satellite, as compared to distant network signals by satellite, the vast majority of them would opt to get the local TV signals, for the reasons that many have indicated today in terms of the importance of local television.

There's another source for those millions of subscribers that you say would be required, and that is people who are subscribing to cable television today throughout the balance of rural America and in the medium sized cities and in the small cities across the U.S. Who will not be receiving the local into local service offered by the commercial companies. These will be the people who will be part of the primary audience for the local into local service that will be subject to these loan guarantees.

I wonder if in compiling this estimate you have looked at the phenomenal rate of growth in the DBS industry just over last several months. I really wonder if you have examined that. One of those companies in 1988 had a market capitalization of $9 billion. Last year it had a market capitalization of $29 billion. Why? Because Wall Street believes these services are going to grow phenomenally. One of the reasons for that, one of the major reasons is the ability to offer local into local service.

Do you happen to know the rate of growth in subscribers per month of these major DBS companies today? Do you know that figure?

Mr. CRIPPEN. I wouldn't. But it's——

Mr. BOUCHER. I can tell you what it is. It's 100,000 per month. The fact that you don't know what that figure is suggests to me that you haven't adequately examined the circumstances that underlie your conclusions, because that rate of growth is directly related to the advent of the new local into local service.

Mr. CRIPPEN. That may well be, which suggests that Wall Street will probably finance into rural areas, because if it's worth it——

Mr. BOUCHER. I haven't suggested that, Mr. Crippen. That's not a reasonable extension of a conclusion from what I've said, either.

Mr. CRIPPEN. If I can respond to your comments so far—some of the comments you made about the available audience base, for example—if the current people who are getting satellite signals want to get local signals, 97 percent of them have the ability to subscribe to cable, so they could take it from cable.

Mr. BOUCHER. That's not true, Mr. Crippen. You simply don't understand the market. I'm sorry to say that, with all due respect, you just don't understand the market. In my district, which I'll cite as the example, most of the people can't get cable. Why? Because it doesn't extend out beyond the towns.

All of America is not towns and cities. A vast part of America is rural terrain where cable services are not provided. In my Congressional District most of the people cannot subscribe to cable. Well over half of the people there can't get cable. Those same people cannot get local TV stations, and in large part because of the mountainous terrain. Much of rural America is exactly like that.

Let me come back to my other point, if I may, and that is that you I think in constructing this analysis have undervalued the attractiveness of the new local into local service. Let me underscore again for you that this tremendous rate of growth of 100,000 per month for each of the major two DBS companies and their subscriber base reflects the power of that new service.

And I would hope that you would go back and reconsider your estimates in light of what is happening today in the market with regard to what now amounts on an annual basis to about 2 million people per year largely deserting cable and signing up with the DBS services driven by the new local into local service. I would hope you would consider that and perhaps rethink your estimate as to what the success of the services subject to this loan guarantee would be.

Mr. Chairman, my time has expired. I thank you for your patience.

Mr. CRIPPEN. Mr. Chairman, may I respond? The point is, Mr. Boucher, 97 percent of the households in this country are passed by cable. That's not in your district; I understand that. But what we're talking about is the economic viability of a very large loan program. Residents of your district who might subscribe are not going to be enough to support this venture in a financial way, which is precisely why we're here.

If the market were able to support this activity, we wouldn't need a loan guarantee. But again, that's not to argue this is not the right thing to do or it's inappropriate. Rather, it's just to say there isn't going to be enough of a market to provide a commercially viable vehicle. If there were, it would happen already. So we have to recognize we're here because we want to subsidize the services; appropriately so, it may well be. But the point is it will cost something.

Mr. BOUCHER. Mr. Crippen, it doesn't have to be commercially viable for it not to cost the government money. I think you're missing the key point here. The purpose of the loan guarantee itself is to buy down the cost of capital sufficiently that the service can then be viable with no lower cost of capital. And a viable service at that point has revenues coming in it. It's what the subscribers pay every month in order to get the signal.

It can then sustain the service at whatever level is necessary to advertise that cost of capital. It doesn't wind up costing the government anything in that scenario. That's where we're trying to— that's the goal we're trying to——

Mr. SHIMKUS. I'll reclaim the time. We need to go to the gentlewoman from Wyoming, Mrs. Cubin, for 5 minutes.

Mrs. CUBIN. Thank you, Mr. Chairman. I would like to direct my comments and questions to Mr. Crippen. I think that there might be some facts that are pertinent here that may not have been considered in the conclusions that your report put forth, and I think they're important things.

One thing I want to tell you. I represent Wyoming, as you probably know. It's 100,000 square miles with 470 or 80,000 people in it. We have just outside of the town where I live a mountain that's considered to be a real small mountain. It's 8,300 feet in elevation. And then the mountains go up from there. In Wyoming what we consider foothills and hills are equivalent to mountains out here in the east where people ski.

And the point that I'm trying to make is that while I appreciate your graph here with what grade B over-the-air service provides, I wanted to ask you, did you look at the difference in the scope of a grade B picture? For example, a grade B picture can actually be clear and acceptable, or it can be nothing but black and white snow with shadows in it. And that's really what this graph represents, not only, but inclusive.

Would you agree with that?

Mr. CRIPPEN. Sure.

Mrs. CUBIN. And did you happen to look at the differences in the grade B?

Mr. CRIPPEN. It wouldn't change our analysis any because, again, 97 percent of the households are passed by cable already. Plus there's obviously a large number of the U.S.—whether it is 90 percent or some lesser number; we think it's about 2 million—who can't receive signals at all.

Mrs. CUBIN. Well, that's another reason that, you know, your statement that so many people in so many areas aren't covered by cable, that's another reason I brought up the hundred thousand square miles. In Wyoming a small proportion of the people, I don't want to say small, but comparatively speaking much smaller than in other parts of the country, can receive cable. There are lots of areas where the only thing they can get is satellite.

And even then it takes special arrangements to get that signal. So your statement in your report, I guess the point I'm trying to make is that the statement on page 3 at the bottom, where it says, "In addition, unlike companies that provide rural electrician or telephone services, those borrowers would immediately confront competitors in the marketplace."

But not where I live. And I know you said to Mr. Boucher, well, you don't have enough constituents to make up the difference. And I don't have enough constituents. But you know what? Collectively we might.

Mr. CRIPPEN. If I might say, we don't disagree. You might. But the point is, on its face the market is going to be hard to penetrate and be relatively small, which makes it risky. Not that it might not succeed. Indeed, if we thought it wouldn't succeed, we would say the estimate is $1.25 billion. But there is a high degree of uncertainty here, because you're going into established markets that have competition where you aren't going to have price leverage.

Mrs. CUBIN. I would like to make two points to you, then. Aren't there protections that are built into this project for the American taxpayer, like first, any entity is going to have to demonstrate they have a business plan that will allow them to pay for the loan? And if the satellite is a solution, and I don't know that it will be in all cases, that this entity would need spectrum and orbital slots, which are very serious investments, they're big investments, and that they also have to purchase insurance for the satellite, and purchase credit risk premiums that would also protect the taxpayer.

It seems to me that this bill is carefully crafted to ensure that local signals would not be putting the telephone at risk. And the second point I would like to make is that this loan guarantee proposal was based on a similar plan for short line railroad, and the CBO said that there would be no impact to the Treasury for that. And with the credit risk premium, why should this legislation be any different?

Mr. CRIPPEN. I'll respond to your last question. In the case of short line railroads, the economics were very much different. They were very likely to succeed. They were taking up established rail lines from larger railroads who wanted to consolidate their rail lines. But the short lines were also monopolists who were entering markets where they didn't have competition from other railroads, certainly, and were much more economically viable on its face, so that the risk was very small in terms of default.

Here, again, all we're suggesting is that there is a risk that these loans ultimately will be in default.

Mrs. CUBIN. Again, the assumption is that they're moving into a competitive market. And my assertion would be that that isn't necessarily the case. And to Mr. Parsons, I would like to associate myself with Chairman Tauzin's remark that certainly absolutely the first choice needs to be over-the-air.

Thank you for just tapping that lightly.

Mr. GOODLATTE. Mr. Chairman, may I respond to the question?

Mr. SHIMKUS. Sure.

Mr. GOODLATTE. I thank you very much. I just want to say to Mrs. Cubin that we strongly disagree with the assertions of the CBO regarding the extent of this market. We think that the true market is 70 to 85 million Americans who will now have an alternative to choose from cable, and that there will be a great many customers who will choose a satellite package that includes these five network channels in that package who would not choose satellite as an alternative without that, because they don't want the inconvenience of switching back and forth between the antenna and the satellite.

And so we think that the risk is much, much smaller than they have analyzed. And we hope to continue to work with them on that issue.

Mrs. CUBIN. Thank you.

Mr. SHIMKUS. Mr. Crippen, take a deep breath. The calvary is coming to the rescue. Now we'll recognize Mr. Largent for 5 minutes.

Mr. LARGENT. Thank you, Mr. Chairman. Mr. McLean, how would you define rural? We're talking about—you are the Administrator of the Rural Utilities Service, is that correct?

Mr. MCLEAN. Yes, sir.

Mr. LARGENT. How would you define rural?

Mr. MCLEAN. As defined in our statute, there are several different definitions. In telecommunications, the original loan has to be 5,000, a community of 5,000 or less. However, as a community grows, it remains eligible as long as there is a continuous mortgage.

Mr. LARGENT. How long has it been since Washington, D.C. Has been classified as rural?

Mr. MCLEAN. I don't say that the District of Columbia was ever classified as rural, although Northern Virginia Electric Cooperative is an eligible entity under our act and under the regulations of the agency. And the economic growth in Northern Virginia I think has partly—can claim that part of the credit for that has been affordable power.

Mr. LARGENT. But you're talking about this Rural Utilities Service offering services to Washington, D.C. And Arlington, isn't that what you said in your testimony?

Mr. McLEAN. Northern Virginia Power is an eligible entity, because at the time they applied for the REA loan they were within the population criteria.

Mr. LARGENT. Offering services to Washington, D.C.?

Mr. McLEAN. No, to rural Virginia.

Mr. LARGENT. Who is the guarantor of an RUS loan?

Mr. McLEAN. The full faith and credit of the United States.

Mr. LARGENT. And who is that?

Mr. McLEAN. Taxpayers.

Mr. LARGENT. Exactly.

Mr. SHIMKUS. Will the gentleman yield for a minute? Mr. McLean, if you could move that microphone so that everyone can hear you——

Mr. LARGENT. Your Inspector General has said that in $11 billion of loan guarantees that you're administering currently, I guess that's in electricity, that only one half of 1 percent is actually invested in infrastructure in rural America.

Mr. McLEAN. I'll let Roger speak for his study. Every dollar of our $32 billion portfolio goes for electric infrastructure. Roger's report speaks to the co-ops' own money, and co-ops are owned by their members. And as we discussed in the exhibit on Northern Electric Power——

Mr. LARGENT. Wait a second. We are talking all the time in this committee about the fungibility of money. Why should the American taxpayer loan $11 billion to anybody who already has nearly $11 billion, just short of it, $61 million worth of assets that they own themselves? I mean, investment assets.

Mr. McLEAN. Cooperative equity does not equal cash available for investments.

Mr. LARGENT. According to Mr. Viadero—let me see. I've got the testimony here. He's talking about it being invested in stocks and bonds and mutual funds and the like. Why should the American taxpayer have to loan money to people that could—basically they're getting commercial lending, or could finance it of their own ability?

Mr. McLEAN. We've had a principle in this nation that we are one nation indivisible, and that we——

Mr. LARGENT. I understand that. What I'm saying is, why are we loaning money to people who don't need it? That's the question.

Mr. McLEAN. We have a fundamental disagreement with the conclusion of Mr. Viadero's study, that people don't need those funds. It's three times on average more expensive to serve rural America, in both telecommunications and electricity. If it were not for the Rural Utilities Service, if it were not for that affordable capital which is the largest part of large infrastructure investments, that's exactly the reason that this committee is considering legislation to finance with loan guarantees a very large infrastructure investment, is that it reduces the cost to the people, the 25 percent of the people who live in the 75 percent of the geography of this country.

That is our mission. We follow our statute. Roger in his—both reports have acknowledged that these are not illegal activities, that these are in fact—in the telecommunications report he says to have a credit elsewhere test would require a change in the statute.

We don't agree with that conclusion that a credit elsewhere test would further the purposes of the Rural Electrification Act and rural telecommunications, because we know there is a digital divide in rural America. We have to do everything possible to bring down the cost of service so we can all be part of this growing economy.

Mr. LARGENT. But in reality what's taking place is this: You have Rural Electric Service or Rural Utilities Service that is borrowing money from you at a low cost, and it's a low cost because the taxpayer subsidizes the difference, they take that money and they borrow at 3, 4, 5 percent, whatever, at something below market, and then they take that money and they invest it in the market and get 2 or 3 points above that.

That's good business sense, but it's at the expense of the American taxpayer. That's exactly what's taking place, is it not?

Mr. MCLEAN. Every dollar that is borrowed, that is lent for rural electric, rural telephone, is tied to actual infrastructure and investment.

Mr. LARGENT. Then why should we loan money to people who don't need it? Because they have the same amount of assets that we're loaning to them invested, and they don't need the money from the American taxpayer. They can either self-fund it or get it on the commercial——

Mr. MCLEAN. The consequence of that decision, if the Congress should make that decision, would be the people who live in rural America will have higher electric rates, higher telephone rates, lower levels of investment in infrastructure, lower levels of reliability in electricity, lower levels of quality in telecommunications.

Mr. LARGENT. But point in fact, in rural Oklahoma today their electric rates are lower than my rates in Tulsa, Oklahoma. Why? Because the American taxpayer subsidizes their electric bill and their phone bill and soon to be their cable bill and DBS bill.

Mr. MCLEAN. But throughout America, and I'm very proud of the co-ops in Oklahoma that they are doing a very good job, but throughout America in general rural Americans pay higher rates already.

Mr. LARGENT. Mr. Viadero, I guess I would like to ask you the question, how you've come up with—reached the conclusion in terms of one half of 1 percent of the loans are actually used for infrastructure.

Mr. VIADERO. That's an easy one. That was self-reported by the companies. They reported it. And I would also——

Mr. LARGENT. Sir, what is your response to Mr. McLean's answers to my questions?

Mr. VIADERO. Well, what I find, and I would like to, if I can, bear with me, this is a response to——

Mr. SHIMKUS. This is the last question. You need to do it relatively succinctly.

Mr. VIADERO. Yes, sir. This is the RUS response to the audit report. It's on page 46 of the report.

I read, "RUS agrees that its borrowers should be making a conscious effort to provide for and facilitate rural development in these areas. As stated in the audit and the regulation, RUS assumes," underlined, "assumes that borrowers will use the latitude afforded to them by Section 312 of the Rural Electrification Act to make needed investments in rural community infrastructures. RUS will strategically develop and implement policies and procedures that strongly encourage borrowers to meet the intent of the Congress."

Mr. Largent, your question is the exact same question we have. We don't see any investment in rural America. And I'm from the rural part of the South Bronx, which is very close to the rural part of Wall Street, where the bulk of these funds seem to be going.

Mr. SHIMKUS. And the chair now will turn to the gentleman from Georgia, Mr. Deal, for his 5 minutes.

Mr. DEAL. Thank you, Mr. Chairman. My first question, in light of this discussion about the financial status of the telephone borrowers and the electric program borrowers, is can either of those entities or both carry out the purposes of this legislation under current law and without further authorizations as provided in this legislation?

In other words—I suppose I should direct it to RUS. Can these two sets of borrowers who come to your agency, could they under current law use proceeds of loans from RUS to expand into the rural areas to provide the kind of service we're talking about in this legislation wanting to provide?

Mr. MCLEAN. No.

Mr. DEAL. Why not?

Mr. MCLEAN. Because the eligible investment, the eligible purposes for an RUS loan is the electric, telecommunications, water infrastructures.

Mr. DEAL. Why is this not telecommunications?

Mr. MCLEAN. We have a restriction in our statute that specifically lists CATV and broadcast television. I don't believe that I have the authority to make a loan for delivery of television services at this time.

Mr. DEAL. Has anybody ever researched that question?

Mr. MCLEAN. Yes, we have, in determining the comments on this legislation.

Mr. DEAL. Mr. Viadero, do you have an opinion on that?

Mr. VIADERO. I have an opinion on most things, Mr. Deal, unfortunately.

Mr. DEAL. Do you have a good opinion on that?

Mr. VIADERO. That's a much smaller list. I would like to say, though, that we don't—and we haven't gone into the exact legislation, but we don't see any prohibition that the companies can't use the $11 billion that they're holding of our money right now for that purpose.

Mr. DEAL. That would be their accumulated surpluses outside of a new loan, is that what you're saying?

Mr. VIADERO. That's correct, sir.

Mr. MCLEAN. In fact, if you look at how satellite services have been rolled out throughout rural America, they have been through rural electric co-ops and rural telephone companies and rural telephone co-ops. And in fact Roger's comments cited Northern Virginia participating in the roll-out of satellite services. The National Rural Telecommunications Cooperative is a cooperative of cooperatives that has invested in the original launch of DBS.

And so that's how you have the rural service in satellite right now, where cooperatives have used their own money to roll out the service.

Mr. DEAL. So they're not prohibiting you from using your own money, they're just not allowed to use your loan money for that purpose?

Mr. MCLEAN. Correct. However, under the legislation that Roger cites, if the investments of the rural electric cooperative exceeded 15 percent for nonelectric purposes, they would have to seek a waiver or seek permission from the Rural Utilities Service. And that is the point of the legislation, to move that threshold from 3 percent to 15 percent.

Mr. DEAL. That leads to my next question. I really directed it to Mr. Goodlatte, but perhaps some of the panel members could answer it. As I was leaving to vote, he was asked a question related to existing cable providers being able to qualify and to expand their services into the rural areas. I believe his answer was he thought the legislation would authorize that. Is that correct?

Mr. MCLEAN. That is correct.

Mr. DEAL. Is that the answer?

Mr. MCLEAN. That is correct. It's the position of the administration that if the legislation is adopted, it should be technologically neutral. I should observe RTS and NTIA are about to publish a report on availability of advantaged telecommunication services in rural areas. And we've tried to research your 97 percent figure from the National Cable Association. We found out that there are about 91 million homes passed by cable out of a universe of about 105 million homes. Both from our observation and the arithmetic, we think it is closer to the low 90 percent.

Mr. DEAL. Let me ask the next question. If the money could be used by existing cable operators to expand their service to rural customers who are now being bypassed or not served at all, would this legislation also authorize loans under this program from RUS to rural electric cooperatives, for example, to purchase existing cable network operations and expand those?

In other words, could the loan be used to purchase a system that is not providing the service that this legislation anticipates, but with the idea that by purchasing that you make it financially solvent enough to then perform the purposes under this legislation? Would that be a possibility?

Mr. MCLEAN. I think that might fit in the——

Mr. SHIMKUS. Again, if you can speak into the microphone.

Mr. MCLEAN. I think that might fit in the acquisition section of the bill. But where that example would be problematic is in the priority section of the bill. In other words, we interpret what the Agriculture Committee is saying in this legislation is that you basically start from the bottom up. Then, all things being equal, you try to get the most service to the most underserved.

Mr. DEAL. I understand that. But to counter the arguments that CBO and others have made about the financial viability of this being possible, without that kind of a solid base of customers, don't you really have very, very jeopardized loans where you are reaching out to only those that are underserved and have no foundation of a current customer base?

Mr. McLEAN. And I think that is the concept that Congressman Boucher has talked about and Congressman Goodlatte has talked about, is that in aggregating the demand of the lower urban markets, that the private sector has clearly said in three different hearings that I've participated in that they have no plans to serve, that by aggregating that demand plus the rural demand, this may be a feasible project. Now——

Mr. DEAL. Excuse me for interrupting, but I have one very quick last question, and my time is running out. Mr. Parsons, I'm just interested to know, do any of your NTA members qualify for RUS loans? Have they ever qualified?

Mr. PARSONS. I would not be sure about that. But I think Mr. Largent asked a question that needs to be answered more thoroughly, what really is rural.

That is one of the stumbling blocks, why we were not able to produce or get additional applications through the FCC, is because that particular thing was never identified, what is rural. We've heard numbers all the way from 50,000 down. I don't know what is rural. Until we get that defined, then it's a pretty broad brush.

Mr. DEAL. Your membership, who are they?

Mr. PARSONS. The licensees of the translators would generally be counties, cities, towns, Lions Clubs, nonprofit groups. They are nonprofit, I'll guarantee you that.

Mr. DEAL. Do they use their own money then in order to provide this service?

Mr. PARSONS. It generally comes from recreational fees in the counties. It comes from small fees that's attached to the sets. One study that I run, three different counties in our state, it runs from 38 cents a month to 48 cents a month for eight channels of television.

Mr. DEAL. Thank you, Mr. Chairman.

Mr. TAUZIN. The gentleman's time has expired. I turn now to the gentleman from California, Mr. Cox, for 5 minutes.

Mr. COX. I thank the Chairman. I apologize, at least I have a microphone here so I'll get my voice across, for sounding a little bit like Stephen Hawking today, with one of those little voice devices. I wonder if I might ask Mr. Viadero, do you have opinions that you might have expressed when I was not in the hearing room about the legislation itself? Are you supportive or opposed to the legislation?

Mr. VIADERO. We don't have an official position on that, Mr. Cox.

Mr. COX. Do you feel free to express one, or do you feel constrained because of your role as IG to not comment on pending legislation?

Mr. VIADERO. Yes, I would prefer to see the pending legislation to come from the Department which we would review in the normal process. We would just as soon not be violative, if we could wait for the Department's position to come out and comment on it.

Mr. COX. And Mr. Parsons, assuming that the legislation did not permit access to these credit facilities by any of your association's members, which I take it it may not as presently written, would you support or oppose the legislation?

Mr. PARSONS. Well, I think there's been some reference made to the quality of pictures in the grade B contours. If you were to look at the map on the document I submitted, we go through as high as six and seven relay stations to get to the small hamlets. Better reception could be utilized had we had access to some of these satellite feeds. At the present time we're not allowed to do that, nor are the cable systems.

Also, I would like to say at this time that once you get out of the metropolitan area of Salt Lake City, all of the cable systems rely on our translators. So if we can't improve them, it's not going to be a very level playing field, where you have DBS signals coming into the homes and signals that's picked up through our translator relays who are denied the rights to use the satellite signals. It's kind of an unlevel playing field.

Mr. COX. Mr. Crippen, you have told us that Federal assistance for this venture would likely be costly, and that you would present to us options to reduce the cost. And you have then stated that the best way to reduce the cost is to reduce the size of the program. Are you specifically suggesting that $1.2 billion is not the right level then, some smaller amount would make more sense?

Mr. CRIPPEN. No, actually we're just trying to make the point that obviously the less you cover, the less exposure to the taxpayer. Rather, or I should say, in addition, to compare the House bill with the Senate bill, which provides an 80 percent guarantee, we estimate a much lower subsidy rate, because it covers 80 percent of the loan and not 100 percent. Obviously the lower that is, the lower the cost would be, no matter what the total guarantee, but the lower coverage as well reduces the subsidy rate.

Mr. COX. The purpose of this legislation, as I understand it, is to jump-start industry participation. What are the odds that once commenced this program would ever go away?

Mr. CRIPPEN. I don't know that I have any way of answering that.

Mr. COX. Well, using your experience as an evaluator of government programs, is it your experience that once started, a program like this sunsets itself, or that alternatively Congress routinely comes in and sunsets the program?

Mr. CRIPPEN. That's more a question for the General Accounting Office. I can tell you from my non-CBO experience—I tell this story often—my doctoral dissertation was on a program called general revenue sharing, which shortly after I finished my dissertation was eliminated. But it's one of the few that I know of.

Mr. COX. We had a hearing in here just a few days ago where we were considering the 3 percent Federal telephone tax, which was put in place for the purpose of financing the Spanish American War in 1898. Of course, because that tax now collects $6 billion a year, it has made the Spanish American War the most expensive war in American history.

My concern is that this legislation as presently written uses taxpayer resources to finance not the kind of things that Mr. Parsons's members provide, which are free over-the-air services, but rather subscription services only. So that's breaking from our tradition of subsidizing this industry through the provision of free spectrum, for example, on the grounds that it's available to the public, the taxpayers who support it.

Here we would be levying a tax, implicitly the principal amount of the loans, on the taxpaying public at the rate of $10 a head, if you consider there are 120 million taxpayers in the country, and in return they would get nothing unless they paid for it. They would have to pay a fee for subscription service only.

What is the justification for that, for breaking from this long-standing Federal tradition of saying Federal subsidies go to provide services for the public good, whereas here we're providing only subscription services? You can build a cable system with this legislation, as I see it.

And so we've got cable TV providers who are going to come in and charge $40 a month, whatever they charge, and they're doing it with a Federal subsidy. What is the justification for that, Mr. McLean?

Mr. MCLEAN. I think the determination for this committee and the Congress to make, the fact that you charge for electric service, charge for telecommunications service, charge for the Internet, or charge for cable or satellite delivery of services is not the critical issue.

The question is whether the marketplace will serve that part of the market that is rural America. And from the record that's been developed, I have not heard a single witness in now four hearings which I've had the privilege of participating in where anybody has said they would be willing to go below market, 67. There are 211 television markets in America.

And we're facing an additional problem as we convert to digital where there could be a further digital divide between rural and urban access to broadcast signals.

Mr. COX. And yet the question that you put is answered only in the context of rather substantial Federal impositions on people that would be willing to provide this service. We've had hearings where we have the satellite providers, for example, come in and tell us the cost of the regulations that we impose on them. If they want to provide certain channels to rural subscribers, they're told they have to provide all the junk as well, they have to use up all of their capacity providing things that the market may not want.

Wouldn't we be wiser, if we were trying to provide access to rural customers, to make it more efficient for the market to do that and lift these Federal regulations?

Mr. MCLEAN. I believe that Congress spoke in passing the Satellite Home Viewer Improvement Act on those very issues. But the model that's being pursued here is what we pursued in rural electrification. In 1935, 10 percent of farmers had power.

Mr. COX. That's the reason I asked the question I did to the Director of the Congressional Budget Office, because the REA, now renamed, having long since provided electricity to rural America, is still around, bigger than ever.

Mr. MCLEAN. There are plants that need to be replaced. The cost of service is still competitive. As we're working in telecommunications since 1949, we still need to modernize. There's always the next generation of technology. Whether the promise of the Telecom Act is kept or not is determined by whether there's going to be resources available to those thin markets.

There's a statistic I find in my business all the time. Seventy-five percent of the geography is rural. Twenty-five percent of the population is urban. Most businesses get 75 percent of their business off of 25 percent of their customers. There's always 25 percent of the marketplace that is always hard to crack. And it's the same thing that we see recurring in the satellite issue. The 67 markets that the private sector has said they're willing to serve without any government assistance represents about 75 percent of the population.

The markets from market 67 to 211 is about 25 percent of the population and 75 percent of the geography. And this has been a time-honored model that has worked. And it's a success. And the very fact that we're being criticized for—taking co-ops from being financially troubled to be financially strong is a good thing for America.

Mr. COX. On that last, if I could just conclude by asking Mr. Viadero for your thoughts, on whether or not the track record of the lending programs that you have just reported on justifies expanding the charter of the same people who have made the mistakes you've talked about.

Mr. VIADERO. Based upon Mr. McLean's statement prior to this, we totally agree that RUS has done just a great job in getting electrification and telephones out to rural America. And there's a pot of money that's available for use, and it's just not being used, that pot of money being the $11 billion. And it just appears that once you start getting this money, albeit in 1935, you're still in it in 2000.

I mean, I moved into—and I'm a proud resident of the Commonwealth of Virginia for the last 18 years, and the county I moved into 6 months prior to that, in 1982, still had a party line system, telephone. And almost 20 percent of the county, which is less than 50 miles from the capital, didn't have electricity. So it's done a great job.

But to add to what Mr. Boucher said, my son lives on a mountaintop in West Virginia. He doesn't get television, because unfortunately, Ms. Cubin would probably say it was just a bump in the road, but it's a mountain out there, he's blocked by a larger bump in the road. He doesn't get television. But it just appears to us that once you're getting the money, there's no way we're going to stop them from getting more money.

Mr. COX. And as a result, what do you infer?

Mr. VIADERO. It needs a legislative fix.

Mr. COX. Such as?

Mr. VIADERO. RUS cannot stop granting money to these people because of the statute. If they qualify, we have to give them the money.

Mr. TAUZIN. Will the gentleman yield on that? Why? Does any law say that they can't—I've heard there's no law specifically that says they can't. Is there?

Mr. VIADERO. I'm going to ask Mr. Ebbitt, if I can, to join me.

Mr. TAUZIN. Mr. Ebbitt, will you tell us whether there's a statutory prohibition against deciding not to make a loan to an entity that doesn't need one?

Mr. EBBITT. Mr. Chairman, it's our reading of the legislation on the telephone side and our understanding from working with RUS that on the telephone side, if you're in the program, you came in, 1935 or 1940 or whenever, that if they come back you to today, they're still an REA, an RUS co-op, and if they present a financially strong case and need money, yes, they have to make the loan.

Mr. TAUZIN. Is that a matter of law, or is that a matter of practice?

Mr. EBBITT. It's our understanding it's a matter of law.

Mr. TAUZIN. I would please ask that you submit the language of the statute that is definitive in this area for the committee.

Mr. EBBITT. May I suggest, Mr. Chairman, that Mr. McLean and the Department's general counsel really need to get that for you. I mean, I would be happy to, but you really need to get the position of the USDA.

Mr. TAUZIN. I thank the gentleman for yielding.

Mr. COX. Thank you. Mr. Chairman, I'll just conclude by saying that I think there are serious problems with this legislation as presently written. It would, for example, encompass application of the proceeds of the lending not only to construction but to the launch of the service, by which I understand the statute or the bill to mean even the advertising costs and promoting the service to people.

This Internet economy that we live in is generating spectacular amounts of capital. The market capitalization of many of the companies in a 6-block radius of my district office is enough to pay for this program 10 times over. The notion that credit is not available to the telecommunications industry is rather odd. And so we have to ask ourselves what is the Federal Government doing to the market that's causing it to be unattractive to this industry.

I'm not surprised that if my colleagues are willing to propose a $1.2 billion credit facility to an industry, taxpayer subsidized, that industry is in favor of that. I would be too. I wouldn't mind leveraging my private dollars on the taxpayers' backs. And we shouldn't begrudge the industry's support for legislation like this.

But as Members of Congress I would hope we would be a little bit more wise in the expenditure of taxpayer funds and look to see what it is we're doing to these industries that makes it unprofitable for them or makes it not as attractive as other investments to serve rural customers. And I've mentioned just a few of the areas.

I think the burdens we've placed on satellite providers are without justification. And even if we're unwilling to lift those burdens perhaps in urban areas, we should consider lifting them in rural areas. I would try each of those in turn before I laid out an amount of money that CBO has told us is about a third of a billion dollars in terms of the risk. I think that is such a mismatch with this industry, which has as its chief characteristic the ability to generate capital in today's markets.

Mr. TAUZIN. I thank the gentleman.

Before I recognize you, Mr. Pickering, with unanimous consent, if I might ask one question. I want to read you Title VII, Section 930. This is a declaration of congressional policy. Here's what it says specifically.

"Declared to be the policy of the Congress that adequate funds shall be made available to rural electric and telephone systems through insured guaranteed loans at interest rates which allow them to achieve the objectives of this chapter, and that such rural electric telephone systems should be encouraged and assisted to develop their resources and abilities to achieve financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources at reasonable rates and terms consistent with the loan applicant's ability to pay and the achievement of this chapter's objectives."

Isn't that clear congressional intent for your Department to in fact graduate these loans down when in fact people become financially capable of going out and making the loans themselves somewhere else?

Mr. MCLEAN. Well, in fact we meet that congressional statement, No. 1, when Congress created the Rural Telephone Bank in 1972, public private ownership. And we lend in concurrence with——

Mr. TAUZIN. Where in your rules and regulations do you prohibit financially strong companies from borrowing?

Mr. MCLEAN. We will have prepared for the Office of General Counsel a brief on this very issue. But even in Roger's report he acknowledges that to have a credit elsewhere test would require a change in the statute. Now, I——

Mr. TAUZIN. Wait. Stop there. Why is that true, in light of the congressional policy statement? Why do you have to have a credit—why is a credit elsewhere test illegal, when the statement of congressional policy is exactly the opposite, that if you can go get credit elsewhere, the congressional intent is that you encourage and enable them to do so?

Mr. MCLEAN. And in fact we do that. One of the things——

Mr. TAUZIN. Where in the rules and regulations——

Mr. MCLEAN. [continuing] is a regulation to facilitate "swifter, leaner" accommodations——

Mr. TAUZIN. I want you to send us the rules and regulations wherein you carry out the policy of that section of Congress. And we'll submit a letter request to that effect, if you don't mind.

Mr. MCLEAN. Yes, sir.

Mr. TAUZIN. Mr. Pickering is recognized.

Mr. PICKERING. Thank you, Mr. Chairman.

Mr. McLean, welcome to the committee. It's good to see you again. We had a prior life working together, and now it's good to see you in your new role and responsibilities.

Mr. MCLEAN. Thank you very much.

Mr. PICKERING. I'm speaking as one who represents a very rural district in Mississippi. If we look at RUS and the Rural Telephone Bank, what it has done for the deployment of broadband technologies and capabilities is fairly impressive. I don't know if many of you know this, but in the heart of my district, Decatur, Mississippi has the first fully digital telecommunications network, funded through RUS, I believe, and it's a great example of the good work that RUS does.

But today we're asking ourselves to take a new step, and we're confronted with possible issues of can we make the program more effective and make sure that the resources that we're targeting for our policy objective is actually accomplishing our mission.

And so, Mr. McLean, to that end I would like to ask you to comment. In the IG's report, toward the end, he says, "We recommend that RUS develop and implement a strategy to encourage electric borrowers to use some of their $11 billion portfolio to make discretionary investments in rural America. RUS has agreed to develop and implement policies and procedures to strongly encourage borrowers to meet the intent of Congress."

What are those policies and procedures that RUS is adopting to accomplish that?

Mr. MCLEAN. We just received Roger's report I guess the day it appeared in the Wall Street Journal. And so we concur with the recommendation. We work with our borrowers, and my predecessor, Administrator Wally Beyer, and then in the few months I've been in the position of Acting Administrator, we have gone all over this country and encouraged our borrowers to participate in rural development and to participate in economic development for their communities.

And I think if you look at your own experience in your own hometown, you'll find that that in fact is happening. We agree with Roger's recommendation. The disagreement is the figure of $11 billion. There may be a problem with our reporting forms that we would certainly like to work with Roger to make sure that they fully reflect the level of investment.

But, you know, in the next couple of weeks here I think you're going to have rural electrics from all over the country visiting Members of Congress. And ask them, what are you doing for rural economic development, are you investing in infrastructure, are you too rich to borrow from RUS. I think that their answer is going to make you very proud. They're doing a good job.

When you cite the sample of RUS funding for telecommunication, the consequence of pushing people out of the program would be the loss of the bargain that we have with those borrowers to deploy modern, affordable services, and to deploy them in a way that provides area wide coverage, to deploy them in a way that has rates that are affordable, that doesn't have high connection fees.

As I said earlier, no one in an RUS financed system has said to me, boy, we sure would like to be served by one of the big telecommunications companies that don't have the RUS standards and the RUS engineering, the RUS effort.

Mr. VIADERO. Mr. Pickering, if I might, for a point of clarification, this report I signed out on the 13th, it was hand-carried to the RUS front office. The RUS response which was included in this report was dated February 28. They had the draft report. Just for point of clarification, Mr. McLean had this available before the article appeared in this morning's paper.

Mr. PICKERING. Thank you. Mr. McLean, just to follow up again, and again, as a believer in the program, as a supporter of the legislation, but as someone who wants to make sure that Federal dollars are used as intended and used most effectively to accomplish the objectives of the missions we both share, and since the IG has said, and I quote again, "has agreed to develop and implement policies and procedures to strongly encourage borrowers to meet the intent of Congress," can you give specific examples of any reforms or any new policies or procedures that RUS is adopting?

Mr. MCLEAN. We are going to be communicating with our borrowers, bringing these issues to their attention. We're going to be reviewing our reporting forms to make sure that they accurately reflect what we believe in fact is happening. Roger and I have absolutely no disagreement on the purpose and the ideal of investing in rural America with funds that are generated by the co-ops.

Mr. PICKERING. Mr. McLean, let me just say, for the credibility of the program, if you could just get back to the committee on those specific policies and procedures and incentives that you will be providing those who use the program and who borrow, so that we can assure our colleagues that appropriate steps are being taken to make sure that the funds are used in the targeted approach that we want to rural America.

And I guess as a follow-up question, there's reform that RUS administratively can take. Do you recommend any legislative reform or language that would either give greater incentive as a criteria for receiving an RUS loan to invest a portion of their portfolio into rural and economic development?

Mr. MCLEAN. We'll certainly consider that suggestion, Congressman Pickering. We have to be very careful, particularly in electric restructuring. Right now, co-ops and small companies, municipalities face uncertainty at this moment.

And to have a mandated quota for a level of use of funds we think would not be well advised, given the unsettled nature of the regulatory scheme that electric co-ops face right now.

Mr. PICKERING. You can understand the concern, if we're authorizing $1.25 billion which will then leverage—what would it leverage in the capitalization of a loan guarantee program?

Mr. MCLEAN. The loan guarantee would be a $1.25 billion loan guarantee.

Mr. PICKERING. We just don't want to see 1.25 come in one door and go out another door, not into rural America. And so we want to make sure we maximize resources to my district and to others. And so that's—and how we do that, what kind of incentives, what kind of policies. That's how I want you to interpret my comments, in that way. And I don't know if there's any—we've struggled with this in the Telecom Act, do we have a definition of what is rural and what is not, do we need to address that for this program or any other program, again, to make sure that what we are authorizing here does not go to areas that by yours and my definition would clearly be urban or suburban.

Would the rest of the panel like to comment on any of my—Mr. Crippen, do you have any recommendations from the legislative perspective to make sure that we honor the intent of this legislation?

Mr. CRIPPEN. One thing that we talked about in the testimony was that you can reduce the potential exposure to taxpayers by the structure of the loan. And one thing I would encourage you to think about is having the private sector exposed as well as taxpayers in a very real sense, whether it's by collateral or, more appropriately, a guarantee of less than 100 percent of the loan—the point being that private lenders will then have to scrutinize these projects much more closely than they might otherwise. And they're better able, frankly, than we or anyone we know to do the credit-risk analysis.

Mr. PICKERING. Thank you, Mr. Chairman.

Excuse me, Mr. Parsons, do you have a response?

Mr. PARSONS. Yes, just one comment, in going back to the definition of rural. I have constant contact with Salt Lake broadcasters, and they have had way more requests for waivers for Salt Lake, Ogden, and Provo than they had for the rest of the State put together.

Mr. PICKERING. Thank you, Mr. Parsons.

Thank you, Mr. Chairman.

Mr. TAUZIN. Thank you.

Mr. Parsons, I want to know a little bit more about translators. Obviously the FCC can pull their license, it's a secondary license, right, they can re-action that spectrum. They've done it in the past, right? So making you eligible for loans may not be the best idea in the world, because if they pull your license you're sure to default, right?

Mr. PARSONS. Yes. It would be nice to be able to have that. But the economics of an area, somebody has to pay the satellite to deliver.

Mr. TAUZIN. Let me ask you, what are the economics of a translator right now? If you provide free over-the-air boosting of the signal for customers, how do you get paid? How does a translator make money?

Mr. PARSONS. In the county I live in there is a portion of the recreational tax that's paid that ends up being, like I said, 38 cents a family a month. And it comes to like $38,000, $40,000 a year for the budget. And from that, once in a while we get enough money to buy another translator.

Mr. TAUZIN. Are all the translators backed up by local taxes, is that the way they're funded?

Mr. PARSONS. Most of them are.

Mr. TAUZIN. So the voters themselves vote to support a system that will boost and deliver the free over-the-air broadcast signals to these rural areas?

Mr. PARSONS. That's correct.

Mr. TAUZIN. And literally I assume this occurs in areas where either they can't get a good, great signal from the local stations, or they get none at all, right?

Mr. PARSONS. Yes. I don't know whether you have a copy of the Exhibit 1 I have there.

Mr. TAUZIN. Describe that to me, if you don't mind.

Mr. PARSONS. The round circle up near the top, that is the—where the 80 percent of the people in this State live is within that circle. But if you notice, Park City, which most of you are familiar with, depends completely on translators and is financed by the county. The rest of that whole geographic area depends on translators.

The rest of that whole geographic area provides the input signals to the cable systems, which is a very, very key thing. So if the translators go dark, the cable systems have no inputs.

Mr. TAUZIN. So I would take it then that both the broadcaster and the cable companies have an interest in maintaining the translator structure in rural America.

Mr. PARSONS. You just struck a very sensitive nerve. We have been known for a long time for being orphans. Nobody really wants to accept an orphan. And as long as it's part of the DMA, and as long as it's being done by somebody else, let's not do anything about it. So almost everything is done by the local people.

Mr. TAUZIN. Now, in your translator world, are you subject to FCC rules that require you to carry all the local channels? Can you carry the ones you want?

Mr. PARSONS. No. If you noticed on this map, there are 100 locations. We have about 600 translators, which averages out to six per. It depends on the community and how much economic funds they have. And if they have enough money to buy another $5,000 translator down the road, sell cookies or whatever, then they add to the system.

But many of these don't have the full complement, simply because of two things; we've not been able to file, and the other one is they have to budget money, a county has to budget money as it goes along. So it's been very difficult to budget the money in correlation with the applications.

Mr. TAUZIN. And the other problem you have of course is getting the licenses to operate. Now, how do you get the spectrum to operate a translator? Do you go through auctions, is that formally just granted to you by the FCC?

Mr. PARSONS. Not up to this point, we have not gone through auctions. If you look at a small county who is attempting to come up with 5, 10, $15,000 to put in another station, they're not going to be the high bidder in an auction. That's why I said in my statement it was not to the best benefit to include translator areas into the auction.

Mr. TAUZIN. And finally, in terms of the broadcast stations going digital, once they make the transition from analog to digital, were you going to have to upgrade all these translators to carry a digital signal?

Mr. PARSONS. There are already two stations on the air in Salt Lake City with the digital stations. At this point there has not been one test made by anyone about a translator repeating a digital signal.

Mr. TAUZIN. Are the broadcasters not interested in making sure that you can carry their signal further into these rural areas by being capable of carrying the digital signal?

Mr. PARSONS. They seem to have their hands full trying to get up to speed with what they're doing. And so being a secondary service, that thing has haunted us since 1955, that secondary service has haunted us, because initially we were only secondary to creating interference with primary stations. Now we're secondary to anything.

Mr. TAUZIN. Anything. Interesting. But in many places in America you are the only alternative to pay services from cable or pay, if in fact we ever get a second carrier such as a satellite?

Mr. PARSONS. I don't understand that one.

Mr. TAUZIN. Let me say that again. In many places of our country you are the only service available to bring over-the-air free television to people other than them having to buy in from a cable system or perhaps 1 day from an alternate provider?

Mr. PARSONS. That is true. And also, again, I repeat, if we didn't have the translators, many of the cable systems wouldn't have the local.

Mr. TAUZIN. The cable system wouldn't even have the local. Thank you very much.

Mr. McLean, I want to ask you some questions. We'll go back to that audit again, because there are some interesting numbers in it. Going to the audit, the Iowa Telephone Association has as an interest payment ratio of 4,330 to one. That's a pretty strong company, wouldn't you agree?

Mr. MCLEAN. Mm-hmm.

Mr. TAUZIN. If that company, strong as it is, were to go out and make private capital contracts, working through RUS, would that company be subject to the same rules other companies are subject to? It's a telephone company. Wouldn't it be subject to universal service, reliability and affordability standards set by the PUCs and the FCC?

Mr. MCLEAN. You're assuming they have no RUS status?

Mr. TAUZIN. Yes.

Mr. MCLEAN. They would have to comply with the minimum standards of the Public Service Commission and the——

Mr. TAUZIN. FCC?

Mr. MCLEAN. FCC.

Mr. TAUZIN. It doesn't matter where they get their lending, they're going to have to comply with those things, right?

Mr. MCLEAN. But very different quality of service you'll find in the RUS finance system.

Mr. TAUZIN. Why wouldn't a commercial lender be just as concerned about a quality system that he's loaning to that's strong financially and is going to keep a nice return on money, why wouldn't the private lender be just as interested in that as RUS?

Mr. MCLEAN. That's a very good question. But the facts are that there is a differential in quality in rural America. There's a huge debate about the digital divide.

Mr. TAUZIN. Where are those facts?

Mr. MCLEAN. You can look at the digital divide report. In rural areas there's lower quality service. We have a design philosophy at RUS that makes access to services more plausible. In 1993, one of the reasons we think the Congress has spoken very clearly to us in the English amendment to the Rural Electrification Loan Restructuring Act, it said there should be—RUS's design should facilitate advanced services, should be capable of——

Mr. TAUZIN. But Mr. McLean, what I don't understand is, why wouldn't a private lender be just as interested in making sure that the person he's loaning the money to is providing good, strong, reliable service to their customers so they can make sure they get their money back? What makes RUS special in that regard?

Mr. MCLEAN. It's a difference between minimum standards, which of course the private lender would meet the minimum regulatory standards, and the high quality standards that—again, that's the bargain for the loan. That's the agreement between lender and the borrower.

Mr. TAUZIN. What troubles me with your argument is, I can't imagine a commercial lender not being equally interested in making sure that the person he loans it to is the best around. If I've got a choice between loaning somebody who's got some minimum quality service and somebody who's got a high quality, and I'm guaranteed a return on my money from that system, I'm going with the second every day. What's different between them and you?

Mr. Viadero, I want to get your comments on that. Am I right about that or am I wrong?

Mr. VIADERO. We have the same questions you do. We asked your questions, Mr. Chairman.

Mr. TAUZIN. Did you get a good answer?

Mr. VIADERO. No.

Mr. MCLEAN. The vice president of a very large telecommunication company says capital goes where capital grows. That is, the private market will invest into the urban area, into the high growth areas. If you look at large telecommunications companies, you see a very clear difference——

Mr. TAUZIN. Mr. McLean, I think you are mixing apples and oranges. Let me just make a point. I'm a rural guy. I'm always for the co-ops, rural telephone. But for me to be able to support subsidized systems like that for rural customers, I can't bump into audit reports that tell me that rich fat companies with a lot of airtime who don't need the support are getting it, because it makes it harder for me to defend the program and to keep it alive for people who need it.

I just want you guys to think about that. If this audit report is right, and if you have authority to carry out the intent of Congress, which was to wean these systems off of the government guaranteed loan when they didn't need it anymore, and you're not doing that adequately, so that we've got a report that says you've got companies with a 4,330 to one equity to interest payment ratio, then it makes it very hard for us to defend rural co-ops and subsidy programs, to defend that to the folks who are putting up the subsidy.

Why should the taxpayers of some other State put up with that system for very long? They're going to ask for all of it to go away at some point. We're going to lose the baby with the bathwater.

Mr. MCLEAN. We certainly don't want to do that. We do have three products which are graduated, and we have the hardship rate, which is available to the most neediest, that's our 5 percent fixed, to the Treasury rate of interest loan, which is at no subsidy rate in the budgetary policies. We have a loan guarantee program which if you lend from the Treasury Department it's a Treasury plus an eighth, which is actually a negative subsidy. So in fact we do embrace that idea.

In fact we're also trying to facilitate private investment in partnership with our supplemental lenders like CFC and COPEC.

Mr. TAUZIN. Let me ask the IG's office here, if we included a loan graduation provision in this bill which would require the borrowers to move to private credit when they are financially able, what impact if any would that provision have on lowering the projected cost of the government subsidy, and would it have a beneficial impact on the program? Gentlemen?

Mr. VIADERO. Mr. Chairman, I think it's safe—I was not prepared for that question here, I think I'll need some further analysis, and we'll be happy to get back to you.

Mr. TAUZIN. Mr. Crippen?

Mr. CRIPPEN. I have to confess I don't know what's in our baseline assumptions about what the RUS loan rates are going to be to these kinds of companies. Presumably there would have to be some savings, although loans made to those companies, of course, are not nearly as risky as some of the others.

Mr. MCLEAN. Right. Exactly right, Mr. Chairman, because if we were——

Mr. TAUZIN. Take the mike, please.

Mr. MCLEAN. If we were restricted to lending to only uncreditworthy borrowers, the risks that CBO and OMB assess to our program to determine our budget authority would go up. I mean, it's the very security that the members of this committee have asked to secure in the legislation of the satellite bill that we're doing in the telephone program to keep the costs down.

Mr. TAUZIN. We're talking about a provision that provides for companies that become creditworthy over time. We're obviously talking about loaning them money when they need it, not the only criteria, in my view, not loaning them money when they don't need it. I've got something in my craw, you've got a lot of members who have got something in their craw about that. I think you heard it today.

We're talking about taxpayer guaranteed loans to people who don't need them. That kind of gets in your craw. But if you're talking about loaning them to people who need them, but then wean them off as they become creditworthy and don't need it anymore, that ought to affect the cost of the program and ought to affect positively, in a very positive way, the impact of this program on the budget and therefore make it a more desirable program, I think.

Mr. Viadero. Mr. VIADERO. Mr. Tauzin, your point, if I can support it, you just mentioned the one co-op in Iowa with a time interest rate earnings in excess of 4,300. In our exhibit D we have a total of 28 loan applications that couldn't be funded, that were hardships that couldn't be funded.

Mr. TAUZIN. You're telling me you couldn't make loans to people that really needed them because the people that didn't need them had soaked it all up?

Mr. VIADERO. That's correct.

Mr. TAUZIN. Is that what you're telling me?

Mr. VIADERO. That's correct.

Mr. TAUZIN. That's not good testimony. I mean, it's correct testimony, but it's not a good message.

Mr. VIADERO. That's on page 44.

Mr. TAUZIN. How do you answer that, Mr. McLean?

Mr. MCLEAN. I'm trying to understand the statement.

Mr. TAUZIN. Let me say it again, because I kind of paraphrased it for him. But I think what Mr. Viadero said was, on page 14, was that certain loans to people who needed it under the program were denied because there was no longer loan money available, because it had been soaked up in effect by people who didn't need it.

Mr. MCLEAN. Are you saying—I'll address through the Chair, if Roger is saying that hardship funds are going to those companies, or that the total budget authority—hardship is targeted to the most needy and the lowest entities and the highest cost.

Mr. TAUZIN. Well, we don't need——

Mr. MCLEAN. Hardship——

Mr. TAUZIN. We don't need to beat this thing. What I would suggest is for the record, again, I'll ask you this officially, if you will look at that page of the audit report which indicates that loans could not be made to folks who needed them because somehow they weren't available because they had been used by people who needed them, look at that and comment in writing to the committee in answer to it, I would appreciate that.

Let me yield to Mr. Pickering.

Mr. PICKERING. Mr. Chairman, I was wondering if I could ask you to yield just a second.

Mr. TAUZIN. You've got it. Go ahead, Mr. Pickering.

Mr. PICKERING. Just to participate in the conversation, it seems to me there are two dilemmas here. One is possibly the issue being raised that funds are not being made in those hardship cases because funds are being soaked up by those who don't need it. But you have the larger question, the dilemma that I think this bill is trying to address is that those companies that are financially capable are looking at investment decisions.

As they make those decisions, they're going to be looking at the rate of return. That's the way the market works. The problem we face or the dilemma we face in rural America is our rate of return in rural areas will not be as high as the rate of return for investment in urban areas or more dense markets. And so by giving subsidized loans, in essence lowering the cost of capital, you're increasing the rate of return so that those investments are made.

I think we need to look at both ends of it, just because financially able companies are using the subsidized capital to meet our objective of deploying broadband or other technology into rural areas is not in and of itself a bad thing. But we should have a priority of helping those who need it most first. That's a legitimate issue being raised.

Mr. MCLEAN. I absolutely share that priority. In fact in the last fiscal year we used up all of our hardship money, $75 million. But we turned back money, Rural Telephone Bank, loan guarantees. In the last 3 years since the passage of the Telecom Act, in total appropriations we have turned back under-utilized funds. So the crowding out argument, I'm a little bit—I would need more clarification on it.

We'll work together to get that. And the consequence of moving from the RUS loan interest rates to a private market rate would reflect higher rates for consumers.

Mr. PICKERING. Mr. Chairman and Mr. Shimkus, I need to leave, and I was just going to ask Mr. McLean one final question.

Mr. TAUZIN. The gentleman may proceed.

Mr. PICKERING. Mr. McLean, I just wanted to take this time to extend an invitation to come to my district and take a broadband tour of the third district of Mississippi. My former District Director was the REA Administrator in the Bush administration, and I'm sure you all would share a lot in common. We look forward to having you come our way.

Mr. MCLEAN. I would love to do that. And he is a very, very good man, and the program is in good shape in part because of his leadership, and we appreciate that.

Mr. TAUZIN. The gentleman from Illinois, Mr. Shimkus.

Mr. SHIMKUS. Thank you, Mr. Chairman. The charter of a CEO is to maximize shareholder equity in corporate America, and actually a lot of my questions were put more succinctly by my colleague from Mississippi, and the challenge is, how do we incentivise corporate America to provide in those areas that aren't covered. I think we've asked a lot of the questions, and really some of the hard questions were asked by actually sponsors of the legislation, the chairman, myself, Mr. Pickering, who want to represent rural America well, but we also want to do it in a response manner.

And a question was raised of the risk pool, how big is it, do you lower the actual risk by having more versus do you have a smaller pool, higher risk; in the end, through a CBO scoring, would that be less risky. We don't know. But I would ask Mr.—I would ask the chairman, the individuals who are not represented are for the most part the corporate entities, and we have to ask that question, what will incentivise you to get into that area too, because I think that's where we're trying to get a full spectrum.

So I just want to—I, again, don't have any follow-up questions. This has been a good experience. I appreciate the Chairman for calling the hearing. I look forward to working with him to rectify our cosponsorship with being responsible fiscal conservatives.

I yield back my time.

Mr. TAUZIN. I thank the gentleman. Actually we did hear, as you know, from quite a number of the companies last year when we were taking up HSVA. So we've got a good, wide body of information about potential use of this bill.

One thing I would like to know is, perhaps, Mr. Crippen, you could help me on this, if we did make translators the first line of defense to make sure that no one was left in a yellow area without, you know, over-the-air free television, if that's what they wanted to choose, would that reduce the CBO's cost estimate of the bill?

Mr. CRIPPEN. I'm not sure. I would have to think about it probably more than 10 seconds. If it were only for translators in those areas, if they had a revenue source—lots of ifs—it probably would.

Mr. TAUZIN. All right. Well, look. We've got some things we've left for you to respond back to us. Let me ask you to—you've listened to the questions. Sometimes you can learn more by hearing a question than you can by—just learn where people are by the questions they ask than any other thing. I think you got a sense that there are a lot of members who are still troubled, who want to do this thinking, who want to do it right, as I said in the opening statement.

What we are going to need is some help. You made some suggestions to us in your report, you made some, you know, some ideas about, if we changed it, how you might look at the bill. It would be very helpful if you would leave this hearing and think about a supplemental statement after you've learned, you've learned from these questions, learned from the testimony, your colleagues here at the dais, and perhaps give us a supplemental report on how we might make this bill accomplish its purposes in a way that, as Mr.

Shimkus said, is something fiscal conservatives feel comfortable with, recognizing that we're asking Americans to generally back up service for some citizens of our country who without this bill may in fact be left behind and be not part of this new world of extraordinary opportunities. If you'll do that for me, we'll keep the record open for 30 days.

I've also asked some specific questions of you. Please respond to us in writing within the next 30 days on the specific inquiries, the questions I've asked you about the rules and regulations and the statutory sites. If you'll get those back to us.

Again, I thank you very much for the testimony.

The hearing stands adjourned.

[Whereupon, at 12:51 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

USDA

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

DATE: March 13, 2000

REPLY TO
ATTN OF: 09601-1-Te

SUBJECT: Electric Generation and Distribution Borrower Investments

TO: Christopher McLean
Acting Administrator
Rural Utilities Service

ATTN: Sherie Hinton Henry
Director
Financial Management Division

This report presents the results of our audit of Rural Utilities Service's (RUS) electric generation and distribution borrower investments. RUS' written response to the draft report is included as exhibit M, and RUS' comments and the Office of Inspector General position concerning the written response are set forth in the Recommendations section of the report.

We agree with RUS' planned corrective action for Recommendation No. 1; however, additional information is requested to reach agreement with the management decision. We request RUS to reconsider its position regarding Recommendation No. 2. While the agency response is generally supportive of borrower economic development efforts, the RUS response cites changes in the economic climate and stability of the electric utility industry as reasons to avoid specific RUS directives aimed at measuring any changes in borrower investments in rural America. We disagree.

As stated in the RUS response, the uncertain economic climate is likely to force RUS borrowers to reevaluate long-term investments. We believe that the coming reassessment and associated shifts in investment practices will offer an unprecedented opportunity for investment in rural utilities infrastructure, to include such items as fiber optic phone lines to facilitate internet connections and emerging technologies to bring the full range of television programming to rural America.

Please furnish the information needed to reach agreement on the management decisions for Recommendation Nos. 1 and 2 by May 1, 2000. Please note that Departmental Regulation 1720-1 requires a management decision for all recommendations within a maximum of 6 months from the date of report issuance. Please follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

If you have any questions, please call me at 720-8001 or have a member of your staff contact James R. Ebbitt, Assistant Inspector General for Audit, at (202) 720-6945.

ROGER C. VIADERO
Inspector General

RURAL UTILITIES SERVICE
ELECTRIC GENERATION AND
DISTRIBUTION BORROWER INVESTMENTS
WASHINGTON, D.C.
AUDIT REPORT NO. 09601-1-Te

MARCH 2000

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL - AUDIT
SOUTHWEST REGION
ROOM 324, FEDERAL OFFICE BUILDING
101 SOUTH MAIN STREET
TEMPLE, TEXAS 76501

EXECUTIVE SUMMARY

ELECTRIC GENERATION AND DISTRIBUTION BORROWER INVESTMENTS AUDIT NO. 09601-1-Te

RESULTS IN BRIEF

The Rural Electrification Act (RE Act), as amended in December 1987, allows electric generation and distribution borrowers to make investments, loans, and loan guarantees up to 15 percent of their total utility plant (TUP) value without prior approval of the Rural Utilities Service (RUS).[1] Congress amended the RE Act to allow electric borrowers more latitude in making outside investments. It increased the limit of such investments without RUS approval from 3 percent to 15 percent of TUP. While the law did not restrict the type of investments that could be made, the Congressional Record stated the increase was to provide an incentive for electric borrowers to make investments in rural areas. We initiated this review to determine the extent of borrower investments and the extent that those investments were in rural development projects.

We found that the Congressional action to allow electric borrowers' to make investments up to 15 percent of TUP without prior RUS approval has not stimulated increased investments in rural areas. In a 1994 audit, the Office of Inspector General (OIG) reported that less than 1 percent of total investments were in rural areas. This review disclosed essentially the same percentage. We statistically estimated, based on our analysis of calendar year (CY) 1997 data, that of the $10.9 billion in total investments reported by 787 borrowers, only about 90 borrowers invested about $61 million in rural development (about one-half of 1 percent of reported investments).

About three-fourths of RUS borrowers who are current on their mortgage, appear to have the ability to continue to pay their debt, and charge their customers reasonable kilowatt rates are exempted by RUS regulations from the 15 percent investment rule. RUS regulations also permit other borrowers to exclude certain safe type investments from the 15 percent limit. We statistically estimated that 358 of 787 electric borrowers had total investments in excess of 15 percent of TUP. We estimated that these 358 borrowers had total investments of $7.4 billion of which $3.2 billion was in excess of 15 percent of TUP.

[1] RE Act, section 312, Use of Funds, dated December 22, 1987.

Since very little of the total investments (about one-half of 1 percent) have been made in rural development projects, RUS policies and procedures have not significantly helped foster rural development as intended by Congress. Instead, RUS borrowers have used discretionary funds to invest in businesses located in urban areas and a variety of securities and other commercial paper.

KEY RECOMMENDATIONS

We recommend that RUS coordinate with Congress to develop a strategy to encourage electric borrowers to make discretionary investments in rural areas as intended by Congress. We also recommend that RUS include in the Government Performance Review Act (GPRA) Annual Performance Plan a performance measure to assess the increase in borrower investments in rural America.

AGENCY RESPONSE

RUS agreed to strategically develop and implement policies and procedures to strongly encourage borrowers to meet the intent of Congress. However, RUS disagreed that borrower investments in rural development should be included as a GPRA performance measure. A copy of RUS' complete response is included in exhibit M.

OIG POSITION

We agree with RUS' corrective action plan to strategically develop and implement policies and procedures to strongly encourage borrowers to invest in rural development. We requested additional documentation showing the specific actions taken or planned to accomplish this goal and the specific timeframe(s) within which the actions will be completed.

In order to evaluate the effectiveness of the agreed-to strategic action plan, RUS must measure the impact of the policies and procedures implemented to determine whether rural development investments increased. Since the corrective actions must be measured to determine effectiveness in increasing borrower investments in rural development, we continue to believe that such performance measures should be included in RUS' annual GPRA plan. We requested RUS to reconsider its position and include in its annual GPRA plan a performance measure to assess the increase in borrower's investments in rural America.

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EXHIBITS

ABBREVIATIONS

CFR	- Code of Federal Regulations
CY	- Calendar Year
GPRA	- Government Performance Review Act
KWH	- Kilowatt Hour
NRUCFC	- National Rural Utilities Cooperative Corporation
OGC	- Office of the General Counsel
OIG	- Office of Inspector General
RE Act	- Rural Electrification Act of 1936, as amended
REA	- Rural Electrification Administration
RUS	- Rural Utilities Service
TUP	- Total Utility Plant
USDA	- U.S. Department of Agriculture

INTRODUCTION

BACKGROUND

The Rural Electrification Administration (REA) was established in 1935 and became part of the U.S. Department of Agriculture (USDA) in 1939. The REA made insured and guaranteed loans to electric cooperatives in order to extend electric generation and transmission services to rural areas. Statutory provision for the REA is included in the Rural Electrification Act (RE Act) of 1936, as amended. On October 13, 1994, the Rural Utilities Service (RUS) was established by Public Law 103-354, Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994. RUS assumed the duties to administer the electric and telecommunication programs of the former REA and the water and waste programs of the former Rural Development Administration.

RUS serves a leading role in improving the quality of life in rural America by administering electric, telecommunications, and water and waste programs in a service oriented manner. RUS provides policy and planning, in addition to financial and other services, to utilities serving rural areas. The public-private partnership between RUS and local utilities assist rural communities in developing local infrastructure, which support development and improve quality of life in rural America. RUS makes and guarantees loans to electric generation (or power supply) and electric distribution borrowers serving rural areas under the authority of the RE Act of 1936, as amended. These loans and guarantees are made to borrowers generally for a period of 35 years. RUS electric borrowers are either electric generation or electric distribution cooperatives. Electric generation cooperatives generate and/or sell electricity to electric distribution cooperatives who in turn sell the electricity to consumers.

From 1973 to 1993, the REA insured loan interest rate was generally 5 percent; however, the Administrator could approve a 2 percent interest rate in hardship cases. In 1993, the standard interest rate was adjusted to either the municipal rate (based on the current market yield of outstanding municipal obligations) or a hardship rate of 5 percent.

On December 22, 1987, the RE Act was amended by adding Section 312, "Use of Funds." This new section allowed electric borrowers to invest up to 15 percent of the value of their TUP[2] without prior approval of REA (now RUS). Prior to this amendment, a borrower could invest funds up to 3 percent of their TUP value without prior approval from the agency. This 3 percent contractual limit was incorporated as a clause in the borrowers' mortgage agreement.

The Section 312 amendment to the RE Act did not restrict the type of investments, loans, or loan guarantees that borrowers could make. However, the Congressional Record stated that the purpose of increasing the unrestricted investment limit to 15 percent was to provide an incentive for electric borrowers to make investments in rural areas where they were located. In stating its policy that implemented the amendment, RUS assumed that borrowers would use the new latitude afforded them by Section 312 of the RE Act primarily to make the needed investments in rural communities to promote business development and economic diversification projects.

During debate on the Section 312 amendment, Congress expressed concerns that borrowers were restricted in their ability to make needed investments in infrastructure projects (such as water and waste systems, garbage collection services, etc.) or in job creation activities (such as providing technical, financial, and managerial assistance) as well as other activities to promote business development in rural communities. In addition, Congress emphasized that this new level of investments should not in any way put Federal Government funds at risk or impair the borrower's ability to repay their debts.

RUS implemented the Section 312 amendment with a general regulation published in Title 7, Code of Federal Regulation (CFR), part 1717, subpart N. Subpart N specified that borrowers may invest their own funds in any investments, loans, or guaranteed loans without prior approval as long as the borrowers' total investments, loans, or loan guarantees were equal to or less than 15 percent of their TUP value. Subpart N provided for exclusions of certain investments from the calculation of a borrower's investments to TUP percentage ratio and also exempted specific borrowers from obtaining prior approval to invest over 15 percent of their TUP value.

RUS instructions for calculating the percent of investments to TUP is contained in the "Guide for Preparing Financial and Statistical Reports for Electric Distribution Borrowers" (RUS Bulletin 1717B-2) and the "Guide for Preparing Financial and Statistical Reports for Power Supply Borrowers and Electric Distribution Borrowers with Generating Facilities" (RUS Bulletin 1717B-3). As the normal procedure for calculating the percent of investments to TUP, the bulletins state that borrowers should use the amount of funds in "includable" investments added to the balance of funds in their loan guaranties and divide this total amount by the TUP value resulting in the investment ratio expressed as a percent.

[2]Total Utility Plant (TUP) Value is defined as the sum of the borrower's Electric Plant Accounts and Construction Work in Progress - Electric Accounts, as such terms are used in the Uniform System of Accounts (Title 7 CFR 1717.652, Definitions, dated September 21, 1995).

RUS regulations[3] allowed electric borrowers to make unlimited investments in the following "excludable" investment areas:

(1) Securities or deposits issued, guaranteed, or fully insured as to payment by the U.S. Government or any agency thereof;

(2) capital term certificates, bank stock, or other similar securities of the supplemental lender which have been purchased as a condition of membership in the supplemental lender or as a condition receiving financial assistance from such lender, as well as any other investment made in, or loan made to, the National Rural Utilities Cooperative Finance Corporation, the St. Paul Bank of Cooperatives, and Agriculture Cooperative Bank;

(3) patronage capital allocated from a power supply cooperative of which the borrower is a member;

(4) patronage capital allocated from an electric distribution cooperative to a power supply borrower;

(5) invest or lend funds derived directly from grants which the borrower is not obligated to repay, regardless of source or purpose of the grant loans received from or guaranteed by any Federal, State, or local government program designed to promote rural economic development; and

(6) loans made by the borrower and guaranteed by an agency of USDA, up to the amount of principle whose repayment, with interest, is fully guaranteed; and unlimited investments and loans to finance the following community infrastructures that serve primarily consumers located in rural areas and guaranteed debt issued for the construction or acquisition of such infrastructures, up to an aggregate amount of such guarantees not to exceed 20 percent of the borrower's equity: (A) Water and waste disposal systems, (B) solid waste disposal systems, (C) telecommunication and other electronic communication systems, and (D) natural gas distribution systems.

In each of the above four infrastructures, if the system is a component of a larger organization other than the borrower itself, the borrower must certify annually that a majority of the gross revenues of the larger organization came from customers of the systems that were located in rural areas.

Also excluded from the calculation of investments, loans, and loan guarantees made by borrowers are:

- Amounts properly recordable in Account 142 Customer Account Receivable and Account 143 Other Accounts Receivable;
- any investment, loan, or guarantee that the borrower is required to make by an agency of USDA, for example, as a condition of obtaining financial assistance for itself or any other person or organization;

[3]Title 7, Code of Federal Regulations, part 1717, subpart N, Investments, Loans, and Guarantees by Electric Borrowers, dated September 21, 1995.

- investments included in an irrevocable trust for the purpose of funding post-retirement benefits of the borrower's employees;

- reserves required by a reserve bond agreement or other agreement legally binding on the borrower that are dedicated to making required payments on debt secured under the RUS mortgage, not to exceed the amount of reserves specifically required by such agreements; and

- investments included in an irrevocable trust approved by RUS and dedicated for the payment of decommissioning nuclear facilities. The regulation contains a grandfather exclusion for all amounts of individual investments, loans, and guarantees excluded by RUS as of February 16, 1995.

Electric borrowers compute the ratio of investments to TUP per agency instructions and report this ratio on the annual financial reports submitted to RUS. RUS reviews the ratio calculations shown on the annual reports and contacts any nonexempt borrower whose ratio exceeds 15 percent. It is RUS policy to work with any such nonexempt borrower to determine the best course of action to bring the borrower in compliance.

RUS also exempted specific borrowers from any controls in their investment of funds that are used for investments, loans, and loan guarantees under Title 7 CFR 1717.656 with the exception of investments, loans, and loan guarantees made to extend, add to, or modify a borrower's electric system. Borrowers remain exempt if they are in compliance with all provisions of its RUS mortgage, RUS loan contract, and any other agreement with RUS and:

- The average revenue per kilowatt (KWH) for residential services received by a borrower during the two most recent calendar years does not exceed 130 percent of the average revenue per KWH for residential service during the same period for all residential consumers located in the State or States served by the borrowers. (Electric distribution borrowers only.)

- In the most recent calendar year for which data are available, the borrower achieved an operating TIER of at least 1.0 and an operating debt service coverage of at least 1.0 based on the average of the two highest ratios achieved in the three most recent calendar years.

- The borrower's ratio of net utility to long-term debt is at least 1.1 based on year-end data for the most recent calendar year for which data is available.

- The borrower's equity is equal to at least 27 percent of its total assets, based on year-end data for the most recent year for which data is available.

A listing of borrowers who qualified for this exemption was published in Federal Register on September 21, 1995. A total of 590 of the 738 (80 percent) electric distribution cooperatives and 3 of 49 electric generation cooperatives were listed as exempt. RUS officials stated that this listing has not changed since it was published in the Federal Register.

We performed this review of borrowers' investments to determine if the intent of Congress was achieved. We analyzed investments, loans, and loan guarantee information reported to RUS by electric borrowers for CY 1997 in addition to reviewing current RUS policies and procedures. As of December 31, 1997, there were 798 active electric generation and distribution borrowers with outstanding direct and guaranteed loan balances totaling $55.8 billion of which 787 borrowers reported financial information to RUS for CY 1997.

OBJECTIVES

The audit objectives were to determine the extent of electric generation and distribution borrowers' investments and the extent that those investments were in rural development projects.

SCOPE

We obtained electric borrowers' financial information for CY 1997 from the RUS National Office in Washington, D.C. We analyzed Forms 12a, Operating Reports - Financial, and Forms 12h, Operating Reports - Annual Supplement, as of December 31, 1997, for electric generation borrowers. Forms 12a and 12h were reviewed for the 49 electric generation borrowers that provided these reports to RUS for CY 1997. For electric distribution borrowers, we reviewed Forms 7, Financial and Statistical Report, and Forms 7a, Investments, Loan Guarantees and Loans - Distribution, as of December 31, 1997. Forms 7 and 7a were reviewed for a random statistical sample of 100 of the 738 electric distribution borrowers that provided these reports to RUS for CY 1997. The random sample of distribution borrowers was divided into two strata consisting of 50 borrowers who were exempted and 50 borrowers who were not exempted from obtaining prior approval from RUS to invest over 15 percent of TUP value. See exhibit I for the statistical sample design.

We did not visit the selected borrowers to validate the information reported to RUS on the forms 7, 7a, 12a, and 12h. RUS loan funds are audited by RUS field auditors approximately every 3 years and the borrowers' financial statements are certified annually by certified public accountants. The RUS National Office staff also reviews and makes adjustments and corrections to the information submitted annually by the electric borrowers. Therefore, we accepted the information as reported by the borrowers and reviewed and/or amended by RUS personnel for the purpose of this audit. The fieldwork for this audit was performed during the period September 1998 through May 1999.

This audit was performed in accordance with the Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, the audit included such tests of program and accounting records as considered necessary to meet the audit objectives.

METHODOLOGY

To accomplish the audit objectives, we relied on testimonial, documentary, and analytical evidence which consisted of (1) a review of RUS regulations, polices, procedures and interviews with RUS personnel regarding borrower investments, (2) a review of RUS instructions to borrowers for completion of forms 7, 7a, 12a and 12h, (3) a review of 49 electric generation borrowers' forms 12a and 12h submitted to RUS for CY 1997, (4) a review of 100 sampled electric distribution borrowers' forms 7 and 7a submitted to RUS for CY 1997, and (5) computation of total investments reported for the 49 electric generation borrowers and the random sample of 100 electric distribution borrowers. We also contacted two electric borrowers to obtain an understanding of the borrowers' reported investments.

FINDINGS AND RECOMMENDATIONS

CHAPTER 1. RE ACT AMENDMENTS HAVE NOT FOSTERED RURAL DEVELOPMENT INVESTMENTS

BORROWERS NOT INVESTING IN RURAL DEVELOPMENT

FINDING NO. 1

RUS electric generation and distribution borrowers did not increase their investment portfolio in rural development as intended by Congress when it amended the RE Act to increase the amount of investments, loans, and loan guarantees that electric borrowers could make without prior approval of RUS. Electric borrowers have taken advantage of the 15 percent investment rule; however, they have not invested in rural development projects. We statistically estimated that of the $10.9 billion in investments reported by 787 borrowers in CY 1997, only 90 borrowers reported about $61 million in rural development investments (about one-half of 1 percent of the reported investments).

In addition, RUS regulations exempt financially strong borrowers who charged reasonable kilowatt rates from the 15 percent limit. This exclusion applies to about three-fourths of all borrowers. Regulations also permitted other borrowers to exclude certain safe type investments from the limit. Therefore, when we included all investments in computing the percent of investments to total utility plant (TUP) value, we found that almost half of the electric borrowers had total investments, loans, and loan guarantees in excess of 15 percent of TUP. We statistically estimated that 358 of the 787 borrowers had investments in excess of 15 percent of TUP.

In December 1987, Congress amended the RE Act by adding the following under Section 312, Use of Funds: "A borrower of an insured or guaranteed electric loan under this Act may, without restriction or prior approval of the Administrator, invest its own funds or make loans or loan guarantees, not in excess of 15 percent of its total utility plant [TUP]."[4] The Congressional intent for allowing borrowers to invest up to 15 percent of their TUP was to permit borrowers to invest in rural development within their local communities. However, the law as written did not mention rural development. The law stated that REA (now RUS) was to approve borrower investments, loans, and loan guarantees that exceed 15 percent of TUP. Prior to December 1987, borrowers were allowed to make investments, loans, and loan guarantees up to 3 percent of TUP without REA approval by a contractual limit clause incorporated into the mortgage agreement with REA.

In his opening statements for the May 1991 REA hearings before the Subcommittee on Conservation, Credit, and Rural Development, Committee on Agriculture, House of Representatives, the chairman of the subcommittee stated that it was not the intent of Congress that the agency divorce itself as to how those funds are invested, where they are invested, and having knowledge of those investments since all borrower assets are collateral for agency loans. The chairman stated that Congress would expect, as any prudent lender would, that the agency would keep track of where those borrower investments are, what kind of investments they are, how secure they are, and whether they are in keeping with the intent of Congress. The chairman also stated that Congress intended for the borrowers to become actively involved in rural development.

INVESTMENTS IN RURAL AREAS

A review of the Congressional hearing and legislative history of section 312 of the RE Act, shows that the intent of Congress was to reduce the restriction on investments by electric borrowers and to stimulate the rural economy by increasing investments in rural development projects. This was accomplished by increasing the 3 percent imposed by their mortgage agreement with the Government on investment of their funds by permitting borrowers the liberty to invest more of their funds in rural development projects that help their local communities. The legislative history to change the law stated:

> This 3 percent limitation is an undue and counterproductive restriction on REA borrowers. REA borrowers have played a critical role in the economic development of rural areas for over 50 years. However, today rural America faces the challenge of rebuilding its economic base after several years of agriculture depression. Rebuilding a more diversified economy in rural communities will require creative approaches, technical assistance, and new financial resources. Permitting this increase from 3 percent to 15 percent of an electric borrower's total utility plant is a small incremental contribution to that rebuilding effort and should not in any way put Government funds or security at risk.

[4] RE Act, Section 312, Use of Funds, dated December 22, 1987.

Another statement says:

> Borrowers from REA electric loan program are now prohibited administratively from making their fullest contribution to the communities they serve. Under the agency's present policy, electric borrowers are not permitted to invest more than 3 percent of their own funds for "non-Act" purposes, i.e., facilities or projects not required to provide electricity to rural consumers. Because of this restriction which is not statutorily imposed, rural electric borrowers are restricted in their ability to make needed investments in rural community infrastructure projects (such as water and waste systems, garbage collection services, etc.) and in job creation activities (such as providing technical, financial, managerial assistance and other activities) to promote business development in rural communities.

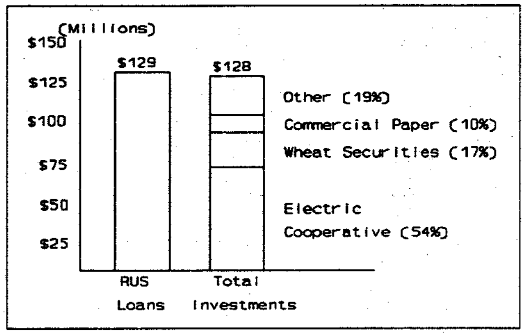
The record clearly indicates that one of the primary purposes of increasing the statutory investment rule was for increasing the funds available for rural development projects and to promote the ability of electric borrowers to improve the rural areas they serve.

We found that only 18 of the 149 borrowers that we reviewed (4 generation and 14 distribution borrowers) reported investments in rural development. Total investments, loans, and loan guarantees for the 149 borrowers reviewed totaled almost $5 billion while rural development investments totaled about $33 million (0.07 percent). See exhibit B for a list of the 18 borrowers that we reviewed who reported investments in rural development.

Electric borrowers reported investments such as patronage capital, U.S. Treasury notes, stocks and bonds, money market certificates, certificates of deposit, commercial paper, cash, capital term certificates, real estate, and mutual funds. For example, one distribution borrower (NM023) reported investments of $43.4 million of which about $78,000 (0.2 percent) was in rural development. Another distribution borrower (VA055) reported investments of $127.6 million of which none was in rural development. See exhibit L for the investments reported by these borrowers.

We discussed investment practices with the president and vice-president, finance, for a large electric distribution borrower located in the suburb of Washington, DC (VA 055). Although this borrower owed RUS $129 million, the cooperative held $127.6 million in investments (39 percent of TUP), none of which was classified as rural development.

The chart below shows the relationship of the borrower's loan balance and its investment portfolio. (See exhibit L for investment details.)



According to the president, the cooperative has limited opportunities to invest in rural development primarily because of its location in a rapidly growing suburban community. In selecting investment opportunities, the cooperative attempts to provide a financial return that maximizes financial benefits to its members. While willing to invest in rural America, the cooperative does not actively seek such opportunities.

Based on the results of our review, we statistically estimated that the 787 electric generation and distribution borrowers in the sample universe reported investments totaling $10.9 billion of which about 90 borrowers reported about $61 million in rural development investments (about one-half of 1 percent of total investments). See exhibits I and J for the statistical sample design and projections.

INVESTMENTS IN EXCESS OF 15 PERCENT

RUS regulations[5] implementing section 312 of the RE Act allows borrowers to make unlimited investments in certain areas (such as safe investments in securities or deposits fully insured by the U.S. Government) and to exclude those investments from the computation of the percent of investments to TUP. Also, certain borrowers were given blanket approval to invest more than 15 percent of TUP. Borrowers who were current on their RUS mortgage, appear to have the ability to continue to pay its debt, and do not charge their customers an excessive amount were classified as "exempt" borrowers. Exempt borrowers were given blanket approval to invest more than 15 percent of TUP without prior approval. (See Background for details regarding excludable investments.)

[5]Title 7, Code of Federal Regulations, Part 1717, subpart N, Investments, Loans, and Guarantees by Electric Borrowers, dated July 1, 1991.

RUS policy instructs borrowers to classify their investments into two types: Excludable and includable. "Excludable" investments (which are considered safe) are not to be used in the computation of the percent of investments to TUP. RUS policy provides that when borrowers compute the percent of investments to TUP, only "includable" investments and the balance of any guaranteed loans are to be considered. As a result, only a portion of the borrowers' investments are used to calculate the investment to TUP ratio.

In CY 1997, 6 of the 149 borrowers that we reviewed (3 exempt and 3 nonexempt) reported that they exceeded 15 percent of TUP when using the RUS methodology for computing the investment to TUP ratio. The average total investment to TUP ratios for the 49 generation, 50 nonexempt distribution, and 50 exempt distribution borrowers that we reviewed were 5.19, 3.75, and 3.50 percent, respectively, using RUS' calculation methodology. The overall average for these 149 borrowers (per the RUS methodology) was less than 5 percent (about 3.9 percent). See exhibits C, E, and G for the investment to TUP ratios for the 149 borrowers in our sample.

However, if all investments, loans, and loan guarantees are considered, the average ratios for the 49 generation, 50 nonexempt distribution, and 50 exempt distribution borrowers that we reviewed were 22.59, 13.55, and 16.89 percent, respectively (as computed by OIG). See exhibits D, F, and H for the 65 borrowers in our sample whose total investments exceeded 15 percent of TUP.

In addition, when all investments, loans, and loan guarantees were considered, 65 of the 149 electric generation and distribution borrowers that we reviewed (27 exempt and 38 nonexempt) had investments, loans, and loan guarantees in excess of 15 percent of TUP. We found that 24 of the 49 electric generation borrowers and 41 of the 100 sampled electric distribution borrowers exceeded 15 percent of TUP. The average investment to TUP ratio for these 65 borrowers was 26 percent. (Note: These percentages are actual for the 149 borrowers that we reviewed and are not statistical estimates for the total universe of 787 electric borrowers.)

Based on the data for the 149 borrowers reviewed, we statistically estimated that 358 of the 787 (sampling precision of 20.5 percent) electric borrowers in our sample universe (24 of the 49 electric generation borrowers and an estimated 334 of the 738 electric distribution borrowers) exceeded 15 percent of TUP when total investments (both "includable" and "excludable"), loan balances, and guaranteed loan balances reported for CY 1997 were used to calculate the percent of investment to TUP. Our best (midpoint) estimate was that these 358 borrowers had total investments, loans, and loan guarantees totaling $7.4 billion (sampling precision of 52.7 percent) of which $3.2 billion was in excess of 15 percent of TUP (sampling precision of 71.8 percent). (We are 95 percent certain that these 358 borrowers had investments totaling at least $4.7 billion of which at least $1.6 billion was in excess of 15 percent of TUP.)

We found that the actual investment to TUP ratio was 26 percent for the 24 generation borrowers that reported investments in excess of 15 percent (see exhibit D). We statistically estimated that the percent investment to TUP ratio was 23 percent for the 334 distribution borrowers who reported investments in excess of 15 percent of TUP. See exhibit J for the statistical estimates.

Figure 1 below illustrates the estimated investments, loans, and loan guarantees that were included and excluded by these 358 borrowers when computing investments as a percent of TUP. (Figure values may not total due to rounding and statistically projected values.)

Figure 1: Investments, Loans, and Loan Guarantees for the Estimated 358 Electric Generation and Distribution Borrowers That Had Total Investments in Excess of 15 Percent of TUP Value During CY 1997

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(billions)

$10 |
$9  |
$8  |                         $7.4
    |                         TTTTTT
$7  |                         TTTTTT
    |               $5.7      TTTTTT
$6  |               EEEEEE    TTTTTT
    |               EEEEEE    TTTTTT
$5  |               EEEEEE    TTTTTT
    |               EEEEEE    TTTTTT    $4.2
$4  |               EEEEEE    TTTTTT    PPPPPP
    |               EEEEEE    TTTTTT    PPPPPP    $3.2
$3  |               EEEEEE    TTTTTT    PPPPPP    YYYYYY
    |               EEEEEE    TTTTTT    PPPPPP    YYYYYY
$2  |     $1.6      EEEEEE    TTTTTT    PPPPPP    YYYYYY
    |     IIIIII    EEEEEE    TTTTTT    PPPPPP    YYYYYY
$1  |     IIIIII    EEEEEE    TTTTTT    PPPPPP    YYYYYY
    |     IIIIII    EEEEEE    TTTTTT    PPPPPP    YYYYYY
0   |_____IIIIII____EEEEEE____TTTTTT____PPPPPP____YYYYYY

          Invest-   Invest-   Total     15%       Invest-
          ments     ments     Invest-   of TUP    ments
          Included  Excluded  ments               Over
          in RUS    in RUS                        15%
          Percent   Percent                       of TUP
          of TUP    of TUP
          Compu-    Compu-
          tation    tation
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Specific details for the electric generation and distribution borrowers are discussed separately in exhibit K.

RUS does not measure the amount of borrower investments in rural America as part of its Government Performance Review Act (GPRA) process. Given the level of Congressional interest in stimulating such investments, and given the relatively low level of accomplishment to date, the agency should begin measuring increases in rural investments as part of the GPRA process.

RECOMMENDATION NO. 1

Develop and implement a strategy to encourage electric borrowers to make discretionary investments in rural areas as intended by Congress.

RUS Response

In his February 28, 2000, written response to the draft report, a copy of which is included as exhibit M, the RUS Assistant Administrator for Electric Programs stated that RUS developed policies and procedures strictly adhering to the letter of the law regarding Section 312, Use of Funds, of the RE Act. The Assistant Administrator said no restrictions were placed on the type of investments, loans, or loan guarantees that borrowers could make due to the fact that no restrictions were included in the legislation. RUS attempts to influence borrowers by stating in the regulations (Title 7, CFR 1717, subpart N, General Section) that electric borrowers are encouraged to utilize their own funds to participate in the economic development of rural areas, provided such activity does not in any way put Government funds at risk or impair a borrower's ability to repay its indebtedness to RUS and other lenders.

The Assistant Administrator stated that many borrowers are investing in rural development projects, but may not classify them as rural development investments on the Forms 7a and 12h submitted to RUS. Many borrowers may be confused with the designations of "included" and "excluded" and may not correctly classify "excluded" rural economic development projects as rural development investments. By not including these "excluded" rural development investments, the amount of borrower investments in rural development is reduced, thus increasing the perception that borrowers are not addressing the need identified by Congress.

The Assistant Administrator agreed that electric borrowers should be making a conscious effort to provide for and facilitate rural development in these areas. RUS assumes that borrowers will use the latitude afforded them by Section 312 of the RE Act to make needed investments in rural community infrastructure projects. RUS will strategically develop and implement policies and procedures to strongly encourage borrowers to meet the intent of Congress. As part of this process, RUS will review the instructions for Form 7a and 12h in an effort to clarify any inconsistencies in identifying "included" and "excluded" rural development projects. This will be a top priority for fiscal year 2001.

OIG Position

We agree with RUS' corrective action plan to strategically develop and implement policies and procedures to strongly encourage borrowers to meet the intent of Congress regarding investments in rural development. To reach agreement with RUS's management decision, we request additional documentation showing the specific actions taken or planned to accomplish this goal and the specific timeframe(s) within which the actions will be completed. We also agree that these actions should be given top priority because such actions are in agreement with the Secretary's initiative of "keeping rural America alive" so that residents, even those who are not involved in production agriculture, will still want to stay in rural America. In addition, such actions should be initiated as soon as possible this fiscal year in order for the action plan to be implemented and given top priority in fiscal year 2001.

RECOMMENDATION NO. 2

Include in RUS' annual GPRA plan a performance measure to assess the increase in borrowers' investments in rural America.

RUS Response

In his written response to the draft report, the Assistant Administrator for Electric Programs stated that RUS recognizes the concept and believes it to be very important to quantify activity using measurable and verifiable means to judge the accomplishment of agency goals and objectives. However, with respect to this particular type of discretionary investing, RUS is of the firm opinion that additional consideration must be given to the original intent of the RE Act and loan security in this time of evolutionary change in the electric utility industry.

The Assistant Administrator said electric industry restructuring efforts are advancing across America ushering in a competitive retail marketplace. States are enacting restructuring legislation or comprehensive restructuring regulatory orders and Congressional committees are reviewing proposed Federal legislation. In light of this uncertainty, electric utilities are placing a major emphasis on controlling expenses in an effort to establish a favorable position in rate competitiveness and many utilities are making strategic investments to improve system reliability. This transition to a competitive marketplace may tend to shrink revenue. Combining shrinking revenue with cost controlling efforts and a renewed emphasis on system reliability will minimize the funds available for non-utility plant investment. The quick changing nature of the electric utility business is forcing RUS borrowers (and non-borrower electric utilities alike) to reevaluate long-term investments, whether these investments be in utility plant of community development projects.

The Assistant Administrator said the economic climate and stability of the electric utility industry has changed dramatically in the 13 years following the approval of this investment legislation. The uncertainty of the electric utility restructuring efforts combined with the lagging rural economic recovery and fragile farm economy mandates that the flexibility provided by the 15 percent investment rule be maintained without instituting specific program performance levels.

The Assistant Administrator said encouragement by RUS to continue community development efforts, at appropriate funding levels determined by each borrower, is a laudable effort. Such investment should help build customer/community loyalty which will prove to be priceless in a competitive environment. However, establishing an arbitrary target percentage of total utility plant or a specific number of borrowers making investments in community economic development will do disservice to the electric program in this time of regulatory and market change. While RUS strongly supports borrower economic development effort, specific RUS directives would not be prudent at this time, and could take the focus off of rate competitiveness, reliability, loan security and the long-term economic health of the borrower and the rural community it serves. Such action would be contrary to the intent of the RE Act and Section 312 amendment.

The Assistant Administrator said RUS believes that improvement to the electric program can be attained by: (1) Strategically developing and implementing policies that encourage borrower investment in rural economic development, (2) reviewing Forms 7a and 12h for proper classification of rural development investments, and (3) revising current Form 7a and 12h instructions to help borrowers improve on the tracking of rural economic development projects.

OIG Position

RUS agreed to strategically develop and implement policies and procedures to strongly encourage borrowers to meet the intent of Congress regarding investments in rural development (Recommendation No. 1). In order to evaluate the effectiveness of the actions taken for Recommendation No. 1, RUS must measure the impact of the policies and procedures implemented and determine whether rural development investments increased. Since the corrective actions must be measured to determine effectiveness, we continue to believe such performance measures should be included in RUS' annual GPRA plan. Therefore, we request RUS to reconsider its position regarding Recommendation No. 2 and include in its annual GPRA plan a performance measure to assess the increase in borrower's investments in rural America.

EXHIBIT A - SUMMARY OF MONETARY RESULTS

There are no monetary results being tracked as a result of this audit.

EXHIBIT B - ELECTRIC BORROWERS' INVESTMENTS IN RURAL DEVELOPMENT PROJECTS

No.	Borrower ID	TUP Value	RD Investments	RD Guaranteed Loans	RD Loans	Total RD Investments
Generation Borrowers						
1	IA 084	$251,318,690	$2,732,758	$0	$0	$2,732,758
2	KY 062	$1,537,355,412	$10,000	$0	$0	$10,000
3	NC 067	$1,718,171,021	$1,000,000	$0	$5,477,408	$6,477,408
4	SD 043	$113,409,511	$652,985	$0	$0	$652,985
Sub Totals		$3,620,254,634	$4,395,743	$0	$5,477,408	$9,873,151
Average		$905,063,659	$1,098,936	$0	$1,369,352	$2,468,288
Nonexempt Distribution	Borrower ID	TUP Value	RD Investments	RD Guarantee Loans	RD Loans	Total RD Investments
5	IA 079	$17,789,843	$65,954	$0	$0	$65,954
6	OR 017	$33,578,939	$22,395	$0	$0	$22,395
7	ND 022	$36,154,267	$591,033	$0	$341,970	$933,003
8	ND 050	$66,756,769	$1,872,841	$0	$1,874,341	$3,747,182
9	IA 073	$17,908,918	$6,831	$0	$0	$6,831
10	SD 012	$69,594,786	$5,260,007	$5,200,192	$1,048,419	$11,508,618
11	KS 044	$58,716,938	$682,417	$0	$0	$682,417
12	SD 020	$12,591,055	$24,000	$306,074	$0	$330,074
13	ND 011	$87,509,276	$482,711	$2,796,413	$0	$3,279,124
Sub Totals		$396,600,791	$9,008,189	$8,202,679	$3,264,730	$20,475,598
Average		$44,066,755	$1,000,910	$911,409	$362,748	$2,275,066
Exempt Distribution	Borrower ID	TUP Value	RD Investments	RD Guaranteed Loans	RD Loans	Total RD Investments
14	KY 021	$58,074,353	$610,185	$0	$0	$610,185
15	MT 031	$11,646,329	$300,000	$0	$0	$300,000
16	SD 036	$11,052,599	$406,666	$0	$0	$406,666
17	AL 025	$37,260,621	$452,000	$0	$0	$452,000
18	KY 034	$37,343,875	$236,440	$0	$236,440	$472,880
Sub Totals		$155,377,747	$2,005,291	$0	$236,440	$2,241,731
Average		$31,075,549	$401,058	$0	$47,288	$448,346
Grand Total	18	$4,172,233,172	$15,409,223	$8,202,679	$8,978,578	$32,590,480
	Borrowers	TUP	RD Investments	RD Guarantee Loans	RD Loans	Total RD Investments
Total in Sample	149	$35,516,165,467	$15,409,223	$8,202,679	$8,978,578	$32,590,480
Average per Borrower		$238,361,647	$103,418	$55,052	$60,259	$218,728

EXHIBIT C - ELECTRIC GENERATION BORROWERS' TOTAL INVESTMENTS

No.	Borrower ID	TUP Value	Reported Investments			Guaranteed Loans Balance	Direct Loans Balance	Total Investments, Loans, and Guarantees	OIG Percent	RUS Percent	Cash and Temporary Investments
			Includable	Excludable	Total						
1	AL 042	$840,554,512	$3,150,480	$80,100,070	$83,250,550	$0	$0	$83,250,550	9.90	0.37	$72,603,583
2	AK 032	$19,441,607	$637,801	$10,460,778	$11,098,579	$0	$0	$11,098,579	57.09	3.28	$2,919,726
3	AR 032	$421,754,787	$1,267,114	$41,255,755	$42,522,869	$0	$0	$42,522,869	10.08	0.30	$11,188,325
4	AR 034	$964,235,318	$41,177,125	$87,024,153	$128,201,278	$0	$0	$128,201,278	13.30	4.27	$109,149,132
5	CO 047	$1,328,283,978	$124,124,502	$100,169,097	$224,293,599	$0	$0	$224,293,599	16.89	9.34	$111,111,774
6	FL 041	$851,538,229	$4,235,848	$182,024,998	$186,260,846	$0	$0	$186,260,846	21.87	0.50	$81,595,153
7	GA 109	$5,117,917,703	$157,527,306	$241,439,960	$398,967,266	$0	$0	$398,967,266	7.80	3.08	$157,796,110
8	GA 110	$902,690,930	$44,407,111	$200,410	$44,607,521	$0	$0	$44,607,521	4.94	4.92	$34,013,211
9	IL 050	$177,205,623	$195,049	$4,806,913	$5,001,962	$0	$0	$5,001,962	2.82	0.11	$2,008,177
10	IN 107	$191,093,830	$24,104,217	$18,461,307	$42,565,524	$0	$0	$42,565,524	22.27	12.61	$25,460,394
11	IA 083	$444,150,112	$23,565,614	$77,198,113	$100,763,727	$1,506,353	$0	$102,270,080	23.03	5.64	$45,110,303
12	IA 084	$251,318,690	$5,499,751	$22,711,580	$28,211,331	$0	$0	$28,211,331	11.23	2.19	$6,294,418
13	IA 085	$85,653,963	$2,898,322	$16,992,576	$19,890,898	$448,321	$0	$20,139,219	23.51	3.67	$221,700
14	IA 086	$9,710,644	$643,600	$4,540,645	$5,184,245	$0	$0	$5,184,245	53.39	6.63	$1,291,172
15	KS 054	$220,286,113	$5,534,540	$23,913,344	$29,447,884	$0	$9,870	$29,457,754	13.37	2.51	$15,924,053
16	KY 059	$1,067,789,559	$17,021,061	$91,864,269	$108,885,330	$0	$813,274	$109,698,604	10.27	1.59	$31,074,541
17	KY 062	$1,537,355,412	$5,086,556	$17,299,721	$22,386,277	$0	$0	$22,386,277	1.40	0.33	$14,781,911
18	LA 030	$1,199,702,844	$137,822,622	$33,565,653	$171,388,275	$0	$0	$171,388,275	14.29	11.49	$19,052,747
19	MN 106	$803,415,768	$56,487,725	$56,143,282	$112,631,007	$0	$187,185	$112,818,192	14.04	7.03	$2,360,898

EXHIBIT C - ELECTRIC GENERATION BORROWERS' TOTAL INVESTMENTS

20	MN 107	$899,915,725	$28,629,737	$57,522,828	$86,152,563	$10,334,039	$5,464,226	$101,950,828	10.20	3.90	$43,427,415
21	MS 053	$826,440,344	$467,836	$50,402,912	$50,870,748	$0	$0	$50,870,748	6.16	0.06	$27,852,019
22	MO 059	$136,085,604	$2,296,429	$46,230,645	$48,527,074	$0	$1,757,243	$50,284,317	36.95	1.69	$4,289,650
23	MO 060	$65,942,239	$109,033	$21,749,929	$21,858,962	$0	$0	$21,858,962	33.15	0.17	$4,587,391
24	MO 070	$51,689,196	$3,222,791	$14,925,041	$18,147,832	$0	$0	$18,147,832	35.11	6.23	$2,746,149
25	MO 071	$116,506,667	$18,672,266	$32,421,992	$51,094,258	$0	$0	$51,094,258	43.86	16.03	$44,783
26	MO 072	$35,527,790	$1,363,448	$17,620,369	$18,983,817	$0	$0	$18,983,817	53.43	3.84	$367,478
27	MO 073	$1,312,107,238	$34,329,691	$145,632,144	$179,961,835	$0	$0	$179,961,835	13.72	2.62	$112,221,996
28	MT 040	$23,719,268	$2,382,863	$14,435,498	$16,818,361	$0	$0	$16,818,361	70.91	10.05	$1,918,294
29	NM 018	$568,559,641	$24,334,815	$11,113,739	$35,448,554	$0	$0	$35,448,554	6.23	4.28	$10,033,156
30	NC 067	$1,718,171,021	$35,940,066	$292,134,661	$328,074,727	$0	$5,541,633	$333,616,360	19.42	2.09	$91,936,131
31	ND 020	$208,608,597	$17,561,809	$0	$17,561,809	$0	$0	$17,561,809	8.42	8.42	$16,048,632
32	ND 042	$60,351,090	$369,728	$11,616,588	$11,986,316	$0	$0	$11,986,316	19.86	0.61	$162,181
33	ND 045	$2,118,713,282	$137,326,671	$518,504,651	$655,831,322	$107,426,738	$336,299	$763,594,359	36.04	11.55	$172,918,842
34	ND 048	$461,879,425	$11,697,358	$0	$11,697,358	$0	$0	$11,697,358	2.53	2.53	$10,629,080
35	OK 032	$813,305,911	$32,616,791	$14,999,936	$47,616,727	$0	$0	$47,616,727	5.85	4.01	$185,230
36	SC 050	$63,398,512	$261,891	$60,027,167	$60,289,058	$0	$0	$60,289,058	95.10	0.41	$13,936,298
37	SC 051	$516,487,989	$3,409,756	$66,103,964	$69,513,720	$0	$0	$69,513,720	13.46	0.66	$37,114,440
38	SD 043	$113,409,511	$12,426,423	$24,339,128	$36,765,551	$0	$4,725,936	$41,491,487	36.59	10.96	$4,506,687
39	TX 121	$500,910,495	$5,498,351	$22,135,905	$27,634,256	$0	$0	$27,634,256	5.52	1.10	$1,389,341
40	TX 148	$89,313,789	$191,272	$17,648,711	$17,839,983	$0	$0	$17,839,983	19.97	0.21	$5,541,072
41	TX 154	$68,224,569	$10,744,170	$2,315,410	$13,059,580	$0	$0	$13,059,580	19.14	15.75	$10,794,170
42	TX 155	$453,912,457	$27,621	$29,454,442	$29,482,063	$0	$0	$29,482,063	6.50	0.01	$13,421,185

EXHIBIT C - ELECTRIC GENERATION BORROWERS' TOTAL INVESTMENTS

43	TX 158	$107,803,738	$8,463,003	$56,176,647	$64,639,650	$0	$0	$64,639,650	59.96	7.85	$25,064,991
44	IN 106	$1,126,266,347	$57,936,025	$51,921,085	$109,857,110	$0	$0	$109,857,110	9.75	5.14	$38,687,987
45	OR 042	$62,866,680	$1,704,196	$4,571,821	$6,276,017	$0	$0	$6,276,017	9.98	2.71	$1,099,844
46	WI 064	$636,327,262	$35,722,411	$98,132,891	$133,855,302	$0	$0	$133,855,302	21.04	5.61	$866,833
47	AZ 028	$437,892,794	$36,691,314	$43,909,590	$80,600,904	$0	$0	$80,600,904	18.41	8.38	$37,996,987
48	PA 027	$715,081,364	$37,285,952	$6,974,073	$44,260,025	$0	$0	$44,260,025	6.19	5.21	$22,018,250
49	TX 157*	$23,443,281	$7,545,503	$4,632,108	$12,177,611	$0	$0	$12,177,611	51.94	32.19	$7,553,750
	TOTAL	$30,866,941,448	$1,224,415,564	$2,847,826,497	$4,072,242,061	$119,715,451	$18,835,666	$4,210,793,178			$1,463,315,592
	Average	$629,957,581	$24,988,073	$58,118,908	$83,106,981	$2,443,172	$384,401	$85,934,555	13.64	4.42	$29,863,584

* Does not include assumed TU Electric note by TX 157.

EXHIBIT D - ELECTRIC GENERATION BORROWERS' INVESTMENTS IN EXCESS OF 15 PERCENT OF TOTAL UTILITY PLANT VALUE

No.	Borrower ID	Insured Debt to RUS as of 12/31/97	TUP Value	Investments			Guaranteed Loans Balance	Direct Loans Balance	Total Investments, Loans, and Guarantees	OIG Percent	RUS Percent	Cash and Temporary Investments
				Includable	Excludable	Total						
1	AK 032	$0	$19,441,607	$637,801	$10,460,778	$11,098,579	$0	$0	$11,098,579	57.09	3.28	$2,919,726
2	CO 047	$56,934,990	$1,328,283,978	$124,124,502	$100,169,097	$224,293,599	$0	$0	$224,293,599	16.89	9.34	$111,111,774
3	FL 041	$7,885,620	$851,538,229	$4,235,848	$182,024,998	$186,260,846	$0	$0	$186,260,846	21.87	0.50	$81,595,153
4	IN 107	$92,036,491	$191,093,830	$24,104,217	$18,461,307	$42,565,524	$0	$0	$42,565,524	22.27	12.61	$25,460,394
5	IA 083	$68,831,893	$444,150,112	$23,565,614	$77,198,113	$100,763,727	$1,506,353	$0	$102,270,080	23.03	5.64	$45,110,303
6	IA 085	$5,487,614	$85,653,963	$2,698,322	$16,992,576	$19,690,898	$448,321	$0	$20,139,219	23.51	3.67	$221,700
7	IA 086	$2,813,717	$9,710,644	$643,600	$4,540,645	$5,184,245	$0	$0	$5,184,245	53.39	6.63	$1,291,172
8	MO 059	$36,135,487	$136,085,604	$2,296,429	$46,230,645	$48,527,074	$0	$1,757,243	$50,284,317	36.95	1.69	$4,289,650
9	MO 060	$11,766,945	$65,942,239	$109,033	$21,749,929	$21,858,962	$0	$0	$21,858,962	33.15	0.17	$4,587,391
10	MO 070	$5,780,724	$51,689,196	$3,222,791	$14,925,041	$18,147,832	$0	$0	$18,147,832	35.11	6.23	$2,746,149
11	MO 071	$31,214,413	$116,506,667	$18,672,266	$32,421,992	$51,094,258	$0	$0	$51,094,258	43.86	16.03	$44,783
12	MO 072	$11,073,304	$35,527,790	$1,363,448	$17,620,369	$18,983,817	$0	$0	$18,983,817	53.43	3.84	$367,478
13	MT 040	$7,703,556	$23,719,268	$2,382,863	$14,435,498	$16,818,361	$0	$0	$16,818,361	70.91	10.05	$1,918,294
14	NC 067	$7,697,808	$1,718,171,021	$35,940,066	$292,134,661	$328,074,727	$0	$5,541,633	$333,616,360	19.42	2.09	$91,936,131
15	ND 042	$26,983,548	$60,351,090	$369,728	$11,616,588	$11,986,316	$0	$0	$11,986,316	19.86	0.61	$162,181
16	ND 045	$100,370,199	$2,118,713,282	$137,326,671	$518,504,651	$655,831,322	$107,426,736	$336,299	$763,594,359	36.04	11.55	$172,918,842
17	SC 050	$68,396,326	$63,398,512	$261,891	$60,027,167	$60,289,058	$0	$0	$60,289,058	95.10	0.41	$13,936,298

EXHIBIT D - ELECTRIC GENERATION BORROWERS' INVESTMENTS IN EXCESS OF 15 PERCENT OF TOTAL UTILITY PLANT VALUE

18	SD 043	$47,230,540	$113,409,511	$12,426,423	$24,339,128	$36,765,551	$0	$4,725,936	$41,491,487	36.59	10.96	$4,506,687
19	TX 148	$9,623,214	$89,313,789	$191,272	$17,648,711	$17,839,983	$0	$0	$17,839,983	19.97	0.21	$5,541,072
20	TX 154	$0	$68,224,569	$10,744,170	$2,315,410	$13,059,580	$0	$0	$13,059,580	19.14	15.75	$10,794,170
21	TX 158	$0	$107,803,738	$8,463,003	$56,176,647	$64,639,650	$0	$0	$64,639,650	59.96	7.85	$25,064,991
22	WI 064	$0	$636,327,262	$35,722,411	$98,132,891	$133,855,302	$0	$0	$133,855,302	21.04	5.61	$866,833
23	AZ 028	$14,382,979	$437,892,774	$36,691,314	$43,909,590	$80,600,904	$0	$0	$80,600,904	18.41	8.38	$37,996,987
24	TX 157*	$0	$23,443,281	$7,545,503	$4,632,108	$12,177,611	$0	$0	$12,177,611	51.94	32.19	$7,553,750
	TOTAL	$612,349,368	$8,796,391,956	$493,739,186	$1,686,668,540	$2,180,407,726	$109,381,412	$12,361,111	$2,302,150,249			$652,941,909
	Average	$25,514,557	$366,516,332	$20,572,466	$70,277,856	$90,850,322	$4,557,559	$515,046	$95,922,927	26.17	7.00	$27,205,913

EXHIBIT E - NONEXEMPT ELECTRIC DISTRIBUTION BORROWERS' TOTAL INVESTMENTS

No.	Borrower ID	TUP Value	Investments			Guaranteed Loans Balance	Direct Loans Balance	Total Investments, Loans, and Guarantees	OIG Percent	RUS Percent	Cash and Temporary Investments
			Includable	Excludable	Total						
1	IA 079	$17,789,843	$247,229	$2,198,903	$2,446,132	$0.00	$65,422	$2,511,554	14.12	1.39	$801,821
2	CO 025	$54,195,389	$808,016	$8,610,042	$9,418,058	$0.00	$12,302	$9,430,360	17.40	1.49	$1,322,370
3	KS 051	$75,039,434	$7,473,871	$2,397,293	$9,871,164	$0.00	$0.00	$9,871,164	13.15	9.96	$3,054,421
4	LA 013	$215,603,476	$2,973,415	$5,776,364	$8,749,779	$333,993	$0.00	$9,083,772	4.21	1.53	$2,028,457
5	ME 012	$28,316,782	$374,329	$1,105,272	$1,479,601	$0.00	$0.00	$1,479,601	5.23	1.32	$70,990
6	CO 035	$21,655,746	$279,668	$3,919,362	$4,199,030	$0.00	$0.00	$4,199,030	19.39	1.29	$1,519,600
7	KS 014	$19,125,094	$79,192	$2,419,516	$2,498,708	$0.00	$0.00	$2,498,708	13.07	0.41	$1,500,258
8	MT 005	$24,569,494	$1,250,122	$2,314,544	$3,564,666	$0.00	$0.00	$3,564,666	14.51	5.09	$1,506,333
9	MI 020	$20,221,483	$144,789	$1,088,782	$1,233,571	$0.00	$0.00	$1,233,571	6.10	0.72	$524,154
10	IN 009	$12,895,472	$3,019,387	$1,000	$3,020,387	$0.00	$0.00	$3,020,387	23.42	23.41	$392,500
11	OR 017	$33,578,939	$1,290,150	$2,600,649	$3,890,799	$0.00	$0.00	$3,890,799	11.59	3.84	$2,906,910
12	KS 057	$29,784,698	$1,468,178	$912,961	$2,381,139	$0.00	$4,340	$2,385,479	8.01	4.93	$73,341
13	ME 016	$1,551,064	$30,809	$0.00	$30,809	$0.00	$0.00	$30,809	1.99	1.99	$13,875
14	TX 080	$14,969,775	$112,375	$788,761	$901,136	$0.00	$18,095	$919,231	6.14	0.75	$283,440
15	ND 022	$36,154,287	$556,512	$3,121,690	$3,678,202	$0.00	$344,495	$4,022,697	11.13	1.54	$67,895

EXHIBIT E - NONEXEMPT ELECTRIC DISTRIBUTION BORROWERS' TOTAL INVESTMENTS

16	KS 019	$19,272,458	$360,978	$2,523,250	$2,884,228	$0.00	$89,483	$2,973,711	15.43	1.87	$947,619
17	PA 013	$46,985,583	$3,619,019	$3,891,026	$7,510,045	$0.00	$0.00	$7,510,045	15.98	7.70	$377,248
18	LA 015	$24,531,690	$1,129,335	$2,189,168	$3,318,503	$0.00	$0.00	$3,318,503	13.53	4.60	$2,211,426
19	CO 036	$63,004,664	$189,145	$6,345,585	$6,534,730	$0.00	$0.00	$6,534,730	10.37	0.30	$4,595,214
20	CO 017	$51,631,411	$913,423	$4,515,127	$5,428,550	$0.00	$2,410	$5,430,960	10.52	1.77	$538,040
21	KS 050	$7,420,428	$178,275	$882,216	$1,060,491	$0.00	$0.00	$1,060,491	14.29	2.40	$628,519
22	OR 037	$8,786,782	$140,312	$887,990	$1,028,302	$0.00	$0.00	$1,028,302	11.70	1.60	$722,013
23	AK 026	$10,201,876	$964,078	$715,636	$1,679,714	$0.00	$0.00	$1,679,714	16.46	9.45	$1,164,942
24	ND 029	$52,398,577	$7,155,004	$11,659,700	$18,814,704	$0.00	$273,559	$19,088,263	36.43	13.65	$189,405
25	ND 050	$66,756,769	$4,198,402	$9,945,105	$14,143,507	$0.00	$1,898,877	$16,042,384	24.03	6.29	$2,409,121
26	SC 037	$94,036,542	$2,254,452	$14,420,084	$16,674,536	$0.00	$1,141,407	$17,815,943	18.95	2.40	$6,076,349
27	MN 109	$101,066,499	$6,095,475	$12,571,827	$18,667,302	$0.00	$800,272	$19,467,574	19.26	6.03	$2,464,478
28	MT 016	$19,435,682	$431,954	$693,660	$1,125,614	$0.00	$0.00	$1,125,614	5.79	2.22	$474,348
29	KY 046	$26,754,538	$3,446,136	$0.00	$3,446,136	$0.00	$0.00	$3,446,136	12.88	12.88	$273,831
30	IA 073	$17,908,918	$159,340	$2,744,307	$2,903,647	$0.00	$8,529	$2,912,176	16.26	0.89	$485,217
31	AL 033	$35,346,773	$0.00	$5,756,530	$5,756,530	$0.00	$0.00	$5,756,530	16.29	0.00	$263,885
32	KS 029	$11,991,777	$310,013	$488,614	$798,627	$0.00	$0.00	$798,627	6.66	2.59	$24,274
33	SD 012	$65,594,786	$1,257,240	$13,592,982	$14,850,222	$5,200,192	$1,713,594	$21,764,008	33.18	9.84	$123,704
34	KS 044	$58,716,908	$2,181,373	$3,875,536	$6,056,909	$0.00	$0.00	$6,056,909	10.32	3.72	$2,537,685
35	KS 028	$34,325,179	$513,209	$2,601,658	$3,114,867	$389,485	$11,700	$3,516,052	10.24	2.63	$1,809,290
36	ME 019	$5,673,389	$119,674	$71,627	$191,301	$0.00	$0.00	$191,301	3.37	2.11	$26,072
37	MD 004	$349,981,336	$5,073,031	$10,850,223	$15,923,254	$0.00	$0.00	$15,923,254	4.55	1.45	$1,116,114

EXHIBIT E - NONEXEMPT ELECTRIC DISTRIBUTION BORROWERS' TOTAL INVESTMENTS

38	SD 020	$12,591,085	$373,634	$1,630,875	$2,004,509	$206,074	$0.00	$2,210,583	17.56	4.60	$236,609
39	KS 038	$16,909,395	$316,768	$1,714,631	$2,031,399	$0.00	$0.00	$2,031,399	12.01	1.87	$858,334
40	TN 061	$61,249,982	$1,174,386	$3,547,093	$4,721,479	$0.00	$0.00	$4,721,479	7.71	1.92	$2,471,232
41	MO 035	$15,428,918	$207,224	$4,591,177	$4,798,401	$0.00	$96,060	$4,894,461	31.72	1.34	$1,418,034
42	NM 014	$15,881,523	$202,798	$1,678,687	$1,881,485	$0.00	$0.00	$1,881,485	11.85	1.28	$458,274
43	NE 086	$38,012,039	$0.00	$5,141,596	$5,141,596	$0.00	$0.00	$5,141,596	13.53	0.00	$860,349
44	MD 011	$87,509,276	$627,501	$4,721,324	$5,348,825	$2,798,413	$484,402	$8,629,640	9.86	3.91	$696,772
45	KS 039	$11,360,434	$111,563	$776,144	$887,707	$0.00	$0.00	$887,707	7.81	0.98	$15,591
46	MT 034	$5,328,083	$177,045	$788,531	$965,576	$0.00	$0.00	$965,576	18.12	3.32	$416,858
47	OK 002	$24,512,227	$233,105	$2,794,071	$3,027,176	$0.00	$62,478	$3,089,654	12.60	0.95	$169,790
48	MT 029	$6,892,567	$241,716	$18,112	$259,828	$0.00	$0.00	$259,828	3.77	3.51	$17,547
49	MT 032	$22,873,853	$753,002	$4,402,449	$5,155,451	$0.00	$0.00	$5,155,451	22.54	3.29	$3,624,550
50	KY 064	$21,408,126	$504,201	$1,700,141	$2,204,342	$457,304	$0.00	$2,661,646	12.43	4.49	$69,541
	TOTAL	$2,117,231,029	$65,720,853	$181,981,821	$247,702,674	$9,383,461	$7,027,425	$264,113,560			$56,838,640
	Average	$42,344,621	$1,314,417	$3,639,636	$4,954,053	$187,669	$140,549	$5,282,271	12.47	3.88	$1,136,773

EXHIBIT F - NONEXEMPT ELECTRIC DISTRIBUTION BORROWERS' INVESTMENTS IN EXCESS OF 15 PERCENT OF TOTAL UTILITY PLANT VALUE

No.	Borrower ID	Insured Debt to RUS as of 12/31/97	TUP Value	Investments			Guaranteed Loans Balance	Direct Loan Balance	Total Investments, Loans, and Guarantees	OIG Percent	RUS Percent	Cash and
				Includable	Excludable	Total						Temporary Investments
1	CO 025	$8,094,187	$54,195,389	$808,016	$8,610,042	9,418,058	$0	$12,302	$9,430,360	17.40	1.49	$1,322,370
2	CO 035	$8,305,054	$21,655,746	$279,668	$3,919,362	4,199,030	$0	$0	$4,199,030	19.39	1.29	$1,519,600
3	IN 009	$1,269,821	$12,895,472	$3,019,387	$1,000	3,020,387	$0	$0	$3,020,387	23.42	23.41	$392,500
4	KS 019	$5,438,778	$19,272,458	$360,978	$2,523,250	2,884,228	$0	$89,483	$2,973,711	15.43	1.87	$947,619
5	PA 013	$18,278,728	$46,985,583	$3,619,019	$3,891,026	7,510,045	$0	$0	$7,510,045	15.98	7.70	$377,284
6	AK 026	$4,074,592	$10,201,876	$964,078	$715,636	1,679,714	$0	$0	$1,679,714	16.46	9.45	$1,164,942
7	ND 029	$18,009,866	$52,398,577	$7,155,004	$11,659,700	18,814,704	$0	$273,559	$19,088,263	36.43	13.65	$189,405
8	ND 050	$35,237,050	$66,756,769	$4,198,402	$9,945,105	14,143,507	$0	$1,898,877	$16,042,384	24.03	6.29	$2,409,121
9	SC 037	$38,377,542	$94,036,842	$2,254,452	$14,420,084	16,674,536	$0	$1,141,407	$17,815,943	18.95	2.40	$6,076,349
10	MN 109	$33,487,341	$101,066,499	$6,095,475	$12,571,827	18,667,302	$0	$800,272	$19,467,574	19.26	6.03	$2,464,478
11	IA 073	$6,606,451	$17,906,918	$159,340	$2,744,307	2,903,647	$0	$8,529	$2,912,176	16.26	0.89	$465,217
12	AL 033	$15,145,969	$35,346,773	$0	$5,756,530	5,756,530	$0	$0	$5,756,530	16.29	0.00	$263,865
13	SD 012	$25,169,822	$65,594,786	$1,257,240	$13,592,982	14,850,222	$5,200,192	$1,713,594	$21,764,008	33.18	9.84	$123,704
14	SD 020	$4,812,234	$12,591,065	$373,634	$1,630,875	2,004,509	$206,074	$0	$2,210,583	17.56	4.60	$236,609
15	MO 035	$4,676,682	$15,428,918	$207,224	$4,591,177	4,798,401	$0	$96,060	$4,894,461	31.72	1.34	$1,418,034
16	MT 034	$975,640	$5,328,083	$177,045	$788,531	965,576	$0	$0	$965,576	18.12	3.32	$416,858
17	MT 032	$9,657,093	$22,873,853	$753,002	$4,402,449	5,155,451	$0	$0	$5,155,451	22.54	3.29	$3,624,550

EXHIBIT F - NONEXEMPT ELECTRIC DISTRIBUTION BORROWERS' INVESTMENTS IN EXCESS OF 15 PERCENT OF TOTAL UTILITY PLANT VALUE

	TOTAL	$237,638,650	$654,537,327	$31,681,964	$101,763,683	$133,445,647	$5,406,266	$6,034,083	$144,886,196			$23,432,525
	Average	$13,978,744	$38,502,196	$1,863,645	$5,986,111	$7,849,756	$318,016	$354,946	$8,522,718	22.14	6.59	$1,378,384

EXHIBIT G - EXEMPT ELECTRIC DISTRIBUTION BORROWERS' TOTAL INVESTMENTS

No.	Borrower ID	TUP Value	Investments			Guaranteed Loans Balance	Direct Loans Balance	Total Investments, Loans, and Guarantees	OIG Percent	RUS Percent	Cash and Temporary Investments
			Includable	Excludable	Total						
1	IL 032	$11,008,183	$885,730	$515,626	$1,401,356	$0	$19,630	$1,420,986	12.91	8.05	$399,411
2	VA 054	$266,341,837	$12,348,880	$43,268,284	$55,615,164	$0	$152,310	$55,767,474	20.94	4.64	$9,188,334
3	SD 040	$26,097,756	$1,936,219	$2,733,132	$4,669,351	$0	$55,823	$4,725,174	18.11	7.42	$2,408,282
4	KY 021	$58,074,353	$626,130	$8,971,220	$9,597,350	$0	$0	$9,597,350	16.53	1.08	$1,986,355
5	TN 037	$47,886,867	$3,272,286	$3,369,048	$6,641,334	$0	$0	$6,641,334	13.87	6.83	$5,560,690
6	GA 066	$39,732,798	$237,905	$5,568,623	$5,806,528	$0	$0	$5,806,528	14.61	0.60	$318,322
7	MS 046	$46,295,713	$238,695	$5,783,899	$6,022,594	$0	$0	$6,022,594	13.01	0.52	$1,978,594
8	KY 055	$55,146,487	$1,132,494	$18,472,953	$19,605,447	$0	$81,261	$19,686,708	35.70	2.05	$962,713
9	MO 028	$19,995,570	$59,483	$1,847,010	$1,906,493	$0	$0	$1,906,493	9.53	0.30	$181,669
10	IL 045	$13,489,784	$412,718	$1,624,348	$2,037,066	$29,166	$151,200	$2,217,432	16.44	3.28	$1,388,862
11	CO 032	$125,199,232	$3,804,585	$16,516,268	$20,320,853	$0	$0	$20,320,853	16.23	3.04	$2,658,983
12	AL 044	$52,690,526	$2,540,593	$6,223,481	$8,764,074	$1,429,191	$4,162	$10,197,427	19.35	7.53	$133,686
13	MT 015	$27,057,062	$122,830	$1,798,887	$1,921,717	$0	$0	$1,921,717	7.10	0.45	$1,313,557
14	KS 007	$14,758,054	$155,668	$1,651,338	$1,807,006	$0	$0	$1,807,006	12.24	1.05	$940,532
15	SD 025	$15,941,302	$287,948	$1,641,579	$1,929,527	$0	$70,152	$1,999,679	12.54	1.81	$81,415
16	MS 041	$53,770,362	$2,364,349	$11,392,880	$13,757,229	$0	$0	$13,757,229	25.59	4.40	$6,422,266
17	TX 065	$49,807,102	$334,233	$12,724,614	$13,058,847	$278,296	$0	$13,337,143	26.78	1.22	$4,048,307
18	MT 031	$11,646,329	$506,403	$1,437,279	$1,943,682	$0	$0	$1,943,682	16.69	4.35	$1,038,937

EXHIBIT G - EXEMPT ELECTRIC DISTRIBUTION BORROWERS' TOTAL INVESTMENTS

19	MO 032	$9,072,982	$1,825,962	$2,630,207	$4,456,169	$0	$0	$4,456,169	49.11	20.13	$1,832,127
20	MN 018	$31,266,515	$215,515	$3,456,387	$3,671,902	$0	$97,824	$3,769,726	12.06	0.69	$767,379
21	SD 017	$12,162,042	$327,190	$2,044,478	$2,371,668	$608,194	$8,207	$2,988,069	24.57	7.69	$26,520
22	SD 036	$11,052,569	$182,428	$1,892,829	$2,075,257	$37,343	$0	$2,112,600	19.11	1.99	$390,012
23	MT 024	$14,135,531	$1,350,783	$903,975	$2,254,758	$0	$0	$2,254,758	15.95	9.56	$1,851,586
24	MT 033	$22,448,332	$808,660	$988,730	$1,797,390	$0	$0	$1,797,390	8.01	3.60	$975,925
25	NE 077	$70,434,145	$0	$9,607,708	$9,607,708	$0	$0	$9,607,708	13.64	0.00	$5,881,183
26	KS 018	$12,525,194	$689,735	$1,678,258	$2,367,993	$0	$0	$2,367,993	18.91	5.51	$1,247,741
27	AL 025	$37,260,621	$782,946	$3,731,476	$4,514,422	$0	$167,166	$4,681,588	12.56	2.10	$98,087
28	NY 024	$5,033,475	$70,620	$288,781	$359,401	$0	$0	$359,401	7.14	1.40	$153,779
29	NM 008	$27,605,469	$417,263	$1,175,109	$1,592,372	$0	$404,980	$1,997,352	7.24	1.51	$619,313
30	CO 020	$72,232,231	$992,932	$12,651,544	$13,644,476	$0	$0	$13,644,476	18.89	1.37	$327,546
31	NM 023	$83,606,280	$20,070,447	$23,321,995	$43,392,442	$0	$77,906	$43,470,348	51.99	24.01	$6,449,486
32	KS 042	$9,342,838	$98,491	$329,832	$428,323	$0	$0	$428,323	4.58	1.05	$94,254
33	VA 036	$23,351,448	$284,202	$5,510,460	$5,794,662	$0	$0	$5,794,662	24.82	1.22	$145,101
34	PA 015	$52,971,797	$109,992	$4,214,008	$4,324,000	$0	$0	$4,324,000	8.16	0.21	$429,443
35	NC 031	$35,799,954	$1,679,596	$1,426,279	$3,105,875	$0	$0	$3,105,875	8.68	4.69	$1,471,902
36	NY 019	$13,974,743	$3,171	$413,491	$416,662	$0	$0	$416,662	2.98	0.02	$98,724
37	GA 065	$28,200,762	$185,592	$3,910,802	$4,096,394	$0	$0	$4,096,394	14.53	0.66	$245,043
38	SD 023	$14,989,892	$425,872	$2,001,077	$2,426,949	$161,687	$0	$2,588,636	17.27	3.92	$87,577
39	NC 039	$89,544,618	$6,446,310	$2,852,327	$9,298,637	$0	$0	$9,298,637	10.38	7.20	$5,235,295
40	KY 034	$37,343,875	$403,199	$5,515,679	$5,918,878	$0	$236,440	$6,155,318	16.48	1.08	$375,267

EXHIBIT G - EXEMPT ELECTRIC DISTRIBUTION BORROWERS' TOTAL INVESTMENTS

41	NE 059	$16,610,565	$164,809	$1,963,663	$2,128,472	$0	$0	$2,128,472	12.81	0.99	$1,559,518
42	KY 061	$32,009,872	$119,520	$2,904,945	$3,024,465	$0	$0	$3,024,465	9.45	0.37	$139,242
43	PA 025	$73,246,520	$1,741,516	$8,524,272	$10,265,788	$0	$1,268,771	$11,534,559	15.75	2.38	$2,349,763
44	VA 055	$326,806,784	$23,966,503	$103,656,866	$127,623,369	$0	$0	$127,623,369	39.05	7.33	$49,890,769
45	TN 031	$35,676,603	$38,716	$4,090,420	$4,129,136	$0	$0	$4,129,136	11.57	0.11	$3,108,365
46	KY 035	$128,451,854	$2,195,728	$6,206,834	$8,402,562	$400,000	$2,098,254	$10,900,816	8.49	2.02	$5,084,634
47	TX 069	$47,554,946	$814,941	$9,898,479	$10,713,420	$0	$0	$10,713,420	22.53	1.71	$4,243,315
48	AZ 027	$149,728,165	$509,395	$10,060,161	$10,569,556	$0	$0	$10,569,556	7.06	0.34	$2,724,557
49	TN 060	$38,626,218	$228,430	$4,674,668	$4,903,098	$0	$0	$4,903,098	12.69	0.59	$337,783
50	IN 038	$34,004,853	$347,555	$9,736,306	$10,083,861	$0	$0	$10,083,861	29.65	1.02	$1,377,553
	TOTAL	$2,532,011,010	$98,765,168	$397,800,515	$496,565,683	$2,943,877	$4,894,086	$504,403,646			$140,729,704
	Average	$50,640,220	$1,975,303	$7,956,010	$9,931,314	$58,878	$97,882	$10,088,073	19.92	4.21	$2,814,594

EXHIBIT H - EXEMPT ELECTRIC DISTRIBUTION BORROWERS' INVESTMENTS IN EXCESS OF 15 PERCENT OF TOTAL UTILITY PLANT VALUE

					Investments		Guaranteed Loans	Direct Loans	Total Investments, Loans, and Guarantees	OIG	RUS	Cash and Temporary
No.	ID	Insured Loan Balance as of 12/31/97	TUP Value	Includable	Excludable	Total	Balance	Balance		Percent	Percent	Investments
1	VA 054	$97,994,959	$266,341,837	$12,348,880	$43,266,284	$55,615,164	$0	$152,310	$55,767,474	20.94	4.64	$9,188,334
2	SD 040	$12,152,278	$26,097,756	$1,936,219	$2,733,132	$4,669,351	$0	$55,823	$4,725,174	18.11	7.42	$2,408,282
3	KY 021	$22,459,397	$58,074,353	$626,130	$8,971,220	$9,597,350	$0	$0	$9,597,350	16.53	1.08	$1,986,355
4	KY 056	$14,930,320	$55,146,487	$1,132,494	$18,472,953	$19,605,447	$0	$81,261	$19,686,708	35.70	2.05	$962,713
5	IL 045	$3,509,059	$13,489,784	$412,718	$1,624,348	$2,037,066	$29,166	$151,200	$2,217,432	16.44	3.28	$1,388,862
6	CO 032	$54,642,848	$125,199,232	$3,804,585	$16,516,268	$20,320,853	$0	$0	$20,320,853	16.23	3.04	$2,658,983
7	AL 044	$14,967,501	$52,690,526	$2,540,593	$6,223,481	$8,764,074	$1,429,191	$4,162	$10,197,427	19.35	7.53	$133,666
8	MS 041	$12,439,701	$53,770,362	$2,364,349	$11,392,880	$13,757,229	$0	$0	$13,757,229	25.59	4.40	$6,422,266
9	TX 065	$18,058,978	$49,807,102	$334,233	$12,724,614	$13,058,847	$278,296	$0	$13,337,143	26.78	1.23	$4,048,307
10	MT 031	$2,194,286	$11,646,329	$506,403	$1,437,279	$1,943,682	$0	$0	$1,943,682	16.69	4.35	$1,038,937
11	MO 032	$3,191,849	$9,072,982	$1,825,962	$2,630,207	$4,456,169	$0	$0	$4,456,169	49.11	20.13	$1,932,127
12	SD 017	$6,397,434	$12,162,042	$327,190	$2,044,478	$2,371,668	$608,194	$8,207	$2,988,069	24.57	7.69	$26,520
13	SD 036	$3,507,460	$11,052,569	$182,428	$1,892,829	$2,075,257	$37,343	$0	$2,112,600	19.11	1.99	$390,012
14	MT 024	$4,295,498	$14,135,531	$1,350,783	$903,975	$2,254,758	$0	$0	$2,254,758	15.95	9.56	$1,851,566
15	KS 018	$2,504,310	$12,525,194	$689,735	$1,678,258	$2,367,993	$0	$0	$2,367,993	18.91	5.51	$1,247,741
16	CO 020	$17,591,688	$72,232,231	$992,932	$12,651,544	$13,644,476	$0	$0	$13,644,476	18.89	1.37	$327,546
17	NM 023	$13,778,864	$83,606,280	$20,070,447	$23,321,995	$43,392,442	$0	$77,906	$43,470,348	51.99	24.01	$6,449,486

EXHIBIT H - EXEMPT ELECTRIC DISTRIBUTION BORROWERS' INVESTMENTS IN EXCESS OF 15 PERCENT OF TOTAL UTILITY PLANT VALUE

18	VA 036	$5,142,198	$23,351,448	$284,202	$5,510,460	$5,794,662	$0	$0	$5,794,662	24.82	1.22	$145,101
19	SD 023	$6,438,248	$14,989,892	$425,872	$2,001,077	$2,426,949	$161,687	$0	$2,588,636	17.27	3.92	$87,577
20	KY 034	$9,452,709	$37,343,875	$403,199	$5,515,679	$5,918,878	$0	$236,440	$6,155,318	16.48	1.08	$375,267
21	PA 025	$25,715,424	$73,246,520	$1,741,516	$8,524,272	$10,265,788	$0	$1,268,771	$11,534,559	15.75	2.38	$2,349,763
22	VA 055	$129,068,671	$326,806,784	$23,966,503	$103,656,866	$127,623,369	$0	$0	$127,623,369	39.05	7.33	$49,890,769
23	TX 069	$19,232,837	$47,554,946	$814,941	$9,898,479	$10,713,420	$0	$0	$10,713,420	22.53	1.71	$4,243,315
24	IN 038	$6,430,972	$34,004,853	$347,555	$9,736,306	$10,083,861	$0	$0	$10,083,861	29.65	1.02	$1,377,553
	TOTAL	$506,097,487	$1,484,348,915	$79,429,869	$313,328,884	$392,758,753	$2,543,877	$2,036,080	$397,338,710			$100,931,088
	Average	$21,087,395	$61,847,871	$3,309,578	$13,055,370	$16,364,948	$105,995	$84,837	$16,555,780	26.77	5.66	$4,205,462

EXHIBIT I - STATISTICAL SAMPLE DESIGN

The general statistical sample design for this audit was a stratified simple random sampling scheme where electric generation and distribution borrowers were selected from a data base obtained from the Rural Utilities Service (RUS). There was a total of 787 electric generation and distribution borrowers in this universe. The 787 borrowers were stratified according to the following subjective criteria:

	STRATA
Nonexempt Distribution Borrowers	1
Exempt Distribution Borrowers	2
Electric Generation Borrowers	3

A sample size of 149 borrowers was selected and subjectively allocated to Strata 1 through 3 by sampling 50 each in Strata 1 and Strata 2 and selecting all 49 generation borrowers in Strata 3. A summary of the sample design is presented below.

STRATA		Number of Borrowers	Sample Size
1	Nonexempt Distribution Borrowers	148	50
2	Exempt Distribution Borrowers	590	50
3	Electric Generation Borrowers	49	49
	TOTAL	787	149

The borrowers within Strata 1 and Strata 2 were selected with equal probability without replacement within each strata. The borrowers in Strata 3 were selected with probability equal to one. The sample unit within each strata was a borrower. A 95 percent lower one-sided confidence level was used for all of the statistical estimates in this audit.

All statistical analysis was accomplished on a Pentium personal computer using the Windows version of SAS and SUDAAN. The statistical estimates used for projections along with their standard errors were produced with SUDAAN, which analyzes sample survey data gathered from complex multistage sample designs. SUDAAN was written by B.V. Shah of Research Triangle Institute, Research Triangle Park, North Carolina. The sample design and sample selections used in this audit were determined using SAS.

EXHIBIT I - STATISTICAL SAMPLE DESIGN

The term sample precision (sp), as used in the report for estimating dollar values and number of occurrences, is defined as

$$sp=\frac{t*STDERR}{PTEST}$$

where

t - t factor for a 95% one-sided lower confidence level
PTEST - point estimate (estimate of the total)
STDERR - standard error of the point estimate

The sample precision for estimating percentage values is defined as

$$sp=t*STDERR$$

where

t - t factor for a 95% one-sided lower confidence level
STDERR - standard error of the point estimate (percentage value)

EXHIBIT J - STATISTICAL PROJECTIONS

The following statistical projections are based on a one-sided 95 percent confidence level. We are 95 percent certain that the value of the condition is at least at the lower limit. The midpoint estimate is our best estimate of the condition.

Condition	Midpoint Estimate	Lower Estimate	Sampling Precision (Percent)
1. Number of generation and distribution borrowers with rural investments.	90	48	48.6
2. Number of exempt and nonexempt distribution borrowers with total investments, loans, and loan guarantees in excess of 15 percent of TUP.	334	265	20.5
3. Number of generation and distribution borrowers with total investments in excess of 15 percent of TUP.	358	289	20.5
4. Ratio of investments to TUP for distribution borrowers who had investments in excess of 15 percent of TUP.	.23	.20	12.6
5. Total rural development investments of generation and distribution borrowers.	$60,976,996	$32,104,139	56.5
6. Total investments, loans, and loan guarantees for generation and distribution borrowers.	$10,944,532,338	$8,334,447,878	38.8
7. Total investments, loans, and loan guarantees for all exempt and nonexempt distribution borrowers with investments in excess of 15 percent of TUP.	$5,117,459,918	$2,422,544,857	52.7

EXHIBIT J - STATISTICAL PROJECTIONS

8.	Total investments, loans, and loan guarantees for generation and distribution borrowers with investments in excess of 15 percent of TUP.	$7,419,610,167	$4,724,695,106	52.7
9.	Total investments, loans, and loan guarantees in excess of 15 percent of TUP for all exempt and nonexempt borrowers.	$2,216,461,331	$ 625,915,161	71.8
10.	Total investments, loans, and loan guarantees in excess of 15 percent of TUP for generation and distribution borrowers.	$3,199,152,787	$1,608,606,617	71.8
11.	Amount of total investments, loans, and loan guarantees used to compute the investment percent of TUP for exempt and nonexempt borrowers who had investments in excess of 15 percent of TUP.	$1,031,051,068	$ 416,819,926	59.6
12.	Amount of total investments, loans, and loan guarantees used to compute the investment percent of TUP for generation and distribution borrowers who had investments in excess of 15 percent of TUP.	$1,646,532,777	$1,032,301,635	59.6
13.	Amount of total investments, loans, and loan guarantees not used to compute the investment percent of TUP for exempt and nonexempt borrowers who had investments in excess of 15 percent of TUP.	$3,998,501,925	$1,858,155,984	53.5

EXHIBIT J - STATISTICAL PROJECTIONS

14.	Amount of total investments, loans, and loan guarantees not used to compute the investment percent of TUP for generation and distribution borrowers who had investments in excess of 15 percent of TUP.	$5,685,170,465	$3,544,824,524	53.5
15.	15 percent of total TUP values for all exempt and nonexempt distribution borrowers that had total investments in excess of 15 percent of TUP.	$2,917,912,153	$1,679,348,507	42.4
16.	15 percent of total TUP values for generation and distribution borrowers that had total investments in excess of 15 percent of TUP.	$4,237,370,946	$2,998,807,300	42.4

EXHIBIT K - ANALYSIS OF GENERATION AND DISTRIBUTION BORROWERS

ELECTRIC GENERATION BORROWERS

Our analysis of REA Forms 12a, "Operating Report-Financial," and Forms 12h, "Operating Report-Annual Supplement," submitted by 49 electric generation borrowers for CY 1997 revealed that 24 borrowers had total investments, loan balances, and guaranteed loan balances in excess of 15 percent of TUP. Total investments as a percent of TUP for these 24 borrowers ranged from 16.89 percent to 95.10 percent and averaged 37.04 percent. These 24 borrowers reported TUP values totaling about $8.8 billion and had total investments, loans, and loan guarantees of $2.3 billion of which about $982.7 million was in excess of 15 percent of TUP. See exhibit C for the borrowers reviewed and exhibit D for the borrowers that had investments in excess of 15 percent of TUP.

Figure 2 below illustrates the amount of investments per RUS, total investments per OIG, 15 percent of TUP, and amount of investments over 15 percent of TUP for the 24 electric generation borrowers that had investments exceeding 15 percent of TUP.

Figure 2: Twenty-four Electric Generation Borrowers Who Had Total Investments in Excess of 15 Percent of TUP

```
(billions)

$5 |
$4 |
$3 |                        $2.3
   |             $1.8      TTTTTT
$2 |            EEEEEE     TTTTTT     $1.3
   |            EEEEEE     TTTTTT    PPPPPP    $1.0
$1 |   $0.5     EEEEEE     TTTTTT    PPPPPP    YYYYYY
   |  IIIIII    EEEEEE     TTTTTT    PPPPPP    YYYYYY
 0 |  IIIIII    EEEEEE     TTTTTT    PPPPPP    YYYYYY

    Invest-    Invest-     Total     15 %      Invest-
    ments      ments       Invest-   of TUP    ments
    Included   Excluded    ments               Over
    in RUS     in RUS                          15 %
    Percent    Percent                         of TUP
    of TUP     of TUP
    Calcu-     Calcu-
    lation     lation
```

The following example illustrates how the RUS regulations are applied. An electric generation borrower (NC 067) had a TUP value of more than $1.7 billion and $333.6 million in total investments, loans, and guarantees. We computed the investment to TUP ratio to be 19.42 percent when all investments, loans, and loan guarantees are considered. The CY 1997 form 12h submitted by the borrower showed "includable" investments and guaranteed loan balance totaling $35.9 million. The investment to TUP ratio per the RUS methodology was 2.09 percent. Investments totaling more than $292.1 million was not used per the RUS computation methodology.

EXHIBIT K - ANALYSIS OF GENERATION AND DISTRIBUTION BORROWERS

ELECTRIC DISTRIBUTION BORROWERS

We selected a random sample of 100 of the 738 electric distribution borrowers that submitted Forms 7, "Financial and Statistical Report," and Forms 7a, "Investments, Loan Guarantees and Loan - Distribution," for CY 1997. The sample was divided into two strata. One strata included 50 of the 148 nonexempt electric distribution borrowers and the other strata included 50 of the 590 exempt electric distribution borrowers. See exhibits E through H for the borrowers selected for review and exhibit I for the statistical sample design.

We found that 41 of the 100 sampled distribution borrowers (17 of the 50 nonexempt and 24 of the 50 exempt) had made investments, loans, and loan guarantees in excess of 15 percent of TUP. Based on this data, we statistically estimated that 334 electric distribution borrowers (approximately 50 nonexempt and 284 exempt (statisticially rounded)) made investments, loans, and loan guarantees in CY 1997 that exceeded 15 percent of TUP. We estimated that these 334 distribution borrowers made investments, loans, and loan guarantees totaling $5.1 billion of which $2.2 billion was in excess of 15 percent of TUP.

Figure 3 below illustrates the projected amount of investments per RUS, total investments per OIG, 15 percent of TUP, and amount of investments over 15 percent of TUP for the estimated 334 electric distribution borrowers that had investments exceeding 15 percent of TUP. (Figure values may not total due to rounding and statistically projected values.)

EXHIBIT K - ANALYSIS OF GENERATION AND DISTRIBUTION BORROWERS

Figure 3: Estimated 334 Electric Distribution Borrowers Who Had Total Investments in Excess of 15 Percent of TUP

```
(billions)

$6 |
   |                       $5.1
$5 |                      TTTTTT
   |            $4.0      TTTTTT
$4 |           EEEEEE     TTTTTT
   |           EEEEEE     TTTTTT     $2.9
$3 |           EEEEEE     TTTTTT    PPPPPP
   |           EEEEEE     TTTTTT    PPPPPP     $2.2
$2 |           EEEEEE     TTTTTT    PPPPPP    YYYYYY
   |   $1.0    EEEEEE     TTTTTT    PPPPPP    YYYYYY
$1 |  IIIIII   EEEEEE     TTTTTT    PPPPPP    YYYYYY
   |  IIIIII   EEEEEE     TTTTTT    PPPPPP    YYYYYY
 0 |  IIIIII   EEEEEE     TTTTTT    PPPPPP    YYYYYY

      Invest-  Invest-   Total     15 %      Invest-
      ments    ments     Invest-   of TUP    ments
      Included Excluded  ments               Over
      in RUS   in RUS                        15 %
      Percent  Percent                       of TUP
      of TUP   of TUP
      Calcu-   Calcu-
      lation   lation
```

For example, a nonexempt borrower (SD 012) who exceeded the 15 percent limit had a TUP value of $65.6 million and "includable" investments of almost $1.3 million and $5.2 million in guaranteed loan balances computed an investment to TUP ratio of 9.84 percent using RUS instructions. Our analysis of the CY 1997 form 7a revealed that the borrower had total investments, loans, and guarantees totaling over $21.7 million and $1.7 million in loan balances resulting in an investment to TUP ratio of 33.18 percent. The borrower had investments, loans, and guarantee balances that exceeded 15 percent of TUP by more than $11.9 million.

An exempt borrower (VA 054) who had a TUP value of $266.3 million and about $12.3 million in "includable" investments computed a 4.64 percent investment to TUP ratio. The CY 1997 forms 7 disclosed that the borrower actually had total investments, loans, and guarantees of almost $55.8 million and an actual investment to TUP ratio of 20.94 percent. About $43.3 million in "excludable" investments were not used in the computation of the percent of investments to TUP. The borrower had investments, loans, and guarantees that exceeded 15 percent of TUP by over $15.8 million.

EXHIBIT L - EXAMPLE ELECTRIC BORROWER INVESTMENTS

Electric Distribution Borrower NM023 reported the following investments for CY 1997:

Non-Utility Property:	
Land	$ 57,150
Investments in Associated Organizations:	
Patronage Capital TX Electric Cooperative	108,087
Patronage Capital CUFC (inactive cooperative financial corp)	1,189,766
CUFC Capital Term Certificates	3,032,820
Memberships (various)	1,710
Other Investments (bonds and notes):	
Associates Corp (bonds)	978,112
Federal National Mortgage Association	1,007,560
Federal National Mortgage	1,006,140
Federal National Mortgage Term	1,001,556
Federal Home Loan Medium Term	1,013,125
Federal Home Loan Bank	750,899
Special Funds (certificates of deposit (CD), notes, bonds):	
Queens County Bank (CD)	99,000
New York Federal (CD)	99,000
Goodnue County Bank (CD)	99,000
Union Chelsea National (CD)	99,000
Fajardo Savings Bank (CD)	99,000
Center National Bank (CD)	99,000
Providian National (CD)	100,000
Rockwood Bank (CD)	99,000
Federal National Mortgage (note)	500,542
Bellsouth Capital Corp (bond)	505,242
General Electric Capital Corp (bond)	310,817
Federal National Mortgage (note)	744,631
Federal Home Loan (note)	700,000
U.S. Treasury Notes	5,371,983
Wachovia Bank Medium Term	1,002,318
Pitney Bowes Corp	598,218
Federal Home Loan Mortgage	500,000
Rockwell International Corp	993,151
Du Pont De Nemours	1,009,077
Bank One Sub Note	991,232
General Motors Acceptance Corp	1,024,974
Archer Daniels Midland Note	996,514
Wall Mart Note	1,017,981
J.P. Morgan & Co.	1,035,524
Federal Home Loan Note	1,001,523
Associates Corp Note	965,059
AT&T Corp Note	1,017,074
Pacific Bell Senior Note	993,959
National Rural Coop Finance Corp	500,634
General Electric Capital Corp	1,012,940
Merill Lynch & Co Note	991,389
Ford Motor Co Note	1,016,816
Excelsior Money Fund	20,431

EXHIBIT L - EXAMPLE ELECTRIC BORROWER INVESTMENTS

Cash - General:	
Plains State	113,589
Lea County State Bank	967,519
Norwest Bank	541,647
Temporary Investments (money market accounts):	
Norwest Financial Senior	748,975
Federal Home Loan Bank	500,575
Federal National Mortgage Association	999,701
Estacado Credit Union	99,000
Prudential Money Market	2,852
Edward Jones Money Market	37,633
Solomon Smith Barney Money Market	59,509
Merill Lynch Money Market	49,959
Federal Ginnie Mae	2,328,527
Accounts and Notes Receivable:	
Phillips Petroleum Notes	17,617
Energy Research & Development Note	43,000
Leaco Rural Telephone Cooperative	215
Accounts Receivable Employees	3,376
Accounts Receivable Aid-to-Construction	290,684
Accounts Receivable-Other	483,889
*Notes Receivable Energy Conservation	77,906
Postretirement Benefits	264,315
TOTAL INVESTMENTS	$43,392,442

*Reported as a rural development investment. The notes involved loans to customers to winterize their homes.

[NOTE: Total investments as a percent of TUP was 52 percent.]

EXHIBIT L - EXAMPLE ELECTRIC BORROWER INVESTMENTS

Electric Distribution Borrower VA055 reported the following investments for CY 1997:

Investments In Associated Organizations:	
Patronage Capital - NRUCFC	$ 2,721,520
Patronage Capital - Old Dominion Electric Cooperative (ODEC)	56,526,972
Investment in Assoc Co/Land & Bldg/VMDAEC	71,280
Other Investment in Organization - NRUCFC	1,000
Investment NRUCFC Capital Term Certificates	5,973,423
Investment CSC Services, Inc.	113,412
Investment in Assoc Co - Novastar	100,000
Other Investments:	
Patronage Capital Credit - So States	3,976
Patronage Capital Credit - United Utilities	32,666
Patronage Capital Credit - Eraco	2,867
Special Funds:	
Other Special Funds - Mint Plan/Def Comp - DI	199,754
Other Special Funds - Stafford Sub & Lee	42,720
Other Special Funds - Section 457	142,007
Cash - General:	
Cash General - Crestar	1,956,760
Cash General - Central Fidelity	60,847
Cash General - Working Funds	3,900
Temporary Investments:	
Temp Invest - NRUCFC	13,268,379
Temp Invest - ODEC Prepaid Power Bill	12,748,549
Temp Invest - Wheat Securities	21,556,507
Temp Invest - Signet	295,827
Accounts & Notes Receivable:	
Notes Receivable - City of Manassas	592,000
Other Accounts Receivable - Net	2,344,062
Accounts Receivable - Sales	8,864,941
TOTAL INVESTMENTS	$127,623,369

[NOTE: Total investments as a percent of TUP was 39 percent.]

EXHIBIT M - RUS WRITTEN RESPONSE TO THE DRAFT REPORT

United States Department of Agriculture
Rural Development

Rural Business–Cooperative Service • Rural Housing Service • Rural Utilities Service
Washington, DC 20250

FEB 28 2000

John O. Leavy
Regional Inspector General
USDA Office of Inspector General
101 South Main Street, Room 324
Temple, Texas 76501

Dear Mr. Leavy:

This is in response to the Office of Inspector General's (OIG) official draft report; Rural Utilities Service - Electric Generation and Distribution Borrower Investment, Audit No. 09601-1-Te.

Before offering comments on the specific audit recommendations, the Electric Program of the Rural Utilities Service (RUS) wants to take this opportunity to thank the OIG for the exhaustive audit effort and extensive report. RUS appreciates the professionalism displayed by the auditors while working with our staff and the honesty and integrity of the report.

The Audit findings question whether RUS electric generation and distribution (G&T) borrowers increased their investment in rural development programs as intended by Congress when it amended the RE Act in 1987. In regards to the implementation of Section 312, "Use of Funds", amendment to the RE Act, RUS developed policies and procedures strictly adhering to the letter of the law. No restrictions were placed on the type of investments, loan or loan guarantees that borrowers could make, due to the fact that no restrictions were included in the legislation. However, it should be noted that RUS does attempt to influence borrowers by stating in the regulation published in Title 7, Code of Federal Regulation (CFR), part 1717, subpart N, General Section, "RUS electric borrowers are encouraged to utilize their own funds to participate in the economic development of rural areas, provided that such activity does not in any way put government funds at risk or impair a borrower's ability to repay its indebtedness to RUS and other lenders."

RUS believes that many borrowers are investing in rural development projects thereby addressing the Congressional mandate. These rural economic development projects are listed in Forms 7a and 12h as either "included" or "excluded" but, for lack of specific direction, may not be classified by the borrower as rural development investment. Many borrowers may be confused with the designations of "included" and "excluded" and, as such, may not be correctly classifying "excluded" rural economic development projects. By not including these "excluded" rural development investments, the amount of borrower investment in rural infrastructure projects or job creation and business development activities is reduced, thus increasing the perception that borrowers are not addressing the need identified by Congress.

In response to specific audit recommendations, RUS presents the following comments:

<u>Recommendation No. 1</u> - Develop and implement a strategy to encourage electric borrowers to make discretionary investments in rural areas as intended by Congress.

EXHIBIT M - RUS WRITTEN RESPONSE TO THE DRAFT REPORT

RUS agrees that its borrowers should be making a conscious effort to provide for and facilitate rural development in these areas. As stated in the audit and in the regulation, "RUS assumes that borrowers will use the latitude afforded them by Section 312 of the RE Act to make needed investments in rural community infrastructure projects...." RUS will strategically develop and implement policies and procedures to strongly encourage borrowers to meet the intent of Congress. As part of this process, RUS will also review the instructions for Form 7a and 12h in an effort to clarify any inconsistencies in identifying "included" or "excluded" rural development projects. This will be a top priority for FY 2001.

Recommendation No. 2 - Include in RUS' annual GPRA plan a performance measure to assess the increase in borrower's investments in rural America.

RUS recognizes the concept and believes it to be very important to quantify activity using measurable and verifiable means to judge the accomplishment of Agency goals and objectives. However, with respect to this particular type of discretionary investing, RUS is of the firm opinion that additional consideration must be given to the original intent of the RE Act and loan security in this time of evolutionary change in the electric utility industry.

Electric industry restructuring efforts are advancing across America ushering in a competitive retail marketplace. Currently 24 states have enacted restructuring legislation or have comprehensive restructuring regulatory orders. Congressional committees are reviewing proposed federal legislation. In light of this uncertainty, electric utilities are placing a major emphasis on controlling expenses in an effort to establish a favorable position in rate competitiveness. Many utilities are also making strategic investments to improve system reliability. The transition to a competitive marketplace may tend to shrink revenue. Combining shrinking revenue with cost controlling efforts and a renewed emphasis on system reliability will minimize the funds available for non-utility plant investment. The quick changing nature of the electric utility business is forcing RUS borrowers (and non-borrower electric utilities alike) to reevaluate long-term investments, whether these investments be in utility plant or community development projects.

The economic climate and stability of the electric utility industry has changed dramatically in the 13 years following the approval of this investment legislation. The uncertainty of the electric utility restructuring efforts combined with the lagging rural economic recovery and fragile farm economy mandates that the flexibility provided by the 15 percent investment rule be maintained without instituting specific program performance levels.

Encouragement by RUS to continue community development efforts, at appropriate funding levels determined by each borrower, is a laudable effort. Such investment should help build customer/community loyalty which will prove to be priceless in a competitive environment. However, establishing an arbitrary target percentage of total utility plant or a specific number of borrowers making investments in community/economic development will do disservice to the electric program in this time of regulatory and market change. While RUS strongly supports borrower economic development efforts, specific RUS directives would not be prudent at this time, and could take the focus off of rate competitiveness, reliability, loan security and the long-term economic health of the borrower and the rural community it serves. Such action would be contrary to the intent of the RE Act and Section 312 amendment.

EXHIBIT M - RUS WRITTEN RESPONSE TO THE DRAFT REPORT

RUS believes that improvements to the electric program can be attained by: 1) strategically developing and implementing policies that encourage borrower investment in rural economic development, 2) reviewing Forms 7a and 12h for proper classification of rural development investments, and 3) revising current Form 7a and 12h instructions to help borrowers improve on the tracking of rural economic development projects.

RUS respectfully submits these comments as our reply to the recommendations listed in Audit No. 09601-1-Te.

Sincerely,

BLAINE D. STOCKTON
Assistant Administrator
Electric Program

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