MATTERS TO BE CONSIDERED: Emergency policy to govern the forfeiture of street time under 28 C.F.R. § 2.52(c)(2) in the Ninth Circuit, in order to comply with *Rizzo* v. *Armstrong*, _____F.2d_____ (9th Cir. August 30, 1990).

AGENCY CONTACT: Pamela Posch, Paralegal Specialist, Office of General Counsel, United States Parole Commission, (301) 492-5959.

Dated: September 17, 1990.

Michael A. Stover,

General Counsel, U.S. Parole Commission.

[FR Doc. 90-22317 Filed 9-17-90; 12:47 pm]

BILLING CODE 4410-01-M

Wednesday,
September 19, 1990

Part II

Department of Labor

Employment and Training Administration

Employment Service Reform Initiative; Notice; Request for Comments

DEPARTMENT OF LABOR

Employment and Training Administration

Employment Service Reform Initiative

AGENCY: Employment and Training Administration, Labor.

ACTION: Notice; request for comments.

SUMMARY: The Secretary of Labor has announced a Workforce Quality Agenda to assure that the American workforce has the skills to meet the challenges of the 1990's and beyond. The Agenda includes an initiative to reform the Employment Service (ES). The objectives of the Initiative are to increase the efficiency of the labor market, more effectively spend the $800 million in funding the Employment Service receives annually, and reform and refocus the Employment Service to meet the labor market challenges of the new century. As part of the ES Reform Initiative, the Secretary is seeking the views of key business, labor, and State officials. The Secretary also wants to know the reaction of the public at large, and, therefore, is requesting comment on a series of questions about the role of the ES and its funding.

DATES: Written comments on this notice are invited. Comments shall be received by October 19, 1990.

ADDRESSES: Comments shall be mailed to Roberts T. Jones, Assistant Secretary for Employment and Training, U.S. Department of Labor, 200 Constitution Avenue, NW., room N-4470, Washington, DC 20210, Attention: Robert A. Schaerfl, Director, U.S. Employment Service.

FOR FURTHER INFORMATION CONTACT: Robert A. Schaerfl, Director, U.S. Employment Service, Employment and Training Administration. Telephone: (202) 535-0157 (this is not a toll free number.)

SUPPLEMENTARY INFORMATION: Upgrading the skills of the American workforce, expediting the process where workers are matched with jobs in an era of slow labor force growth, and keeping our nation competitive in a complex global market, are all goals of the Secretary of Labor (Secretary). A key factor in reaching these goals is a strong and vital public Employment Service (ES).

A community of employers and jobseekers regularly use and benefit from the services and labor market information the ES provides. However, a number of facts lead to concern that the ES is not geared for the dynamics of the 1990's.

- For example, while nearly all of our employers pay the federal unemployment tax, only about 25 percent list job vacancies with the ES. In 1957, that figure was 42 percent.
- Since 1962, ES placements as a percent of all national hires has declined from 20 percent to 7 percent.
- The percent of jobseekers using the ES to find work has dropped from 30 percent in 1970 to 21 percent in 1988. As few as 3 percent of those persons seeking work actually find jobs through the ES.

The Department of Labor (Department) believes the ES can and must do better; that the $779,039,000 in annual funding the ES received in Program year 1990 should be more effectively and efficiently spent.

Increasing concern about ES performance is undoubtedly related to increasing confusion as to its appropriate role. Changing laws, regulations, and Congressional mandates have perhaps caused the ES to lose sight of a specific goal, and to try to be a bit of everything to everybody. However, despite the declining impact of the ES, there is no clear consensus among policymakers, employers, unions or employees about reasons for the decline or of the appropriate role for ES in today's economy.

The Department intends to present to the Congress early next year, legislation to reform and refocus the ES into an institution ready to tackle the challenges of the new century. To do that, it needs the help and expertise of all interested parties. The Department wishes to know what the public at large thinks should be contained in this legislation. Specifically, the Department wants to know what the public thinks the ES should be, whom it should serve, and how it can most effectively fulfill its mission.

- Should the ES be a comprehensive labor market exchange soliciting job listings across a wide range of skills and wage levels?
- Would it be most efficient for the ES to focus its services on unemployment insurance claimants making their return to work its primary goal—thus reducing employer payroll taxes?
- Should the ES continue to direct its services on disadvantaged individuals whose labor force participation is marginal or impaired by barriers to employment?
- Should the ES drop its placement activity altogether and act as a diagnostic and referral agent to programs offering job training, remediation and other services?
- Should the ES make development and dissemination of labor market information its primary role and, as part of that activity, make job listings and applicant files directly available to job seekers and employers?
- Should the ES charge employers for special screening and services above basic access to the applicant pool?

Request for Public Comment

The Department of Labor is seeking public comment. Interested parties are requested to submit comments, recommendations, and/or suggestions for improving the performance of the Employment Service.

Signed at Washington, DC, this 12th day of September, 1990.

Roberts T. Jones,

Assistant Secretary for Employment and Training.

[FR Doc. 90-22104 Filed 9-18-90; 8:45 am]

BILLING CODE 4510-30-M

Wednesday,
September 19, 1990

Part III

Department of Agriculture

Rural Electrification Administration

7 CFR Part 1717

Federal Pre-emption in Rate Making in Connection With Power Supply and Electric Borrowers; Final Rule

DEPARTMENT OF AGRICULTURE

Rural Electrification Administration

7 CFR Part 1717

RIN 0572-AA40

Federal Pre-emption in Rate Making in Connection With Power Supply Borrowers

AGENCY: Rural Electrification Administration, USDA.

ACTION: Final rule.

SUMMARY: The Rural Electrification Administration (REA) hereby amends 7 CFR chapter XVII by adding part 1717, Post-Loan Policies and Procedures Common to Insured and Guaranteed Electric Loans. This part establishes policies and procedures to implement certain provisions of (a) The Rural Electrification Act of 1936, as amended (7 U.S.C. 901 *et seq.*) (the "RE Act"); and (b) REA loan documents, including wholesale power contracts between the power supply borrowers and their members, which provide, among other matters, for the establishment of rates for the sale of electric power and energy by power supply borrowers. This subpart addresses the pre-emption under certain circumstances of the regulation of power supply borrowers' rates by State Regulatory Authorities.

EFFECTIVE DATE: The final rule is effective October 19, 1990.

FOR FURTHER INFORMATION CONTACT: Mr. Laurence V. Bladen, Financing Policy Specialist, Rural Electrification Administration, Room 1272, South Building, U.S. Department of Agriculture, Washington, DC 20250-1500, telephone number (202) 382-9558.

SUPPLEMENTARY INFORMATION: Pursuant to the RE Act, REA hereby amends 7 CFR chapter XVII by adding part 1717, Post-Loan Policies and Procedures Common to Insured and Guaranteed Electric Loans and by adding, subpart G—Federal Pre-emption in Rate Making in Connection with Power Supply Borrowers.

This regulation is issued in conformity with Executive Order 12291, Federal Regulation. It will not (1) Have an annual effect on the economy of $100 million or more; or (2) result in a major increase in costs or prices for consumers, individuals, industries, Federal, state, or local government agencies or geographic regions; or (3) result in significant adverse effects on competition, employment, investment or productivity; and has been determined not to be "major".

This action does not fall within the scope of the Regulatory Flexibility Act. REA has concluded that promulgation of this final rule would not represent a major Federal action significantly affecting the quality of the human environment under the National Environmental Policy Act of 1969 (42 U.S.C. 4321 *et seq.* (1976)) and, therefore, does not require an environmental impact statement or an environmental assessment. This program is listed in the Catalog of Federal Domestic Assistance as 10.850, Rural Electrification Loans and Loan Guarantees. For the reasons set forth in the final rule related Notice to 7 CFR 3015 subpart V in 50 FR 47034, (November 14, 1985), this program is excluded from the scope of Executive Order 12372 which requires intergovernmental consultation with state and local officials.

The reporting and/or recordkeeping requirements contained in this final rule have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 *et seq.*) The OMB approval number for these requirements is 0572-0089.

The public reporting burden for this collection of information is estimated to average 6 hours per response including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Department of Agriculture, Clearance Officer, Office of Information Resources Management, Room 404-W, Washington, DC 20250 and to the Office of Management and Budget, Paperwork Reduction Project, (OMB # 0572-0089), Washington, DC 20503.

Background

On April 2, 1990, REA published a Proposed Rule at 55 FR 12194 proposing to revise 7 CFR chapter XVII, by adding a new Part 1714, Electric Rates, Services, and Contracts, consisting of Subpart E—Federal Pre-emption in Rate Making in Connection with Power Supply Borrowers. After issuing that Proposed Rule, and in the process of developing the Final Rule, REA has undertaken a project to simplify, clarify, and update agency regulations. This project, when complete, will provide a more logical arrangement of agency regulations in order to assist borrowers and others. As part of this project, this regulation relating to Federal pre-emption has been redesignated as subpart G—Federal Pre-emption in Rate Making in Connection with Power Supply Borrowers to a new Part 1717, Post-Loan Policies and Procedures Common to Insured and Guaranteed Electric Loans. This redesignation is not substantive and does not require public comment.

This regulation, 7 CFR part 1717, subpart G—Federal Pre-emption in Rate Making in Connection with Power Supply Borrowers is related in subject matter to a Final Rule, 7 CFR part 1717, subpart H—Federal Pre-emption in Rate Making in Connection with REA Electric Borrowers in Bankruptcy, which is being published elsewhere in today's **Federal Register**. Interested parties should refer to Subpart H and, in particular, the "Background" paragraphs for further discussion of the circumstances which give rise to both final rules. While subpart H and this subpart G are related in subject matter, this rule addresses the matter of pre-emption of State Regulatory Authorities' jurisdiction over the rates of power supply borrowers. This rule can be implemented separately and is therefore being promulgated separately.

Comments

In Proposed Rule, published on April 2, 1990, REA invited interested parties to file comments on or before June 1, 1990. On May 29, 1990, REA received a number of requests from the public for a 30 day extension of the comment period. Since these requests were received just prior to the June 1, 1990 scheduled end of the 60 day comment period for this Proposed Rule, REA did not extend the comment period.

In order to be responsive to these requests, however, and to give other interested parties an additional opportunity to comment, REA published a notice on June 12, 1990, at 55 FR 23748 to reopen the public comment period on this Proposed Rule for an additional 30 days, from June 12, 1990 to July 12, 1990.

Seventy four different organizations or groups commented on the Proposed Rule during the initial comment period. They were:

1. Alaska Public Utilities Commission.
2. Allegheny Electric Cooperative, Inc.
3. Arizona Corporation Commission
4. Arkansas Electric Cooperative Corporation
5. Arkansas Public Service Commission
6. Basin Electric Power Cooperative
7. Boone County Rural Electric Membership Corporation
8. Buckeye Power, Inc.
9. Cajun Electric Power Cooperative, Inc.
10. Carroll County Rural Electric Membership Corporation
11. Central Electric Power Cooperative, Inc.
12. Central Iowa Power Cooperative

13. Colorado Association of Municipal Utilities
14. Colorado Public Utility Commission
15. Corn Belt Power Cooperative
16. Cotton Electric Cooperative, Inc.
17. Delta Montrose Electric Association
18. East Kentucky Power Cooperative, Inc.
19. East River Electric Power Cooperative
20. Electric Consumers Resource Council
21. Empire Electric Association, Inc.
22. Fruit Belt Electric Cooperative
23. Grand Valley Rural Power
24. Hancock County Rural Electric Membership Corporation
25. Hendricks County Rural Electric Membership Corporation
26. Hoosier Energy Rural Electric Cooperative, Inc.
27. Hot Springs County Rural Electric Association, Inc.
28. Indiana Utility Regulatory Commission
29. Intermountain Rural Electric Association
30. Iowa Association of Electric Cooperatives, Inc.
31. Jasper County Rural Electric Membership Corporation
32. Jay County Rural Electric Membership Corporation
33. Kankakee Valley Rural Electric Membership Corporation
34. Kansas Corporation Commission
35. Kosciusko County Rural Electric Membership Corporation
36. LaGrange County Rural Electric Membership Corporation
37. Logan County Co-operative Power and Light Association, Inc.
38. Louisiana Public Service Commission
39. Marshall County Rural Electric Membership Corporation
40. Miami-Cass County Rural Electric Membership Corporation
41. Michigan Public Service Commission
42. National Association of Regulatory Commissioners, Inc.
43. A jointly signed comment from:
   a. National Association of State Utility Consumer Advocates
   b. Interim Director of Public Advocacy—Vermont
   c. Office of Consumer Counsel—Colorado
   d. Office of Utility Consumer Counselor—Indiana
44. National G&T Managers Association
45. National Rural Electric Cooperative Association
46. National Rural Utilities Cooperative Finance Corporation
47. New Mexico Public Service Commission
48. New York Department of Public Service
49. Newton County Rural Electric Membership Corporation
50. Noble County Rural Electric Membership Corporation
51. Northwest Iowa Power Cooperative
52. Oglethorpe Power Corporation
53. Parke County Rural Electric Membership Corporation
54. Phelps Dodge
55. Public Service of Indiana, Inc.
56. Public Utility Commission of Texas
57. San Isabel Electric Association, Inc.
58. Southeast Colorado Power Association
59. State of Maryland Public Service Commission
60. State of New Hampshire Public Utilities Commission
61. Steuben County Rural Electric Membership Corporation
62. The Western Michigan Electric Cooperative
63. Tipmont Rural Electric Membership Corporation
64. Tri-State Generation and Transmission Association, Inc.
65. United Power Association
66. United Rural Electric Membership Corporation
67. Vermont Department of Public Serivce
68. Wabash County Rural Electric Membership Corporation
69. Wabash Valley Power Association, Inc.
70. Warren County Rural Electric Membership Corporation
71. Western Interstate Energy Board
72. White County Rural Electric Membership Corporation
73. Wyoming Public Service Commission
74. Y–W Electric Association, Inc.

During the additional 30 day comment period, REA received comments from the following organizations:

1. Cooperative Power Association
2. East Kentucky Power Cooperative, Inc.
3. Fulton County Rural Electric Membership Corporation
4. Carkane Power Association, Inc.
5. Honorable John T. Myers, Member of Congress
6. A jointly signed comment from:
   a. North East Texas Electric cooperative, Inc.
   b. Tex-La Electric Cooperative
7. Northeastern Rural Electric Membership Corporation
8. The Brown-Atchison Rural Electric Cooperative Association, Inc.
9. A jointly signed comment from:
   a. The National Rural Electric Cooperative Association
   b. Ogelthorpe Power Corporation
   c. Paul, Hastings, Janofsky & Walker
10. Wabash Valley Power Association, Inc.

For the purposes of discussion, the comments of these organizations have been categorized and or summarized. Because both this subpart G—Federal Pre-emption in Rate Making in Connection with Power Supply Borrowers and subpart H—Federal Pre-emption in Rate Making in Connection with REA Electric Borrowers in Bankruptcy were published in proposed rule form in the **Federal Register** on the same day (April 2, 1990) many commentors submitted a single set of comments addressing both Proposed Rules. Because in many cases it was not possible to determine which specific comments pertained to which proposed rule, many of the comments have been addressed in both this Final Rule and the Final Rule, subpart H—Federal Pre-emption in Rate Making in Connection with REA Electric Borrowers in Bankruptcy which is being published elsewhere in today's **Federal Register**.

General Discussion

A number of comments opposing the proposed regulation argued that REA is not authorized under the RE Act to pre-empt state rate regulation, that REA is simply a lender seeking to use pre-emption as a means of debt collection, and that the interests of the consumer will not be protected if REA pre-empts a State Regulatory Authority. REA believes that these comments do not reflect a firm understanding of the objectives of the REA program and the structure which has been historically adopted to achieve these objectives. Further, these comments fail to recognize the fundamental problems which can arise as a result of rate regulation of not-for-profit cooperatives, problems which go to the very heart of the REA program. While these matters were discussed at some length in the background for the Proposed Rule, it may be helpful to further discuss the REA program and the basis for this regulation before addressing these comments more specifically.

The RE Act is consumer legislation designed to accomplish the social objective of providing affordable and reliable electric service to unserved persons in rural areas. REA was created as a lending agency to provide loans for rural electrification at a time when existing utilities were not providing service in many rural areas. REA has, pursuant to the broad discretion granted by Congress under the RE Act, created a structure to accomplish this statutory objective—a structure which for more than 50 years has succeeded in providing not only electric service to RE Act beneficiaries, but the repayment of REA loans. REA is promulgating this regulation to protect this structure.

There are two features of the REA program which are of particular importance in considering the need for this regulation. These features are, the corporate structure of REA-financed electric systems, and the provisions of the REA loan documents.

Most REA-financed electric systems are not-for-profit cooperatives organized on the democratic principle of "one person/one vote". The members/consumers are owners of the cooperative and control their cooperative through the election of a Board of Directors and through the exercising their other rights as members. Through their electric bills and the rates charged, members pay for the cost of electric service and contribute equity capital which is used by the cooperative. When the cooperative is financially able, the contributed capital is periodically returned to the members. The members of the cooperative are not "investors" in the generally accepted meaning of the word. Unlike the shareholders of an investor owned utility, who receive dividends, the member/owners of a cooperative do not receive an economic return on the capital they contribute.

Rather, the members receive the benefits of ownership through lower rates for electricity. Without the need to provide a return on equity to "investors", the rates charged for electricity can be lower than would otherwise be the case. The cooperative structure itself thus serves to promote the RE Act objective of providing electric power at as low a cost as practicable.

Electric cooperatives, by their very structure, are more sensitive to cost increases such as construction cost overruns, and to revenue decreases such as caused by cyclical downturns in the economy. These changes can require immediate rate increases. Without timely rate relief borrowers can face potential payment defaults on loans.

It has been suggested that the lenders to the rural electric industry especially the Federal Government, are in effect the "equity investors" in the cooperative in lieu of stockholders who are absent in the cooperative structure. REA believes that this perception of the Federal Government and other lenders as "equity investors" is erroneous and wholly incompatible with the structure of the REA program.

Equity investors place money at risk for the potential of receiving unlimited returns on their investment (while returns on equity may be controlled in a regulated environment, stock price is not). The risk that equity investors assume in return for these potential benefits are substantial. They accept uncertainty about the amount and timing of the benefits that they may receive and accept junior priority of repayment in adverse circumstances.

Commercial lenders on the other hand have a senior priority of claims, accept less risk, and are compensated for this risk by accepting a finite benefit, the interest rate charged on their loans.

In the case of rural electric lending the Federal Government provides financing to power supply borrowers at approximately its cost of money. The RE Act does not provide the Federal Government with the right to receive the kind of unlimited benefits an equity investor may receive. Nor does it provide the Federal Government with the right to receive "profits" from its lending activities. In fact, REA is unable to act like a true commercial lender. It is not permitted to charge a fee for its services. Interest rates are fixed by statute, and REA is therefore unable to charge a risk adjusted interest rate on its loans. Additionally, unlike other lenders, REA has no funded reserve for loan losses. When a borrower defaults on a loan, there is no pool of funds set aside to make the payment for the debtor, nor is the shortfall covered by increased payments from other rural electric borrowers. Instead, any and all losses in the rural electrification program are borne by the Rural Electrification and Telephone Revolving Fund (the Revolving Fund), which was established under the provisions of the RE Act as a source of debt capital for REA-financed utilities and as the initial source of capital used by REA to make payments under contracts of guarantee.

Any shortfalls paid by the Revolving Fund either have the effect of depleting fund assets thus limiting the availability of capital to other REA financed systems or must be ultimately reimbursed by the nation's taxpayers.

Congress, in enacting the RE Act, intended that the loans made by REA, be repaid by the beneficiaries of the particular loan, not by the taxpayers. Under the RE Act, the Administrator is given the authority to make self liquidating loans—not grants. The RE Act provides the Administrator with only limited authority to restructure loans by lengthening the repayment period and no authority to write them off.

As explained in the background to the Proposed Rule, (55 FR 12195), REA financed cooperatives are generally organized on a two tier system with power supply borrowers providing wholesale service to their member/owners, the distribution cooperatives. The power supply borrower owns or controls generation and bulk transmission facilities. The distribution members own the facilities necessary to serve on the retail level. Taken together, a power supply borrower and its distribution members are essentially one economic unit, similar to a single investor owned utility which owns or controls both the sources of production and the retail franchises.

The REA power supply program is carried out by means of a series of financing documents: The REA loan contract, the security instrument, and, in particular, the REA wholesale power contract.

The wholesale power contract provides that the power supply borrower shall sell, and its members shall purchase, power at rates which are sufficient, but only sufficient, to meet the power supply borrower's costs, including repayment of REA loans. This key provision of the wholesale power contract is the foundation of the rural electric program and has provided REA assurance that its loans to power supply borrowers will be repaid. At the same time this provision, which requires a review of the adequacy of rates not less frequently than annually, carries out the objective of providing reliable electric service to RE Act beneficiaries at costs that are as low as practicable.

It should be noted that this wholesale power contract provision does not, of course, ensure that the rates charged for electric power and energy by REA-financed electric systems will not be higher than rates charged by other utilities for similar service. Indeed, historically, rates of REA borrowers have been higher than rates of other utilities. Nor does it, in and of itself, guarantee REA that the loans made to a borrower will be repaid within the time agreed. There are several situations where REA is prepared to face the potential for losses because the economics of the area served by the borrower would not sustain rates at a level necessary to repay REA as scheduled. Nevertheless, this rate provision of the wholesale power contract is the economic underpinning of the REA program—both providing the assurance of repayment and carrying out the social objectives of rural electrification.

As noted at length in the background section of the Proposed Rule, courts have recognized the significance of the wholesale power contract to the REA program and have upheld the contract in a number of different contexts. For example, the 10th Circuit Court of Appeals, in concluding that the contract obligates a distribution member to maintain its power requirements and remain in business throughout the term of the contract, stated:

> The all-requirements contracts which form the (power supply borrower's) system are not simple requirements contracts but rather inter-dependent, joint and mutual contracts with a common purpose of securing the REA loans and thereby effectuating the REA policy to provide the economic means for supplying electricity to rural areas. *Tri-State G&T Assn.* v. *Shoshone River Power & Light*, 874 F.2d 1359 (10th Cir. 1989).

The Court concluded that interference with the contract (in that case, a sell out by a distribution member to an investor owned utility) would "constitute an abuse of the federal program" (p. 1360). So it has been in other cases involving the wholesale power contract, and so it is, when a State Regulatory Authority exercises its jurisdiction over rates in such a manner as to prevent the power supply borrower from charging rates adequate to repay REA loans as required by the terms of the wholesale power contract.

It is true, of course, that REA is a lending agency, not a conventional regulatory agency, and that Congress anticipated that cooperatives would be organized and operated in accordance with State law and State Regulatory Authorities. For the most part, the REA program has operated harmoniously with State Regulatory Authorities, with very few conflicts between the goals of REA and the goals of the state agencies regulating the rates and services of REA-financed electric systems.

REA loan funds are not advanced unless all required approvals from State Regulatory Authorities have been received. Further, REA has allowed for the jurisdiction of State Regulatory Authorities in the design of electric rates. The standard security instrument required of borrowers provides, in section 15 of article II, that, "* * * subject to applicable laws and rules and orders of regulatory bodies * * *," the borrower will design its rates to meet certain financial objectives. Thus, a State Regulatory Authority can establish rates which are lower than rates that the borrower would otherwise be required to set, absent state regulation. REA has not, however, deferred to State Regulatory Authorities the decision of whether REA loans will be repaid.

While the REA program has operated in harmony with state rate regulation, the opportunity for conflict exists, particularly where a State Regulatory Authority seeks to regulate an REA borrower in the same manner it regulates as an investor owned utility. There are fundamental differences between the REA-financed utilities and investor owned utilities which must be taken into consideration.

Investor owned utilities are owned and controlled by shareholders who are seeking to maximize the return on their investment. Such stockholders are not necessarily the rate paying customers of the utility. Thus, friction exists between the goals of the utility—to maximize stockholders' return on investment—and the goals of the rate payers—to keep the cost of electricity low. Rate regulation balances the interests of the ratepayers and the stockholders and thus protects the ratepayers from monopoly pricing by the investor owned utility.[1]

Cooperatives, on the other hand, are owned and controlled by the member/owners, i.e. the ratepayers, at both the distribution and power supply level. Since in a cooperative there are no investors and since no return is provided on contributed capital, the member/owner receives the benefits when the organization is operating efficiently through lower power costs, not through a return on investment. Similarly, the member/owners face the risk of higher rates if the organization encounters financial problems. Because the cooperatives' ratepayers and owners are one and the same, the friction between owners and customers does not exist. Thus, in a cooperative structure, there is not the same need for regulation to protect the ratepayers interests from the owners. Underscoring this is the fact that the majority of the States do not regulate cooperatives. Most States that regulate cooperatives recognize that the concept of "rate of return" does not exist in the cooperative structure. In these States cooperatives tend to be regulated on a "times interest earned" basis, which is designed to ensure rates adequate to pay the cooperative's obligations.

Indeed, the cooperative structure creates problems for regulatory authorities which apply a regulatory scheme designed for investor owned utilities. Should a regulatory authority refuse to approve rates required by the terms of the REA wholesale power contract, the member/owners benefit through lower rates. This is significantly different from the situation in an investor owned utility when a rate increase needed to cover its costs is denied. In such a case the owners/shareholders are expected to bear the loss.

It is clear that a State Regulatory Authority may see advantages to shifting the cost from ratepayers of the cooperative to the Federal Government. As an example, the Indiana Supreme Court recently upheld[2] its State Regulatory Authority's decision to exclude from the rates charged by a power supply borrower pursuant to the wholesale power contract an investment in a failed generating plant, on the grounds that the investment did not result in facilities that were "used or useful." This determination runs contrary to the logic of rate regulation. It rewards member/owners of the REA borrower, where it would have penalized the owner/shareholders of an investor owned utility under similar circumstances. This determination means that the member/owners of an REA borrower get all of the benefits when the organization is operating efficiently while bearing none of the burdens when problems occur.

The REA program stands to be frustrated by such actions. If a State Regulatory Authority does not allow an REA borrower to charge rates adequate to repay its debts, the Revolving Fund and the federal taxpayer will have to bear the financial loss. The State will have succeeded in interfering with the enforcement of the REA wholesale power contract which, for the history of the REA program, has been the means of bringing affordable and reliable electric service to rural areas.

If the REA contracts can no longer be enforced in accordance with their terms because of State interference, then the contracts will no longer provide the assurance of repayment that REA and private lenders believe necessary to permit continued financing. One consequence of this process could be the collapse of the program's financial structure. Even if it were possible to restructure the REA program, unquestionably, any restructuring would be significantly more expensive for the ultimate rate payers—a result that clearly frustrates the REA program objectives. Such state inference with the wholesale power contracts is, to use the words of the 10th Circuit Court, "an abuse of the federal program."

Additionally, this result also frustrates Congressional policy, which states,

> * * * it is hereby declared to be the policy of the Congress that adequate funds should be made available to rural electric and telephone systems * * * which will allow them to achieve the objectives of the Rural Electrification Act of 1936, as amended; and that such rural electric and telephone systems should be encouraged and assisted to develop their resources and ability to achieve the 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 the Act's objectives.[3]

While REA in its lending program takes the business risk associated with lending to a specific company, and the risk of whether that company has the "ability to pay", it cannot accept the risk that a State Regulatory Authority may decide to shift costs to the federal taxpayer. Therefore, in order to manage such risk and still carry out the objectives of the RE Act, it is incumbent

[1] See generally, Charles F. Phillips, Jr. "The Regulation of Public Utilities" (Arlington, Virginia: Public Utilities Reports, 1988), pp 163–194.

[2] *National Rural Utilities Cooperative Finance Corporation v. Public Service Commission of Indiana*, 552 N.E. 2d 23 (1990).

[3] May 11, 1973, Public Law 93–32, Section 1, 87 Stat. 65; 7 U.S.C. 930.

on REA to pre-empt State Regulatory Authority action when its actions prevent repayment of secured loans.

Specific Discussion

Many of the comments REA received focused on one or more of several issues. The following is a discussion of the principal areas of comment and REA's response.

1. A number of commentors challenged the authority of REA to issue these regulations. These comments argued, among other matters, that the RE Act does not explicitly provide for pre-emption and the Congress did not intend to delegate to REA the authority to pre-empt state regulatory jurisdiction, that Congress intended REA to be a lender, not a rate making agency, and that there is no inconsistency between state rate regulation and carrying out the objective of the RE Act. The commentors cited the RE Act, its legislative history and case law in support of their arguments.

These regulations are being promulgated in order to displace state law in those very rare cases in which state law and the RE Act are in conflict, where the state law stands as an obstacle to the carrying out of the RE Act. Specifically the regulations displace state law where the State Regulatory Authority is preventing REA from enforcing its rights and is preventing an REA borrower from carrying out its obligations, set forth in the loan documents, to charge rates sufficient to repay REA loans. In displacing the state law, REA is not assuming the role of a conventional rate regulatory agency. Rather REA is simply putting the borrower in the same position as those borrowers which are not rate regulated. Currently, 45 of approximately 66 power supply borrowers are not subject to rate regulation by State Regulatory Authorities. REA will not, by this regulation, assume any greater authority or rights over its borrowers than it currently has pursuant to the loan documents. REA will enforce its existing rights and the borrower will meet its obligations pursuant to such loan documents and thus carry out the objectives of the RE Act free the obstacle imposed by state law. For the purpose of clarifying this point, REA has changed certain language in the regulation to emphasize that REA shall exercise jurisdiction over the rates pursuant to the terms of the loan documents.

The very narrow use of pre-emption authority pursuant to this regulation is well within the constitutional test for pre-emption i.e., that state law will be displaced to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines* v. *Davidowitz*, 312 U.S. 52, 67–68 (1941); *see also Schneidewind* v. *ANR Pipeline Co.*, 108 S.Ct. 1145, 1150–51 (1988); *Jones* v. *Roth Packing Co.*, 430 U.S. 519 (1977). Further, in REA's view this use of pre-emption authority is precisely what was contemplated by the Supreme Court when it stated:

> There may come a time when the REA changes its present policy, and announces that state rate regulation of rural power cooperatives is inconsistent with federal policy. If that were to happen, and if such rule was valid under the Rural Electrification Act, it would, of course, pre-empt any further exercise of jurisdiction by the [state regulatory authority]. *Arkansas Elec. Coop. Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 388–89 (1983).

The Supreme Court followed that statement with the even more pointed statement which recognizes the particular circumstances, which the regulation addresses, where state law would be pre-empted:

> [E]ven without an explicit statement from the REA, a particular rate set the [state regulatory authority] may so seriously compromise important federal interest including the ability of the [cooperative] to repay its loans as to be implicitly pre-empted by the Rural Electrification Act. (461 U.S. 389)

The express language of the RE Act, its legislative history and applicable case law confirm that the pre-emption provided in the regulation is consistent with and necessary to achieve the objectives of Congress. It is clear from the RE Act and legislative history that Congress viewed REA as being basically a lending agency, and that REA would operate in cooperation with the states. It is also clear from the express language of the RE Act and from legislative history that Congress intended that REA loans be repaid. Section 4 (7 U.S.C. 940) requires the Administrator to determine that security for the loan is adequate and that the loan will be repaid in accordance with its terms. The legislative history well illustrates that Congress assumed that, despite state regulation, see 80 Cong. Rec. 5316 (1936) (Rep. Lea) "all of the money loaned * * * will be recaptured by the Government with interest," id. at 5279 (Rep. Withhrow). There are many other examples in the legislative history which confirm that Congress intended the loans to be repaid.

The express language of the RE Act and the legislative history also make clear that the Administrator is to have broad authority to structure the program in a manner that would best achieve the purposes of rural electrification. Section 4 of the RE Act provides the Administrator with the authority to establish the "terms and conditions" of the loans. Pursuant to that authority, REA has established a unique structure that for more than 50 years has effectively carried out the objectives of the RE Act to provide reliable, affordable electric service to persons in rural areas while providing for repayment of loans. The REA program is implemented by, and the Administrator relies upon, the REA loan documents including the wholesale power contract. When a State Regulatory Authority refuses to approve rates required by the terms of the wholesale power contract and necessary to permit repayment of the REA loans, then that structure does not function properly and REA and its borrowers are unable to carry out the REA program as envisioned by Congress.

There is substantial case law, in addition to the *Arkansas Electric* case discussed above, which supports REA's authority to pre-empt. In the case of *Public Service Co. of Indiana* v. *Hamil*, 416 F.2d 648 (7th Cir. 1969) *cert. denied*, 386 U.S. 1010 (1970), the court held that REA may operate power supply facilities without being subject to State Regulatory Authority requirements. Two Ninth Circuit Court of Appeals cases,[4] held that REA had the authority to pre-empt state laws pursuant to which municipal bodies sought to acquire assets from a borrower. See also *Tri-State, supra*, and those cases referred to in the background section of the proposed rule regarding the wholesale power contract. These cases support the proposition that the Administrator has the authority under the RE Act to establish terms and conditions of loans including requiring borrowers enter into a wholesale power contract, and that the Administrator has authority to enforce such terms and conditions notwithstanding state laws which interfere with the REA program.

2. A number of commentors cite the recently decided *Wabash Valley Power Association, Inc.* v. *Rural Electrification Administration*, 903 F.2d 445 (7th Cir. May 23, 1990) as suggesting that Congress did not intend for REA to be a rate making organization and that REA may not pre-empt a State Regulatory Authority. As stated earlier, REA is not, through this regulation, attempting to become a rate making agency, but rather is displacing state law which constitutes an obstacle to carrying out the REA

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[4] *Public Util. Dist. No. 1* v. *United States*, 417 F.2d 200 (9th Cir. 1969) and *Public Util. Dist. No. 1* v. *Big Bend Elec. Coop.*, 618 F.2d 601 (9th Cir. 1980).

program and, specifically, to carrying out the terms and conditions established in the loan documents. Moreover, it is clear that the court did not decide the issue of authority to pre-empt:

> (REA) has issued a notice of proposed rulemaking * * * to consider thorough substitution of federal for state regulation. It would be inappropriate to interrupt that process by deciding in advance whether REA has statutory authority. Its effort to preempt state regulation of Wabash's rates alone founders on a mundane obstacle: it neglected to use the procedures required by the APA. 903 F.2d at 453, slip Op. at 14.

3. A number of commentors also argue that the proposed regulation would unlawfully abrogate contracts between REA and its power supply borrowers and between those borrowers and their members. The commentors appear to assume that, since the standard REA mortgage provides that the borrower shall design its rates to meet certain financial ratios, subject "to applicable laws and rules and orders of regulatory bodies," REA has contractually deferred rate matters to the States and that the regulation would abrogate such contractual commitments. These comments overemphasize REA's willingness to allow local control over rate design, expressed in one provision of the mortgage, but ignore REA's fundamental requirement, stated repeatedly in all loan documents, that its loans be repaid.

As discussed above, REA has, for the most part, worked harmoniously with State Regulatory Authorities. As provided in § 4 of the RE Act, REA will not make loans unless the State Regulatory Authority with jurisdiction has approved the loan. Borrowers which must change their rates, do so in accordance with applicable state law and with the approval of the State Regulatory Authority having jurisdiction.

The REA loan documents require a borrower to maintain a level of revenue sufficient (its revenue requirements) to meet the borrower's operating expenses and to repay its loans. These revenue requirements are allocated among the various classes of the borrower's consumers through the rate design it adopts. REA believes that each borrower's rate design, in general, is best determined by parties familiar with local conditions. Most borrowers design their own rates, but a few State Regulatory Authorities have been granted jurisdiction over the rates of some or all of the borrowers in their State.

REA has allowed local parties acting pursuant to the rate design provision of the REA mortgage to assume some limited authority to vary the level of the borrower's revenues, so long as the borrower has sufficient funds to meet its borrowing needs, financial requirements, and legal obligations. However, REA has never allowed State Regulatory Authorities to determine whether REA loans will be repaid. The loan documents unconditionally require the borrower to repay its REA loans as and when due.

The pre-emption of State Regulatory Authority provided for in this subpart G is to be triggered by a financial default by the borrower caused by the failure of the State Regulatory Authority to approve adequate rates. The pre-emption permits the borrower to establish rates required by the loan documents unfettered by obstacles imposed by the State Regulatory Authority. The pre-emption places the borrower in the same position as are all other borrowers whose rates are not subject to regulation by a State Regulatory Authority. Several States have recognized the unique structure of REA borrowers and have accepted self-regulation by the cooperative membership as the best way to assure fair and equitable rates. By analogy, in some circumstances, borrowers were, at the time of the REA loan, subject to rate regulation by the State and subsequently, either the State decided to deregulate the borrowers, or the borrowers elected under State law to remove themselves voluntarily from rate regulation. In either case the borrowers' rates thereafter were established pursuant to the provisions of the loan documents notwithstanding the language of the mortgage referring to State regulatory bodies. Conversely, there have been circumstances where borrowers were not subject to State rate regulation at the time a loan was made but later became regulated as to rates. In such situations, REA and its loan documents accommodate regulation. So it is with the pre-emption regulation.

This regulation in no way abrogates a contractual right of the borrower. The borrower does not have a contractual right to default on REA loans. To the contrary, the regulation removes an obstacle which is interfering with the ability of the borrower and REA to carry out their contractual rights and obligations.

4. Some commentors argued that the regulation is invalid to the extent it applies to outstanding loans because it is impermissible retroactive rulemaking.

REA's response to the preceding comment applies as well to this comment. The regulation does not change the respective rights and obligations of REA and the borrowers as set forth in the loan documents evidencing outstanding REA loans. Rather the regulation displaces State law which interferes with the carrying out of the terms and conditions of REA loans. While the REA standard mortgage accommodates rate regulation by a State Regulatory Authority, in no sense has REA, through its loan documents or otherwise, deferred to a State Regulatory Authority to determine whether REA loans shall be repaid. In the event that State rate regulation is pre-empted pursuant to the regulation, the borrower shall stand in the same position as any other unregulated borrower—it shall be able to carry out its obligations in accordance with their terms.

5. A number of commentors also asserted that the proposed regulation fails to provide interested parties with necessary due process. The commentors view REA as assuming the role of a conventional rate regulatory body and argue that the regulation must provide standards for ratemaking and a mechanism for interested parties, including ratepayers, to participate in the determination of the appropriate rates for borrowers.

REA has a twofold response to these comments. First, as stated previously, REA is not, pursuant to the regulations, attempting to assume the role of a conventional rate regulator. REA is simply displacing a State Regulatory Authority where the action or inaction of the Authority has prevented REA and the borrower from carrying out the terms of the loan documents. Where REA has pre-empted, REA will have those rights, set forth in the loan documents and particularly the wholesale power contract, to approve rates and will exercise those rights as it currently does for unregulated borrowers in accordance with the standards set forth in the loan documents.

It is initially the borrower's responsibility to design rates to meet the provisions of the loan documents. The loan documents grant wide discretion to the borrower in designing rates. The ratepayers may exercise any and all rights which they may have as member/owners of their cooperative to control management decisions of the borrower in such a way as to ensure rate designs are satisfactory. Unlike the ratepayers of an investor owned utility, the member/owners of a cooperative have an opportunity to participate in the rate setting process from inception. In members' meetings and through their locally elected representative on the Board of Directors they participate in all financial decisions of the cooperative, from the planning for a new project to the timing and structure of rate increases. Their representatives have complete access to the financial books and records of the utility. It should be noted that some borrowers which are not rate regulated have adopted procedures which provide the members with notice and opportunity to participate in the rate setting process. REA certainly has no objections to borrowers affording members such rights.

Secondly, because of the structure of the REA program, REA borrowers do not require the conventional form of regulation, which was designed to balance the interests of ratepayers and owners. The purpose of REA and of REA-financed electric systems is to bring reliable power at as low a cost as practicable to rural consumers. The not-for-profit cooperative structure, the rights of the member/owners, and the provisions of the loan documents all serve to promote this objective and to protect the interests of the ratepayer. This structure and particularly REA's role in the structure provided the basis for the Federal Power Commission (FPC), now Federal Energy Regulatory Commission (FERC), to conclude that REA borrowers are not subject to regulation under the Federal Power Act, *Dairyland Power Cooperative,* 37 F.P.C. 12 (1976), *aff'd sub nom., Salt River Project* v. *FPC,* 391 F.2d 470 (D.C. Cir.), *cert. denied,* 393 U.S. 857 (1968). The court in *Salt River* stated:

> Through its lending authority REA exercises extensive supervision over the planning, construction and operation of the facilities it finances. * * * Moreover, REA's concern is not only with providing high standards of electric service and guaranteeing its loan, but also with reducing the cost of service to the cooperative's consumers. * * * Though REA regulation and supervision of cooperatives are, in many respects, far more comprehensive than those which the Federal Power Commission exercises over investor-owned utilities, there are certain areas, such as ratemaking, where the cooperatives enjoy a freer hand. But it is in these areas that, by their structural nature, the cooperatives are effectively self-regulating. They are completely owned and controlled by their consumer-members, and only consumers can become members. They are non-profit. Each member has a single vote in the affairs of the cooperative, and service is essentially limited to members. No officer receives a salary for his services and officers and directors are prohibited from engaging in any transactions with the cooperative from which they can earn any profit. (391 F.2d at 473).

The court went further to recognize that rate regulation was intended to address "venal conditions and iniquitous practices" (p. 475) in the investor-owned electric utility industry but that virtually none of the major abuses "could be associated with the cooperative structure where ownership and control is vested in the consumer-owners." (p. 475). It upheld the determination by the FPC that REA borrowers were not subject to jurisdiction under the Federal Power Act concluding that the Federal Power Act and the RE Act "were arrived at wholly disparate problems and the supervisory agencies established under them were to deal with fundamentally different sorts of utilities." (p. 475).

As the FPC and the courts have recognized, the structure of the REA program and of its borrowers is such that conventional regulation is not required to protect the interests of the consumer.

6. One commentor opposed what has been redesignated as § 1717.307, Distribution Members Rates, which requires State Regulatory Authorities to pass through the power supply borrower's rates in determining rates for distribution members. The commentor argued that the regulation improperly relied on *Mississippi Power & Light Co.* v. *Mississippi Ex Rel. Moore,* 108 S.Ct. 1249 (1988) and *Nantahala Power & Light Co.* v. *Thornburg,* 106 S.Ct. 1249 (1986). The commentor contended that because REA would not be establishing rates which were "just and reasonable" but rather would be setting rates at a level high enough to ensure repayment of its loans, the filed rate doctrine of these cases is inapposite.

Section 1717.307 provides that State Regulatory Authorities which have been pre-empted may continue to exercise rate jurisdiction over distribution members. However, the State Regulatory Authority must pass through the power supply borrower's rates in determining rates for distribution member. This provision is required if the underlying purpose of the regulation, i.e. to displace a State Regulatory Authority which is interfering with the carrying out of the REA program, is to be fulfilled. The background section of the Proposed Rule analogized this provision to the filed rate doctrine under which power rates filed with or fixed by the FERC must be given binding effect by State Regulatory Authorities.

As the holding of the *Dairyland* case (discussed above) makes clear, Congress designed two different structures when it enacted the Federal Power Act and the RE Act. REA borrowers are not subject to regulation under the Federal Power Act because the consumers interests are protected through the structure of the program. Nevertheless, the rationale underlying the FERC filed rate doctrine applies as well to the REA program. In *Nantahala,* the Supreme Court stated:

> When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a state may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of pay the FERC, approved rate * * * Such a trapping of costs is prohibited. (106 S.Ct. at 2359.)

The wholesale rates established pursuant to the REA structure must be passed through or the objectives of the RE-Act would be frustrated just as the objectives of the Federal Power Act would be frustrated if FERC approved rates were not passed through by the State Regulatory Authority.

7. A number of commentors felt that REA failed to consider the provisions of Executive Order 12291, Federal Regulation, when it issued the Proposed Rule. REA and the Department of Agriculture continue to believe that this program does not (1) Have an annual effect on the economy of $100 million or more; or (2) result in a major increase in costs or prices for consumers, individuals, industries, Federal, state, or local government agencies or geographic regions; or (3) result in significant adverse effects on competition, employment, investment or productivity.

REA and the Department of Agriculture believe that the economic impacts resulting from this regulation establishing certain circumstances for pre-emption are minimal. The economic impact of a lending decision occurs at the time the loan is made and funds are disbursed. The timely repayment of loans has no additional economic impact.

Of the 46 states in which REA-financed electric systems operate only 17 currently regulate the rates of 293 REA distribution borrowers. The State Regulatory Authorities of only 12 states assert jurisdiction over the wholesale electric rates of approximately 21 REA-financed electric power supply systems.

In most cases, the rates approved by these Authorities are sufficient to ensure the repayment of the Federal government's loan and loan guarantees. REA believes that in most situations Federal interests and State interests will continue to coincide. Therefore, REA expects conflicts with Federal interests to occur infrequently.

Pre-emption shall occur pursuant to this regulation if a State Regulatory Authority fails to approve adequate rates. In such a situation, the amounts to be charged upon pre-emption will be no greater than the amounts that the power supply borrower's members should have been paying under their wholesale power contract and therefore the issuance of this regulation has no marginal effect on the economy.

REA acknowledges that the failure to make payments on lawfully incurred debts does have an economic impact and would transfer the burden of payment from the member/owners of the cooperative, who derive a benefit from the rural electrification program, to the nation's taxpayers as a whole.

Therefore, REA and the Department of Agriculture continue to believe that this regulation is not a "major rule" under the scope of Executive Order 12291.

8. Some commenters have suggested that REA has failed to comply with four specific policies of Executive Order 12612, Federalism. In preparing the Proposed Rule and Final Rule, REA considered the specific Federalism provisions which pertained to this regulation and has complied with the Secretary of Agriculture's Memorandum 1200–1, dated February 19, 1988, which implements Executive Order 12612 within the Department of Agriculture.

Contrary to the comments received, REA believes that constitutional authority for this Federal action (the regulation) is clear and REA has firm and palpable evidence compelling the conclusion that the Congress intended pre-emption of State law.

REA carefully assessed the necessity for this regulation. As discussed in REA's responses to comments challenging the authority to issue this regulation under the RE Act, REA affirms the conclusion that Congress intended REA to have the authority to pre-empt State law, when the exercise of State authority in regulating rates directly conflicts with the exercise of Federal authority to establish the terms and conditions of loans made under the RE Act.

Also contrary to comments received, REA believes that to the extent practicable, REA, in administering its loan program, consults with appropriate officials and organizations representing the States in an effort to avoid conflicts and to eliminate the need for pre-emption.

Notwithstanding the terms and conditions imposed by the Administrator in REA loan documents and the overriding Federal interests in carrying out the REA program, Congress has recognized that State Regulatory Authorities have an appropriate role in the REA power supply program. Section 4 of the RE Act in one instance expressly requires the Administrator to defer to State authority providing:

> That no loan for the construction, operation, or enlargement of any generating plant shall be made unless the consent of any applicable State Regulatory Authority is first obtained.

Consequently, REA does not finance facilities for power supply borrowers without the required approvals of all State Regulatory Authorities.

REA has not deferred to State Regulatory Authorities the decision of whether REA loans will be repaid. For the most part, REA and the States' interest coincide and State Regulatory Authorities exercise their authority in a manner consistent with protecting Federal interests, by approving rates adequate to ensure loan repayment.

REA continues to believe that, while opportunities exist for conflict between State Regulatory Authorities and Federal interests, in almost all cases conflict can be avoided through cooperation among the interested parties. Even when faced with a borrower in default and experiencing extreme financial problems, REA and some State Regulatory Authorities have been able to resolve the problems in a way that protects Federal interests and is satisfactory to the State Regulatory Authority.

Some comments assert that this regulation is unnecessary because the problems confronting the rural electrification program are not of national scope as provided in Executive Order 12612.

REA-financed electric systems provide service to rural consumers in 46 states. While only 17 states regulate power supply or distribution cooperatives, the problems that this regulation addresses are of a national scope. Unless REA can pre-empt State Regulatory Authorities in the limited circumstances covered by the regulation, the State Regulatory Authorities would be given a means of shifting costs from consumers in their state to Federal taxpayers. It could well be that the type of interference with and abuse of the REA program which has occurred in Indiana (see above) may have a snowballing effect; that other State Regulatory Authorities which heretofore have acted in a manner consistent with the structure of the REA program would feel compelled to also shift costs to the Federal taxpayer. It should also be noted that in effect, as Federal taxpayers the electric consumers in other States are paying for the cost of electric service to rural Indiana consumers. Unless state law, which in these limited circumstances stands as an obstacle to carrying out the REA program, is displaced, the intent of Congress in providing for rural electrification through a lending program would be frustrated and the American taxpayers as a whole will end up subsidizing rural electric service well beyond the levels envisioned by Congress.

Under the Secretary of Agriculture's memorandum 1200–1, dated February 19, 1988, REA has subjected this regulation to close internal scrutiny by policy officials before publication in the **Federal Register.** This regulatory action is being taken only after a thorough analysis with a view toward maximizing the net benefits to society. As determined by the Memorandum, the Administrator was initially responsible for identifying proposed policies, regulatory initiatives and legislative proposals that have sufficient Federalism implications to warrant the preparation of a Federalism assessment pursuant to the Order. In accordance with the principal and purpose of the Executive Order 12612, Federalism, REA has considered whether the Proposed Rule would have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. It is the opinion of REA that during the rule making process the Federalism implications of this Final Rule have been assessed in compliance with the requirements of Executive Order 12612.

The following is a brief summary of the modifications made in the final regulation:

Several modifications have been made in the regulatory text to make it clear that should REA pre-empt a State Regulatory Authority, REA rate regulation will thereafter be pursuant to the REA documents (§ 1717.300, § 1717.301(e)).

A new definition of State Regulatory Authority has been added to the regulation (§ 1717.302(a)).

The regulatory text has been modified to make it clear that the REA wholesale power contract provides that revisions to electric rate shall not be effective until approved by the Administrator (§ 1717.303(b)).

Under the regulations, in order to pre-empt a State Regulatory Authority, the Administrator must determine that approved rates are inadequate to make payments on secured debt and that the borrower has failed to make required payments. The provision in the proposed regulation that authorized pre-emption upon the determination by the Administrator that the borrower will fail to make required payments has been eliminated (§ 1717.305(a)).

The regulation now provides that a public notice of REA pre-emption of rates be published in the **Federal Register** (§ 1717.305(b)).

The regulation has been modified to make clear that REA has the option, but is not required to exercise remedies pursuant to the REA documents should a borrower subject to REA rate jurisdiction fail to establish rates in accordance with the wholesale power contract (§ 1717.306(c)).

List of Subjects in 7 CFR Part 1717

Administrative practice and procedure, Electric power rates, Electric utilities, Federal pre-emption, Guaranteed loans, Loans programs—energy, Wholesale power contracts.

In view of the above, REA amends 7 CFR chapter XVII by adding part 1717, to read as follows:

PART 1717—POST-LOAN POLICIES AND PROCEDURES COMMON TO INSURED AND GUARANTEED ELECTRIC LOANS

Authority: 7 U.S.C. 901–950b; Delegation of Authority by the Secretary of Agriculture, 7 CFR 2.23; Delegation of Authority by the Under Secretary for Small Community and Rural Development 7 CFR 2.72.

Subpart A—Area Coverage [Reserved]

Subpart B—Electric Retail Rates [Reserved]

Subpart C—Service to Large Power Loads [Reserved]

Subpart D—[Reserved]

Subpart E—[Reserved]

Subpart F—[Reserved]

Subpart G—Federal Pre-emption in Rate Making in Connection With Power Supply Borrowers

§ 1717.300 Purpose.

This subpart contains regulations of the Rural Electrification Administration (REA) implementing provisions of Section 4 of the RE Act (7 U.S.C. 904) which authorize the Administrator to establish terms and conditions of loans and implementing provisions of the REA wholesale power contracts and other REA documents which provide for the establishment of rates to be charged by power supply borrowers for the sale of electric power and energy. This subpart contains the general regulations of REA for the pre-emption, under certain circumstances, which are not exclusive, of the regulation of a power supply borrower's rates by a state regulatory authority under state law and for the exercise of exclusive jurisdiction over rates by REA pursuant to the REA documents.

§ 1717.301 Policy.

(a) REA makes and guarantees loans to borrowers to bring electric service to persons in rural areas. REA requires, as a condition to making or guaranteeing any loans to power supply borrowers, that the borrower enter into REA wholesale power contracts with its several members and assign and pledge such contracts as security for the repayment of loans made or guaranteed by REA and for other loans which, pursuant to the RE Act, REA has permitted to be secured pursuant to the REA mortgage. The REA wholesale power contract requires, among other matters, that the rates charged for power and energy sold thereunder produce revenues sufficient to enable the power supply borrower to make payments on account of all indebtedness of the power supply borrower. The Administrator relies upon the REA wholesale power contracts together with other REA documents to find and clarify, as required in Section 4 of the RE Act (7 U.S.C. 904), that the security for the loan is reasonably adequate and the loan will be repaid within the time agreed.

(b) REA requires power supply borrowers to take such actions as may be necessary to charge rates for the sale of electric power and energy which are sufficient to pay the principal and interest on loans made or guaranteed by REA in a timely manner and to meet the requirements of the REA wholesale power contract and other REA documents.

(c) With respect to power supply borrowers which are not subject to rate regulation by a state regulatory authority, REA requires that such borrowers establish rates and obtain REA approval of such rates as required by the terms of the REA wholesale power contract and other REA documents.

(d) With respect to power supply borrowers which are subject to regulation by a state regulatory authority, REA does not make or guarantee a loan for the construction, operation or enlargement of any generating plant or transmission facility unless the consent of the state regulatory authority having jurisdiction in the premises is first obtained.

(e) Pursuant to applicable provisions of state law state regulatory authorities regulate many aspects of a power supply borrowers business activities, including such matters as the setting of wholesale electric rates, the borrowing of money, and the mortgaging of property. A state regulatory authority's jurisdiction over the rates charged by a power supply borrower shall be pre-empted where the Administrator has determined that such jurisdiction has compromised Federal interests, including without limitation, the ability of the borrower to repay its secured loans in accordance with the terms of the REA documents. Thereupon, REA shall, pursuant to the REA documents, exercise exclusive jurisdiction over the rates charged by a power supply borrower.

§ 1717.302 Definitions and rules of construction.

(a) Definitions. For the purpose of this subpart, the following terms shall have the following meanings:

Administrator means the Administrator of REA.

Borrower means any organization which has an outstanding loan made or guaranteed by REA for rural electrification. Unless otherwise stated in the text, "borrower" shall mean power supply borrower.

Loan contract means the agreement, as amended, supplemented, or restated from time to time, between a borrower and REA providing for loans made or guaranteed pursuant to the RE Act.

Power supply borrower means any borrower engaged in the wholesale sale of electric power and energy to distribution members either directly or though other power supply borrowers pursuant to REA wholesale power contracts.

REA means Rural Electrification Administration, an agency of the United States Department of Agriculture.

RE Act means Rural Electrification Act of 1936, as amended (7 U.S.C. 901 *et seq.*).

REA documents means the loan contract, mortgage and REA wholesale power contract of a power supply borrower.

REA mortgage means the mortgage and security agreement, as from time to time supplemented, amended and restated, made by and among the borrower, REA, and, if a party thereto, third party lenders, or any other form of mortgage or security instrument or indenture of mortgage and deed of trust, securing the payment of outstanding loans made or guaranteed by REA and other lenders.

REA wholesale power contract means the contract for the wholesale sale of electric power and energy between a power supply borrower and its member as approved by REA.

Secured loans shall mean outstanding loans secured pursuant to the REA mortgage.

State regulatory authority means any state board or local governing body having jurisdiction under state law to regulate, or in any way, approve the electric rates charged by a power supply borrower or electric distribution member of a power supply borrower.

(b) Rules of Construction. Unless the context shall otherwise indicate, the terms defined in § 1717.302(a) hereof include the plural as well as the singular, and the singular as well as the plural. The words "herein," and "hereunder", and words of similar import, refer to this subpart as a whole. "Includes" and "including" are not limiting and "or" is not exclusive.

§ 1717.303 Requirements of REA documents.

(a) Pursuant to the terms of the REA documents each power supply borrower shall establish and adjust rates for the sale of electric power and energy in such a manner as to assure that the borrower will be able to make required payments on secured loans.

(b) Pursuant to the terms of the REA wholesale power contract, the Board of Directors or Board of Trustees of the power supply borrower shall review rates not less frequently than once each calendar year and revise its rates as therein set forth.[1] The REA wholesale power contract further provides that the borrower shall notify the Administrator not less than 30 nor more than 45 days prior to the effective date of any adjustment and shall set forth the basis upon which the rate is to be adjusted and established. The REA wholesale power contract provides that no final revision in rates shall be effective unless approved in writing by the Administrator.

(c) Pursuant to the terms of the REA mortgage, each power supply borrower must design its rates as therein set forth and must give 90 days prior notice to REA of any proposed change in its general rate structure.

(Approved by the Office of Management and Budget under control number 0572-0089)

§ 1717.304 State regulatory authority rate jurisdiction.

(a) In the event that rate revisions required by the terms of the REA wholesale power contract or other REA documents may be subject to the approval of a state regulatory authority, the power supply borrower shall seek such required approval in a timely manner.

(b) REA recognizes the need of state regulatory authorities for documents, information and records for use in connection with an application for rate approval and will consider any reasonable request by a borrower or a state regulatory authority for such documents, information and records. The failure of REA to provide requested documents, information or records shall not limit any rights of REA including the right with respect to pre-emption of the state regulatory authority as provided in this subpart.

(c) In the event that the state regulatory authority shall fail to act favorably upon the borrower's application for rate increases required by terms of the REA wholesale power contract or other REA documents, the borrower shall pursue such legal and administrative appeals as may be available to it, unless REA shall approve otherwise in writing.

§ 1717.305 Pre-emption.

(a) *Inadequate rates.* State regulatory authority jurisdiction over a power supply borrower's rates shall be pre-empted by the RE Act if the Administrator shall have determined that the borrower's rates approved by the state regulatory authority are, after taking into account the borrower's costs and expenses, inadequate to produce revenues sufficient to permit the borrower to make required payments on its secured loans and the borrower has failed to make required payments on its secured loans.

(b) *Public notice.* The Administrator shall:

(1) Notify the borrower and the state regulatory authority in writing of the determination, indicating the jurisidiction of the state regulatory authority over the rates of the borrower has been pre-empted pursuant to this part and the borrower shall henceforth establish its rates in accordance with the term of the REA documents.

(2) publish a notice in the **Federal Register** informing the public of the action.

§ 1717.306 REA required rates.

(a) Upon the publication in the **Federal Register** of the notice of pre-emption of state regulatory authority as provided in this subpart, REA will exercise exclusive jurisdiction over the rates of the borrower pursuant to the terms of the REA documents. The borrower shall immediately establish rates with the approval of REA that are sufficient to satisfy the requirements of the REA wholesale power contract and other REA documents described in § 1717.303 of this subpart. The borrower shall establish such rate notwithstanding provisions of state law, and rules, orders or other actions of state regulatory authorities, and notwithstanding any provision of the REA documents referring to such laws, rules, orders or actions.

(b) So long as the state regulatory authority shall be pre-empted hereunder, REA shall be considered the governmental regulatory body with jurisdiction over rates for the purposes of the REA documents and for the purposes of section 1129(a)(6) of the Bankruptcy Code of 1978, as amended (11 U.S.C. 1129(a)(6)).

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[1] The Wholesale Power Contract, with minor modifications which are approved by REA on a case by case basis, provides that the rate charged for electric power and energy,

shall produce revenues which shall be sufficient, but only sufficient, with the revenues of the Seller from all other sources, to meet the cost of the operation and maintenance (including without limitation, replacements, insurance, taxes and administrative and general overhead expenses) of the generating plant transmission system and related facilities of the Seller, the cost of any power and energy purchased for resale hereunder by the Seller, the cost of transmission service, make payments on account of principal and interest on all indebtedness of the Seller, and to provide for the establishment and maintenance of reasonable reserves. (Section 4. Rates (b), REA Form 444, "Wholesale Power Contract—Federated Cooperative"; Rev. 6-60.)

(c) If a borrower, which is subject to exclusive REA rate jurisdiction, shall fail to establish rates in accordance with terms of the REA wholesale power contract and other REA documents in a timely fashion, REA may proceed to exercise any and all right and remedies available pursuant under the REA documents or otherwise.

(d) The jurisdiction of the state regulatory authority over the rates of the borrower shall continue to be pre-empted hereunder until the Administrator shall in writing approve the resumption of jurisdiciton by the state regulatory authority and publish in the **Federal Register** a notice to such effect. The administrator shall approve resumption only after determining that such jurisdiction shall be exercised in a manner consistent with Federal interests.

§ 1717.307 Distribution members' rates.

A state regulatory authority which has been pre-empted as provided in this subpart may continue to exercise jurisdiction, pursuant to applicable provisions of state law, over all other business affairs of the power supply borrower and over the rates of its distribution members: Provided, however, that the state regulatory authority shall treat any REA approved rate for the power supply borrower as fair and reasonable and shall not in any manner, directly or indirectly, prevent or impede the distribution member from recovering the costs of paying the REA approved rates to the power supply borrower.

§ 1717.308 REA approval of nonconforming rates.

Borrowers may request and REA may approve rates which do not conform with the requirements of the REA wholesale power contract and other REA documents if REA determines, in its sole discretion, that such approval is in the interests of REA. If REA approval is granted prior to pre-emption hereunder, and if the state regulatory authority shall have approved such rates, then, so long as REA's approval of the nonconforming rates remains in effect, the jurisdiction of the state regulatory authority over the rates of the borrower shall not be pre-empted hereunder.

§ 1717.309 Additional statutory pre-emption.

This subpart addresses pre-emption of state law and state regulatory authority in only those specific circumstances herein described. Nothing in this subpart waives, limits, or otherwise affects the explicit pre-emption or pre-emption, which is implicit and shall occur pursuant to the RE Act as a matter of law, of state law or action of a state regulatory authority where such state law or such action compromises Federal interests, including the ability of any borrower, including power supply borrowers, to repay loans made or guaranteed by REA.

§§ 1717.310 to 1717.349 [Reserved]

Subpart H—[Reserved]

Subpart I—[Reserved]

Subpart J—[Reserved]

Dated: September 10, 1990.

Gary C. Byrne,

Administrator.

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