REPORT TO

THE CONGRESS OF THE UNITED STATES

SALE OF HYDROELECTRIC POWER BY THE DEPARTMENT OF THE INTERIOR UNDER SECTION 5 OF THE FLOOD CONTROL ACT OF 1944 AT RATES NOT APPROVED BY THE FEDERAL POWER COMMISSION

BY

THE COMPTROLLER GENERAL OF THE UNITED STATES

NOVEMBER 1964

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

B-125032

NOV 23 1964

To the Speaker of the House of Representatives
and the President pro tempore of the Senate

The Department of the Interior has been selling hydroelectric power and energy, generated by three projects under the control of the Department of the Army, to the Tennessee Valley Authority at rates which have been specifically disapproved by the Federal Power Commission. About $12.6 million in additional revenues would have been collected from the Tennessee Valley Authority over the past 15 years if rates conforming to the criteria contemplated by the Federal Power Commission had been in effect. In addition, the Department agreed to an amendment revising the rates in a power-marketing contract with the Arkansas Power & Light Company but did not submit the revised rates to the Federal Power Commission for approval. During calendar year 1961, the period in which the amendment was in effect, the Government received $822,000 less from the Arkansas Power & Light Company than would have been received for the same amount of hydroelectric energy if the contract had not been amended.

Section 5 of the Flood Control Act of 1944 (16 U.S.C. 825a) provides that rate schedules for the marketing of hydroelectric power and energy by the Secretary of the Interior from projects under the control of the Department of the Army become effective upon confirmation and approval by the Federal Power Commission. However, the act does not state what action can or should be taken when power and energy are marketed at rates that have been disapproved by the Federal Power Commission or at rates which have not been submitted for confirmation and approval.

Since December 1948 the Department of the Interior has been selling hydroelectric power and energy generated at and not needed in the operation of three projects under the control of the Department of the Army to the Tennessee Valley Authority although the rate schedules for the power and energy were specifically disapproved by the Federal Power Commission in May 1958. In our report to the Congress, dated October 31, 1961 (B-125032), on the audit of the Southeastern Power System and Related Activities for fiscal years 1959 and 1960, we recommended that the President of the United States direct the Secretary of the Interior to submit for Federal Power Commission approval revised rates and charges for the sale of power from the three projects designed to comply with the Federal Power Commission's interpretation of the requirements of controlling

legislation concerning the costs to be returned to the Government. In another report to the Congress dated February 20, 1964 (B-114850), on the audit of the financial statements of the Tennessee Valley Authority for fiscal year 1963, we called attention to our prior recommendation to the President and pointed out that the Tennessee Valley Authority is contingently liable for any retroactive adjustment resulting from approval by the Federal Power Commission of a higher rate for the sale of power and energy than that being used. Finally, more than 15 years after the contract for the sale of the power was signed and more than 6 years after the rates were disapproved, a revised schedule of rates was submitted by the Department of the Interior to the Commission for approval on October 15, 1964. This submission was made after the Department had reviewed a draft of this report which again brought the situation to its attention. The Commission has not yet either approved or disapproved the revised rate schedule.

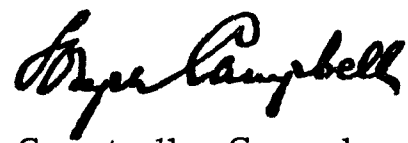
In another situation, the Department of the Interior, in January 1961, agreed to an amendment to a power-marketing contract with the Arkansas Power & Light Company under which the Government received $822,000 less in revenues during 1961 than would have been received for the same amount of hydroelectric energy under the contract provisions in effect prior to the amendment. The Department of the Interior did not consider the amendment to constitute a rate change and therefore did not submit the amendment to the Federal Power Commission for confirmation and approval. When we brought this matter to the attention of the Federal Power Commission, the Chairman informed us that, in the Commission's opinion, the amendment did constitute a rate change which required the Commission's approval. However, the Chairman stated that our advice of the matter was the Commission's first notice of the amendment and that the Flood Control Act of 1944 does not provide the Commission with retroactive authority.

We believe that these circumstances indicate that, if the Federal Power Commission is to effectively confirm and approve rate schedules for the marketing of hydroelectric power by the Secretary of the Interior from projects under the control of the Department of the Army, section 5 of the Flood Control Act of 1944 will have to be amended. The Assistant Secretary for Administration, Department of the Interior, has advised us

that the Department does not believe that the circumstances which we have cited warrant such an amendment at this time. The Chairman of the Federal Power Commission has advised us that the Commission also does not believe that an amendment is needed. He has stated that the Commission believes that, where an operating agency fails to comply with the statutory scheme, the appropriate enforcement role which the Commission should play is to report the violation to the President of the United States and the Congress.

We have been advised by an official of the Commission that neither of the situations discussed in this report has been formally reported to the President or the Congress by the Commission. Because of the significant amounts of revenue involved in the decisions of the Department of the Interior to market power at rates which have not been approved by the Federal Power Commission, we are recommending that the Congress consider amending section 5 of the Flood Control Act of 1944 to (1) prescribe the course of action to be taken when schedules of rates are disapproved by the Federal Power Commission and (2) require the Secretary of the Interior to submit to the Federal Power Commission all proposed amendments to contracts for the marketing of power under section 5 of the act so that the Commission can determine whether such amendments have an effect on previously approved schedules of rates.

Copies of this report are being sent to the President of the United States, the Chairman of the Federal Power Commission, and the Secretary of the Interior.



Comptroller General
of the United States

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REPORT ON
SALE OF HYDROELECTRIC POWER
BY THE DEPARTMENT OF THE INTERIOR
UNDER SECTION 5 OF THE FLOOD CONTROL ACT OF 1944
AT RATES NOT APPROVED BY THE
FEDERAL POWER COMMISSION

INTRODUCTION

The General Accounting Office has made a review of the administration by the Department of the Interior and the Federal Power Commission (FPC) of that portion of section 5 of the Flood Control Act of 1944 (16 U.S.C. 825a) which provides that the rates at which the Department of the Interior markets hydroelectric power and energy generated at projects constructed and operated by the Department of the Army become effective upon confirmation and approval by the FPC. Our review was made at the offices of the Department of the Interior in Washington, D.C., and at the Southwestern Power Administration in Tulsa, Oklahoma. We reviewed the applicable legislation, related policies and procedures of the agencies involved, selected contracts, and related background data, concerning the marketing of hydroelectric power by the Department of the Interior. This review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67). A list of the principal policy-making officials of the respective agencies responsible for the activities discussed in this report is contained in appendix I.

Section 5 of the Flood Control Act of 1944 provides for delivery to the Secretary of the Interior of the electric power and energy generated at and not needed in the operation of reservoir projects under the control of the Department of the Army. The

Secretary of the Interior is directed to transmit and dispose of such power and energy in such a manner as to encourage the most widespread use thereof at the lowest possible rates to consumers consistent with sound business principles, the rate schedules to become effective upon confirmation and approval by the FPC. The rate schedules are to be drawn with regard given to the recovery of the cost of producing and transmitting the electric energy, including the capital investment allocated to power amortized over a reasonable period of years.

In carrying out these responsibilities, the Secretary of the Interior has designated the Southeastern Power Administration as the agency to market the power generated from projects operated by the Department of the Army, in the southeastern part of the United States, and he has designated the Southwestern Power Administration as the agency to perform a similar function in the southwestern States. Data prepared by the marketing agencies indicates that, during fiscal year 1964, power and energy sales were being made to electric cooperatives, municipalities, other public agencies, Federal agencies, and private utilities, pursuant to 229 separate contracts.

FINDING AND RECOMMENDATION

SALE OF HYDROELECTRIC POWER AT RATES NOT APPROVED BY THE FEDERAL POWER COMMISSION

The Department of the Interior has been selling hydroelectric power and energy, generated by three projects under the control of the Department of the Army, to the Tennessee Valley Authority (TVA) at rates which have been specifically disapproved by the FPC. About $12.6 million in additional revenues would have been collected from TVA over the past 15 years if rates conforming to the criteria contemplated by the FPC had been in effect. In addition, the Department agreed to an amendment revising the rates in a power-marketing contract with the Arkansas Power & Light Company (AP&L) but did not submit the revised rates to the FPC for approval. During calendar year 1961, the period in which the amendment was in effect, the Government received $822,000 less from AP&L than would have been received for the same amount of hydroelectric energy if the contract had not been amended. We believe that these situations indicate that, if the FPC is to effectively confirm and approve rate schedules for the marketing of hydroelectric power by the Secretary of the Interior from projects under the control of the Department of the Army, section 5 of the Flood Control Act of 1944 will have to be amended.

Sale of power at rates disapproved by the Federal Power Commission

On December 18, 1948, the Department of the Interior contracted to sell to TVA the hydroelectric power and energy generated at and not needed in the operation of the Wolf Creek, Center Hill, and Dale Hollow projects in the Cumberland River basin. The agreement provides that TVA pay an annual charge based on the generating units in operation and adjusted in accordance with the unregulated

flow of water into the Wolf Creek Reservoir. Under the contract, as amended, the annual charges are expected to average about $4.1 million and are intended to result in the receipt of revenues sufficient to cover interest; amortized Federal investment in power; and expenses for operation, maintenance, and power marketing.

Because the projects involved are under the control of the Department of the Army and are therefore subject to section 5 of the Flood Control Act of 1944, the contract provides that the schedule of rates and charges become effective upon confirmation and approval by the FPC and apply retroactively to December 18, 1948.

The rates and charges in the agreement were not filed with the FPC by the Secretary of the Interior until September 15, 1955. Additional information was filed by the Secretary on February 20, 1958. On May 20, 1958, nearly 10 years after execution of the basic contract with TVA, the FPC found that the rate schedules, which were based on only the project costs incurred because of the inclusion of power facilities and on an interest charge of only 2 percent on the unamortized investment, were not sufficient to return the cost of these projects pursuant to the requirements of section 5 of the Flood Control Act of 1944. The FPC accordingly disapproved the proposed rate schedules.

In the order disapproving the rate schedules, the FPC indicated that the project costs to be used as the basis for the rate schedules should include an allocated portion of those costs relating to the entire project rather than only those costs specifically related to the inclusion of power facilities. The FPC indicated also that the Secretary's use of a 2-percent interest rate had not been justified, pointing out that the Secretary had since 1945 used a 2.5-percent rate of interest in determining the cost

to be returned by all Federal projects under his jurisdiction for which rate schedules must be approved by the FPC.

In a letter dated May 5, 1959, the Assistant Secretary of the Interior advised the Chairman, Committee on Public Works, House of Representatives, that, although the rate schedule had been disapproved by the FPC, the Department of the Interior would continue to abide by the terms of its contract with TVA (see appendix II). Identical letters were sent to the Chairmen of the Senate Committee on Public Works and the House and Senate Committees on Appropriations.

In our report to the Congress, dated October 31, 1961 (B-125032), on the audit of the Southeastern Power System and Related Activities for fiscal years 1959 and 1960, we recommended that the President of the United States direct the Secretary of the Interior to submit for FPC approval revised rates and charges for the sale of power from the Wolf Creek, Center Hill, and Dale Hollow projects designed to comply with the FPC's interpretation of the requirements of controlling legislation. However, at June 30, 1964, no such revised schedule of rates had been submitted to the FPC for approval, and the Department of the Interior, through the Southeastern Power Administration, had continued to sell at the disapproved rates the power and energy generated at and not needed in the operation of the three projects.

The Corps of Engineers has made a determination of the amount of the Federal investment in power at the three projects by using a cost-allocation method of the type contemplated by the FPC and by using a 2.5-percent interest factor. If the contract were amended to retroactively incorporate the annual charges as estimated by the Corps of Engineers, additional revenues of about

$12.6 million would be due from TVA for the period from the date of the contract through fiscal year 1964. In our report to the Congress, dated February 20, 1964 (B-114850), on the audit of the financial statements of the TVA for fiscal year 1963, we called attention to our prior recommendation to the President and stated that we believe that a contingent liability for a retroactive adjustment that may be material in relation to TVA's current assets arises from a possible approval by the FPC of a higher rate under the contract and should be appropriately disclosed as a footnote to the financial statements.

Finally, more than 15 years after the contract was signed and more than 6 years after the rates were disapproved, a revised schedule of rates was submitted by the Department of the Interior to the FPC for approval on October 15, 1964. This submission was made after the Department had reviewed a draft of this report which again brought the situation to its attention. The FPC has not yet either approved or disapproved the revised rate schedule.

The Department of the Interior has been able to continue to market power and energy at rates which have not been approved by the FPC because section 5 of the Flood Control Act of 1944 does not state what action can or should be taken in those instances where schedules of rates are disapproved. In this connection, the Chairman of the FPC informed the Chairman of the Senate Committee on Interior and Insular Affairs in 1957 that the FPC was firmly of the opinion that the present unsatisfactory condition with respect to rate approval should not be continued and that either the Congress should give the FPC complete authority to regulate rates for the sale of power from all Federal projects, including authority to initiate rate changes and to require modifications in rate

schedules, or else it should relieve the FPC of all responsibility with respect to such rates. We believe that, if the FPC is to effectively confirm and approve schedules of rates for the marketing of power by the Secretary of the Interior under section 5 of the Flood Control Act of 1944, the act will have to be amended to prescribe the course of action to be taken in those instances where schedules of rates are disapproved by the FPC.

Power rates amended without submission to the Federal Power Commission for approval

On January 29, 1952, the Secretary of the Interior entered into a contract with AP&L and the Reynolds Metals Company for the sale of hydroelectric energy. The purpose of the contract was to assure Reynolds the electric energy necessary for effective operation of certain aluminum production facilities which Reynolds proposed to construct in the State of Arkansas.

Under the contract, AP&L agreed to purchase an average of 30 million kilowatt-hours of electric energy a month from the Southwestern Power Administration for a period of 30 years. The contract was subsequently amended to provide that the rates charged for this energy would be subject to review and redetermination every 5 years. For the 5-year period beginning January 1, 1959, the FPC approved a rate of 6.6 mills a kilowatt-hour for the first 22 million hours purchased each month and a rate of 3.3 mills for the remaining 8 million hours. The FPC had previously approved contract terms providing generally that (1) AP&L could purchase additional energy at a rate of 1.5 mills a kilowatt-hour, if available, and (2) in the event that AP&L delivered less than 30 million kilowatt-hours of energy to Reynolds in any one month, AP&L would pay the Government an additional 1 mill a kilowatt-hour for the amount of energy thus made available to AP&L for its own use.

On January 16, 1961, the contract was amended to provide for the following changes in the contract provisions then in effect. These changes applied only to calendar year 1961.

1. AP&L was given an option to reduce the amount of energy required to be purchased from the Southwestern Power Administration during calendar year 1961 from 30 million kilowatt-hours a month to 15 million.

2. The rate for such energy was established at 5.72 mills a kilowatt-hour.

3. The additional charge of 1 mill a kilowatt-hour was waived in months in which AP&L exercised the above-mentioned option.

Under the contract, as amended, in any month in which AP&L exercised its option to reduce the amount of energy which it was required to purchase, additional energy could still be purchased at 1.5 mills a kilowatt-hour if such energy was available. Therefore, it should have been apparent to the Department of the Interior at the time the contract was amended that, if AP&L exercised its option to purchase only 15 million kilowatt-hours of energy a month at the rate of 5.72 mills and then purchased an additional 15 million kilowatt-hours a month at the rate of 1.5 mills, the Government would receive revenues of $760,000 less during 1961 than it would have received for the same amount of energy under the contract provisions in effect prior to the amendment. Also, in those months during which AP&L delivered less than 30 million kilowatt-hours of energy to Reynolds, the Government's revenues would be reduced by an additional 1 mill a kilowatt-hour for the energy thus made available to AP&L for its own use.

Throughout calendar year 1961, AP&L exercised the option contained in the contract amendment, and on the basis of the amounts of energy actually delivered the Government received $822,000 less from AP&L than would have been received if the contract had not been amended.

Although it should have been apparent to the Department of the Interior that the amendment could result in the Government's receiving substantially less revenue for the same amount of energy,

the rates and charges specified in the amendment were not submitted to the FPC for approval and confirmation. The Assistant Secretary of the Interior for Water and Power Development advised us that 5.72 mills a kilowatt-hour represented the average rate which would be paid by AP&L to the Southwestern Power Administration if 30 million kilowatt-hours of energy were purchased under the contract provisions in effect prior to the amendment. He further stated that, since the reduction in the amount of energy to be furnished by the Southwestern Power Administration was in the interest of the Government and since application of the average rate to the lesser amount of energy preserved the unit price under the rate structure previously confirmed and approved, there appeared to be no requirement to submit the amendment to the FPC. He also informed us that waiver of the additional 1 mill charge was necessary since the purpose of the amendment was, among other things, to permit a reduction in the amount of energy which AP&L was obligated to deliver to Reynolds.

The Chairman of the FPC has informed us that the FPC is of the opinion that the rates and charges specified in the amendment constituted new rates and charges which required the FPC's approval pursuant to the Flood Control Act of 1944. He has further stated, however, that our advice of this matter was the FPC's first notice of the amendment and that the Flood Control Act does not provide the FPC with retroactive authority.

If the FPC is to effectively confirm and approve schedules of rates for the marketing of power by the Secretary of the Interior under section 5 of the Flood Control Act of 1944, we believe that the act will have to be amended to require the Secretary of the

Interior to submit to the FPC all proposed amendments to power-marketing contracts. After such an amendment, the FPC could determine the effect of contract amendments on previously confirmed and approved schedules of rates.

Agency comments and our evaluation

The Assistant Secretary for Administration, Department of the Interior, advised us in a letter dated June 23, 1964, that the sale of power to TVA at rates disapproved by the FPC had been described to the Congress by the Department several times over the years and that neither the Congress nor any of its committees had ever taken any action in regard to it. He further stated, with respect to the contract with AP&L and the Reynolds Metals Company, that the application of the average rate to a lesser amount of energy had also been the case in earlier amendments of the same contract, which had been entered into in 1954 and 1955 and were not submitted to the FPC for approval. According to the Assistant Secretary, the failure to submit the contract amendment discussed in this report was predicated upon the administrative construction of some years standing that the retention of the preexisting average rate did not constitute a change in rate schedules necessitating FPC approval. He also stated that, although the need for the amendment of section 5 of the Flood Control Act of 1944 may arise in the future, the Department did not believe that the isolated circumstances which we have cited in this report warranted such consideration.

We have not obtained the FPC's comments on the prior amendments to the contract with AP&L and the Reynolds Metals Company, referred to by the Assistant Secretary, and we therefore do not know whether the FPC would consider them as constituting rate changes subject to approval and confirmation. We also have not reviewed all the Department's power-marketing contracts to determine whether other instances exist in which rate changes may have been made without obtaining FPC approval. We believe, however, that the significant amounts of revenue involved in the decisions of the

Department of the Interior to market power at rates which have not been approved by the FPC indicate the need for amendatory legislation to (1) enable a final determination to be made as to the appropriate rates to be charged for power sold to TVA in the event that the FPC disapproves the revised rate schedule which has been submitted, (2) provide assurance that the FPC is made aware of all changes in previously approved rate schedules, and (3) prevent situations similar to those described in this report from occurring in the future.

In a letter dated July 29, 1964, the Chairman of the FPC advised us that the role played by the FPC in approving and confirming the rates set by various marketing agencies of the Department of the Interior is to the best of the FPC's knowledge unique in the Federal system. He further stated that the FPC continues to believe that, as an expert body not directly involved in the operation of the Federal marketing system or the negotiation of the power contracts underlying the rates, it can perform a useful function for the Congress and the executive branch of the Government in reviewing the rates to assure that they conform to the statutory criteria.

The Chairman also has informed us that the FPC recognizes that its review can be effective only if the responsible operating agencies cooperate in promptly submitting proposed new or modified rates to the FPC for approval and in taking appropriate action where the FPC fails to approve a submitted rate. However, the Chairman has stated that, in the FPC's view, where such compliance with the statutory scheme is not forthcoming on the part of the operating agency, the appropriate enforcement role which the FPC should play is to report the violation to the Congress and the

President, together with such information as they may need to consider what remedial action may be appropriate in the particular situation. The Chairman has advised us that the FPC is convinced that such a procedure, which would leave further enforcement to the authorities in the legislative and executive branches of the Government, is far preferable to entrusting the enforcement of section 5 to the FPC.

With respect to the Chairman's statement concerning the appropriate enforcement role which the FPC should play, we were advised by an official of the FPC that neither of the situations discussed in this report had been formally reported to the President or the Congress by the FPC. We believe that the continued sale of power to TVA by the Department of the Interior over an extended period of years at rates disapproved by the FPC indicates that there is a need for amendatory legislation to prescribe the course of action to be taken in such situations. Further, in the absence of a requirement that all amendments to power-marketing contracts be submitted to the FPC, there is no assurance that the FPC will be made aware of changes in power-marketing rates requiring confirmation and approval. We therefore believe that, if the FPC is to effectively confirm and approve rate schedules for the marketing of hydroelectric power by the Secretary of the Interior from projects under the control of the Department of the Army, section 5 of the Flood Control Act of 1944 will have to be amended.

Recommendation to the Congress

We recommend that the Congress consider amending section 5 of the Flood Control Act of 1944 to (1) prescribe the course of action to be taken when schedules of rates are disapproved by the FPC and (2) require the Secretary of the Interior to submit to the FPC all

proposed amendments to contracts for the marketing of power under section 5 of the Flood Control Act of 1944 so that the FPC can determine whether such amendments have an effect on previously approved schedules of rates.

APPENDIXES

PRINCIPAL POLICY-MAKING OFFICIALS

RESPONSIBLE FOR THE ACTIVITIES DISCUSSED

IN THIS REPORT

	Tenure of office	
	From	To
DEPARTMENT OF THE INTERIOR		
SECRETARY OF THE INTERIOR:		
Douglas McKay	Jan. 1953	Apr. 1956
Fred A. Seaton	June 1956	Jan. 1961
Stewart L. Udall	Jan. 1961	Present
ASSISTANT SECRETARY--WATER AND POWER DEVELOPMENT:		
Fred G. Aandahl	Feb. 1953	Jan. 1961
Kenneth Holum	Jan. 1961	Present
ADMINISTRATOR, SOUTHEASTERN POWER ADMINISTRATION:		
Charles W. Leavy	Jan. 1953	Present
ADMINISTRATOR, SOUTHWESTERN POWER ADMINISTRATION:		
Douglas G. Wright	Oct. 1943	Present
FEDERAL POWER COMMISSION		
CHAIRMAN:		
Jerome K. Kuykendall	May 1953	Aug. 1961
Joseph C. Swidler	Sept. 1961	Present

COPY

UNITED STATES
DEPARTMENT OF THE INTERIOR
OFFICE OF THE SECRETARY
WASHINGTON 25, D. C.

May 5, 1959

Dear Mr. Buckley:

We are taking this means of informing the Committee concerning a matter that has arisen in the marketing of power by this Department under Section 5 of the Flood Control Act of 1944, and of the course that this Department is pursuing in reference thereto.

On May 20, 1958, the Federal Power Commission entered an Order (copy attached as Exhibit 1) disapproving the rates and charges contained in this Department's contract with the Tennessee Valley Authority, dated December 18, 1948, as amended. The contract covers the sale of the entire output of the Wolf Creek, Center Hill, and Dale Hollow Projects to TVA. The contract is for an indefinite term but may be cancelled on ten years' notice, the cancellation to be effective not earlier than December 18, 1968. The Commission did not find that the rates and charges were not sufficient to recover all elements of costs required by Section 5 of the Flood Control Act of 1944 as determined by the Secretary of the Interior; rather, it found the rates and charges unjustified, after having first substituted its judgment for that of the Secretary as to what portion of the multiple purpose projects' costs should be allocated to power and what rate of interest should be recovered on the Federal investment.

On December 18, 1948, after approximately three years of negotiations, the Secretary of the Interior concluded a long-term contract with TVA, a copy of which is attached hereto as Exhibit 2. The records show that inextricably involved in this contractual undertaking were the following matters: The Corps of Engineers, the construction agency of the projects, had advised that construction of power plants at Wolf Creek and Center Hill would not be resumed without a request by the Department of Interior, the power marketing agency. This Department would not make such a request until the market was properly explored and a suitable outlet for the power was determined to be available through which the Secretary could accomplish his statutory responsibilities. TVA, the only entity in the area capable of absorbing the power, all factors considered, would not agree to purchase the power in the absence of certain knowledge respecting costs especially with respect to the method of determining capital costs allocated to power and, because Congress had not required TVA to recover interest on its own hydroelectric power investment with respect to the interest rate as an element of cost as required by Section 5. The above was necessary for TVA to make proper comparisons between the

cost of this power and costs from alternate sources (taking into consideration the extensive interconnection and transmission line expense necessary to utilize the power in its system) so that it might comply with the requirements of the TVA Act.

Acting pursuant to authority delegated him by Section 5 of the Flood Control Act of 1944 and consistent with then existing policy and regulations, the Secretary determined that the law as to these projects could best be carried out by allocating to power the difference between the total estimated first cost (to be replaced by actual cost when known) for the multiple-purpose projects and that for the flood control only projects, that is the incremental cost of power, and by requiring an interest rate (2%) equivalent to the then current average rate on outstanding marketable obligations of the United States. The Secretary found additional support for his determinations respecting cost allocations in the legislative history of the projects, which is discussed in Exhibit 3 attached hereto, and from executive pronouncements as contained in the President's budget message of January 3, 1947, and in communications from officials of the Department of the Treasury regarding the matter of interest, which is discussed in Exhibit 4 attached hereto.

While no one desires to minimize the effects or responsibilities involved, it appears that no relevant or useful purpose would be served here to elaborate upon the successive events that delayed Interior's rate submission until 1955 or the Commission's issuance of its Order until 1958. Suffice it to say that unavoidable delay in submitting the rates at the outset led to the conclusion on the part of Southeastern Power Administration that the submission should be made on the basis of actual costs rather than estimates and the actual cost data assembled in turn led Southeastern to the conclusion that the contract rates should be adjusted under the terms of the contract. In 1953 officials of the Department, faced with the problem of rate approval, reviewed the matter and considered it at great length. After further consultation and receipt of legal advice, an amendment of the contract with TVA was negotiated, a copy of which is attached as Exhibit 2a, which resulted in a substitution of actual capital costs where only estimates were previously available and in bringing charges for operation and maintenance of the facilities and marketing expenses in line with current costs, all as contemplated by the original agreement. The rates in the original contract, as amended, were then presented to the Commission with a request for confirmation and approval.

Our review of prior departmental action attempted to give full, yet proper, consideration to the many faceted problem. We recognized that the contractual power of the United States had been exercised by the official so empowered to exercise it, after lengthy negotiation. We were not unmindful of the comprehensive

Congressional purposes which were required to be carried out or of the rights, obligations, reliances and other chain reactions that the exercise of such contractual power entails. Our review recognized the importance to our system of Government of the doctrine of giving finality to the administrative acts of responsible officials in the absence of a compelling showing of discriminatory or arbitrary and capricious action.

Our review revealed a considerable body of precedent and developed policy that has been formulated since the long term sale of power from these projects, and while very valuable for then present and future considerations, it offered no legitimate help in properly evaluating executive decisions made in prior years. More recent agreements between interested Federal agencies, methods of cost allocation developed and accepted in recent years, present thinking on the inclusion of a particular rate of interest on the investment as an element of cost and revised policy guides including those by the Bureau of the Budget, these, while now contributing valuable assistance in current policy formulation could not have offered guidance either to contractors or the Secretary of the Interior prior to December 18, 1948, when the Secretary was faced with decisions which by their nature required a finality of determination.

Our review revealed that the first power sold from any Corps of Engineers' constructed project in the United States which received final authorization after the passage of Section 5 of the Flood Control Act of 1944 and which was marketed pursuant to its terms was from one of the projects here in question. Because of this, our review included a look at the earlier history of the other but related parts of the Federal Power program. As to the two pertinent matters of cost allocations and interest rate, what was adopted in other programs and under other laws prior to December 18, 1948, was given by us persuasive importance, but our review of the approaches thereunder, rather than offering single well developed precedents, revealed quite the contrary or varied and different approaches.

Of importance was the fact that the flood control only projects (as originally authorized in the Flood Control Act of 1938) that were involved in the Secretary's allocations of cost were in and of themselves feasible in 1948 and remained so at the time of our review and remain so today. Of even greater significance is the undisputed fact that on the basis of the 1948 contract and the costs used by the Secretary of the Interior, the benefit-cost ratio on the three projects was better than one to one and this is also true of each of the purposes of the projects. The sale was therefore made on a basis which would preserve multipurpose feasibility.

While more recently developed policy, with which we agree, anticipates that normally the costs allocated to a particular purpose should be related to the benefits contributed by such

purposes, we were unable to find any such requirement in law or policy prior to December 18, 1948. And, while present thinking considers appropriate an interest rate approximately equivalent to the long-term cost of money to the Government, we found neither well defined policy nor precedent sufficient to render the Secretary's use of an interest rate equivalent to the average cost of money to the Government so unreasonable as to be contrary to law.

The decision to which we came after our review does not mean that present officials of the Department personally agree with what a prior Secretary did in 1948; nor that our judgment necessarily coincides with his; nor that we or someone else in authority then or now would not have done differently. Properly viewed, however, these observations are immaterial.

To declare the rates and charges contrary to law in the face of the previously recited facts, the Commission was required to move to an extreme position. When the Commission indicated that it was itself giving serious consideration to this extreme position as urged by its staff, we felt it necessary in our last written communication to officially but tactfully suggest to the Commission that necessary recognition should be given to the judgment of the Secretary of the Interior.

While recent years have witnessed our cooperation in moving toward an accommodation of the interests of other involved agencies, the position of the Commission in disqualifying the judgment and the discretion used by the Secretary prior to December 18, 1948, in arriving at a cost-allocation basis and the interest rate used in this contract does not, in our view, find so demonstrable a base in Section 5 of the Flood Control Act of 1944 as to justify our concluding that the Commission is authorized to substitute its judgment of desirable policy for that theretofore reached by the Secretary of the Interior.

In these circumstances, this Department will, as indeed we think it must, continue to abide by the terms of its contract.

Recent correspondence between the Southeastern Power Administration and TVA on the matter is attached as Exhibit 5.

Sincerely yours,

(Sgd) Fred Aandahl

Assistant Secretary of the Interior

Hon. Charles A. Buckley
Chairman, Committee on Public Works
House of Representatives
Washington, D.C.

Enclosures 6 in duplicate