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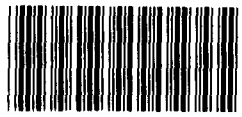
GAO Testimony



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Basic Changes Needed to Avoid Abuse of the 960-Acre Limit

Statement of
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Before the
Subcommittee on Water and Power
Committee on Energy and Natural Resources
United States Senate

GAO/T-RCED-90-100

Dear Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our October 1989 report on the implementation of the 960-acre limitation for federally subsidized water under the Reclamation Reform Act of 1982, as amended.[1] The report discusses whether the act's acreage limitation is being implemented in a manner consistent with the statute and congressional expectations. It also discusses whether large farms have been reorganized since the act was passed to receive subsidized water on acreage that exceeds the legislatively mandated limit and, if so, how they have been reorganized. We will also discuss our June 1990 report on the Westhaven trust arrangement, which enabled a 23,238-acre farming operation to be irrigated with subsidized water.[2] Finally, we will provide our views on certain provisions of S.2659 recently introduced to amend the 1982 law.

RESULTS IN BRIEF

In summary, we found that the Reclamation Reform Act and the Bureau of Reclamation's implementing regulations do not preclude multiple landholdings, each of which is within the act's 960-acre limit, from continuing to be operated collectively as one large farm, while individually qualifying for federally subsidized water. Some farmers have taken advantage of this loophole by using various partnerships, corporations, and/or trust arrangements to reorganize their farms into multiple, smaller landholdings and became eligible to receive additional federally subsidized water from the Bureau. For all practical purposes, these smaller landholdings continue to be operated collectively as single large farms, much as they were before being reorganized. While these

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[1]Water Subsidies: Basic Changes Needed to Avoid Abuse of the 960-Acre Limit (GAO/RCED-90-6, Oct. 12, 1989).

[2]Water Subsidies: The Westhaven Trust Reinforces the Need to Change Reclamation Law (GAO/RCED-90-198, June 5, 1990).

reorganizations are not precluded by the act, they are not consistent with what we believe the Congress was trying to accomplish in establishing the 960-acre limit.

A consequence of these reorganizations has been a reduction in revenues to which the federal government would have been entitled if the multiple landholdings had been considered collectively as large farms subject to the act's 960-acre limit. This reduction in revenues likely will continue to occur annually under the existing act.

We believe that if federally subsidized water is to be limited to no more than 960 acres of leased and/or owned land being operated as one farm or farming operation, the act must be amended. Our October 1989 report included proposed legislative language to apply the act's acreage limit to "farms" and "farm operations" which are evidenced by indicators of operation, ownership, management and other factors. S.2659 would address the indicator of an operator of a landholding or parcel of irrigation land, but does not consider other indicators. While both revisions are aimed at accomplishing the same purpose, we believe that because our suggested legislative language addresses more indicators, it would more effectively close the loophole that has allowed multiple landholdings to operate together as one large farm and receive subsidized water on the entire acreage.

BACKGROUND

Let me briefly present some background information on how the acreage limitation under reclamation law has evolved. From 1902 to 1982, the Department of the Interior's Bureau of Reclamation provided relatively inexpensive federal water at rates that excluded any interest on the federal government's investment in the irrigation component of its water resource projects. Water

delivered at these rates is referred to as "subsidized water" because the lost interest is viewed as a subsidy to farmers. The differences between subsidized and full-cost water rates vary among water projects and districts and are often substantial. For example, in California's Westlands Water District, the subsidized rate is about 2.5 times less than the full-cost rate. Thus, a Westlands farmer using the average acre-feet of water annually to irrigate a 960-acre tract saves about $66,000 a year by using subsidized water.

Until 1982 federal reclamation law allowed water to be delivered at subsidized rates to owned land of up to 160 acres. The Bureau permitted married couples who owned a farm to irrigate up to 320 acres with subsidized water. Federal reclamation law was silent on leased acreage, and the Bureau provided federally subsidized water to large farms, some consisting of thousands of acres of leased land.

Recognizing the need to limit the number of both owned and leased acres the federal government helps a farmer irrigate, as well as the need to increase the size of an economically viable farm from the 160 acres designated in 1902, the Congress passed the Reclamation Reform Act of 1982. This act was expected to put an end to the Bureau's providing federally subsidized water to farms consisting of thousands of leased acres by limiting to 960 the maximum owned or leased acreage that an individual or legal entity, such as a partnership or corporation, can irrigate with subsidized water. Generally, the act provides that owned land above the limit cannot be irrigated with federal water, and farmers must pay the full cost for water delivered to leased land over the limit. The act exempts from its 960-acre limit land held for beneficiaries by a trustee in a fiduciary capacity as long as no single beneficiary's interest exceeds the law's ownership limits.

THE DICHOTOMY BETWEEN CONGRESSIONAL EXPECTATIONS AND THE LANGUAGE OF THE RECLAMATION REFORM ACT OF 1982

On the basis of the legislative history of the Reclamation Reform Act of 1982, we believe that the Congress expected to stop the flow of federally subsidized water to owned and/or leased land over 960 acres being operated as one farm. For example, the conference report that accompanied the act stated that both the Senate and the House agreed to reduce the subsidy for "larger farming operations" and that the benefits of the new law should be available only if a water district agreed to amend its contract with the Bureau to reduce the subsidy for farming operations exceeding 960 acres.

However, the act does not specifically preclude multiple landholdings from individually qualifying for federally subsidized water while being operated collectively as one large farm. This occurs because the act (1) limits the amount of land the government will help a farmer irrigate rather than the size of a farm, (2) defines and uses the term "landholding" rather than "farm" or "farming operation" in establishing the acreage limit, and (3) is silent on whether multiple landholdings can be operated together as one farm while qualifying individually for federally subsidized water on up to 960 acres.

EXAMPLES OF REORGANIZATIONS TO RECEIVE SUBSIDIZED WATER

For our October 1989 report, we selected eight farms that were larger than 960 acres before the 1982 act was fully implemented in order to determine whether farms have been reorganized to receive subsidized water on more than 960 acres. The eight farms are not necessarily representative of all large farms throughout the West; however, they do provide examples of how large farms have been reorganized through partnerships, corporations, and trusts.

We developed 11 indicators, any one or more of which would suggest that individual small landholdings are, in fact, parts of larger farms. Most of these indicators focus on arrangements between and among owners, lessees, and/or farm operators rather than on the individual landholdings. These indicators are not absolute determinants in themselves, but when they are applied to entire farming operations, they suggest that for all practical purposes these landholdings continue to be operated collectively as single large farms. Examples of these indicators include situations in which the same individuals make management decisions for multiple landholdings; a single farm management company operates multiple landholdings; or the farm manager or operator acknowledges that the small landholdings are being operated collectively as one farm. Attachment I lists the 11 indicators we developed.

In six of the eight cases we selected, the owners or lessees had reorganized large farms into multiple, smaller landholdings to be eligible to receive additional federally subsidized irrigation water from the Bureau. For example, in one case, a 12,345-acre cotton farm (roughly 20 square miles), operating under a single partnership, was reorganized into an elaborate network of 15 separate landholdings through 18 partnerships, 24 corporations, and 11 trusts. Five indicators that the 15 landholdings continued to be operated as one large farm were:

-- One partnership leased all 12,345 acres, and then subleased portions of it to other new partnerships.

-- The partners obtained one operating loan secured by the farms' crops and other assets.

-- Crop subsidy records indicate that the landholdings are interrelated.

-- Two farm management companies operate all 15 landholdings.

-- Four individuals make the management decisions for nine of the 15 landholdings.

Attachment II shows graphically how this farming operation was reorganized.

Another vivid example is the Westhaven Trust arrangement that enables a 23,238-acre farming operation to be irrigated with subsidized water. The J.G. Boswell Company, a large farm operator located in the Bureau's Central Valley Project, has taken advantage of the act's provision that exempts from the 960-acre limit land held for beneficiaries by a trustee in a fiduciary capacity, as long as no single beneficiary's interest exceeds the law's ownership limits. The act does not preclude multiple landholdings from being operated collectively under a trust as one farm while qualifying individually for federally subsidized water. Accordingly, the J.G. Boswell Company was able to reorganize land of the Boston Ranch Company, a wholly owned subsidiary of the Boswell Company, by selling the 23,238 acres to the Westhaven Trust in May 1989, with the landholdings attributed to each of 326 salaried employees. According to the Department of the Interior's Office of the Solicitor, because the landholdings attributed to the 326 trust beneficiaries range from 21 acres to 547 acres per beneficiary, the trust meets the act's requirement that no individual beneficiary's interest exceeds 960 acres. Thus each landholding was eligible to receive federally subsidized water.

Before the land was sold to the trust, the Boswell Company operated the 23,238 acres as one large farm. Five indicators suggest that after the farm was sold the entire acreage continues to be operated as one large farming operation:

-- One of the stated purposes of the trust is to operate the entire acreage as one farm under a farm management agreement. Officials from the Boswell Company and the Westhaven Trust acknowledge that the Westhaven Trust land is generally operated as one farm.

-- The 23,238 acres were purchased with one loan.

-- The trustee makes management decisions for the entire acreage.

-- The annual farming operation is financed with one operating loan.

-- The beneficiaries have an undivided interest in the land.[3]

Although the act does not preclude large farming operations organized as multiple landholdings under a trust from receiving federally subsidized water on the entire acreage, this situation is not consistent with what we believe the Congress was trying to accomplish in establishing the 960-acre limit. A graphic presentation of this case is shown in attachment III.

FARM REORGANIZATIONS ARE REDUCING FEDERAL REVENUES

A consequence of these farm reorganizations and other arrangements is that the federal government is not collecting the revenues to which it would be entitled if multiple landholdings being operated together were considered collectively as one large farm or farming operation subject to the act's 960-acre limit. For four of the farms discussed in our October 1989 report, owners or

[3]No individual beneficiary owns a specific parcel of land, Rather, each beneficiary is allocated a percentage of the total acreage of the trust. This percentage is based on each beneficiary's salary from the J. G. Boswell Company relative to the total salaries of all 326 beneficiaries.

lessees paid a total of about $1.3 million less in 1987 for federal water delivered by the Bureau than they would have paid if their respective multiple landholdings had been considered collectively as large farms subject to the act's acreage limit. Before the Westhaven Trust, the Boswell Company had paid full cost for the federal irrigation water delivered to the acres for the 18-month period ending in May 1989. When the trust bought the land, the entire acreage became eligible to receive federally subsidized water. Had the Westhaven Trust been subject to the acreage limitation, the trust would have been required to pay about $2 million more per year for its federal water. Reduced revenues will likely continue to occur annually unless the 1982 act is amended.

GAO'S VIEWS ON S.2659

In May 1990, S.2659 was introduced to amend the 1982 act. Some provisions are directed at closing the loophole that has allowed multiple landholdings to operate collectively as one large farm, while individually qualifying for federally subsidized water, by addressing one major indicator of a farm or farm operation. The bill is directed at the operator of a landholding, which the bill defines as an individual or entity that performs the greatest proportion of the decisionmaking or supervision for an agricultural enterprise on a given landholding or parcel of irrigation land at a given point of time.

We applied this definition of operator to the farms included in our October 1989 report and found that it was sometimes difficult to identify the individual or legal entity performing the greatest proportion of the decisionmaking or supervision. For example, four individuals made the management decisions for 9 of the 15 landholdings comprising the 12,345-acre cotton farm, and it would be difficult to ascertain which of the four was responsible for the greatest proportion of the decisionmaking. In another instance, a 4,638-acre farm was operated by a single farm

management company owned by four members of a family. Unless the company qualified as a legal entity, it would be necessary to either (1) develop sufficient information about the company to show that one individual performs the greatest proportion of the decisionmaking or (2) divide the irrigated acreage equally among the four family members. This latter alternative would allow all 4,638 acres (with 2,553 equivalent acres) to continue to receive federally subsidized water even though the family continues to operate the four landholdings as one farm.

We agree that it is important to identify the operator of a farm or farming operation but believe that other indicators also should be applied to determine whether multiple landholdings continue to be operated as large farms. These indicators would include ownership, management, financing, or other factors individually or working together. Therefore, we believe that the act should be amended to apply the acreage limit to farms and farming operations as well as to individual landholdings. If our proposed legislative language becomes law, we would envision the Bureau applying indicators similar to the ones we developed to arrangements between and among owners, lessees, and/or farm operators.

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In conclusion, we recognize that the Congress could not have envisioned all the different types of reorganizations and arrangements that have developed in the act's aftermath. In our view, farm reorganizations and other arrangements that allow multiple landholdings to continue to be operated as parts of large farms while individually qualifying for federally subsidized water are not consistent with what we believe the Congress was trying to accomplish in establishing the 960-acre limit. Effectively closing this loophole will require legislative language similar to that proposed in our October 1989 report.

Mr. Chairman, this concludes my statement. We would be pleased to respond to any questions you or the Subcommittee members may have.

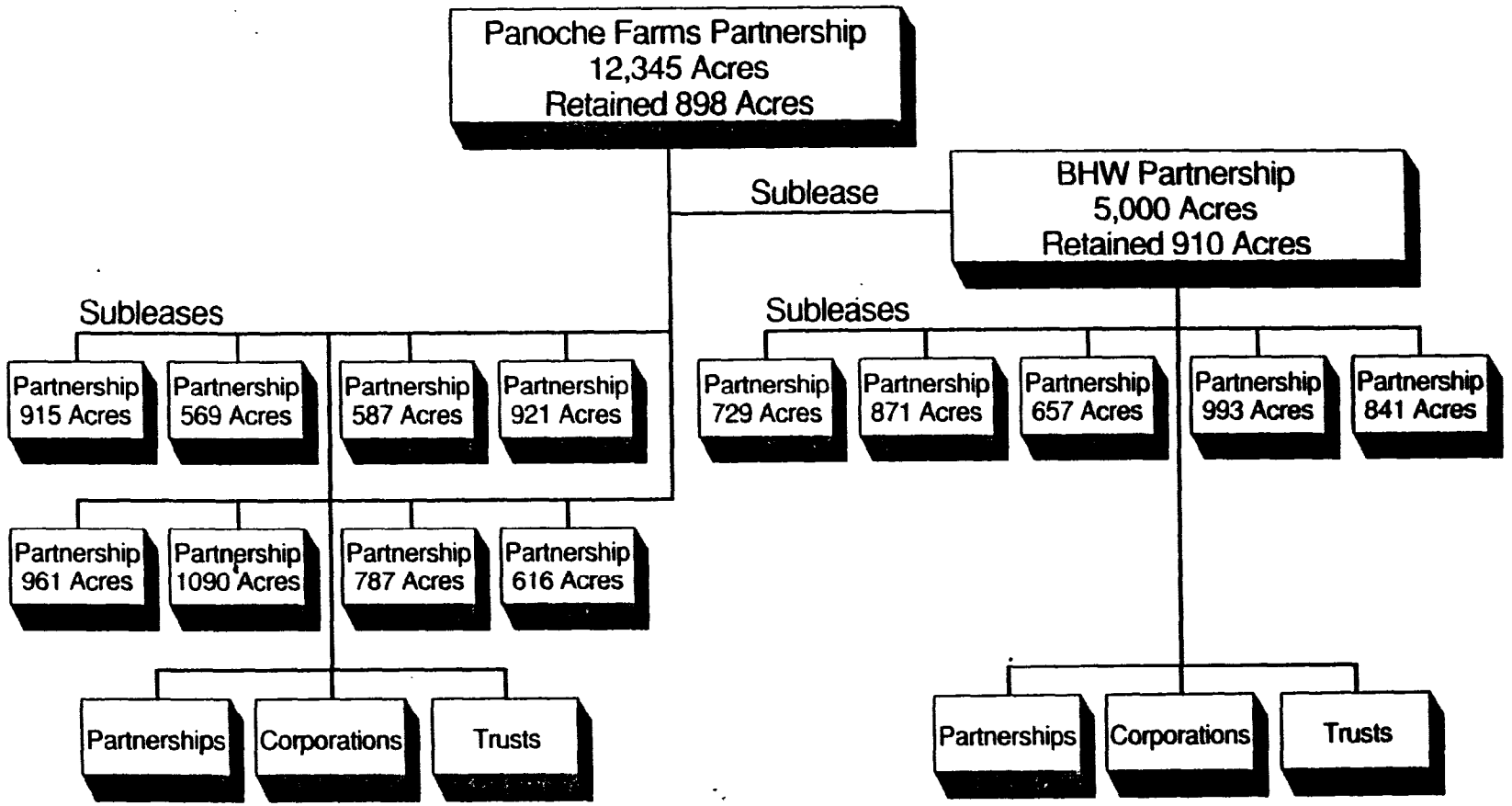
ATTACHMENT I

LIST OF INDICATORS THAT COULD BE USED TO IDENTIFY MULTIPLE LANDHOLDINGS THAT ARE PARTS OF A LARGER FARM

- The individual landholdings or other farm assets are combined as collateral for loans.
- The principal owners or lessees of the individual landholdings agree to cover loan defaults of other principals.
- The farm manager or operator bears an economic risk associated with the production and sale of the crops.
- The same individuals make management decisions for multiple landholdings.
- The owners of the farm management company that operates the small landholdings are the same individuals who owned or leased the land before the reorganization occurred.
- The small landholdings are leased from the large farm that existed before the reorganization.
- The same individuals own or lease the small landholdings.
- A single farm management company operates multiple landholdings.
- Crop subsidy records indicate that the landholdings are interrelated.
- The small landholdings share equipment or labor, sometimes without charge.
- The farm manager or operator acknowledges that the small landholdings are being operated collectively as one farm.

ATACHMENT II

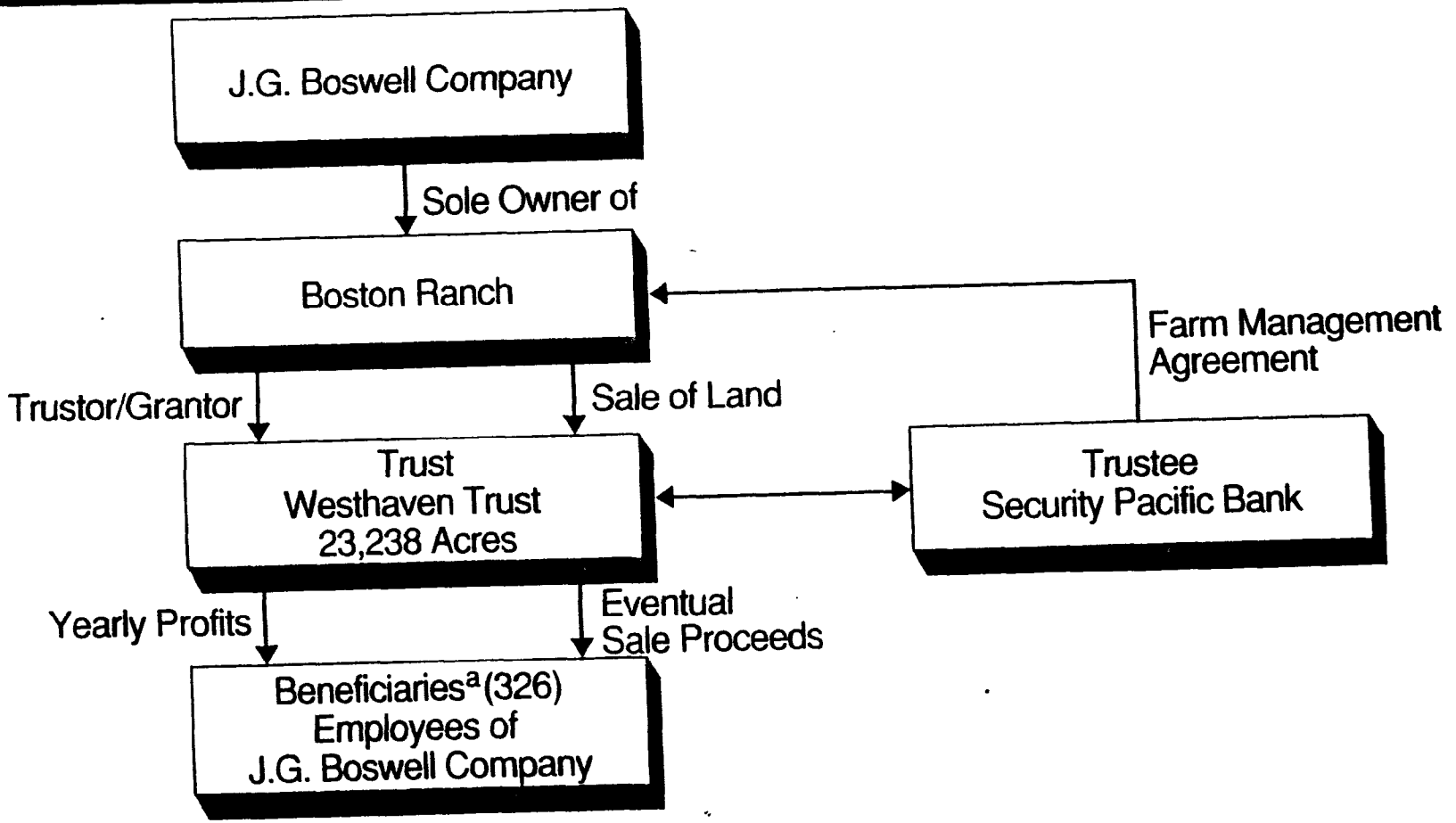
GAO The Panoche Farm



Note: Each of the 15 landholdings received subsidized water.
Acres shown are actual acreage. Equivalent acreage for each landholding is less than 960 acres.

ATTACHMENT III

GAO Boswell Farm



[a]Landholdings attributed to each beneficiary received subsidized water.