

# The Broken Promise of Reclamation Reform

by

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Congress established the federal reclamation program in 1902 to open up the arid West to irrigated farming and the accompanying economic development.<sup>1</sup> The overriding goal of the reclamation program was to foster the creation of small, family-sized farms in areas irrigated by federal projects.<sup>2</sup> Over the years, irrigation subsidies have become as entrenched in western agriculture as the federal farm program subsidies that support agriculture throughout the country.<sup>3</sup>

Although water subsidies originally may have possessed a legitimate social purpose, that purpose largely has been outlived. Instead of the

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1. Reclamation Act of 1902, 43 U.S.C. §§ 371-616 (1902).
2. For background on the goals and evolution of reclamation law, see *Ivanhoe Irrigation Dist. v. McCracken*, 357 U.S.275 (1958) and *United States v. Tulare Lake Canal Co.*, 535 F.2d 1093 (9th Cir. 1976), *cert denied*, 429 U.S.1121 (1977).
3. In its 87 year history, the Bureau of Reclamation has grown to be the largest water provider in the West. As of 1985, the Bureau delivered 31 million acre-feet of water per year in 17 western states. BUREAU OF RECLAMATION, U.S. DEP'T OF THE INTERIOR, 1985 SUMMARY STATISTICS: VOL. 1, WATER, LAND AND RELATED DATA 2-3 (1985) (on file at *The Hastings Law Journal*). The value of the taxpayer subsidies associated with Bureau water projects is enormous. For example, the Central Valley Project, one of the Bureau's California projects, enjoys a subsidy estimated at \$3.5 billion. E. LEVEEN & L. KING, TURNING OFF THE TAP ON FEDERAL WATER SUBSIDIES VOLUME 1: THE CENTRAL VALLEY PROJECT: THE \$3.5 BILLION GIVEAWAY (1985) (on file at *The Hastings Law Journal*); see also Supplemental Declaration of David Schuy, Court Record Vol. VI, Tab 71, Ex. E, *Peterson v. United States Dep't of the Interior*, Civ. No. S-85-1644-RAR (E.D. Cal. June 24, 1987), *appeal pending*, Nos. 87-2681, 87-2766, 87-2779, 87-2780, 87-2781 (9th Cir. filed Aug 22, 1987) (Bureau's estimate is \$3.6 billion).

intended small family farmers receiving the benefits, much of the subsidies now go to large growers and corporations.<sup>4</sup> Moreover, the magnitude of the subsidies has grown much larger than Congress ever intended. A recent report on the Central Valley Project found that \$1.5 billion of the total \$3.5 billion subsidy was dispensed by the Bureau of Reclamation (Bureau) through practices inconsistent with reclamation law.<sup>5</sup>

Unlimited irrigation subsidies are undesirable from an environmental standpoint. Water prices set far below cost encourage wasteful irrigation practices and increase the demand for new dams and more diversions of valuable fresh water.<sup>6</sup> In addition, subsidized water service encourages irrigation of marginal land, which can aggravate drainage and pollution problems. In recent years, severe environmental problems have resulted from Bureau water projects that dump selenium-laden agricultural drainage into rivers, streams, and wetlands. For example, at the Bureau's drainage ponds in the Kesterson National Wildlife Refuge in California, thousands of fish and waterfowl were killed or deformed by a relatively small amount of this toxic drainage originating in one Bureau-served water district.<sup>7</sup>

In an attempt to modernize reclamation law while preserving the goal of family farming—as well as to eliminate improper and excessive subsidies and the resulting environmental harms—Congress enacted the Reclamation Reform Act of 1982 (RRA).<sup>8</sup> The RRA made numerous changes to reclamation law. Most significantly, it increased the number of acres for which a farmer could receive subsidies from 160 acres to 960

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4. For example, in 1981 the Bureau reported that the largest 3% of reclamation landholders control 31% of the land. WATER AND POWER RESOURCES SERVICE, U.S. DEP'T OF THE INTERIOR, ACREAGE LIMITATION DRAFT ENVIRONMENTAL IMPACT STATEMENT 3-13 to 3-14 (1981) [hereinafter WATER AND POWER RESOURCES SERVICES] (on file at *The Hastings Law Journal*).

5. E. LEVEEN & L. KING, *supra* note 3, at 3.

6. As with most commodities, below cost pricing of water alters the level of demand: "Federally subsidized marketable water services tend to be undervalued and overconsumed by users . . . . Moreover, federal subsidies—hence low prices for water—blunt western farmers' incentive to conserve water. . . ." CONGRESSIONAL BUDGET OFFICE, EFFICIENT INVESTMENT IN WATER RESOURCES: ISSUES AND OPTIONS xiv (1983); *see also* Levy, *Pricing Federal Irrigation Water: A California Case Study*, in FEDERAL RESERVE BANK OF SAN FRANCISCO, ECONOMIC REVIEW 35 (Spring 1982) (higher water prices would reduce demand for water and for new water projects).

7. *See generally Tragedy at Kesterson Reservoir: Death of a Wildlife Refuge Illustrates Failings of Water Law*, 15 *Env'tl. L. Rep. (Env'tl. L. Inst.)* 10,386 (1985) (reviewing the various legal theories being pursued to challenge the Kesterson contamination).

8. Pub. L. No. 97-293, 96 Stat. 1263 (codified as amended at 43 U.S.C. §§ 390aa to 390zz-1 (1982)).

acres. It required, however, that landholdings in excess of 960 acres pay the "full" cost of any additional water.<sup>9</sup> Thus, although the law increased the acreage limitation of a family farm from 160 acres to 960 acres, it brought all farm operations within that definition and sought to prohibit distribution of subsidized water to land above the limit.

In addition to changing reclamation law substantively, the RRA authorized the Bureau to adopt regulations implementing the new provisions.<sup>10</sup> To the surprise of many veteran reclamation observers, the Bureau initially responded with signs of vigor to its new mandate under the RRA. Unfortunately, however, the Reagan administration's philosophical opposition to subsidies soon gave way to pressure by agribusiness leaders and intervention of high-level political appointees with ties to western irrigators.<sup>11</sup> Through new schemes and continued bureaucratic indifference, a new set of abuses has taken hold and the goal of true reform remains unfulfilled.

Nevertheless, the opportunity for genuine reform still exists. In December 1987, Congress called for a tightening up of the Bureau's implementation of the RRA. In a series of amendments to the Act, Congress closed certain loopholes in the Bureau's rules and implementing regulations and toughened up the requirements for auditing large scale farm operations and collecting underpayments of water costs.<sup>12</sup> While these amendments constituted an important first step toward vindicating the promise of the RRA, Congress failed to complete a more detailed review of the Bureau's implementing regulations.<sup>13</sup> The Bureau itself, however, can revisit the issue as it develops additional data on the failure of its current rules to accomplish the goals and to implement the directives of the RRA.

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9. § 205(a), 43 U.S.C. § 390ee(a).

10. *Id.* § 224(c), 43 U.S.C. § 390ww(c).

11. See *infra* section 111.

12. The amendments are contained in the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 5302(a), 100 Stat. 1330 (1987) (codified at 43 U.S.C. §§ 390nn, 390ww (Supp. 1988)). The amendments ended subsidies to the very largest farmers who held land under "extended recordable contracts." They also limited the use of "revocable trusts" as a means to get around the acreage limitation.

13. During final consideration of the amendments, the chairmen of both the House and Senate oversight subcommittees made clear that Congress would be taking another look at the issue. For example, Representative George Miller declared, "[T]he amendments in this bill do not attempt to address all of the questions and concerns that have been raised about the implementation of the Reclamation Reform Act." 133 CONG. REC. E4995-96 (daily ed. Dec. 22, 1987). Senator Bill Bradley stated, "I would alert my colleagues, the Department of the Interior, and certain water users that this is not the end of the issue." 133 CONG. REC. S18,677-78 (daily ed. Dec. 21, 1987).

This Article suggests a number of specific actions the Bureau can take to carry out that continuing mandate and achieve the goal of genuine reform of this massive program. To highlight the goals of the RRA, section I examines the history of the Reclamation Act of 1902 and the problems that led to adoption of the RRA. Section II details the design and intent of the RRA. Section III then examines the gap between the RRA and the Bureau's 1983 and 1987 implementing regulations. Finally, section IV concludes that a complete revision of the 1987 rules will be required to give effect to the intent and mandate of the RRA and makes several recommendations to accomplish this end.

### I. The History of the RRA and the Need for Reform

The federal reclamation program was established in 1902. The sponsors of the program made clear that it was intended to foster economic development and settlement of the West by encouraging small family farms. For example, Representative Newlands of Nevada, the principal sponsor of the Reclamation Act, proclaimed that "the very purpose of this bill is to guard against land monopoly and to hold this land in small tracts for the people of the entire country, to give to each man only the amount of land that will be necessary for the support of a family."<sup>14</sup> These goals were echoed by F. H. Newell, the first Commissioner of the United States Reclamation Service, who saw the purpose of the Act as

not so much to irrigate the land as it is to make homes. . . . It is not to irrigate the lands which now belong to large corporations or to small ones, it is not to make these men wealthy, but it is to bring about a condition whereby that land shall be put into the hands of **the** small owner, whereby the man with a family can get enough land to support that family.<sup>15</sup>

To insure that the subsidy was restricted to bona fide family farms, the 1902 Act included antimonopoly and antispeculation provisions. Foremost among these provisions were the well-known 160-acre limitation and the residency clause.<sup>16</sup> The 160-acre limitation provided that

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14. 35 CONG. REC. 6734 (1902) (statement of Rep. Newlands).

15. Official Proceedings of the Irrigation Congress 28 (1905), *quoted in* Frampton, *The Enforcement of Federal Reclamation Law in the Westlands Water District: A Broken Promise*, 13 U.C. DAVIS L. REV. 89, 92 (1979).

16. No right to the use of water for land in private ownership shall be sold for a tract exceeding one hundred and sixty acres to any one landowner, *and* no such sale shall be made to any landowner unless he be an actual bona fide resident on such land, or occupant thereof residing in the neighborhood of said land.

§ 5, 43 U.S.C. § 431 (1902) (emphasis added).

project water should be used on tracts of 160-acres or less.<sup>17</sup> The residency clause required that landowners reside on or near the land receiving subsidized water. These two provisions were intended to apply simultaneously.<sup>18</sup> Thus, reclamation water was to be used only on 160-acre plots farmed by the actual residents of that land.

Nonetheless, landholders devised a variety of multiple ownership arrangements and other creative devices to circumvent the specific statutory limitations on the **subsidy**.<sup>19</sup> Foremost among these practices was leasing, since the 160-acre limit was applied only to land that was "privately" owned. As long as an operator owned no more than 160 acres, he could lease literally thousands of acres, and the Bureau would accept this as proper compliance with the 160-acre **limitation**.<sup>20</sup> As a result, it became common for large landowners and corporations, "posing as bare-foot family **farmers**,"<sup>21</sup> to make huge profits farming thousands of acres with heavily subsidized water "paid for in part by the taxpayers from all over the **country**."<sup>22</sup> Needless to say, this was possible only because of the Bureau's failure to enforce the acreage limitation and the residency requirement together.<sup>23</sup>

Eventually, the abuses of the reclamation program were documented, particularly by the late University of California historian Paul S. Taylor,<sup>24</sup> and then **publicized**.<sup>25</sup> A 1981 Bureau report on acreage limitation found that only twenty-three percent of the land receiving subsidized

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17. *Id.*

18. *Id.*

19. *See generally* BUREAU OF RECLAMATION, U.S. DEP'T OF THE INTERIOR, SPECIAL TASK FORCE REPORT ON THE SAN LUIS UNIT 198-99 (1978) [hereinafter SPECIAL TASK FORCE] (leasing and multiple ownership arrangements have been used to circumvent the goals of the 1902 Act).

20. *Id.*

21. 128 CONG. REC. 8827 (1982) (statement of Rep. Udall).

22. *Id.*

23. The United States does not sell project water directly to the farmer. Rather, the reclamation laws direct the Secretary of the Interior to enter into water service contracts with irrigation districts organized under state law. Omnibus Adjustment Act, § 46, 43 U.S.C. § 423e (1926). The districts then execute subcontracts with the actual users of the water. According to this arrangement, the districts, rather than the United States, have initial responsibility for ensuring that the recipients of project water comply with federal reclamation law, including the acreage limitation and excess land provisions. *See* United States v. Tulare Lake Canal Co., 535 F.2d 1093, 1094 (9th Cir. 1976), *cert. denied*, 429 U.S. 1121 (1977). The Bureau, however, retains the ultimate responsibility for enforcement and establishes the policies that guide the districts' enforcement of the law.

24. *See, e.g.*, Taylor, *The Excess Land Law: Calculated Circumvention*, 52 CALIF. L. REV. 978 (1964); Taylor, *The Excess Land Law: Execution of a Public Policy*, 64 YALE L.J. 477 (1955).

25. *E.g.*, L. LUDLOW & W. HEARST, THE PAPER FARMS (1976) (based on an award-winning 1975 series of articles in the *San Francisco Examiner*).

water was farmed in operations of 160 acres or less.<sup>26</sup> The report also found that about thirty-seven percent of the land irrigated by Bureau water was leased, and that almost one-third of Bureau-served farms included leased land in their operation.<sup>27</sup>

The increasing notoriety surrounding the longstanding abuses of the reclamation program came to a head in the mid-1970s with lawsuits, public attention, and congressional hearings. In 1975, National Land for People, an organization of farmworkers and small farmers from the San Joaquin Valley in California, filed suit to challenge the Bureau's failure to implement the provisions of reclamation law governing excess lands.<sup>28</sup> These provisions required large farms (those over 160 acres) to be broken up after a period of time and sold at reduced prices that were affordable to genuine family farmers.<sup>29</sup> A District of Columbia district court agreed with the plaintiffs that the Department of the Interior should initiate rulemaking proceedings to carry out these crucial and longstanding provisions of reclamation law.<sup>30</sup> The court enjoined the approval of new sales of excess lands pending the enactment of new rules.<sup>31</sup> In response, the Bureau issued proposed rules in August 1977 that would have implemented the excess land law; these rules also would have required strict enforcement of the existing residency requirement and acreage limits.<sup>32</sup> Affected growers from California's San Joaquin Valley, however, immediately filed suit in a California district court and obtained an injunction in December 1977, blocking the final rules.<sup>33</sup> The court required the Bureau to prepare an Environmental Impact Statement (EIS) on the potential impact of the proposed rules, but before the final EIS was completed, several years passed and a new administration moved into the White House. With the 1977 rules enjoined and the advent of the Reagan Administration, the focus shifted to Congress to resolve the uncertainties in the enforcement of reclamation law.

During the 1970s, congressional concern about the reclamation program was on the increase. Members of Congress denounced the various devices for circumventing the 160-acre limitation, especially "the practice of long-term leasing [which] has long since made a mockery of the

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26. WATER AND POWER RESOURCES SERVICES, *supra* note 4, at 3-14.

27. *Id.* at 3-13.

28. *National Land for People, Inc. v. Bureau of Reclamation of the Dep't of the Interior*, 417 F. Supp. 449 (D.D.C. 1976).

29. 43 U.S.C. § 423e (1982).

30. *National Land*, 417 F. Supp. at 452-53.

31. *Id.* at 453.

32. 42 Fed. Reg. 43,044 (1977).

33. *County of Fresno v. Andrus*, Civ. No. F-77-202 (E.D. Cal. Dec. 7, 1977).

law.”<sup>34</sup> Indeed, after reviewing a General Accounting Office report that detailed a pattern of investments in reclamation lands followed by leases of those same lands to large farm operators,<sup>35</sup> Senator Gaylord Nelson concluded that “reclamation law has, at best, had no effect on the size of farming operations, and consequently has not fostered family farms. At worst, it has served to encourage large-scale farms.”<sup>36</sup>

A special task force set up by Congress on the San Luis Unit of the Central Valley Project specifically found that the practice of leasing frustrated congressional intent. It noted that large farm operators retained “*de facto* control,” if not ownership, over thousands of acres, and observed further that “[t]he legislative history of the 1902 Act and later reports . . . show that Congress in no way intended that large scale leasing or multiple ownership arrangements (such as corporations and trusts) might be allowed to circumvent the goals of the reclamation program.”<sup>37</sup> The Secretary of the Interior also agreed that “[l]easing has become perhaps the principal vehicle for frustrating the intent of reclamation law.”<sup>38</sup>

In addition to the problem of leases, Congress also became concerned about the *magnitude* of the subsidies collected by large farm operations. In some cases subsidies had grown to scandalous proportions. In 1979 Senator Nelson reported with astonishment that one Bureau customer, the Southern Pacific Railroad, would receive a ten-year taxpayer subsidy amounting to \$60 million.<sup>39</sup>

As a result of congressional concern about abuses in the reclamation program, as well as western growers’ fear of the Bureau’s 1977 proposed regulations, Congress considered various proposals to revise and reform reclamation law.<sup>40</sup> After five years of legislative debate, a compromise

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34. *Acreage Limitations and Bureau & Reclamation Projects: Hearings Before the Subcomm. on Public Lands and Resources & the Senate Comm. on Energy and Natural Resources, 95th Cong., 2d Sess. 541 (1978) [hereinafter Acreage Limitations Hearings] (statement of Sen. Church); Will the Family Farm Survive in America? Part I, Joint Hearings Before the Select Comm. on Small Business and the Comm. on Interior and Insular Affairs, 94th Cong., 1st Sess. (1975).*

35. COMPTROLLER GENERAL OF THE U.S. REPORT TO THE CONGRESS: CONGRESS SHOULD REEVALUATE THE 160-ACRE LIMITATION ON LAND ELIGIBLE TO RECEIVE WATER FROM FEDERAL WATER RESOURCES PROJECTS 1-3 (1972) (on file at *The Hastings Law Journal*).

36. *Acreage Limitations Hearings, supra* note 34, at 231 (statement of Sen. Nelson).

37. SPECIAL TASK FORCE, *supra* note 19, at 199.

38. *Acreage Limitations Hearings, supra* note 34, at 541 (statement of Cecil B. Andrus).

39. 125 CONG. REC. 24,342 (1979) (statement of Sen. Nelson).

40. Frampton, *supra* note 15, at 103.

was reached in the RRA and the final version of the RRA was approved on October 12, 1982.<sup>41</sup>

It is ironic that the RRA emerged near the beginning of the Reagan administration. While this administration supposedly was committed to a free market philosophy and actively hostile to government subsidy programs, the RRA in many respects expanded taxpayer subsidies, and loosened up most of the key restrictions in the 1902 law. Nevertheless, the bill contained one fundamental trade-off for these major new benefits to western agribusiness: All operators that exceeded 960 acres would have to pay the "full cost" for the water delivered to those excess acres.<sup>42</sup> Moreover, there was reason to believe that the Reagan administration would work to uphold the RRA, and that irrigation subsidies at long last would be limited as Congress originally had intended. For example, when he first came into office, Interior Secretary James Watt ordered a cessation of water deliveries to the Westlands Water District by the end of 1981 unless that district agreed to pay a higher price for its water.<sup>43</sup>

Unfortunately, the Reagan administration's commitment to end water subsidies proved short-lived. The last six and a half years have shown that the Bureau's approach to enforcing the acreage limits and pricing requirements of the RRA is as recalcitrant and politically controlled as was the traditionally lax enforcement that led to the adoption of the RRA in the first place.

## 11. The Design and Intent of the RRA

### A. The Basic Scheme of the RRA

In passing the RRA, Congress made some fundamental changes in the previous reclamation law. The Act's principal features include:

- (1) an expanded acreage limitation for the delivery of subsidized water to owned land of up to 960 acres;<sup>44</sup>
- (2) an allowance for the delivery of subsidized water to leased lands up to 960 acres;<sup>45</sup>
- (3) an allowance for the delivery of full-cost water to unlimited leased lands in excess of 960 acres;<sup>46</sup>

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41. Pub. L. No. 97-293, 96 Stat. 1263 (codified as amended at 43 U.S.C. §§ 390aa to 390zz-1 (1982)).

42. § 205, 43 U.S.C. § 390ee(a)(1).

43. Letter from Assistant Secretary of Interior to General Manager of the Westlands Water District (May 21, 1981) (on file at *The Hastings Law Journal*).

44. § 204, 43 U.S.C. § 390dd.

45. *Id.* § 205, 43 U.S.C. § 390ee.

46. *Id.*

(4) a requirement that water prices in all new or amended contracts be increased as necessary to cover full project operation and maintenance (O & M) costs;<sup>47</sup>

(5) the “hammer clause,” which provides that by April 12, 1987, all landholders must conform to the new law or pay full cost for water delivered to lands leased in excess of 160 acres;<sup>48</sup> and

(6) elimination of the residency requirement.<sup>49</sup>

Each of these provisions is discussed in detail below.

The decision to increase the acreage limit from 160 acres to 960 acres reflects the view of some western interests that 960 acres is the modern-day equivalent of a 160-acre farm in 1902.<sup>50</sup> While Congress was willing to relax its notion of the size of a family farm, it clearly expressed its impatience with the type of “paper farming” schemes that had been so prevalent in the past. Thus, the **RRA** mandated that large-scale farmers be charged “full cost” for all water delivered to land in excess of 960 acres.<sup>51</sup>

In addition to requiring large growers to pay full cost for water used on lands in excess of 960 acres, the **RRA** made an important change affecting the level of subsidy available to all water users. While Congress wished to continue to extend the interest subsidy to small farmers, it wanted *all* water users to pay a price at least great enough to cover the Bureau’s O & M costs.<sup>52</sup> Many users do not pay prices adequate to meet the program’s costs. For example, in one of the Bureau’s largest projects, the Central Valley Project in California, long-term contracts for irrigation water have kept water prices so low that payments have not even covered full O & M costs.<sup>53</sup> To address such problems, the **RRA** pro-

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47. *Id.* § 208, 43 U.S.C. § 390hh(a).

48. *Id.* § 203(b), 43 U.S.C. § 390cc(b).

49. *Id.* § 211, 43 U.S.C. § 390kk.

50. 128 CONG. REC. 8808-09 (1982) (statement of Rep. Kazen). The Bureau found that 97.4% of the farms receiving federal reclamation project water as of the late 1970s were 960 acres or less. WATER AND POWER RESOURCES SERVICES, *supra* note 4, at 3-14.

51. § 205, 43 U.S.C. § 390ee(a)(1).

52. *Id.* § 208, 43 U.S.C. § 390hh. This provision did not address the other component of reclamation contracts allocated to repayment of construction costs. *See, e.g.*, 43 U.S.C. § 485h(d)(2) (1939).

53. In 1987, the Bureau reported that its fixed contract rates in the CVP “have been exceeded by annual operation and maintenance costs in a substantial number of cases.” BUREAU OF RECLAMATION, MID-PACIFIC REGION IRRIGATION RATESETTING POLICY, PUBLIC REVIEW DOCUMENT, CENTRAL VALLEY PROJECT, CALIFORNIA 1 (1987) [hereinafter IRRIGATION RATESETTING POLICY]. The legality of allowing such O & M deficits is questionable. Section 9 of the 1939 Act, like all other preexisting provisions of reclamation law that are not inconsistent with the RRA, was expressly reaffirmed by the RRA. § 224(a), 43 U.S.C. § 390ww(a) (1982). In § 9(e) of the Reclamation Project Act of 1939, Congress required the Secretary to set contract rates that “will produce revenues *at least* sufficient to cover an appropriate share of the annual operation and maintenance cost *and* an appropriate share of . . .

vides that water prices in all new or amended contracts be adjusted to cover full project O & M costs.<sup>54</sup> Moreover, to bring water users under the new pricing provisions, the RRA uses a carrot and stick approach to encourage districts to amend their existing contracts.

The main carrot offered by the RRA is the option of increasing the amount of acreage eligible to receive federal water. If a district wishes to receive subsidized water to deliver to farmers owning or leasing more than 160 acres, either the district must amend its contract with the Bureau,<sup>55</sup> or those individual farmers must sign an "irrevocable election" agreeing to conform with the new law.<sup>56</sup> This irrevocable election would require, among other things, that the farmer pay at least the *full* O & M costs on all water received, including any increases that may occur in the future. In addition, the new rates must reflect the allocated share of project construction costs, although without interest.<sup>57</sup>

If a district with landholdings over 160 acres does not amend its contract and its farmers have not met the new law's requirements, then the stick is applied. Beginning in April 1987, all operators in such districts were required to pay the full cost for all water delivered to land leased above 160 acres. The full cost includes a capital component, interest on the unrepaid capital, and full O & M costs.<sup>58</sup> This "stick" often has been referred to as the "hammer clause."<sup>59</sup>

The RRA requires similar price concessions from a district that wishes to amend its contract with the Bureau to obtain "additional or supplemental benefits."<sup>60</sup> For example, if a district wishes to increase the acreage that may receive subsidized water or the amount of water it receives, or obtain some other additional benefit, the district must amend its contract with the Bureau to conform to the RRA and agree to pay a rate that recovers both the district's share of the project's capital costs

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[construction] charges." Reclamation Project Act of 1939, 43 U.S.C. § 485h(e) (1939) (emphasis added). In addition, § 6 of that Act requires "advance payment of *adequate* operation and maintenance charges." *Id.* § 485e (emphasis added). Contract payments that are inadequate to cover the allocated O & M charges are obviously *not* "adequate" under § 6, and since that also means that *no* construction charges are being recovered for those contracts, § 9(e)'s requirement that "an appropriate share" of construction costs be recovered is also being ignored.

54. § 208, 43 U.S.C. § 390hh(a).

55. *Id.* § 203(a), 43 U.S.C. § 390cc(a).

56. *Id.* § 203(c), 43 U.S.C. § 390cc(c).

57. *See supra* note 53. Amendments to § 9(e) contracts that are subject to the RRA must insure repayment of an "appropriate share" of construction charges as well as full O & M charges. The Bureau, however, generally has disregarded this requirement. *Id.*

58. § 203(b), 43 U.S.C. § 390bb(3)(A) (1986).

59. *See, e.g.*, 128 CONG. REC. 26,073 (1982) (statement of Rep. Udall).

60. § 203(a), 43 U.S.C. § 390cc(a) (1982).

and the Bureau's current and future O & M costs. As indicated above, many districts currently are paying a rate that does not recover even actual O & M costs.<sup>61</sup> Thus, the requirement that amended contracts provide for these higher rates, even though they are less than the full cost rate, already has resulted in modest to significant price jumps for many districts,<sup>62</sup> and will continue to do so as rates are adjusted each year in the future.

While it might appear that the prospect of paying increased rates to cover O & M costs would dissuade growers from amending their contracts, the prospect of paying full cost for water used on lands in excess of 160 acres should be an even stronger counter-balancing incentive *for* amendment. This is so because full cost rates are much greater than full O & M rates. For example, the full cost rate in the Kanawha Water District in the Sacramento Valley was calculated in 1987 to be \$52.62 per acre-foot, in contrast to a rate of \$11.42 for O & M plus capital costs that excludes interest (also called the "cost of service" rate).<sup>63</sup> Similarly, the full cost rate in the Arvin-Edison Water Storage District in the San Joaquin Valley was calculated at \$48.69 per acre-foot, while the cost of service rate was only \$12.47 per acre-foot.<sup>64</sup>

## B. The Goals Behind the RRA

The new acreage limitation was intended to cover all operations of 960 acres, whether the acres were distributed in numerous districts or concentrated in one district.<sup>65</sup> Many in Congress, however, felt that the new acreage limit was too high and the allowable subsidy too great. A number of Senators denounced the **RRA** for giving up the residency requirement and expanding the acreage limitation while at the same time authorizing water service to unlimited amounts of leased land.<sup>66</sup> Nonetheless, in exchange for these and various other new benefits for western water users, Congress did establish one major reform: a firm, comprehensive limit on the size of a farm unit eligible for subsidized water. Under the **RRA**, water service to any landholdings or farm units in excess of the 960-acre limit must be at full cost.

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61. See *supra* note 53 and accompanying text.

62. IRRIGATION RATESETTING POLICY, *supra* note 53, at 1.

63. *Id.* Schedule 1.

64. *Id.*

65. § 202(6), 43 U.S.C. § 390bb(6) (1982). The Conference Report and other legislative history repeatedly speak of farming "operations," demonstrating an intent to go beyond the previous focus on ownership to cover all farms, however structured. See, e.g., H.R. REP. NO. 855, 97th Cong., 2d Sess. 30-31, reprinted in 1982 U.S. CODE CONG. & ADMIN. NEWS 1265.

66. 128 CONG. REC. 25,110-16 (1982) (statements of Sens. Proxmire and Moynihan).

Though Congress specifically exempted certain types of situations, such as isolated tracts of **land**,<sup>67</sup> these exemptions were intended to apply only to the ownership ceiling, *not* to the pricing requirements of the law or the full cost repayment **mandate**.<sup>68</sup> Thus, as indicated by Representative Miller, a primary author of the legislation, the provisions of the RRA were to be applied broadly and were not to be avoided through the use of legal subterfuge:

Clearly, if a farm operation is several thousand acres, whether by ownership or lease, the goal of small farming is frustrated. . . . We are not going to impose a compulsory land redistribution program on western farmers. But neither are we going to shower on large, profitable farming operations the benefits intended for small, family farmers. . . . While most individuals knowledgeable about the water issue agree that the pricing reforms are equitable, some question how broadly they will be applied. This is a crucial question, because the last thing we want *to* do is to create a sound pricing program that applies to no one, or merely to those who cannot afford expensive lawyers who can wiggle their way loose of this legislation. There is no wiggle room in this **legislation**.<sup>69</sup>

In sum, the RRA was an attempt by Congress to preserve the heart of federal reclamation law—to foster family farming and to avoid the monopolization of federal irrigation subsidies by large corporations—while updating the law in response to modern farm economic pressures. Moreover, the Act represents a clear attempt to eliminate the huge subsidies flowing to large-scale private interests due to the Bureau's mismanagement, lax enforcement, and incorrect interpretations of existing reclamation law. Unfortunately, the RRA's vision largely has been ignored or undermined by the Bureau.

### III. The Gap Between the Law and Its Implementation

In addition to changing reclamation law substantively, the RRA expressly authorized the Bureau to adopt regulations implementing its various new **provisions**.<sup>70</sup> The adoption of formal implementation regulations marks a major departure from the Bureau's past practices, when regional directors or other political appointees typically called the shots through internal memoranda or legal opinions that largely were hidden from public view.<sup>71</sup> Unfortunately, the Bureau has proved just as

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67. § 217, 43 U.S.C. § 390qq.

68. *Id.*

69. 128 CONG. REC. 26,076-77 (1982) (statement of Rep. Miller).

70. § 224(c), 43 U.S.C. § 390ww(c).

71. See, e.g., *National Land for People, Inc. v. Bureau of Reclamation of the Dep't of the Interior*, 417 F. Supp. 449, 452 (D.D.C. 1976); see also *Northern Cal. Power Agency v. Mor-*

vulnerable to the pressure of agricultural interests in its rulemaking process as it was in its former ad hoc decisionmaking approach.

The Bureau has promulgated two major sets of rules to implement the RRA. The first set of rules was adopted on December 6, 1983,<sup>72</sup> shortly after passage of the Act, and the second set was adopted on April 13, 1987,<sup>73</sup> the day after the hammer clause was to go into effect. In both rulemaking proceedings a clear pattern emerged. Proposed rules were issued providing for relatively vigorous enforcement of the Act. Then, following extensive pressure by water lawyers and agribusiness lobbyists, the Bureau published a set of final rules, which acceded to the growers' complaints on virtually every significant issue. In so doing, the Bureau has adopted rules that defy the clear intent of the RRA. Following is a description of the main areas in each set of rules in which the Bureau bowed to growers' protests and abdicated its responsibilities under the RRA.<sup>74</sup>

#### A. Round One: The 1983 Rules

The Department of the Interior (acting on behalf of the Bureau) initiated the first rulemaking proceeding shortly after the RRA passed. Proposed rules were published in the *Federal Register* on May 3, 1983.<sup>75</sup> While the proposed rules generally embodied both the spirit and the requirements of the RRA, the final rules that emerged after the extensive comment period represented a major retreat. The Bureau reversed itself between the proposed and final rules on two key issues: (1) implementation of the hammer clause, and (2) treatment of capital repayment obligations in amended contracts.

The proposed rules provided for full implementation of the key provision of the RRA, the hammer clause.<sup>76</sup> Nonetheless, in response to protests against the hammer clause from western agricultural interests, the Department deleted all reference to the hammer clause in the final rules. The Supplemental Information accompanying the final rules indicates two reasons for this major omission. First, fifty-two people voiced

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ton, 396 F. Supp. 1187, 1189-91 (D.D.C. 1975), (Bureau's informal, unpublished power rate making procedures held unlawful) *aff'd*, 539 F.2d 243 (D.C. Cir. 1976).

72. 48 Fed. Reg. 54,748 (1983).

73. 52 Fed. Reg. 11,938 (1987) (codified at 43 C.F.R. § 426 (1987)).

74. The rules are extensive and complex. There were dozens of changes from the proposed rules to the final rules, many of them contrary to clear congressional intent. This discussion focuses only on the most prominent changes.

75. 48 Fed. Reg. 19,900 (1983).

76. See, e.g., § 426.7, 48 Fed. Reg. 19,905-08 (1983).

strong objection to the hammer clause.<sup>77</sup> Second, the Department itself was considering proposing legislation to repeal the hammer clause due to a number of concerns about its impact.<sup>78</sup> Indeed, Secretary of the Interior William Clark claimed section 203(b) of the RRA was unconstitutional and asked Congress to repeal it.<sup>79</sup> Congress took no action on Clark's request, however, and the hammer clause ultimately was held constitutional by a federal court in California.<sup>80</sup>

The second key issue on which the Bureau reversed itself between the proposed and final rules was the treatment of capital repayment obligations in amended contracts. Under the RRA, districts that amend their contracts with the Bureau to receive "additional or supplemental benefits," for example additional water deliveries, also must comply with the RRA, including its pricing reforms.<sup>81</sup> This means, among other things, that districts that come under the RRA must pay at least enough to cover full O & M charges. For those districts with whom the Bureau has a typical "9(d) repayment contract,"<sup>82</sup> this determination is easy, because such contracts specify separate charges for O & M versus capital repayment. In some projects, however, such as the Central Valley Project, districts have "9(e) water service contracts,"<sup>83</sup> which contain a sin-

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77. *See id.* at 54,757.

78. The Secretary [of the Interior] is also concerned about the potential impact of this section of [sic] the financing abilities of some irrigation districts. The Department is considering proposing legislation to repeal section 203(b). If section 203(b) is not repealed by January 1, 1987, however, then the Department will take all actions necessary to fully implement this section of the law.

*Id.*

79. 130 CONG. REC. S584 (daily ed. Jan. 31, 1984) (statement of Sen. McClure, introducing, "at the request of the administration," S. 2238, "A Bill to Repeal Section 203(b) of the RRA").

80. Findings of Fact, Conclusions of Law and Order, *Peterson v. United States Dep't of the Interior*, Civ. No. S-85-1644-RAR (E.D. Cal. June 24, 1987), *appeal pending*, Nos. 87-2681, 87-2766, 87-2779, 87-2780, 87-2781 (9th Cir. filed Aug. 22, 1987). The district court granted summary judgment for the defendant United States and intervenor-defendant Natural Resources Defense Council in five consolidated actions. *Id.* at 15. Plaintiffs appealed and their appeals were consolidated with an appeal from a similar case, *Central Valley Project Water Ass'n v. United States Dep't of the Interior*, Civ. No. S-87-0175-RAR. The appeals are pending before the United States Court of Appeals for the Ninth Circuit.

81. § 203(a), 43 U.S.C. § 390cc(a) (1982).

82. These are contracts executed under authority of Reclamation Project Act of 1939, § 9(d), 43 U.S.C. § 485h(d) (1939). These provide for the complete repayment of construction costs (without interest) in a specified period (as contrasted with § 9e contracts).

83. These contracts are executed under authority of the Reclamation Project Act of 1939, § 9(e), 43 U.S.C. § 485h(e). These are for projects, not yet completed, for which a final construction cost to be repaid has not been established. The contract rate then is based on an estimate of the construction costs and other costs to be paid.

gle rate that does not distinguish between O & M charges and capital charges.

Operators and districts in California used this lack of a bifurcated rate in their contracts to argue against the Bureau's proposed rules,<sup>84</sup> which required that all amended contracts include charges for both capital repayment (without interest for all lands below 960 acres) and full O & M costs.<sup>85</sup> The water users argued that the RRA only allowed an increase in the single contract rate sufficient to cover full O & M, not full O & M plus capital. While the growers' view clearly is contradicted by existing reclamation law, which requires *all* contracts to collect "an appropriate share" of capital costs,<sup>86</sup> the Department bowed to the growers' pressure and changed the proposed rule. The final 1983 rule required that the amended contract rate be set sufficiently high to cover only O & M costs.<sup>87</sup>

#### B. Round Two: The 1987 Rules

The skirmishes between the growers and the Bureau during the 1983 rules were just a warmup for the battle during the second rulemaking proceeding in 1987. The impetus behind the second rulemaking proceeding was the need to adopt regulations implementing the hammer clause, which was scheduled to go into effect on April 12, 1987.<sup>88</sup> In addition, the Bureau sought to address new farming arrangements designed to circumvent the Act's acreage limitations. Needless to say, this second set of proposed rules drew another storm of protest from large-scale growers.

In early 1986, a field draft of the new proposed rules was leaked to California water users, who immediately expressed their opposition to *any* changes in the regulations. The Bureau's response was quick and sympathetic. Commissioner C. Dale Duvall held meetings with the water users before the draft regulations were released to the public.<sup>89</sup> Some of these same water users were parties to lawsuits seeking to overturn the hammer clause and to block its implementation. The secrecy surrounding the field draft and proposed rules provoked a letter from Representative George Miller, Chairman of the House Subcommittee on Water and Power Resources, to Interior Secretary Donald Hodel, accus-

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84. See 48 Fed. Reg. 54,758 (1983) (comment 1 on § 426.8(a) of the proposed rules).

85. § 426.8(a)(1), 48 Fed. Reg. 19,908 (1983).

86. See *supra* note 53 and accompanying text.

87. 48 Fed. Reg. 54,748, 54,776 (1983).

88. § 203(b), 43 U.S.C. § 390cc(b) (1982).

89. See Letter from C. Dale Duvall to Hamilton Candee (June 3, 1986) (*on file at The Hustings Law Journal*); Draft Letter from C. Dale Duvall to Rep. George Miller (May 21, 1986) (*on file at The Hustings Law Journal*).

ing the Bureau of violating the requirements of openness and fairness in the rulemaking process.<sup>90</sup>

Following these private discussions and one subsequent public session, representatives of the Bureau, the Department of Interior, the Office of Management and Budget, and the Department of Justice spent seven months negotiating changes. The proposed rules ultimately published on November 7, 1986,<sup>91</sup> were weaker in various aspects than the earlier field draft.<sup>92</sup> Nonetheless, they were stronger than the 1983 rules and would have improved the Bureau's enforcement of the law considerably. After much further outcry, however, the situation changed dramatically when the final rules were adopted on April 13, 1987.

Perhaps the best explanation of the Bureau's radical modification of its proposed rules was given by Bureau Commissioner C. Dale Duvall, in a briefing on the final rules to the National Water Resources Association:

[W]e used somewhat the purposes of the Act to come up with the November rules. I think that's as close to an apology as I am going to give to you. That set of rules pretty well carried out what the Congressmen and the Senators said they were doing with that Act. Our new set of rules that we've put into place are cut based upon an entirely different principle, and the different principle came as a result of our putting the November rules out on the street and coming out here in the West and sitting through fifteen agonizing days of workshops and hearings, wherein you people for the most part did that which, thank God, we are allowed to do in this country, you sat back on your heels and you bellyached . . . .<sup>93</sup>

Thus, the Bureau exhibited once again its willingness to accommodate the concerns of western agribusiness. Following is a description of how the Bureau capitulated, issue by issue, to the interests of the water users in the final 1987 rules.

### *(1) Farm Management Arrangements*

Leasing was the predominant business arrangement employed before passage of the RRA to circumvent the old acreage limitation, and

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90. Letter from Congressman George Miller to Interior Secretary Donald Hodel (May 12, 1986) (on file at The *Hastings Law Journal*).

91. 51 Fed. Reg. 40,742 (1986).

92. For example, in an effort to prevent trusts for minor children from being used to increase a family's acreage entitlement, the field draft provided that such a child could not establish "independence" (that is, the right to a separate acreage limit) on the basis of the trust itself. In the November proposed rules, however, this was weakened to a one year waiting period before dependents (for I.R.S. purposes) could become "independent" for RRA purposes. See § 426.6(b)(4), 51 Fed. Reg. 40,753-54 (1986).

93. Remarks of Bureau Commissioner C. Dale Duvall, meeting of the National Water Resources Association, Reno, Nevada, Apr. 13, 1987 (on file at The *Hastings Law Journal*).

Congress expressly applied the acreage limitation and full cost pricing requirements to leased **land**.<sup>94</sup> If Congress had realized how easily leases would be transformed into similar alternative arrangements, it undoubtedly would have expressly, rather than implicitly, applied the same acreage limitation and full cost pricing requirements to such arrangements as were applied expressly to leases.

In fact, following passage of the RRA the lawyers and accountants of large-scale growers were quite busy creating new farm management arrangements. Bureau staff began to discover a disturbing pattern of reorganizations. Landowners began setting up what the Bureau considered “questionable *farm management arrangements* in order to avoid becoming subject to the full cost payments” applicable to leased **lands**.<sup>95</sup> These farm management arrangements, which have been documented by the California Institute for Rural **Studies**,<sup>96</sup> are essentially amalgamations of 960-acre parcels, usually contiguous, that are managed by a business that in turn typically consists of the same people who hold the 960-acre parcels. For example, a 7,000-acre operation in Westlands previously operated under a lease would simply “restructure” the leased lands into separate 960-acre parcels, each owned by a different business partner or investor, who then collectively “manage” the entire operation via a separate company that is owned or controlled by the same partners or investors.

In order to prevent such abuses, the proposed rules sought to close the farm management arrangement loophole by requiring that any such arrangement in which the farm manager or operator had any economic interest, direct *or* indirect, be treated the same as a **lease**.<sup>97</sup> Thus, all farming operations in excess of 960 acres would have been presumed to be the equivalent of a lease except for farm operations in which the outside manager or operator is paid a fee that does not depend upon the amount of crop produced.

The proposed rules also would have placed the burden on large-scale operators to demonstrate that any operation in excess of 960 acres was not a **lease**.<sup>98</sup> The proposed rules included a requirement that leases

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94. §§ 202(b), 205, 43 U.S.C. §§ 390bb(6), 390ee (1982).

95. BUREAU OF RECLAMATION, U.S. DEP'T OF THE INTERIOR, ISSUE PAPER NO. 4, at 1 (1986) (**emphasis added**).

96. D. VILLAREJO, **How Much is Enough? Federal Water Subsidies and Agriculture in California's Central Valley** (1986) [hereinafter **How Much is Enough**] (on file at *The Hastings Law Journal*); D. VILLAREJO & J. REDMOND, **MISSED OPPORTUNITIES—SQUANDERED RESOURCES** (1988).

97. § 426.7(a)(1), 51 Fed. Reg. 40,756 (1986).

98. *Id.*

*and agreements* concerning the operation of a farm be in writing and be made available to the **Secretary**.<sup>99</sup> In addition, owners *and* operators, as opposed to owners and lessees, would have been required to complete certification and reporting forms.<sup>100</sup> The proposed rules also contained penalty provisions for any “scheme or device” designed to evade or having the effect of evading the **rules**,<sup>101</sup> and for failure to report landholding information.<sup>102</sup>

Thus, the proposed rules would have curtailed sharply the ability of water users to avoid the 960-acre subsidy limitation through farm management arrangements. Common economic interests between an operating company and the owners of land parcels would have triggered the same full cost pricing requirements as a lease. Moreover, instead of the Bureau doing the unlikely job of ferreting out these scams, the proposed rules would have created a rebuttable presumption that an operation is a lease (because it is over 960 acres) and placed the burden on the grower to prove otherwise.

The final rules, however, abandon these two safeguards. First, under the final rules, the definition of a lease excludes the type of farm management arrangements described above. A lease includes only those farm management arrangements in which the operator assumes the economic risk in the operation and management of the **farm**.<sup>103</sup> Thus, as long as the payment received by the entity that “manages” or operates the large operation is not directly dependent on the success of the operation, the final rules contain no limitation on the subsidies that can be obtained through such arrangements.

Second, the final rules remove the rebuttable presumption for large operations and put the burden back on the Bureau to discover and prove all potential abuses by farm management **arrangements**.<sup>104</sup> This job was made particularly difficult by several other changes in the final rules. For example, the final rules weaken the sanctions of the proposed rules for failure to report landholding **data**.<sup>105</sup> Also, the final rules retain the ultimate sanction of terminating water service, but do not indicate what penalty is applicable to water already delivered to a water user who has failed to **report**.<sup>106</sup> By contrast, the proposed rules would not have per-

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99. § 426.7(b)(1), 51 Fed. Reg. 40,756 (1986).

100. *Id.*

101. § 426.23, 51 Fed. Reg. 40,774 (1986).

102. § 426.10(k), 51 Fed. Reg. 40,763 (1986).

103. 43 C.F.R. § 426.7(a)(3)-(4) (1987).

104. *Id.*

105. *Id.* § 426.10(k).

106. *Id.*

mitted nonreporting irrigators to continue receiving water service without risking higher charges. The final rules encourage the irrigator to just wait for the Bureau to discover them and initiate a cut-off. Similarly, the final rules drop the provision found in the proposed rules that imposed a penalty for the use of any scheme or device intended to avoid the intent of the rules.<sup>107</sup> The growers had protested this rule on the grounds that it was an unfounded "insult" to suggest that any irrigator would ever use a scheme or device to evade acreage **limitation**.<sup>108</sup>

The final rules also made the Bureau's job more difficult than did the proposed rules by not requiring operators to submit reporting forms<sup>109</sup> and by not even defining who is an "operator."<sup>110</sup> In contrast, the proposed rules defined an operator as "a person who operates a farm by either doing or supervising the work and by making day-to-day operating decisions."<sup>111</sup> Operators would have been required to submit certification and reporting forms along with owners and lessees. The water users, however, pressured the Bureau to delete any reference to the word "operator," presumably to limit all acreage and pricing limitations to formal owners and lessees, rather than the full range of managers, consultants, or other operators who might actually run the farms. While the Bureau staff originally took the position that it could not determine whether a farm operator was in fact a lessee under the regulations unless it had information about those operators, the final rules dropped all reference to "operators." Thus, only owners and lessees, and not operators, are required to comply with reporting requirements.

## (2) *Trusts*

A key ingredient of the farm management arrangements that sprung up after 1982 was the trust. A 1986 Bureau report pointed out that the 1983 regulations did not place sufficient restrictions on the development of trusts, and "as a result, trusts could become a means for circumventing the acreage limitation of the **RRA**."<sup>112</sup>

Trusts are used in this way, for example, when a large landowner with four minor children and 4,000 acres of land creates a trust of 960 acres for each child, as promulgated, but continues to operate the entire

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107. Compare § 426.23, 51 Fed. Reg. 40,774 (1986) with § 426.23, 52 Fed. Reg. 11,979 (1987).

108. See 52 Fed. Reg. 11,953 (1987) (comment 1 on § 426.23).

109. 43 C.F.R. § 426.10(c)-(d) (1987).

110. *Id.* § 426.4.

111. 51 Fed. Reg. 40,751 (1986).

112. BUREAU OF RECLAMATION, U.S. DEP'T OF THE INTERIOR, ISSUE PAPER NO. 3, at 1 (1986).

farm as one integrated unit. The final rules permit the owner to escape full cost pricing on the entire farm.<sup>113</sup>

Don Villarejo of the California Institute for Rural Studies documented glaring examples of such abuse.<sup>114</sup> For instance, Villarejo traced the recent transformation of a large-scale farming operation into seven discrete business entities in the Westlands Water District. Five of these entities are trusts, and all but two of these "new" landholdings are less than 960 acres. Villarejo found that each of these allegedly separate "farms" actually reports the identical address to the U.S. Department of Agriculture.<sup>115</sup> While the entire operation totals 6,279 acres, just 63 acres are subject to full cost pricing.<sup>116</sup> Villarejo also found that the trustees and trustors are all stockholders of the same corporation that farms the land in question. He concluded:

It can hardly be an accident that the seven "separate" farms listed above were formed subsequent to the passage of the RRA and that, with two exceptions, each have landholdings less than 960 acres. This suggests that rather than being seven independent farms they form, in fact, a single farming unit.<sup>117</sup>

As the Bureau itself pointed out:

[P]arents who are subject to the discretionary provisions could establish a separate trust for each of their minor children. They could then claim, as some already have, that each child is actually a nondependent and entitled to own and receive irrigation water on 960 acres. The claim for a child's nondependency has even been made based on the child's holding title to Reclamation land. By permitting such holdings to count, basically all minors can prove nondependency.<sup>118</sup>

The proposed rules would have limited the use of trusts to evade the 960-acre limit by requiring that trusts be irrevocable.<sup>119</sup> If the trust was revocable, all land covered by the trust would be attributed to the owner/grantor's landholding. Also, the proposed rules would have prevented the trust's beneficiaries (if they were minors) from using the trust as a basis of financial independence for the first year if the beneficiaries had been listed the previous year as dependents on the owner/grantor's tax

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113. See 43 C.F.R. § 426.6(b)(4) (1987).

114. Testimony of Dr. Don Villarejo, Executive Director, California Institute for Rural Studies, Before the U.S. Dep't of the Interior, Sacramento, California (Dec. 11, 1986) [hereinafter Villarejo Testimony] (on file at *The Hastings Law Journal*); **HOW MUCH IS ENOUGH**, *supra* note 96.

115. Villarejo Testimony, *supra* note 114, at 4.

116. *Id.*

117. *Id.* at 5.

118. BUREAU OF RECLAMATION, U.S. DEP'T OF THE INTERIOR, ISSUE PAPER NO. 3, at 1 (1986).

119. § 426.6(b)(4), 51 Fed. Reg. 40,753 (1986).

returns.<sup>120</sup> As indicated above, the earlier field draft of the rules would have gone even further and prevented the trust property from being used as a basis for establishing the financial independence of the trust beneficiaries altogether.<sup>121</sup>

These protections were discarded in the final rules, which do not require that trusts be irrevocable to include the acreage in the beneficiary's **entitlements**.<sup>122</sup> In addition, the final rules allow a beneficiary to use income derived from the land (even though farmed by the parent in the case of a minor) as the basis of the beneficiary's independent status.<sup>123</sup> This provision was adopted in response to water users' comments on the proposed rules that "the Act itself does not provide any limitations on trusts other than the limitations on the ownership entitlement of any single **beneficiary**."<sup>124</sup> Thus, the final rules permit large operators to continue to use trusts in connection with farm management arrangements to evade acreage limitations and full cost pricing.

### (3) *Operation and Maintenance Charges*

As described earlier, the Bureau capitulated to the growers' position regarding the treatment of **O & M** costs in amended contracts.<sup>125</sup> In the 1983 rules, the RRA's requirement that the price in all amended contracts "be at least sufficient to recover all operation and maintenance charges"<sup>126</sup> was interpreted to mean that the price must be sufficient *only* to cover **O & M** costs, regardless of repayment of the district's share of the project's construction costs.<sup>127</sup> Under this approach, little if any revenue would be collected from districts with amended contracts to cover their share of capital costs.

In 1986, however, the Bureau finally acknowledged its obligation to recapture an appropriate share of capital costs in addition to **O & M** costs even under 9(e) contracts when it stated:

The emphasis within the RRA on the collection of at least full **O & M** should not be interpreted to mean that the law placed a deemphasis on the recovery of capital expenditures. It did not. Sections **203** and **208** in combination clearly mandate the measures necessary to correct any

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120. § 426.6(b)(4), (d)(6), 51 Fed. Reg. 40,753, 40,755 (1986).

121. See *supra* note 92.

122. This loophole was narrowed substantially by Congress in its 1987 amendments to the RRA. Omnibus Budget Reconciliation Act of 1987, 43 U.S.C. § 390nn(b) (1987). See *infra* note 154 and accompanying text.

123. 43 C.F.R. § 426.6(b)(4) (1987).

124. Dep't of the Interior News Release 4 (Apr. 9, 1987).

125. See *supra* notes 81-87 and accompanying text.

126. § 208(a), 43 U.S.C. § 390nn(a) (1982).

127. § 426.8(a), 48 Fed. Reg. 54,758 (1983).

past contracting practice which may have inadvertently resulted in annual direct repayments that do not at least cover O & M. The recovery of the capital investment, at least up to the agricultural users' ability to pay, is still one of the underpinnings of Reclamation law and was not changed by RRA.<sup>128</sup>

While the final rules adopted in 1987 do not fully carry out that obligation, they do at least give a nod to the capital component. They provide that if a district's contract rate, less the O & M costs of delivering water, is positive when the district amends its contract to conform with the RRA, that positive difference must still be paid annually to the United States to cover capital costs, in addition to any adjusted O & M costs.<sup>129</sup> If the contract rate is equal to or less than O & M costs, however, the rate will be increased only to cover O & M costs, and no additional payments to cover capital costs will be required.<sup>130</sup> Although this change pays lip service to the mandate to collect full repayment of capital costs, it continues to allow many districts to pay a rate that falls short of the requirement. Indeed, it rewards those districts that were contributing the least to capital repayment.

#### (4) *Involuntary Foreclosures*

Under the RRA, land that exceeds 160 acres and is sold after the expiration of a recordable contract must be sold at a price approved by the Secretary of the Interior.<sup>131</sup> Additionally, it must carry a ten-year deed covenant restricting resale at a price higher than that approved by the Secretary.<sup>132</sup> During the RRA debates, some bankers and large landowners hoped Congress would grant an exemption from this deed covenant restriction for formerly excess land that is subject to involuntary foreclosure.<sup>133</sup> While they did not succeed, a new battle was waged over

128. BUREAU OF RECLAMATION, U.S. DEP'T OF INTERIOR, ENVIRONMENTAL ASSESSMENT, PROPOSED RULEMAKING FOR ACREAGE LIMITATION 6 n.3 (1986) [hereinafter ENVIRONMENTAL ASSESSMENT].

129. 43 C.F.R. § 426.8 (1987).

130. *Id.* The final rules give the following example:

A district amends its water service contract for the sole purpose of conforming to the discretionary provisions. Prior to its amendment, the district's contract obligated it to pay a rate of \$3.00 per acre-foot of water for the remaining 10 years of its 30-year contract. At the time of the contract amendment, the district's actual O & M costs are \$6.50 per acre-foot. Since the current contract rate of \$3.00 does not cover these O & M costs, the district's rate will be increased to \$6.50. If the district's O & M costs increase by \$.50 per acre-foot the following year, the district's rate would then be adjusted to \$7.00 per acre-foot.

*Id.*

131. § 209(a), 43 U.S.C. § 390ii(a) (1982).

132. *Id.*

133. See *Reclamation Reform Act Hearing, Transcript of Proceedings, Before the U.S.*

the issue during the 1987 rulemaking process because the language in the **RRA** is potentially ambiguous on this point.

The need for such a price restriction was explained by the Bureau in a report on the impacts of the final rules:

When excess land is sold with the expectation that it will be eligible to receive project water in the hands of the new owner, a covenant must be placed in the deed requiring Secretarial price approval on any resale of that land for a period of 10 years following the date of its sale from excess status. This covenant prevents the excess land buyer from reselling the land at fair market value and thereby reaping an unwarranted windfall based on the Federal investment in the land. This requirement discourages the buying of excess land for speculative profit and encourages the purchase of excess land by legitimate farmers.<sup>134</sup>

Restrictions on the sale price of excess land lie at the heart of reclamation law because they insure that large landholdings will be broken up, and that the benefits of the reclamation program will be distributed widely.<sup>135</sup> These goals were reaffirmed *explicitly* in the **RRA**.<sup>136</sup> Section 209(f) of the **RRA** requires that

[e]xcess lands which *have been* or *may be* disposed of in compliance with Federal reclamation law . . . shall not be considered eligible to receive irrigation water unless . . .

(2) in the case of disposals made after October 12, 1982, their title is burdened by a covenant prohibiting their sale, for a period of ten years after their original disposal to comply with Federal reclamation law . . . for values exceeding the sum of the value of newly added improvements and the value of the land as increased by market appreciation unrelated to the delivery of irrigation water.<sup>137</sup>

The intent of the **RRA** is that while truly *nonexcess* land can be sold at its full market value, *formerly excess* land cannot be sold above the secretarial-approved price by *anyone* for the ten-year period of the deed covenant. The radical change sought by certain commercial and financial interests was the ability to use legal processes such as foreclosure, deed in lieu of foreclosure, or "gifts," as a way to abolish or remove deed covenants before ten years has expired. Yet, Congress intended no such loophole in the **RRA**. Had Congress wished to provide a method by which deed covenants could be avoided, it would have added such language to section 209(f)(2).

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*Dep't of the Interior, Bureau of Reclamation 27-28* (Dec. 19, 1986) (statement of Rep. George Miller) (on file at *The Hastings Law Journal*).

134. ENVIRONMENTAL ASSESSMENT, *supra* note 128, at 5.

135. See *United States v. Tulare Lake Canal Co.*, 535 F.2d 1093, 1094 (9th Cir. 1976), *cert. denied*, 429 U.S. 1121 (1977).

136. See, e.g., H. REP. No. 458, 97th Cong., 2d Sess. 9 reprinted in 1982 CODE CONG. & ADMIN. NEWS 1267, 1268; 128 CONG. REC. 26,073 (statement of Rep. Udall).

137. § 209(f), 43 U.S.C. § 390ii(f) (1982) (emphasis added).

To understand the potential impact of allowing lenders and others to ignore the deed covenant, consider the potential opportunities for Southern Pacific Railroad, which, through subsidiaries, owns over 100,000 acres in the Westlands Water District in California.<sup>138</sup> Virtually all of this excess land has been under recordable contract since the 1960s and 1970s and therefore must be sold in the next few years.<sup>139</sup> The price will have to be approved by the Secretary and must not reflect the value of the Bureau water supply. But if Southern Pacific were to hold the new mortgage on each of these parcels of land, and then foreclose a few years later and resell the land at the full market value, theoretically it could circumvent the entire purpose of the recordable contract. By doing this, Southern Pacific (or any other excess landowner) still could obtain the full land value of the federal water supply after having enjoyed the benefit of subsidized Bureau water on its excess land for the last fifteen years.

Similarly, a landowner precluded from selling her excess land at full market value could take out a loan on the land for its full market value and then default on the loan. The bank then could turn around and sell the land for full market value, thus allowing both the defaulting owner and the bank to obtain full market value on the excess land in spite of the deed covenant. As the Bureau staff pointed out in an issue paper, this would permit an excess landowner to "captur[e] through a loan what the law does not allow through a sale."<sup>140</sup> The issue paper also noted that there is a likelihood of "cozy" foreclosures for speculative gain.<sup>141</sup> Moreover, the paper emphasized that removing deed covenants from involuntarily foreclosed land may loosen banks' lending policies so that "almost anyone, particularly nonfarmer investors or speculators, [can] become active participants in the bid for excess land, thereby reducing the likelihood that real farmers will be able to compete successfully for the land."<sup>142</sup>

To avoid such scenarios, the proposed regulations would have required that the ten-year deed covenant apply even in the event of involuntary foreclosure.<sup>143</sup> Nonetheless, numerous banks and water users

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138. A "Multiple Ownership Report of Landholdings" submitted on April 19, 1987 by Southern Pacific's parent company, Sante Fe-Southern Pacific Corporation, listed 112,176.20 acres in reclamation districts, including 103,292.27 acres in Westlands (document on file at *The Hastings Law Journal*).

139. In fact, Southern Pacific recently announced its intention to begin selling these lands. See Johnson, *Subsidies Gush from Loophole*, *Sacramento Bee*, Oct. 11, 1987, at A1, col. 1.

140. BUREAU OF RECLAMATION, U.S. DEP'T OF THE INTERIOR, ISSUE PAPER No. 2, at 2 (1986).

141. *Id.*

142. *Id.*

143. § 426.16(a)(2), 51 Fed. Reg. 40,771 (1986).

pressed hard to change the proposed rule. Eventually, in response to “concerns that the proposed rules did not comport with the language of the RRA and would limit the use of formerly excess land to support credit for legitimate farm operations,”<sup>144</sup> the Bureau backed away from the more restrictive proposed rules.

While the proposed rules would have allowed removal of the deed covenant solely for land used to secure an operational loan,<sup>145</sup> the final rules create an enormous loophole in the deed covenant restriction through the device of “involuntarily acquired land.” Specifically, sections 426.16 and 426.11(h)(2) provide that a deed covenant may be removed from land that is acquired involuntarily through foreclosure (or any similar involuntary process of law), conveyance in satisfaction of a debt (including, but not limited to, a mortgage, real estate contract, or deed of trust), inheritance, devise, or gift.<sup>146</sup> Once again, the final rules give in completely to the arguments made by financial interests and the largest landholders.

#### *(5) Reporting Requirements*

A final respect in which the Bureau has neglected its RRA obligations is in the collection of ownership and leasing data. One of the ways that Congress sought to reduce abuses in the reclamation program was by increasing the reporting requirements for reclamation beneficiaries. Thus, the RRA provides that “[a]ny contracting entity subject to the ownership or pricing limitations of federal reclamation law shall compile and maintain such records and information as the Secretary deems reasonably necessary to implement sections 390aa to 390zz-1 of this title and Federal reclamation law.”<sup>147</sup> The Secretary then issued “certification and reporting forms” for districts to collect from each water user.<sup>148</sup> Given that farming operations have exceeded the 160-acre limitation primarily through leasing arrangements, one would have expected the Bureau to use its authority to begin collecting lease data immediately. After meeting with water users, however, the Bureau decided to wait until 1987 before requesting leasing information from landowners in districts

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144. Dep’t of the Interior News Release 6 (Apr. 9, 1987) (on file at *The Hastings Law Journal*).

145. § 426.16, 51 Fed. Reg. 40,771 (1986).

146. §§ 426.11(h)(2), 426.16, 51 Fed. Reg. 40,771 (1986). Subsequently, the Bureau amended those rules to delete the term “gift.” 52 Fed. Reg. 39,918 (1987).

147. § 228, 43 U.S.C. § 390zz (1982).

148. See 43 C.F.R. § 426.10 (1987).

remaining under the old law,<sup>149</sup> again illustrating the Bureau's general reluctance to implement the RRA. This is particularly irresponsible given that the hammer clause went into effect in April 1987<sup>150</sup> and, therefore, the Bureau needed, at a minimum, complete leasing' data from 1986 (compiled and analyzed) to carry out its mandate under that clause.

### C. Reaction to the 1987 Final Rules

Congressional and editorial reaction to the final 1987 rules was indignant. Representative Miller, chairman of the subcommittee with oversight of the Bureau, criticized the regulations as having "severely undermined the 1982 law in many respects by permitting the use of trusts, farm management arrangements and other devices to circumvent the acreage limitation."<sup>151</sup> On June 26, 1987, the House of Representatives passed an appropriations amendment in response to the final rules designed to protect the good features of the RRA from "the greed of the few, and the complicity of the Bureau of Reclamation and the Interior Department in that evasion of the intent of the law."<sup>152</sup> Congressman Miller stated that the amendment was "necessitated by the unbelievable allegation of the Commissioner of Reclamation that he has no responsibility to enforce the intent of reclamation law."<sup>153</sup> Although that measure was revised by a House-Senate Conference Committee, the final language in the Omnibus Budget Reconciliation Act enacted significant, though limited, amendments to the RRA that should close some loopholes and tighten overall enforcement capabilities.<sup>154</sup> Unfortunately, the Bureau's new rules to implement the 1987 amendments also are flawed, reflecting a continued refusal to carry out congressional intent with any vigor.<sup>155</sup> Thus, despite the progress in the 1987 amendments, much remains to be done to carry out the mandate of the 1982 Act.

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149. Water and Agribusiness Newsletter, Jan. 25, 1985, at 3 (on file at The *Hastings* Law Journal).

150. § 203(b), 43 U.S.C. § 390cc(b).

151. 133 CONG. REC. H5450 (daily ed. June 24, 1987) (statement of Rep. Miller).

152. *Id.*

153. *Id.*

154. Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 5302(a), 100 Stat. 1330 (1987) (codified at 43 U.S.C. §§ 390nn, 390ww (Supp. 1988)). The amendments in § 5302 clarify that full cost must be paid for water delivered to any land under recordable contracts that are more than ten years old and that revocable trusts are not covered by the RRA's acreage limitation exemption for trusts. They also require the Bureau to audit all farm operations, collect all underpayments and past due water charges with interest, and report to Congress annually about the progress of the agency's enforcement efforts.

155. The final rules implementing the 1987 amendments were issued on December 16, 1988. 53 Fed. Reg. 50,530 (1988).

#### IV. Recommendations

The Bureau can and should do a number of things to correct its misinterpretation and betrayal of the RRA. First, and foremost, the Bureau should go back to the proposed rules of November 1986 and renew its earlier effort to carry out the intent and purpose of the RRA. Without a departmental commitment to effectuate congressional intent, any rulemaking inevitably will be flawed.

Second, the Bureau should consider carefully the existing rules of the United States Department of Agriculture (USDA) governing the crop subsidy program.<sup>156</sup> The crop subsidy program and the reclamation program have similar limitations and often apply to the same farmers. Consequently, many of the methods used to evade the subsidy limitations of the USDA are similar to the paper farming scams used to circumvent the reclamation limitations. The USDA regulations, however, are more successful in policing abuse. For example, they require that trusts for minor children not be treated as separate "persons" for purposes of the subsidy limitation unless the child's parents take no part in the operation of the child's farm and own no interest in the **farm**;<sup>157</sup> they strictly limit the use of farm operating agreements (referred to as "custom farming" arrangements) to avoid the subsidy **limits**;<sup>158</sup> and they have an explicit penalty for the use of any "scheme or device" to evade the **rules**.<sup>159</sup> In sum, while the USDA regulations, like the Bureau's proposed 1986 regulations, would not be completely satisfactory in carrying out the RRA's flat limitation on subsidies, they provide a far superior starting point than the Bureau's discredited final rules of 1987.

A third measure that could help improve the Bureau's enforcement of the RRA would be the restoration and expansion of the Bureau's Acreage Limitation Branch. Until the drafting of the final 1987 rules, this unit of the Bureau, which employed the agency's top experts on reclamation law and acreage limitations, was responsible for drafting and implementing all rules under the RRA. When the Branch's proposed 1986 rules caused an uproar among the regulated water users, however, the political appointees of the department simply removed the Branch from any further decisionmaking on the rules. Instead, the final rules were written by political appointees in Sacramento and Washington, and their staffs, whose views were closer to those of the regulated commercial interests. In June 1988, the Branch was dissolved-altogether and its di-

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156. See 7 C.F.R. § 795.1-.24 (1988).

157. *Id.* §§ 795.9, 795.12.

158. *Id.* § 795.16.

159. *Id.* § 795.17.

rector transferred to an entirely new field. Despite a chorus of protests from the oversight committees in Congress,<sup>160</sup> this blatant retaliation was allowed. As a result the Bureau is finding virtually no violations or improprieties under the RRA even when auditing large scale farming operations that have not increased their **rates**.<sup>161</sup> Restoring an experienced enforcement branch beyond the reach of political appointees and giving it the necessary staff for serious enforcement are essential to giving the RRA's pricing and acreage limits any meaningful effect.

Finally, if the Bureau, despite the RRA's manifest legislative intent, persists in the belief that problems in the law prevent it from carrying out that congressional intent, the Bureau should seek legislative amendments from Congress rather than simply evading the congressional intent to serve western water users.

### Conclusion

In developing final rules to implement the RRA, the Bureau has sided repeatedly with the large-scale farming interests, who receive the largess of federal water subsidies, instead of carrying out its clear enforcement obligations. Indeed, the Environmental Assessment, released by the Bureau with the final 1987 rules, admits that the decision to reject the Bureau's own proposed rules and to adopt rules advocated by western agribusiness will cost the taxpayers more money, allow farmers more ways to avoid full cost pricing, and, most appalling of all, primarily benefit only four hundred and fifty-six of the largest farm operations, which are located almost exclusively in two of the seventeen reclamation states.<sup>162</sup>

The final rules adopted by the Bureau defy the intent and the mandate of the RRA. Even more troubling, the entire revision of the proposed rules reflects the Bureau's willingness to abandon all hope of carrying out the goals of the RRA, giving large growers the benefit of every doubt, especially every opportunity to avoid full cost pricing. Any hope that the Bureau would use the RRA to limit subsidies to the origi-

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160. See, e.g., Letter from Representatives George Miller, Sam Gejdenson, and Patricia Schroeder to Secretary Donald Hodel (June 16, 1988) (on file at *The Hastings Law Journal*); Letter from Senator Bill Bradley to Secretary Donald Hodel (May 16, 1988) (on file at *The Hastings Law Journal*).

161. See, e.g., Memorandum from Assistant Regional Director, Bureau of Reclamation, Sacramento, California, to Deputy Commissioner of Reclamation (Aug. 15, 1988) (entitled *Audit & Farming Operations Identified by Don Villarejo—Reclamation Reform Act (RRA)*) (on file at *The Hastings Law Journal*).

162. BUREAU OF RECLAMATION, U.S. DEP'T OF THE INTERIOR, ACREAGE LIMITATION ENVIRONMENTAL ASSESSMENT 17-26 (Apr. 8, 1987).

nally intended beneficiaries was undermined by the final **1987** rules. For the Bureau to restore any public faith in its ability, and commitment, to enforce limits on taxpayer subsidies, an entire change in its approach is needed.