OVERSIGHT OF THE U.S. DEPARTMENT OF AGRICULTURE DEBT COLLECTION

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

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OVERSIGHT OF THE U.S. DEPARTMENT OF AGRICULTURE DEBT COLLECTION

MONDAY, MARCH 30, 1998

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2247, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representative Horn.

Staff present: J. Russell George, staff director and chief counsel; Mark Brasher, senior policy director; John Hynes, professional staff member; Matthew Ebert, clerk; and Mark Stephenson, minority professional staff member.

Mr. HORN. The hearing of the Subcommittee on Government Management, Information, and Technology will come to order.

Today we will examine the implementation of a bipartisan law, the Debt Collection Improvement Act of 1996. This law was a cooperative effort of Congress and the administration designed to improve debt collection procedures and practices in the credit agencies. We will examine the loan programs and debt collection efforts at the Department of Agriculture.

The Department of Agriculture is a very important part of our Federal Government, one of the oldest Cabinet departments. Its loan programs provide many benefits in rural America. It has the most varied programs and probably holds the most varied debts of any Federal department. It holds 40 percent of the loans receivable owed to the Federal Government, over $100 billion.

The Debt Collection Improvement Act has not met its promise, as agencies have not implemented the law which Congress passed in April 1996, almost 2 years ago. Still, the law will have a beneficial effect once implemented. There are powerful tools included in the act. They include: administrative offsets to intercept the payments owed to a delinquent debtor; the use of private collection agencies to assist in the collection of delinquent debts; and wage garnishment.

According to information provided by the Department of the Treasury, the Department of Agriculture accounts for 20 percent of the delinquent debts held by major credit agencies and almost 50 percent of the debts which have not yet been referred to the Department of the Treasury for collection action. It has also lagged in referring debts for administrative offsets.

These statistics establish the Department of Agriculture as a laggard, the laggard-in-chief, in fact, in the implementation of the Debt Collection Improvement Act. Of course, there are others, but we want to assure that each Federal agency takes advantage of the available tools to collect the delinquent debts owed the taxpayer.

Additionally, there is a reporting failure in our debt indicators. One bureau, the Rural Utility Service, lists only $50,000 in delinquent debts in a total portfolio of $35 billion or so. However, recent GAO reports have pointed out that many borrowers in the Rural Utility Service's electricity programs are financially troubled. The taxpayer is potentially at risk for $10 billion in losses to these troubled lenders in a program that has lost $1.5 billion in fiscal year 1996 and the first half of fiscal year 1997 through write-offs. We will examine this program. It was, unfortunately, below the radar screen until the General Accounting Office did its fine work.

The General Accounting Office will be represented by Linda Calbom. We appreciate her taking her time away from the audited financial statements, which we will deal with on Wednesday. We will be having four hearings on that very valuable project during April.

We also have officials from the Department of Agriculture, who are attempting to rectify the deficiencies at the agency level, and we will welcome each witness.

Right now I will call forth panel one, which is the General Accounting Office, Ms. Linda Calbom, Director, Civil Audits, accompanied by Mr. Arthur Brouk, Senior Accountant; and Mr. McCoy Williams, Assistant Director, Accounting and Information Management.

[Witnesses affirmed.]

Mr. HORN. The clerk will note all three witnesses have affirmed the oath. Please proceed as you would like.

STATEMENT OF LINDA CALBOM, DIRECTOR, CIVIL AUDITS, ACCOMPANIED BY ARTHUR BROUK, SENIOR ACCOUNTANT; AND MCCOY WILLIAMS, ASSISTANT DIRECTOR, ACCOUNTING AND INFORMATION MANAGEMENT

Ms. CALBOM. Thank you.

Mr. Chairman, I am happy to be here today to testify on our risk assessment for the Rural Utility Service Electric Loan Portfolio. I am accompanied by Mr. McCoy Williams, who is the Assistant Director who led this segment of our work; and Mr. Art Brouk from our St. Louis office, who performed much of the analysis.

My testimony is based on a report we issued in September 1997, entitled Federal Electricity Activities: The Federal Government's Net Cost and Potential For Future Losses. As part of this report, we provided an assessment of the Federal Government's risk of future losses from the RUS electric portfolio, particularly given the onset of competition in the electricity industry.

Our assessment was generally based on the condition of the loan portfolio as of September 30, 1996. At that time, the electric portfolio totaled over $32 billion, or 75 percent of RUS's entire portfolio. Based on our recent discussions with RUS staff, we understand some changes have occurred since the date of our review. However, we believe our analysis of the portfolio risks is still valid.

My testimony today will focus on the findings from our September report concerning substantial write-offs of loans to rural electric cooperatives, likely additional losses from electricity loans that are considered to be financially stressed, and the potential for losses from loans that are currently considered viable that may become stressed in the future due to high production costs and competitive or regulatory pressures.

In the interest of time, I will only briefly summarize our findings in each of these three areas but ask that my testimony be submitted in its entirety for the record.

Mr. HORN. Without objection, your testimony and everybody's, once they are introduced, is automatically in the record.

Ms. CALBOM. Thank you.

During fiscal 1996 and through July 31, 1997, as you mentioned, Mr. Chairman, RUS wrote off approximately $1.5 billion of loans to rural electric cooperatives. The most significant loan write-offs were related to two generation and transmission cooperative borrowers, which I will refer to as G&Ts.

In fiscal year 1996, about $982 million of one G&T's loans was written off because the borrower was unable to sell its electricity at a price sufficient to service its RUS loans. This borrower had high costs due to an investment in an uneconomical nuclear plant. In the early part of fiscal year 1997, loans to another G&T were written off for a loss of about $502 million because the borrower was unable to recover costs for a coal-fired generating plant built to satisfy a demand that did not materialize.

It is probable that RUS will have additional loan write-offs in the short-term from borrowers that had been identified as financially stressed by RUS management. At the time of our review, RUS reports indicated that about $10.5 billion, as you mentioned, was owed by 13 financially stressed G&T borrowers.

Attachment 1 on page 13 of my statement provides a listing and brief discussion of each of these borrowers. Of these 13, 4, with about $7 billion in outstanding debts, were in bankruptcy. The remaining nine had investments in uneconomical generating plants and/or had formally requested financial assistance in the form of debt forgiveness from RUS.

Based on our recent discussions with RUS staff, we understand the most significant changes to this list since our review were a reduction of approximately $1.4 million in borrower A's debts, due to reversal of accrued interest disallowed by the bankruptcy court, and a partial repayment by borrower H of approximately $148 million and write-off of the remaining $165 million balance. In addition to these financially stressed loans, RUS had loans outstanding to G&T borrowers that were considered viable by RUS but which we believe may become stressed in the future due to high costs and competitive or regulatory pressures. We believe the future viability of these G&Ts will be determined based on their ability to be competitive in a deregulated electricity market.

In order to assess the ability of RUS G&T cooperatives to withstand competitive pressures, we focused on production costs for 33 viable G&T borrowers with loans outstanding of about $11.7 billion as of September 30, 1996. Our analysis showed that for the vast majority of these G&Ts, production costs were higher than inves-

tor-owned utilities and publicly owned generating utilities in their respective regional markets. The relatively high average production costs indicate that the majority of RUS G&T borrowers may have difficulty competing in a deregulated market. Therefore, we believe it is probable that the Federal Government will eventually incur losses on some of these G&T loans.

Mr. Chairman, that concludes my statement. I would be happy to answer any questions at this time.

Mr. HORN. Well, we thank you.

[The prepared statement of Ms. Calbom follows:]

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to summarize the results of our work analyzing the Rural Utilities Service's (RUS) electric loan portfolio and the potential for future losses to the federal government from these loans. My testimony is based on our September 1997 report[1] on federal electricity activities, which discusses these issues in depth. Although the RUS portfolio contains electricity, telecommunications, and water and waste disposal loans, you asked that our testimony focus on electricity loans since they generally pose the greatest risk of loss to the federal government, particularly given the onset of competition in the electricity industry.

Deregulation of the electricity industry has led to wholesale competition, which, combined with other factors, has caused wholesale electricity prices to fall in many parts of the country. The increasingly competitive wholesale market and the financial vulnerability of the RUS borrowers have increased the risk of future losses the federal government faces. Thus, my testimony today will focus on the RUS electric loan portfolio and will discuss the findings from our September 1997 report concerning

[1]Federal Electricity Activities: The Federal Government's Net Cost and Potential for Future Losses (GAO/AIMD-97-110 and 110A, Sept. 19, 1997).

- substantial write-offs of loans to rural electric cooperatives;
- likely additional losses to the federal government from loans to financially stressed[2] borrowers; and
- the potential for future losses from viable loans that may become stressed in the future due to high production costs and competitive or regulatory pressures.

I would like to begin my testimony by providing a brief background on the history and purpose of RUS. I will then discuss our risk assessment of the electric loan portfolio. Our assessment was generally based on the condition of the portfolio as of September 30, 1996; therefore, changes may have occurred since the date of our review.

BACKGROUND

The U.S. Department of Agriculture (USDA) is the federal government's principal provider of loans used to assist the nation's rural areas in developing their utility infrastructure. Through RUS, USDA finances the construction, improvement, and repair of electrical, telecommunications, and water and waste disposal systems. RUS provides credit assistance through direct loans and through repayment guarantees on loans made by other lenders. Established by the Federal Crop Insurance Reform and the Department of Agriculture Reorganization Act of 1994, RUS administers the electricity and

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[2]Borrowers classified by RUS as financially stressed have defaulted on their loans, had their loans restructured but are still experiencing financial difficulty, declared bankruptcy, or have formally requested financial assistance from RUS.

telecommunications programs that were operated by the former Rural Electrification Administration (REA)[3] and the water and waste disposal programs that were operated by the former Rural Development Administration (RDA). As of September 30, 1996, which was the most recent information available to us at the time of our review, RUS' entire portfolio of loans–including direct and guaranteed electricity, telecommunications, and water and waste disposal loans–totaled $42.5 billion.[4] Electricity loans made up over $32 billion, or 75 percent of this total.

Most of the RUS electric loans and loan guarantees were made during the late 1970s and early 1980s. For example, from fiscal years 1979 through 1983, RUS approved loans and loan guarantees of about $29 billion, whereas during fiscal years 1992 through 1996, it approved a total of about $4 billion in electric loans and loan guarantees. RUS electricity loans were made primarily to rural electric cooperatives; more than 99 percent of the borrowers with electricity loans are nonprofit cooperatives. These cooperatives are either Generation and Transmission (G&T) cooperatives or distribution cooperatives. A G&T cooperative is a nonprofit rural electric system whose chief function is to produce and sell electric power on a wholesale basis to its owners, who consist of distribution

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[3]The Rural Electrification Act of 1936, as amended (7 U.S.C. 901 et seq.), provides the basic statutory authority for the electricity and telecommunications programs, including the authority for loans to be made by the Federal Financing Bank.

[4]For a further discussion of the financial condition of the entire RUS portfolio, as of September 30, 1996, see our report Rural Development: Financial Condition of the Rural Utilities Service's Loan Portfolio (GAO/RCED-97-82, April 11, 1997).

cooperatives and other G&T cooperatives. A distribution cooperative sells the electricity it buys from a G&T cooperative to its owners, the retail customers.

As of September 30, 1996, the bulk of the electric loan portfolio was made up of loans to the G&Ts. The principal outstanding on these G&T loans was approximately $22.5 billion, about 70 percent of the portfolio. Distribution borrowers made up the remaining 30 percent of the electric portfolio. At the time of our review, there were 55 G&T borrowers and 782 distribution borrowers. Our review focused on the G&T loans since they make up the majority, in terms of dollars, of the portfolio and generally pose the greatest risk of loss to the federal government.

The federal government incurs financial losses when borrowers are unable to repay the balance owed on their loans and the government does not have sufficient legal recourse against the borrower to recover the full loan amount. In all instances, G&T loans are collateralized; however, RUS has never foreclosed on a loan. RUS generally has been unable to successfully pursue foreclosure once the borrower files for bankruptcy because the borrower's assets are protected until the proceedings are settled. In addition, in recent cases where debt was written off, the government forgave the debt and therefore did not attempt to pursue further collection.

SUBSTANTIAL LOAN WRITE-OFFS

OCCURRED IN RECENT YEARS

Under Department of Justice (DOJ) authority, during fiscal year 1996 and through July 31, 1997, RUS wrote off about $1.5 billion of loans to rural electric cooperatives. The most significant write-offs relate to two G&T loans. In fiscal year 1996, one G&T made a lump sum payment of $237 million to RUS in exchange for RUS writing off and forgiving the remaining $982 million of its RUS loan balance. The G&T's financial problems began with its involvement as a minority-share owner in a nuclear project that experienced lengthy delays in construction as well as severe cost escalation. When construction of the plant began in 1976, its total cost was projected to be $430 million. However, according to the Congressional Research Service, the actual cost at completion in 1987 was $3.9 billion as measured in nominal terms (1987 dollars). These cost increases are due in part to changes in Nuclear Regulatory Commission health and safety regulations after the Three Mile Island accident. The remaining portion is generally due to inflation over time and capitalization of interest during the delays. The borrower defaulted in 1986, had its debt restructured in 1993, and finally had its debt partially forgiven in September 1996. This borrower is no longer in the RUS program.

In the early part of fiscal year 1997, another G&T borrower made a lump sum payment of approximately $238.5 million in exchange for forgiveness of its remaining $502 million loan balance. The G&T and its six distribution cooperatives borrowed the $238.5 million

from a private lender, the National Rural Utilities Cooperative Finance Corporation. The G&T had originally borrowed from RUS to build a two-unit coal-fired generating plant and to finance a coal mine that would supply fuel for the generating plant. The plant was built in anticipation of industrial development from the emerging shale oil industry. However, the growth in demand did not materialize, and there was no market for the power. Although the borrower had its debt restructured in 1989, it still experienced financial difficulties due to a depressed power market. RUS and DOJ decided that the best way to resolve the matter was to accept a partial lump sum payment on the debt rather than force the borrower into bankruptcy. The borrower and its member distribution cooperatives are no longer in the RUS program.

ADDITIONAL LOSSES FROM FINANCIALLY STRESSED G&T LOANS ARE PROBABLE IN THE SHORT TERM

It is probable that RUS will have additional loan write-offs and therefore that the federal government will incur further losses in the short term from loans to borrowers that have been identified as financially stressed by RUS management. At the time of our review, RUS reports indicated that about $10.5 billion of the $22.5 billion in G&T debt was owed by 13 financially stressed G&T borrowers.[5] Of these, 4 borrowers with about $7 billion

[5]In our previous report, Rural Development: Financial Condition of the Rural Utilities Service's Loan Portfolio (GAO/RCED-97-82, April 11, 1997), we noted 12 G&T and distribution borrowers that were delinquent or in financial distress. However, in this

in outstanding debt were in bankruptcy. The remaining 9 borrowers had investments in uneconomical generating plants and/or had formally requested financial assistance in the form of debt forgiveness from RUS. According to RUS officials, these plant investments became uneconomical because of cost overruns, continuing changes in regulations, and soaring interest rates. These investments resulted in high levels of debt and debt-servicing requirements, making power produced from these plants expensive. (See attachment 1 for a list and brief discussion of these borrowers.)

Since cooperatives are non-profit organizations, there is little or no profit built into their rate structure, which helps keep electric rates as low as possible. However, the lack of retained profit generally means the cooperatives have little or no cash reserves to draw upon. Thus, when cash flow is insufficient to service debt, cooperatives must raise electricity rates and/or cut other costs enough to service debt obligations. If they are unable to do so, they may default on their government loans.

This was the scenario for the previously discussed write-offs in fiscal year 1996 and through July 31, 1997. Additional write-offs are expected to occur. For example, according to RUS officials, at the time of our review, the agency was considering writing off as much as $3 billion of the total $4.2 billion debt owed by Cajun Electric, a RUS

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testimony, as in our September 1997 report, we discuss 13 financially stressed G&T borrowers identified by RUS management. The primary difference is that this testimony and our September 1997 report do not include one financially stressed distribution borrower, but did include two borrowers that have officially requested financial assistance.

borrower that has been in bankruptcy since December 1994. Cajun Electric filed for bankruptcy protection after the Louisiana Public Service Commission disapproved a requested rate increase and instead lowered rates to a level that reduced the amount of revenues available to Cajun to make annual debt service payments. Several factors contributed to Cajun's heavy debt, including its investment in a nuclear facility which experienced construction cost overruns and its excess electricity generation capacity resulting from overestimation of the demand for electricity in Louisiana during the 1980s.

SOME LOSSES FROM LOANS CONSIDERED VIABLE ARE PROBABLE IN THE FUTURE

In addition to the financially stressed loans, RUS had loans outstanding to G&T borrowers that were considered viable by RUS but may become stressed in the future due to high costs and competitive or regulatory pressures. We believe it is probable that the federal government will eventually incur losses on some of these G&T loans.

We believe the future viability of these G&T borrowers will be determined based on their ability to be competitive in a deregulated market. In order to assess the ability of RUS

cooperatives to withstand competitive pressures, we focused on production costs[6] for 33 of the 55 G&T borrowers with loans outstanding of about $11.7 billion as of September 30, 1996. We excluded 9 G&Ts that only transmit electricity and the 13 financially stressed borrowers discussed above. Our analysis showed that for 27 of the 33 G&T borrowers, production costs were higher in their respective regional markets than investor-owned utilities, and that for 17 of the 33, production costs were higher than publicly-owned generating utilities. The relatively high average production costs indicate that the majority of G&Ts may have difficulty competing in a deregulated market. RUS officials told us that several borrowers have already asked RUS to renegotiate or write off their debt because they do not expect to be competitive due to high costs. RUS officials stated that they will not write off debt solely to make borrowers more competitive.

As with the financially stressed borrowers, some of the G&T borrowers considered viable by RUS at the time of our work had high debt costs because of investments in uneconomical plants. In addition, according to RUS officials, there are two unique factors that cause cost disparity between the G&Ts and their competition. One factor is the sparser customer density per mile for cooperatives and the corresponding high cost of providing service to the rural areas. A second factor has been the inability to refinance higher cost Federal Financing Bank (FFB) debt when lower interest rates have prevailed. However, RUS officials said that recent legislative changes which enable cooperatives to

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[6]As a surrogate for production costs, we used average revenue per kilowatthour (kWh) for wholesale sales (sales for resale), which is explained in detail in our September 1997 report.

refinance FFB debt with a penalty may help align G&T interest rates with those of the investor-owned utilities.

In the short term, G&Ts will likely be shielded from competition because of the all-requirements wholesale power contracts between the G&T and their member distribution cooperatives. With rare exceptions, these long-term contracts obligate the distribution cooperatives to purchase all of their respective power needs from the G&T. In fact, RUS requires the terms of the contracts to be at least as long as the G&T loan repayment period. However, wholesale power contracts have been challenged recently in the courts by several distribution cooperatives because of the obligation to purchase expensive G&T power. According to RUS officials, one bankrupt G&T's member cooperatives challenged their wholesale power contracts in court in order to obtain less expensive power. RUS officials believe that the long-term contracts will come under increased scrutiny and potential renegotiation or court challenges as other sources of less expensive power become available.

Wholesale rates under these contracts are set by a G&T's board of directors with approval from RUS. In states whose commissions regulate cooperatives, the cooperative must file a request with the commission for a rate increase or decrease. Several of the currently bankrupt borrowers were denied requests for rate increases from state commissions. However, RUS officials indicated they do not expect G&Ts to pursue rate increases as a means to recover their costs because of the recognition of declining rates in a

competitive environment. RUS officials also acknowledge that borrowers with high costs are likely to request debt forgiveness as a means to reduce costs in order to be competitive in the future.

As discussed above, denials of requested rate increases by state commissions culminated in several G&Ts filing for bankruptcy. Eighteen of the RUS G&T borrowers operate in states where regulatory commissions must approve rate increases. These commissions may deny a request for a rate increase if they believe such an increase will have a negative impact on the region. According to RUS officials, some commissions have denied a rate increase to cover the cost of projects that the commission had previously approved for construction. Therefore, G&Ts with high costs may be likely candidates to default on their RUS loans, even without direct competitive pressures.

In summary, in the last several years, through July 1997, RUS has experienced loan write-offs of $1.5 billion. Additional write-offs related to the $10.5 billion in loans identified by RUS as financially stressed as of the time of our review are likely in the near term. And finally, RUS has loans outstanding to G&T borrowers that are currently considered viable by RUS that may become stressed in the future due to high production costs and competitive or regulatory pressures. We believe it is probable that the federal government will incur losses eventually on some of these G&T loans. The future viability of these G&T loans will be determined based in part on the RUS cooperatives' ability to be competitive in a deregulated market.

Mr. Chairman, that concludes my statement. I would be happy to answer any questions you or other Members of the Subcommittee may have.

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The following is a list and brief discussion of each of the 13 financially stressed G&T borrowers. This information is as of September 30, 1996; therefore, changes may have occurred subsequent to our review.

Table 1: RUS Financially Stressed G&T Cooperatives, as of September 30, 1996

(Dollars in millions)

Borrower	Total debt outstanding
Borrower A[a,b]	$1,619.6
Borrower B	167.9
Borrower C	103.2
Borrower D[b]	562.3
Borrower E[b]	183.3
Borrower F[a,b]	1,101.2
Borrower G[a,b]	4,154.8
Borrower H[b]	313.4
Borrower I[b]	354.8
Borrower J	1,070.7
Borrower K	445.1
Borrower L	351.7
Borrower M[a]	92.8
Total debt	**$10,520.8**

[a]Cooperative in bankruptcy.
[b]State regulated cooperative.

 ATTACHMENT I

Borrower A: Invested in construction of a nuclear plant that experienced cost overruns and was never completed. The state commission denied rate increases to cover the cost of the cooperative's investment in the plant. The borrower defaulted on its loan in 1984 and declared bankruptcy in 1985. The bankruptcy proceedings have been in court for 12 years and are still not completely resolved.

Borrower B: Made an investment in a nuclear plant that proved to be uneconomical. While this borrower does not appear to be currently experiencing financial difficulties, RUS considers them financially stressed because they have formally requested financial assistance due to impending competitive pressures.

Borrower C: Made an investment in a nuclear plant that proved to be uneconomical. While this borrower does not appear to be currently experiencing financial difficulties, RUS considers them financially stressed because they have formally requested financial assistance due to impending competitive pressures.

Borrower D: Uses primarily coal-fired generation. The borrower overbuilt due to anticipated growth in electricity demand that did not occur. During construction of a new plant, economic conditions in the area changed and demand for electricity dropped, which resulted in less revenue than predicted from the plant. The cooperative was repeatedly denied rate increases to cover the cost of its plants by the state commission.

Borrower E: Has a small percentage share in a nuclear plant that proved to be uneconomical. The borrower has substantially higher electricity rates than the investor-owned utilities in its region. The cooperative has been denied rate increases to cover its losses by the state commission. Although the borrower has had some of its debt refinanced, it is still experiencing financial difficulties.

Borrower F: A G&T with primarily coal-fired generating plants that overbuilt due to anticipated industrial growth related to two large aluminum smelting companies. When aluminum prices dropped in the early 1980s, the companies threatened to move their operations if the cooperative did not lower electricity rates. The state commission denied rate increases over the fear of losing these industries. RUS restructured the borrower's debt in 1987 and 1990. The cooperative filed for bankruptcy in September 1996 because its other creditors were unwilling to negotiate.

Borrower G: Built a coal-fired plant and invested in a nuclear plant in the mid-1970s which was completed late and experienced construction cost overruns. Several factors contributed to the cooperative's heavy debt, including excess electricity generation construction resulting from overestimation of the demand for electricity during the 1980s. The new capacity was intended to serve a growth in demand that did not materialize. The state commission disapproved a rate increase and instead lowered rates to a level which precluded full debt service coverage. The commission also refused to support a

restructuring agreement that included a significant RUS loan write-off.[7] The rate increase was requested by the cooperative because of its high costs. The borrower filed for bankruptcy in December 1994.

Borrower H: Invested in construction of a nuclear plant that proved to be uneconomical. The project was completed 10 years late and over budget. In addition, there was a dramatic drop in the demand for electricity in the cooperative's service area, and the state commission would not allow rate increases to recover capital investment. The borrower had its debt restructured in 1987; however, it is requesting additional financial assistance due to anticipated competitive pressure. A final settlement between RUS and the borrower was reached in June 1997. The borrower was expected to receive a write-off of $165 million. The final payment and related debt write-off were scheduled to occur December 30, 1997.

Borrower I: Invested in a clean-burning coal plant that experienced severe cost overruns. The borrower has substantially higher electricity rates than the investor-owned utilities in its region. The state commission has denied the cooperative's request for rate increases. The borrower had some of its debt refinanced, but it is still experiencing financial difficulty.

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[7]In states that regulate cooperatives, the state commission must approve restructuring agreements between the cooperative and its creditors.

Borrower J: Invested in a nuclear plant that proved to be uneconomical. The plant was completed late, which resulted in cost overruns. As a result, the cooperative's wholesale power rates are very high. The borrower has requested debt restructuring due to its high cost of production and anticipated competitive pressure.

Borrower K: Invested in a nuclear plant that proved to be uneconomical. The plant was completed late, which resulted in severe cost overruns. The cooperative's wholesale power rates are very high, which has resulted in extreme unrest in the member distribution cooperatives. The borrower is surrounded by investor-owned utilities with lower wholesale rates. In addition, the borrower's system is very difficult and expensive to maintain and experiences frequent power outages. The borrower has requested financial assistance because of anticipated competitive pressure.

Borrower L: Invested in a nuclear plant that proved to be uneconomical. The plant was completed late, which resulted in severe cost overruns. The cooperative has only five member distribution cooperatives, which makes it difficult to cover its high production costs. This borrower chose not to declare bankruptcy and is seeking financial assistance. This borrower has refinanced its debt to lower its interest rate, but is still experiencing financial difficulty and has requested additional financial assistance.

Borrower M: Invested in a nuclear plant that proved to be uneconomical. In addition, the cooperative had a stagnant customer base in the 1980s. RUS tried to negotiate a restructuring agreement, but the state commission denied two separate plans. In April 1996, the borrower filed for bankruptcy.

Mr. HORN. I noticed, just to go to your testimony a minute, on page 6, about the fifth line from the top, you noted that in this one particular case that the growth and demand simply did not materialize and there was no market for the power. I guess I am wondering, did you ever take a look at some of the projections that were given in their application for the Department of Agriculture funding, loan—whatever you want to call it—and were they just off the mark completely or what happened?

I realize the high interest cost of the 1970's. That was laid out pretty well. But what about that particular situation?

Ms. CALBOM. We did not look at the application process or the origination process as part of the work that we did in this report, but that is certainly something we would be happy to follow up on.

Mr. HORN. Well, I was just curious.

The other thing I noticed in the departmental submissions is that we face the problem where you have a Federal entity that has to depend on the State commission in terms of its rate structure. Did GAO look at the legislative history on this at all? Is that something we knew from the beginning?

And, if so, I wonder why—and I am going to ask, obviously, the departmental officials that—but I was just curious if you had an overview as to how we ever got into having the future of an instrumentality of the Federal Government depending on the actions of a State commission.

I thought *McCulloch* v. *Maryland* settled that a few hundred years ago. But have you looked at all on the legislative history of that?

Ms. CALBOM. That, again, was not something looked at, but I do share your concern. There was at least one of these plants where the State approved the building of the actual plant and yet then disallowed a rate increase requested by the G&T.

Mr. HORN. Have you had a chance to read the Department of Agriculture's audited financial statements in the particular area of the Rural Utility Service?

As you know, we are going to look at those consolidated statements this Wednesday. Did you have a chance to look at the Department's audited financial statement in relation to the Rural Utility Service?

Ms. CALBOM. We did take a look at both the 1996 statement and at the 1997 work that was performed by the IG, although the 1997 report, as you know, is not out yet.

Mr. HORN. Well, how did the Rural Utility Service fare in the audited financial statement of the Department?

Ms. CALBOM. They show up with about $5 billion in reserve for losses on these particular problem loans that we have been talking about. Since 1994, the IG has given a qualified opinion to Rural Development, which RUS is part of, and that qualified opinion relates to the inability of the Department to properly implement credit reform.

Mr. HORN. That $5 billion you found, do you think that is adequate for what faces the Rural Utility Service?

Ms. CALBOM. The IG did an analysis of the adequacy of that reserve. We did look at their work, and I believe their conclusion was that they felt it was adequate.

Mr. HORN. Did they specify the time period for that $5 billion in losses to be recognized?

Ms. CALBOM. I don't believe that was specified.

Art, do you know?

Mr. BROUK. No. And what is important to note on the $5 billion, that it is presented on a present value basis. So it depends exactly when they project the loss. And a lot of these, the write-offs, are pretty hard to project when exactly they will occur in the future.

Mr. HORN. Give me a little definition here on "present value" and at what point that kicks in. Does it kick in when they are about to be delinquent or what?

Mr. BROUK. It kicks in when you set up the allowance account, because it is the present value of future cash-flows. So it is very important to determine when in the future the write-offs—and then, they spread it out over whenever the write-off is going to occur, then bring it back to the present value.

Ms. CALBOM. Even though these loans are precredit reform and they are not required to report them under credit reform, as you know, so the subsidies do not show up that way, they do have the option to go ahead and restate them in a similar present value manner, as is required under credit reform, which, in essence, requires you to record them at the present value.

In other words, discount back to today your expected cash-flows going out into the future. So they would have had to make some projections of cash flows in doing that analysis, but we just don't have that information.

Mr. HORN. So you didn't look at the analysis to see if it is credible?

Ms. CALBOM. What we did is we used the work of the Inspector General, who did look at that analysis. Now, again, the Inspector General qualified, or we expect they will qualify, their opinion related to Rural Development because of the inability to properly implement credit reform.

That has been the situation since 1994, and a lot of that relates to the lack of good historical data on which to base those cash-flow estimates.

Mr. HORN. Well, I see we don't have the Inspector General on our list here of witnesses so we might have to interview him separately on this.

As I look at that summary chart you attached to your testimony on the first part of attachment 1, page 13, what you have here are the 13 borrowers that you are labeling A through M. And borrower A has a $1.6 billion problem on debt outstanding, and then borrower F has a $1.1 billion problem, borrower G is the all-time high at $4.1 billion, and then borrower J at roughly a little more than $1 billion.

Now, borrower A is a nuclear facility, borrower F is a coal facility, and the $4.1 of borrower G is both coal and nuclear at various points in time, and borrower J is nuclear. Most of these are nuclear, in fact, 4 of the 13 are three-fourths of the default out of the 13. Then, we have a substantial number, nine, plus one in a mixed mode, on the nuclear basis.

Did you have a chance or has GAO ever had other looks at nuclear power facilities in this country? Is that just what we are to

expect with a nuclear facility, as opposed to perhaps coal? Although coal sure hits the top two here.

It just seems the whole estimations were not in tune with reality, and I guess the question is: did they know it when they loaned the money?

Ms. CALBOM. Again, we didn't do a lot of in-depth analysis at that level, but my understanding is that a lot of those nuclear plants were being built when regulations were changing, and that is one of the explanations that was given. But we really didn't do a real analysis.

Mr. HORN. There is no doubt costs go up. If they have to abide by State regulations, it is a major problem, because the costs just escalate, whether it is in the private sector or the public sector, in this case, although this is sort of a mixed bag as to what sector they are in.

It seems they have to do just about what any nuclear plant—Illinois has been fairly successful, I believe—does do. I guess I would say any enlightenment GAO can have on any other studies they have done, we would appreciate it.

I take it in terms of this present value it has been inflation adjusted. Is that all it amounts to on the present value?

Ms. CALBOM. In essence. You, in effect, try to state in today's dollars what the expectation is. So you are correct.

Mr. HORN. On your examples, let us take borrower G, which is the big one, at a $4.1 billion debt outstanding. When was their last payment?

Ms. CALBOM. I believe they have been in bankruptcy since, when is it?

Mr. BROUK. December 1994.

Ms. CALBOM. December 1994.

Mr. HORN. Would you say that is a delinquent debt owed the Federal Government?

Ms. CALBOM. I would say that is a delinquent debt, and there is an expectation of a $3 billion write-off in the fairly near term.

Mr. HORN. What does that mean in terms of the debt structure of the United States? They are declaring bankruptcy. Are we ever going to get anything out of this thing?

Ms. CALBOM. Well, to the extent that these loans are written off, and again $3 billion is expected in a write-off fairly soon, I believe, that is money that will never be recovered.

As you know, these troubled loans are precredit reform loans which means at the time they were recorded as outlays in the budget. However, there is an expectation that payments would be coming back. And, in essence, what we have is a permanent increase to the Federal debt because we won't be receiving the expected repayments.

Mr. HORN. You used the word bankruptcy. Have they filed for bankruptcy?

Ms. CALBOM. Yes, this borrower is in bankruptcy.

Mr. HORN. There is Cajun Electric; right?

Ms. CALBOM. Correct.

Mr. HORN. Are they still delivering power?

Ms. CALBOM. Yes, I believe they are.

Mr. HORN. Is this simply a write-down of the whole operation, or like office buildings around this country and this kind of thing? What does this boil down to in terms of reality daily? Do the customers get served with electricity, let's say?

Ms. CALBOM. The customers are being served with electricity in this case, yes.

Mr. HORN. Are the costs simply still going up, even if they are in bankruptcy? Is there a bankruptcy judge that is allocating who they owe money to in a write-off or whatever?

Ms. CALBOM. I am not sure what the bankruptcy situation is on that particular loan.

If you don't mind, Mr. Chairman, Mr. Tom Armstrong of our Office of General Counsel has some information.

Mr. HORN. You heard the oath and you, I take it, will affirm it?

Mr. ARMSTRONG. Yes, I will.

Mr. HORN. The clerk will note that. Yes.

Mr. ARMSTRONG. We haven't looked at the Cajun Electric situation in particular, but, generally, in a bankruptcy proceeding, a debtor, in his repayment of his debts, is protected by the court. The debt that the debtor owes the Federal Government is all going to be adjudged by the court, because the bankruptcy proceeding is basically the court offering its protection to the debtor and the debtor's repayment of his debts.

Operations of the entity, the bankrupt entity, generally continue, but the financing of those operations and what creditors get from debts that they are owed is all really at the discretion of the court.

Mr. HORN. You are saying the court treats the Federal Government no different than any other bankrupt, I take it?

Mr. ARMSTRONG. I am not an expert on the bankruptcy code, but I understand from law school, and it has been a few years, that the Federal Government does have certain priorities under the bankruptcy code. Now, where the Government's priorities are, particularly with the RUS loans, I am not sure.

Mr. HORN. Well, I guess what I would like to know is, are we still going further and further into debt? Obviously, we will ask the Department that, but I just wondered, in passing, if you know.

It is still operating. They are still serving various customers. They are under the jurisdiction of a bankruptcy court. Are they still likely to run up an even worse debt than they have now with that $4.1 billion?

Ms. CALBOM. I don't think that there is anything else being added to that debt. I don't believe that the Department has been providing additional funds to this borrower.

But one thing to note, there is a cost that continues to grow to the Federal Government, because interest that continues to accrue on the funds that the Federal Government provided to make that loan. Now, the borrower is in bankruptcy, so they don't have to pay that, but we calculate it as part of our work in this area, that the Federal Government is losing about $1 million a day as a result of this loan sitting there not being repaid.

Mr. HORN. Now, is this one loan or all the loans?

Ms. CALBOM. This one loan.

Mr. HORN. So the $4.1 billion, you are saying, boils down to another loss of $1 million a day?

Ms. CALBOM. Because you figure, as I said, if it doesn't get repaid, it becomes a permanent increase to the Federal debt. And, of course, interest continues to be a cost to the Federal Government on that Federal debt because the funds won't be provided to pay it back.

Mr. HORN. Does anything in their law give them the right to convert to a grant in terms of loans? Or you haven't checked that, I take it?

Mr. ARMSTRONG. We haven't checked that. I am not familiar with anything that would permit them to turn it into a grant.

Ms. CALBOM. But, in essence, the net impact is the same as if it were a grant.

Mr. HORN. My impression, over a half a century, is that Agriculture often does this, in terms of just granting it. Whether it be a loan or not, it somehow disappears.

So I am just curious, is anybody ever serious over there in terms of debt collection? It doesn't look like it, based on what the record finds. They aren't doing much with it or doing much about it.

A family farm is one thing. I weep on that. I don't weep on coal-fired utilities or nuclear facilities. They should know better than a family farmer who is working 18 hours a day. Since I grew up on a family farm, I have some feelings on that.

In your testimony, you noted they have already experienced write-offs in the past year and a half of that $1.5 billion, and that one borrower alone would receive a $3 billion write-off even though it is 4–1 and they have reserved $5 billion. You are saying they will receive a $3 billion write-off?

Ms. CALBOM. That is the expectation.

Mr. HORN. So that will leave them with $1.1 billion in debt?

Ms. CALBOM. That is my understanding.

Mr. HORN. Well, is there any further impact you can tell us about these various transactions? Just that they are a debt of the United States, is that it? We are stuck with something else again?

Mr. BROUK. In the case of Cajun, they are working out a sale right now of the assets. So I think what they are anticipating is that they will be able to pay off the rest of the debt.

Mr. HORN. Well, would it continue, then, do you think? Are you optimistic as to what they are doing?

Mr. BROUK. In terms of Cajun, it looks like they are fairly close to resolving it. I don't know if you can be optimistic about a $3 billion write-off, but there is probably going to be some return to pay off some of the debt. Maybe a billion.

Mr. HORN. Well, there is an old quote: If you owe somebody $10,000, that's your problem; but if you owe somebody else $4 billion, that's their problem.

Does competition in the electricity market cause heightened concern for these Federal debts? What does it boil down to?

Ms. CALBOM. Yes, it does. Many of these G&T cooperatives, as I was mentioning earlier, have much higher costs than what would be their competition once deregulation kicks in. So there is a concern that they would not be able to effectively compete unless they got some relief on their debt. And many have asked RUS for relief.

Mr. HORN. Did you note the role of the State regulatory commission? Were they not permitting an increase in fees to the customers?

Ms. CALBOM. That has been the case in a number of these bankruptcy situations. In fact, this Cajun Electric, with the $3 billion write-off anticipated, the State regulatory commission denied them a rate increase. In fact, I believe they implemented a rate decrease in the case of Cajun.

And that has been problematic with a number of these borrowers. So even absent the advent of competition, some of these entities are in trouble.

Mr. HORN. Well, we will get to it with the Department, and we thank you for coming and giving us the overview on it. We appreciated reading your testimony.

Ms. CALBOM. Thank you.

Mr. HORN. Thank you very much.

The next panel is the Department of Agriculture; and we will have the Honorable Sally Thompson, the Chief Financial Officer; Mr. Keith Kelly, the Administrator of the Farm Service Agency; Mr. Wally Beyer, the Administrator of the Rural Utility Service; Mr. Jan Shadburn, the Administrator of the Rural Housing Service.

If you would come forward, we will swear you in.

[Witnesses affirmed.]

Mr. HORN. The clerk will note all four witnesses have affirmed.

We will just go down the order in which they are on the program here.

Miss Sally Thompson is the Chief Financial Officer, and welcome.

STATEMENTS OF SALLY THOMPSON, CHIEF FINANCIAL OFFICER; KEITH KELLY, ADMINISTRATOR, FARM SERVICE AGENCY; WALLY B. BEYER, ADMINISTRATOR, RURAL UTILITIES SERVICE; AND JAN E. SHADBURN, ADMINISTRATOR, RURAL HOUSING SERVICE

Ms. THOMPSON. Thank you, Mr. Chairman and members of the subcommittee. I appreciate this opportunity to share with you the progress that USDA has made in implementing the Debt Collection Act of 1996.

My remarks today mark the beginning of my 5th week as the Chief Financial Officer at the Department of Agriculture. The subcommittee has received my written testimony, and I will take this opportunity to just highlight the issues discussed in that material.

The U.S. Department of Agriculture fulfills its responsibilities to communities and rural residents through large complex programs, including credit programs to finance water and wastewater systems, decent affordable housing, electric and telephone utilities, as well as rural businesses, and, as you mentioned, farm ownership and operations.

In addition, the Department provides emergency disaster assistance and relief. In several cases, very special emphasis has been given to designing programs that will even stimulate and promote small business in the rural development area. Consequently, each of these credit programs varies significantly in the types of credit

and the types of loans, payment schedules, interest rates, payback provisions, and loan servicing offered. The USDA holds a number of noncredit-related debt as well in their activities that they are involved with.

USDA has provided pivotal roles in the Federal Government's credit program. It is the largest user of Federal direct credit of any agency. USDA's receivables—credit and other type of debt—as of September 30, 1997, comprised 39.8 percent of the total nontaxed debt owed to the Federal Government. However, USDA's delinquency rate is approximately 7.2 percent, or about $7.5 billion, which is far below the Federal delinquency rate of 20 percent; or, if you took USDA out, it would be 29 percent for all Federal agencies.

We attribute that performance to our guiding principle that every debt should be repaid in accordance with the terms that it was made. We have long used available tools to collect that debt. In fact, we implemented several of the debt collection provisions as far back as 1985. We also have been working closely with Treasury in implementing the act.

For example, Treasury has established a framework of four work groups and a steering committee to bring closure to a number of the operational and policy issues, and we are chairing that committee, that steering committee, as well as having a number of representatives on each one of the work groups.

USDA views the administrative offset as a critical component of the Debt Collection Improvement Act. We have been an active participant in the IRS refund offset, internal offsets within the agency, and the salary offset programs as well. Only $2.1 billion of the USDA's $7.3 billion worth of delinquent debts is actually eligible for the 180-day delinquent debt. Of that amount, $774 million has been referred to Treasury; and we have already, in the first couple of months of this calendar year, collected over $56 million.

The $1.3 billion that has not been referred for administrative offset represents debt which is more difficult to refer to Treasury. However, we are working with those types of questions. This debt has to do with debt that has been in foreclosure and bankruptcy and has a lot of other issues involved with that, but we are working to make sure that we have sent to Treasury everything that is eligible for offset.

However, as I mentioned earlier, its reason is quite often the States are involved with the collection of debt, like in the area of food stamps. Litigation, where the amounts of debt are in dispute and they are either in the court, are also, as was mentioned in the GAO testimony, those that are in foreclosure or bankruptcy.

We are committed to transferring debt for administrative offset, and those actions include working with the States who administer those food stamp programs. In fact, over almost $1 billion of that is food stamps, and we are trying to work with that.

There is some legislation here in Congress right now that would allow the State and Federal Government to work together. We have also spent quite a bit of money trying to automate our systems so that the offset of the debt program can be electronically transferred to Treasury and our systems match.

We have also been working with Treasury to improve and implement a lot of the suggestions related to the multiple debts of single borrowers or single debts with multiple borrowers that cannot be electronically transmitted to the Treasury.

Of the USDA's total debt, approximately—the $1.9 billion eligible for cross-servicing to the Treasury, which is another key component of the Debt Collection Improvement Act—approximately half of this amount is administered by State agencies. And, as I mentioned, we are working hard with the States to try to resolve these issues so that these debts can also be sent over.

At this time, USDA has requested to be a designated debt collection center for individual administrative debts. We are awaiting Treasury's decision on that.

We are also discussing with Treasury the most effective processing of certain specialized debt, particularly debt that has specified legislative types of servicing requirements.

A significant obstacle to our referring debt to Treasury for cross-servicing has been the need to reprogram several of the USDA systems to accommodate the requirements of Treasury. We are balancing the need of resources to change those systems, along with the resources needed to bring up all of the systems at USDA for year 2000 compliance. While everything has been slower than we would have liked, we are looking at the summer to be able to complete the cross-servicing of referring those debts to Treasury. I think our systems will be up and ready for that.

I have focused many of my comments just on administrative offset and cross-servicing portions of the act. I have included in my written testimony a number of other examples that we are working on.

We administer, as I mentioned, credit programs that assist rural communities, agriculture producers, and consumers. These credit programs vary significantly in their objectives. We, again, believe that every debt should be repaid in accordance with the conditions under which the loan was made, and we intend to use all the tools available to help us and you collect those delinquencies.

The Debt Collection Improvement Act provides a number of new tools to assist us in that debt management and credit management program. We look forward to working with the Office of Management and Budget, the Treasury, and other Federal departments and agencies. And through the Federal Credit Policy Working Group, the Chief Financial Officers Council is also addressing this, of which we are a very active member.

I would invite any questions that you may have. While I have only been here 5 weeks, I do have over 30 years of professional financial management experience as a CPA with Touche Ross, in the banking industry, in the S&L industry, and most recently as the Kansas State treasurer. So I do have a strong financial background.

I understand loans and I understand delinquencies and the collection thereof; and I can make a commitment to you that, as the Chief Financial Officer at the Department of Agriculture, I will work very, very hard to collect this debt that is owed to the Federal Government.

Mr. HORN. Well, we appreciate your commitment. Maybe that S&L experience was a good one for the Department of Agriculture. If you knew what you know now, would you have taken the job? I guess.

Ms. THOMPSON. That is probably true.

[The prepared statement of Ms. Thompson follows:]

STATEMENT OF
SALLY THOMPSON
CHIEF FINANCIAL OFFICER
U.S. DEPARTMENT OF AGRICULTURE
BEFORE THE
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION AND TECHNOLOGY
OF THE
HOUSE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
TESTIMONY ON
DEBT COLLECTION AND CREDIT MANAGEMENT

March 30, 1998

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to share with you the progress that we have made in implementing the Debt Collection Act of 1996 (DCIA).

The Department of Agriculture's (USDA) programs serve all of us in a number of ways, every day -- in the food we eat, the water we drink, the clothes we wear, the school lunch program that feeds our children, and many others. Therefore, it is critical that we maintain a healthy, stable economy for producers and consumers of American agricultural products. Stability and prosperity in the agricultural community and in rural America depends on economic opportunity. Thus, a major strategic goal of USDA is to "Expand Economic and Trade Opportunities for Farmers and Other Rural Residents."

USDA fulfills its responsibilities to communities and rural residents through large, complex programs, including credit programs to finance:

- water and waste water systems,
- decent, affordable housing,
- electric and telephone utilities and rural businesses, and
- farm ownership and operations.

In addition, USDA provides emergency disaster assistance and relief. All of these credit and assistance programs were designed to meet the specific needs of (rural) America. In several cases, special emphasis has been given to designing programs that will stimulate and promote private investment. Consequently, each of the credit programs varies significantly in the types of loans, payment schedules, interest rates, payback provisions and loan servicing offered. USDA's other debts are comprised of non-credit, non-collateralized, domestic debt arising mostly from food stamp over-issuances, timber operations, and crop insurance over-payments.

To fulfill our mission, USDA is the biggest user of Federal direct credit of any Federal agency. USDA's receivables (credit and other debt) as of September 30, 1997, comprise 39.8 percent of the total non-tax debt owed to the Federal Government. As of September 30, 1997, USDA had more than 1.1 million program loan accounts, totaling more than $102.5 billion and about 3.1 million of non-credit debt accounts totaling over $2 billion. In total, USDA had outstanding debt of approximately $104.5 billion in 4.2 million accounts as of September 30, 1997.

USDA's delinquency rate of approximately 7.2 percent or $7.5 billion is far below the overall Federal delinquency rate of 20 percent or 29 percent when USDA is excluded from the computation. Over $992 million of this delinquent debt is attributable to the Food and Nutrition Service's Food Stamp Program, which is administered by State governments. Excluding the State administered debt, debtors in bankruptcy and foreign debt, USDA's delinquencies over 180

days are only 2.6 percent of our entire portfolio.

In administering USDA programs, we believe that every debt should be repaid in accordance with the terms under which it was made; we are using all the tools available to us to reduce the amount of delinquent debt. As a result, delinquent debts over 180 days and write-offs are steadily declining. At the end of Fiscal Year (FY) 1992, USDA delinquencies represented 11.4 percent of outstanding receivables and write-offs were 2.2 percent of receivables; at the end of FY 1997, our delinquencies to receivables ratio was 7.2 percent and write-offs to receivables were 1.2 percent.

USDA has long used a wide variety of available tools to collect delinquent debt and, in fact, implemented several of the DCIA provisions as far back as 1985 including: referral of delinquent debt for income tax refund offset, reporting of delinquent consumer debts and all commercial debts to credit bureaus, and reporting write-offs to the IRS for inclusion in debtors' taxable income.

We have also made significant progress in implementing the new provisions of the Act. We have published regulations in the Federal Register, modified internal regulations, and established regulations for routine use of personal identifiers; modified automated systems requirements, designs and programs; are requiring Taxpayer Identification Numbers (TINs) from our vendors; are planning to make more use of private collection contractors; have applied to become a Debt Collection Center for specific debts; and are implementing the new provisions for civil monetary penalties provisions. To date we have sent over 431 thousand delinquent accounts amounting to $773.8 million to the Department of the Treasury (Treasury) for Administrative Offset. Since January 1, 1998, $56.3 million has been collected through Treasury's Administrative Offset Program (the majority of this has been collected through the IRS Refund Offset Program.)

USDA, together with a number of other credit agencies, is working with Treasury to resolve a number of operational and policy issues that have had an impact on the implementation of the various provisions of the Act. Treasury has established the framework of four Work Groups and a Steering Committee to bring closure to these operational and policy issues of implementing DCIA. USDA has accepted the leadership role as the Chair of the Steering Committee and has representatives on the Working Groups.

The following sections outline USDA's activities in implementing major provisions of DCIA.

Treasury's Administrative Offset Program

USDA views administrative offset as a critical component of DCIA. We have been an active participant in the IRS, internal, and salary offset programs which are predecessors of Treasury's Administrative Offset Program. Of USDA's $7.3 billion of delinquent debt over 180 days as of September 1997, only $2.1 billion may be "eligible" for administrative offset. Of that, as previously noted, $774 million has been referred to Treasury for administrative offset. The remaining $1.3 billion represents debt which is more difficult to refer to Treasury or for which there are questions as to whether it should be referred. This debt is being analyzed to determine whether it should be referred. More importantly, we are identifying action steps to refer all debt which should be sent to Treasury. Preliminary findings show that the primary reasons for not referring this debt fall into the following categories:

- debt in litigation where the existence of the debt or the amount of the debt is in dispute,
- debt administered by State governments,
- delinquencies that extend beyond the statue of limitations, and
- debt where due process procedures are not complete.

To reach this point in transferring debt for administrative offset, USDA activities to date include:

- Developed and published regulations in the *Federal Register* and developed internal Departmental regulations to implement Treasury's debt collections processes.

- Revised and published in the *Federal Register* new systems of records for routine use of personal identifiers for 10 USDA agencies. In that way we ensure that our debtors are aware that their TIN would be shared with Treasury and the Internal Revenue Service for both the Administrative Offset and Income Tax Refund Offset Programs.

- Working with the States who administer the Food Stamp Program, we prepared and sent 381 thousand accounts of former food stamp recipients to Treasury for Income Refund and Administrative Offset.

- Developed and modified our automated systems to provide debt information to Treasury in their required format. This involved writing programs that extract data from several data bases to establish a new offset database, and establishing protocols necessary to send the data to Treasury electronically.

- Working with Treasury to resolve software issues which prevents us from referring multiple debts of a single borrower or single debts with multiple borrowers for administrative offset.

- Working with the Department of Treasury to establish the salary offset program. This cooperative effort will result in a coordinated salary offset program.

Cross-Servicing of Delinquent Debt

Of the USDA total debt 180 days or more delinquent, $1.96 billion is eligible for cross-servicing. Approximately half of this amount is administered by State agencies. We are working with the States and Treasury to determine which of this debt is truly eligible for cross servicing and how best to transmit this debt from individual states to Treasury.

At this time one USDA agency has requested to be designated a Debt Collection Center for individual administrative debts. We are awaiting Treasury's decision prior to referring that portion of debt for cross-servicing.

In addition, we are discussing with Treasury the most effective processing of certain specialized debt, particularly debt with specified. legislative servicing requirements. A significant obstacle to our referring debt to Treasury for cross servicing has been the need to reprogram several USDA systems to accommodate the requirements of Treasury. We are balancing resource needs for such programming with the need to make the changes necessary for Year 2000 compliance. While the systems changes have been slower in completion than we would like, we are coordinating closely with Treasury and plan to begin to refer debt for cross servicing during the summer of 1998.

Taxpayer Identification Numbers

USDA collects TINs from most of our vendors, borrowers, clients, and debtors. In February 1997, USDA issued a Departmental Regulation requiring USDA agencies to provide TINs on all requests for payment. The National Finance Center began to gathering TINs in January, 1998 for vendors for which National Finance Center makes payments. Other USDA agencies plan to gather TIN information in September 1998. We are encountering some problems with verifying TINs (as are other Federal agencies); however, we believe that the collection of TINs will significantly increase collection of delinquent debts by allowing full

participation in Treasury's administrative offset initiative and assuring that discharges of indebtedness are reported to IRS.

Reporting of Write-Offs to IRS on 1099-C

USDA has been reporting Form 1099-C write-offs to the IRS for inclusion in debtors' taxable income since 1990. USDA agencies reported 1996 write-offs totaling more than $1.2 billion.

Civil Monetary Penalties

USDA published a Final Rule pertaining to civil monetary penalties, which incorporates inflation adjustments, in the July 31, 1997, *Federal Register*.

Report to Credit Bureaus

USDA has referred both delinquent and current commercial accounts to credit bureaus since 1985. We have referred delinquent individuals to credit bureaus since 1990. USDA routinely refers more than $60 billion of current and delinquent debt annually.

Use of Private Collection Agencies

Now that we are able to fully utilize collection agencies, USDA intends to take full advantage of the collection contracts awarded by Treasury. Until recently, two of our largest creditor agencies (Farm Service Agency and Rural Development) were prohibited from using collection contracts.

Barring Delinquent Debtors

USDA supports the provision to bar delinquent debtors from obtaining additional (non-essential) Federal loans or loan insurance guarantees. The provision does not bar delinquent debtors from receiving essential Federal benefits (such as food stamps), but will prevent problem debtors from incurring new Federal debt. In addition, this provision may provide an incentive for delinquent debtors to resolve their current debt and result in decreases of future delinquencies.

Sales of Delinquent Receivables

As part of the government-wide initiative to maximize taxpayer returns on delinquent debt, we plan to review our portfolios to determine whether and to what extent sales of delinquent loans would result in greater federal returns.

Report on Receivable from the Public

One last comment. Currently agencies report accounts receivable and delinquencies to Treasury on the so-called Schedule 9's. We are working closely with Treasury, OMB and the Federal Credit Policy Working Group to re-design this report so that it is more useful to USDA, management, other Federal credit agencies, the oversight agencies and the Congress.

Conclusion

USDA administers many programs that assist (rural) communities and agricultural producers, consumers, and improve the rural economy and quality of life, including credit programs. Credit programs administered by USDA vary significantly in their objectives and goals. As a result, they differ in the type of credit, payment schedules, interest rates, payback provisions, and servicing they require. These differences must be considered as we approach debt collection,

however, USDA believes that every debt should be repaid in accordance with the conditions under which the loan was made, and we intend to use all the tools available to us to collect delinquencies.

DCIA provides a number of new tools to assist us with our debt management and credit management program, and we look forward to working with the Office of Management and Budget, Treasury, and other Federal departments and agencies, and through the Federal Credit Policy Working Group, and the Chief Financial Officers Council to coordinate initiatives that reduce the amount of delinquent debt owed the Federal Government.

Mr. HORN. We are just going to go down the line and get everybody on the record first, and then we will share questions and dialog.

Mr. Kelly, you are next.

Mr. KELLY. Thank you, Mr. Chairman.

For the record, my name is Keith Kelly. To members of the subcommittee, I want to thank you for the opportunity to appear here today to comment on the progress that the Farm Service Agency has made toward implementing the Debt Collection Improvement Act of 1996. My testimony will focus on the act's debt collection provisions, particularly with respect to Treasury's offset program and cross-servicing by the Department of the Treasury.

One of the Farm Service Agency's primary roles is as a lender or as a guarantor through its farm commodity programs, farm ownership, operating and emergency loans, emergency and disaster assistance, domestic and international food assistance, and international export credit programs. These programs are funded through the Commodity Credit Corporation and the Agricultural Credit Insurance Fund.

We strive to provide equitable, friendly, effective, and efficient customer service and to enhance the ability of small limited resource, beginning and socially disadvantaged farmers and ranchers to operate successfully. In these efforts, our responsibility as stewards of the land and our financial responsibility to protect the country's financial assets makes our job challenging, especially when we are faced with making sure borrowers comply with their own fiduciary responsibility to service their debts.

The Farm Service Agency, as of September 30, 1997, had a total debt portfolio of approximately $34.6 billion. Approximately $23.5 billion is with foreign countries, leaving $11.1 billion under the farm loan programs and approximately $34.7 million under the Commodity Credit Corporation program.

Fortunately, Mr. Chairman, most of this debt is being serviced in a timely fashion. However, in accordance with Treasury reporting requirements, approximately $4.9 billion of this debt is considered delinquent and is being reported as such on the Treasury's Schedule 9.

The Farm Service Agency is already complying with the DCIA's Treasury offset program. We have referred $471.4 million of the reported delinquent debt, representing all of the farm loan program eligible delinquent debt and those farm program domestic debts that are centralized in our Kansas City management office.

We have been referring debts to the Treasury offset program since the last quarter of 1997. To date, the Treasury offset program referrals have netted the FSA agency approximately $448,000. We plan to be 100 percent compliant with the Treasury offset for both Commodity Credit Corporation and the Ag Credit Insurance Fund no later than September 1998.

With respect to the Treasury's cross-servicing requirements, we plan to be fully compliant, as I mentioned, by September. Systems enhancements need to be implemented and work needs to be done to address the year 2000 computer issue before we can see the full compliance with its provisions. However, because of DCIA exemptions, legislative-imposed servicing rights for the farm loan pro-

gram borrowers, and the sovereign status of our foreign debtors, only about $39.7 million of the total $4.9 billion will be transferred to Treasury.

I would like to explain to you why there is such a difference between the total of the $4.9 billion delinquent reported on the Schedule 9 and the $39.7 million which will be transferred to Treasury for cross-servicing. I have provided the staff with two pie charts that might help tell the story on that. And what the total is on the left, on the smaller pie chart, of $34.6 billion of total debt, of which $4.9 billion is reported to the Treasury on Schedule 9, I have moved that over to the larger pie chart, which then shows up to make up the $4.9 billion in debt; and I will show you how we will get down to the $30.97 million of the $4.9 billion that will actually be transferred for cross-servicing.

If I can refer to the yellow part of the pie chart, about $2.5 billion is sovereign debts under our foreign export programs. Sovereign debts are not covered under the DCIA. Of this amount, $2 billion is owed by Iraq and the remainder by some of the poorest of the poor countries of the sub-Saharan Africa. These debts are basically uncollectible but cannot be written off without legislation.

Second, approximately $1.2 billion of the total is automatically exempt by DCIA, and that is the green portion at the top, and I guess I would call it the off-white portion. Those two added up are about $1.2 billion. They are in bankruptcy, litigation, including foreclosure. They are in dispute or appeal or beyond the statute of limitations or otherwise satisfied under the tenets of the law.

Third, approximately $16.6 million is collectible by internal offset, and that is the very small blue sliver you see in there under the farm programs under the Commodity Credit, and that is their production flexibility contract payments that can be paid off within 3 years. These debts are exempted by the DCIA from being referred to Treasury.

Fourth, and this is referring to the deep pink, or fuchsia, I guess, approximately $421.4 million of our farm loan program delinquencies are exempt because of statutory servicing rights provided by the farm loan program borrowers. Because of these legislative servicing requirements, it is mandatory these debts remain in the field until such time as all servicing rights are exhausted and foreclosure and liquidation of all assets is concluded. Even after foreclosure and liquidation, the borrower may still have rights under the Homestead Protection Program.

Included in this amount, Mr. Chairman, is approximately—and that is the salmon color—$721.9 million of debts for which the borrower may be delinquent on some but not necessarily all of their debt. However, for Treasury's Schedule 9 reporting purposes, the total balance that is reported to Treasury appears as being delinquent, when it actually is not. So you have the $4.9 billion pie and the small purple sliver out at the side for this cross-compliance of $39.7 million.

The FSA, including program components of the Farmers Home Administration, the SCS, and the Commodity Credit have been utilizing many of the debt collection tools required by the Debt Collection Improvement Act for years and has already taken steps to enhance that even further. Specifically, since the late 1980's, the

aforementioned agencies have participated in the IRS tax refund program. To date, this program has resulted in the collection of over $8.3 million in delinquent debts; and in 1988 participation began in the Federal salary offset program.

The former ASCS also began referring borrowers to the private collection agencies under the General Services Administration scheduling in 1993, netting to date over $400,000. The farm loan programs have been prohibited from using private collection agencies.

We have also been making referrals to commercial credit reporting agencies since 1984. Since 1989, we have been using the IRS forms 1099 C and 1099 G to report borrowers' incomes from debt settlements. We have also been long-time advocates of the taxpayer identification number as a basis for determination payment limitations and for reporting income to the IRS.

The tool which has provided us with the greatest return has been the use of internal administrative offsets. In fiscal year 1997, we collected $1.2 billion; and in 1988 to date, $45.3 million in offsets have been collected on the farm program debt side. In fiscal year 1988, approximately $20 million have been offset to cover farm loan program debts.

I think I spoke of them in reverse. The bulk of these offsets have been from CCC's program flexibility contract payments.

Because of FSA's critical involvement as a lender and/or guarantor, our portfolio represents approximately 33 percent of USDA's total debt portfolio. Even before DCIA, this agency has made significant inroads toward improving our debt collection techniques and using all available collection tools. Since DCIA's implementation, we have improved significantly our debt collection techniques and are using tools that work. Since the implementation we have improved significantly our collection success.

Further improvements to systems and procedures will remain on track to ensure we fully comply with the DCIA tenets and requirements as soon as possible. We recognize the value the legislation's collection tools have to offer and support the Department of the Treasury's efforts to continue with full implementation of the more complex provisions. We also support this committee's concerns on implementation.

I appreciate the opportunity to testify here and would be happy to respond at the appropriate time.

Mr. HORN. Thank you, Mr. Kelly.

[The prepared statement of Mr. Kelly follows:]

STATEMENT OF
KEITH KELLY
ADMINISTRATOR, FARM SERVICE AGENCY
U.S. DEPARTMENT OF AGRICULTURE
BEFORE THE
HOUSE SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY

March 30, 1998

Mr. Chairman and Members of the Subcommittee, I would like to thank you for the opportunity to appear here today to comment on the progress the Farm Service Agency has made toward implementing the Debt Collection Improvement Act (DCIA) of 1996. My testimony will focus on the Act's debt collection provisions, particularly with respect to Treasury's offset program and cross servicing by the Department of the Treasury.

The Farm Service Agency touches just about every farmer and rancher in the United States through the administration of farm commodity programs; farm ownership, operating and emergency loans; conservation and environmental programs; emergency and disaster assistance; domestic and international food assistance; and export credit programs. These programs are funded through the Commodity Credit Corporation (CCC) and the Agricultural Credit Insurance Fund (ACIF).

These programs provide a safety net to help farmers produce an adequate food supply; maintain viable operations; compete for and expand the sale and export of agricultural commodities in the world marketplace; and contribute to the year-round availability of a variety of

low-cost, safe, and nutritious foods. With the Farm Service Agency's major role in exporting U.S. agricultural commodities to major markets throughout the world, our programs become worldwide in scope.

The Farm Service Agency also plays a significant role in enhancing the environment by the development and implementation of programs which ensure adequate protection of our natural, cultural, and historic resources. We assist agricultural producers and landowners in achieving a high level of stewardship of soil, water, air, and wildlife resources on America's farmland and ranches.

We strive to provide equitable, friendly, effective, and efficient customer service and to enhance the ability of small, limited resource, beginning and socially disadvantaged family farmers/ranchers to operate successfully. In these efforts, particularly, our responsibility as stewards of the land and our financial responsibility to protect the country's financial assets makes our job challenging, especially when we are faced with making sure borrowers comply with their own fiduciary responsibility to service their debts.

One of the Farm Service Agency's primary roles in many of these programs is as a major lender or as guarantor. Often this role is as a lender of last resort due to the weak financial condition of our borrowers; and in the case of our international programs, the Federal Government is often the only lender or guarantor due to the riskiness of doing business in the international sector. We take our responsibility for collecting on these and all of our debts

seriously and are in the process of complying with all provisions of DCIA to the fullest extent of the law for both CCC and ACIF program debts.

Farm Service Agency Debt Portfolio and Delinquencies

As of September 30, 1997, the Agency had a total debt portfolio of approximately $34.6 billion, which is approximately 33.1 percent of USDA's total portfolio. Of this amount, approximately $4.9 billion is owed by debtors who are delinquent on some, but not necessarily all, of their debt. However, for Treasury's Schedule 9 reporting purposes, the total balance is reported to Treasury and appears as being delinquent, when it actually is not. Because of DCIA exemptions, statutory imposed servicing rights for Farm Loan Program borrowers, and the sovereign status of our foreign debtors, only $39.7 million of this delinquent debt will be eligible for cross servicing. For example, because of statutory servicing rights for Farm Loan Program borrowers, it is necessary for these debts to remain in the field until such time as all servicing rights are exhausted and foreclosure and liquidation of all assets are concluded. Even after foreclosure and liquidation, the borrower may still have rights under the Homestead Protection programs.

In addition, another $678.2 million is in bankruptcy and $325.8 million in litigation or foreclosure, thus exempt from DCIA. Another $23.5 billion of the total debt is due from sovereign debtors under our export guarantee programs and PL 480 programs. Although $2.5 billion of this is delinquent, these debts are currently ineligible for cross servicing due to political

sensitivities, legislative and budgetary concerns related to sovereign debts, and the fact that the collection center may not have the legal authority to negotiate foreign debt on behalf of another Federal agency. In addition, Mr. Chairman, other statutory requirements prohibit us from referring these debts to Treasury. These amounts include approximately $56.3 million in debts under appeal, $421.4 million under statutory servicing rights, $16.6 million which can be collected through internal offset with in three years, $127.4 million which has been resolved by the debtors since the September 1997 Treasury Schedule 9 was prepared, and approximately $13.6 million which we believe has been misclassified on the Schedule 9. We are researching this issue.

Pre-DCIA Use of Debt Collection Tools

The Farm Service Agency's program components, formerly from the Farmers Home Administration (FmHA), the Agricultural Stabilization and Conservation Service (ASCS), and the Commodity Credit Corporation (CCC) have been utilizing many of the debt collection tools required by DCIA for years and have already taken steps to enhance their use. Specifically:

In the late 1980's, ASCS, CCC and FmHA began to participate in the Internal Revenue Service's (IRS)Tax Refund Program. To date, this program has resulted in the collection of over $8.3 million in delinquent debts.

In 1988, participation began in the Federal Salary Offset Program; and in 1993, ASCS began referring delinquent borrowers to private collection agencies under the General Services

Administration schedule. Private collection agencies have netted us over $400,000 in past due debts. The debts of the Farm Loan Program under the former FmHA were prohibited from using private collection agencies. We have also been making referrals to commercial credit reporting agencies since 1987 for Farm Program debts and since 1984 for Farm Loan debts.

The collection tool that has been most effective for FSA over the years has been the use of internal administrative offset. Internally offsetting existing debts against benefits coming due is an extremely cost-effective way to collect on debts because it keeps the process simple and completely in-house. We have been using this tool for years. FSA collects in the high 90 percentile of its Farm Program debt by administrative offset. In fiscal year 1997, $1.2 billion in offsets were taken, and in 1998, to date, we have collected $45.3 million in Farm Program debts by internal administrative offset. A large percentage of these offsets were from Program Flexibility Contract payments. In August 1997, we published an interim rule for our Farm Loan Program that would allow for internal administrative offset of delinquent borrowers prior to their debts being accelerated. As a result, in the first two payment cycles of fiscal year 1998, we have collected approximately $20 million in offsets on these delinquent Farm Loan Program debts. The success of this collection tool is significant.

Centralization Efforts

The Farm Service Agency has, for years, attempted to minimize the cost of debt servicing by centralizing certain functions.

In 1987, a central office in Kansas City was established to centralize the collection efforts of all delinquent debts of Farm Program debtors who no longer participate in our programs, as well as all Farm Program installment notes. Our St. Louis office has always had a centralized payment collection receiving center to receive and process borrower payments. The actual servicing of these loans has and will remain a responsibility of the county office due to legislated servicing requirements. Finally, debt collection operations relating to our commodity operations have been centralized in our Kansas City office since the mid-1970's.

TOP Referrals

These existing mechanisms and our successes to date will make our transition to full DCIA compliance manageable, albeit a challenge. To date, we have made considerable progress in implementing the nontraditional DCIA provisions.

In late 1997, all of our eligible Farm Program delinquent debts which were centralized at that time and all of our eligible Farm Loan Program delinquent debts were referred to Treasury for inclusion in the Treasury Offset Program (TOP). In total, approximately $471.4 million has been referred to TOP, including both CCC and ACIF debts. TOP has netted the Farm Service Agency approximately $448,000.

Planned Enhancements

We are actively working to implement the other key provisions of DCIA. Full TOP referral is expected to be completed no later than September 1998. We are currently modifying systems and developing procedures necessary to comply fully with this provision. These changes are significant but must be balanced with priority Year 2000 systems compliance issues. Referral to Treasury for Cross Servicing will also begin in September 1998 for both Farm Programs and Farm Loan Programs. Our goal is to have these capabilities in place before that time. However, significant systems enhancements and procedural changes need to be implemented and work needs to be done to address the "year 2000" computer issue before we can achieve full compliance with this provision. Consumer Credit Bureau Reporting will begin in July 1998 for Farm Programs and in December 1998 for Farm Loan Programs.

Impediments

I mentioned briefly that only approximately $39.7 million of our debts will be transferred to Treasury for cross servicing because of DCIA exemptions, legislated requirements, and foreign sovereignty issues.

With respect to our Farm Loan Program debts, approximately $721.9 million is not available for cross servicing. In this category of debt, the entire loan is reported as delinquent on the Treasury Schedule 9, even though only a portion of the debt is delinquent. In addition, another $421.4 million is delinquent, but because of statutory servicing rights, the debt must remain in the field to allow the borrower time to arrange to become current. As a result, these

amounts cannot be considered for offset. The enabling legislation and the mission for this program is to assist family farmers and ranchers to become profitable operations, to provide a source of affordable credit not available to these borrowers, and to supervise and assist these individuals in developing a financially sound enterprise. Over the years, numerous statutory provisions have been enacted to expand the servicing options available to assist these farmers. These servicing requirements are designed to keep these borrowers in business, which does understandably delay the agency in proceeding with its collection efforts to satisfy the debt. Various legislation that has expanded servicing rights for Farm Loan Program borrowers includes the Omnibus Budget Reconciliation Act of 1986, The Agriculture Credit Act of 1987, and The Food, Agriculture, Conservation and Trade Act of 1990. These acts provide safety net provisions giving farmers the opportunity to maintain their farms and continue farming, while making arrangements for adequate servicing of their debts. This Administration fully supports the mission of this program and the safety net provisions provided to these borrowers.

In addition, approximately $23.4 billion of the debt is with foreign governments which is considered exempt under DCIA. In-house debt collection efforts for foreign debts is being handled by the Office of the Controller, CCC. Approximately $13 billion of this amount has been serviced in a timely manner, and approximately $8 billion has been rescheduled, or refinanced, under the auspices of the Paris Club, an international group of the world's major creditors, including the United States. The remaining $2.5 billion is delinquent, $2.0 billion which is owed by Iraq and the remainder by some of the poorest-of-the-poor countries in Sub-Saharan Africa. Obviously, this debt is essentially uncollectible, although we are prohibited

from writing the debt off due to legal and budgetary constraints. With respect to the Iraqi debt, the CCC has initiated efforts to collect on this debt, and the Department of the Treasury is considering legal actions for collection under various versions of proposed legislation.

Foreign debt collection efforts are generally conducted in consultation with the Department of State which is responsible for negotiating the terms of Paris Club rescheduling agreements for all Federal agencies. As a Government Corporation, CCC participates closely with the Department of State in these reschedulings to ensure that the interests of the corporation are considered in the negotiations. Centralizing delinquent foreign debt collection efforts is not considered to be a viable option and may not always be in the best interest of the Agency or the Federal Government. For example, in the past USDA has had an advantage in its foreign debt collection efforts, particularly from the standpoint that our foreign debtors often see an incentive in keeping current with CCC so they can ensure continued access to credit which is needed to facilitate imports of U.S. agricultural commodities and foodstuffs. For example, a country will often pay CCC before they pay other debtors to ensure a reliable open supply of U.S. food and other agricultural products, while they may not be as inclined to remain current with another Federal agency, such as the Export Import Bank of the United States, or other countries. In the past, this has been particularly true under the GSM Export Credit Guarantee Programs, which have been able to maintain exemplary repayment records for this very reason. While we do periodically incur losses for political reasons, such as with Iraq, most reschedulings are caused by economic reasons, and we are generally able to reschedule the debts in the Paris Club. We, in turn, maintain an open and fluid relationship with the debtor country.

A prime example is in the case of Mexico, which defaulted in the 1980's but then rescheduled, became current, and went on to be one of our best customers in the early 1990's.

Taxpayer Identification Numbers

The Farm Service Agency has had a long history of obtaining taxpayer identification numbers (TIN's) from farmers who participate in its programs. The TIN has been used as a basis for determining payment limitation and for reporting income to the Internal Revenue Service. With the passage of DCIA, we are, now requiring all vendors who do business with the CCC to provide their taxpayer identification number.

At the headquarters level, we have mandated that contract bidders either provide their TIN or a certification that the TIN is already on file with the agency, as part of the bidder's official response to requests for proposals.

For payments initiated by the Kansas City Commodity Office, the agency is developing requirements to enhance its Processed Commodity and Grain Inventory Management Systems to include the TIN as a requirement for making payments. This enhancement will, however, not be completed until after "year 2000" compliance issues with the systems are resolved. Another system, the Cotton Inventory Management System, already has the TIN as a requirement.

Other systems enhancements and requirements will be completed to ensure all programs

require to collection of the TIN.

Barring Delinquent Debtors

The former FmHA began referring delinquent farm loan program debts to the Credit Alert Interactive Voice Response System in 1993 in an attempt to identify applicants with delinquent Federal debts. Also, FSA uses commercial and consumer credit reports to help identify applicants who have delinquent Federal debts. Now that DCIA mandates that delinquent debtors of the Federal Government are no longer eligible for Federal assistance, we are seeking Treasury's guidance on establishing a more comprehensive data base of delinquent debtors to ensure that we comply with this provision.

Sales of Delinquent Debt

As a part of a government-wide initiative to maximize taxpayer returns, we will review our portfolio of loans that have been delinquent for more than a year to see if sales of them would be cost-effective in certain instances.

Conclusion

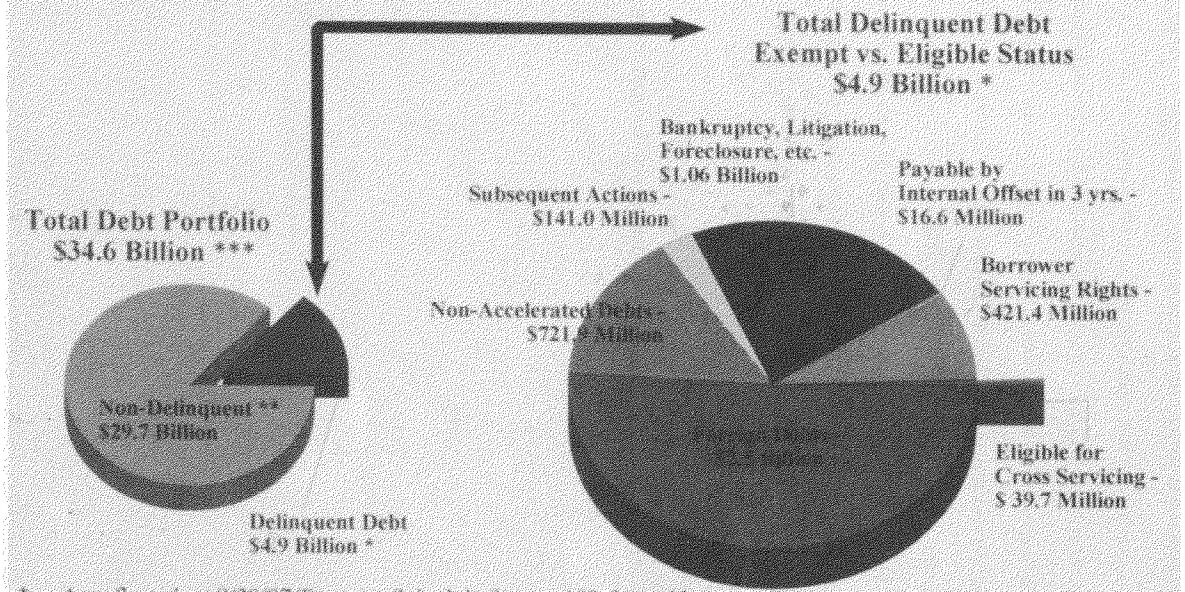
In one way or the other, the programs administered by the Farm Service Agency touch the lives of just about every person in the United States. We also have a significant impact on

the world economy in general. Because of our critical involvement as a lender and/or guarantor, our debt portfolio represents approximately 33 percent of USDA's total debt portfolio. Even before DCIA, this Agency had made significant in-roads towards improving our debt collection techniques and our record for collecting current and delinquent debts. Since DCIA's implementation, we have improved significantly our collection successes. Further improvements to systems and procedures will remain on track to ensure that we fully comply with DCIA's tenets and requirements as soon as possible. We recognize the value the legislation's collection tools have to offer and support the Department of the Treasury's efforts to continue with full implementation of the more complex provisions. We also appreciate this committee's concerns on implementation.

I appreciate the opportunity to testify today and I will be happy to respond to your questions.

Farm Service Agency Debt Portfolio

Eligibility for Cross Servicing by Treasury
Under the Debt Collection Improvement Act of 1996



* As reflected on 9/30/97 Treasury Schedule 9, over 180 days old.
** Includes debts less than 180 days old.
*** Commodity Credit Corporation and Agricultural Credit Insurance Fund.

Mr. HORN. The next speaker is Mr. Beyer.

Mr. BEYER. Thank you very much, Mr. Chairman. I appreciate the opportunity to be here and participate in this hearing.

Rural America continues to be a vital part of our Nation and its economy. The global marketplace is our customers and competitors. We must prepare to meet these challenges, however, to secure its future, rural America must reinvest in infrastructure. Safe, affordable, modern utility infrastructure is a key component not only to economic competitiveness, but also to the success and quality of life.

Through a successful local-public partnership with the Federal Government, RUS programs have provided capital and critical credit support necessary to leverage private capital for infrastructure financing. RUS finances facilities and systems that provide electric, telecommunications, and water and waste disposal services to rural Americans.

As rural America is changing to meet these challenges, RUS is changing as well. We are reinventing our program delivery, streamlining our organizational structure, and leveraging private investment. On a 5-year average, there is about $3 billion invested in rural infrastructure. RUS provides one-third of that investment. Two-thirds is leveraged with private investors. Our goal is to help provide rural America with the necessary tools for economic development while ensuring the security and creditworthiness of our $31 billion electric loan portfolio.

Since its inception, RUS has worked closely with its borrowers to ensure the integrity of the loan portfolio. As such, the financial health of each borrower is of the utmost concern to the Agency, and when that health is jeopardized, RUS immediately undertakes the steps necessary to minimize its delinquencies. RUS' loan security goals and debt collection activities are, therefore, totally consistent with the goal of DCIA to maximize the collection of delinquent debts owed to the Federal Government by ensuring that collection activities are promptly pursued. For these reasons, we believe RUS has taken the steps necessary to comply not only with the letter of the DCIA, but with the spirit as well.

For many years, RUS has complied with several provisions of DCIA, including the reporting of delinquent debts to credit bureaus and reporting of write-offs to the Internal Revenue Service to be included in the debtors' taxable income. Currently, RUS has no delinquent debt eligible to transfer under the cross-servicing provisions of DCIA. Settlement of all RUS delinquent debt is being serviced through existing debt restructuring agreements or is being actively pursued with the Department of Justice through a joint effort through the bankruptcy process.

I want to say that all of the restructuring, all of the debt write-off, all of the bankruptcies have been a joint effort to date with RUS and the Department of Justice. We have about eight people assigned to a Financial Services Department in RUS, and DOJ is providing six to eight attorneys at any given time in all the processes, bankruptcy or workouts.

We are proud to report that the RUS Telecommunications Program has no delinquent debts and the RUS Water and Environmental Programs have only a handful of debts from a universe of

about 7,000 active borrowers and grantees in the water and waste water program.

The overwhelming majority of RUS' financially stressed borrower loans are a result of RUS-financed Generation and Transmission cooperative investments, minority investments in nuclear generating facilities from the 1970's to the 1980's. We are dealing here with 15- to 20-year-old investments. These loans and loan guarantees were made under a Federal energy policy of 1978, the National Fuels Act, which restricted the use of burning natural gas and petroleum in power plants, and it moved everyone into investing in coal and nuclear power at that time.

The assumptions underlying this policy were based upon the construction cost, load growth projection, and economic trends, which the utility industry as a whole accepted at that time, which, however, turned out to be inaccurate. Moreover, this construction took place during a time when the Nation's interest rates were among the highest in history, some as high as 14 percent, thereby only increasing the financial burden of the RUS borrowers.

In contrast to the many loans made by private lenders, RUS guaranteed loans, which were the majority of them in the generating transmission systems, made by the Federal Financing Bank at Treasury, could not be refinanced to lower interest rates until Congress changed the law to accommodate FFB refinancing in 1993. So there is a period of 10 or 12 years when double-digit interest was accumulating on these high investments in nuclear facilities.

As interest rates fell in the late 1980's, investor-owned utilities refinanced their high cost debt and actively pursued and won large industrial and commercial loads that further improved their economies of scale. RUS borrowers, however, were forced to continue to make debt service at interest rates well in excess of market rates. This combination of extremely high plant and financing costs created economic stress that some borrowers could not bear. In fact, one of the borrowers ended up with a hole in the ground. The plant was canceled, and everybody had to deal with that particular debt.

In the 1996 farm bill, Congress empowered the Secretary of Agriculture with the authority to settle claims arising from RUS loan programs. Final regulations implementing this authority set forth comprehensive procedures that RUS utilizes in identifying, analyzing, and resolving the collection problems of our financially stressed borrowers. These procedures, which are the product of the Agency's many years of experience in working with financially stressed borrowers, are designed to encourage borrowers to reject the alternative of bankruptcy and to work with RUS to resolve their financial problems.

Since the 1980's, 14 power supply borrowers with outstanding principal of over $9 billion have sought debt restructuring. Since entering debt restructuring negotiations with these borrowers, the Federal Government has collected in excess of $4.5 billion on the debt. The complexity of the organizational structures and financing arrangements must be addressed in the cost servicing issue.

With few exceptions, resolving the G&T financial difficulties has proven to be a very difficult process due in part to their complicated organizational structures and financing relationships. State regulatory problems also exist. Two States have taken a Fed-

eral preemption on rate increases to court, and we have lost in both States. That is a very difficult process, particularly in our environment of federalism versus State rights. We are dealing with that.

The regulatory commissions in several States have refused to approve the wholesale rates required for the G&Ts to service their government debt. G&Ts also have complex financing relationships that often include many different types of debt instruments, such as secured and unsecured notes, letters of credit arrangements, and municipal bonding financing. As such, creditors often consist of a diverse mix of municipalities, Wall Street investors or credit firms, local banks, and investment companies that exist specifically to provide credit to cooperative electric utilities. In some cases, the creditor represents a consortium, including foreign investors and financial institutions.

RUS expertise with financially stressed borrowers has gained a tremendous amount of experience in the last dozen years. Due to their complex organizational structure and financing relationships and arrangements, RUS has created a special in-house staff devoted entirely to these issues. Financially stressed electric utility borrowers are assigned to the FSS, and we now have about 15 years of experience in working with the Department of Justice on all of these restructurings, and bankruptcy debts to date.

For the reasons stated above, RUS and DOJ have generally concluded that it is in the best interest of the Federal Government to resolve the financial problems of RUS borrowers outside of bankruptcy, and in recent years have endeavored to convince borrowers that all parties are better served by working together to restructure debt. In order to persuade borrowers to work with the government outside of bankruptcy, we must assure borrowers that RUS is willing and able to undertake and complete a long and complicated process of debt restructuring, and that, in the end of the process, RUS will have the necessary authority to make appropriate restructuring arrangements.

Under DCIA, funding made available by the Federal agency to an individual or entity could be used to offset any delinquent debt that the individual or entity had with another Federal agency, thereby minimizing the Federal Government's exposure by not allowing Federal dollars to be used by recipients that are delinquent on their Federal debt. Treasury offset could, therefore, lead to inadequate funding and cancellation of the RUS projects, which are all actually corporations, municipalities, Native American entities, and so forth.

As we have previously indicated, only 14 RUS power supply electric borrowers have entered into debt restructuring negotiation during the past 18 years, less than 1 borrower a year. The negotiations and ultimate restructurings associated with each are often years in the making, thereby rendering the 180-day DCIA timeframe for debt recovery impractical. RUS's current ability to address delinquent debt has been successful, and we believe that we should continue that course of action.

In fact, when I arrived here in 1993, in November 1993, these debts all existed. And for a period of 10 or 12 years it was a very frustrating activity with the borrowers to get them restructured. I am pleased to say that we are dealing with six now. We are dealing

with six actively. We had four in bankruptcy. Three of them have a court-approved resolution, and one, Cajun Electric, that you mentioned, is the one bankruptcy that we still have that we are frankly struggling with for a solution.

We look forward to working with the Office of Management and Budget, and the Treasury, to ensure the integrity and the security of the RUS loan portfolio. As I am sure you will agree, it is critically important to protect and ensure program integrity and congressional intent as we continue to comply with the DCIA.

Mr. HORN. We thank you for your statement. Last week we learned, in a series of hearings, that there are only two executive departments that have increased in the number of personnel. Justice was one of them. And I thought last week that maybe it was all the independent counsels that were loose, but now I know it is the Department of Agriculture needing help on various loans in bankruptcy. So at least the sequencing of this hearing was excellent.

Mr. BEYER. Thank you very much for that support.

[The prepared statement of Mr. Beyer follows:]

United States Department of Agriculture

Rural Utilities Service

Statement of Wally Beyer, Administrator

Before the House Subcommittee on Government Management,

Information, and Technology

March 30, 1998

Mr. Chairman and Members of the Committee, I am pleased to appear before you today to discuss the Rural Utilities Service's (RUS) progress toward compliance with the Debt Collection Improvement Act of 1996.

Rural America continues to be a vital part of our nation and its economy. The global marketplace is our customers, and competitors. We are prepared to meet these challenges; however, to secure its future, rural America must reinvest in its infrastructure. Safe, affordable, modern utility infrastructure is a key component, not only to economic competitiveness but also to the success and quality of life.

Through a successful local/public partnership with the Federal government, RUS programs help provide the capital and critical credit support necessary to leverage private capital for infrastructure financing. RUS finances facilities and systems that provide electric, telecommunications, and water and waste disposal services to rural Americans.

As rural America is changing to meet these challenges, RUS is changing as well. We are reinventing program delivery, streamlining our organizational structure, and leveraging private investment. We view each new challenge as an opportunity. Our goal is to help provide rural America with the necessary tools for economic development while ensuring the security and

creditworthiness of our $31 billion loan portfolio.

Since its inception, RUS has worked closely with its borrowers to ensure the integrity of its loan portfolio. As such, the financial health of each RUS borrower is of the utmost concern to the Agency and when that health is jeopardized, RUS immediately undertakes the steps necessary to minimize its delinquencies. RUS' loan security goals and debt collection activities are, therefore, totally consistent with the goal of DCIA — to maximize the collection of delinquent debts owed to the Federal government by ensuring that collection activities are promptly pursued. For these reasons, we believe RUS has taken the steps necessary to comply with not only the letter of the DCIA legislation, but its spirit, as well.

For many years, RUS has complied with several provisions of DCIA including the reporting of delinquent debts to credit bureaus and the reporting of write-offs to the Internal Revenue Service to be included in the debtors' taxable income. Currently, RUS has no delinquent debt eligible for transfer under the cross-servicing provisions of DCIA. Settlement of all RUS delinquent debt is being serviced through existing debt restructure agreements or is being actively pursued with the Department of Justice (DOJ) through the bankruptcy process. We are proud to report that the RUS Telecommunications program has no delinquent debts and the RUS Water and Environmental programs have only a handful of problem borrowers from a universe of more than 7,000 active borrowers and grantees.

The overwhelming majority of RUS' financially stressed borrowers loans are the result of RUS-financed Generation and Transmission cooperatives (G&T's) minority investments in nuclear generating facilities from the 1970s and early 1980s. These loans and loan guarantees were made under a federal energy policy (1978 Fuels Act) that encouraged investment in nuclear

plants and restricted the use of natural gas. The assumptions underlying this policy were based upon construction cost estimates, load growth projections, and economic trends that the utility industry, as a whole, accepted at that time, which, however, turned out to be inaccurate. While most RUS borrowers never owned more than a small minority interest in any nuclear power plant and no RUS borrower ever had responsibility for constructing or operating a nuclear plant, the embedded plant costs associated with these minority interests were enormous given the small customer base of the RUS borrowers. Moreover, this construction took place during a time when the nation's interest rates were among the highest in recent history (some as high as 14%), thereby only increasing the financial burden of RUS borrowers. In contrast to many loans made by private lenders, RUS guaranteed loans made by the Federal Financing Bank could not be refinanced to lower interest rates until the Congress changed the law to accommodate FFB refinancing in 1993. As interest rates fell in the late 1980's, investor-owned utilities refinanced their high cost debt and actively pursued and won large industrial and commercial loads that further improved their economies of scale. RUS borrowers were, however, forced to continue to make debt service payments at interest rates well in excess of market rates. This combination of extremely high plant and financing costs created economic stresses that some borrowers could not bear.

Due to the diverse financial interests and complex financing strategies that initially provided the capital for each of these generating facilities, debt restructuring negotiations traditionally begin before the debt actually becomes delinquent and continue until a settlement among all parties is reached. Because of the complexities of these negotiations, final debt restructuring agreements are months, if not years, in the making.

In the 1996 Farm Bill, Congress empowered the Secretary of Agriculture with the authority to settle claims arising from the RUS loan programs. Final regulations implementing this authority set forth comprehensive procedures that RUS utilizes in identifying, analyzing, and resolving the collection problems of our financially stressed borrowers. These procedures, which are the product of the Agency's many years of experience in working with financially stressed borrowers, are designed to encourage borrowers to reject the alternative of bankruptcy and to work with RUS to resolve their financial problems.

Since 1980, fourteen power supply borrowers with outstanding loans in the principal amount of over $9 billion have sought debt restructuring. Since entering debt restructuring negotiations with these borrowers, the Federal government has collected in excess of $4.5 billion on this debt.

Cross-Servicing Issues

Complexity of Organizational Structures and Financing Arrangements

With few exceptions, resolving the G&T's financial difficulties has proven to be a very difficult process due, in part, to their complicated organizational structures and financing relationships. G&Ts are owned and controlled by member distribution borrowers who are bound by long-term purchase power contracts to pay for power at rates sufficient to recover the costs of the G&T's operations. However, many distribution members, through their representatives on the G&T's board of directors, have pursued strategies, including bankruptcy, that keep their rates low, thereby adversely impacting the G&T's cash inflows and its ability to repay its government loans. State regulatory problems also exist. The regulatory commissions in several states have refused to approve the wholesale rates required for the G&Ts to service their government debt.

G&Ts also have complex financing relationships that often include many differing types of debt instruments such as secured and unsecured notes, letter of credit arrangements, and municipal bond financings. As such, creditors often consist of a diverse mix of municipalities, Wall Street investment or credit firms, local banks, and investment companies that exist specifically to provide credit to cooperative electric utilities. In some cases, the creditor represents a consortium, including foreign investors and financial institutions.

RUS Expertise with Financially Stressed Utilities

Due to their complex organizational structures and financing arrangements and relationships, RUS has created a specialized in-house staff devoted entirely to these issues. Financially stressed electric utility borrowers are assigned to the Financial Services Staff (FSS), a staff with thirteen years of experience in resolving the delinquencies of financially stressed G&Ts and in restructuring RUS borrower debt. FSS performs detailed analyzes of each borrower's financial problems, develops alternative resolutions, and, in coordination with DOJ and the Department of Agriculture's Office of General Counsel, negotiates restructuring terms with the appropriate parties. When necessary, FSS can call on the services and expertise of various consultants.

Bankruptcy May Result in Minimized Recovery

The RUS borrowers' financial problems have resulted in seven bankruptcies and spawned a great deal of litigation as the government sought to protect its interests before state regulatory commissions, in bankruptcy court, and in the state and Federal court systems. Attempts to preempt state rate regulation have been largely unsuccessful. The Federal government has experienced mixed results in bankruptcy and other litigation. The bankruptcy process, in some

cases, has resulted in decisions that have been openly hostile to the interests of the U. S. taxpayers.

The cost of the bankruptcy process only added to the problems facing the Federal government. Because of the many parties involved and the complicated nature of these cases, bankruptcy is an extremely costly process to all parties involved. The bankrupt estate must bear costs, typically measured in the millions of dollars that can greatly reduce the government's ultimate recovery of its debt. There are, as well, the indirect costs of bankruptcy. Once in bankruptcy, it simply costs a utility system more to operate. Because of the uncertainty of the outcome, a borrower is greatly handicapped in planning for its future. At a time when the electric utility industry is rapidly changing and utilities are facing competitive pressures, the ability to respond quickly, exercise flexibility, and take meaningful steps to plan for the future is critical to the financial success and future economic health of any utility. Since the repayment of government loans and loan guarantees depends almost entirely on the continued economic health of the borrower, a lengthy bankruptcy proceeding further limits the potential recovery of government funds.

Integrity of the Settlement Process

For the reasons stated above, RUS and DOJ have generally concluded that it is in the best interests of the Federal government to resolve the financial problems of RUS borrowers outside of bankruptcy and, in recent years, have endeavored to convince borrowers that all parties are better served by working together to restructure debt. In order to persuade borrowers to work with the government outside of bankruptcy, we must assure borrowers that RUS is willing and able to undertake and complete the long and complicated process of debt restructuring and that,

at the end of the process, RUS will have the necessary authority to execute the appropriate restructuring agreements. Because a restructuring involves not only the G&T and its member distribution cooperatives, but other creditors, utilities, and state regulators, the process may involve renegotiating contracts, negotiating sales or leases of utility plant, and evaluating a variety of other options and alternatives. Our experience has shown that this process can take several years to complete and can become particularly protracted when state regulatory hearings are required.

If RUS cannot provide reasonable assurances that it will be able to retain the responsibility and authority to settle claims during the often prolonged settlement process, we believe borrowers will be more inclined to pursue the bankruptcy alternative.

Administrative Offset

Under DCIA, funding made available by a Federal agency to an individual or entity could be used to offset any delinquent debt that individual or entity had with another Federal agency thereby minimizing the Federal government's exposure by not allowing Federal dollars to be used by recipients that are delinquent on Federal debt. Treasury offset could, therefore, lead to inadequate funding and the cancellation of projects.

Conclusion

As we have previously indicated, only fourteen RUS power supply electric borrowers have entered into debt restructuring negotiations during the past eighteen years; less than one borrower each year. The negotiations and ultimate restructurings associated with each are often years in the making, thereby rendering the 180-day DCIA time frame for debt recovery impracticable. RUS current ability to address delinquent debt has been successful, and we

believe we should continue on this course of action as long as this remains true.

We look forward to working with the Office of Management and Budget and Treasury to ensure the integrity and security of the RUS loan portfolio. As I am sure you will agree, it is critically important to protect and ensure program integrity and Congressional intent as we continue to comply with DCIA.

Mr. HORN. Mr. Shadburn, Administrator of the Rural Housing Service.

Mr. SHADBURN. Thank you, Mr. Chairman and members of the subcommittee. Thank you for this opportunity to testify today on debt collection and credit management activities at the Rural Housing Service within the U.S. Department of Agriculture and the progress that we have made in implementing the Debt Collection Improvement Act of 1996.

Mr. Chairman, I will present my testimony to you in two parts: first, I will briefly describe the housing and community facilities programs administered by the RHS, and this Agency's efforts to improve service delivery to rural America; second, I will summarize the Agency's implementation of DCIA to date.

We provide rural people and communities with access to credit, which, as you know, having been from a rural community, is often limited in rural areas; grants, including subsidized direct loans and rents; and technical assistance and support to complete their community development efforts. The direct loans are made to individuals, families, communities, and other entities that do not have access to credit at similar terms through the commercial market. We do have a large portfolio, over $35 billion, over 1 million units of home ownership, rural rental housing or community facility projects.

An essential part of the service we provide is congressionally mandated supervised credit to our low- and very low-income customers. This is an important point I would like to emphasize. It is one of our principal goals to not only provide the financing of the physical structure of a modest home, but provide additional servicing actions to help preserve home ownership through economic and medical hardships. These actions have made it possible for literally thousands of low-income rural residents to stay in their homes.

In addition, our borrowers have a right to appeal adverse decisions through the national appeals division. These unique servicing rights require more than simply debt collection as traditionally done in other agencies and the private sector.

I would also like to point out that with those supervised servicing opportunities, that this Agency has, in my opinion, one of the lowest delinquencies in our multifamily housing portfolio of 2.1 percent on 18,000 projects, Community Facilities Program with 1 percent with 1,000 projects, and we have just converted the largest conversion to a centralized operation in our single-family housing operation of 700,000 loans, which we believe will not only provide consistent but timely servicing.

We will be escrowing taxes and insurance, and the savings to the government of over $250 million when fully implemented. At conversion we had 12.5 percent delinquency, and when implemented we feel like we will be able to bring that under 10 percent.

The section 502 single-family direct and guaranteed loan programs offer rural people and their families the most basic piece of the American dream: the chance to own their own homes. The section 502 Direct Single-Family Program reduces the interest rate down to as low as 1 percent in income and provides 100 percent financing. This program serves low- and very low-income residents

under 80 percent median income and 50 percent median income respectively.

The section 502 Guaranteed Single-Family Housing Program guarantees loans to low- and moderate-income residents under 115 percent of median income. This program allows 100 percent financing for individuals who could not obtain credit with similar terms from the commercial sector.

The section 523 Mutual Self-Help Housing grants are made to nonprofit and Government agencies to provide technical assistance to small groups that average 6 to 10 families in constructing their own homes. The Mutual Self-Help Program enables low- and very low-income rural families to become homeowners through the efforts of their sweat equity contribution while simultaneously building and stabilizing their communities. The sweat equity reduces the mortgage and allows the Agency to reach to very low-income residents, in some cases with as little as an annual income of $10,000.

The section 515 Rural Rental Housing Program, consisting of 18,000 projects, 445,000 rental units, makes direct loans to developers to provide affordable rental housing for low- and very low-income families and elderly individuals, which, I might add, is 40 percent of our portfolio of elderlies living in our rental housing portfolio, in rural communities, with an average income of approximately $7,300. Subsidies are provided through as low as 1 percent financing and rental assistance for almost half of tenants. Rental assistance is a unit-based subsidy that allows many of our low- and very low-income residents to pay only 30 percent of their income toward rent.

We are entering in the third year of the section 538 Guaranteed Multifamily Rural Rental Housing Program, which guarantees loans made by certified lenders for multifamily housing projects available to moderate- and low-income residents.

The section 514/516 Domestic Farm Labor Housing Loan and Grant Program provides assistance to build and maintain rental housing for migrant and year-round farm laborers. The loan rates can be as low as 1 percent, with rental assistance also available. The companion grant program can also provide up to 90 percent of the development cost for farm labor units.

Our Community Facility Loan Program provides funding for essential community facilities, such as health care centers, fire stations, municipal buildings, and day care centers. Direct and guaranteed loans are made to public bodies and nonprofit organizations to provide essential community facilities to rural residents in communities of not more than 50,000 residents.

There is a small grant component to the program that assists communities that experience high poverty. The facilities financed allow rural communities to improve the quality of life for their citizens and remain competitive in attracting jobs and businesses. Servicing both multifamily housing and CF loans requires specialized expertise in order to keep the projects operating and serving rural America in addition to repayment of the debt.

I will now turn to the Agency's implementation of DCIA. As I have discussed, the Rural Housing Service programs consist of a variety of loan guarantee and grant programs, plus technical as-

sistance in the areas of housing and community facilities. The basic tenets of these programs is that they are not to compete with private credit, but, rather, supplement that credit. Authorizing legislation provides for supervised credit and allows the borrower certain loan servicing rights before an account can be liquidated.

Although faced with these challenges, Rural Housing Service protects the interest of the government by requiring adequate security for the loans in the form of real estate mortgages, assignments of income, personal and corporate guarantees, and liens on revenues. The Rural Housing Service and other USDA agencies are working with Treasury to resolve a number of operational and policy issues that impact on the various provisions of the act.

Rural Housing Service has made significant progress with implementing provisions of the act in a time when resources were limited and demands for automation support were at an all-time high because of our commitment to our centralized servicing operation and to having our automated systems year 2000-compliant. The following outlines the Rural Housing Service activities in implementing the provisions of the DCIA.

The Treasury Administrative Offset Program—this act requires agencies to refer any debt over 180 days delinquent to Treasury for inclusion in the Treasury Offset Program. Because the Treasury Offset Program enables Rural Housing to collect funds from tax refund offset, administrative offset, and salary offset, we placed a high priority in complying with this part of the act.

In September 1997, Rural Housing Service identified accounts to be reviewed for referral to Treasury, notified the borrower and gave them an opportunity to either pay their delinquent debt or provide us with evidence that would preclude us from reporting them. After 60 days had elapsed, we reviewed each borrower's account. If they remained delinquent, the account was referred to Treasury.

In accordance with our established target dates, Rural Housing Service, in December 1997, referred over 28,000 accounts, representing over $65 million in delinquent debt, to the Treasury offset process. As of May 9, 1998, we have collected on 6,991 accounts at about $7 million from the Treasury offset process referrals.

RHS is in compliance with the Treasury offset provision, and we are updating the list of referred debt as borrowers either become current or go delinquent. The administrative offset feature of the act causes Rural Housing Service concerns for the continued viability of our programs. If approved, loan and grant proceeds and payments can be offset by Treasury to satisfy another Federal debt of the proposed recipient. Critically needed projects could be jeopardized.

Rural Housing Service policy is to prohibit making loans to applicants with delinquent Federal debt. However, there are circumstances, such as when a debtor becomes delinquent on a Federal debt, after Rural Housing Service has approved the loan or closed the loan, or, despite its best efforts, the Rural Housing Service is unaware of the delinquency, where administrative offsets of the loan or grant payment would adversely impact or defeat the purpose of the program.

RHS is requesting exemption from Treasury where administrative offset of the loan or grant payment would jeopardize the com-

pletion of a community facility, a single-family housing, or multifamily housing project that is vital to the sustainability of a community or would adversely affect the health or safety of rural residents and payments that are needed to meet our commitments to private sector lenders who participate with us on interim financing arrangements.

One quick example might be where we issue a conditional commitment to finance a home for an individual who, in turn, goes to a contractor. They go to the private sector and get an interim loan. The construction is completed. Then we get ready in advance to pay off that private sector lender, and someone who is offset on those proceeds would leave the contractor and the whole process in a state of chaos. So I just wanted to make that point very clear.

On cross-servicing, Rural Housing Service is currently reviewing its delinquent debt to determine which accounts are eligible for cross-servicing. Not all of the accounts over 180 days delinquent are eligible for cross-servicing because of statutory loan servicing requirements that include more moratoriums and workout agreements. Also, many of the accounts are in foreclosure, bankruptcy, or other litigation, which precludes the use of a cross-servicer.

System modification to provide required data to a cross-servicer are much more extensive than the modifications that were necessary for the Treasury Offset Program reporting. I anticipate that Rural Housing Service will refer its first debt to Treasury for cross-servicing in June 1998. We will continue to refer more debt as system modifications are made.

In conclusion, our credit programs administered by the Rural Housing Service vary significantly in their objectives and goals. As a result, the programs differ in the type of credit, payment schedules, interest rates, payback provisions, and servicing they require. Although these differences must be considered when pursuing debt collection, we believe that every debt should be repaid in accordance with the conditions under which the loan was made.

We have a good security position with the vast majority of our loans. We must also remember the majority of our programs serve low- and very low-income customers, and we must take extra steps to assist and preserve the homes and facilities we finance. It is in the best interest of the government and the rural residents we are here to serve.

We will make every effort to implement the additional provisions of the act as the rules and requirements are identified by Treasury for such features as wage garnishment and gainsharing. The act provides us with many new tools to assist us in the efficient and effective management of our loan portfolios.

We look forward to working with the Office of Management and Budget, Treasury, and other Federal departments and agencies through the Federal Credit Policy Working Group and the Chief Financial Officers Council to coordinate initiatives that reduce the amount of delinquent debt owed to the Federal Government.

Mr. Chairman, thank you for the opportunity to testify today and discussing the progress we have made in the implementation of the Debt Collection Improvement Act. I will be delighted to answer any questions that you may have at this time.

Mr. HORN. Thank you, Mr. Shadburn.

[The prepared statement of Mr. Shadburn follows:]

Statement of Jan E. Shadburn, Administrator
Rural Housing Service
U.S. Department of Agriculture
Before the Subcommittee on Government Management,
Information and Technology
Committee on Government Reform and Oversight
U.S. House of Representatives
March 30, 1998

Mr. Chairman and members of the Subcommittee, thank you for this opportunity to testify today on debt collection and credit management activities at the Rural Housing Service (RHS) within the U.S. Department of Agriculture (USDA) and the progress that we have made in implementing the Debt Collection Improvement Act of 1996 (DCIA).

Mr. Chairman, I will present my testimony to you in two parts. First, I will briefly describe the housing and community facility programs administered by the RHS and this Agency's efforts to improve service delivery to rural America. Second, I will summarize the Agency's implementation of DCIA to date.

Rural Housing Service

The RHS was established under the Department of Agriculture Reorganization Act of 1994, succeeding the Farmers Home Administration.

We provide rural people and communities with: access to credit -- which, as you know, is often limited in rural areas; grants, subsidized loans and rents; and technical assistance and support to complete their community development efforts. A very important part of the service we provide is "supervised credit."

We deliver our programs and necessary technical assistance through a network of State and local offices, many of which are, or will be, collocated with other USDA agencies in USDA one-stop Service Centers.

We invest in two of our most vital assets- our people and our small rural communities- and enable them to have a part of the American Dream. Our assistance literally allows individuals, families and communities to turn their lives around and become self sufficient. The impact on the community and the individual goes far beyond the tens of thousands of construction related jobs, the millions of dollars generated each year in building and associated trades, the more than $1 billion boost in State and local taxes, and the actual physical shelter provided.

Housing Programs

The section 502 single family direct and guaranteed loan programs offer rural people and their families the most basic piece of the American Dream -- the chance to own their homes. The section 502 direct single family program reduces the interest rate down to as low as 1 percent based on income with an average interest rate of around 3 percent. This program serves low- and very low-income residents under 80 percent median income and 50 percent median income

respectively.

The section 502 guaranteed single family housing program guarantees loans to low- and moderate-income residents under 115 percent median income. This program allows 100 percent financing for individuals who could not obtain credit from the commercial sector.

In addition, RHS makes section 504 repair loans and grants to finance necessary repairs for substandard units to remove health hazards. One-percent loans are made to very low-income applicants for not more than $20,000 for a period not to exceed 20 years. RHS also administers a section 504 grant program limited to elderly applicants under which individuals can receive up to $7,500 in their lifetimes for repairs. A loan and grant combination can also be used if the applicant is very low-income and has repayment ability.

Section 523 Mutual and Self-Help Housing grants are made to nonprofit and Government agencies to provide technical assistance to small groups that average 6 to 10 families in constructing their own homes.

The Mutual Self-Help Grant program enables low- and very low-income rural families to become homeowners through the efforts of their "sweat equity" contribution while simultaneously building and stabilizing their communities. The sweat equity contributed by these families not only builds communities, but also reduces the cost of the mortgage and enables RHS to reach a lower-income customer. The majority of the mortgages are provided by the section 502 direct

loan program which allows the interest rate to be subsidized down to as low as 1 percent based on income. These self-help borrowers have exceptional track records--both lower delinquency rates and better graduation. Over half have paid off their loans in full or graduated to private credit.

We are continuing to carry out the Congressionally mandated escrow of taxes and insurance for our section 502 direct single family borrowers. This involved the transfer of over 700,000 loans from the field offices across rural America to one centralized unit in St. Louis. The Centralized Servicing Center (CSC) is providing state-of-the-art servicing comparable with any other system available to homeowners across the Nation. Our system is unique because of the Congressional mandated "supervised credit" that is available to our borrowers to preserve homeownership through economic or other hardships individuals and families may experience. For this reason, we have had to modify the private sector software we purchased to ensure these servicing options were handled in a consistent and efficient manner. These servicing features include: 7-day-a-week, 24-hours voice response for detailed information on loans; nationwide consistency for servicing, including payment assistance, moratorium, reamoritization and other services; centralized cash management providing fiduciary control; a monthly statement sent to each borrower; escrow of taxes and insurance; and expanded (7:00am-6:00pm) customer service representatives to handle more complex issues for our borrowers.

In addition to the single family housing programs, RHS administers multi-family housing programs to assist rural residents who cannot afford to own a home. The section 515 rural rental housing program makes direct loans to developers to provide affordable rental housing for low-

and very low- income families and elderly individuals in rural communities. Subsidies are provided through as low as 1 percent financing and rental assistance for almost half of tenants. Rental assistance is a unit-based subsidy that allows low- and very low-income residents to pay only 30 percent of their income toward rent.

We are entering the first year, after two-year pilot, with the section 538 guaranteed multi-family rental housing program which guarantees loans made by certified lenders for multi-family housing projects available to moderate- and low-income rural residents.

The section 514/516 domestic farm labor housing loan and grant program provides assistance to build and maintain rental housing for migrant and year-round farm laborers. The loan rates can be as low as 1 percent with rental assistance also available. The companion grant program can provide up to 90 percent of the development costs for farm labor units.

Community Facilities

Our community facilities program provides funding for essential facilities such as health care centers, fire stations, municipal buildings and day care centers. Direct and guaranteed loans are made to public bodies and nonprofit organizations to provide essential community facilities to rural residents in communities of not more than 50,000 residents. There is a small grant component to the program that assists communities that experience high poverty. These facilities allow rural communities to improve the quality of life for their citizens and remain competitive in attracting jobs and businesses.

Protecting the Government's Interest

RHS has taken many steps, both administratively and through legislative changes to protect the Government's interest in the administration of all our programs.

RHS and the USDA's Office of Inspector General (OIG) are working on a joint initiative to identify section 515 rural rental housing projects and participants where the potential for financial abuse may exist.

The OIG has previously reported a number of cases where tenant household income information provided to RHS was incomplete or unreliable. As a result, both tenant and owner received subsidies to which they were not entitled.

The Agency is pursuing legislation that would allow access to the National Database for New Hires. This data would be used to verify income information provided by tenants renting rural multi-family housing units and applicants for, or borrowers and grantees of, rural housing loans or grants administered by the Agency.

Other examples of actions to protect the Government's interest include implementation of a series of reforms to the section 515 program that were enacted by Congress as part of the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriations Act for

fiscal year 1997. The regulations implementing the reforms were published as an interim rule on May 7, 1997 and as a final rule on December 23, 1997. In developing these rules, RHS worked extensively with stakeholders representing for-profit and non-profit developers as well as housing advocacy groups, state housing finance agencies, the OIG and other interested parties.

As a result of this Congress' and the Administration's efforts to provide the necessary tools to provide the proper oversight and management, the section 515 multi-family housing portfolio is healthier and safer today. The tenants' and Government's interest are protected. But we're not stopping there.

I'll turn now to the Agency's implementation of the DCIA.

As described above, the RHS programs consist of a variety of loan, loan guarantee, and grant programs, plus technical assistance, in the areas of housing and community facilities. The basic tenet of these programs is that they are not to compete with private credit, but rather supplement that credit. Although faced with these challenges, RHS protects the interest of the Government by requiring adequate security for the loans in the form of real estate mortgages, assignments of income, personal and corporate guarantees, and liens on revenues.

In fulfilling our responsibilities to our constituents and the American taxpayer, we believe that each and every debt should be repaid in accordance with the requirements under which the loan was made, including proper exercise of the repayment and servicing provisions specified by the

enabling legislation that created specific programs.

RHS, through it's predecessor Agency has long used all available tools to collect delinquent debt and, in fact, implemented several of the provisions of DCIA (the Act) as far back as 1985 including: reporting of delinquent consumer debts and all commercial debts to credit bureaus, and reporting write-offs to the IRS for inclusion in debtors' taxable income.

RHS was also an active participant in the IRS offset program and in the salary offset program, both of which were predecessors to the Treasury Offset Program (TOP). For the period 1987 through 1997, RHS collected in excess of $7.2 million from IRS offset.

RHS and other USDA agencies are working with Treasury to resolve a number of operational and policy issues that impact on the implementation of the various provisions of the Act. RHS has made significant progress with implementing provisions of the Act in a time when resources were limited and demands for automation support were at an all time high because of our commitment to having all of our automated systems Year 2000 compliant.
The following outlines RHS activities in implementing the provisions of DCIA.

Treasury Administrative Offset Program (TOP)

The Act requires Agencies to refer any debt over 180 days delinquent to Treasury for inclusion in TOP. Because TOP enables RHS to collect funds from Tax Refund Offset, Administrative Offset, and Salary Offset, we placed a high priority in complying with this part of the Act. In September

1997, RHS identified accounts to be reviewed for referral to Treasury, borrowers who were more than 90 days delinquent and were not excluded by statute for reasons including pending litigation or foreclosure. In addition, based on Treasury's guidance we also excluded borrowers who were in bankruptcy from our file of borrowers who could be referred for Treasury offset. The borrowers that we identified during this process were then notified and given an opportunity to either pay their delinquent debt or provide us with evidence that would preclude us from reporting them. After 60 days had elapsed, we reviewed each borrowers' account and if they remained delinquent, the account was referred to Treasury.

In accordance with our established target dates, RHS in December 1997, referred over $65 million in delinquent debt to TOP. As of March 9, 1998, we have collected about $7.2 million from the TOP referrals. RHS is in compliance with TOP and we are updating the list of referred debt as borrowers either become current or go delinquent.

It took some time to comply with provisions in the Act and refer debt to TOP, because RHS had to revise systems and procedures as follows:

- Revised the System of Record to be published in the Federal Register to provide for the sharing of records necessary to implement TOP.
- Developed internal regulations to implement Treasury's debt collection processes.
- Modified automated systems to establish a new offset database, and established protocols necessary to send the data to TOP electronically.

In addition, because Treasury is in the process of updating its TOP system to allow for the submission of multiple debts for a single borrower and to accept information related to co-borrowers, RHS will be required to modify its automated systems to take advantage of the capabilities afforded by Treasury's new Grand TOP program. Also, once we complete the changes needed in the due process letter needed to comply with legal requirements, we will be able to begin participating in Treasury's pilot salary offset program.

Cross-Servicing of Delinquent Debt

RHS is currently reviewing its delinquent debt to determine which accounts are eligible for cross-servicing. Not all of the accounts over 180 days delinquent are eligible for cross-servicing because of statutory loan servicing requirements that include moratoriums and workout agreements. Also, many of the accounts are in foreclosure, bankruptcy or other litigation which precludes the use of a cross-servicer. System modifications to provide required data to a cross-servicer are much more extensive than the modifications that were necessary for TOP reporting. I anticipate that RHS will refer its first debt to Treasury for cross-servicing in June 1998 if all legal requirements have been met. We will continue to refer more debt as system modifications are made.

Taxpayer Identification Numbers (TIN)

RHS already collects TINs from most of its vendors, borrowers, and other clients. The TINs are required in the application process prior to loan or grant approval. RHS does experience some

problems verifying TINs; however, we recognize the collection of TINs will improve the collection of delinquent debts by allowing full participation in TOP and assuring that any subsequent discharges of indebtedness are reported to the IRS.

Reporting of Write-offs to IRS on Form 1099-C

RHS has been reporting write-offs to the debtor and to the IRS on Form 1099-C for inclusion in the debtor's income since 1990. For 1997, we reported write-offs totaling more than $82 million.

Civil Monetary Penalties

The USDA has developed and published in the July 31, 1997, Federal Register, a Final Rule pertaining to civil monetary penalties which incorporates inflation adjustments. RHS has adopted the Department's rules.

Use of Private Collection Agencies

Until recently, RHS was prohibited from using collection contracts. The Agency uses many tools to collect delinquent debt and the use of private collection agencies will be considered. We will continue to refer delinquent debts to the Department of Justice for litigation when appropriate.

Barring Delinquent Debtors

RHS supports the Act's provision to bar delinquent debtors from obtaining additional Federal loans or loan insurance guarantees. During the application process, RHS uses credit reports as a

tool in determining the credit worthiness of individuals, businesses, or other organizations who are applying for loans and grants.

Electric Funds Transfer (EFT)

DCIA requires RHS to make all disbursements by electric funds transfer (EFT) by 1999. The Agency has initiated the system design changes necessary to comply with this requirement.

Guaranteed Loans

RHS's guarantees of single-family loans are different from many federal guarantee programs in that we do not take back loan collateral or the loan upon borrower default. Therefore, we do not have DCIA issues with our guarantees.

Conclusion

Credit programs administered by the Rural Housing Service vary significantly in their objectives and goals. As a result, the programs differ in the type of credit, payment schedules, interest rates, payback provisions, and servicing they require. Although these differences must be considered when pursuing debt collection, we believe that every debt should be repaid in accordance with the conditions under which the loan was made.

We will make every effort to implement the additional provisions of the Act as the rules and requirements are identified by Treasury for such features as Wage Garnishment and Gainsharing. The Act provides us with many new tools to assist us in the efficient and effective management of

our loan portfolios. We look forward to working with the Office of Management and Budget, Treasury, other Federal Departments and agencies, through the Federal Credit Policy Working Group and the Chief Financial Officers Council to coordinate initiatives that reduce the amount of delinquent debt owed to the Federal Government.

Thank you for the opportunity to testify today and discuss the progress we have made in the implementation of the Debt Collection Improvement Act. I would be delighted to answer any questions that you may have at this time.

Mr. HORN. What I am going to do is go with the questions in two ways: One is the nitpicking department, just so I understand the statements you have each made; and then I will get to broader policy questions.

So I will start with you, Ms. Thompson, and see if there is something here that I might not have thoroughly understood, and I do want to understand.

The debt administered by State government. On page 4 you say preliminary findings show the primary reasons for not referring this debt fall into the following categories. You have debt in litigation where the existence of the debt or the amount of the debt is in dispute, and then debt administered by State government. Why should that lag, the State government debt?

Ms. THOMPSON. I can't answer very specifically, but the deputy, Ted David, is here. But that relates mostly to the food stamps, which is about $1 billion in debt there, and that is administered by the State governments, as you know. They have the individual detail. They are also entitled to a portion of that.

If you want some more specifics on that, I think that Ted David can answer that for you.

Mr. HORN. Well, why don't we just file it for the record. Send the response to Mr. Brasher, and we will put it in the record.

Ms. THOMPSON. Be glad to do that.

[The information referred to follows:]

The Food Stamp Act delegates the responsibility for the identification and management of Food Stamp debt to State agencies. Although the recipient debt established through Food Stamp overpayments is technically Federal debt, it is managed by States using a combination of Federal and State standards. The Food Stamp Act and regulations issued pursuant to the Act identify required Federal standards for the management and reporting of the debt. Food Stamp State agencies report the value of the debt established and the value of the debt disposed through collection and other methods of resolution. At the present time, neither the Act nor regulations issued pursuant to the Act require State agencies to report debt delinquency to FNS although FNS has notified State agencies of its intent to seek this requirement in recently published proposed Program regulations.

FNS does not believe that all debt eligible for referral to Treasury has yet been identified by its State agencies. Much of the delinquent Food Stamp debt is actually managed by local offices or counties within State jurisdictions. In the past, these local offices may not have had the resources or the focus to properly identify and manage the delinquent debt. FNS and State agencies are working with those offices to identify and forward all appropriate debt to the Treasury Offset Program. The 47 State agencies currently participating with this debt under Treasury's TOP, are doing so voluntarily. We expect all States will be part of the effort as of January 1999.

Historically, participating State agencies may not have reliable addresses for the delinquent debtors, a necessary condition for referral under TOP. States rely on the addresses provided by the IRS, however the IRS is not able to provide an address for all accounts. In addition, until the effective date of the provisions of the Personal Responsibility and Work Opportunity Act of 1996, State agencies were not able to submit overpayments caused by State administrative error; these overpayments amounted to approximately 1/3 of the total value of the recipient claims. Many State agencies are still examining these accounts to determine those that may be eligible for referral to TOP.

In spite of all the barriers cited above, we have a very positive history with our State partners in the debt collection arena. The States, in 1997, collected over $120 million on their own with no intervention from the Federal level and about $60 million through voluntary participation in TOP. Since 1992 over $220 million has been collected through the Federal Tax Refund and Salary Offset programs. These collection totals are even more impressive considering that, while the total amount of the debt portfolio is large, it mainly consists of very small debts. (There are in excess of 3 million individual claims.) Systems for establishing, referring, tracking and managing this volume of activity are necessarily large and complex to administer, and our State partners have done an outstanding job.

FNS is committed to referring all delinquent Food Stamp recipient debt to Treasury. Its participating State agencies deserve full credit for the effort that presently produces more than 80% of the USDA's total collection. In the coming years, FNS and its State agencies will continue to improve the thoroughness of their referrals and the accuracy of their reporting.

Mr. HORN. I am not quite clear when you say debt where due process procedures are not complete. Does that say they are partway through bankruptcy or what?

Ms. THOMPSON. I think it also refers to the rural housing area, and I could let the representative here answer that. But there is a certain process of due process in the foreclosure, then there is a year's period of time when a resident can reclaim that, pay up their back taxes, that sort of thing.

Mr. SHADBURN. Yes, we have certain servicing options in our supervised credit that is available to our borrowers that allows such things as moratoriums, debt reamortization, and a multitude of servicing options that are afforded to our borrowers that, through the process, allows them the opportunity to try to be successful homeowners. And through the mandate of Congress, we do afford them all those servicing opportunities necessary.

Mr. HORN. And it can extend up to 1 year?

Mr. SHADBURN. It can be longer than that. Yes, sir.

Mr. HORN. Where is that in this law? This is the authorization of the program?

Mr. SHADBURN. Well, in terms of some of the servicing actions that we are involved in, in terms of supervised credit with moratoriums and some bankruptcy actions and things like this, we have situations that could extend in excess of 180 days to a year, yes, sir.

Mr. HORN. Back to you, Ms. Thompson. On the second bullet from the bottom, on page 5, you say working with Treasury—well, the lead is: "To reach this point in transferring debt for administrative offset, agriculture activities to date include," and this is one of those, "Working with Treasury to resolve software issues, which prevents us from referring multiple debts of a single borrower or single debts with multiple borrowers for administrative offset."

What is the big hangup there?

Ms. THOMPSON. It has to do with the two systems talking to each other. If you think about it, when Treasury wants to go after debt, we may have one borrower that has debt in the housing area, farm loan area. They may even be involved, I don't know, in utilities.

Mr. HORN. Are you telling me Agriculture's internal computer systems are incapable of getting the person? Because that is what started me, frankly, on this debt improvement law—this is before your time, but there was a default of several million dollars, I believe, in Sonoma County, on a ranch, and the person went to Santa Barbara, built himself a beautiful new office building, got a great mansion to live in in Santa Barbara, and the same Agency, I think Rural Housing, loaned him again. They couldn't even find it within the Agency.

What are the problems on the software there, and are we trying to do something about it?

Ms. THOMPSON. Absolutely, we are trying to do something. As you know, I believe the Department of Agriculture had 120 different systems, and they were not coordinated. They didn't come together. And that has been the major project that we have been working on, called the FISVIS Program, to be able to pull together also the consolidated financial statements as well.

In terms of the details on that, maybe Ted David could give you a better answer for me.

Mr. HORN. Fine. Mr. David, you heard us administer the oath to everybody else. I take it you affirm.

Mr. DAVID. I do so, sir.

Mr. HORN. Fine. Proceed.

Mr. DAVID. As Ms. Thompson said, part of the issue has been to coordinate our systems with Treasury. We do have some borrowers who have multiple loans, for instance in the housing area or in other areas, and we do have some loans where we serve multiple borrowers. We have been working with Treasury so that their systems will accept those kinds of loans.

We tried to send those over to Treasury early on in the process, and we found that the systems didn't talk to each other, and that Treasury was not able to accept the information that we sent. Since then we have been working with them to coordinate our systems.

Mr. HORN. Are you optimistic they will get coordinated?

Mr. DAVID. Yes, sir. If we are not there, we are very close to having them coordinated.

Mr. HORN. Is this a year off, 1 month off?

Mr. DAVID. I would say closer to 1 month than a year, but I will get you that information for the record, sir.

[The information referred to follows:]

It is my understanding that Treasury's Financial Management Service (FMS) is in the process of making the necessary automated systems changes to accept delinquent debt from a debtor that may have multiple delinquent debts. However, it is also my understanding that FMS has not started to address the issue of delinquent debts that are held by multiple debtors. Therefore, until the FMS addresses this issue, USDA will not be able to refer these debts.

Mr. HORN. We will ask about it at the half-year point when we have everybody back to see what we are doing.

Mr. DAVID. OK.

Mr. HORN. OK. Thank you on that.

You say on page 6, "At this time one USDA agency has requested to be designated a debt collection center for individual administrative debts." Which one is that?

Ms. THOMPSON. That is our National Finance Center that is under the chief financial officer in New Orleans. We are the ones that process payments, travel vouchers, salaries for USDA and other agencies, as well as their thrift plan.

Mr. HORN. I thought it might be. We have high regard for that center, as I recall.

Over here on the civil monetary penalties, on page 7, is all that that Federal Register filing of July 31, 1997, is it simply the inflation adjuster, or is there something else there?

Mr. DAVID. It is both the inflation adjustment as well as the time, the frequency with which those rates are changed. So, yes, it is basically inflationary.

Mr. HORN. What is the frequency period?

Mr. DAVID. It is annually readjusted.

Mr. HORN. Annually readjusted.

Mr. DAVID. Yes, sir.

Mr. HORN. Now, down in the next one, report to credit bureaus. You say Agriculture has referred both delinquent and commercial

accounts to credit bureaus since 1985. Then you say, we have referred delinquent individuals to credit bureaus since 1990. And this is the sentence that gets me: "USDA routinely refers more than $60 billion of current and delinquent debt annually."

Now, is this just a total of $60 billion for the whole Department, or are you giving $60 billion a year that is a different $60 billion?

Mr. DAVID. That would be the total for the entire Department.

Mr. HORN. So that might be 5 years of debt, 10 years of debt, 20 years of debt? We are not going into new debt of $60 billion each year? That is what it sounded like to me, and I thought it was another scandal.

Mr. DAVID. No, sir.

Ms. THOMPSON. No, sir.

Mr. HORN. Which is coming close, anyhow.

Then we say down here, use of private collection agencies. Now we are able to fully utilize collection agencies. USDA intends to take full advantage of the collection contracts awarded by Treasury. Until recently, two of our largest creditor agencies, Farm Service Agency and Rural Development, were prohibited from using collection contracts.

Now, was that by the authorizing committee?

Mr. DAVID. We were prohibited, I believe it was, by the Appropriations Committee, but I would ask both FSA and Rural Housing to possibly comment on that. But we were not able to use the private collection contractors.

Mr. HORN. Was this by the late Jamie Whitten?

Mr. DAVID. I understand that was the history.

Mr. HORN. We have changed our mood up here on a number of things. So I take it that they dropped that from the Appropriations Act?

Mr. DAVID. Yes, they have, sir.

Mr. HORN. Thank you. Because one of the things that concerned me, Mr. Shadburn, I think it was your testimony, we will get to it, was how seriously are we taking private collectors. It seems to me the only way you are going to get the money back. And let us face it, it is in your interest as an Agency to be a nice guy to the farmers and the nuclear types that presumably are generating electricity for farmers.

And it would seem to me, I would just love it if I were a civil servant. I would say, "great, turn them over to the private collectors, let them take the heat." And that way we get some of this money back in the Treasury, I think.

Mr. DAVID. We now have the opportunity to do so.

Mr. HORN. Great. And I take it we are going to, Ms. Thompson?

Ms. THOMPSON. Absolutely, Mr. Chairman.

Mr. HORN. Good. Are there any exceptions to that that are going to occur within the Department?

Ms. THOMPSON. Only those that either because of litigation or States rights or those kinds of things legally that would prevent us from doing that; or, I assume, those that we could recover more money through the Treasury Offset Program.

Mr. HORN. What would be the point at which you would turn it over to private collectors? Is it 3 months, 6 months, 1 year? What is your thinking on that?

Ms. THOMPSON. I think I don't have an answer to that for you, but I will certainly get you an answer in the written responses.

[The information referred to follows:]

In those cases where there are no legal constraints, I recommend turning delinquent debt over to private collectors 6 months after the debt becomes delinquent. This time is required to provide due notice to our debtors, to employ those debt collection tools within USDA and time to establish work out agreements with those debtors where appropriate.

Mr. HORN. My feeling, looking at all of the mess we have inherited here, is that if you don't get on people in the 60-day period, you can forget it. They think it is a grant, not a debt, not a loan. We have had a number that just didn't face up to it, and IRS is a fine example. The new Commissioner I hope will change all that nonsense.

Ms. THOMPSON. We had a very successful program in the State of Kansas of offset there, so I do have that familiarity as well, and you are absolutely right. I worked with the health care industry and found if they didn't get on those immediately, you had the same problem.

Mr. HORN. Yes. In Kansas did you turn any of the debt over to private collectors?

Ms. THOMPSON. Yes, we were just starting to do that in the last 18 months or so. I think that is kind of new for a lot of Government agencies, to think in those terms.

Mr. HORN. What is your period? Do you let the Government agency try to collect it first and then turn it over, or do you just turn it over to start with?

Ms. THOMPSON. Usually we looked at anywhere from 90 to 180 days.

Mr. HORN. OK. Then, Mr. Kelly, on some of these things, I wanted to make sure I understand it clearly. I guess on page 3, the first paragraph, we talk about the delinquent debt, roughly $40 million, to be eligible for cross-servicing. And I'm just curious where the homestead protection programs come in. Do they apply strictly to the so-called family farm, or do they also apply to the large corporate farm?

Mr. KELLY. Congressman, I will have to get back to you with a specific answer on the whole protection act.

Mr. HORN. We will put it in the record at this point. I just want to get the clarification. There is a difference there, I think.

[The information referred to follows:]

Question : Homestead protection, does it apply strictly to the so-called family farm, or does it also apply to the large corporate farm ?

Answer : The protection, which comes from Section 352 (a) through (e) of the Consolidated Farm and Rural Development Act (7 USC 2000), applies to all FSA Farm Loan Program borrowers, whether corporate or family-sized farmers, provided they meet the eligibility requirements of 7 CFR 1951.911(b)(3). The applicant must be:

1) An individual who is or was personally liable for the FLP loan that was secured in part by the Homestead Protection property, or, if a non-borrower pledged the property to secure the FLP loan, the owner of the property. In either case, the applicant must be or have been an owner of the Homestead Protection property. A member of an entity who is or was personally liable for a loan that is or was secured by the homestead protection property is considered an owner for homestead protection purposes, so long as either the member of the entity or the entity itself held fee title to the property;

2) When more than one member of an entity was personally liable for an FLP loan, each such member who possessed and occupied a separate dwelling as his or her principal residence, on property that is or was security for the loan may apply separately for homestead protection of their individual dwellings;

3) The applicant and any spouse must have received, from the farming or ranching operations, gross farm income reasonably commensurate with the size and location of the farm and reasonably commensurate with local agricultural conditions in at least two calendar years during the preceding 6 year period.

Mr. HORN. Now, here in the next paragraph, you talk about another $23.4 billion of the total debt which is due from sovereign debtors under our export guarantee programs and Public Law 480 programs. Basically, you are talking about foreign nations, I assume. Is that correct?

Mr. KELLY. That is correct, most of it being Iraq.

Mr. HORN. Well, I guessed it before I came to it. I knew it was going to be Iraq. And that leads me to the next point, which is a little more substantive, and that is: if an Iraqi ship shows up in an American port, can't you file a lien on that ship and start collecting some of that money back?

Mr. KELLY. I will have to get that answer for the record. I would like to state for you that Commodity Credit is seeking a judgment against the Central Bank of Iraq for approximately $3 billion. We have filed that in New York. Even with this judgment, we will be currently precluded from seeking to enforce the judgment against Iraqi assets.

Mr. HORN. Now, who is precluding this? The Department of State?

Mr. KELLY. Yes.

Mr. HORN. How about the frozen Iraqi assets in the Federal Reserve?

Mr. KELLY. I do not have an answer for that. I will try to figure that out.

Mr. HORN. Could you get that?

Mr. KELLY. Yes.

[The information referred to follows:]

Question : If granted a judgment against Iraqi for the debt owed to CCC, why could it not be enforced ?

Answer : The Commodity Credit Corporation (CCC), like any other commercial claimant in the United States against Iraq, requested and received a license from the Office of Foreign Assets Control (OFAC) within the United States Department of the Treasury to pursue a judgment against Rafidain Bank and the Central Bank of Iraq. OFAC issues such licenses pursuant to the Iraqi Sanctions Regulations, the International Emergency Economic Powers Act, Executive Orders 12722 and 12724 of August 2 and 9, 1990, respectively, and certain other statutory authorities. Such statutes, regulations, and executive orders have effectively blocked all property and interests in property of the Government of Iraq, including the Central Bank of Iraq, and transfer of blocked Iraqi assets is currently not permitted without OFAC authorization. The license issued to CCC expressly prohibits "the transfer of blocked funds, or entry or execution of any judgment."

Mr. HORN. I don't want to telegraph your punch, but it seemed to be it should be punched anyhow, even if it is telegraphed.

Now, at the bottom of that page you say, in addition, Mr. Chairman, "other statutory requirements prohibit us from referring these debts to Treasury." I'd like a list of the other statutory requirements, if you would.

Mr. KELLY. OK.

Mr. HORN. We will put it at this point in the record, because if it is something stupid we are doing up here, I want to see that that gets changed. And I realize how authorizing committees are often the patron and protector of each cabinet department they review. We aren't. Neither are the appropriations committees.

[The information referred to follows:]

Question : What are the statutory/regulatory citations that provide Farm Loan Program borrowers with the rights that prohibit the speedy collection of delinquent debts?

Answer : We are assuming that this question refers to the debt restructuring available through loan servicing. Debt restructuring for Farm Loan Program borrowers comes from Section 353 (a) through (p) of the Consolidated Farm and Rural Development Act, 7 USC 2001. The regulations are found at 7 CFR 1951, subpart S, 1951.901 through 1951.950.

A delinquent borrower who is 60 days delinquent (90 days past due) is provided an opportunity to apply for 1951-S servicing. A borrower who applies for this servicing can be considered for debt restructuring, consisting of rescheduling or reamortization, interest subsidy, deferral, and writedown (not to exceed $300,000). If a feasible cash flow cannot be developed, a borrower is given the opportunity to apply for mediation and, ultimately, for homestead protection (for a house and up to 10 acres) if a feasible plan cannot be developed. Adverse decisions during the loan servicing process are appealable to the National Appeals Division, and this may occur several times during servicing. In some cases it can take several years to work through this process.

The 1996 FAIR Act restricted debt forgiveness to one writedown.

Mr. HORN. And here you say in the bottom sentence, it says, "these amounts include approximately $69.9 million in debts under appeal." Now, is that under appeal through a bankruptcy process, or what does under appeal mean there?

Mr. KELLY. On which page? I lost you.

Mr. HORN. Well, it was the bottom of page 3. I was just curious. Is that an administrative law judge procedure, or are we in the Federal courts and one Federal court ruled one way, and we are up on appeal? What are we talking about?

Mr. KELLY. Congressman, we are under appeal in both cases. We have administrative appeals. They have all the servicing rights provided for them within the authorizing legislation for the Ag credit program. And, as well, we have many of those that are in some form of litigation or bankruptcy, and particularly, as you may be aware, a lot of the million dollar plus loans we had from the 1980's. Those are the people that have the most resources to fight everything through the judiciary system.

Mr. HORN. Well, just give us an idea in a statement filed for the record, at this point it will be inserted, of what we mean; are these primarily administrative appeals, are they article 3 judiciary appeals? Just what are they?

Mr. KELLY. OK.

[The information referred to follows:]

The $69.9 million is in administrative appeal.

Mr. HORN. OK. And I take it down at the bottom of page 4, you say, "the debts of the farm loan program under the former Farmers Home Administration were prohibited from using private collection agencies." And you are saying that has been changed now?

Mr. KELLY. That is correct, it is changed now.

Mr. HORN. Thank you.

Up at the top of page 5, you are saying that "internally offsetting existing debt against benefits coming due is an extremely cost-effective way to collect on debt because it keeps the process simple and completely in-house." Is that in-house within Agriculture or within the executive branch? What do you mean?

Mr. KELLY. In this particular case, Congressman, we would be referring to within the Department of Agriculture to collect the debt.

Mr. HORN. When I am not asking questions, you can feel comfortable, I am skipping pages.

Mr. KELLY. Thank you.

Mr. HORN. It is to your benefit when I am not saying something. How far along is that year 2000 compliance?

Mr. KELLY. We are looking at 2000-compliant for our whole mission area of field-testing it all, I believe, by September of this year, in September of this year, on this particular program, what we plan to have in effect with the Treasury.

Mr. HORN. Is that true of the other agencies here, the 2000 problem?

Mr. SHADBURN. Yes, sir.

Mr. BEYER. Yes, sir.

Mr. HORN. You feel pretty good about it? You will get them all straightened out so farmers won't be getting a 1993-year delin-

quency when it is only a 3-year? That has already happened; not to farmers, but to a few other people.

Now, Mr. Beyer, on page 2, you note that the Department of Justice is actively pursuing some of these situations through the bankruptcy process. How successful have they been to this point? Do you have a feeling for that?

Mr. BEYER. Mr. Chairman, yes, sir. Over the years that the Agency has worked with the Department of Justice, I would have nothing but good things to say about the civil branch over there at Justice. They are definitely working for the American taxpayer, I can tell you that. They are very, very good at what they do.

And States' rights and the confrontational nature of some of these workouts and the bankruptcies are the difficult part. The fact that you mentioned Cajun Electric, I would offer that there are about 3 dozen lawyers involved in that thing, and there are delays, and there are delays, and there are delays. We think we have a solution one day, and the next week something happens. And it is an extremely high and low activity, I can tell you that.

But I would just praise the Department and our people. Those folks are working nights and they are working weekends trying to get solutions to these problems.

Mr. HORN. Is it true that the Rural Utilities Service that you head has received authority to unilaterally write off debts without review by the Attorney General?

Mr. BEYER. Yes, the Secretary, in the last farm bill, received authority to write off debts, and he has delegated that to us.

Mr. HORN. So you don't have to go to Justice for that?

Mr. BEYER. We don't have to, but in our procedures we are going to. We are going to notify Justice. And like I say, we are close to implementing that, and when we do, we will be coordinating with Justice, yes, sir.

Mr. HORN. On page 3, toward the bottom of the penultimate paragraph, you say, "RUS borrowers were, however, forced to continue to make debt service payments at interest rates well in excess of market rates, interest rates that have since 1975 provided an additional $1.3 billion in revenues to the Federal Treasury."

Was that interest rate situation the fault of Congress, or was it just something of the legacies of the 1970's, or what was that?

Mr. BEYER. Well, Mr. Chairman, it was probably a combination of things. There was not much excitement at the Department of Treasury. In fact, there were high costs, high penalty costs to these borrowers to refinance, and it just wasn't feasible.

Congress in 1993, in the Rural Electric Restructuring Act, provided a provision that limited the penalty to I think it was 1 year's interest rate for refinancing. And we, in fact, have assisted in refinancing about $9 billion over the last 3 years.

In addition to that, we disagreed with the GAO report on the cost. They are coming up with some pretty large numbers, obviously, and they are basically right in a lot of them. We did disagree, however, with their calculation on loss to the Treasury vis-a-vis the interest charges to the borrowers and the interest charges to government. In fact, we have made a tabulation of all of the loan contracts with the borrowers since 1975, and, according to our cal-

culation, the Treasury made about $1.2 billion on it, when you match the loan contract to the date of the government money.

I would be glad to submit that for the record.

Mr. HORN. Do you have it there?

Mr. BEYER. Yes, sir, I do.

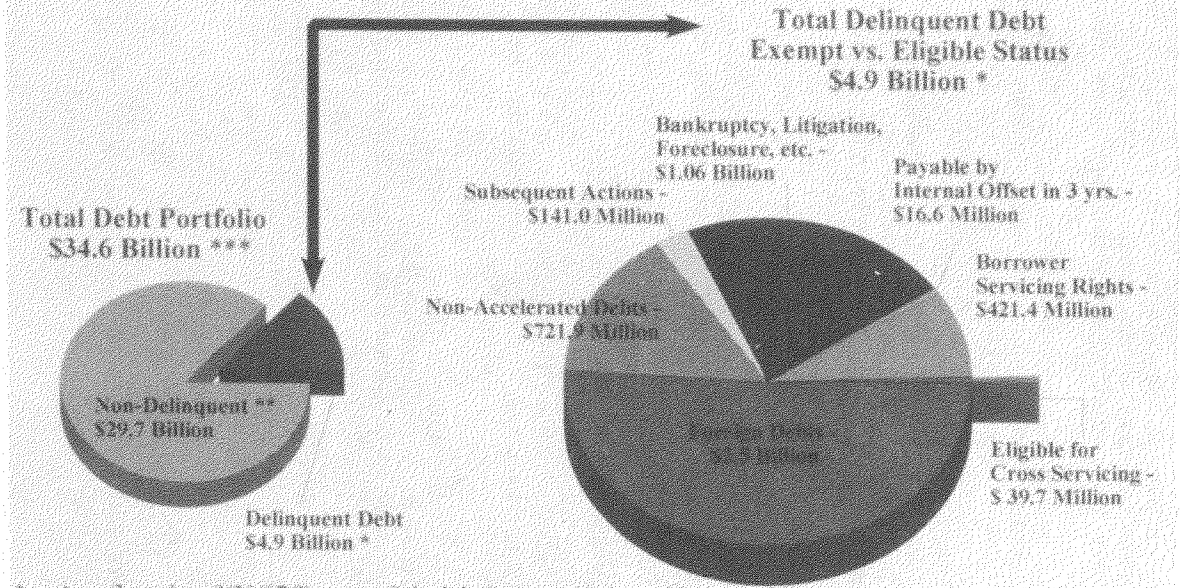
Mr. HORN. Without objection it will be in the record at this point.

[The information referred to follows:]

Farm Service Agency Debt Portfolio

Eligibility for Cross Servicing by Treasury

Under the Debt Collection Improvement Act of 1996



* As reflected on 9/30/97 Treasury Schedule 9, over 180 days old

** Includes debts less than 180 days old

*** Commodity Credit Corporation and Agricultural Credit Insurance Fund

Mr. HORN. This is a policy question I was going to raise when I get to that, but let us raise it now on these State commissions. You note on page 7 near the top, "our experience has shown that this process can take several years to complete and can become particularly protracted when State regulatory hearings are required."

How do we get a Federal program under the review of a State utilities commission? Should we not be under the review of the State? Did that question come up over the years in the legislative history of going back to rural electrification?

Mr. BEYER. Yes, sir, it has, and about half of the States have passed laws taking the rural electric cooperatives or placing them under their public service commissions and about half have not. And that is where you get into the preemption issue.

And we faced two preemption issues—it was very, very dramatic—in Indiana and in Louisiana. One of the reasons Cajun is bankrupt is because Louisiana Public Service Commission—I don't know if I want to use the word unilaterally, that is kind of a tough one, but they really did—they reduced the rates from Cajun, which, in fact, just reduced our ability to recover, and that is when the bankruptcy occurred.

Mr. HORN. You referred to that. Do these cases get into Federal court on whether you have preemption or not?

Mr. BEYER. Yes. In fact, it went all the way. The first one went all the way up through the court system right underneath the Supreme Court, which we encouraged that to happen. Matter of fact, Treasury or the Department of Justice asked the Supreme Court for a hearing on that, and they turned it down.

Mr. HORN. Can you give us an insert for this part of the record that gives us the name of the cases and so forth, and get the general counsel in Agriculture to tell us what, if any, is the Federal court guidance in this area and should something be legislated in this area?

Mr. BEYER. Yes, sir.

Mr. HORN. I realize when they reduce the fee structure, that is great on helping people, but it doesn't pay the bills on the debt. So it all depends, as Rufus Miles once said, where you sit depends on where you stand.

Mr. BEYER. We will be happy to provide you that.

Mr. HORN. There we are. Good. Without objection at this point it will be in the record.

[The information referred to follows:]

Wabash Valley Power Association, Inc.

During the 1970s, Wabash Valley Power Association, Inc. (Wabash), a generation and transmission cooperative serving distribution cooperatives in Indiana, Michigan and Ohio, purchased a 17 percent interest in the Marble Hill nuclear generating station and financed this purchase with loans guaranteed by the Rural Electrification Administration (REA), now the Rural Utilities Service (RUS). Public Service Company of Indiana, the owner of the other 83 percent of Marble Hill, abandoned construction of the plant in January 1984. Wabash defaulted on its loans and REA was required to pay under the loan guarantees. REA instructed Wabash to file for rate increases sufficient to assure repayment to REA. Wabash complied with what a court later referred to as "transparent insincerity," and the Indiana Utility Regulatory Commission refused to allow Wabash to recoup its investment in Marble Hill. On November 23, 1988, the Administrator of REA sent Wabash a letter asserting federal control over Wabash' rates and instructing Wabash to raise its rates by nine percent. Wabash did not implement the increase, but sought a declaratory judgment that the REA lacked authority to preempt state law and exercise control over its rates.

The district court granted Wabash's motion for summary judgment in Wabash Valley Power Ass'n, Inc. v. Rural Electrification Administration 713 F.Supp. 1260 (S.D.Ind.1989) which was affirmed by the United States Court of Appeals 903 F.2d 445 (7th Cir. 1990). The Appellate Court held that the preemption letter was invalid under the Administrative Procedure Act because the REA did not follow the prescribed procedures for rulemaking. The Court held that RUS was precluded from asserting an implied authority to preempt state regulation, and made it clear that it doubted REA had such implied authority. The court rejected REA's argument that states are preempted by implication when they set rates so low that a federal loan cannot be repaid. The court asserted that REA received the same treatment under state law as any other lender to Wabash and suggested that REA should take grater precautions with higher risk loans rather than seeking preferential treatment.

After notice and comment, REA promulgated two new preemption regulations on September 19, 1990. The first regulation addressed preemption for inadequate rates set by a state regulatory authority and the second regulation preempted state regulatory authority jurisdiction over rates of bankrupt REA borrowers. Wabash brought suit in federal court for a declaratory judgment to prevent their enforcement. The district court held the rules to be invalid in Wabash Valley Power Ass'n Inc. v. Rural Electrification Admin., 773 F.Supp. 1178 (S.D. Ind. 1991) and the Appellate Court affirmed. 988 F.2d 1480 (7th Cir. 1993).

The Court stated that in order for REA to enforce its preemption regulations, it must overcome two significant obstacles: 1.) the longstanding presumption against preemption of an area traditionally subject to state regulation; and 2.) finding that the appropriate authority granted by Congress was properly exercised by the agency. REA argued that Congress intended to give it preemption authority since the imposition of inadequate rates by a state regulatory authority could impair repayment and thus jeopardize the viability of the rural electrification program. The Court dismissed REA's argument regarding the necessity of loan repayment under the RE Act and stated that rural electrification is the fundamental goal of the RE Act. The Court stated that it

could not find that the federal interest in recovering its monies is sufficiently strong to upset the tradition of shared state and federal responsibility over the utility rates of REA-financed cooperatives. In support for its position, the Court cited Congress' sustained subsidization of rural electrification. The Court also pointed out that Congress has not embraced the regulatory approach in the original statute or its amendments. The Court stated that the RE Act appears to reflect an assumption by Congress that REA could protect itself by setting conditions on the extension of credit. The Court acknowledged that state regulation may occasionally impede the ability of power supply cooperatives to repay their loans, but maintained that the structure and operation of the REA subsidies reflect a congressional preference for the government bearing this risk, rather then the cooperative members.

Cajun Electric Power Cooperative, Inc.

Cajun Electric Power Cooperative, Inc. (Cajun) is a generation and transmission cooperative that provides wholesale electricity to 12 distribution cooperatives in Louisiana. In 1979, Cajun used REA financing to purchase a 30 percent interest in the River Bend nuclear power plant by utilizing REA financing. In 1987, Cajun defaulted on its loans to REA and began debt restructuring negotiations. On May 31, 1990, Cajun and REA entered into an agreement restructuring Cajun's $3.18 billion debt to REA. The Louisiana Public Service Commission (LPSC) subsequently approved this debt restructure agreement. However on December 16, 1994 the LPSC entered a rate order directing Cajun to reduce its average rates from 54.4 mills to 48.81 mills. The Secretary of Agriculture notified Cajun on December 20, 1994, that the rate order was pre-empted by federal law The next day Cajun filed a new tariff in accordance with the LPSC rate order, a petition for relief under Chapter 11 bankruptcy (Cajun now owed RUS $4.2 billion), and a suit for declaratory judgment as to whether the Secretary or the LPSC had jurisdiction over Cajun's rates.

The District Court granted summary judgment in favor of the LPSC, holding that neither the RE Act nor RUS regulations expressly or impliedly pre-empt the LPSC's rate order Cajun Electric Power Cooperative, Inc., v. Louisiana Public Service Comm., No. 94-2764-B (M.D.La 1995) and the 5th Circuit Appellate Court affirmed. 109 F.3d 248 (5th Cir. 1997). Finding the Secretary's intent to pre-empt the rates set by the LPSC unambiguous, the Court focused on the question whether such action was within the scope of the Secretary's delegated authority. The Court recognized that regulations seeking to pre-empt state law should not be disturbed "unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned." 109 F.3d at 254. The Court found that not only did the RE Act not expressly authorize the preemption of state jurisdiction over rates, but further concluded that the language and history of the RE Act indicate that Congress did not intend the Secretary to preempt such jurisdiction with the narrow objective of raising a borrower's rates and revenues for the purpose of satisfying RE Act loan obligations. The Court stated that it could be plausibly assumed that the federal interest of primary importance under the RE Act...affordable electric energy for rural consumers...would be seriously compromised by the increased consumer rates that would be required by the Secretary's preemption regulations .

Mr. HORN. Now, here on your last page you say, as we have previously indicated, "only 14 new RUS power supply electric borrowers have entered into debt restructuring negotiations during the past 18 years, less than one borrower per year."

Then you go on to say that "negotiations and ultimate restructurings associated with each are often years in the making, thereby rendering the 180-day Debt Collection Improvement Act timeframe for debt recovery impracticable."

What would you suggest? If the 180-day will not work, what do you think works?

Mr. BEYER. Well, Mr. Chairman, I am not sure that I would put a timeframe on it. I can tell you we had one system in bankruptcy for 13 years. Now, that was the preemption issue. One of the issues was the preemption issue, and it goes on and on. I think that the strategy that we have had recently is to look for long-term solutions and get this thing behind us. We must get this behind us.

We are selling off assets vis-a-vis some of the bankruptcies. You asked the question, I think, earlier to somebody about are we making—some of these systems get out of the loan portfolio. We are not going to make any loans. We are not accepting, from a government standpoint, we are not accepting ownership of any nuclear investment. We think that would be a serious mistake. They are all joint operations with private utilities. And if we have the government ownership on some of that nuclear stuff, Katy, bar the door. So we are not doing that. We are trying to streamline the loan portfolio so it is more risk averse.

There are not really any problems with the wire system, the distribution systems. They are fine. It is the power supply systems of those large, basically nuclear investments, and, in some cases, in one case, it was the oil shale. It was an oil shale development out West. And these folks signed contracts with the generation and transmission system to add generation capacity for a particular industry. There are two of them with large industry. One of them we are going to recover everything, and I will be glad to let you know when that happens. The other one——

Mr. HORN. Will you and I be on Medicare when that happens?

Mr. BEYER. I hope not, Mr. Chairman. We are making progress.

Mr. HORN. I take it you don't want to auction this stuff and see what we can get for it?

Mr. BEYER. The fact of the matter is we are auctioning at Cajun. That is on the auction block. We are going to sell that. There will be no Federal presence in that one when we get done with it. It is on the auction block.

Mr. HORN. Do you have a minimum bid, do you expect?

Mr. BEYER. Well, we have a minimum bid that we are hoping for, and I can tell you that we are over that now. So we are very happy about that.

Mr. HORN. Is this a rolling bid or what? How does it work?

Mr. BEYER. The judge controls that, Mr. Chairman. We would like to see him put a certain date on this thing and get it over with. I think we are getting close to that.

Mr. HORN. So this is the bankruptcy judge——

Mr. BEYER. Yes, sir.

Mr. HORN [continuing]. That is controlling that. Are you thinking of doing that with some of the other major debts?

Mr. BEYER. Well, we have, yes, sir. In fact, we are. In the three bankruptcies that are confirmed by the court, one of them includes some assets that we are selling off, and we are auctioning that. Yes, we are auctioning that.

Mr. HORN. Mr. Shadburn, let me move to you. On page 6, bottom of the page, you note that currently the Food and Consumer Service is the only agency within the United States Department of Agriculture to which this information is made available.

Now, this is the data that "would be used to verify income information provided by tenants renting rural multifamily housing program units and applicants for or borrowers and grantees of rural housing loans or grants administered by the Agency."

I should have read it from the beginning. The ability to verify incomes would ensure that subsidy is not provided more than necessary.

I take it there is only the food stamp program that is permitted to get that income data? Or what is it?

Mr. SHADBURN. At the present time that is my understanding. Of course, we verify income. But let me check with my staff here.

Food stamps is who gets the wage-matching information right now.

Mr. HORN. I understand the former ranking Democrat on the committee has this in her bill, so we might solve that problem.

Mr. SHADBURN. It would help us tremendously in our programs, yes, sir.

Mr. HORN. Good.

Well, there is one thing that worries me on page 12, that is under your use of private collection agencies. I don't know if you ever saw my favorite TV program, "Yes, Minister." It came from England. Any of you ever see that? It is worth seeing if it comes on public television again.

There is a political appointee at the top, and then there is a very smooth ranking civil servant that guides him around by the nose. I am assuming all four of you are that very smooth-ranking civil servant. That is why I'm going to get to this particular point in Mr. Shadburn's testimony.

Use of private collection agencies. You say the Agency uses many tools to collect delinquent debt, and the use of private collection agencies will be considered.

Now, that is what Humphrey would have said, the ranking civil servant in that particular TV thing, and things being considered I don't regard as being implemented. So is something going to happen on the private collection thing?

Mr. SHADBURN. Well, as was mentioned earlier, we have been in the past prohibited from using collection agencies. However, obviously, in the future we are going to look at every way to make sure that we do collect the debt.

But the main thing that we want to do is make sure the supervised credit mandate we have from Congress—we are precluded from using credit agencies until all the borrower's rights have been exhausted, so once all of those have been exhausted, as I say, any

tools we can see in the future that will help us collect debt, we will use those and consider those.

Mr. HORN. Well, I thank you, and let us hope we get something done there.

Now we will get down to some of the more substantive questions. We will start with Ms. Thompson.

Has the Department completed implementation of the Debt Collection Improvement Act? What do we need to do that we have not done under the law?

Ms. THOMPSON. I think that we have to complete the system so that our systems talk with the Treasury's systems. As Mr. David said, we are within a month or two of that. There may be some small areas out there. We need to continue to work with the States in terms of their collection rights and ours. Those are the big ones that come to mind. I think Mr. David could be a little more specific on that.

Mr. DAVID. I think Ms. Thompson has it right. Many of the issues we have talked about today are issues in which we are currently working with Treasury, with the Federal Credit Policy Working Group, to complete the implementation of the administrative offset, to complete the implementation of the cross-servicing, to understand precisely the nature of each of our various loan programs and how they would be properly implemented, and to take advantage of some of the new tools that are now available to us, such as the use of collection agencies. And I believe that we are moving forward on each one of those fronts.

Mr. HORN. Well, as we look at the Department of the Treasury statistics, USDA needs to refer $2 billion to the administrative offset program, but it has only referred $774 million. In your testimony, Ms. Thompson, you indicate that the debt is "more difficult to refer to Treasury or for which there are questions as to whether it should be referred."

What is the characteristic of this debt that makes it difficult to refer?

Mr. DAVID. Well, some of it we have talked about here this morning, of debt with various servicing rights. And as Ms. Thompson indicated before, some of it is debt that is maintained by the States. But to go even further than that, some of that State debt is maintained by county governments, where they administer the food stamp programs on behalf of both the State and the Federal Government.

In some cases the States and the counties have to find the debt, have to find the records, and have to assure that all of the rights of those individuals are being met.

The Food and Nutrition Service, for example, is currently working with Treasury on an experimental program where the States or the counties can transmit that debt directly to Treasury so that they can, if you will, cut out the middleman and get that debt over to Treasury.

There is some debt that is in litigation, in which there is honest disagreement as to whether they really owe the money or they don't owe the money, and so we have had to go through some of those litigation processes.

Mr. HORN. Is most of that money, the $2 billion that Treasury says you should refer, food stamp money?

Mr. DAVID. Of the remaining $1.3 billion, approximately a little over half of that is food stamp money.

Mr. HORN. That is of the $1.3 billion?

Mr. DAVID. That is of the $1.3 billion.

Mr. HORN. So we are talking about $650 million?

Mr. DAVID. It is about $770 million of that.

Mr. HORN. $770 million. That would be, what, fraud having been committed, overpayments because a person registered five times or something?

Mr. DAVID. It is either fraud, administrative error, or there may have been some honest mistakes. But it is a combination of those kinds of issues, sir.

Mr. HORN. OK. Also, Ms. Thompson, USDA needs to refer $2.0 billion for collection action, but has not referred any amounts. When will USDA refer its debts for collection action?

Mr. DAVID. Again, some of the same issues are involved in the collection or in the cross-servicing as are involved in the administrative offsets. Much of that is the same debt that is currently with the States for collection by the States or the counties and is facing some of the very same issues.

As several others have testified here this morning, it gets into some of the computer systems and the resource issues in terms of balancing work on DCLA and Y2K. For instance, some of the agencies have to get information from their local offices, and there are systems involved in developing that.

Mr. HORN. Well, the question is really when will the U.S. Department of Agriculture sign a memorandum with the Treasury outlining its actions to implement the Debt Collection Improvement Act? If we are correctly informed, it is the only agency of the big five agencies not to have signed such an agreement.

Mr. DAVID. We have memorandums—some of our agencies already have memorandums with Treasury. For instance, the Forest Service does a signed memorandum with Treasury for cross-servicing activities. The other agencies are currently working with that, and I would defer to the agencies as to when such memorandums will be signed.

We do anticipate, though, that we will start to refer debt for cross-servicing this summer. I believe that Mr. Shadburn mentioned June in terms of some of the Rural Housing debt.

Mr. HORN. You better get that microphone close to you.

Mr. DAVID. Sorry.

Mr. HORN. Ms. Thompson, are we going to have all of the Agriculture programs implemented by the Department of the Treasury, and, if so, when is that going to happen?

Ms. THOMPSON. From what I have been able to understand in the 4 weeks I have been there, I could say probably between midsummer to, as I am saying, from June, end of June, through probably August. Also, we should have some feedback within that timeframe as to the approval from Treasury for the finance center to also be a cross-servicing agent.

Mr. HORN. Mr. Beyer, Treasury statistics indicate that the Rural Utility Service has delinquent debts of only $50,000. GAO says that

$10.5 billion is owed by financially troubled borrowers, including several bankrupt ones owing billions that we have talked about. Why does the Rural Utility Service list as performing loans the billions of dollars owed by financially troubled borrowers? Are they really performing loans?

Mr. BEYER. Yes, sir, they are servicing their debt. They are projected as financially stressed, but they are making their debt service.

Mr. HORN. So GAO is wrong? They say $10.5 billion is owed by the financially troubled borrowers.

Mr. BEYER. If you characterize it as debt, yes, it is owed. It doesn't mean they are not servicing it. That is the way I would characterize that statement.

Mr. HORN. So they are not delinquent?

Mr. BEYER. No, they are not delinquent.

Mr. HORN. OK. GAO's report says that one borrower, and this is our favorite one, of course, the Cajun Electric that you have up for auction, has not paid since 1994 the $30 million owed to the taxpayers each month.

Is that true that they haven't paid? I realize they are up for auction, are they just saying, "the heck with it, we are not going to pay anything else?"

Mr. BEYER. Larry Belluzzo from our financial services staff is here.

Mr. HORN. Why doesn't he advise you and then you advise us. Pull up a chair and advise him, and he can, now that he is the one under oath.

Mr. BEYER. Mr. Chairman, when they go into bankruptcy, then the court is in charge. In bankruptcy, they are not servicing their debt. Prior to bankruptcy they were servicing their debt.

Mr. HORN. In other words, when did they go into bankruptcy, in 1994?

Mr. BEYER. December 1994, yes, sir.

Mr. HORN. December 1994. And up to that time they paid the $30 million each month?

Mr. BEYER. They were paying under a debt restructuring agreement that we had entered into with them, like about in 1990, is recollection of that DRA.

Mr. HORN. So up to December 1994, it was a performing loan?

Mr. BEYER. Yes.

Mr. HORN. It seems we go straight from a good performing loan to a write-off directly, and we skip delinquency. Is that sort of where we are or what?

Mr. BEYER. Well, the DRA, the Debt Restructuring Agreement, I suppose you could characterize that as taking care of a delinquency, yes.

In addition to that, Mr. Chairman, the Treasury is whole through all of these things because the Agency loans and guaranteed loans are serviced through a liquidating fund to the Treasury.

Mr. HORN. Well, the purpose of reporting a delinquent loan is to inform the Congress of problems, and with these loans we have had no indication that there were problems until the General Accounting Office report submitted it to us. I mean, was Agriculture trying to hide it under a carpet or what?

Mr. BEYER. No, sir. I can tell you that we are trying to get the message out. We have had a hearing with Senator Lugar in the Ag Committee last year and talked about all of this stuff. So it is not that we have been—we are focused on solutions for this thing. We need to get this behind us in the best interest of the government security and in the best interest of the electric borrower system.

Mr. HORN. What happens to the money if you have a successful auction? Where does that go, just to the Treasury generally?

Mr. BEYER. It goes into the RUS liquidating fund. All of the debts go into the liquidating fund, and all of the obligations go out of there. So that would go in the Agency liquidating funds.

Mr. HORN. Well, is that to then retire the loan that has been made to Cajun Electric?

Mr. BEYER. Yes, sir.

Mr. HORN. Or is that in the general pot?

Mr. BEYER. That is in the general pot, and that pot retires the loan of Cajun Electric. I don't know how many years is on that. It is probably a 35-year loan. So the debt service on that loan to FFB, the Treasury, is coming out of that liquidating fund.

Mr. HORN. So it would be exclusively applied to Cajun Electric, not to all other delinquent accounts, even though you haven't called them delinquent, but they are delinquent, I think?

Mr. BEYER. All of the obligations that the agency has in direct loans or guaranteed loans comes out of that liquidating fund to the financier. In this case, the majority of it is the Federal Finance Bank at Treasury.

Mr. HORN. Well, but basically, let's say you got $2 billion for selling Cajun Electric; does that go in simply and retire the Cajun Electric loan?

Mr. BEYER. No, it goes into a liquidating fund and, you know, that's a cash-flow situation once it gets into there. And it will pay Treasury on the debt. So Treasury is whole on that Cajun debt and on any other debt.

Mr. HORN. In other words, the $30 million that it has lost every month since the deal was made in December 1994 by the bankruptcy court, that would be recouped?

Mr. BEYER. Yes.

Mr. HORN. By the Treasury?

Mr. BEYER. The debt service to the Treasury is ongoing. And when the thing is settled, then that money comes in to the liquidating fund.

Mr. BEYER. I am informed that any lost interest would not be paid.

Mr. HORN. In other words, the $90 million due the Treasury a month on interest is not paid, or the $30 million—I am sorry—due to the Treasury, which they were getting before December 1994, will not be paid; is that it?

Mr. BEYER. I am not sure of that question, Mr. Chairman. I would be happy to provide you with some detail on that.

[The information referred to follows:]

As previously indicated Cajun Electric Power Cooperative, Inc. (Cajun) utilized REA financing to purchase a 30 percent interest in the River Bend nuclear power plant. In 1987, Cajun defaulted on its loans to REA and began debt restructuring negotiations. On May 31, 1990, Cajun and REA entered into an agreement restructuring Cajun's $3.18 billion REA debt. Cajun made full payments on its restructured debt until it declared bankruptcy in December 1994, at which time it ceased all payments as permitted by the bankruptcy court. In accordance with U. S. Department of Agriculture policy, interest charges are not calculated, accrued, or reported as income on debt that is 90 days delinquent. Therefore, no interest has been accrued and no income report since Cajun entered bankruptcy in 1994.

Cajun's loans were made prior to the adoption of the Credit Reform Act and are, therefore held and accounted for in the Rural Electric and Telecommunications liquidating account. The liquidating account is used to advance loan funds on all pre-credit reform loans, process payments made by RUS borrowers on such loans, repay the certificates of beneficial ownership that provided the seed money for pre-credit reform loans, and repay pre-credit reform loans guaranteed by RUS when the primary creditor defaults.

All proceeds received by RUS from the settlement of Cajun's outstanding debt will, therefore, be deposited into the liquidating account. Cash flowing into the liquidating account is utilized for any of the purposes detailed above including the payment of all monies due on the Cajun debt. To reduce the interest burden on the Federal Treasury, RUS is prepaying, at the first call date, all non-Federal, nonperforming debt guaranteed by RUS.

Mr. HORN. Why don't you? Take a look at it.

Mr. BEYER. Yes, sir, we certainly will.

Mr. HORN. Wherever we are.

When is that going to be consummated, that auction? Is there any time period?

Mr. BEYER. Mr. Chairman, I wish I could tell you a time period. We are very anxious for a time period. The judge has now said this is the final auction, but, you know, we are not sure final is final.

Mr. HORN. Is there any competition in this auction?

Mr. BEYER. There is three bidders; yes, sir.

Mr. HORN. OK. Are they allowed to keep the bid moving upward?

Mr. BEYER. Well, they have been until the last bar date, which was March 18th, and we are hoping that—we are hoping that we are—you know, we are focusing on a real solution here at this point in time.

Mr. HORN. Is the judge the one responsible for saying the date as to when it ends?

Mr. BEYER. Yes, sir.

Mr. HORN. Is that it?

Mr. BEYER. The bankruptcy judge is controlling all of that.

Mr. HORN. Is that normal bankruptcy-judge practice, to allow the competitors to ace each other up a little bit? I think it's a great deal for the government if we can do it.

Mr. BEYER. It is, and we try to encourage that. Some bankruptcy judges, you know, do it different. Basically, there is a difference in——

Mr. HORN. So they have discretion in this area?

Mr. BEYER. Yes, sir.

Mr. HORN. Well, maybe that's a law we should get a little more competition into, except nothing ever seems to happen on bankruptcy legislation around here. We all have bones to pick with it, shall I say.

The housing in particular, where people can take and string out the owners who have to pay the mortgage and they just live there free for a month, who cares? For a year, who cares? You know, for 2 years, so forth. And so much for the bankruptcy laws.

Anyhow. Mr. Beyer, the distribution cooperatives own these power cooperatives to which you make loans, right?

Mr. BEYER. Yes, sir.

Mr. HORN. OK. Could you make them responsible for these debts? And is there a shell game going on to hide the assets?

Mr. BEYER. Mr. Chairman, there is no shell game going on to hide the assets. We know all of that. There gets to be a particular. The whole infrastructure, the electric industry, as you know, in this country, is going through a dramatic historic macro change, incidentally, and we are moving from a monopoly, predictable regulatory environment, into a highly competitive, for-profit customer choice environment, not unlike the telecom industry.

Mr. HORN. Now, do you think that environment will help the Department of Agriculture, your agency in particular? Are there people that are willing to add things to their portfolio that they might not have added in a monopoly situation, but now that they are competitive? Does that go to your benefit?

Mr. BEYER. We are encouraging that, and we think it will go to the benefit. It just depends upon, you know, how this thing is molded. It is really up for grabs. It is a very, very high-risk time for infrastructure in this country.

Mr. HORN. That's for sure. And I just wondered if you are working on it and looking at it in depth.

Mr. BEYER. Yes, sir. We are encouraging borrowers to consolidate, to come together to strengthen themselves, and there is a lot of that going on. There are some very strong borrowers, incidentally. We just happen to be working with very few which have large dollar amounts.

Mr. HORN. Now, Mr. Kelly, you noted that 90 percent of your farm program debts are collected by administrative offset, and you appear to have maximized the figure. Do you have any advice to give your colleagues in the department on this panel?

Mr. KELLY. I will review that and see if I can't get back to you. I don't have any to offer here.

Mr. HORN. Well, if they all did what you are doing, we wouldn't be holding a hearing. We will have another one in a few months, by the way, so hopefully we can get some of these operations moving. And with your new financial officer, we are counting on the chief financial officer to be helping us achieve that goal.

So you are too shy to mention the obvious, are you, Mr. Kelly? I never knew a shy Irishman—and I am half Irish—but go ahead.

Mr. KELLY. Well, the administrative offsets that has really worked on the farm program side is that—the 3-year timeframe that is in there is that we are allowed to collect that. I would have to get specific information to be able to provide good, accurate information for you, is what I am truthfully trying to say.

Mr. HORN. Is there a group, Ms. Thompson, within Agriculture that has these problems that we share ideas with, I would hope?

Ms. THOMPSON. Yes, sir, there is.

[The information referred to follows:]

Question : Does the FSA share its administrative offset process with other Federal agencies?

Answer : FSA has used its successful internal offset procedure and payment systems to collect debts owed to other Federal creditor agencies, such as the Small Business Administration, the Department of Education, the Internal Revenue Service, and other Departments of Agriculture agencies, upon request of the Federal creditor agency.

The criteria by which FSA and CCC approve offset requests from other Federal creditor agencies are found, for FSA, at 7 CFR 792.7(f)(1), and for CCC, at 7 CFR 1403.7 (j)(1). Conforming requests are sent to our County FSA Offices or other payment offices, where the debt information is entered in an automated system. As payments are being prepared, the system alerts the payment official to the debt, and requires diversion of payments to the Federal creditor agency to the extent of the debt owed by the FSA or CCC program participant

Mr. HORN. I know there is——

Ms. THOMPSON. We have a Chief Financial Officers Advisory Council.

Mr. HORN. OK. According to USDA statistics, Mr. Kelly, 20 percent of the direct loans by the Farm Service Agency are delinquent, but only 2 percent of the loans guaranteed by the Farm Service Agency are made by commercial banks. What accounts for the dramatic difference? Do we know?

Mr. KELLY. Congressman, in that case, and the numbers are probably adjusted slightly downward since then, less than 20 percent, and still approximately 2 percent. But in the case of the guarantee program, the customer/client relationship really is with the U.S. Department of Agriculture and the financial institution, and the institution then does the service on that loan out there.

In the case of the direct borrower, with the U.S. Department of Agriculture, the customer/client relationship is with the borrower itself. The big noted difference is that we are often referred to as lenders of last resort, and so many of those people who have the least stability or credit worthiness try to qualify in the direct category, where they probably would not under the guaranteed program.

Mr. HORN. OK. That's very helpful.

Mr. Shadburn, prior General Accounting Office reports have faulted your agency for providing loans to people who had previously been delinquent. One lucky borrower received a loan, defaulted; received a second loan, defaulted; and received a third loan. Have we found a way to prevent this type of abuse?

Mr. SHADBURN. Well, first of all, Mr. Chairman, I am sorry that that—that did occur, and that has been brought to your attention. Certainly, we are taking all the steps necessary to do the necessary credit bureau checking and to prevent anyone who has delinquent debt from obtaining a loan or a grant from our institution.

I would also like to just add a couple of things, if I could, Mr. Chairman. I will provide you written statutory citations on the additional servicing options that we are to offer our customers and, at the same time, will protect the government's interest. So I will make sure that we provide that to your subcommittee.

In addition, on the cross-servicing for our community facilities and multifamily housing program, which is about $19 billion, we will be able to do our cross-servicing in June. We will be able to do our single-family housing portfolio of about 700,000 borrowers in September, and this is due to the fact that we just completed the largest centralized servicing of single-family housing accounts either in the Federal agency or in the private sector. So we are needing the extra time to make sure that we go through and check—as we made the centralizing of our accounts from the field to a centralized operation in St. Louis, we want to make sure that we do not have any customers who have fallen through the crack.

Mr. HORN. Last—well, I have one general question, but one specific, Mr. Shadburn, for you. As I read the General Accounting Office report regarding cancellation of Farmer's Home Loan debts, it says, the USDA, "is not adequately protecting Federal interests during debt settlements."

GAO made a series of recommendations in that 1994 report. Have those recommendations been implemented?

Mr. SHADBURN. What I would need to do, Mr. Chairman, is to go back and give you a written followup on what steps we are taking.

Mr. HORN. That's fine.

Mr. SHADBURN. But I can assure you that certainly we are looking at the GAO report and will take those steps that they have outlined.

Mr. HORN. Well, we will hold open the record for a couple of weeks until we can get a reply from you as to the status of implementing those recommendations in the GAO 1994 report. Without objection, the answer will be included at this point in the record.

[The information referred to follows:]

Agency Comments and Our Evaluation

The comments from USDA, the three PMAs, BPA and TVA generally focused on our analysis of net financing costs and the federal government's risk of future financial losses related to the electricity-related activities of these entities. All of these entities generally disagreed with our estimates of their net financing costs. In addition, they also disagreed with our assessment of the federal government's risk of future financial losses related to their electricity-related activities.

Net Financing Costs

USDA, the three PMAs, and BPA took issue, for varying reasons, with our estimate of net financing costs.

Department of Agriculture

USDA disagreed with our use of the portfolio methodology[45] in estimating net financing costs on RUS outstanding federal debt. It noted that our analysis resulted in larger estimates of net financing costs to the federal government than the estimates obtained in USDA's application of the credit

[45]See appendix II of volume 2 of this report for a description of the portfolio methodology.

reform methodology that were discussed in our April 1997 report.[46] As we stated in our current report, the majority of outstanding RUS electricity loans and guarantees, approximately 90 percent, were made prior to 1991 and therefore are not required to be reported under credit reform. Additionally, because the USDA Inspector General deemed the RUS credit reform estimates unreliable, we chose to use actual costs incurred rather than any credit reform estimates for our analysis.

Comments From the Rural Utilities Service

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

JUL 8

Ms. Linda M. Calbom
Director, Civil Audits
Resources, Community, and
Economic Development Issues
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Calbom:

We appreciate the opportunity to review and comment on the draft General Accounting Office (GAO) report entitled Federal Electricity Activities: The Federal Government's Net Cost and Potential for Future Losses. We understand this report is for the Chairman of the House Budget Committee and the Chairman of the House Committee on Resources, Subcommittee on Water and Power Resources.

We have the following comments:

See comment 1.

We agree that the overwhelming majority of the Rural Utilities Service (RUS) electric borrowers are financially sound. This was the conclusion of the GAO report completed as recently as April 1997, and reaffirmed by this report. As indicated in both reports, there is a small number of borrowers, less than 2 percent of the total, who, because of the timing of their involvement in electric generating projects (in all cases minority ownership partners with investor-owned utilities in large nuclear generating plants) are experiencing financial difficulties. These projects were initiated during a period 15 to 20 years ago, when changing environmental and nuclear safety regulations, double-digit inflation and double-digit interest rates, resulted in ultra high costs of new plant construction (some as high as 4 times the original estimate) throughout the electric industry. Concurrent with this situation is the fact that projected demand for energy did not materialize.

The financial markets and the electric utility industry have long been aware of the events of this period and the industry has changed as a result. It is important that we remain cognizant of this history, however, as the entire electric utility industry is facing a new environment due to sweeping changes in the legislative and regulatory climate in which it operates. We believe our focus should also be on these changes and their future effects on America's rural electric infrastructure.

AN EQUAL OPPORTUNITY EMPLOYER

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We do foresee some write-offs of debts in the near future because of the 15 to 20 year old investments initially made by borrowers. We take exception, however, to the GAO statement that it is probable that other borrowers, those who are not currently financially stressed, will also require write-offs of their loans. Clearly the past history of power plant investment is not useful in projecting the future in a new competitive, restructured, unbundled, infrastructure.

The April 1997 GAO Audit-Report indicated the majority (98%) of electric borrowers had favorable financial ratios. They are meeting their loan obligations and delivery service to their member owners and contributing to economic infrastructure of their rural communities.

See comment 2.

As additional support for our position, we quote a report from Standard and Poor of April 1995. This special report deals with those RUS-financed generation and transmission borrowers who have received public financial ratings. It states:

> "As competition increases in the electric utility industry, publicly rated generation and transmission rural electric cooperatives (G&Ts) are well positioned to remain viable power suppliers in the future. These G&Ts have demonstrated their ability to compete in a changing environment through proactive management, low power production costs, access to wholesale markets, and minimal capital expenditures for regulatory compliance. S&P believes that the challenge to the G&Ts will be to work with their member systems in continuing to reduce the end user's retail rates through load management, economic development rates, and system efficiency improvements."

As the electric utility industry evolves into the new deregulated, competition driven, customer choice environment, Federal and state legislative and regulatory policies will play the major role in the future risk exposure to the RUS loan portfolio as well as in the continued availability of reasonably priced electric energy in rural areas. We believe that these policies must take into consideration the special challenges facing rural systems that provide electric service in the remote and high cost service areas of rural America. As it has throughout its history, this agency is working closely with its borrowers to ensure that these challenges are recognized and addressed.

See comment 1.

Regarding the method the GAO employs in calculating the financing costs of the RUS electric program, we are somewhat confused. It appears that the GAO applied a long-term average interest rate for Treasury borrowings to the outstanding cumulative debt of RUS. We do not see the relevance of this calculation in determining the costs to the Government of the current lending program. Your report of April 1997 stated the

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total costs for the Electric Loan Program from 1992 through 1996 were $551.3 million instead of the $4.796 billion calculated in this report. The April report was based on Credit Reform measures and indeed the report goes to some length in describing Credit Reform methods of measuring program costs. It would appear that your latest study implies that Credit Reform does not exist or does not accurately measure program costs.

See comment 3.

We disagree with the GAO use of average revenue per kilowatt-hour as an indicator for energy production costs. We believe that there are many variables which have not been addressed in your analysis that could significantly alter any comparison. We would suggest that this material not be included in your current report.

Again, we appreciate the opportunity to comment on this draft report.

Sincerely,

JILL LONG THOMPSON
Under Secretary
Rural Development

Mr. HORN. Now, let me get to one last question here. What advice could you give your colleagues throughout the Federal Government on the implementation of the Debt Collection Improvement Act? What is wrong with it that you would like to see changed? What do you think is useful? What did we forget that is—perhaps could be in a successor bill?

I would just appreciate any thoughts you have on it.

Yes.

Ms. THOMPSON. Mr. Chairman, in my short 4 weeks here, I have found the biggest problem is probably in the validity of the data that's within the Federal systems. And I know at USDA we are all working hard to get that data cleaned up to make sure, of course, that you are sending to Treasury the right people and all the identification with that. That's probably the biggest problem. And that just takes some time, as you know.

The other thing, as I have seen too at USDA, is the lack of compatible systems. All of that data is contained in systems, and most of those systems are obsolete compared to today's technology, because technology has moved so quickly in the last 5 to 8 years.

So I think between the two of those, the data that's within the systems and the systems' ability to talk to each other, are the two biggest issues that have slowed the implementation of the debt collection.

Mr. HORN. Mr. Kelly, any thoughts?

Mr. KELLY. Congressman, I would certainly second that with the computer systems with these enormous data banks, in which the information was kept for other reasons or slightly different reasons, they can't quite communicate with each other. The other thing—and going back to our own internal programs—is the partnering that may be done internally, when you referenced the 90 percent collection rate there. The administrative offset has been a tremendous help within our agency to get it before we even have to move things over to Treasury to load up their computers. So perhaps more of these partner-type things to other type of agencies, where their computers—programs—are easily more understandable, it might be of some help.

Mr. HORN. Thank you.

Mr. Beyer.

Mr. BEYER. Thank you, Mr. Chairman. It seems to us, you know, that we are trying to fit the utility industry, infrastructure industry, into what seems to be the focus of the debt DCIA into individual loan—with an individual loan focus. That's kind of where we see it, and we are trying to fit ourselves into that somehow.

Mr. HORN. Mr. Shadburn.

Mr. SHADBURN. Two areas. Certainly, the supervised credit that we are mandated by Congress to give our borrowers certainly has a lot of uniqueness to it that the private sector does not have, and certainly it takes quite awhile to understand what those pieces are, and that does affect the numbers.

The other thing was, that is certainly very focused on our minds, and that is the offset on our customers. As I explained in my brief opening remarks, that if we are—if someone is able to offset on one of our loans to take proceeds, it is going to throw chaos into our loanmaking ability.

Mr. HORN. Well, any other thoughts any of you have had; anything in the testimony you want to clarify?

Mr. Beyer, I have a couple of closing questions for you. Are you familiar with Soyland Power Cooperative? Are you familiar with that particular——

Mr. BEYER. Yes, sir.

Mr. HORN. According to press reports, they received a $1 billion loan write-down in 1996, and that was the same year the Soyland executives received six-figure bonuses totaling up to $420,000. Does that just sound like the Federal taxpayer is, again, getting it in the neck?

Mr. BEYER. Well, Mr. Chairman, they did get a bonus and it came out of their general funds. It was not government dollars.

Second, they voluntarily paid it back.

Mr. HORN. They did, after receiving it?

Mr. BEYER. Yes, sir.

Mr. HORN. So they have paid back the $420,000?

Mr. BEYER. Yes, sir.

Mr. HORN. And even though they had a $1 billion loan write-down, was that correct action, do you believe, by those directors?

Mr. BEYER. I think it was—we obviously encouraged it, and I——

Mr. HORN. You encouraged that they pay it back?

Mr. BEYER. I don't think it was good action in the first place.

Mr. HORN. In other words, you don't approve of the billion dollar loan write-down they did in 1996? OK.

Mr. BEYER. The write-down, yes, sir, we did approve that.

Mr. HORN. You did approve it?

Mr. BEYER. Yes, sir. We approved it. That was a joint activity with the Department of Justice.

Mr. HORN. But they—but you disapproved of the bonuses that went to them? And they did pay it back.

Mr. BEYER. Yes, sir.

Mr. HORN. OK. They apparently owed money to other private lenders. Why were they not required to share the losses in the same proportion as the Federal Government, as required by the Rural Utility Service loan agreement?

Mr. BEYER. Well, Mr. Chairman, you know, we would have to get back into the—Soyland was a result of a merger with, I believe it was WIPCO, another G&T, a long time ago, like—mid-eighties, something like that, and the result was we made one big bad one instead of two little bad ones. That's what happened. Because it was all nuclear investment.

In addition, I need to note that through a debt restructuring agreement, they paid—those members out there at Soyland paid some of the highest rates in the country for about 8 years, like how much—how many million was that—over $700 million in debt service in those troubled years.

So, you know, it sounds bad but it was an extremely stressful situation.

And third, I might add that a bankruptcy would—if a bankruptcy would have occurred, it would have been in the same circuit as the Wabash bankruptcy that we spent 13 years on.

All of those things were taken into consideration and it was simply our conclusion, along with the Department of Justice, that it

was in the best interest to get another $235 million and they are gone; no more liability, no more loans.

Mr. HORN. Apparently Soyland owed money to other private lenders. And why weren't they required to share the losses in the same proportion as the Federal Government, as required by that loan agreement? That's what we are curious on.

Mr. BEYER. Well, we certainly tried to do that. And I can tell you that any private lender that's involved in these complex financing arrangements, they just don't move. It is very difficult to get them to move, even in the bankruptcy courts. And they stonewall it, really.

Mr. HORN. Well, we are used to being stonewalled, so I know what you are going through.

Mr. BEYER. Yeah.

Mr. HORN. Did the government really take the entire loss on this and let the other lenders off the hook?

Mr. BEYER. Well——

Mr. HORN. Isn't that what it got down to?

Mr. BEYER. Actually, the other lender took the risk of buying it out. So they have the future risk. The government doesn't have the risk anymore. So, you know, there is—that's a value to the government, really.

Mr. HORN. Would you say you were easier on Soyland than its other creditors, or do you think it is a good deal?

Mr. BEYER. We think it is a good deal. We think it was—we think it was the best—we think we recovered the maximum recovery for the government in that deal; yes, sir.

Mr. HORN. Was that the sixth circuit that you were worried about, or which circuit?

Mr. BEYER. The collective wisdom here was the seventh.

Mr. HORN. The seventh circuit.

In 1935, and I remember this rather well, only 10 percent of America's farms had electricity. That was the chief purpose of the Rural Electrification Administration, which has done a terrific job. And according to recent statistics, 99.9 percent of rural residents currently have electricity, a lot of that due to the REA. Since the original mission of the agency has largely been completed, why is the rural utility service still needed, particularly given the spectacular losses that have been experienced recently?

Mr. BEYER. Mr. Chairman, I thank you for that question. I have waited for the opportunity to talk about that because today there is about $3 billion invested in the infrastructure. The agency is a shining star from the standpoint of the evolution of leveraging private capital. Out of the $3 billion, $1 billion is taxpayer loan dollars and $2 billion is private capital. That's a tremendous success story.

The fact that the system is built, and it is a good system, also leads us to thinking about the aging system. Some of that stuff has been up there for 50 years and there is a huge replacement cost that's going on right now. And looking—you know, we have really got two major focuses here. No. 1, we are trying to look for solutions for these nuclear investments-type thing and we are getting out and we are—we are making progress.

And second, we look forward to deregulation and competition. These systems, in my judgment, are going to end up to be wire systems, because there is no profit in rural America—there is a lot of—25 million Americans are served in 80 percent of the land mass. And when you get into a competitive environment, wherever there is a profit center, there is going to be a lot of cherry picking; and there is going to be left in rural America, wire systems that are going to be needed to serve the high-cost-to-serve areas.

We are seeing it in the telecom infrastructure right now. In fact, one of the telecom executives made a comment in U.S. News and World Report here a couple of weeks ago, that said why should we be investing more money in these high-cost-to-serve rural areas when we need to invest in the urban areas?

So who is going to be left? Who is going to serve rural America? I think these nonprofits are going to be there. They are local people, and they are going to have a real challenge going into a new competitive customer choice environment to maintain quality, reliabilty, and reasonable rates into the future.

Mr. HORN. Have you required a replacement fund for updating the equipment and, if they are worn out, replacing them? I mean, what's the policy that you have set for these various utilities around the country? And what is your information as to whether they really are following that guidance?

Mr. BEYER. Well, we do not mandate a replacement pool in them. We mandate—we require financial indicators that they have to operate in, of course, and, you know, part of the two-thirds of the $3 billion invested comes from internally generated funds. It is their internally generated funds, in addition to private lender capital. So they are doing some of that, no question about it.

And the other issue, of course, is competitive rates.

Mr. HORN. You are not doing them a favor if you don't require that they put away money for a rainy day. Isn't that sort of being irresponsible?

Mr. BEYER. Well, Mr. Chairman, you know, there is a fine line between hanging on to what they have in a competitive environment, which is going on right now incidentally, and raising their rates out of competitiveness.

In the end, if their rates are—you know, 46—43 out of 46 States, the rural systems have higher rates now and there is going to be a tremendous pressure on them to keep their rates down. So it is kind of a fine line between financial responsibility and getting their rates so high they are going to lose all of their lucrative loads.

Mr. HORN. Well, I still think—I am just shocked, frankly, that they haven't had replacement funds put away over the years. I mean, that's just—it means they are forever part of the government bureaucracy and you, Santa Claus, will presumably save them from themselves. And I do not get it. As a farmer, I would want to be responsible and I wouldn't object to somebody saying, hey, we will put so many dollars in each month and let's see what happens after 5 or 6 or 10 years and when we need it. Otherwise, we have got to come begging and borrowing, and I don't think I would put my future on that.

Mr. BEYER. Well, Mr. Chairman, I certainly appreciate your comments. My only response to that, I guess, is the leveraging that's

going on. So the Federal Government is today not providing all of the capital for these rural electrics. In fact, there is a lot of them that are bought out. There are about—over 100—I want to say 150, but that may be a little high. There are over 100 systems that have bought out of the program and are in longer here, and that continues.

Mr. HORN. Now, what has happened to them? I mean, have they been bought by private utilities?

Mr. BEYER. No, they bought out themselves.

Mr. HORN. They bought out themselves?

Mr. BEYER. Because they are strong enough, Mr. Chairman, to access capital. Access of capital is going to be a real issue. That's how it started in 1936. There was no access to capital. Nobody wanted to invest.

Mr. HORN. That's how every farm revolt has started.

Mr. BEYER. Exactly. Thank you.

Mr. HORN. So do you see more investment coming, or is it—and do you know who is likely to do this? I mean——

Mr. BEYER. Mr. Chairman, I think the critical thing in this whole remolding of a new infrastructure is what Congress does. Congress is going to—in fact, that's where it is going to happen. And what the States do in stranded investment cost recovery issues and in support of high-cost-to-serve areas like the telecom, the telecom has a—they call it a universal service fund. It is really a support to high-cost-to-serve areas. That is just a little tweaking. I mean, I can't believe that Congress is not going to continue that, because if Congress doesn't, in the end somewhere down the road, maybe beyond my lifetime, I don't know, after this thing is molded, we could end up with energy haves and energy have-nots and we could end up with high-cost States and low-cost States, and that gets you right down into how do you develop the high cost States?

You know, right now, there are entrepreneurs running around doing national contracts with the big chains like McDonald's. They are good loads and they want one contract across the Nation, wherever they are located. It doesn't make any difference. That's going to go on. And I think that's going to be part of the new infrastructure.

So it seems to me that it is in the best interest, good national policy, to provide some support for high-cost-to-serve areas as we go on.

Mr. HORN. In the evolution of the REA, and with the funding that you have inherited, was there a recognition that maybe the more successful ones have an obligation to help the less successful ones? And did you basically pool the resources?

Mr. BEYER. No, sir, I couldn't characterize it that way. There is a buy-out provision in the law—Congress put the buy-out provision in, which is titled a discount buy-out, which is really a net present value buy-out. And these systems are saying, look, we can do this on our own. We don't want to come to government for funds. We will leave that for the truly higher-cost-to-serve. So it is the stronger ones that are buying out.

You know, some of these systems—actually, the portfolio looks like this: I know one system of 800 members, way too small. There are too many systems out there, no question about it. And there

are systems with 140,000 members. Now, the 140,000-member system can most likely buy out, and they are. It is going to be a natural evolution. And that just provides, you know, more of the scarce dollars, wherever they come from—Federal, their own dollars, or private dollars—for the other systems. I think that's going to be the evolution of it.

Mr. HORN. Is there a density factor that you have found over the years makes sense for minimum survivability in this area of so many farmers per mile in terms of having to string the poles and all of that?

Mr. BEYER. Well, Mr. Chairman, we have looked in the agency, and you know, I had a thought once, well, we will just decide on what is a surviving, sustainable unit. But that's very difficult because there are so many differences around the country. And, you know, we don't know how to deal with that, because—well, going into this whole new competitive environment, the thing is just—everything is going to change.

What we are trying to do is encourage these borrowers, and we have a regulation where, within our authority, we can help some in mergers, consolidations, and just make sure that the efficiencies of the system are maxed out.

Mr. HORN. Well, we thank you. Sorry we have kept you past a reasonable lunch hour. And we thank you very much for coming and sharing your insights with us.

I now would like to thank various members of the staff who put together this hearing. J. Russell George, our staff director and chief counsel; sitting back there on my left, your right, Mark Brasher, the senior policy director who specifically worked on this hearing; along with John Hynes, professional staff member; Matthew Ebert, the clerk; David Coher, our faithful intern; and Kamela White, another intern assigned to the subcommittee; Mark Stephenson, minority professional staff member; Earley Green, staff assistant for the minority; and our court reporters are Pam Garland and Mindi Colchico. And we thank you all for your role in this. With that, this hearing is adjourned.

[Whereupon, at 12:30 p.m., the subcommittee was adjourned.]

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