

MEMORANDUM

State of Alaska

Department of Transportation & Public Facilities

TO: The Honorable Steve Cowper
Governor

DATE: August 9, 1989

FILE NO:

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FROM: Mark S. Hickey *MSH*
Commissioner

SUBJECT: Alaska Marine Highway
System Authority -
Issue Analysis

The purpose of this memorandum is to discuss the advisability of creating a public authority or corporation to run the Alaska Marine Highway System (AMHS), and to explore the key issues involved with undertaking such an endeavor. In recent times, a number of key state policy-makers have suggested that this type of structure should be established or seriously studied as a way to address problems or shortcomings apparently due to the current structure.

What is missing so far from the debate regarding establishment of an AMHS authority is enunciation of a clear, widely held explanation or statement of the long-term mission of the System. As part of that effort, there needs to be some clarification of what exactly have been the problems and what exactly is desired in fundamental changes in how the System functions. Once there is some consensus on these points, it is then possible to examine the current organization and alternatives to design appropriate adjustments to achieve that mission.

The failure of a clear, widely held view¹ being enunciated by authority supporters about what role the AMHS needs to fulfill and why it should pursue that role is easily my largest reservation about the advisability of pursuing creation of an authority at this time. As they say in transportation, I'm afraid the cart may be in front of the horse.

Background

The AMHS was created in 1963 as a fleet of four ferries to serve Alaskans in Southeast in lieu of "hard links" or roads connecting isolated Alaskan communities with other communities and the connected road systems through Canada. Since then the System has evolved into a fleet of nine ferries, now also serving most of Southcentral Alaska and the Aleutian Chain, and providing a direct "Lower 48" connection through the Puget Sound. There has been a tremendous increase in the number of communities, passengers and vehicles served since its beginning. In addition to its primary role of providing Alaskans with basic transportation services, an ever increasing part of the System's business is to support tourism.

Since FY 85, the AMHS total annual operating budget has remained essentially unchanged in current dollars, with a slight decrease in FY 90 due to the health benefit reduction by the legislature. During this same period of time, passenger ridership has grown 8.1% and vehicle usage is up 12.5%. Revenues have also grown, along with considerable improvement in the ratio or percentage of total expenditures funded by generated revenues. For example, FY 89 revenues covered over 56% of total costs, which is a new high. Costs have also risen during this time, partly due to increased usage and the effects of inflation on certain items. Inability under the labor contracts to control effectively leave usage levels during this period probably added to service level impacts.

Vessel age has increased during this period, while the level of annual capital appropriations for general system repairs has dropped. Starting in FY 88, most vessel overhauls have been performed at the Ketchikan Shipyard Repair Facility, creating an increased level of expense. The net result of these considerations is that a greater portion of the annual operating budget has had to be used for major vessel maintenance and overhaul costs, thereby further reducing the amount of funds to support direct service.

The implication of these factors is that during a time of ever increasing demand for service by Alaskans and non-Alaskans alike, the AMHS has experienced ever increasing real reductions in its purchasing power or funds to provide direct service. In most cases, this has usually meant a loss in frequency and/or convenience, versus a complete elimination of service to a particular community. It should also be noted that there appears to be widely held views that service levels have dropped more than the facts would support. Unfortunately, years like FY 89, during which funding could not support maintenance service levels and overhaul problems curtailed certain winter services, have further exacerbated these views.

Management Emphasis

In April 1984, former Governor Sheffield's AMHS Task Force concluded that among other issues the System "is handicapped by the lack of current, specific and accurate information." They called the record keeping systems "archaic" and in need of immediate replacement. They also found a need to redefine the goals of the system, and that there was a definite "lack of continuity of purpose" and a need for a comprehensive plan to provide for future operations.

Interestingly, the Task Force also addressed the basic question of organization and suggested consideration of a public authority or corporation, or continuation of the present arrangement under DOT&PF with a policy-making commission at its head. The main issue they seemed concerned about was ensuring continuity in top department and AMHS management. Without endorsing this concept, I must concur that the entire DOT&PF organization has suffered greatly due to its overall lack of continuity in top management since its inception.

Within three months of assuming responsibility over the AMHS in December 1986, it became quite evident that there existed an absolute void of useable information about almost all aspects of its operations. Further, I found little evidence of any real consideration for accountability or sound management practices guiding day-to-day actions. Nor did I discover any real effort by the past administration to address these matters as identified by their Task Force, with the possible exception of the reservations system.

As a result, we set out on a process to first put in place a streamlined management team of competent professionals in all key posts, followed by the next step of establishing the necessary management practices to generate useable information and control day-to-day actions. The final step in the plan was to generate a comprehensive system plan using the information created through the prior steps. In practice, it has taken longer to implement the first two steps than originally thought, thereby delaying our attention on the comprehensive plan.

On the other hand, real successes have been achieved in the last two and a half years, including the development of a reasonably accurate vessel-by-vessel cost data base for FY 88 and 89. We now possess considerable more ability to predict accurately the relevant fiscal implication of various proposals (e.g., labor provisions) or actions necessary to implement budget reductions.

Authority Impetus/Popular Myths

The combination of our inability to articulate the comprehensive system plan, and the real and perceived impacts resulting from the growing budget dilemma (including the resulting impact on legislative perceptions about the System's efficiency), has served as the primary impetus for many to support the establishment of a public authority as a way to address existing problems. Whether an authority structure will allow better resolution of these issues is debatable, depending in part on exactly how the authority is structured, and whether the right type of board members and top managers are selected. Anyone who argues that one organization approach is a guarantee for success, while another means certain failure is providing too simplistic an analysis.

Many proponents have argued that an authority will automatically result in certain benefits that will probably not materialize. For example, one argument is that an authority will help remove the AMHS from "politics." Although an authority may change the politics, it will not remove the System from politics when it needs in excess of \$30 million a year in general funds to operate, and the legislature must act annually to appropriate all funds. Even if a constitutional amendment is passed to establish a dedicated fund to keep and manage its revenues, annual appropriations will still be needed. There are also future capital decisions needed eventually regarding vessel age and replacement that will significantly involve the legislature.

Another argument is that an authority will allow the AMHS to keep its own revenues and ultimately become a self-sustaining entity. Putting aside the dedicated fund problem, I disagree that it is possible to make the AMHS a self-sustaining entity unless its mission is significantly changed, and a completely different type of vessel is used allowing for a significant reduction in operating costs. Although I believe it's a worthwhile goal to have the AMHS act in a more businesslike manner and achieve greater self-sufficiency within reason, I don't think it's realistic or appropriate to seek a total self-sufficient operation. The AMHS is fundamentally a basic transportation system similar to our land highway system. Highways do not fully pay for their own existence, nor can or should the AMHS particularly given the high operating costs inherent in its operation.

Real benefits will accrue if the AMHS is allowed to spend the revenue it generates. This would create more of a direct relationship with performance, and work as an incentive. Some consideration could be added through a formula whereby a percentage of new revenues goes to help reduce the general fund contribution. The real question is whether it's necessary to establish an authority to create this relationship. This proposal can be pursued under the current organization, and is a concept that we tried to develop with some success last session. We intend to present for your consideration a proposal for the FY 91 budget that would give the AMHS the benefit of any increase in revenue performance over prior years.

One other argument often mentioned in support of an authority is that as part of DOT&PF, the AMHS doesn't have an advocate working solely on its behalf. While I'd agree that the DOT&PF Commissioner institutionally has other considerations and duties that on occasion may moderate AMHS advocacy, the department does act as a System advocate. In fact, last session we did better on behalf of the AMHS than any other part of the department. On the other hand, there is some validity to the argument that under an authority there would be an advocate in the legislature with more of a single purpose. Whether an administration will want to allow that much freedom in the budget process might work to moderate the "advantages" gained by the organization structure.

Taking the AMHS out of the department will also have the effect of allowing the DOT&PF Commissioner freedom to argue more strongly for the other modes with less regard for AMHS needs. It's worth observing that we continue to spend almost as much money to run the AMHS as we do to maintain every state highway and airport except for AIAS. There are AMHS non-advocates in the legislature that might desire more independence in order to argue more easily that less funds are needed for the System, but that instead more support should be given to other modes. One outcome from establishing an authority is that the "subsidy" issue may be viewed as more of a regional issue in the legislative budget debate.

A final, related argument that I question is that setting up the AMHS as an authority will better allow increases in funding, particularly to meet growing service demands. To the extent an authority ensures greater accountability and tighter management, there may be some truth to this argument. However, the organizational structure will be much less a determinant on this issue than OPEC and oil industry developments. Whether more money goes to support ferries is fundamentally a direct function of the decision-making process to allocate the scarce and ever dwindling general fund resource.

Railroad Comparison

Many authority proponents argue that what is needed for the AMHS is the same approach as was used in setting up the Alaska Railroad Corporation (ARRC). They argue that it worked for the ARRC, therefore it should work for the AMHS. This argument fails to recognize there are fundamental differences between these two organizations and their respective missions. The ARRC is basically a freight transportation and real estate development company that provides limited essential or basic surface transportation services to rural areas (e.g., Whittier; Hurricane-Talkeetna), while the AMHS is fundamentally a basic transportation system serving as the primary means of surface transportation for most users. The ARRC has a clear capacity to operate in a self-sustaining manner even in spite of its limited passenger service responsibilities; the AMHS has no realistic prospect to operate on a self-sustaining basis, at least under its current mission.

There are also more subtle differences between the two organizations that could greatly affect the chances for successful implementation of an AMHS authority. The ARRC was never part of state government or our political system; the AMHS is firmly ingrained in all aspects, whether its labor relations, risk management, legal services, or annual budget approval. As a practical matter, I question just how autonomous an organization can be created for the AMHS. At some point there is a real risk of effectively establishing just another line agency masquerading as an authority, which should be weighed against the chaos and negative aspects of making the change.

As an aside, I think there are legitimate policy concerns with pursuing too much autonomy for an organization that spends in excess of \$30 million annually in general funds.

Another difference to consider is that the ARRC had to confront restructuring of its basic organization due to the federal government's decision to pursue divestiture; there is no similar impetus to force the change for the AMHS. While it's hard to predict the implication of this point, I believe at a minimum it may force more accommodations during the legislative process to achieve the desired result, once again potentially diluting the end result. This could be particularly the case with many of the employee issues.

The actual experience of considering and then pursuing establishment of the ARRC is useful as a possible model. Four separate legislative sessions were spent crafting the legislation establishing the ARRC. A thorough and thoughtful analysis and debate occurred exploring the issue of the Railroad's basic mission, followed by a full assessment of all organizational options. Attached is one document generated during that effort. While it should be acknowledged that passage of federal legislation was needed in the case of the Railroad, I believe the analogy is relevant and, as a primary player on that issue, must observe that it will be next to impossible to achieve a good piece of authorizing legislation in only one legislative session.

Possible Benefits

Having played devil's advocate, let me turn to an analysis of some possible benefits that could be achieved through establishment of an AMHS authority. The major, potential benefit that I see is an authority could greatly aid in providing continuity in top management at the System. This has clearly been a problem, as identified in the 1984 Task Force Report. While there are other ways to achieve this goal, an authority clearly allows for greater management continuity. In this aspect, it can be argued that it minimizes the potential for playing politics; although that depends on the board and sitting governor too. Additionally, if you have a problem management team, it might prove more difficult to pursue a prompt change.

Another benefit would be more control over the labor relations functions, particularly with the vessel employees. This benefit will only materialize if there's a willingness to give the authority real control over this function. One reason for using the authority structure is to set an organization apart from the rest of state government, thereby reflecting a somewhat unique mission requiring special considerations. If one goal is more accountability and businesslike performance, then I believe it's critical to give the organization the tools necessary to achieve that goal.

Given the large percentage of the System's costs attributable to labor, I would argue it's imperative to give direct responsibility over labor relations to the authority if it's going to have a reasonable chance to succeed.

I think you can also craft an argument that the AMHS may improve its basic management performance quicker because under an authority structure there should be more public and legislative scrutiny and visibility. This is very difficult to predict, and may not materialize if there's a long "honeymoon" period. Frankly, given the current demands for AMHS service increases and general revenue trends, I doubt there will be much patience in waiting to see performance improvement.

A final argument that holds value is that making the AMHS an authority will make the job of running DOT&PF that much easier. As a general matter, this would be true. The AMHS has clearly taken probably 20% of my time, which means I don't spend that time on other parts of the department. On the other hand, removing the AMHS from the department defeats one of the primary purposes for creating an integrated, multi-modal DOT&PF. Having management for all modes under one structure should mean more efficient service delivery, particularly in Southeast where the modes are intricately interlinked. It is debatable whether this has yet happened after twelve years, and certainly coordination of the planning effort can occur regardless.

This latter point is a consideration that deserves careful review and discussion. I think it's premature to declare DOT&PF a failed experiment. Given the role of transportation in a state like Alaska, I firmly believe it's imperative to have a well-structured and managed DOT&PF managing the state's transportation systems. Whether that means direct and full responsibility for all modes and systems is debatable. Clearly part of the department's problem has been the lack of top management continuity. On the other hand, I would submit that great strides have been made in the last four or five years irrespective of the continuity issue.

Key Authority Issues

If a decision is made to pursue establishment of an authority to run the AMHS, there are a number of key policy issues that must be addressed correctly if the new organization is to be successful. The following is a partial listing of the major items:

- (1) Findings and Purpose: There is a need to articulate clearly the basic purpose and mission expectations.

- (2) Employees/Labor Relations: Will the employees be employees of the state or the authority? Will the authority have direct control over the labor relation functions, particularly collective bargaining?
- (3) Board Composition: What criteria should govern board composition? Should an employee sit on the board? Should there be other government officials other than the DOT&PF Commissioner
- (4) Budgeting/Revenues: What mechanism will be used to allow expenditure of generated revenues? Should a dedicated fund be pursued? How should subsidy levels be set? What about authority to incur debt, or to carry forward funds for reserve purposes?
- (5) Land Ownership: How should this be handled insofar as terminal holdings are concerned? What restrictions, if any, should apply to appropriate land uses? Should any powers of eminent domain be granted?
- (6) Legal Services: Should the AG serve as legal counsel, or should that be left up to the authority similar to the ARRC?
- (7) Regulatory Oversight: What regulatory oversight, if any, should govern rate-setting and major service changes? What limitations should govern competition with private sector services?
- (8) Capital Fund Allocation: Most capital needs are provided for through federal-aid highway funds. How should this funding support be ensured? Should it continue to pass through the DOT&PF?
- (9) Transportation Planning/Coordination: What steps should be taken, if any, to ensure adequate transportation planning and coordination occurs with DOT&PF?
- (10) Procurement: What exceptions, if any, will apply to the authority's procurement requirements?
- (11) One-Time Costs: Initial estimates are that establishing an AMHS authority will result in one-time costs of approximately \$450,000, and that added, ongoing costs will run about \$300,000. How should these expenses be funded?

- (12) DOT&PF Services: DOT&PF currently performs a number of support service, many of which are funded as part of overall department operations (e.g., accounting support; computer services; right-of-way support). Who should perform these services? How should they be funded? The AMHS also provides some transportation support for other department functions. How should this be handled?

Findings/Recommendations

As is probably evident by the analysis, I have serious reservations about the advisability of pursuing legislation at this time to establish a public authority to run the AMHS. Nor am I convinced that an authority is necessary to accomplish the goal of efficiently operating the AMHS. Without more work leading to the development of a widely held consensus identifying the basic, long-term mission and explaining clearly what changes are desired and why, I think at a minimum it is premature to conclude that an authority is the way to go.

I also think it's unrealistic to expect passage of such a comprehensive restructuring in a single legislative session, at least if the desire is to obtain good legislation. It should also be understood that putting the AMHS through such a change will mean additional chaos in performance of basic management duties for at least one to two years. Just when we're beginning to demonstrate some headway in this area, I'd hate to lose ground to implement what may be an out-of-focus reaction to problems largely beyond the System's control.

At the same time, I realize there is a need¹ to provide leadership for the legislature and the public to address both the real and perceived shortcomings with the status quo. Accordingly, I recommend adoption of the following course of action as a more realistic, yet responsive approach:

- (1) Announce an awareness by the administration of the problems due to current budgetary pressures, long standing AMHS deficiencies, and lack of a current, publicly-held, focused mission.
- (2) Acknowledge efforts and successes of current management team to tackle basic problems. Concurrently, acknowledge that you believe basic structural changes may be needed, but first more work is needed to address #1 above. Perhaps offer you sense of what that mission should be and how some of the current budget issues should be confronted.

- (3) Announce a special effort to analyze these issues, with particular emphasis on historical trends involving service changes and AMHS efficiency. Some amount of independent scrutiny should be built into this work. This effort should include polling of users (particularly Alaskans) to ascertain concerns, level of satisfaction and views about the long-term mission.
- (4) Depending on whether warranted based on the results under #3 above, commission the AMHS Advisory Board to perform the following tasks: (a) help articulate answers to #1 above; and (b) propose organizational adjustments if warranted, with special attention to the authority and any specific legislation that should be pursued. This results of this work could be given to the new administration for action during 1990.

I realize this won't be well received by some quarters advocating immediate action. Nevertheless, I believe it's the more responsible way to handle a fairly significant issue. One way to accommodate those who want more now would be to pursue revenue-based budgeting for FY 91 and commit to increments to restore the System's purchasing power to ensure a level of service closer to levels prior to FY 89. Both are responsible positions, and I intend to advocate something like this during the upcoming budget process.

If after reviewing this material, you decide we should pursue an authority structure now, then it's imperative we marshal the necessary resources promptly in order to competently and thoroughly address this matter. This includes ensuring drafting and passage of competent legislation, and funding the costs to carry out establishment of the authority.

Attachment

cc. Garrey Peska, Chief of Staff, Office of the Governor
Bob Evans, Legislative Liaison, Office of the Governor
Ron Clarke, Special Staff Assistant, Office of the Governor
W. Keith Gerken, Deputy Commissioner, Operations
George Davidson, System Director, Alaska Marine Highway System