# SB

# 42

FILE

# Alaska State Legislature

## Senate

### Rules Committee

Official Business

State Capitol
Juneau, AK. 99801-1182

## MEMORANDUM

**DATE:** October 1, 1997

**TO:** Tamara B. Cook, Director
LAA Legal and Research Services

**FROM:** Senator Tim Kelly, Chairman
Senate Rules Committee TDK

**SUBJ:** Request For Legal Opinion

I would appreciate your review of questions I have regarding functions of the Alaska Railroad. Given that the railroad is not currently under the Executive Budget Act and its funding not appropriated by the legislature, is it constitutionally appropriate for railroad employees to spend money; ie. perform purchasing activities such as buying locomotives? What is the authority for this action?

In the same context, what is the authority for the sale of coal, for example, from lands owned by the University, the Department of Natural Resources, or the Mental Health Lands Trust, in the absence of constitutional or legislative authorization?

I would appreciate your opinion as soon as possible, and would like it sent to my Anchorage office. Thank you.

TDK/tb/m05

# LEGISLATIVE TELECONFERENCE NETWORK

TCN # 70562
TC Line: Dedicated
Time Dialed In: 8:30
Time Dropped Off: _____
Date: 9-24-97

# SIGN-IN SHEET

*Please Print!!*

**Sponsor:** SENATE RULES COMMITTEE

**Subject:** SB 42 - AK R.R. UNDER EXECUTIVE BUDGET ACT

| Name - Organization You Are Representing | Address | Zip | Phone # | *Testify* | *Observe* | Bill # |
|---|---|---|---|---|---|---|
| ✓ Jeff COOK / MAPCO | 1150 H+H Lane North Pole | 99705 | 488-2711 | ✓ | | SB 42 |
| John SIMMS / USABELLI COAL | 1935 Sweden Dr. Fbks. | 99709 | 479-0153 | ✓ | | " |
| ✓ Bill Sheffield PRES. AK R.R. | 3125 Susitna Dr. Univ Grv | | 265-2403 | ✓ | | " |
| ✓ RP. J. JAMES | FBKS LIO | | | ✓ | | " |
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# COMMITTEE TAPE LOG

COMMITTEE: RLS DATE: 9/24 TIME: 9:00 AM

SUBJECT: SB 42:

MEMBERS: Sen Leman Sen. Taylor Sen. Duncan Sen. Thorgerson
on Teleconference Sen. Kelly

| SPEAKER | TAPE# | SIGNIFICANT INFORMATION |
|---|---|---|
| TAPE 1 SIDE 1 | 1:48 | Rep. Jim Mattox |
| | 11:17 | Dick Cook |
| | 29:18 | Ronald Waters |
| | 41:30 | Mac Hubbard |
| | ↓ | |
| TAPE 1 SIDE 2 | ↓ | |
| | 42:53 | Rep. James |
| TAPE 2 SIDE 1 | ↓ | |
| | 5:55 | Kevin Burchaud → ANC |
| | 9:00 | John Sims |
| | 16:54 | Bennett → |
| | 17:25 | Rep. Cannady |
| | 18:00 | Bill Taylor |
| | | CONTRACT AMEND |
| | 19:50 | |
| | 21:00 | Sen Leman |
| | | Sen Duncan ART. |
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09/24/97 LEGISLATIVE TELECONFERENCE NETWORK SYSTEM LTN1150
09:07:40 PARTICIPANT LIST (ALL PARTICIPANTS) BY:ANC
TCN:70862 SCHEDULED FOR:09/24/97 09:00 TO 13:00 FOR:ANC
PUBLIC HEARING SENATE RULES

LOCATION:ANCHORAGE

| | | | | | |
|---|---|---|---|---|---|
| SB 42 | REP | TERRY | MARTIN | | TESTIFY |
| SB 42 | REP | JOHN | COWDERY | | TESTIFY |
| SB 42 | | KEVIN | BERGSRUD | UNITED TRANS UNI | TESTIFY |

09/24/97 LEGISLATIVE TELECONFERENCE NETWORK SYSTEM LTN1150
09:32:02 PARTICIPANT LIST (ALL PARTICIPANTS) BY:ANC
TCN:70862 SCHEDULED FOR:09/24/97 09:00 TO 13:00 FOR:ANC
PUBLIC HEARING SENATE RULES

LOCATION:ANCHORAGE

| | | | | | |
|---|---|---|---|---|---|
| SB 42 | REP | √TERRY | MARTIN | | TESTIFY |
| SB 42 | REP | √JOHN | COWDERY | | TESTIFY |
| SB 42 | | √KEVIN | BERGSRUD | UNITED TRANS UNI | TESTIFY |
| SB 42 | | THERESA | OBERMEYER | | TESTIFY |

09/24/97 LEGISLATIVE TELECONFERENCE NETWORK SYSTEM LTN1150
09:08:16 PARTICIPANT LIST (ALL PARTICIPANTS) BY:JNU
TCN:70862 SCHEDULED FOR:09/24/97 09:00 TO 13:00 FOR:JNU
PUBLIC HEARING SENATE RULES

LOCATION:JUNEAU

| | | | | | |
|---|---|---|---|---|---|
| ALL ITEMS | | JERRY | BURNETTE | | TESTIFY |
| ALL ITEMS | | RANDY | WELKER | LEG. AUDIT | OBSERVE |
| ALL ITEMS | | ANNETTE | KREITZER | | OBSERVE |

# ITINERARY - SENATOR KELLY

(Fairbanks Rules Meeting / University Regents)

***IN FAIRBANKS:***

PRESIDENT JEROME KOMISAR - wk/474-7311
WENDY REDMAN - wk/474-7582 hm/479-6114
LEGISLATIVE INFO. OFFICE (Melba) - 452-4448
ALASKA AIRLINES - (800)-426-0333

## Wednesday, September 24th

5:50 am - Go to Anc airport one hour ahead of flight

6:50 am - Depart for Fairbanks on Alaska Airlines flight #89

7:44 am - Arrive Fairbanks / Pickup by Tim B. or take cab to LIO

9:00 am - Public hearing on SB 42

11:00am - End of public hearing on SB 42

11:30am - Meeting with university regents / Pickup by Wendy R.
(Butrovich Bldg., ground level board conf. room)
(upper campus near Geophysical Institute)

3:30 pm - End of university meeting

(OPEN TIME UNTIL DEPARTURE)

5:15 pm - Go to Fbks airport one hour ahead of flight

6:15 pm - Depart for Anchorage on Alaska Airlines #196

7:11 pm - Arrive Anchorage

TDK/tb/itin

**Bill/Resolution History** 11:11 AM 09/18/97 Page 1

BILL: SB 42 SHORT TITLE: ALASKA RR BUDGET AND LAND

BILL VERSION:

SPONSOR(S): RULES BY REQUEST OF LEGISLATIVE BUDGET AND AUDIT

CURRENT STATUS: (S) RLS STATUS DATE: 5/02/97

HEARING:(S) RLS SEP 24 09:00 AM FAIRBANKS LIO TELECONFERENCE

TITLE: "An Act relating to the fiscal operations of the Alaska Railroad Corporation and to land acquired by the State of Alaska under the Alaska Railroad Transfer Act of 1982 or otherwise acquired for railroad purposes; and providing for an effective date."

**SB 42** **Bill/Resolution Floor Action** Page 2 of 2

Current Status: **(S) RLS**

| | Jrn-Date | Jrn-Page | | Action |
|---|---|---|---|---|
| 1 | 01/13/97 | 25 | (S) | READ THE FIRST TIME - REFERRAL(S) |
| 2 | 01/13/97 | 26 | (S) | TRA, STA, FIN |
| 3 | 01/14/97 | 41 | (S) | RES REFERRAL ADDED |
| 4 | 01/14/97 | 42 | (S) | TRA, STA, RES, FIN |
| 5 | 02/21/97 | 447 | (S) | TRA RPT 1DP 2NR 1AM |
| 6 | 02/21/97 | 447 | (S) | DP: WARD; NR: WILKEN, GREEN; AM:LINCOLN |
| 7 | 02/21/97 | 447 | (S) | FISCAL NOTES (LAW, DNR-2) |
| 8 | 04/01/97 | 914 | (S) | STA RPT CS 2DP 1NR NEW TITLE |
| 9 | 04/01/97 | 914 | (S) | DP: GREEN, WARD; NR: DUNCAN |
| 10 | 04/03/97 | 956 | (S) | ZERO FN TO CS (LAW) |
| 11 | 04/11/97 | 1107 | (S) | RES REFERRAL WAIVED |
| 12 | 05/02/97 | 1642 | (S) | FIN RPT CS 4DP 1NR NEW TITLE |
| 13 | 05/02/97 | 1642 | (S) | DP:PEARCE, PHILLIPS, ADAMS, TORGERSON |
| 14 | 05/02/97 | 1642 | (S) | NR: SHARP |
| 15 | 05/02/97 | 1642 | (S) | ZERO FNS TO CS (DNR-2) |
| 16 | 05/02/97 | 1642 | (S) | PREVIOUS ZERO FN APPLIES (LAW) |
| 17 | 05/02/97 | 1642 | (S) | REFERRED TO RLS |

Selection=> _____

**PF1 HELP** **PF2 SUBJ** **PF3 EXIT** **PF4 MENU** **PF5 TEXT** **PF6 PRINT** **PF7 BWD** **PF8 FWD** **PF9 CMT/JRNL** **PF10 FIRST** **PF11 LAST** **PF12 QUIT**

9-24-97 RLS FBKS 9:00 AM
SB 42

(1) RP. MARTIN

(2) JEFF COOK - MAPCO VP EXT. AFFAIRS
- will incr. R.R. shipments by 50%

(3) RP. COWDERY - questions of Jeff Cook

(4) RANDY WELKER, LB & A - audits of the R.R. need to be more complete. Budget process has been a good forum for scrutiney.

- KELLY - how affect the state budget?

- DUNCAN - capability for legis. to go in and micromanage R.R.

(5) GOV. SHEFFIELD - general review of operations, and ethics stmt.

— RP. COWDERY

(6) RP. JAMES — MAPCO, USABELLI, EILSON all in her district

(7) KEVIN BURKSHOES, UNITED TRANS. UNION

(8) JOHN SIMMS, USABELLI

(9) JERRY BURNETT — for SN. PHILLIPS

(10) RP. COWDERY - already

(11) SN. TAYLOR - wants further discuss. on constitut. authority, and whether expenditures by R.R. employees are approp.

(12) Contract amendment on James M. Johnson.

moved TDK — object. SN. DUN.

2nd

approved 4-1

# Alaska State Legislature

## Senate

### Rules Committee

Official Business

State Capitol
Juneau, AK. 99801-1182

## MEMORANDUM

**DATE:** September 22, 1997

**TO:** Senators Duncan, Leman, Taylor and Torgerson
Members, Senate Rules Committee

**FROM:** Senator Tim Kelly, Chairman TDK
Senate Rules Committee

**SUBJ:** Senate Rules Committee Hearing - Fairbanks

The Senate Rules Committee meeting will take place in the Fairbanks LIO Conference Room at 9:00am, Wednesday, September 24th. It is my understanding that you will all be there in person.

There is no van pickup service available, so you are encouraged to take cabs from the airport, or possibly share a rental car or cab if you can coordinate with other members.

We will take up Senate Bill 42, the bill proposing to bring the Alaska Railroad under provisions of the Executive Budget Act. Some material has gone out to you in advance, however, complete folders will be available at the meeting.

We will also take up a contract amendment for Mr. James Martin Johnson in the amount of $3,258.36.

If you have questions, please contact Tim at 258-8180.

c: Sn. Phillips
Rp. Martin
Rp. Therriault
Rp. Cowdery
Spkr. Phillips

TDK/tb/m15

FILE

# Alaska State Legislature


Sen. Tim Kelly, Chairman
Anchorage
Sen. Loren Leman, Vice-Chair
Anchorage
Sen. Robin Taylor
Wrangell
Sen. John Torgerson
Kasilof
Sen. Jim Duncan
Juneau


Official Business

## Senate Rules Committee


State Capitol
Juneau, AK 99801-1182
(907) 465-3822
Fax: (907) 465-3756
1-800-770-3822
(JANUARY - MAY)
INTERNET: //http.//www.state.ak.us

716 West 4th, Suite 400
Anchorage, AK 99501
(907) 258-8180
Fax: (907) 258-4524


# MEMORANDUM

**DATE:** September 3, 1997

**TO:** Senators Duncan, Leman, Taylor and Torgerson
Members, Senate Rules Committee

**FROM:** Senator Tim Kelly, Chairman
Senate Rules Committee

**SUBJ:** Senate Rules Committee Hearing

This confirms the Senate Rules Committee meeting in Fairbanks on September 24th, at the Legislative Information Office. The public hearing will be held from 9:00am to 11:00am, and will take up Senate Bill 42, bringing the Alaska Railroad under the Executive Budget Act.

Whether you're traveling to Fairbanks or participating by teleconference, please let Tim Benintendi in my Anchorage office know as soon as possible.

If you have questions, or need more information, please contact Tim.

TDK/tb/m15

FILE

# Alaska State Legislature


Sen. Tim Kelly, Chairman
Anchorage
Sen. Loren Leman, Vice-Chair
Anchorage
Sen. Robin Taylor
Wrangell
Sen. John Torgerson
Kasilof
Sen. Jim Duncan
Juneau


Official Business

## Senate Rules Committee


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INTERNET: //http.//www.state.ak.us

716 West 4th, Suite 400
Anchorage, AK 99501
(907) 258-8180
Fax: (907) 258-4524


# MEMORANDUM

**DATE:** September 3, 1997

**TO:** All Legislators

**FROM:** Senator Tim Kelly, Chairman
Senate Rules Committee TDK

**SUBJ:** Senate Rules Committee Hearing

This confirms the Senate Rules Committee meeting in Fairbanks on September 24th, at the Legislative Information Office. The public hearing will be held from 9:00am to 11:00am, and will take up Senate Bill 42, bringing the Alaska Railroad under the Executive Budget Act.

If you have questions, or need more information, please contact Tim Benintendi in my Anchorage office.

TDK/tb/m15

# CONFIRMED RULES MTG.
# 9-24-97

9-3 Fx'd to: TAYLOR, TORGERSON, DUNCAN LEMAN

9-3 HANDED to: LEMAN (RACHEL), TAYLOR (Chris) MARTIN.

9-3 MAILED to: THERRIAULT, DAVIES, BRICE, G. DAVIS, GREEN (L.), HODGINS, JAMES, KELLY, KOHRING, MASEK, OGAN, SHARP, WILLIAMS.

9-4 PUT IN BOXES: ADAMS, BARNES, BERKO, BUNDE, COWDERY, CROFT, DONLEY, (POUCH) DYSON, ELLIS, ELTON, FOSTER, GREEN, GRUSSENDORF, HALFORD, HANLEY, HOFFMAN, HUDSON, IVAN, JOULE, KEMPLEN, KOOKESH, KOTT, KUBINA, MACKIE, MILLER, MULDER, NICHOLIA, MOSES, MOSES, PEARCE, PHILLIPS, PHILLIPS, PORTER, ROKEBERG, RYAN, SANDERS, VEZEY, WARD, WILKEN.

## ALASKA RAILROAD CORPORATION (ARRC)

| | | |
|---|---|---|
| Gov. Bill Sheffield<br>President & CEO | 265-2403<br>Fax 258-1456 | PO Box 107500<br>Anchorage AK 99510-7500<br>327 Ship Creek Ave |
| James B. Blasingame<br>Vice President,<br>Corporate Affairs | 265-2680<br>Fax 258-1456 | |
| George Erickson<br>Vice President,<br>Transportation Svcs | 265-2578<br>Fax 258-1456 | |
| Phyllis C. Johnson<br>Vice President,<br>General Counsel | 265-2461<br>Fax 258-1456 | |
| David Eagle<br>Vice President, Real Estate | 265-2671<br>Fax 258-1456 | |
| Jerry Anderson<br>Vice President, Chief Financial Officer | 265-2516<br>Fax 258-1456 | |

RULES

SN. TORGERSON – 235-0690 in FBKS

SN. TAYLOR – 225-8088 in FBKS

SN. LEMAN – 258-8189 in FBKS

SN. DUNCAN – 465-4766 in FBKS

SN. KELLY – 258-8180 in FBKS

TESTIMONY

BILL SHEFFIELD – 265-2403 (C.E.O. Alaska R.R.)

RANDY WELKER – 465-3830 (Legislative Audit)

JOHNE BINKLEY – 479-6006 (Alaska R.R. Board)

WESLEY ROGERS – 279-7117 (United Trans. Union)

TERRY MARTIN – 258-8169 (V-Chair, LB+A)

JERRY BURNETT – 465-4949 (Senator Phillips' aide)

RP. COWDERY – 258-

T/C – ANC, JNO

# RULES - FAIRBANKS

~~1.~~ 9-10 get supporters and opponents lined up to speak.

~~2.~~ 9-4 lodging ~~for~~ TDK at Steve Frank's
RIVER'S EDGE R.V. & RESORT
(907) 474-~~0286~~ None for TDK (returning same day)

3. 9-5 make ~~Johnnie~~ Binkley aware of mtg.
(907) ~~479~~-6006

~~4.~~ 9-5 get ~~airlines~~ reservations for
TDK ~~&~~ TB ~~Atanko~~ - 786-3270

~~5.~~ 9-24 get ~~lodging~~ for TB "Molly" ~~23~~ + 24
FAIRBANKS EXPLORATION INN
(888)-452-1920
(907)-451-1920

~~6.~~ 9-4 make ~~Linda~~ Anderson aware of mtg.
(907) 474-~~9463~~

~~7.~~ 9-12 get ~~RANDY~~ WALKER to make a presentation

~~8.~~ 9-12 get United Transportation Union to comment / be aware.

9:00 – 1:00 PM

# RULES MTG: 9-24 (WED) FBKS

① CONTRACT AMENDM. – JAMES MARTIN JOHNSON
– final pmt of # 3,258.36.

② SB 42 AK RR UNDER EXEC, BUDGET ACT
– public hearing

~~deleted~~
③ ~~SB 169~~ VOLUNTARY FLEX TIME FOR MINES
– public hearing

ok-P SN. KELLY – ✓Tim ✓
ok-TC SN. LEMAN – ✓Annette – 465-2095
in KETCH. ← SN. TAYLOR – STATE CHAMBER CONV. ✓Joe – 225-8088 ✓MARY 874-2318
ok-P SN. TORGER – ✓Mary – 283-2690 KRYSTAL
ok-P SN. DUNCAN – ✓Roxanne 465-4766

SB 42 SN. PHILLIPS – ✓Jerry + ✓Martin
SB 169 SN. LEMAN – (above) + Therriault ✓

✓ Sheffield + lobbyist
✓ RR union – Wes Rogers
✓ copy all legislators w/(announcement) relevant lobbyists
✓ Union,
✓ labor interests – Barbara Huff

# *Alaska State Legislature*

## *Legislative Affairs Agency*

***Division of Administrative Services***

*130 Seward Street, Suite 313 Juneau, Alaska 99801-2197 (907)465-3852 or Fax (907)465-3234*


DATE: July 29, 1997

TO: Ted Popely, Majority Legal Counsel
Project Director - Johnson Contract

FROM: Karla Schofield, Deputy Director
Legislative Affairs Agency

SUBJ: James Martin Johnson Contract

We have received invoices for the James Martin Johnson contract which exceed the current $25,000 contract amount by $ 3,258.36. The contract between the Alaska State Senate Rules Committee and Mr. Johnson is to provide the Leadership of the Alaska State Senate and the Alaska State House of Representatives with technical assistance and evaluation of tribal sovereignty and resource issues.

In order to pay Mr. Johnson the $3,258.36, the contract will have to be amended. This will require the approval of the Senate Rules Committee in a meeting. As this contract was entered into under the small procurement provision of the Legislative Procurement Procedures (Sec. 045) a memo to the file from you as project director is required stating the basis for the amendment.

Please let me know what you wish to do regarding this contract. If you have any questions I can be reached at 465-6626.

cc: Senator Tim Kelly, Chair
Senate Rules Committee

# *Alaska State Legislature*

## *Legislative Affairs Agency*

***Division of Administrative Services***

*130 Seward Street, Suite 313 Juneau, Alaska 99801-2197 (907)465-3852 or Fax (907)465-3234*


DATE: July 29, 1997

TO: Ted Popely, Majority Legal Counsel
Project Director - Johnson Contract

FROM: Karla Schofield, Deputy Director
Legislative Affairs Agency

SUBJ: James Martin Johnson Contract

We have received invoices for the James Martin Johnson contract which exceed the current $25,000 contract amount by $ 3,258.36. The contract between the Alaska State Senate Rules Committee and Mr. Johnson is to provide the Leadership of the Alaska State Senate and the Alaska State House of Representatives with technical assistance and evaluation of tribal sovereignty and resource issues.

In order to pay Mr. Johnson the $3,258.36, the contract will have to be amended. This will require the approval of the Senate Rules Committee in a meeting. As this contract was entered into under the small procurement provision of the Legislative Procurement Procedures (Sec. 045) a memo to the file from you as project director is required stating the basis for the amendment.

Please let me know what you wish to do regarding this contract. If you have any questions I can be reached at 465-6626.

cc: Senator Tim Kelly, Chair
Senate Rules Committee

**MEMORANDUM**

TO: Senator Tim Kelly
Chairman, Senate Rules Committee

FR: Ted Popely

RE: Jim Johnson Contract

DT: August 1, 1997

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**April 26, 1996** - $25,000 six month contract with Jim Johnson (Sen. Miller, Chair Senate Rules). Contract Term: 3/1/96 to 9/1/96.

**September 12, 1996** - Contract term only extended until 2/28/97 (Sen. Miller, Chair Senate Rules). Amount unchanged.

**Current Invoice** - $3,258.36 over the $25,000 contract.

Jim Johnson ranks among the most qualified attorneys in the country with experience in Indian Law before federal courts, including the U.S. Supreme Court. He was retained as a consultant to the Alaska Legislature shortly after the Ninth Circuit Court of Appeals decided that Indian Country exists in Alaska.

His counsel thus far has been invaluable in getting the issue before the United States Supreme Court. Mr. Johnson is also largely responsible for convincing colleagues in California and 22 other states to file briefs in support of Alaska in this case. He is dedicated to this issue and to victory for Alaska. He has performed a substantial amount of work on our behalf for no charge, and he continues to do so even as we speak. To be candid, Mr. Johnson has instructed me not to pursue payment of the $3,258 balance above the contract amount. I believe it is in the State's best interest to pay the balance, but the decision ultimately rests with Senate Rules.

Encl.

# James M. Johnson

Office: Capitol Court, Suite 225
1110 S. Capitol Way
Olympia, Washington 98501
(360) 357-3104

Home: 3042 Oldport Lane
Olympia, WA 98502
(360) 866-2370

**1993 - Present**: In private practice, I continue to apply the expertise in major litigation I developed as Chief of Special Litigation for the State of Washington. In United States v. Washington, Washington's (in)famous treaty fishing case, the tribes are attempting to extend their claim to shellfish and public and private lands. My clients are private landowners, parties only after I won a Ninth Circuit appeal of an order denying them intervention. I have just completed and filed briefs in the appeal of the final decision. (Note the Tribes also appealed the rulings favorable to us.) In the Washington Supreme Court in Walker v. Munro, 124 Wn.2d 402 (1994), I successfully defended Washington's tax-limitation Initiative 601 (for the taxpayers, sponsors of the Initiative). In Mille Lacs Band of Chippewa v. Minnesota, I represent nine intervenor counties and work with the State of Minnesota to defend that Indian treaty case. In 1996, I represented the Clerk of the Washington House of Representatives in litigation with major newspapers. I also authored an amicus brief for Wyoming and Montana counties in the United States Supreme Court in Hagen v. Utah and participated in a NAAG moot court (as a "Justice") in preparing the Utah Attorney General for argument. (The Court ruled for us 7-2.)

**1983-1993**: Until April of 1993, I was the Chief of the Special Litigation Division, in the Washington State Attorney General's Office, representing over twenty-five client agencies, and litigating "special" cases for the State. I enjoyed being the team leader for much of the State's important litigation at the state and federal trial and appeal levels, including the United States Supreme Court. I was also national affairs liaison to the National Association of Attorneys General (NAAG) and the Conference of Western Attorneys General (CWAG). I know personally and have worked with nearly every states' Attorney General, and top staff. I was contributing editor for the CWAG on American Indian Law Deskbook (March 1993, University of Colorado Press).

Recent major cases included the "Ninth Congressional District" litigation cases to retain Washington's 9th U.S. House seat (the last awarded after the census). This included four federal district court cases, and two United States Supreme Court cases. I also authored a brief amicus for twenty-two states in the successful effort to uphold states' election protection statutes last term in Burson v. Freeman, United States Supreme Court No. 90-1056.

I have handled nearly one hundred appellate cases in the federal courts of appeal, Washington Supreme Court and United States Supreme Court. Some of these cases are listed on the attached Appendix A.

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**Other Experience:**

| | |
|---|---|
| 1970-71 | Counsel to Washington State Legislative Joint Committee on Banking Insurance and Transportation. |
| 1971-73 | United States Army Lieutenant (Chief of Administrative Services for Ninth Infantry Division). |
| 1973-1983 | Chief Attorney for Fisheries/Game Division of Washington State. |

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**Interests:** I enjoy running (including marathons), sailing, fishing, hunting, and opera.

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**Education and Bar Admissions:** Harvard University, B.A. 1967 (Economics); University of Washington, J.D. 1970.

Admitted to Washington Bar 1970; also admitted to practice in the Washington State Supreme Court; federal district courts of Washington and California, Eighth Circuit, Ninth Circuit and District of Columbia Circuit Federal Courts of Appeals; United States Supreme Court. I have also practiced on a pro hac vice basis in federal courts in seven other states.

Attachment A

# LITIGATION EXPERIENCE/LEGAL ACCOMPLISHMENTS
# JAMES M. JOHNSON

## I. TRIAL AND APPELLATE EXPERIENCE

My experience includes hundreds of trials in both the federal and state systems and nearly one hundred appellate cases up to, and including, the United States Supreme Court. Most of the appellate work involved cases I personally tried.

In federal court alone, I have tried over two hundred cases. Most cases have been civil trials, but my trial experience has also included criminal trials in Washington State Superior Courts involving environmental and hunting and fishing cases.

This extensive litigation and appeal practice has extended to each of the courts of which I am a bar member. I have appeared pro hac vice in another six states' federal courts.

Some noteworthy cases--my favorites--illustrating the variety of my experience are the following:

### A. United States Supreme Court

1. I personally briefed and argued Munro v. Socialist Workers, 479 U.S. 499 (1986) successfully upholding the constitutionality of Washington election ballot restrictions.

2. Hagen v. Utah, (No. 92-6281, decided February 23, 1994). I wrote the brief for similarly-situated counties in Wyoming and Montana. I helped prepare the Utah Attorney General for argument (as a "justice") in moot court sessions.

3. Montana v. U.S. Dep't of Commerce, 112 S. Ct. 1704, 503 U.S. 997 (1992). The "Equal Proportions" method of allocating U.S. House seats was upheld, saving Washington's ninth seat from one challenge. I briefed at both the three-judge district and United States Supreme Court and was a justice at the moot court preparing Solicitor General Starr who argued.

4. Franklin v. Massachusetts, 112 S. Ct. 3056, 503 U.S. 929 (1992). The Census' inclusion of U.S. military--overseas on the census day was upheld, saving Washington's ninth seat from another challenge. I briefed at both three-judge district and United States Supreme Court. At the Supreme Court level, this was coordinated with the U.S. Solicitor, whom I helped prepare for argument (again as a moot court justice).

5. Burson v. Freeman, United States Supreme court No. 90-1056. I authored a brief amicus for twenty-two states. The Tennessee law, like that of Washington, proscribes activities such as campaigning around the election polls. Our brief was especially important since one justice adopted our arguments in his concurring opinion. The case was won five to three so this vote was critical (four to four would have upheld the unfavorable lower court).

6. Idaho v. Washington, Oregon, 444 U.S. 380 (1980); 462 U.S. 1017 (1983). An original action between states, challenging regulation and harvest of fish runs in Columbia River and tributaries. I tried the case to the special master appointed by the Court and participated in briefing and argument preparation for the two United States Supreme Court hearings.

7. The treaty Indian "fish cases." Department of Game v. Puyallup, 414 U.S. 44 (1973); Puyallup Tribe v. Washington Dep't of Game, 433 U.S. 165 (1977); Washington v. Washington Comm'l

Passenger Fishing Vessel, 443 U.S. 658 (1979) involving fishing regulation and Indian treaty law. I was a participant in briefing and argument preparation.

8. Antoine v. Washington, 440 U.S. 194 (1975). This dealt with Indian reservation boundaries and hunting. I was a participant in briefing and argument preparation.

**B. Washington Supreme Court and Washington Court of Appeals**

I have personally handled and/or argued approximately 35 cases, more than half in the Washington Supreme Court. Some recent examples include:

1. Walker v. Munro, Washington, 124 Wn.2d 402, 879 P.2d 920 (1994), upheld Initiative 601, which places a limit on state tax and budget increases.

2. Ellensburg v. Washington, 118 Wn.2d 709 (1992), held the State is not required to pay full funding for fire protection services for Central Washington University. I participated in writing the briefs and argued the case before the Supreme Court. It was decided in our favor on January 16, 1992.

3. Schrempp v. Munro, 116 Wn.2d 929 (1991), involved a challenge to the Secretary of State's acceptance of initiative. I briefed and argued this case. The court held in favor of the Secretary--allowing the voters to decide.

4. Vangor v. Munro, 115 Wn. 2d 536 (1990), involving a challenge to the Secretary of State's processing of an initiative. I briefed and argued this case, which upheld the Secretary.

5. Rains v. State, 100 Wn.2d 660 (1983), upheld the State's immunity from suit for alleged civil rights violation under 42 U.S.C. § 1983 (briefed and argued).

6. Snyder v. Munro, 106 Wn.2d 380 (1986). Washington legislative redistricting, including two "split" districts, upheld as constitutional (briefed and argued).

7. Nuxoll v. Munro, 104 Wn.2d 456 (1985). Election process for superior court judges upheld (briefed and argued).

8. Washington v. Crown Zellerbach, 92 Wn.2d 894 (1979). The stream protections of the hydraulics code and enforcement through criminal prosecution for violations was upheld (briefed, argued, and won criminal jury trial on remand).

9. The Indian Treaty Fishing Cases: Numerous cases and trials at the Superior Court (Washington's trial court) led to Washington Supreme Court cases of Puget Sound Gillnetters v. Moos, 88 Wn.2d 677 (1977); State Comm'l Passenger Ass'n v. Tollefson, 89 Wn.2d 276 (1977); Purse Seine Ass'n v. Moos, 88 Wn.2d 799 (1977). All held the state must treat citizens the same, and could not regulate for special Indian fisheries. After the United States Supreme Court review (see A-6, above), Fishing Vessel Ass'n v. Tollefson, 92 Wn.2d 939, (1980) upheld the state's authority to regulate fisheries.

C. Federal Courts of Appeal

I have personally handled and/or argued approximately 50 cases in the federal courts of appeal. Examples, indicating the breadth of experience are:

1. Federal Energy Regulation Commission appeals (FERC appeals). The Federal Power Act (16 U.S.C. 825(L)) allows appeals to either the circuit for the District of Columbia or the circuit in which the owner resides or does business. Among significant appeals, I have participated in both circuits, are:

(a) Rock Island (Confederated Tribes v. FERC, 734 F.2d 134 (9th Cir. 1983);

(b) Lewis River-Merwin Dam (relicensing). Clark-Cowlitz JOA v. FERC. 826 F.2d 1074 (D.C. Cir. 1987). (Argued)

(c) Ross Dam (Seattle Light)

2. Indian Treaty Fishing cases. United States v. Washington, 384 F. Supp. 319 (1974), is the "Boldt" case on Indian treaty fishing rights (which predates my tenure; I inherited the case one year later). Over 200 mini-trials ensued, involving implementation from one day to one week. Thirty-seven decisions (selected by the judge) are published seriatim, beginning 459 F. Supp. 1020 (1978). Dozens are separately reported. Approximately 30 appeals resulted from the first five years' implementation. One anecdotal illustration; four cases are found seriatim in 573 F.2d 1117, 1118, and 1121 (9th Cir. 1978). The latter was, itself, five separate proceedings. I argued this case and most of the others.

On November 2, 1993, I won an appeal granting private landowners party status in the Ninth Circuit (No. 93-35324) Phase III (shellfish and private beaches) case in time for the 1994 trial.

United States v. Oregon, 302 F. Supp. 899 (1969). (The Indian treaty fishing rights case on the Columbia River predated "Boldt." Washington only intervened in 1975). Here, too, there were dozens of hearings and trials (under a week). There are six separate reported appeals. Most important are: 657 F.2d 1009 (9th Cir. 1981) (our injunction against Yakima fishing, including on reservation, was upheld in face of tribal immunity argument) and 529 F.2d 570 (9th Cir. 1976) ("Boldt" 50 percent formula need not apply to Columbia). I briefed and argued both.

3. Confederated Tribes of Colville v. Washington, 649 F.2d 1274 (9th Cir. 1981). State has jurisdiction over non-Indians within boundaries of Indian reservation. (Argued)

4. Sandidge v. Washington, 813 F.2d 1025 (9th Cir. 1987). National Guard officer immune from civil rights suit by subordinate.

5. Herald v. Munro, 758 F.2d 350 (9th Cir. 1984) and 838 F.2d 380 (9th Cir. 1988). ABC, CBS, NBC, and the New York Times challenged the Washington Statute prohibiting "exit-polling" around election area. The statute was upheld--first decision, invalidated by second). (Argued both) My client did not authorize U.S. Supreme Court review, but see Burson v. Freeman, supra, p.1.

6. Williams v. Dolliver. (Our client, Justice Dolliver, was then Chief Justice of Washington's Supreme Court) 894 F.2d 321 (1988). Washington courts' practice of dividing military retirement pay in divorce proceedings upheld. (Argued)

7. Socialist Workers' v. Munro, 765 F.2d 1417 (9th Cir. 1985) challenged Washington's election restrictions on ballot access for minor parties. The unfavorable decision was reversed by the U.S. Supreme Court, supra, which upheld Washington's law. (Argued both)

8. Columbia Gorge United v. Yeutter, 960 F.2d 110 (9th Cir. 1992) upheld the constitutionality of the Gorge Act (briefing was cooperative; Oregon Attorney General Frohnmayer argued this case).

9. Broughton Lumber v. Columbia Gorge Comm'n, State of Washington, Ninth Circuit Court of Appeals No. 91-35183 (Sept. 15, 1992). State sovereign immunity was not waived by the Gorge Act; state may not be sued in federal court for actions of the Gorge Commission. (Argued)

**D. Administrative Proceedings: FERC and EFSEC**

Specialized practice before such agencies has included:

1. FERC (Federal Energy Regulation Commission) Hydroelectric dam cases. Trials of licensing, relicensing, jurisdiction, and sub-issues, including:

   (a) Skagit River; "High" Ross Dam (Seattle City Light)

   (b) Lewis River-Merwin Dam (Pacific Power & Light competing with Clark-Cowlitz JOA)

   (c) Elwha River, Glines & Elwha projects (Crown-Zellerbach Corporation)

   (d) Nisqually River -- proceedings involving each project
   - Yelm diversion (City of Centralia)
   - Alder Dam (City of Tacoma)
   - La Grande Dam (City of Tacoma)

   (e) Columbia River -- all five mid-Columbia projects
   - Rock Island Dam
   - Rocky Reach Dam
   - Wanapum Dam
   - Priest Rapids Dam
   - Wells Dam

   (f) White River -- (Puget Power & Light)

2. EFSEC (Washington State's Energy Facility Site Evaluation Council) provides and enforces licenses for major power facilities. I participated in trial proceedings involving:

   (a) WPPSS II (Hanford Nuclear Plant)

   (b) WPPSS 4 and 5 (Satsop Nuclear Plant)

   (c) Northern Tier Pipeline

   (d) Fish Kill supplemental proceedings in WPPSS II resulted in award of a hatchery facility

## II. TEACHING CREDENTIALS AND PUBLICATIONS
(chronological listing with sponsoring organization)

A. CLE's (Continuing Legal Education courses taught to Bar members)

1. Indian Treaty Hunting and Fishing, Washington State Criminal Justice Training Commission, 1977.

2. Indian Fishing Rights, Governmental Lawyers Association, 1978.

3. Anadromous Fish Management and Protection, Environmental Law Review, Northwest School of Law, 1979.

   (1) Federal Energy Regulatory Commission Practice, Fish and Wildlife Protection; and
   (2) Indian Fishing Rights (two separate presentations), Lewis and Clark Law School, 1980.

4. Environmental Law, Current Trends in Natural Resource Law, Office of the Attorney General, 1981.

5. Attorneys' Fees Awards Under the Civil Rights Act, Office of the Attorney General, 1982.

6. Federal Trial Practice (new Rule 16), Office of the Attorney General, 1984.

7. Constitutional Law; "EXIT-POLLING" Debate, Washington Bar Association, "Today's Constitution and You" (Bicentennial Program), 1986.

8. Appellate Practice (Argument), Office of the Attorney General, 1987.

9. Columbia River Legal Issues; Fish, Water, Power and Competing Users (U.S. and international), Western Association of Attorneys General, 1991.

B. Publications

James M. Johnson, Indian and Aboriginal Hunting and Fishing Claims (including marine mammals), International Association of Fish and Wildlife Commissioners, Toronto, Canada, 1978 (published proceedings).

Kenneth O. Eikenberry, James M. Johnson, David M. Driesen, Enforcing Washington Judgments in Canadian Courts: Taking the Dams out of the Stream of Commerce; U.Puget Sound L. Rev. 491 (1990); Washington State Bar News 45 (1991); B.C. Sup. Ct. R. 54(2).

Conference of Western Attorneys General, (James M. Johnson, contributing author/editor) The American Indian Law Deskbook (U. Colorado press 1993).

SECRETARY of STATE

Ralph Munro

Legislative Building
P.O. Box 40220
Olympia WA 98504-0220
(206) 753-7121

February 11, 1993

To Whom it May Concern:

I am pleased to write to you on behalf of Jim Johnson, a Senior Assistant Attorney for the Washington Attorney General's Office. Jim has been my attorney for many years while I have served as your Secretary of State. He is outstanding.

This office deals in a wide variety of matters, from Elections to Corporate Licensing and Archives. Jim has counseled both me, my staff, and the entire office in a multitude of legal matters in which we have been involved.

More often widely noted has been his representation as our chief litigator on many important cases, which I and the state have been involved in over the last decade. A number of cases have gone to the Washington State Supreme Court, and we have won them all. Several have gone through the federal court system and one all the way to the United States Supreme Court. Jim argued the case in U.S. Supreme Court, and we won.

Should you have any questions about Jim's capabilities, background or potential, please feel free to call on me directly. I feel he is an excellent attorney and has represented us extremely well.

Sincerely,

RALPH MUNRO
Secretary of State

RM:ll

Ken Eikenberry
ATTORNEY GENERAL OF WASHINGTON
7th FLOOR, HIGHWAYS-LICENSES BUILDING • PO BOX 40100 • OLYMPIA, WASHINGTON 98504-0100

*January 5, 1993*

*TO WHOM IT MAY CONCERN:*

*This is to introduce and heartily recommend Jim Johnson, one of the finest attorneys I have known (and I have known many). It reflects my confidence in Jim and his abilities that he has been Chief of the Special Litigation Division for the last ten years. He has tried and/or litigated on appeal many major cases of high profile and importance to the State's people. As his resume reflects, his experience of nearly one hundred appellate cases -- up to and involving the United States Supreme Court -- is unequalled anywhere in this state. The trial record is equally distinguished.*

*During this part of his career Jim has litigated with many top quality opponents, including all of the "major" firms in this state, as well as major New York and Washington, D.C. firms. With his leadership and expertise, Washington has won most of the litigation he has handled -- and he has settled many other major cases on very favorable bases.*

*His reputation among professionals is indicated by the fact that his assistance has been requested on United States and Washington Supreme Court cases by prosecutors' offices in this state, Attorneys General of other states, and the United States Solicitor General.*

*Jim's reported cases read like a list of major state litigation over the last decade. From the litigation over Washington's Ninth Congressional Seat, to the "Boldt" fish cases, to important commercial litigation for the state, he has acquired extensive and diverse experience. Some major cases are not reported. In recent years the Deferred Compensation Board's million dollar case against RainierBank and Consortium Automated Library Services vs. Dataphase were litigated aggressively to favorable settlements. The latter resulted in replacement of a regional computer system as well as payment.*

*One of Jim's especially valuable talents is litigating economically -- learned of necessity from litigating against far better funded opponents. Jim has both the ability to manage litigative resources, and advanced technological skills (computer research and discovery).*

*As you would expect, Jim has become a valuable resource for this office of over 400 attorneys because he is willing to advise and assist on problems for other attorneys. He has even found time to teach numerous CLE courses to improve professional levels in this office and publish a variety of topics.*

*To these extensive skills, he adds enthusiasm for his work. I have no doubt of my conclusion that Jim Johnson would be a great asset to your organization.*

*Sincerely,*

*KEN EIKENBERRY*
*Attorney General*

**Bill/Resolution History** 11:11 AM 09/18/97 Page 1

BILL: SB 42 SHORT TITLE: ALASKA RR BUDGET AND LAND

BILL VERSION:

SPONSOR(S): RULES BY REQUEST OF LEGISLATIVE BUDGET AND AUDIT

CURRENT STATUS: (S) RLS STATUS DATE: 5/02/97

HEARING:(S) RLS SEP 24 09:00 AM FAIRBANKS LIO TELECONFERENCE

TITLE: "An Act relating to the fiscal operations of the Alaska Railroad Corporation and to land acquired by the State of Alaska under the Alaska Railroad Transfer Act of 1982 or otherwise acquired for railroad purposes; and providing for an effective date."

**SB 42** **Bill/Resolution Floor Action** Page 2 of 2

Current Status: **(S) RLS**

| | Jrn-Date | Jrn-Page | | Action |
|---|---|---|---|---|
| 1 | 01/13/97 | 25 | (S) | READ THE FIRST TIME - REFERRAL(S) |
| 2 | 01/13/97 | 26 | (S) | TRA, STA, FIN |
| 3 | 01/14/97 | 41 | (S) | RES REFERRAL ADDED |
| 4 | 01/14/97 | 42 | (S) | TRA, STA, RES, FIN |
| 5 | 02/21/97 | 447 | (S) | TRA RPT 1DP 2NR 1AM |
| 6 | 02/21/97 | 447 | (S) | DP: WARD; NR: WILKEN, GREEN; AM:LINCOLN |
| 7 | 02/21/97 | 447 | (S) | FISCAL NOTES (LAW, DNR-2) |
| 8 | 04/01/97 | 914 | (S) | STA RPT CS 2DP 1NR NEW TITLE |
| 9 | 04/01/97 | 914 | (S) | DP: GREEN, WARD; NR: DUNCAN |
| 10 | 04/03/97 | 956 | (S) | ZERO FN TO CS (LAW) |
| 11 | 04/11/97 | 1107 | (S) | RES REFERRAL WAIVED |
| 12 | 05/02/97 | 1642 | (S) | FIN RPT CS 4DP 1NR NEW TITLE |
| 13 | 05/02/97 | 1642 | (S) | DP:PEARCE, PHILLIPS, ADAMS, TORGERSON |
| 14 | 05/02/97 | 1642 | (S) | NR: SHARP |
| 15 | 05/02/97 | 1642 | (S) | ZERO FNS TO CS (DNR-2) |
| 16 | 05/02/97 | 1642 | (S) | PREVIOUS ZERO FN APPLIES (LAW) |
| 17 | 05/02/97 | 1642 | (S) | REFERRED TO RLS |

Selection=> _____ _____

**PF1 HELP** **PF2 SUBJ** **PF3 EXIT** **PF4 MENU** **PF5 TEXT** **PF6 PRINT** **PF7 BWD** **PF8 FWD** **PF9 CMT/JRNL** **PF10 FIRST** **PF11 LAST** **PF12 QUIT**

January 28, 1997

# Alaska Railroad Corporation

## Financial Audits

- The financial affairs of the Alaska Railroad Corporation are audited annually by a public accounting firm. The corporation typically receives a "clean" opinion on its financial statements.

## Performance Audits

- Alaska statute also requires the corporation to have an annual performance audit conducted by a recognized railroad management expert. This audit is conducted presently by Mercer Management Consulting and is presented to the Board of Directors of the corporation annually.

## Significant Special Audits

Ship Creek Redevelopment Follow-up, November 17, 1994

- This audit was conducted to follow up on the findings and conclusions we made in our original review (1992) of this project. Several of the issues we initially raised appeared to have been satisfactorily resolved. Our concern in this review was whether the development would be successful.

- The redevelopment project had yielded little construction to date. None of the four centerpiece projects envisioned had commitments in place.

Anchorage Gravel Activities, July 3, 1996

- The report addresses our concerns that the Alaska Railroad Corporation's (ARRC) agreement with the Flamingo Brothers Partnership to market and extract gravel from the corporation's Anchorage property may not have been in the best interest of the corporation.

- ARRC's public procurement process was not followed. In the corporation's opinion, the gravel agreement was the disposal of real property and therefore, not subject to its procurement rules. We believe it was a commodity sale that should have been subject to the provisions of those rules.

- ARRC's real estate leases are inappropriately offered on a "first come, first served" basis.

- ARRC's justification of the project was unclear.

- ARRC's lack of public process excluded the community.

- We recommended ARRC improve its monitoring of employee conflict of interest disclosure statements.

Chena Landings Development, August 20, 1996

- This audit reviewed ARRC's management of the development project related to utility procurement, leasing, and public amenities.

- The utility project was delayed by planning and design difficulties.

- Request for proposal criteria and evaluation procedures were inadequate.

- The corporation lacked documentation regarding project development planning.

- Leases are not competitively offered; ARRC inappropriately uses a "first come, first served" approach to leasing property.

## Ongoing or Pending Audits

Alaska Railroad Corporation, Equipment Purchases/Disposals
Alaska Railroad Corporation, Real Estate Appraisal Methodology

## Auditor Observations

The Alaska Railroad Corporation has been under the "legislative microscope" for the last few years. The Audit Division has conducted five audits of the corporation since 1992 and has one audit in progress and another pending. Of those seven audits, two deal with rail operations, and five involve the corporation's management of real estate.

During the interim, the Legislative Budget and Audit Committee also pursued a greater understanding of the corporation and its assets. We believe that it is important that the Legislature understand the operation of the corporation and be aware of issues that impact its operation. The Legislative Budget and Audit Committee appears to be the appropriate vehicle currently available to provide that oversight.

The Alaska Railroad Corporation finds itself in an unenviable position. On one hand, it is operating under a statutory mandate to generally manage the corporation on a self-sustaining basis. On the other hand, as a corporation wholly owned by the State, the corporation must be

held to certain standards of openness and public accountability. It is in this vein that we often find ourselves at odds with the corporation. We believe that as long as the corporation is owned by the public, public accountability must come first.

We also believe that the corporation can be run in an efficient manner and still uphold those public accountability standards. Management by corporate officers and policy direction by the board of directors should strive for the appropriate balance. In our opinion, we have seen recent signs of improvement in this effort by the board, primarily through our contact with the chairman. We are hopeful that the appointment of a new chief executive officer will further foster these goals.

Without going into great detail on issues we remain concerned about regarding the Alaska Railroad Corporation, we offer these summary observations and would be happy to discuss them further with any member or committee of the Legislature. They are in no particular order of significance.

- The corporation's budget is not subject to the Executive Budget Act. We see no reason why the corporation should be exempt or even whether constitutionally, it can be. Similarly, significant federal funds have been received by the corporation for capital rehabilitation and improvements without any legislative oversight.

- The corporation has shown a profit for the last two fiscal years (calendar year end). Total net income for 1996(unaudited) and 1995 was $8.0 million and $7.9 million, respectively. The net income from operations represented $4.0 million and $4.1 million, respectively. Approximately half of the corporation's income is generated from management of its real estate. The majority of this real estate is considered non-rail use property.

- A much talked about concern is deferred maintenance, however, little is factually known about the extent or estimated cost of that maintenance. We believe that a serious discussion needs to take place. It is possible, or even likely, that without the federal funding authorized the last two years ($10 million per year) the railroad's income statement would look significantly different. Neither the financial statements nor the notes to the financial statements reflect any estimate of the amount of deferred maintenance.

- An observation that is important to understanding the fragile nature of the corporation's financial health is its dependence on two major customers. As disclosed in the notes to the financial statements for 1995, these two customers accounted for 45% of the corporation's revenue. The corporation's existence is dependent on those two customers.

- Through a combination of statute and corporation rules, the salary of railroad employees is confidential and therefore can not be disclosed to the public. Statute provides that the corporation may by rule designate and withhold public disclosure of matters of a

privileged or proprietary nature. Statute goes on to describe matters as including personnel records. Corporation rules include salary as a personnel record.

- Alaska Statute 42.40.260(b) requires the annual report of the corporation to include an analysis of potential sale arrangements whereby the corporation may be transferred into private ownership. The corporation has not pursued sale discussions with potential or interested buyers. The corporation has gone so far as to notify interested parties that the Board of Directors is not interested in selling the railroad.

- Statute requires the corporation to have an annual performance audit conducted by a recognized railroad expert to assure that the railroad is being managed and operated effectively and efficiently. There are two reports generated from this review. A confidential report is produced for the use of railroad management. A public version of the report is issued that does not go into nearly as much detail. We recommend that the legislature annually request a confidential briefing on the detail version of the performance report.

# LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

130 Seward Street, Suite 409
Juneau, Alaska 99801-2105

**MEMORANDUM** February 7, 1997

**SUBJECT:** Alaska Railroad Corporation (HB 55)

**TO:** Representative Terry Martin
Attn: Christopher Knight

**FROM:** Tamara Brandt Cook
Director TBC

You has asked me whether the Alaska Railroad Corporation may constitutionally spend revenue it generates without an appropriation. The corporation is exempted from a number of laws under AS 42.40.920(b), including the Executive Budget Act. It is far from certain to me that an exemption from the Executive Budget Act necessarily means that money involved in the exemption may be spent without an appropriation. To the extent that the state constitution requires an appropriation before money is spent, that requirement controls.

The federal Alaska Railroad Transfer Act contains a provision dedicating revenue generated by the railroad to railroad purposes. I am not convinced that a dedication of revenue, however valid under Article IX, sec. 7, places that revenue outside of the appropriation requirement of Article IX, sec. 13. It is possible that a court could conclude that, while revenue may be used only for railroad purposes, before it is so used it must be appropriated. In short, the legislature may still have the right and constitutional obligation to review proposed railroad expenditures and determine whether money will be spent for a particular railroad purpose, rather than another railroad purpose, and in what amount. The Attorney General's office has likewise concluded that a good probability exists that revenue of the Alaska Railroad Corporation is subject to appropriation before expenditure. (Memorandum, 366-575-84, May 26, 1984, copy attached)

It has been argued that money of a public corporation (like the Alaska Railroad Corporation) with an existence independent from the state is not in the state treasury and, therefore, not subject to appropriation. The Attorney General has, however, concluded that money in one public corporation (AHFC) is subject to appropriation to the extent that it is unencumbered. (Informal Opinion, 366-463-85, April 24, 1985, copy attached) That opinion was cited by the Alaska Supreme Court with approval and the court has specifically recognized that money appropriated from AHFC must be counted as "available for appropriation" for purposes of applying Art. IX, sec. 17, relating to the budget reserve fund. (Hickel v. Cowper, 874 P.2d 922 (Alaska 1994) footnotes 11 and 23) This conclusion of the court necessarily

presupposes that the legislature does, indeed, have the power to make appropriations from AHFC's unencumbered assets. If revenues of that public corporation are subject to appropriation, it would seem quite likely that the revenues of the Alaska Railroad Corporation would also be treated as subject to appropriation by the court.

TBC:pl
97-030.plm

Enclosures

**DEPARTMENT OF LAW**

*OFFICE OF THE ATTORNEY GENERAL*

*REPLY TO:*

☐ *1031 W 4th AVENUE*
*SUITE 200*
*ANCHORAGE, ALASKA 99501*
*PHONE: (907) 276-3550*

☐ *1ST NATIONAL CENTER*
*100 CUSHMAN ST.*
*SUITE 400*
*FAIRBANKS, ALASKA 99701*
*PHONE: (907) 452-1568*

☑ *POUCH K - STATE CAPITOL*
*JUNEAU, ALASKA 99811*
*PHONE: (907) 465-3600*

April 24, 1985

Hon. Al Adams, Chairman
House Finance Committee
Alaska House of Representatives
Pouch V
Juneau, AK 99811

Re: Legislative power of appropriation over funds of public corporations
Our file: 366-463-85

Dear Representative Adams:

You have requested our advice whether the legislature's power of appropriation includes the power to appropriate money administered by the Alaska Housing Finance Corporation (AHFC). AHFC was created to administer a state enterprise consisting almost entirely of making housing loans or providing a secondary mortgage market for housing loans originated by private lending institutions. AHFC is a state agency with the power to incur indebtedness if repayment is secured by pledging revenue earned from AHFC enterprises. See Alaska Const. art. IX, § 11. The pledge is secured by dedicating money, including revenues earned from the loan enterprise, to special accounts established for the benefit of bondholders. You desire to know whether the legislature may appropriate directly from AHFC's Alaska housing finance revolving loan fund (AS 18.52.082) for a purpose unrelated to AHFC. In addition, you ask if the unobligated balance of an appropriation from the general fund to the revolving fund may be reappropriated for another purpose.

First, we believe there is little doubt that the legislature may reappropriate the unencumbered and unobligated balance of an existing appropriation. See Inf. Op. Att'y Gen. (Sept. 26; 366-132-81). The legislature is merely reducing the authorization to spend money. The formal act of appropriating money does not invest a person or entity with the right to ultimately expend the money unless a valid, binding contract is made with that entity. It is very doubtful that a political subdivision of the state being entirely a creature of statute could claim a vested right to expend money under an appropriation absent the intervention of innocent third parties. Based on these principles, we

conclude that the unexpended and unobligated balance of an appropriation to the AHFC revolving fund may be appropriated for purposes unrelated to AHFC.

We next turn to the more difficult question of whether the balance of the AHFC revolving fund may be appropriated by the legislature for a purpose unrelated to AHFC. The AHFC revolving fund serves as a central pool of money consisting of the following:

(1) appropriations from the legislature;

(2) assets transferred there by AHFC; and

(3) unrestricted repayments of principal on loans made or purchased by AHFC.

The assets of the revolving fund are transferred to separate funds when necessary to satisfy covenants made with bondholders. Amounts remaining in the fund do not secure specific bond issues of AHFC and remain unrestricted for use by AHFC "for the purposes of the corporation." Id.

The answer to your question turns on whether the revolving fund is within the state treasury or, failing that, if the fund is an asset of the state which may be appropriated by the legislature. Revolving funds administered by state agencies are generally included in the state treasury for financial reporting purposes. However, the AHFC revolving fund is not carried on the state's ledgers as an asset of the state treasury. Rather, the revolving fund is an asset of AHFC. In a recent appropriation Act, the legislature has specifically appropriated to the AHFC revolving fund interest earned on loans made or purchased by AHFC on deposit in the fund. See sec. 1, ch. 129, SLA 1984. This was done to remove any question that AHFC had improperly dedicated an unrestricted revenue source of the state for a special purpose in violation of the dedicated fund prohibition set out in section 7, article IX of the Alaska Constitution. This provides some evidence that the legislature considers unrestricted earnings of AHFC to be subject to appropriation. It is important to note that we have identified these earnings as "unrestricted." This means that the rights of innocent third parties to retain the fund balance as security for the payment of debt service on bonds have not intervened to restrict the ability of AHFC to spend them. We believe that the AHFC revolving fund is not in the state treasury. The effect of this conclusion is that AHFC may spend money in the fund without further appropriation. However, money earned from investments or assets of the

fund have customarily been considered a state asset which may be transferred and deposited into the general fund.

The question then becomes: if the AHFC revolving fund is not in the state treasury, but is an asset of a state agency, is the fund subject to appropriation? We believe that unrestricted money in the fund is probably available for appropriation. No specific authority was located to support this conclusion. We base our opinion on a belief that the legislative power of appropriation will be liberally construed by the courts. The appropriation power is often described as plenary. That is, the power to appropriate is limited only by express provisions set out in the Alaska Constitution. Judicial decisions reciting this principle are legion. See, e.g., San Francisco Labor Council v. Regents of University of California, 608 P.2d 277 (Cal. 1980); City of Sand Springs v. Department of Public Welfare, 608 P.2d 1139, 1148 (Okla. 1980). Absent a specific prohibition in the Alaska Constitution against appropriating assets of an executive branch agency held outside the state treasury, we believe that the legislature may do so. This opinion does not hold that the legislature must appropriate revenue of a public corporation before it can be spent, only that the legislature may exercise control over unrestricted assets of a public corporation. To deny this power would establish an entity capable of segregating unrestricted state revenue forever. At some point, this would do violence to the dedicated fund prohibition set out in article IX, section 7 of the Alaska Constitution.

We believe it is also our responsibility to inform you that there is a contrary view on this subject. The argument could be made on behalf of bondholders that AHFC has undertaken certain obligations to bondholders which are binding on AHFC and the legislature. AHFC bonds are issued as general obligations of the corporation. Typically, AHFC covenants in its indenture that it will "defend, preserve and protect the pledge of the program obligations, pledged revenues, and other assets." Bondholders could attack any direct appropriation of the AHFC revolving fund as a violation of the covenant to preserve assets. We believe this covenant will not restrict legislative appropriations of unrestricted assets of AHFC which are unnecessary to secure the repayment of debt service on bonds. See Opinion of the Justices, 313 N.E.2d 882 (Mass 1977); Opinion of the Justices, 136 N.E.2d 223 (Mass 1956). This means that the directors of AHFC must be certain that an appropriation of corporation assets will not jeopardize its ability to pay debt service on outstanding bonds.

To prepare for and meet any challenge to the appropriation of AHFC assets, we recommend that the legislature not only

appropriate the asset but also amend the enabling Act of AHFC to assure bondholders that an impairment of their security will not occur. Under this approach, a valid transfer of assets requires not only an appropriation from the AHFC revolving fund but also an amendment to AS 18.56.020 which provides authority for AHFC to transfer unrestricted surplus to the general fund. */ Authorization by general law for the transfer of assets of public corporations has been used in the past. In 1980, the legislature transferred the assets of the Alaska State Development Corporation (AS 44.59.010), the Small Business Development Corporation (AS 44.60.020), and the Alaska Toll Bridge Authority (AS 44.57.010) to the Alaska Industrial Development Authority. Sec. 42, ch. 106, SLA 1980. The transfer was made not in an appropriations bill, but in a bill proposing the enactment of general law. It is curious to note that no corresponding appropriation was made. This approach is consistent with another familiar adage of public finance law that appropriation bills may not be used to amend substantive law. Legislative Budget & Audit Committee v. Hammond, No. 1JU-80-1163 CIV (Alaska Super., May 25, 1983). It could be argued that AS 18.56.020 implies that the assets of AHFC will be transferred to the state treasury only upon termination. Because an appropriation cannot amend existing law, a transfer from the fund before dissolution of AHFC would be subject to question.

While we believe that a direct appropriation of surplus AHFC assets is legally defensible, to avoid any question as to the validity of a transfer appropriation, we recommend that the legislature

(1) enact an amendment to AS 18.56.020 authorizing interim transfers of unrestricted surplus assets of AHFC to the general fund;

(2) provide that the board of directors shall annually determine the amount of surplus available for transfer; and

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*/ AS 18.56.020 provides:

> ALASKA HOUSING FINANCE CORPORATION. The Alaska Housing Finance Corporation is a public corporation and government instrumentality within the Department of Revenue, but having a legal existence independent of and separate from the state. The corporation may not be terminated as long as it has bonds, notes or other obligations outstanding. Upon termination of the corporation, its rights and property pass to the state.

(3) appropriate the assets from the fund to the general fund in accordance with the transfer authorization.

We hope this memorandum has answered your questions.

Sincerely yours,

NORMAN C. GORSUCH
ATTORNEY GENERAL

By: James L. Baldwin
James L. Baldwin
Assistant Attorney General

JLB/pjg

# MEMORANDUM State of Alaska

TO: Honorable Al Adams, Chairman
House Finance Committee
Alaska State Legislature

DATE: May 26, 1984

FILE NO: 366-575-84

TELEPHONE NO: 465-3600

FROM: Norman C. Gorsuch
Attorney General

SUBJECT: Appropriation of Alaska Railroad revenue

By: James L. Baldwin
Assistant Attorney General

Luann Cutler, on your behalf, has requested our opinion whether revenues of the Alaska Railroad must be appropriated before expenditure. Under the provisions of the Alaska Railroad Transfer Act (45 U.S.C. § 1207 -- 45 U.S.C. § 1214), "revenues generated by the state-owned railroad shall be retained and managed by the state-owned railroad for railroad and related purposes." 45 U.S.C. § 1207(a)(5).

This constitutes a dedication of revenue mandated by federal law. Even if a revenue source is dedicated for a specific purpose, amounts may not be expended by an agency within the executive branch from that revenue source unless appropriated by law. Alaska Const. art. IX, §§ 12, 13; see also, Kelley v. Hammond, C.A. No. 77-4, 1st Jud. Dist. (Alaska 1977). The important distinction of a validly dedicated revenue source is that money may not be expended for a purpose other than the Alaska Railroad, not necessarily that the money may be expended without appropriation.

We acknowledge that if the railroad's function is assigned to a public corporation which is established as a political subdivision of the state, an argument can be made that railroad revenue is not a part of the state treasury, much the same as the revenues collected by municipal corporations. If this view is adopted in Alaska, railroad revenues could be expended without appropriations. To date, this view has been repudiated at the superior court level. Kelley v. Hammond, C.A. No. 77-4, 1st Jud. Dist. (Alaska 1977).

We hope this opinion answers your question.

JLB/mg

# MEMORANDUM State of Alaska

TO: Bruce Tennant
Assistant Attorney General
Transportation Section-Anchorage

DATE: March 8, 1985
FILE NO: 366-386-85
TELEPHONE NO: 465-3603

FROM: Norman C. Gorsuch
Attorney General

SUBJECT: Public notice for railroad leases

By:
Jack B. McGee
Assistant Attorney General
Transportation Section-Juneau

You raised the following two questions in relation to the Alaska Railroad's leasing procedure:

1) Must the Alaska Railroad give prior public notice whenever it proposes to lease railroad lands?

2) Must the Alaska Railroad award leases of railroad lands by competitive bidding?

Our answer to question 1) is yes; our answer to question 2) is no.

Discussion of Question 1:

Article VIII, section 10, of the Alaska Constitution reads as follows:

> Section 10. PUBLIC NOTICE. No disposals or leases of state lands, or interests therein, shall be made without prior public notice and other safeguards of the public interest as may be prescribed by law.

The first question to be addressed is whether article VIII, section 10 requires prior public notice or whether it leaves the question of whether there is to be any public notice at all up to the legislature. Section 10 appeared originally as section 12 of the Alaska Constitutional Convention Resources Committee's proposal no. 8/A in a slightly different form:

> Disposals or leases of state lands or interests therein shall be preceded by such public notice and other appropriate safeguards of the public interest as the legislature shall prescribe.

6 Proceedings of the Alaska Constitutional Convention 95 (Jan. 16, 1956).

The Resources Committee's commentary to section 12 reads as follows:

> "Sec. 12. Public Notices and Safeguards of the ...lic Interest)
>
> ...tain safeguards of the public interest are essential in public land transactions. Such transactions may vary in importance from routine matters to those of substantial value. If general constitutional provisions impose too rigid requirements, the land administration can become hopelessly ensnarled in red tape. As a result this section of the constitution provides for the legislature to establish public notice, and other safeguards to protect the public interest. As requirements change and many transactions become routine, appropriate modifications can be made in procedures if rigid requirements are not specified in the constitution itself.

6 Proceedings at 100.

The wording of section 12 was subsequently changed to the present text of section 10 by the Committee on Style and Drafting. See 5 Proceedings of the Alaska Constitutional Convention 3630-3632 (Jan. 30, 1956). Section 10 was then adopted by the convention on January 31, 1956. See 5 Proceedings at 3716.

Two significant changes were made in the final draft of what is now article VIII, section 10. First, the phrasing was stated in the negative, i.e., "[N]o disposals or leases of state land, or interests therein, shall be made without prior public notice ...." Second, the word "such" was deleted. Prior to this deletion, it was at least arguable that the intent of section 12 was to allow the legislature to determine whether prior public notice for leases of state land was to be required. The deletion of "such," however, undercuts this argument and makes it clear that the framers thought it necessary that there be some sort of public notice for leases of state lands and that the question of whether there is to be any public notice at all was not meant to

be left to legislative discretion. 1/ Our conclusion, then, is that article VIII, section 10, requires prior public notice for any lease of state land.

Given the above conclusion, the question now becomes whether lands owned by the Alaska Railroad are to be considered "state lands" for the purposes of this constitutional provision. To be sure, section 42.40.350(a) of the Alaska Railroad Corporation Act authorizes the Alaska Railroad to hold title to railroad lands. Furthermore, the Alaska Railroad Corporation is said to have a legal existence independent of the state. See AS 42.-40.010. But the fact that the Alaska Railroad Corporation holds legal title to railroad lands rather than some other political or bureaucratic subdivision of the state and the fact that the Alaska Railroad Corporation has an independent legal existence does not necessarily warrant the conclusion that railroad lands are not state lands for the purposes of article VIII, section 10.

A constitution must be regarded as fundamental law and it should be interpreted in such a manner as to carry out the broad principles contained in it. See Opinion of Justices to Senate, 436 N.E.2d 935 (Mass. 1982). Every provision of a constitution should be given meaning and effect, and related provisions should be harmonized. See Park v. State, 528 P.2d 785 (Alaska 1974). Moreover, a constitutional provision should receive a reasonable and practical interpretation in accordance with common sense. See Warren v. Thomas, 568 P.2d 400 (Alaska 1977). Lastly, a court, in construing a constitutional provision, must consider the meaning the voters would have placed on the provision. See Division of Elections v. Johnstone, 669 P.2d 537 (Alaska 1983); Hammond v. Hoffbeck, 627 P.2d 1052 (Alaska 1981); State v. Lewis, 559 P.2d 630 (Alaska 1977).

When all the provisions of article VIII are considered together, it is difficult to discern a constitutional distinction between lands owned by a public corporation created by the state and other state lands. Section 9, for example, authorizes the legislature to "provide for the sale or grant of state lands ...." No one would seriously argue that the legislature has no such authority over Alaska Railroad lands because they are

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1/ The Alaska Supreme Court has held that the work product of the Committee on Styling and Drafting is a valuable aid in determining the intent of the Constitutional Convention. See Walters v. Cease, 388 P.2d 263 (Alaska 1964).

not state lands. In fact, AS 46.40.235 of the Alaska Railroad Corporation Act requires prior legislative approval of any sale of the railroad's "entire interest in its lands." One must conclude, then, that the word "state" is used in broad, generic sense throughout article VIII. That is to say, the word does not refer simply to the state's executive branch and its various bureaucratic departments but rather refers to a political community of self-governing citizens. 2/ Given this interpretation, "state land," as used in article VIII, section 10, encompasses all lands held in common by the political community of Alaskan citizens rather than only those lands nominally held by one of the principle departments of the executive branch recognized by article III, section 22, of the Alaska Constitution. This, of course, includes lands held by the Alaska Railroad. The Alaska Railroad, after all, is a public corporation. It has a public nature and, in a deeper sense, is owned by the people of Alaska. See 18 C.J.S. Corporations § 18. This public nature, then, is enough to bring it within the scope of article VIII, section 10.

The same result is reached if one applies the test set out in Hammond v. Hoffbeck, 627 P.2d 1052 (Alaska 1981). No one would seriously argue that, had the Alaska Railroad Corporation been in existence at the time of ratification, the voters who ratified the Alaska Constitution would have considered its lands to be exempt from article VIII, section 10. The exact opposite would have been the case. The voters would clearly have viewed Alaska Railroad lands as state lands. Accordingly, it is our opinion that the phrase "state lands," as it appears in article VIII, section 10, encompasses lands held by the Alaska Railroad and, as a consequence, prior public notice must be given before the Alaska Railroad leases any of its lands.

Discussion of Question 2:

AS 38.05.075 requires leases of state lands to be awarded to the highest qualified bidder. Section 42.40.-920(b)(10) of the Alaska Railroad Corporation Act, however, specifically exempts the Alaska Railroad from the requirements of AS 38. Accordingly, the Alaska Railroad Corporation is not required to award leases of its land by competitive bidding.

JBM:ebc

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2/ This interpretation is in accord with the rule that a constitutional provision should be interpreted so as to carry out the broad principles contained in it.

# Audit criticizes railroad project

By DAVID GERMAIN
The Associated Press

JUNEAU — The Alaska Railroad Corp. mishandled the lease and sale of heavy-construction equipment used to replace rail ties last year, according to a legislative audit released Tuesday.

While one lawmaker said it's a sign the state must watch the railway's operations and finances more closely, railroad management said it made sound business decisions to obtain equipment that could handle the work more efficiently.

The report by the Legislative Budget and Audit Committee said the railroad owned machinery that might have handled the work in 1996, when about 98,000 railroad ties were replaced. But railroad operators decided to lease other equipment to do the job then sold off much of the machinery it already owned, the audit said.

The railroad failed to compare the cost of using the machinery it owned with the expense of leasing equipment, the audit said.

ANCHORAGE
DAILY NEWS
JUNE 25, 1997

# RAILROAD: Audit criticizes project

Continued from Page F-1

Without such an analysis, railroad managers cannot know if they made the right business decision, the report said.

"Similar to findings in previous audits, the railroad continues to avoid competitive business practices," the report said.

While the rail ties were being replaced, the corporation sold some of its heavy machinery to two out-of-state companies for about $409,000. The audit criticized railroad management for not putting the equipment up for sale through a competitive auction that could have brought a higher price.

"They might have gotten more money for it. We just don't know," said Rep. Terry Martin, R-Anchorage, vice-chairman of the legislative audit committee and a frequent critic of railroad operations. "The point is they didn't even attempt it. It was a quick deal for some quick money."

Former Gov. Bill Sheffield, the railroad's board chairman and acting president, said the corporation struck a good deal for equipment that had a limited market and that "We got top dollar for it."

The railroad chose to lease machinery because the rental equipment was newer, faster and more efficient, Sheffield said.

Martin said the railroad has had a history of operating inefficiently since the state bought it from the federal government in 1985. As a separate corporation, the railroad has a freer hand on its finances and operations than do state agencies or the Alaska ferry system.

A bill proposed by Martin would put the railroad under the state budget, subjecting it to legislative funding approval and stricter rules.

Sheffield said such a move would eventually kill the railroad. The uncertainties of year-to-year budget review by the Legislature would foul up the railroad's long-term contracts and loans with suppliers and banks, he said.

# NEWS RELEASE

## 20th Alaska Legislature

For Immediate Release
June 23, 1997

Contact: Rep. Terry Martin
(907) 258-8169

## AUDIT UNDERSCORES MISMANAGEMENT OF ALASKA RAILROAD ASSETS

ANCHORAGE, AK -- The Alaska Railroad Corporation needs to clean up its act when it comes to leasing equipment and disposing of surplus equipment it may no longer need, according to an audit of ARRC activities released today by the Legislative Budget and Audit Committee.

LBA vice-chairman Rep. Terry Martin said the audit clearly shows that railroad managers need to be brought under tighter control by the state.

"Here we have a maverick, state-owned corporation blowing its budget on new equipment instead of using equipment it already owns," Martin said. "Then it disposes of the equipment -- state property -- without bothering with competitive bids. Even the state's old steel desks are sold by sealed bid, but that's not good enough for the railroad. They got more than $400,000 for the stuff, but Lord only knows how much more it was worth on the open market. This exposes the railroad to charges of favoritism."

The audit takes the railroad to task for leasing heavy equipment used last year to replace 98,000 cross ties. The leased equipment was contracted under the railroad's loosely-worded emergency procurement rules that circumvent accepted bidding procedures laid out in state law. The audit also notes that the railroad should have produced an analysis to document the need for new equipment, as opposed to using adequate equipment that the state owned outright.

Instead, that equipment was surplused and sold through direct negotiations between a lower-level supervisor and two outside companies, an action that also is outside the standard disposal process. In its response to the

audit, the railroad said the fact that upper management did not sign off on the sale documents was an "oversight."

Martin said he was disappointed by the railroad's arrogant attitude toward the audit, in which ARRC board chairman Bill Sheffield said he appreciated the auditor's "willingness to share (his) opinions with us."

"This is not the legislative auditor 'sharing' his opinion," Martin said. "This audit points to glaring deficiencies in the management of state assets. If Mr. Sheffield and his people had given sincere consideration to the findings and recommendations of the auditors over the past two years, instead of just making snotty comments, the railroad would not continue having the problems it has today."

- end -

# ALASKA STATE LEGISLATURE

## LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit

P.O. Box 113300
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347
Internet e-mail address:
legaudit@legis.state.ak.us

**MEMORANDUM**

**TO:** Members of the Legislative Budget and Audit Committee

**FROM:** Randy S. Welker
Legislative Auditor

**DATE:** June 17, 1997

**RE:** Final Audit Report

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At the Legislative Budget and Audit Committee meeting held on May 12, 1997, a motion was unanimously approved that provided for the release of the preliminary audits presented at that meeting.

According to the discussion, it was the committee's desire to release the reports in a timely fashion instead of waiting for the next meeting. The enclosed final report on the Alaska Railroad is ready for release, therefore, we are sending the audit to you for your review. After you have had a chance to review the report, please contact me, if you have any objection to its public release.

If we have not heard any objection to the release of the report by 12:00 p.m. (noon) on Monday, June 23, 1997, we will consider the report a public document and proceed with our final audit distribution. If objection is heard, we will notify all members that the report will be held for the next meeting of the Committee. The other preliminary audits will follow in the same manner in the very near future. We have not yet received all responses from the audited agencies and/or completed our review of their response.

Thank you for your review, and if you have any questions, please contact me at 465-3830.

REP. MARTIN

# ALASKA STATE LEGISLATURE

## LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit

P.O. Box 113300
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347
Internet e-mail address:
legaudit@legis.state.ak.us

SUMMARY OF: A Special Report on the Department of Commerce and Economic Development, Alaska Railroad Corporation, Equipment Acquisitions and Disposals, March 24, 1997.

FINAL REPORT

### PURPOSE OF THE REPORT

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we conducted an audit of the Alaska Railroad Corporation's (ARRC or the railroad) activities related to selected acquisitions and disposals of heavy rail equipment in 1996.

### BACKGROUND INFORMATION

ARRC received a $10 million federal grant in 1996 to undertake an extensive railroad tie replacement program and smaller track stabilization projects. To complete such efforts, the railroad believed it needed the use of new equipment; ARRC's current machinery was not thought to be sufficient for the tasks envisioned. As such, the railroad leased both tie replacement and track surfacing machinery during 1996; these procurements were effected through two invitations to bid (ITB) issued under the auspices of "emergency procurements." Additionally, ARRC issued an ITB for brushcutting equipment to be used for routine maintenance of way activities. ARRC then disposed of its wholly-owned equipment that the leased machinery replaced; the railroad negotiated sales of the items to two rail service companies based outside of Alaska. ARRC received $408,908 in proceeds.

### REPORT CONCLUSIONS

#### No formal analysis of equipment options performed

No formal analysis documenting the basis for ARRC's decision to lease new equipment and sell the owned machinery was prepared. The railroad did not perform any comparison of the cost or productivity of ARRC's equipment to that of the prospective leased machinery. Without this type of information, it is impossible for ARRC to know if it correctly evaluated all available options and made a sound business decision.

Disposals of equipment not competitively handled

During the latter part of 1996, ARRC privately placed 30 pieces of heavy rail equipment and ancillary parts to two rail service companies; no competitive offering was apparently considered. We believe this violates good business practices and the spirit of the railroad's surplus property disposal policy; ARRC had no way of knowing if it received a fair price for the machinery. We believe a disposal of this magnitude warrants a competitive offering.

Equipment sales decisions made by lower-level supervisor

No documentation is available to show that the proper approvals were provided prior to the retirement and sales of the subject equipment and parts. A lower-level supervisor was the only ARRC signer on many authorization for retirement and bill of sale forms. No executive management authorization was evident in any of the forms available for our review.

Weaknesses noted in procurement of leased equipment

We noted weaknesses in the methodology ARRC followed to procure leases of equipment. Specifically, we have concerns about the railroad not advertising the ITBs within Alaska, the bid evaluation criteria not being well-defined, ARRC not protecting itself through the use of liquidated damage provisions in contracts, and the railroad modifying the details of an ITB after selecting a contractor.



ARRC definition of emergency procurements overly broad

ARRC's definition of what may constitute an emergency procurement does not appear to be substantially equivalent to that in the state procurement code. Under the railroad's definition, almost any procurement could be construed as impacting ARRC's financial condition and therefore classified as an "emergency." We do not believe this rule to be necessary as it could encourage circumvention of competitive practices.

FINDINGS AND RECOMMENDATIONS

1. ARRC should document the rationale behind its management decisions.

2. ARRC should competitively offer significant disposals of its assets.

3. ARRC should ensure asset disposals show evidence of management approval.

4. ARRC should improve its competitive bid procedures.

5. ARRC should modify its purchasing rules related to emergency procurements.

# REP. MARTIN

**DEPARTMENT OF COMMERCE AND**
**ECONOMIC DEVELOPMENT**
**ALASKA RAILROAD CORPORATION**
**EQUIPMENT ACQUISITIONS AND DISPOSALS**

**March 24, 1997**

# CONFIDENTIAL

08-4552-97

# ALASKA STATE LEGISLATURE

## LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit

P.O. Box 113300
Juneau. AK 99811-3300
(907) 465-3830
FAX (907) 465-2347
Internet e-mail address:
legaudit@legis.state.ak.us

March 24, 1997

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT
ALASKA RAILROAD CORPORATION
EQUIPMENT ACQUISITIONS AND DISPOSALS

March 24, 1997

Audit Control Number

08-4552-97

The objective of this audit was to determine if the Alaska Railroad Corporation's activities related to selected 1996 acquisitions and disposals of heavy rail equipment were reasonable and in compliance with applicable statutes and the railroad's rules.

The audit was conducted in accordance with generally accepted government auditing standards. Field work procedures utilized in the course of developing the findings presented in this report are discussed in the Objective. Scope, and Methodology section of this report. Audit results can be found in Report Conclusions and Findings and Recommendations.

Randy S. Welker, CPA
Legislative Auditor

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# OBJECTIVE, SCOPE, AND METHODOLOGY

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we conducted an audit of the Alaska Railroad Corporation's (ARRC or the railroad) activities related to selected acquisitions and disposals of heavy rail equipment in 1996.

## Objective

The objective of our audit was to determine if ARRC's activities related to specific 1996 acquisitions and disposals of heavy rail equipment were reasonable and in compliance with applicable statutes and ARRC rules.

## Scope

Acquisitions: We reviewed ARRC's procurement of leased heavy rail equipment to be used on railroad tie replacement, rail surfacing, and brushcutting activities during 1996. A total of eleven such items were leased by ARRC during portions of 1996.

Disposals: We reviewed six 1996 ARRC sales of used rail equipment and associated parts that included 30 pieces of heavy machinery.

## Methodology

Our methodology included review and analysis of ARRC procurement and disposal files for the subject items, including ARRC bid documents, contractor replies to bids, ARRC evaluation of bids, correspondence, contracts, bills of sale, and railroad property records. We also reviewed Alaska Statutes and ARRC asset procurement and disposal rules. Further, we examined railroad organizational charts, delegations of authority, and a relevant consultant report. We also reviewed trade publications, complaints about the railroad to the state ombudsman's office, and the 1996 deferred maintenance grant agreement between ARRC and the federal government.

Additionally, we interviewed ARRC management and staff, representatives from the state ombudsman's office, personnel from the Department of Transportation and Public Facilities, and representatives of various heavy rail equipment manufacturers.

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## ORGANIZATION AND FUNCTION

The Alaska Railroad Corporation (ARRC or the railroad) was established by AS 42.40 after the railroad was purchased for $22.3 million by the State from the federal government in January 1985. ARRC is a public corporation and an instrumentality of the State within the Department of Commerce and Economic Development, but by statute it has a legal existence independent of, and separate from, the State. The corporation's board of directors is responsible for its management, but has delegated the powers and duties necessary for the administration of daily affairs and operations of the corporation to the chief executive officer (CEO). In turn, the CEO has designated other executive officers to oversee the various departments.

The Maintenance and Engineering Division is directed by a vice-president and includes areas of functional responsibility such as the engineering and mechanical departments, environmental services, and purchasing. Engineering and purchasing were the two departments with primary responsibility for the acquisition and disposal of the equipment that is the subject of this audit.

ARRC is not subject to the Executive Budget Act; capital improvement programs are approved by the railroad's board of directors. While the board members are appointed by the governor and subject to confirmation by the legislature, neither the executive nor legislative branch has direct control over the daily financial and program activities of the corporation.

(Intentionally left blank)

# BACKGROUND INFORMATION

In late 1995, the Alaska Railroad Corporation (ARRC or the railroad) applied for a grant from the U.S. Department of Transportation. Federal Railroad Administration (FRA) to provide the majority of the funding of particular capital rehabilitation and improvement projects. Specifically, the railroad wished to undertake a major railroad tie replacement program in 1996 estimated to cost approximately $9.6 million; additional smaller track stabilization projects were also planned for that year.[1] As a result. FRA granted ARRC $10 million to complete the tie and stabilization projects. The scope of the grant included funding the purchase and installation of approximately 81.000 cross ties as well as stabilizing the track structure in Healy Canyon. The work was to be completed by the end of calendar year 1996.[2]

ARRC has represented that the federal grant monies and the resulting extensive tie replacement program were major impetuses in its actions relating to its 1996 acquisition and disposal of heavy rail equipment. According to the railroad, ARRC's last major tie replacement program occurred in 1989 when approximately 120,000 ties were installed. Since that point, the railroad's tie programs had been considerably smaller, averaging approximately 9,000 ties per year. As a result, ARRC did not believe that its current heavy equipment used in tie replacement and track surfacing activities would be sufficient to complete a project of the magnitude planned. The railroad decided to use a portion of the federal grant monies to lease new equipment to be used on the work effort. ARRC determined it needed to lease equipment both for tie replacement[3] and track surfacing activities.[4]

To effect these procurements. ARRC issued two invitations-to-bid in late January 1996. Both were issued under the auspices of ARRC procurement rule 1400.3, *Emergency Procurements*, permitting "*competition that is practicable under the circumstances.*"[5] Soon after, ARRC entered into lease contracts for the equipment it desired. ARRC used the machinery throughout 1996 on the extensive work effort: approximately 98,000 ties were replaced before weather concerns halted the program for the year. At completion of the project for the year, the railroad returned the majority of the equipment to the lessors, exercising a purchase option on one piece of machinery; lease costs totaled $374,746 for this equipment for the year, while ARRC paid $181,000 to exercise the purchase option. For the 1997 tie program, ARRC plans to lease more equipment. primarily through sole-source conventions; this approach is based on compatibility concerns for operations and repair.

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[1] In its application for the grant monies. ARRC pledged to expend $2.3 million of its funds for projects designed to "*extend the benefits of the FRA funded programs.*" The railroad-funded projects were to include "*additional ballasting and surfacing, rail programs, passenger equipment rehabilitation. and depot improvements.*"

[2] A subsequent amendment to this agreement extends the completion date of the project until December 31, 1997. We understand that ARRC and FRA have entered into another separate $10 million grant arrangement for additional tie replacement and purchase of collision avoidance equipment for 1997.

[3] Tie replacement equipment included two tie insertors and one each anchor squeezer. anchor spreader. and spike reclaimer.

[4] Track surfacing equipment included ballast regulators and production tampers.

[5] See Report Conclusions for more information on this topic.

With ARRC's leasing of this new tie replacement and surfacing equipment, the railroad was faced with the question of what to do with its own wholly-owned equipment that was replaced. The railroad decided to take advantage of what it called "better-than-average" market conditions for used heavy rail equipment and sold 30 pieces of machinery and corresponding miscellaneous parts to two rail service companies based outside of Alaska. ARRC received a total of $408,908 in proceeds from the sales.

# REPORT CONCLUSIONS

As stated in the Objective, Scope, and Methodology section of the report, this audit reviewed the Alaska Railroad Corporation's (ARRC or the railroad) activities related to selected 1996 acquisitions and disposals of heavy rail equipment. We noted shortcomings in both areas. We are concerned that the railroad failed to prepare a formal determination delineating ARRC's rationale for electing to lease new on-track heavy equipment and dispose of its older machinery. Further, the disposal process undertaken by ARRC did not include competitively offering the equipment to the entire marketplace; similar to findings in previous audits, the railroad continues to avoid competitive business practices. We also took issue with a decision of this magnitude seemingly being made by a relatively low-level employee; the railroad could not provide documentation of ARRC management's knowledge nor approval of the disposal proceedings. We also noted weaknesses in the manner in which ARRC attempted to procure the leased equipment used in the 1996 tie replacement and rail surfacing programs. Finally, we believe the railroad's definition of what constitutes an emergency procurement may permit excessive latitude in its business dealings. Our detailed conclusions follow.

No formal analysis of equipment options performed

One of the findings of ARRC's annual management audit performed by an outside consulting firm has been that the railroad appeared to be carrying an "*extraordinarily large*" heavy equipment fleet; further, the consultants stated that a number of pieces of equipment are in use "*well beyond their expected life.*" As such, the consultants recommended that ARRC reduce heavy equipment ownership and stated that "*as equipment needs to be replaced, other alternatives . . . should be carefully examined.*" [Emphasis added] ARRC has represented to us that, based upon this recommendation, the requirements of the upcoming tie replacement program, and an overall favorable used rail equipment market, the railroad decided to dispose of a considerable amount of on-track heavy equipment and lease the machinery needed for the 1996 work effort.

However, no formal analysis documenting the basis for ARRC's decisions was prepared. The railroad has represented to us that the ARRC general roadmaster and the track and equipment supervisor reviewed work orders and discussed reliability issues with the mechanics who repair the railroad's equipment fleet: this was purportedly done in an effort to determine which machines had been troublesome in the past and should be retired. No documentation of this review was ever prepared, however. More importantly, no comparison of the cost nor productivity of the owned machinery to that of the prospective leased equipment was ever made; it does not appear that the railroad took such concepts as cost per unit of production nor other quantitative measures into account in reaching its conclusion about which course of action to follow.

ARRC had a number of options available in preparing for the 1996 work season. Simply stated, the railroad could have used its existing wholly-owned machinery, leased new equipment, or purchased new equipment.[6] To make such a decision, we believe prudence dictates that the railroad perform some form of analysis that details the relative costs and benefits to be derived from each alternative. Without this information, it is impossible for ARRC to know if it correctly evaluated all options and made a sound business decision.

It is important to note that ARRC's consultant recommended that the railroad examine the alternatives. The firm did not state that ARRC should enter into equipment leases without doing further analysis.

ARRC appears to have made the decision to lease new machinery and dispose of the older equipment without any analysis supporting this determination. Prudent administration of most organizations, particularly government-owned organizations, requires that management document the basis for major decisions. This is especially true when facing questions with far-reaching impacts such as those involving major equipment acquisitions and disposals. As discussed in Recommendation No. 1, we believe ARRC needs to document the rationale behind its actions.

Disposals of equipment not competitively offered

Subsequent to its "decision" as to which items were to be retired, ARRC turned its attention to the manner in which they would be offered for sale. ARRC represented to us that it contacted several companies that it believed might have potential uses for the equipment;[7] however, these contacts were not documented. From July through November 1996, the railroad's track and equipment supervisor negotiated the sale of 30 items[8] to two companies; prices were purportedly set through the negotiation process, subject to a range determined through review of trade publications. However, no documentation was prepared detailing the negotiations. Further, no competitive offering was apparently considered.

We believe a private placement such as this violates the most basic tenets of good business practices. By not offering the sale of this equipment competitively in the open market, ARRC had no way of knowing if it received a fair price for the equipment. The railroad received $408,908, a considerable sum; however, it is unknown what proceeds this equipment may have provided if it were offered to a larger number of prospective buyers, each on equal footing.

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[6]These options, of course, are not mutually exclusive; the railroad could also have used some combination of the three alternatives.

[7]ARRC purportedly selected these companies from its knowledge of the industry and a review of trade publications.

[8]In addition to the equipment, ancillary parts reported to be specific to the machinery sold were also included in the negotiated sales.

ARRC Board Rule No. 9 defines the objective of ARRC's surplus property disposal policy as assuring

> ". . . *that [ARRC] identifies and disposes of excess personal property in a manner that maximizes the return to the [railroad], and provides a fair and equitable opportunity to all members of the general public who are interested in purchasing the excess property.*" [Emphasis added]

The rule continues that surplus property may be sold by sealed bid, public auction, or through direct sales. We believe that, in order to meet the intent of the policy requirements, a disposal of this magnitude warrants a competitive offering. See Recommendation No. 2.

Equipment sales decisions made by lower-level supervisor

Alaska Statute 42.40 permits the railroad's board of directors to delegate the powers and duties necessary for the daily administration of the corporation to the chief executive officer (CEO). The CEO may then designate other executive officers different powers. The vehicle used by ARRC to delegate this authority to the officers and others is the railroad's *Approval Authority Guide* (AAG). The intent of this guide is to "*show normal day-to-day business activities that are delegated to assure a smooth running company.*"

The AAG delegates the authority for the disposal of material and equipment to the executive officers. While any of the vice-presidents may declare property excess, only the CEO and vice-presidents of finance/administration and operations may actually approve the transfer of title.

However, no documentation is available to show that the proper approvals were provided prior to the retirement and sales of the subject equipment and parts. In a number of cases, ARRC's track and equipment supervisor was the only railroad signer on the authorization for retirement and bill of sale forms.[9] No executive management authorization was evident in any of the forms available for our review.

While ARRC has represented to us that management was aware of the proposed excess and sales activities, no documentation of such could be provided by the railroad. As we discuss in Recommendation No. 3, there is no substitute for properly documenting that appropriate parties are informed and consent to the determined course of action.

[9]This supervisor was the same individual who purportedly determined the firms to be contacted and conducted the negotiations for the sale and transfer of the equipment.

Weaknesses noted in procurement of leased equipment

In its efforts to procure the leases of equipment, ARRC issued two invitations-to-bid (ITBs) for on-track heavy equipment to be used on its tie replacement and track surfacing projects in 1996. Additionally, ARRC wished to lease an on-track brushcutter for routine upkeep of the railroad's maintenance of way; a separate ITB was issued for this purpose.

While we commend ARRC for attempting to use competitive principles in these procurements, we noted weaknesses in the railroad's methodology during our review. Specifically:

- ARRC did not advertise the issuance of the ITBs within Alaska; rather, national trade publications were reviewed and potential vendors selected to receive copies of the solicitations. ARRC has represented that it knows that none of the manufacturers of the subject equipment have dealers or distributors in Alaska. As such, the railroad reasoned, any Alaskan bidders would only be brokers not truly engaged in selling railroad products on an ongoing basis, but rather reaping the benefits of the Alaska bidder's preference required to be afforded them. This argument does not appear persuasive; if an Alaskan bidder offers a piece of equipment on a competitive basis and performs on all other aspects[10] of the contract, the question of whether it is a manufacturer or reseller appears to be moot. In the spirit of competition and positive public relations, we believe ARRC should have, in addition to the other means it took, advertised the issuance of its ITBs within the state.

- The evaluation criteria used in the surfacing and tie replacement equipment bids was not well defined. The ITBs stated that "*[a]n award will be made to the low, responsive, responsible bidder that meets the requirements as set forth in the specifications and compliance thereof.*" However, the solicitation also states that "*[t]he delivery date may be a deciding factor in the award of a contract* " and requests the bidders to furnish the earliest firm date for delivery if the delivery date specified in the ITB cannot be met. If ARRC wished to introduce evaluation criteria other than price, we believe it may have been prudent to issue this procurement inquiry as a request for proposal rather than an ITB and explicitly define the criteria and respective point values to be used in the evaluation.

- ARRC did not include a provision for liquidated damages in its lease contracts for the 1996 equipment. As such, there was no tangible incentive for the vendors to meet the promised delivery dates. At least one vendor was substantially late in delivery; ARRC was forced to scramble to find a replacement unit to permit the planned projects to continue. We understand the railroad has included such a clause in some contracts for the 1997 lease procurements; we believe this provision should be included in all ARRC procurement contracts where timeliness of performance is critical.

[10]Through additional criteria in an ITB, perhaps related to provision of maintenance or training, ARRC can ensure it receives the necessary service from a vendor.

- In its solicitation for brushcutting equipment, all indications were that ARRC was requesting bids for one machine. However, based on the responses to the ITB, the railroad instead decided to lease two machines from the successful bidder. This doubling of the quantity initially specified in the ITB could have the effect of changing the economics of the bid for the prospective vendors: it may not be feasible for a company to bid on providing one brushcutter, but it may for two such machines. The overall effect is that the railroad may be limiting its options by excluding possible bidders from the pool of prospective vendors; at the same time, ARRC's actions could heighten its exposure to bid protests and lawsuits.

We further discuss this issue in Recommendation No. 4.

ARRC definition of emergency procurement overly broad

Alaska Statute 36.30.015(e) requires the railroad to adopt procurement procedures that are "*substantially equivalent*" to those of executive branch state agencies as embodied in the state procurement code and accompanying regulations.[11] ARRC's procurement rules appear to mirror the state procurement rules in certain respects. However, a significant difference is evident in an important aspect of emergency procurements.

Both the state procurement code and ARRC's rules define situations under which emergency procurements may be considered necessary. Under both documents, conditions such as fire, flood, epidemic, environmental accident, critical equipment failure, or similar compelling reasons may be adequate justification for bypassing standard competitive practices. Additionally, both state that emergency procurement may be justified in a situation in which the standard practices of competitive sealed biddings or proposals are "*impracticable or contrary*" to the interest of the agency facing the emergency. However, ARRC's rules continue that such a situation may be due to "*delays inherent in the normal procurement process that could cause ARRC to lose a market opportunity. . . .*"

Under the railroad's definition, almost any procurement could be construed as impacting ARRC's financial condition and therefore classified as an "emergency." We do not believe this rule to be necessary as it could encourage circumvention of competitive practices. While we did not note evidence of such in this audit, we believe ARRC should nonetheless modify its procurement rules to eliminate this provision. See Recommendation No. 5.

[11] A number of Division of Legislative Audit reports have chronicled ARRC's difficulties with the "substantially equivalent" requirement of the state procurement code.

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# FINDINGS AND RECOMMENDATIONS

The recommendations presented below are closely tied with the discussion presented in our Report Conclusions section. As such, much of the detail related to these recommendations will be found in that section and has been omitted here.

Recommendation No. 1

The Alaska Railroad Corporation (ARRC or the railroad) should document the rationale behind its management decisions.

Prudent and accountable management are hallmarks of well-run organizations. A primary means of maintaining this accountability is to require that management document the rationale behind decisions, financial and programmatic, that have considerable impact on the entity. ARRC should not be an exception to this standard; quite the opposite, the railroad, in its unique position as a state-owned for-profit corporation, should be in the forefront of providing clear evidence as to the rationale supporting its decisions.

However, this was not the case regarding the 1996 decision to retire certain heavy rail equipment and replace some of it with leased machinery; no formal analysis documenting the basis for ARRC's decision was prepared. We believe a decision of this magnitude should have been subject to such a standard. Some form of analysis that compared the relative costs and benefits of the options available to the railroad and provides support for the decision made should have been prepared and retained. Without it, there is no defensible basis for the decision and therefore no means for ARRC to know if it selected the most appropriate alternative. In the future, we recommend ARRC take the steps necessary to document its rationale behind decisions of such magnitude.

Recommendation No. 2

ARRC should competitively offer significant disposals of its assets.

By not competitively offering the heavy rail equipment disposed of in 1996, ARRC cannot know if it received the best possible price for the machinery. Additionally, the private placement practice that occurred heightens ARRC's exposure to charges of favoritism to certain contractors.

As such, we recommend that significant disposals, such as those that occurred in 1996, be subject to a competitive process in the future.

Recommendation No. 3

ARRC should ensure asset disposals show evidence of management approval.

In the documentation of the 1996 heavy rail equipment disposals, ARRC was unable to provide evidence of management authorization being given. We recommend, for significant future railroad asset disposals, that appropriate management approval be received and documented prior to undertaking retirement or disposal activities. This control not only is a solid business practice, it is required through ARRC's delegation of authority handbook.

Recommendation No. 4

ARRC should improve its competitive bid procurement procedures.

The railroad should ensure that all prospective bidders are given an equal opportunity to bid and that the evaluation criteria presented are clear. Further, we believe ARRC should include liquidated damage provisions in contracts when timing is important. Finally, ARRC should not materially deviate from quantities requested in bid specifications if such a change could impact the prospective bidders.

Recommendation No. 5

ARRC should modify its purchasing rules related to emergency procurements.

The railroad's procurement rules permit excessive latitude in determining what may be considered emergency procurements. We recommend that these requirements be tightened to more closely approximate the state procurement code.

# ALASKA RAILROAD CORPORATION

Corporate Address: P.O. Box 107500, Anchorage, Alaska 99510
327 W. Ship Creek Avenue, Anchorage, Alaska 99501

VIA FACSIMILE & U.S. MAIL

June 6, 1997

*EXECUTIVE OFFICE*
*TELEPHONE (907) 265-2403*
*FACSIMILE (907) 258-1456*
*email: sheffieldw@akrr.com*



Randy Welker, Legislative Auditor
Alaska State Legislature
Budget & Audit Committee
Division of Legislative Audit
P.O. Box 113300
Juneau, Alaska 99811

Re: Preliminary Audit Report on Department of Commerce and Economic Development, Alaska Railroad Corporation
Equipment Acquisitions and Disposals
March 24, 1997
Your Audit Control Number 08-4552-97

Dear Mr. Welker:

We have reviewed your draft report (08-4552-97) on the Alaska Railroad Corporation ("ARRC"), the stated objective of which was to determine if our activities related to specific 1996 ARRC acquisitions and disposals of heavy rail equipment were reasonable and in compliance with applicable statutes and ARRC rules. We recognize that your opinions on the reasonableness of specific actions may differ from ours, but do appreciate your willingness to share those opinions with us. Our comments on your specific recommendations follow.

How sweet of them

Recommendation No. 1

**The Alaska Railroad Corporation (ARRC or the railroad) should document the rationale behind its management decisions.**

We agree with the importance of documenting the rationale for significant capital expenditures. ARRC's Authorization for Expenditure ("AFE") process was designed to assure that significant capital expenditures are properly justified and documented. This

process is currently being revised to update the procedures and strengthen controls. We will also examine our asset disposition procedures to determine if the authorization and documentation process needs to be revised.

**Recommendation No. 2**

**ARRC should competitively offer significant disposals of its assets.**

We agree that significant asset disposals should be subject to a competitive process, and believe that our disposal processes do provide for reasonable competition. In this instance the auditors are critical of the process used by ARRC since the excess equipment was not sold through a public offering in Alaska. We determined that there was no practical reason to incur the time and expense of a public offering in Alaska since there are no potential buyers in Alaska for railroad track maintenance equipment. In addition, the value of the equipment being sold was based on the seasonal needs of the railroad industry and would likely have decreased had we taken the time for a public offering. ??

**Recommendation No. 3**

**ARRC should ensure asset disposals show evidence of management approval.**

We agree that asset disposals should show evidence of management approval. In this instance the appropriate managers had approved the dispositions, but through oversight had not signed all of the proper forms. Who's Kidding Who?

**Recommendation No. 4**

**ARRC should improve its competitive bid procurement procedures.**

ARRC strives to continuously improve its competitive bid procurement processes. The legislative auditors' opinions will be considered and implemented as appropriate in future procurement actions.

**Recommendation No. 5**

**ARRC should modify its purchasing rules related to emergency procurements.**

→ Let's repeal

ARRC's authorizing legislation (AS 42.40.100(8)) directs it to adopt procurement rules based on those of the railroad industry. Subsequent legislation (AS 36.30.015(e)) requires that ARRC's procurement rules be "substantially equivalent" to those of the State. We

believe that our procurement rules are consistent with the dual legislative directions ARRC has been given.

Thank you again for your suggestions and comments.

Sincerely,

William J. Sheffield
Acting President & CEO

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# ALASKA STATE LEGISLATURE

## LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit

P.O. Box 113300
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347
Internet e-mail address:
legaudit@legis.state.ak.us

June 9, 1997

Members of the Legislative Budget
and Audit Committee

We have reviewed the Alaska Railroad Corporation's (ARRC or the railroad) response to the preliminary audit report. In general, we are encouraged by ARRC's apparent willingness to review and update its procedures. However, we noted two areas in the corporation's response that require additional discussion.

Recommendation No. 2

ARRC should competitively offer significant disposals of its assets.

The railroad's response to this recommendation states that Legislative Audit was "*critical of the [disposal] process used by ARRC since the excess equipment was not sold through a public offering in Alaska.*" (Emphasis added) In contrast, nothing within the recommendation nor the related audit conclusion specifically mentioned ARRC not offering the equipment for sale within the State. Rather, we were critical of the railroad's decision to not offer to sell the equipment in any open market, where all prospective bidders would have an equal opportunity to purchase these assets. Our concern was with the private placement and overall lack of open market competition, not merely that a public offering did not take place within Alaska.

Recommendation No. 5

ARRC should modify its purchasing rules related to emergency procurements.

In its response, the railroad states it believes its procurement rules are "*consistent with the dual legislative directions ARRC has been given.*" The dual directions ARRC alleges consist of AS 42.40.100(8), which states that the procurement procedures of the corporation shall "*meet accepted railroad industry standards,*" and AS 36.30.015(e), which states that ARRC shall adopt procedures "*substantially equivalent*" to the State Procurement Code and underlying regulations.

However, contrary to the railroad's apparent interpretation, the differences in these two statutes cannot be used to justify substantial variances from the Procurement Code. The rules of statutory construction clearly favor procurement procedures that are substantially equivalent to the State's Procurement Code, as follows:

- As both of these individual statutes set minimum standards, the more restrictive provisions of the two become the standard to follow. For example, if one statute required a certain procedure for purchases larger than $100,000 and the other required it for purchases of only $50,000, the $50,000 test would become the standard as it is more restrictive. That is, individual statutes are considered to be part of a coherent whole. In no case would procedures less restrictive than substantially equivalent to the Procurement Code ever become the standard.

- The detailed, specific procurement procedures as spelled out in the Procurement Code prevail over the vague, generalized direction to "*meet accepted railroad industry standards.*" Statutory construction favors specific requirements over vague guidelines when differences exist.

- The "*substantially equivalent*" rule also prevails over "*industry standards,*" in areas where they differ, because it is a more recent statute. The rules of statutory construction assume that the legislature was aware of the old "*industry standards*" guideline and wished to modify then-current railroad procedures by mandating that ARRC adopt procedures substantially equivalent to the Procurement Code.

To summarize, we see no "*dual legislative directions.*" mixed signals, confusion, or ambiguity. The statutory requirement for ARRC to follow procurement procedures "*substantially equivalent*" to the Procurement Code is firm. As such, we continue to recommend that the railroad follow purchasing rules that more closely approximate the State Procurement Code.

Randy S. Welker, CPA
Legislative Auditor

# Audit Report

**DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT**

**ALASKA RAILROAD CORPORATION**

**ANCHORAGE GRAVEL ACTIVITIES**

**July 3, 1996**

Audit Control Number:

08-4547-96


Division of Legislative Audit

P.O. Box 113300, Juneau, Alaska 99811-3300

# LEGISLATIVE BUDGET AND AUDIT COMMITTEE

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**Randy S. Welker, CPA**
**Legislative Auditor**
**Merle R. Jenson, CPA**
**Deputy Legislative Auditor**

**P.O. Box 113300**
**Juneau, Alaska 99811-3300**

**(907) 465-3830, Juneau**
**(907) 561-1445, Anchorage**
**(907) 465-2347, Juneau FAX**

# ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE
Division of Legislative Audit

P. O. Box 113300
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347

July 3, 1996

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT
ALASKA RAILROAD CORPORATION
ANCHORAGE GRAVEL ACTIVITIES

July 3, 1996

Audit Control Number

08-4547-96

The objectives of this audit were to determine if the Alaska Railroad Corporation's (ARRC or the railroad) activities related to the agreement between the railroad and the Flamingo Brothers Partnership were reasonable and in compliance with applicable statutes and ARRC rules, if ARRC's actions adversely impacted the Municipality of Anchorage's plans to redevelop the derelict Hollywood Vista Apartment complex located adjacent to ARRC's property, and if ARRC's communications with the local government and community regarding this matter were at an appropriate level.

The audit was conducted in accordance with generally accepted government auditing standards. Field work procedures utilized are discussed in the Objectives, Scope, and Methodology section. Audit results can be found in Report Conclusions and Findings and Recommendations.

Randy S. Welker, CPA
Legislative Auditor

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# OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Title 24 of the Alaska Statutes and a Legislative Budget and Audit Committee special request, we conducted an audit of the Alaska Railroad Corporation's (ARRC or the railroad) activities related to the planned gravel extraction on the east bluff of its downtown Anchorage property.

## Objectives

The objectives of our audit were:

- To determine if ARRC's activities related to the agreement between the railroad and the Flamingo Brothers Partnership (FBP) were reasonable and in compliance with applicable statutes and ARRC rules.

- To determine if ARRC's actions adversely impacted the Municipality of Anchorage's (MOA) plans to redevelop the derelict Hollywood Vista Apartment complex located adjacent to ARRC's property.

- To determine if ARRC's communications with the local government and community regarding this matter were at an appropriate level.

## Scope and Methodology

During our review, we interviewed persons from the Government Hill Community Council, MOA, state agencies, and others from the community; additionally, we spoke with FBP's partners and members of ARRC's senior management. Our methodology also included the following:

- Review of relevant files from ARRC's real estate and legal departments.

- Review of the agreement and pro forma income statement between ARRC and FBP for development of the east bluff area.

- Review of ARRC rules and Alaska Statutes.

- Review of similar ARRC transactions.

- Review of statutes, regulations, and procedures applicable to state agencies for similar types of transactions.

- Review of ARRC senior management's reading files.
- Review of minutes from meetings of the railroad's board of directors.
- Review of the Greenbelt lease between ARRC and MOA.
- Review of ARRC and MOA legal opinions.
- Review of conflict of interest disclosure statements for ARRC directors and senior management.

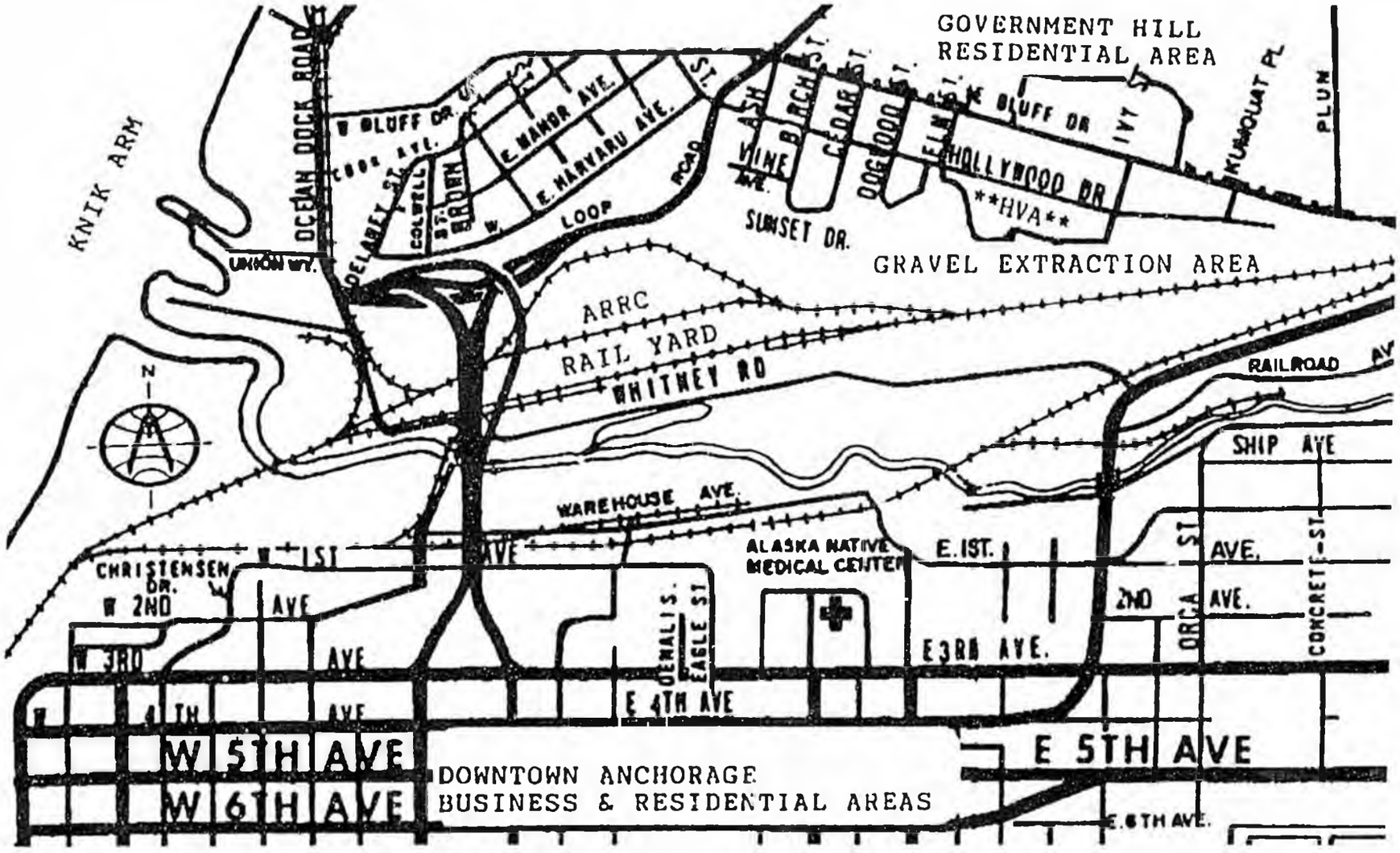
# ORGANIZATION AND FUNCTION

The Alaska Railroad Corporation (ARRC or the railroad) was established by AS 42.40 after the railroad was purchased for $22.3 million by the State from the federal government in January 1985. ARRC is a public corporation and an instrumentality of the State within the Department of Commerce and Economic Development, but by statute it has a legal existence independent of, and separate from, the State. The corporation's board of directors is responsible for its management, but has delegated the powers and duties necessary for the administration of daily affairs and operations of the corporation to the chief executive officer (CEO). In turn, the CEO has designated other executive officers to oversee the various departments.

ARRC has title to substantial land holdings in the state and the majority of its revenue is derived from freight and passenger transportation and real estate activities. One of ARRC's current goals is to increase its revenue through improved utilization of its real estate assets. As such, it is beginning to manage these assets more aggressively, in part through the issuance of leases, permits, and license agreements involving railroad land. Currently, approximately 2,300 acres, roughly 16 percent of ARRC's holdings, are leased for commercial, industrial, or residential use.

The site of the planned Flamingo Brothers Partnership gravel extraction, the primary subject of this audit, totals 28.42 acres and is located immediately north of downtown Anchorage; it includes the east bluff area of ARRC's downtown property and is just below the derelict Hollywood Vista Apartment complex. See page 4 for a map of the area. The extraction area is currently undeveloped land.

Alaska Railroad Corporation
Proximity of Gravel Extraction to Residential Areas




**HVA** Hollywood Vista Apartments

# BACKGROUND INFORMATION

## Municipality of Anchorage and Hollywood Vista Apartments

In 1988, the Municipality of Anchorage (MOA) purchased the vacated and derelict Hollywood Vista Apartments (HVA) from the federal Housing and Urban Development agency for $1. As they contained asbestos, a condition of the sale was that MOA would demolish the apartments. The HVA property is adjacent to the Alaska Railroad Corporation's (ARRC or the railroad) east bluff property separated only by a tract of land leased to MOA from ARRC (the Greenbelt lease).[1]

On May 15, 1995, the MOA assembly passed a resolution to establish the Hollywood Vista Advisory Task Force, the purpose of which was to advise it on the disposition of the land underlying the HVA complex. Specifically, the task force was asked to advise and make recommendations to a municipal steering committee regarding the future of the property.

Late in July the members of the task force were appointed[2] by the mayor. The task force met on eight different occasions to study the issues, hear expert witnesses, and develop its recommendations. At the October 11, 1995 meeting, the task force heard testimony from several Anchorage Neighborhood Housing Services[3] representatives who stated that it was important that ARRC participate in any solution to the HVA redevelopment and that coordination of gravel removal would benefit both ARRC and MOA by jointly terracing the property, as well as reducing any seismic risks. The representatives continued that such a gravel extraction could also help pay for the demolition or site development with the sale of approximately 500,000 tons of gravel that could be removed from the HVA site. Such a removal would also allow the terracing of the joint properties.

This approach was consistent with the 1992 findings of a previous HVA advisory task force regarding the HVA redevelopment project. MOA's plans for the redevelopment were to execute a joint extraction agreement between ARRC and MOA and use the money earned from the extraction of MOA's gravel to offset the costs of the demolition and the redevelopment of the HVA property.

However, the task force was surprised to find out that ARRC had different plans for the property when, on October 17, 1995, ARRC entered into a contract with the Flamingo Brothers Partnership (FBP or the partners) to extract gravel from the railroad's east bluff property; the task force was unaware of such plans until after the contract was executed. At

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[1]The Greenbelt lease is approximately 30 acres of land leased by MOA from ARRC for the purpose of creating a low intensity park development and trails for public use.

[2]The manager of passenger services for ARRC at that time was appointed to the task force as a citizen member, not as an official representative of the railroad. While ARRC's Chief Executive Officer was aware of the appointment, ARRC has represented that no other members of the railroad's senior management were informed of this.

[3]Anchorage Neighborhood Housing Services is a not-for-profit entity that provides housing services for low-income individuals in the Anchorage area.

this time, the task force revised its preliminary recommendations, as a joint gravel extraction project with ARRC was no longer a possibility.

Alaska Railroad Corporation and Flamingo Brothers Partnership

ARRC had considered modifying the east bluff area for a considerable time; this is evidenced by the railroad's reserving certain rights in the 1990 Greenbelt lease with MOA. Specifically, ARRC foresaw a need to expand and it reserved the right, in the lease, to re-grade the east bluff area below the derelict HVA complex. In 1995, ARRC decided to act when it entered into an agreement with FBP.[4]

According to ARRC, FBP approached the railroad with a draft proposal for a five-year, long-term lease to extract gravel from the east bluff and develop 5,000 feet of new track and related facilities for the purpose of off-loading petroleum products transported by the railroad to the Anchorage Port Area. Soon afterwards, ARRC management and the partners negotiated the details for a short-term lease. The 5,000 feet of new track and related facilities were removed from the agreement as management felt the proposed addition was unnecessary and only further complicated the process. In October 1995, ARRC management determined the agreement should be a license (permit) rather than a short-term lease. The contract was executed on October 17, 1995. The details of the contract will be discussed later in the Report Conclusions section of the report.

Shortly after the agreement was signed, FBP filed two applications with MOA's Planning and Zoning Commission[5] to rezone approximately nine acres of ARRC's property and approve a conditional use permit for the natural resource extraction. The commission's staff reviewed the petitions and recommended the board adopt the petitions at its February 5, 1996 meeting. The planning and zoning commission adopted staff's recommendations and approved the conditional use permit and the rezone. The MOA assembly held meetings regarding the rezoning request on May 28, 1996 and June 11, 1996. At the June meeting, the assembly approved the plan adopted by the Planning and Zoning Commission with minor modifications.

[4]FBP is an Alaskan partnership formed in August 1995 whose general partners are a real estate agent and an engineer, both based in Anchorage.

[5]One of FBP's partners is the vice chair of the municipal Planning and Zoning Commission, the agency responsible for approving the applications for the conditional use permit and the rezone of ARRC's property. It should be noted the partner did abstain from voting on both issues. Further, the other FBP partner is the chair of the Zoning Board of Examiners and Appeals. He is a partner of the engineering firm that prepared the applications and represented FBP at the Planning and Zoning Commission meetings.

## REPORT CONCLUSIONS

As stated in the Objectives, Scope, and Methodology section of the report, this audit reviewed the Alaska Railroad Corporation's (ARRC or the railroad) activities related to the planned gravel extraction on the east bluff of its downtown Anchorage property. Based upon our field work, we are concerned that ARRC's agreement with the Flamingo Brothers Partnership (FBP or the partners) to market and extract gravel from the railroad's Anchorage property may not be in the best financial interest of ARRC. Additionally, although the substance of this agreement is that of the railroad contracting with an agent to remove and sell an ARRC resource, we noted that ARRC inappropriately entered into this contract without benefit of the public procurement process. While it appears the railroad was aware that its actions would greatly impact the Municipality of Anchorage's (MOA) efforts to redevelop the derelict Hollywood Vista Apartment complex, ARRC proceeded ahead with no public notification of its proposed actions, excluding possible input from the affected community.

We also take issue with certain aspects of ARRC's process for selecting users of its real estate. We believe the railroad's purported *"first come, first served"* basis of selecting lessees and other users is not appropriate on lands in areas of high public interest or if the opportunity for competition exists.

Our detailed conclusions follow.

### Contract with FBP may not be in ARRC's best interests

As discussed in the Background Information section, ARRC and FBP entered into a contract on October 17, 1995 where the partnership was given the *"exclusive right and privilege . . . to enter upon, produce, excavate, screen and remove gravel"* from all or part of the east bluff of ARRC's downtown Anchorage property. The contract requires FBP to pay ARRC proceeds in excess of costs and profits based upon sales contracts the partnership negotiates with gravel users located solely within the Anchorage Port area. The agreement, though initially proposed as a five-year, long-term lease, was eventually structured as a four-year permit and included a pro forma income statement[6] that provides a basis for the financial portion of the accord.

Our review of the contract leads us to believe the agreement may not adequately represent the best financial interests of the railroad; certain provisions appear to be overly generous to the partnership at the expense of ARRC. For example:

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[6]The project pro forma income statement provides a listing of the partners' estimated costs and revenues and projected net profit. The estimated costs include charges for legal services, accounting and auditing services, an environmental study, development costs such as approval for rezoning and the conditional use permit, municipal fees, engineering services, geotechnical studies and reports, design of mining and restoration plans, landscaping, construction administration, restoration, loading and scaling, truck transportation, placement and compaction, and a developer's fee of 10 percent of gross revenue.

- The agreement is structured in a cost reimbursement plus a fee manner. FBP, as the developer, is guaranteed a fee of ten percent of gross revenues from the gravel sales in addition to all the partnerships costs being reimbursed; as such, the entire risk of this project is borne by ARRC.

- As all the partnership's expenses are reimbursed, there is no incentive for FBP to contain development costs.

- The agreement stipulates that included in the expenses to be reimbursed are fees paid to the partnership related to construction administration; the estimated cost shown in the pro forma income statement is an additional $200,000 over and above the ten percent of gross revenues and other costs.

- The contract does not provide for a minimum amount of revenues to be received by the railroad. ARRC management believes, based upon the contract document and the negotiations that preceded it, that ARRC has the ability to veto any plan proposed by FBP to sell the extracted gravel that would provide the railroad with net revenues of less than $1 per ton. However, this power is not explicitly stated in the contract, and FBP's partners have represented that the partnership is not bound by such a requirement; based upon our review, it is not apparent how ARRC arrived at this conclusion.

- Through discussions with local contractors and suppliers, we determined that the estimated costs presented in the pro forma income statement could be understated by as much as $300,000, or 8 percent of the total estimated costs. Assuming FBP's estimated sales price of $5 per ton of gravel is correct, ARRC's net profit would then be approximately $.69 per ton, well below what ARRC management considers to be an acceptable revenue of $1 per ton. While the estimated costs are the basis of the financial portion of the agreement, ARRC's net profit will be based upon the actual costs incurred in the gravel extraction process.

- The contract does not require FBP to receive fair market value (FMV) for the gravel. Had ARRC retained veto power over the proposed sales contracts, FMV for the gravel would have been more likely. FBP does not have a great incentive to hold out for the highest possible price for the extracted gravel.

- FBP is not obligated to incur restoration costs. The contract requires eight percent of gross revenues to be deposited into a reserve account for that purpose; such costs could exceed such deposits, particularly if the operation was active for only a short period. Further, no performance bond is required to ensure FBP completes its efforts in an adequate manner.

- ARRC did not have the property appraised by a qualified appraiser, nor was the property competitively offered; therefore, ARRC did not determine what the FMV of the gravel resource was, and has no way of knowing if it entered into a contract that would provide it with an appropriate return.

ARRC has entered into three similar resource extraction agreements,[7] all structured as licenses or permits. The primary difference between these agreements and the FBP contract is how ARRC's payments are calculated. In the three other agreements, the contractor bears all the costs of extraction and the railroad is guaranteed to earn a royalty, if the contractor extracts resources from the property. Conversely, in the FBP contract, ARRC will reimburse FBP for all actual costs, plus a guaranteed profit, and the railroad will receive only the net profits, if any.

In general, we are concerned that the manner in which the agreement with FBP was structured may not be in the best financial interest of the railroad.

Public procurement process not followed

ARRC, being an instrumentality of the State, operates in a unique environment. As distinct from a private concern, we believe the public should be able to expect an entity such as ARRC to focus on accountability, safeguarding of public assets, competitive practices, and an open public process even if such activities decrease efficiency and effectiveness when compared to the private sector. Procedures must be in place that allow for competitive practices throughout the process whenever practicable, not just to maximize return for ARRC, but also to provide assurance the process is free from favoritism, bias, and conflicts of interest in both fact and in appearance. In our opinion, anything less than a process that is above reproach will cripple the public confidence that is critical to such a process. Public perception plays a key role in maintaining this confidence. Among other items, a perceived lack of fairness, competition, equitable treatment, or anything other than an open public process can be highly damaging and can have far-reaching consequences, whether factual or not. As such, we believe it is imperative that ARRC be cognizant that appearance, in addition to fact, can play a significant role in maintaining, or conversely, harming public confidence in ARRC.

The above principles are central to any public procurement system. Alaska Statute 36.30 (the state procurement code) requires ARRC adopt procurement procedures "*substantially equivalent*" to those of the State. To meet this statutory mandate, the railroad established Board Rule No. 8, ARRC procurement rules. These rules require ARRC to provide public notice and use competitive bids for procurement of services and supplies, subject to certain exceptions.

However, ARRC did not follow its procurement rules in handling the FBP contract. The substance of the agreement appears to be that of hiring a contractor to market and extract gravel from ARRC's east bluff; there does not appear to be any reason such a transaction should not be subject to the public procurement process. However, ARRC effectively

[7]According to the railroad, ARRC's permits are usually issued for the construction of a project, use of track, or use of land for cabins, picnic and camping areas, and lawn and garden permits. Only three other permits have been issued by ARRC for such types of resource extraction projects as FBP's gravel extraction of the east bluff area.

handled the procurement as a private placement without the required public procurement process. No competitive offering was made, and as discussed later in this section, no public notice of ARRC's intentions was given. The railroad's actions in this matter fly squarely in the face of the most basic tenets of an open public process.

ARRC Rule 2000.1(4) states that the procurement rules apply to every expenditure of ARRC funds, except for "*. . . acquisitions or disposals of real property or an interest in real property . . . .*" However, we do not believe the substance of ARRC's agreement with FBP falls under the umbrella of such an exemption. This contract appears similar to a broker/client relationship.[8] Through the contract, ARRC, in substance, has hired a broker to find a market for the railroad's gravel and then extract it and transport it to the buyer; FBP is simply a conduit between ARRC and the buyers. Such an agency relationship cannot, in our opinion, be construed to be a "*disposal of real property,*" as stated above.[9]

Although the procurement code mentions the expenditure of money, the state attorney general holds that it must be read to cover cases where instead of money some other type of valuable consideration is provided by an entity in exchange for a good or service. While ARRC is not expending funds for this project there is no doubt valuable consideration is provided by both parties to the contract.

Further, good business practices would dictate that a transaction such as this should have been competitively offered in order to maximize ARRC's profits. Without a competitive offering or appraisal to determine FMV, the railroad cannot be sure it is receiving an adequate return from this natural resource extraction.

We believe management should have considered the substance of the contract and competitively offered the project using ARRC's procurement rules. The essence of the agreement is FBP is an agent for ARRC. The gravel project should have been publicly noticed with ARRC's intent to extract the gravel by issuing a request for proposal for competitive bids, rather than as a private placement to FBP.

ARRC's real estate leases inappropriately offered on a "*first come, first served*" basis

ARRC's Board Rule No. 11 is the railroad's policy on long-term real estate leases. While this rule requires rent be set at FMV as determined by a qualified appraiser or competitive offering, it is silent on how lessees are selected. However, ARRC's management has an informal policy of "*first come, first served,*" meaning, presumably, the first party to bring a

[8] In the past, ARRC has taken a similar position that procuring the services of a real estate broker to market the railroad's old general office building should not have been subject to its procurement rules. We disagree with ARRC's analysis regarding such a transaction. We do not believe an agreement of this nature is a "*disposal of real property,*" but rather a contract to market the property and locate a prospective buyer.

[9] In our opinion, ARRC management hired FBP as an agent or broker for the marketing and extracting of the gravel. ARRC is the landowner, and FBP is acting as an agent or broker on ARRC's behalf, hence, the gravel should be considered severable from the land, as if ARRC had marketed and extracted the gravel itself. This is supported by the fact that ARRC and FBP have approached businesses together as a team in the Anchorage Port area in an effort to market the gravel.

proposal to the railroad for a given property will be given the first opportunity to lease that property. In ARRC's view, this rewards those who propose *"new and innovative ideas"* to the railroad. ARRC stated that FBP approached it with a new and innovative idea and therefore received the contract.

However, we do not believe certain aspects of this policy are in the best interests of either ARRC or the public. As discussed in Recommendation No. 1, we believe that ARRC offering leases for railroad property in this manner in rural areas with minimal economic interest for investors may be appropriate; nonetheless, in areas with high public interest lands, greater economic viability, and the opportunity for competition, such as the east bluff, we do not believe it is appropriate for the railroad to offer contracts on this basis.

In our view, such types of lands should be offered to the public through competitive procedures utilizing the request for proposal (RFP) process. Such a process would entail public notice and provide an equal opportunity for all parties to propose ideas and approaches regarding use of the railroad's land. In addition to fair and equal treatment of the public and stimulating creativity, this approach would increase the railroad's financial return by allowing ARRC to choose between the best uses and financial opportunities for the railroad. FMV is best defined through the market place: while appraisals may still be used to determine the minimum amount of an acceptable rental,[10] competitive offering of leases would provide ARRC with a clearer picture of FMV for a specific parcel of land.

Additionally, ARRC does not always adhere to its informal policy of *"first come, first served."* Regarding the east bluff gravel, we noted the following:

- One of Anchorage's larger gravel contractors contacted ARRC about the possibility of extracting the gravel in 1993. However, no further activity occurred until ARRC was in the process of negotiating the FBP agreement.

- A potential developer of the HVA complex was the Anchorage Neighborhood Housing Services (ANHS). This organization approached the railroad in 1992, in response to a request for interest issued by MOA. ANHS met with the railroad and described how it could request the Greenbelt lease be assigned to the HVA redevelopment project, enabling the developer to re-grade both of the properties, and sell the gravel in a joint project. The railroad's response was that *"this would not conform with the intent of the Greenbelt Lease."*

Further, ARRC management informed us that there were a number of other entities who had previously shown interest in developing the east bluff area; the *"first come, first served"* policy is not followed.

[10]Through the RFP process ARRC would not be required to lease the property if the best use or financial terms were not satisfactory. Appraisals could be a vital tool in making this determination.

We believe ARRC management's *"first come, first served"* policy is the antithesis of the public process as it does not sanction the maximization of the value of the property and fosters charges of favoritism and bias. ARRC is a for-profit instrumentality of the State and is charged with the responsibility of maximizing the returns from its activities and assets; however, the railroad is also responsible for assuring its policies ensure freedom from favoritism, bias, and conflicts of interest in both fact and in appearance. Anything less will cripple the public's confidence which is so critical to such a process. Management's *"first come, first served"* policy plays a key role in negating this confidence; in fact, it fosters a perceived lack of fairness, competition, equitable treatment, and anything other than an open public process. This policy has damaging and far-reaching consequences; therefore, it is critical the railroad become aware of such perceptions and increase its efforts to improve the public's confidence in ARRC.

Project justification unclear

The railroad's motivations for entering into the agreement with FBP in the manner that it did are, at best, unclear. ARRC does not appear to need the gravel for its own purposes, and it has no current plans for future expansion of the additional area. Further, as discussed earlier, it does not appear that revenue was the key motivation, given the manner in which this contract was arranged and written.

ARRC's lack of public process excluded the community

As discussed earlier in this report, several other parties have shown considerable interest in the gravel from the area around the east bluff and the HVA complex. However, ARRC excluded them from the process through its private placement with FBP that was accomplished unbeknownst to the other participants and without the benefit of public notice.

The railroad was very much aware that MOA established a task force and the task force's strategy was to excavate the gravel from the HVA site and sell it to offset the costs of the demolition and redevelopment. There appears to have been an opportunity for a mutually beneficial arrangement between ARRC and MOA to combine their gravel extraction activities: the larger volume could possibly have brought lower extraction costs. Nonetheless, ARRC willfully proceeded to act in a manner that was questionable for its own interest and was detrimental to the interests of others in the community. MOA has spent much time, effort, and money on this project, and ARRC's efforts and actions clearly undermined the work on the HVA demolition and redevelopment project.

Additionally, ARRC did not provide any notification to the community of its intentions to enter into the agreement with FBP. As the topic of redeveloping the derelict HVA complex has been a significant issue for the Government Hill community for a considerable time, we do not believe it was appropriate for ARRC to exclude possible public input regarding the railroad's proposed actions.

Insufficient monitoring of possible conflicts of interest

Due to the nature of the FBP contract, we reviewed the conflict of interest disclosure statements for ARRC's board of directors and senior management. No ties to FBP were disclosed in these statements.

However, in order for conflict of interest disclosure statements to be effective, such statements must be filed in a timely manner.[11] Further, issues that are disclosed should be subject to follow-up review to determine whether or not a conflict of interest does or does not exist. ARRC does not meet these standards. See Recommendation No. 2.

- We reviewed 65 disclosure statements and found that 32 percent were filed after the deadline. One statement from a vice president was filed four months late: this disclosure was completed on the day we requested the conflict of interest statements.

- We noted an instance where a member of ARRC's senior management disclosed information that we believe should have been subject to follow-up review. The officer disclosed he is active in his profession outside of his employment with ARRC: no other details of the activity were disclosed. This employment may or may not have involved direct work with members of the community with significant dealings with ARRC. Based upon subsequent discussion with the officer, we determined no conflict exists: however, ARRC should have performed this follow-up review. We also noted the officer did not consistently disclose his activities in years he was required to.

- Two other members of ARRC's senior management failed to disclose their creation of and involvement in a nonprofit corporation.

Neither ARRC upper management, the legal department, nor the human resources department performed a follow-up review or inquired about any of the disclosures or nondisclosures. According to the human resource manager, ARRC does not perform any follow-up procedures nor seek explanation of disclosures made by directors, senior management, or employees.

[11]The deadline is established by Board Rule 14 Code of Ethics, which states:

> *Beginning in January 198*, and on an annual basis each year thereafter, all current Directors and nonrepresented employees shall complete a Code of Ethics Disclosure Statement and submit it to the Director, Personnel Department or General Counsel, whichever is applicable. All newly-appointed Directors and all newly-hired nonrepresented exempt employees shall complete such a statement at the time of appointment or hire and every January thereafter. These statements shall be reviewed by the Director, Personnel Department or General Counsel in accordance with the Administration section of this policy.*

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## FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The Alaska Railroad Corporation should establish a high public interest land policy that includes both an open public process and competitive bidding principles.

The current ARRC long-term lease policy outlines the requirements for most real estate transactions of five years or greater. However, this policy does not speak to how lessees or other users of ARRC lands are selected. Currently, ARRC's informal policy for making these determinations can best be described as "*first come, first served,*" where supposedly the first party to bring an offer to ARRC for a given property will be given the opportunity to lease that property.[12]

While this policy may work in certain rural areas that do not have high public interest lands, we do not believe it is acceptable in urban communities or other areas where high profile lands with a higher economic value exist. The lack of an open public process can easily lead to charges of bias or favoritism and can increase the possibility of a negative public perception of the railroad's real estate activities. Additionally, without some form of competitive offering for lands with high public interest, ARRC is not assured of receiving the highest possible long-term value from the agreement. Currently, fair market value is estimated through an independent appraisal process. However, this process, at times, may be conducted using old or unreliable market information; fair market value is often best determined through the open market, allowing interested parties the opportunity for competition.[13] Additionally, competition also increases the probability that innovative ideas promoting the best use of the land will be proposed to the railroad; this, in turn, provides long-term stability and is in ARRC's best interest.

As such, we recommend that ARRC modify its real estate policies to institute an open public process based on competitive offering of real estate for railroad lands of high public interest.[14] Use of the request for proposal (RFP) format for competitively offering land appears appropriate; correctly done, RFPs provide a methodology for ARRC to select land users based on specific criteria,[15] while fostering a competitive environment and providing

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[12]ARRC has represented that this is also the methodology used for determining who is selected for other, nonlease real estate transactions; however, as discussed earlier, there is evidence the railroad does not adhere to this policy.

[13]However, appraisals could still be used to determine a baseline or minimum amount necessary for ARRC to proceed with the proposed transaction.

[14]"High public interest" lands could be designated as such through ARRC management or board of directors' action based upon public input and ARRC's previous experience with the land.

[15]While one of the criteria would doubtlessly be the amount of rent proposed, other valuable criteria could include proposed use of the land or financial strength of the proposer, among others.

adequate public notice.[16] We believe that proper implementation of this recommendation will eliminate many of the charges of bias or favoritism leveled against ARRC regarding its real estate transactions and will increase the long-term value received by ARRC from its users of railroad real estate.

Recommendation No. 2

ARRC should improve its monitoring of employee conflict of interest disclosure statements.

As discussed in the Report Conclusions section, conflict of interest disclosure statements by ARRC directors and employees have not always been filed in a timely manner nor provided adequate follow-up review. As field work showed, 21 disclosure statements were filed after the reporting deadline, with one statement being filed four months late. We also noted an instance where an ARRC senior manager disclosed limited information about outside work that could, with no further information, appear to be a possible conflict; however, no follow-up review was performed.

The filing of conflict of interest disclosure statements help ensure both the board of directors and the public that management is not engaging in activities that would adversely affect the railroad in either fact or appearance. However, without timely filing or appropriate follow-up review, the potential benefits of these procedures are greatly diminished.

We recommend ARRC take action to ensure that conflict of interest disclosure statements are filed in a timely manner and that appropriate follow-up review is completed. Failure to do so increases the possibility of negative public perception of ARRC activities and sends an inappropriate message to employees.

[16] In 1987, ARRC's board of directors considered adopting a policy regarding high public interest lands. The purpose of the proposed policy was to ensure public input be provided to management on these lands. The proposed policy identified lands considered high public interest lands; additional railroad land was nominated by the public for consideration. The east bluff property which is the subject of this audit was nominated for such consideration. At the time, ARRC management noted, "*while the approach may not eliminate controversial land decisions, the longer comment periods should help to mitigate public concerns.*" However, this plan was never adopted.

LASKA RAILROAD CORPORATION

porate Address: P.O. Box 107500, Anchorage, Alaska 99510
327 W. Ship Creek Avenue, Anchorage, Alaska 99501

September 30, 1996

*EXECUTIVE OFFICE*
*TELEPHONE (907) 265-2403*
*FACSIMILE (907) 258-1456*

Randy S. Welker, Legislative Auditor
Division of Legislative Audit
Legislative Budget and Audit Committee
Alaska State Legislature
P.O. Box 113300
Juneau, Alaska 99811-3300



Re: Alaska Railroad Corporation Anchorage Gravel Activities
July 3,1996 Preliminary Audit Report

Dear Mr. Welker:

Thank you for the opportunity to provide comments on the Division of Legislative Audit's report on ARRC Anchorage Gravel Activities. While we disagree with a number of the report's factual findings and conclusion, we believe several of the comments are well taken and we will improve some of our processes to address your concerns.

Conclusion: Contract with FBP may not be in ARRC's best interests

We strongly disagree with the report's conclusion that the contract with Flamingo Brothers Partnership ("FBP") may not be in the corporation's best interest. The Board of Directors of ARRC has delegated to management certain duties with which they are vested by statute, generally to manage the daily affairs of the corporation. We are further directed by the preamble to the corporation act to operate on a self-sustaining basis. The property at issue in the FBP contract illustrates the ordinary complexity of day-to-day management. ARRC management required the FBP contract to achieve operational, market and revenue goals, all of which were achieved (see discussion under "project justifications" below). We do not concede that there was any poor business judgment exercised in this matter as Legislative Audit seems to believe, and we will refute several of their most glaring misconceptions below. However, even if there were decisions about which reasonable people can differ, nevertheless the audit points to no permanent impairment of the corporation or its assets. One is left with the impression that, after completing the "audit"

function, the report goes into a mode of "second guessing" business decisions, without any justification or particular expertise.

The numerous specific misstatements and misleading conclusions expressed in the report suggest that the auditors either did not thoroughly research their subject or misunderstood the information they gathered. For example, the initial draft report described the history of the Hollywood Vista Apartments ("HVA") Advisory Task Force, including testimony as late as October 11, 1995 regarding the importance of ARRC participation in any solution to the HVA problem. There is nothing more than mere surmise to show that ARRC was aware of any of these discussions prior to execution of the FBP contract on October 17. Footnote 2 states that an ARRC employee (from passenger services, not the real estate department) was a member of the Task Force albeit as a private citizen rather than a railroad representative. Despite this obvious segregation of an employee's personal civic activity, and the lack of any written announcement to ARRC of the appointment, the report goes on to attribute knowledge of this fact to ARRC senior management. According to ARRC's information, only one member of ARRC senior management was even aware of the other employee's service on the Task Force early on (learning of the appointment in September, 1996), and he was not advised of any intentions or plans regarding joint gravel removal.[1] The report seemingly criticizes ARRC for moving forward with its own plans for the bluff, but makes no showing that ARRC was aware of the parallel plans being made by the Task Force. Further, the report does not acknowledge that the FBP contract allowed reasonable access to and usage of the property by ARRC and third parties designated by it (see License Agreement ¶6), which was later utilized to execute a coordination agreement with the municipality.

The report lists eight provisions of the FBP contract that are alleged to be "overly generous" to FBP. ARRC strongly disagrees with this assertion. As described fully to the auditors, the corporation had identified the opportunity, concerns and justification for gravel extraction when executing the Greenbelt Lease in 1990. The report accurately notes that, after 1990, two other parties had expressed interest in the gravel resource but the report fails to add that neither inquiry was pursued, and worse, both inquiries were based upon revenue or market assumptions that the ARRC could not accept. The FBP contract accepts ARRC's limitation on the market area (the port), a performance time line, and requires no investment of ARRC funds. FBP was required to perform engineering, geotechnical investigation and a public permitting process on a speculative basis. Given

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[1]Note that the original draft of the report asserted that ARRC's president and CEO was aware of the appointment, but this statement was removed when ARRC pointed out that the president denied having such knowledge and had never been interviewed by audit investigators.

the absence of a specific gravel buyer in the port area at the time of this agreement, the cost-plus-fee formulation was an appropriate approach, and ARRC performed its own due diligence regarding historical gravel sales and royalty data.

While ARRC has acknowledged that any writing, including this one, can always be improved upon, the report ignores a fundamental underpinning of the contract that both ARRC and FBP agree exists: both parties intend for ARRC to realize at least $1.00 per ton of gravel extracted, both parties examined the probable costs and revenues, and both parties will do everything within their power to fulfil the pro forma, causing $1.00/ton to accrue to ARRC. Rather than focus on the positive and cooperative relationship between the contracting parties, the audit chooses to foment dissension by noting that "FBP's partners have represented that the partnership is not bound by such a requirement." The simple fact is that the contract indeed does not state such a requirement in black and white but has provisions that, taken together, ARRC deems adequate to assure performance.[2] Whether ARRC has other legal recourse with the partnership, should performance not be satisfactory, is not an issue for this audit to determine.

The audit's eight specific criticisms of the FBP contract are summarized and rebutted as follows:

- *"Cost plus fee" arrangement places the entire risk of the project on ARRC.*

  FBP is expending considerable funds speculating on possible gravel sales in the port area, sales which may in fact never materialize, resulting in FBP's loss of these funds. FBP has significant cash at risk.

- *With reimbursed expenses, FBP has no incentive to contain development costs.*

  This ignores ARRC's right to audit the partnership's books found in paragraph 4 of the License Agreement. ARRC would assert that a breach of the contract had occurred if FBP unreasonably and in bad faith escalated its costs.

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[2] We would be more than happy to meet again with the auditors and go through all the provisions and the due diligence upon which ARRC relied to reach this level of comfort, if this would be helpful.

- *FBP to recoup additional $200,000 for construction administration in addition to its 10% of revenues.*

  The 10% is essentially FBP's profit. Construction administration is commonly an overhead expense, as illustrated by typical DOT/PF contracts which allow 10% overhead and 15% profit.

- *No minimum amount of revenues established to be received by ARRC.*

  ARRC has reviewed its original due diligence assessment of projected costs and revenues and continues to find them reasonable. Coupled with our ability to audit FBP's accounts for the project, we feel confident that our minimum expectation of $1.00/ton over the life of the contract will be met.

- *Costs are understated in pro forma.*

  We do not concede that this is true based on our earlier due diligence review, but even if so, the report fails to note that $.69/ton is still twice the going royalty rate or that a greater return is possible.

- *Without ARRC veto power, FBP has little incentive to hold out for the highest possible price for gravel.*

  It is correct that there is no veto power per se, but FBP does earn 10% of gross revenues, so its own economic self interest should encourage it to seek the highest possible price.

- *The restoration reserve may not be sufficient, with no other guaranty of performance.*

  The restoration costs were adequately estimated in the pro forma and the reserve account serves as protection until the end of the project.

- *Failure to appraise the property, no way to know if appropriate return.*

  To the contrary, as ARRC advised the auditors, we checked existing royalty rates (the amounts of which are public knowledge) and even provided the auditors with a copy of the U.S. Forest Service appraisal summary which set a royalty rate of $.38/ton.

Public procurement process not followed

We concur with the report's observation that ARRC operates in a unique environment and accept its admonition that we must be cognizant of appearance as well as fact in the public arena. However, Legislative Audit fails to provide any real analysis as to how the public procurement process was applicable to this transaction. Specifically, the report cites, and then dismisses, the "real estate" exception to procurement, which reads as follows:

> These rules apply to every expenditure of ARRC funds . . . except that these rules do not apply to . . . acquisitions or disposals of real property or an interest in real property . . . . [ARRC Procurement Rule 2000.1(4)]

To our knowledge, no court has ruled on the construction of this or similar language, and there is no guarantee how a court would answer the question in the context of litigation. However, we continue to believe a credible argument can be made that a contract appurtenant to a disposal of real property comes within the exemption, or the provision would otherwise be superfluous and of no effect at all. Our reasoning is as follows: It is fairly obvious how ARRC would expend funds in a acquisition scenario--"acquisition" meaning to buy or lease real property; and as an acquirer, ARRC would presumably pay appropriate consideration. However, in a disposal of real property, the disposer (ARRC as seller or landlord) does not pay consideration for the property, the buyer/tenant does that. For this language to have any meaning, it must at least refer to those customary expenditures made by a seller or landlord, for example such as survey, appraisal costs, closing costs, and broker fees. It is a standard tenet of statutory construction that language is not presumed to be of no effect, that it will be construed to have an appropriate meaning in the overall context. If, as the report concludes, FBP is acting as ARRC's agent or broker in marketing the gravel, it seems plausibly within the quoted language and therefore exempt from procurement requirements.

ARRC's real estate leases inappropriately offered on a "first come, first served" basis

The audit questions ARRC's "first come, first served" basis for choosing tenants, and disputes that it was even applied in this case. On the latter point, the report refers to a contact from another gravel operator "about the possibility of extracting the gravel in 1993 [emphasis added]" and an inquiry by Anchorage Neighborhood Housing Services ("ANHS") in 1992 about the assignment of the Greenbelt Lease to ANHS to facilitate joint gravel extraction. As Legislative Audit was advised, the other gravel operator never pursued the possibility further, and the ANHS proposal was not within the intended purpose of the Greenbelt Lease. Neither of these was diligently pursued (which is a

necessary corollary of the "first come, first served" principle[3]); neither of the parties filed an application for lease; and neither of them met ARRC's criteria for the project. They were therefore unacceptable as proposed: both ANHS and the other gravel operator intended to sell on the open market, which would have negatively affected ARRC's gravel haul and its other gravel customers.

On the broader policy issue, ARRC continues to believe that its "first come, first served" policy is consistent with our governing statute and, equally important, sound public policy. We first note that ARRC's governing statute expressly directs the corporation to lease its lands "at fair market value as determined by competitive bid or by a qualified appraiser." AS 42.40.350 [emphasis added]. The auditors seemingly believe that an appraiser's determination results in only an approximation of fair market value. The statute's authors clearly had more faith in an appraiser's work product. ARRC takes the additional precaution of having leased property reappraised every five years to ensure that rent continues to reflect fair market value. The statute is worded in the disjunctive. The 1984 Legislature, when it adopted the railroad act, obviously recognized that flexibility would be required to deal with the corporation's holdings of leasable land. In point of fact, ARRC's procedure in this regard is wholly consistent with its governing statute.

The corporation does not oppose the use of competitive bidding procedures where the situation is appropriate for that process. Indeed, when a corporate vision was being pursued for the Ship Creek area in Anchorage, the corporation tested the market with the Ship Creek Redevelopment RFP (which notably resulted in only two responsive offers). However, ARRC strongly believes it to be unfair to a potential tenant with an individual "development" idea for a specific parcel of ground that he/she wishes to lease from ARRC for that idea to be shopped to the entire community in the form of a competitive bid. We believe the flexibility provided by the statute encourages individual enterprise and ambition without sacrificing corporate revenues, and we support it wholeheartedly. We must therefore strongly disagree with the audit's recommendation that ARRC competitively solicit its leases.

Project justification unclear

Contrary to this conclusion, the project justification was made manifestly clear to the auditors. Unfortunately, the auditors chose not to discuss this with ARRC's president and

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[3]This would not be the first time for ARRC that a "first comer" failed to diligently pursue its proposal. It would be poor public policy to tie the corporation's property up for an unreasonably long period without requiring progress to be made towards finalizing a lease.

CEO, nor did they conduct their customary "exit interview" before compiling the report. If they had, they would have been told again that there were five very clear goals and/or guidelines established for this undertaking.

1. We would not negatively impact our existing gravel haul business.
2. We would not negatively impact our gravel customers by allowing gravel to be "dumped" on the market.
3. We would try to cause the gravel to be used to create leasable land at the Port.
4. Upon completion, we would be left with an area for construction of a running track, which is consistent with our original Greenbelt lease.
5. We would generate revenue from the project.

Given these goals, it cannot be said that the justification was unclear. Frankly, we are pleased that this contract provides us the opportunity to accomplish all five of the goals once it is fully implemented. The auditors have chosen to evaluate only the revenue goal, ignoring the operating and market significance of the other four. Indeed, the revenue (potential)(loss) and operational savings are financially more significant. Finally, in reviewing the revenue goal, the report does not admit that $1.00/ton is exceptionally aggressive and that ARRC has far outperformed the market in negotiating such a rate.

ARRC's lack of public process excluded the community

While it is correct that ARRC did not itself conduct public hearings or otherwise solicit public comment on the FBP proposal, it is disingenuous to say that the community was "excluded" from comment on the development proposal and inappropriate to imply that ARRC intended to avoid public comment. As the report mentions briefly, the principals of FBP have undergone a significant public planning process with their rezoning and conditional use applications before the Anchorage Planning and Zoning Commission, including three hearings at the Commission and Assembly level. In addition, the report fails to mention the numerous meetings of both the HVA Task Force and the Government Hill Community Council which were attended by FBP. ARRC was familiar with the public hearings requirements for FBP and expected those hearings to more than adequately allow public comment. In fact, it is ARRC's policy, where local planning and zoning processes are available, to require its lessees and permittees to utilize those existing processes rather than allow ARRC's public notice to become a duplicative process. The concerned public has indeed had an opportunity to make its concerns about the gravel extraction known, and some additional conditions were imposed on FBP's operations as a result of the local planning and zoning process.

Under this heading, the report also again criticizes ARRC for failing to coordinate its gravel extraction with the municipality's plans for HVA. It states that "the railroad was very much aware that MOA established a task force and the task force's strategy was to excavate the gravel from the HVA site and sell it to offset the costs of the demolition and redevelopment." In fact, the background information section in no way establishes this level of knowledge on the part of ARRC, and indeed it did not exist. The Municipality and the HVA Task Force had not involved ARRC in the task force process. We were generally aware of the excavation concept, because ANHS had first floated the idea in 1992. One might expect to find ARRC formally represented on the Task Force or a written request from MOA to ARRC on the subject if joint operations with the adjacent property owner were as well developed a plan as the audit portrays it to be. Unfortunately, that did not occur, and ARRC proceeded to contract in the normal course of business. It must be noted that the ARRC contract can be and has been coordinated with the HVA proposals to the extent of their general intent. A letter of intent between FBP, ARRC and the group administering HVA has already addressed access down the slope and coordination of top of slope to HVA's eventual excavation plan. HVA has no specific excavation plans to be coordinated with even to this day. But in any case, excavation must occur on ARRC land to support the HVA concept, the FBP contract allows for coordination of such efforts, and ARRC stands ready to further cooperate with the HVA group when future plans materialize.

Legislative Audit has criticized ARRC in another report, regarding the Fairbanks Chena Landings Development, for being overly solicitous of local governmental opinions and desires. In this audit, we are criticized for failing to cooperate with a neighboring governmental project. We will continue to strive to find the middle path and improve our processes where appropriate. At the time the FBP contract was entered into, there was no statutory or administrative rule that required public notice of the transactions, to the best of our knowledge. The ARRC Board of Directors and management are very concerned about the sensitive issues presented by railroad land transactions, and we have drafted a policy to broaden public notice guidelines before such activities are finalized. While not a cure for all the report's criticisms, this may alleviate some of the underlying concerns. We expect the policy to be adopted by the Board before the end of the year.

Insufficient monitoring of possible conflicts of interest

We are pleased that the auditors found no conflict of interest to exist in ARRC's dealings with the FBP. We agree with the report's recommendation that ARRC should improve its process of monitoring employee and director conflicts of interest, although we disagree with the report's conclusion that no follow-up procedures are currently followed and believe this is based on an incomplete investigation. For example, the investigators apparently inquired of the human resources manager as to follow-up for directors as well as

employees, when that manager has no jurisdiction over disclosures for directors. That function, pursuant to ARRC Policy and Procedure 64-9, is administered by the general counsel, who reviews and initials disclosure statements filed by directors. The general counsel's files were made available to the auditors and contain numerous examples of consideration being given to potential conflicts, both for directors and employees alike. Likewise, an examination of the Board of Directors minutes will provide examples of directors recusing themselves from Board deliberations when a conflict arise, either on their own volition or after consultation with other directors, the Board secretary, or the general counsel. We are therefore puzzled as to why the audit concludes that no follow up is performed as to directors.

Further, the brief interview with the human resources manager apparently did not elicit the information that the manager does read each disclosure statement filed by employees, although he does not initial each statement or otherwise document his review. In addition, this manager and the general counsel confer when a conflict issue arises, and evidence of such collaboration can be found in the general counsel's files. Indeed, the very example cited by the audit, of a vice president who practices his profession outside of his employment with ARRC, was the subject of a discussion between that vice president and the general counsel, which, again, is documented in the general counsel's conflict of interest file by a memo dated October 26, 1994. In this regard, we believe the audit did not fully investigate the facts before reaching a suspect conclusion.

As another example, the report cites two members of ARRC senior management for "fail[ing] to disclose their creation and involvement in a nonprofit corporation". As was fully explained to the auditors, paperwork was filed by three ARRC employees as incorporators of the referenced nonprofit corporation, known as "Alaska Railroad Historic Association, Inc.", in mid-1995. However, the incorporators never had an organizational meeting, no board or directors has ever been elected by the membership (the incorporators serve as initial directors until the board is elected), and in fact there is no membership. The corporation was created in order to have a shell nonprofit entity already in existence to take over either ownership or administration of Steam Engine No. 1 if it became appropriate. Once the engine was replaced on a pedestal in front of the ARRC depot, the need for a separate entity faded and, indeed, it has never been activated. The audit report fails to include these details and implies a level of activity that has, in fact, never occurred.

In summary, we are quite willing to concede that ARRC should document its review of conflicts more thoroughly, and that timeliness of filings can and should be improved. However, we disagree with the implication that ARRC is cavalier in its approach to conflict of interest and performs no follow up at all. This is simply not the case.

Recommendation No. 1

For the reasons discussed above, ARRC declines to abandon its "first come, first served" real estate leasing policy, although we will also continue to use bidding where specific conditions warrant. We are also working to expand our public notice rule to afford a greater opportunity for public input on land transactions.

Recommendation No. 2

We agree that our conflict of interest monitoring can be improved and will take steps to do so, although we disagree with the implication that adequate monitoring is not currently being performed. In an area with such a serious effect on the public's confidence, improvement is always advisable, and we will continually strive to that end.

Thank you again for the opportunity to comment on this audit report. We hope our response is helpful to you and to the Legislative Budget and Audit Committee. Please feel free to call me if you have any other questions.

Sincerely,

Robert S. Hatfield, Jr.
President & Chief Executive Officer

cc: ARRC Directors

flamingo

# ALASKA STATE LEGISLATURE

## LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit

P. O. Box 113300
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347

October 2, 1996

Members of the Legislative Budget
and Audit Committee:

We have reviewed the response to our preliminary audit from the Alaska Railroad Corporation (ARRC or the railroad). Nothing contained in its response gives us cause to reconsider our findings. While the railroad agrees to improve on its public notice procedures and the monitoring of its conflict of interest statements for management and employees, nonetheless, it takes issue with a number of our findings. In response to the railroad's letter, we offer the following clarification.

Contract with Flamingo Brothers Partnership may not be in ARRC's best interests

We believe this contract could have been constructed in a manner more favorable to ARRC. Management responded to this criticism with detailed information that is for the most part misleading or incorrect. For example, ARRC states that typical Department of Transportation and Public Facilities' (DOTPF) contracts allow 10% overhead and 15% profit. However, these rates are substantially higher than DOTPF averages; management also fails to mention that DOTPF does not enter into privately placed contracts such as this one. Management also states that they hope to earn more than twice the U.S. Forest Service royalty rate; however, they fail to mention that the Forest Service rate is a statewide overall average that does not consider the gravel's proximity to extraction equipment, labor, and the gravel market. Perhaps a sense of this contract's deficiency can be seen through the railroad's own words, "*ARRC would assert that a breach of the contract had occurred if FBP unreasonably and in bad faith escalated its cost.*" What is "unreasonable" or in "bad faith" is often difficult to prove. Rather than relying on the courts, we believe management should have focused its efforts on the contract before it was signed.

In its response, ARRC attempts to rebut knowledge of the Hollywood Vista Advisory Task Force (HVATF) activities that were discussed in the background section of our report. ARRC states, "*[t]here is nothing more than mere surmise that ARRC was aware of any of these discussions prior to execution of the FBP contract on October 17.*" In contrast, an internal document prepared by one of ARRC's senior management in July 1995 demonstrates that ARRC was aware of HVATF activities. In fact, this manager believed that ARRC needed to sign a contract and get underway before HVATF launched its project. If not, the railroad might risk a serious problem and ARRC might be asked to donate gravel to pay for the demolition.

HVATF did not become aware of the privately placed contract with FBP until after it was signed and it was too late to provide input or to arrange a joint extraction project.

Further, senior management was also aware of HVATF and the participation of ARRC's manager of passenger services as a task force member. According to statements made by the passenger services manager, his involvement in HVATF was discussed on several occasions in which ARRC's president and chief executive officer (CEO) was present. Nonetheless, in response to a request by ARRC, we deleted a statement from the preliminary audit report that stated the CEO had knowledge of the manager's appointment to the task force. The railroad made note of this deletion in its response such that a reader might believe an error had been made in its original inclusion. That is not the case. The decision to delete this statement was not because it was incorrect, for we believe the passenger services manager's assertions. We elected to delete the language because we did not verify the statement with the CEO.

Public procurement process not followed

ARRC does not dispute the fact that this was a privately placed contract. Instead, management states that this process is appropriate because the gravel is real property and one of their procurement rules may[1] allow it. In reality, however, the gravel to be severed by ARRC's contractor is a commodity, not real estate, and thus, we believe, the ARRC rule that allows a noncompetitive process for real property is not applicable. Further, the State, its railroad, and the people of Alaska benefit from an open public process; that is the standard by which the railroad should judge its actions.

ARRC's real estate leases inappropriately offered on a *"first come, first served"* basis

ARRC strongly disagrees that it should be required to use an open public process and competitive bidding principles when marketing its real estate assets. The railroad apparently believes that without its informal *"first come, first served"* policy, persons with *"new and innovative ideas"* would not approach ARRC. In contrast, we believe that by issuing a request for proposals, the railroad has a much greater opportunity to attract not only innovative ideas but also to allow it to select the ideas that most complement the railroad's vision. The railroad needs to consider more than just the first person to apply. It should also consider railroad operations, long-term revenue potential, and the appearance of this practice to the public.

ARRC also objects to our position that an appraisal is an approximation of fair market value. We fail to see how anyone could rationally disagree. An appraisal is an estimation of property value based upon numerous assumptions. Depending on what assumptions are made, the results can vary dramatically.

[1] The railroad notes that no court has ruled on how its procurement rule should be interpreted and states *"there is no guarantee how a court would answer the question in the context of litigation."*

Project justification unclear

ARRC believes justification for the project was made "*manifestly clear.*" To the contrary, there were no clear justifications for the project. One key component of project planning is a cost-benefit analysis. ARRC never performed such an analysis. We would have expected to see, at a minimum, an analysis of the impact of various extraction alternatives on rail hauls of competing gravel and how each would impact net profits.

ARRC's lack of public process excluded the community

ARRC states that it was "*inappropriate to imply that ARRC intended to avoid public comment.*" Given the railroad's written assessment that HVATF could become a serious problem, as discussed above, we believe our implication is appropriate. Notwithstanding management's attitude in this respect, we understand that the board of directors have drafted a policy to broaden the public notice requirements.

Insufficient monitoring of possible conflicts of interest

The railroad's response indicates the board of directors' conflicts are adequately monitored. Our primary concern rested with the deficient monitoring and reporting of conflicts of interest of the railroad's senior management. Recommendation No. 2 suggests improved monitoring of employee conflicts of interest statements. We apologize to the board of directors, if on reading our report they understood otherwise.

Other Issues

In its response, ARRC mentions several times that the president and CEO was not interviewed, nor was an exit conference held. Our decision not to have an exit interview was based upon the last experience with the railroad. Regardless, we have made a new commitment to the Chairman of the Board to conduct exit interviews with the CEO in the future and look forward to having constructive and civil dialog.

ARRC was provided ample opportunity to participate in the audit process through interviews. In addition, we issued a management letter early in August which contained a majority of the information contained in this report. The railroad did not respond. The purpose of the management letter was to allow both the railroad and this division an opportunity to resolve any misunderstandings and to give ARRC the chance to provide any additional evidence that it deemed pertinent.

Randy S. Welker, CPA
Legislative Auditor