HB

453

polarconsult alaska, inc.

ENGINEERS • SURVEYORS • ENVIRONMENTAL CONSULTANTS

Representative Bill Williams
House of Representatives
State Capitol
Juneau, Alaska 99801-1182

April 22, 2004

Subject: HB-453

Dear Representative Bill Williams:

I am opposed to HB 453, and I would like to provide you with some reasons why this bill is not good for Alaskans.

For years I and others have been trying to sell renewable power to CEA or to MEA. I have offered this power to MEA at well below what CEA is selling it to them. MEA states that they cannot purchase our power as they have an all requirements contract with CEA.

CEA states they will buy our power at their avoided cost. This is the law. They claim their power production costs are a little more than one-half of the price they charge MEA. Therefore, CEA charges MEA a large amount to administer their contract and without RCA can charge them any amount they choose. CEA proposes to sell their own renewable power but fails to offer or make us part of the pool. That is, only they can own wind turbines or only they control governmentally subsidized hydroelectric plants. No one else need apply. To the maximum extent they are trying to monopolize all power production in the railbelt. If they truly had the consumer's interests at heart they would have a standard offer with their actual avoided cost as a benchmark. They would then sell power at the blended rate from all producers including themselves. This blended amount would always be less then the amount they now charge MEA or their own consumers.

CEA does not want competition, and it functions as a monopoly. It wants their guys in and others out. About 66% of the money spent by a typical utility is in generation and transmission. It is a lot more fun and more lucrative for their employees to play in this puddle. CEA is in actual fact an EOC. That is an employee owned company. Consider the wages they pay for even low level jobs. They have been overcharging MEA and Homer Electric and their own consumers for a long time.

If it were not for RCA there would be no restraint whatsoever on their activities. I am not a great fan of RCA as they do not always do what is right but they have the potential to improve and are sure better than the alternative.

If you care to discuss this whole matter in more detail I am available.

Earle Ausman, PE
Attachment: Williams Article

1503 WEST 33RD AVENUE • SUITE 310 • ANCHORAGE, ALASKA 99503
PHONE (907) 258-2420 • FAX (907) 258-2419 • HOMEPAGE www.polarconsult.net

For your information I have done feasibility and economic studies, designed and built power plants, both hydro and thermal, and have worked on wind generation, and I have a strong preference where feasible for environmentally sound alternatives.

I have included part of an article by Walter Williams who discusses why the populace as whole does not always lookout for itself in situations like this. This information discusses "narrow well-defined benefits and small widely dispersed costs". It explains why a relatively small group of people can hijack a cooperative such as CEA and why CEA, MOA and GVEA need oversight by the RCA and by the State Legislature.

CC: Anchorage News, Daily Frontiersman, MEA, HEA, CEA Board.

THE
FOLLOWING
DOCUMENT(S)
ARE
POOR
ORIGINAL
COPIES

ice of the Times

A CONSERVATIVE VOICE FOR ALASKANS

WILLIAM J. TOBIN
Senior editor

Low-price law kills free coffee

By WALTER E. WILLIAMS

A couple of weeks ago, heading down to George Mason University, I pulled into my favorite Wawa gasoline station just off the Bel Air, Md., exit on I-95 South.

At each of the 20 gasoline pumps, there was a sign posted that Wawa would no longer dispense free coffee to its gasoline customers. Why? The station was warned that dispensing free coffee put it in violation of Maryland's gasoline minimum-price law.

Here's my no-brainer question to you: Do you suppose that Maryland enacted its gasoline minimum-price law because irate customers complained to the Legislature that gasoline prices were too low? Even if you had just an ounce of brains, you'd correctly answer no.

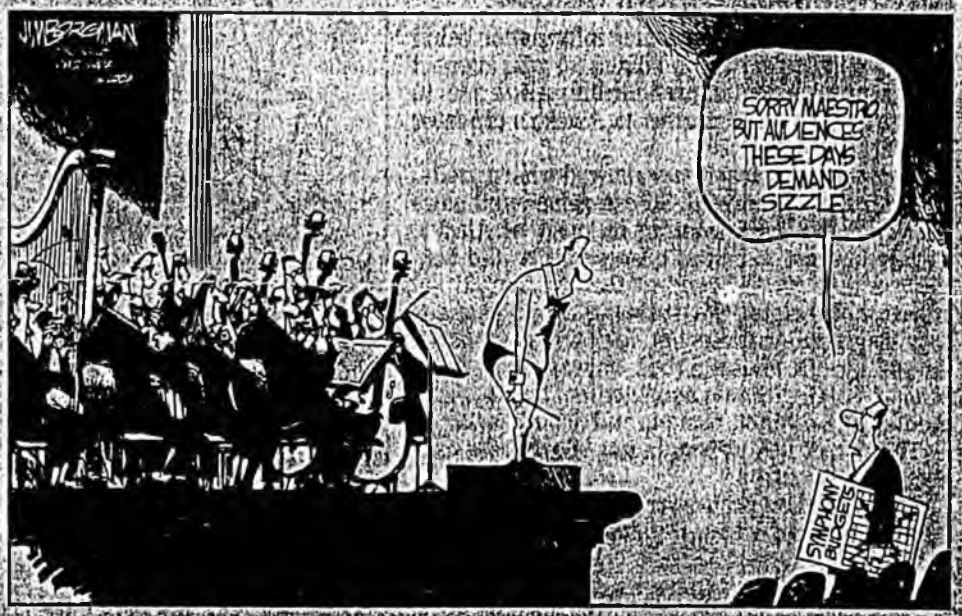
Then, the next question is just whose interest is served by, and just who lobbied for, Maryland's gasoline minimum-price law? If you answered that it was probably Maryland's independent gas-station owners, go to the head of the class.

Williams

Let's first establish a general economic principle. Whenever one sees statutory or quasi-statutory minimum prices, he is looking at a seller collusion against customers in general as well as against particular sellers, those who are seen as charging too low a price.

This economic principle applies whether you're talking about minimum wages, minimum dairy prices or minimum real-estate sales commissions. Members of a seller collusion call for statutory and quasi-statutory minimum prices so they can charge customers higher prices than they could otherwise in the absence of a statutory minimum.

You say, "Williams, that's preposterous; how can they sell legislators on the idea? After all, buyers of gasoline are more numerous than sellers of gasoline." To answer that question, you have to recognize a couple of other facts.



First, legislators aren't known for being rocket scientists. Secondly, legislators love campaign contributions, and satisfying the interests of lobbyists is more important to their political careers than serving the interests of consumers in general.

Lobbyists such as WMDA Service Station & Automotive Repair Association, the Gasoline Retailers Association and the Petroleum Marketers Association of America are able to sell legislators on the fairy tale that if high-marketing gasoline outlets such as Wawa, Sheetz, Wal-Mart and others are allowed to charge prices that are too low, they'll drive all other gasoline stations out of business.

Having done so, these high-marketing outlets could charge any price they pleased and make huge profits.

In economics, we call this strategy predatory pricing. It's an argument that has a ring of plausibility, but there's little evidence anywhere anytime that a predatory pricing scheme produced results even remotely close to what would-be predators envisioned. Questioning this fairy tale and asking for evidence would never cross the mind of a legislator.

Another reason legislators can get away with establishing these minimum-price laws has to do with another economic phenomenon called "narrow, well-defined benefits and small, widely dispersed costs." The beneficiaries of the gasoline seller collusions are relatively few in number and well-organized. The victims, mainly gasoline customers, are difficult to organize, and the costs they bear are relatively small and widespread.

In other words, how many gasoline consumers would be willing to spend their time and energy fighting to unseat a legislator whose actions imposed, say, a nickel a gallon additional cost upon them? It's cheaper just to pay the nickel a gallon more and forget about it, but that's not true about gasoline retailers. It is worth their time and energy to pressure legislators for minimum-price laws, and politicians know this.

Maryland is not the only state with statutory minimum gasoline prices. It's joined by 12 other states, including New York, Michigan and Wisconsin. Wisconsin legislators have the gall to call its government-sponsored seller collusion the "Unfair Sales Act."

Walter E. Williams is a professor at George Mason University at Fairfax, Va. His column is distributed by Creators Syndicate Inc., 5777 W. Century Blvd., Suite 700, Los Angeles, CA 90045; (310) 337-7003.

The Anchorage Times

Editors: **TOM BRENNAN**, 264-8191; **PAUL JENKINS**, 264-8192; **WILLIAM J. TOBIN**, 264-8193.

The Voice of the Times does not represent the views of the Anchorage Daily News. It is published

Alaska State Legislature

Session: (Jan-May)
State Capitol, Room 208
Juneau, AK 99801-1182
(907) 465-3777
Fax (907) 465-2819

Interim: (June-Dec)
716 West 4th Avenue, Suite 600
Anchorage, AK 99501-2133
(907) 269-0155
(907) 269-0154 Fax

Pete Kott
Speaker of the House

Memorandum

Date: April 23, 2004

To: Representative Bill Williams
Co-Chair Finance

From: Representative Pete Kott
Speaker of the House

Re: HB 453

I want to take my name off a joint letter that was sent to you on April 21 in opposition to HB 453. I do, in fact, support the bill.

HB 453 - Public Utilities Reg Act - j wholesale agreements

~~CS - Version H~~

CS (LTC)

FN # 1 Ø CED 2417

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSHB 453(L&C)
(H) Publish Date: 3/24/04

Revision Date/Time (Note if correction):
Dept. Affected: DCED
Title: Joint Action Agencies
RDU: Regulatory Commission of Alaska (399)
Component: Regulatory Commission of Alaska
Sponsor: Representative Heinze
Requester: House Labor & Commerce
Component No.: 2417

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
1141 - RCA Receipts						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2004) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

POSITIONS

Full-time	0	0	0	0	0	0
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This legislation would have no direct fiscal impact on the RCA in the immediate future, although it likely would require long-term adjustments to agency operations in later years.

Prepared by: Mark K. Johnson, Commissioner, Chair
Phone (907) 276-6222
Division: Regulatory Commission of Alaska
Date/Time 2/27/04 2:38 PM
Approved by: Edgar Blatchford, Commissioner
Date 2/27/2004
Agency: Department of Community & Economic Development

HARTIG RHODES HOGE & LEKISCH
A PROFESSIONAL CORPORATION
ATTORNEYS AT LAW

www.hartig.com

717 K STREET
ANCHORAGE, ALASKA 99501-3597
TELEPHONE (907) 276-1592
FACSIMILE (907) 277-4352

ROBERT L. HARTIG (1928-1980)
JAMES D. RHODES (RETIRED)
G. KENT EDWARDS (RETIRED)

PETER B. BRAUTIGAM
VIKRAM N. CHADBAL
ROBERT B. FLINT
SEAN HALLORAN
LAWRENCE L. HARTIG
ANDREW E. HOGE
CHRISTINE FOOTE HYATT
MICHAEL JUNGREIS
ROBERT J. MAHONEY
DOUGLAS C. PERKINS

OF COUNSEL
PETER A. LEKISCH
MARGARET J. RAWITZ
TODD J. TIMMERMANS

RECIPROCAL RELATIONSHIP
GRUENING & SPITZFADEN
JUNEAU, ALASKA

April 22, 2004

The Honorable John Harris, Co-Chairman
House Finance Committee
State Capital, Room 513
Juneau, Alaska 99801-1182
Representative_John_Harris@legis.state.ak.us

The Honorable Bill Williams, Co-Chair
House Finance Committee
State Capital, Room 515
Juneau, Alaska 99801-1182
Representative_Bill_Williams@legis.state.ak.us

Re: HB 453 [CSHB 453(L&C)]

Dear Chairmen:

On behalf of Homer Electric Association, Inc. (Homer Electric) I am responding to the letter of Ronald Saxton of the firm of Ater Wynne LLP. The letter was written on behalf of Chugach Electric Association, Inc. (Chugach), Anchorage Municipal Light & Power (ML&P), and Golden Valley Electric Association, Inc. (GVEA).

I represent Homer Electric in certain of their matters before the Regulatory Commission of Alaska (Commission). I have practiced in Alaska in the area of regulatory law for over 35 years.

Homer Electric depends upon Chugach to supply the power for its members. Homer Electric will be adversely affected if CSHB 453 (HB453) is passed. HB453 removes Commission review of wholesale power contracts between a joint action agency (JAA) and its members. It generally exempts the JAA from regulation by the Commission. While the letter referred to above suggests the legislation will not alter the ability of the Commission to review any rate charged by the utility for service under the jurisdiction of the Commission, the letter also makes clear the Commission cannot review or alter any rate between the JAA and the member utility (page 3, paragraph 4, last sentence). What this means is that the Commission might look at rates being passed on to the consumers of a JAA member; i.e., examine them, but it can do nothing about them.

I will, in this letter, deal with a point by point discussion, and where appropriate, refutation of the issues raised by the letter of April 15, 2004.

The first argument on page 2 is that HB453 removes unnecessary impediments

to building new generation. The first paragraph suggests one of the impediments being removed is the ability of the Commission to inquire into the reasonableness of new construction costs and rates, and whether they should be passed on to the rate payer. Simply stated, the bill affords no independent review of construction costs or their effect on rates. In other words, no body can protect the rate payer. The letter suggests the passage of the bill will merely insure the members of the new JAA will bring the new generation on line in the same efficient manner present utilities enjoy. That may be true as far as it goes; left unsaid, however, is that no independent body, such as the Commission, can review the prudency of construction, financing arrangements or operating costs of these new projects and decide what rates the rate payer should pay.

This argument further notes the JAA would not need a Certificate of Public Convenience and Necessity (CPCN). It suggests that such a requirement would be redundant. Of course, the legislature is never advised what the CPCN review requirements are, and to suggest they are simply redundant, is incorrect.

The last paragraph of the first point observes that the Alaska railbelt will need significant investment in the next 25 years. This is true. But a solution involving only the three largest generating utilities (Chugach, ML&P, and GVEA) and ignoring the utilities serving the Kenai Peninsula and the Matanuska-Susitna Valley, two of the most significant population blocks in the railbelt, is not the way to address the need.

The second point, beginning at the bottom of page 2, is that no one should fear JAAs because they will have the same success as the Four Dam Pool and Bradley Lake projects. It is true the projects are free from direct oversight of the RCA. Distinguishing factors between the Four Dam Pool and the Bradley projects and the current situation are that the participants in those projects are the only consumers of the power from the projects, buying the power from themselves; the contracts among the participants were negotiated before the exemptions were granted; and the exemptions were approved by 100% of the users. It is also true the projects provide extremely cost efficient power; however, that has more to do with the fact that the projects were heavily subsidized with state money, than any organizational efficiencies.

In order to allay the concerns of the Legislature about supervision of the JAAs, as its third point the letter suggests member elected boards of directors or the Municipal Assembly will protect the public. While it might be true in the case of a disastrous project some board or assembly members might be removed, regardless of what happens politically, the ratepayers will still have to pay rates sufficient to pay the debt on the project. AS 42.05.431(c)(3) requires the Commission to honor any rate covenant by a public utility to establish, charge, and collect rates sufficient to meet its obligations under a wholesale power contract [see legislation at page 2, lines 19-20].

The assertion that the interests of the consumers of power from Chugach are represented by the board of directors is false. The Chugach board is not "publicly

elected." Chugach generates power for nearly 115,000 consumers in southcentral Alaska. Approximately 50,000 of those consumers are not members of Chugach and have no right to vote on any Chugach issues. The Chugach board regularly attempts to impose high rates on these customers (who don't elect the board), to benefit the rates of its own retail customers (who do elect the board). If dissatisfied with the utility's "reliability, price, service or strategic planning," the wholesale customers of Chugach have no recourse except to the RCA. If Chugach makes a greater return on its services than predicted, it can keep the wholesale customers' money as long as it wants.

The last point on page 3 is most telling. First, the argument is made that the legislation will not eliminate the Commission's review of existing wholesale power agreements but the legislature is not told what happens when these wholesale power agreements expire. Second, the argument is made that although the Commission cannot review or alter the rates established in the wholesale power agreement between the JAA and its member, it could "examine" the rates if passed on in a subsequent wholesale power contract between a JAA member and a non-JAA member. Such an "examination" of rates would futile at best. If a rate can't be analyzed, reviewed or altered, the power to "examine" the rate is of little value.

The assurance that Commission will continue to play an important role in protecting rate payers and the public at large is hollow if this legislation is passed. The Commission will be stripped of any meaningful role in protecting rate payers from excessive generation and transmission costs.

If Alaskans are embarking on a $5 billion 25-year program to improve the railbelt generation and transmission needs, then more than ever before, there needs to be some impartial third party oversight of these decisions. Homer Electric, while it represents over 20,000 members, has but one vote in Chugach's elections. There has to be some independent review of Chugach or JAA decisions that affect the relationship between Chugach and Homer Electric, and its rate payers and, for that matter, all rate payers including those of Chugach, ML&P, and GVEA. HB 453 should not be passed out of committee.

Very truly yours,

HARTIG RHODES HOGE & LEKISCH

By: Andrew E. Hoge

Andrew E. Hoge

cc: Homer Electric Association, Inc.

Position Paper
Regulatory Commission of Alaska

HB 453 – "An Act exempting from regulation under the Alaska Public Utilities Regulatory Act wholesale agreements for the sale of power by joint action agencies and contracts related to those agreement, and joint action agencies composed of public utilities of political subdivisions and utilities organized under the Electric and Telephone Cooperative Act."

The Regulatory Commission of Alaska is opposed to HB 453. This legislation holds the potential to exempt from regulatory oversight most new electrical generation in the Railbelt in future years. The only effect of HB 453 is to provide an exemption from all forms of regulatory oversight – this legislation does nothing to otherwise enhance the functioning of joint action agencies or define their operations. From the perspective of the RCA, HB 453 provides no tangible or measurable benefits to the consuming public while at the same time creates significant potential for the abuse of monopoly power in Alaska's most capital intensive industry.

The principal joint action agency under Alaska law is the entity created to manage the "four-dam pool" assets which were built with direct state appropriations in the 1980's. This agency has functioned reasonably well, but this has been the case because of the unique circumstances which caused its formation. Underpinning the formation of the four-dam pool joint action agency was the fact that all of the assets which were and are subject to agency management were *already constructed* and that agreements were *already in place* for the purchase and sale of wholesale power from those projects. In summary, the State, with heavy Legislative involvement, determined that these investments were appropriate and that management under the joint action agency concept was the preferred course for the administration of these facilities. AS 42.05.431 (c) grants an exemption to the four-dam pool agency from RCA jurisdiction but that exemption is of limited duration.

In stark contrast, the exemption proposed in HB 453 would extend to an unknown number of new joint action agencies for an undefined number of projects which have not yet been planned, constructed, financed or operated. Further, the exemption would be of unlimited duration.

If exempt from RCA jurisdiction, new electrical generation facilities in the Railbelt constructed under the auspices of one or more new joint action agencies would not be subject to ANY independent review as to (1) their necessity or prudence; (2) the reasonableness of their operating expenses; or (3) the rates to be charged for power produced from these facilities. The RCA believes that a grant of such sweeping authority would be unprecedented in Alaska's history.

A variety of problems could arise under this legislation which would be very difficult to correct once significant resources had been invested in a particular project. One area lies in the scope of projects which might be undertaken. For example, the potential exists that a self-governed, unregulated joint action agency could determine that the provision of generation or transmission facilities might include the construction of extensive private roadways, pipelines or even railroads. No independent mechanism would exist to control or question such decisions or investments. Similarly, no direct mechanism would exist to control or question the sizing of proposed plant investments or their fuel sources.

In the arena of operations and maintenance, no agency could review the reasonableness or prudence of expenses of joint action agency facilities. Any and all expenses would be included in the wholesale rates to be charged to power distributors on a "take it or leave it" basis.

The Legislature should understand that while joint action agencies are identified in the final report of the Energy Policy Task Force as a method for unified system operation, the Task Force Report does *not* mention or endorse the exemption of such agencies from RCA regulation. The RCA agrees with the Energy Policy Task Force recommendations that joint action agencies can play a useful role in the planning, construction and operation of new generation and transmission facilities. In the view of the RCA, constructive use of the joint action agency concept must include statutory provisions as to the scope, governance and operation of such agencies. The complete exemption of such agencies from RCA jurisdiction does not solve any identifiable problem except to satisfy a general desire for the lessening of regulatory burdens.

The Legislature should understand that regional interests of one utility could induce generation and transmission decisions which, while favorable to one utility, are not in the overall public interest. The State needs to retain oversight of major infrastructure decisions, and continued rate-making jurisdiction. Decisions on major infrastructure projects are best reviewed either by the Legislature or through an agency charged with siting and cost analysis that embraces the Railbelt as a whole. This will ensure major infrastructure decisions are made in the public interest.

Multiple and serious costs to the consuming public would arise from the blanket exemption proposed in HB 453. HB 453 should not be enacted by the Legislature.

Alaska Power Association
703 West Tudor Road, Suite 200
Anchorage, Alaska 99503
Ph: 907-561-6103, Toll-free: 1-877-992-7322
Fax: 907-561-5547, URL: www.alaskapower.org

March 31, 2004

Representative Eric Croft
House Finance Committee
Capitol Building, Room 519
Juneau, Alaska 99801

Subject: Alaska Power Association's Support of House Bill 453

Dear Representative Croft:

Alaska Power Association (APA) strongly supports House Bill 453, which would create a joint action agency for Railbelt electric utilities. The purpose for this new entity is to share the ownership and management of the Bradley Lake Hydroelectric project and Alaska Intertie assets, which could be acquired from the Alaska Industrial Development and Export Authority and its affiliate Alaska Energy Authority.

Although owned by the State, the Bradley Lake project and the Alaska Intertie are currently managed and funded by the Railbelt utilities through the Intertie Operating Committee and the Bradley Lake Project Management Committee, respectively. It is important to note that all the Railbelt utilities are either consumer-owned cooperatives or municipal systems that are directly responsible to their customers.

AIDEA has expressed an interest in divesting Bradley Lake and the Alaska Intertie to interested utilities in the Railbelt. The APA Board of Directors believes that it is in the best interest of the Railbelt utilities to have common ownership of these projects, to provide a funding mechanism for the projects' maintenance, capital improvements and repair. Please be aware that there is a difference of opinion on HB 453 among APA's members in the Railbelt. Chugach Electric Association, Anchorage Municipal Light & Power and Golden Valley Electric Association support the bill. Homer Electric Association and City of Seward Light & Power Division oppose it.

Attached is the APA resolution supporting authorization of a joint action agency for state electric infrastructure assets.

Sincerely,

E. P. Yould

Eric P. Yould
Executive Director

Alaska Power Association Resolutions 2004

INFRASTRUCTURE

5.1) A Resolution Supporting the Authorization of a JAA for State Electric Infrastructure Assets

The Alaska Industrial Development and Export Authority/Alaska Energy Authority is the owner of the Bradley Lake Hydroelectric Project and Alaskan Intertie. These assets are currently managed and funded by the Railbelt utilities through the Intertie Operating Committee and the Bradley Lake Project Management Committee, respectively. The Railbelt utilities are made up of a combination of cooperatives and municipalities.

AIDEA has expressed an interest in divesting itself of these electrical projects to interested utilities in the Railbelt. It would be in the best interest of the Railbelt utilities to have common ownership of these electrical projects that will provide a funding mechanism for necessary maintenance, capital improvements and repair of these projects. The Joint Action Agency is a formal organization recognized by the State of Alaska that is particularly useful for organizations that include municipalities and cooperatives. Alaska Power Association strongly supports the authorization of a Joint Action Agency as a new entity to share ownership and manage assets that may be transferred from AIDEA/AEA.

Alaska State Legislature

House Special Committee on Economic Development; International Trade & Tourism
REPRESENTATIVE CHERYLL BOREN HEINZE, CHAIR

SESSION
State Capitol
Juneau, Alaska 99801-1182
(907) 465-4930 Tel
(907) 465-3834 Fax

INTERIM
716 W. Fourth Ave.
Anchorage, Alaska 99501-2133
Tel (907) 269-0160
Fax (907) 269-0177

Sponsor Statement
HB 453

"An Act exempting from regulation under the Alaska Public Utilities Regulatory Act wholesale agreements for the sale of power by joint action agencies and contracts related to those agreements, and joint action agencies composed of public utilities of political subdivisions and utilities organized under the Electric and Telephone Cooperative Act."

With transmission lines dating back to the 1950's and generation assets that are 20-30 years old Alaska's Energy infrastructure is in desperate need of an upgrade. According to the Railbelt Energy Study the cost of these upgrades would be at least $5 billion. The House and Senate recognized this when they passed House Concurrent Resolution 21 establishing the Joint Energy Policy Task Force. HCR 21 mandated the review and analysis of the state's long-term energy needs, and asked the Task Force to develop a long-term energy plan to efficiently enhance Alaska's economic future.

One of the major recommendations made by the JEPTF was that the State "promote unified operation of Railbelt generation and transmission systems." A Unified System Operator would, by coordinating the resources of the various Railbelt utilities, be in a position to undertake the enormous financial obligation of upgrading the Railbelt. The demands of these infrastructure upgrades are beyond the financial capability of any single utility. This bill is a tool that would give a Joint Action Agency the financial stability to fulfill the role of a Unified System Operator.

HB 453 makes slight changes to existing statutes that permit certain entities to create what is called a Joint Action Agency under AS 42.45.300, a business organization of similar structure to an "S" or "C" corporation, partnership, cooperative or limited liability corporation (LLC). Specifically, language is added to AS 42.05.431(c) and AS 42.05.711(o) to exempt contracts by such an agency (a JAA) from regulation. This is altogether fitting and proper in that the entity that is exempted by this change to statute (the JAA) can only be made up of cooperatives under AS 10.25 or entities owned by a political subdivision of the state, both of whose governing bodies are publicly elected.

Further, contracts consummated by a JAA with another public utility for the sale of power, wheeling, storage, regeneration, or wholesale repurchase under a wholesale agreement would be an agreement between two or more willing and capable parties. Any dispute would be handled in superior court according to contractual law. For these reasons I strongly urge you to support HB 453.

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

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM March 23, 2004

SUBJECT: Joint Action Agencies, CS for HB 453(L&C)
(Work Order No. 23-LS1601\H)

TO: Representative Tom Anderson
Attn: Josh Applebee

FROM: Barbara R. Craver BRC
Legislative Counsel

Enclosed is CS for HB 453(L&C). I want to point out that the second amendment made to HB 453 is problematic. I do not see how anything in AS 42.05.431 can modify the general exemption provided in AS 42.05.711(o). Amended by the committee, section 2 of the bill now reads:

> * **Sec. 2.** AS 42.05.711(o) is amended to read:
>
> (o) A joint action agency established under AS 42.45.310 is exempt from regulation under this chapter, including the requirement to obtain a certificate of public convenience and necessity under AS 42.05.221, for the operation of, sale of power from, and other activities related to the power project the joint action agency purchases from the Alaska Energy Authority until the wholesale agreement and any related contract assigned by the authority becomes subject to review or approval by the commission under AS 42.05.431. The exemption provided by this subsection extends to repairs and improvements to the power project the joint action agency purchases from the authority but does not extend to any other power project or other activity of the joint action agency. **A joint action agency established under AS 42.45.300 that is formed by public utilities owned by a political subdivision of the state, by cooperatives organized under AS 10.25, or by a combination of the two is exempt from regulation under this chapter *as specified in AS 42.05.431*, including the requirement to obtain a certificate of public convenience and necessity under AS 42.05.221.**
>
> (italics added to indicate amendment #2 changes)

The language added by the amendment refers to AS 42.05.431 which concerns the power of the Regulatory Commission of Alaska to fix rates. I do not understand how "is exempt

from regulation under this chapter, including the requirement to obtain a certificate of public convenience and necessity under AS 42.05.221" can be modified by "as specified in AS 42.05.431."

There is an earlier reference to AS 42.05.431 in the first sentence of AS 42.05.711(o):

> A joint action agency established under AS 42.45.310 is exempt from regulation under this chapter, including the requirement to obtain a certificate of public convenience and necessity under AS 42.05.221, for the operation of, sale of power from, and other activities related to the power project the joint action agency purchases from the Alaska Energy Authority *until the wholesale agreement and any related contract assigned by the authority becomes subject to review or approval by the commission under AS 42.05.431.*

(italics added). The reference to AS 42.05.431 here operates as a condition that will terminate the exemption from rate regulation when the events described in AS 42.05.431(c) occur. AS 42.05.431(c) applies only to certain wholesale power agreements "entered into between the Alaska Energy Authority and one or more other public utilities or among the utilities after October 31, 1987, and before January 1, 1988." These specific contracts as assigned and amended are the subject of AS 42.05.431(c) which allows those contract prices to be exempt from rate regulation "until all long-term debt incurred to pay the purchase price to the Alaska Energy Authority is retired."

Section 2 of CSHB 453(L&C), as currently drafted with the second amendment to HB 453, does not make sense. You may wish to forward this memo along to the next committee of referral so that committee can consider the issue discussed in this memorandum.

If I may be of further assistance, please advise.

BRC:med
04-312.med

Enclosu e

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

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM February 27, 2004

SUBJECT: HB 453 and Joint Action Agencies (Work Order 23-LS1601\A)

TO: Representative Cheryll Heinze
Attn: Jon Bittner

FROM: Barbara R. Craver BRC
Legislative Counsel

You have asked for an legal opinion on two questions in regard to HB 453. The questions are:

1) Do the exemptions given to joint action agencies in this bill apply to the retail rates of the individual utilities and cooperatives who are members of the agency?

2) Will this bill affect existing contracts between individual utilities?

1. Do the exemptions given to joint action agencies in this bill apply to the retail rates of the individual utilities and cooperatives who are members of the agency?

No. Both sections of this bill apply exclusively to joint action agencies, which are separate legal entities from the members of the agency. Under AS 42.45.300, a joint action agency may only be formed "for the purpose of participation in the design, construction, operation, and maintenance of a generating or transmission facility". It is my understanding that generating and transmitting electricity does not include retail distribution, thus a joint action agency does not conduct retail sales. However, as legally separate entities, each member of the agency operating as a public utility or an electrical cooperative continues to be regulated as before in regard to its retail sales of power. This bill does not change that.

2. Will this bill affect existing contracts between individual utilities?
Generally a new law will not operate to modify existing contracts. In fact, if a law has that effect, it may be found to violate Article I, Section 15, of the Alaska Constitution which provides: ". . . no law impairing the obligation of contracts . . . shall be passed . . ." The legislature cannot retroactively change rights that are fixed under a contract.

If I may be of further assistance, please advise.

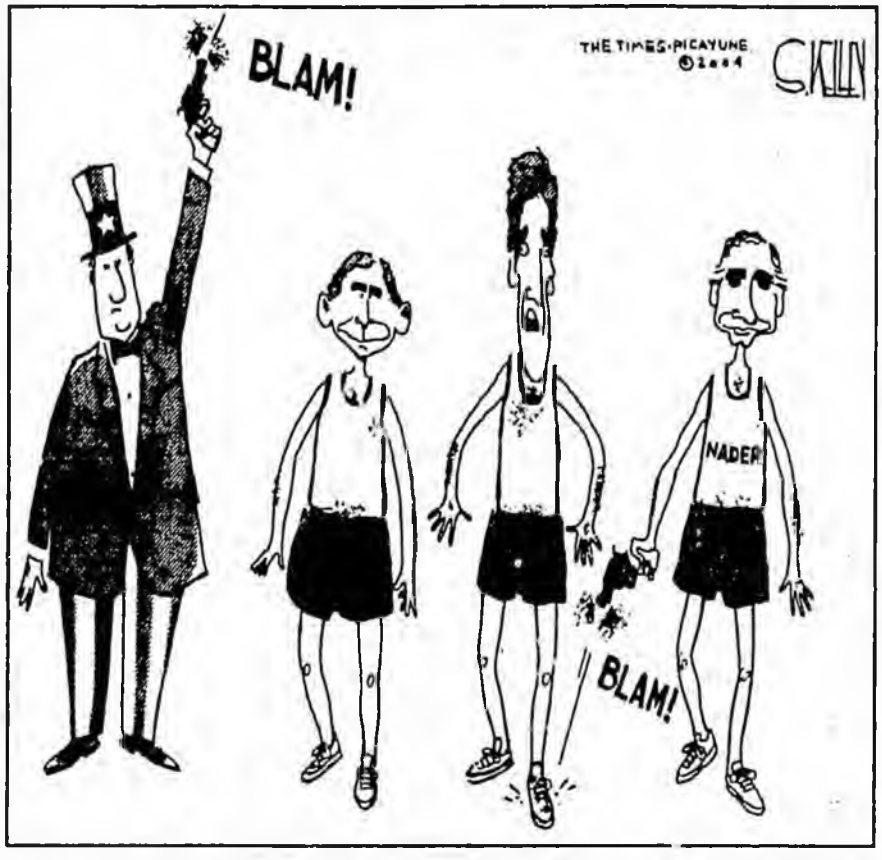
BRC:med:mdr
04-240.med

)ice of the Times
A CONSERVATIVE VOICE FOR ALASKANS

WILLIAM J. TOBIN
Senior editor

What happens if the lights go out?

By REP. CHERYLL HEINZE



Here's a question for you: Will the dwindling natural gas supplies and an aging electrical grid result in future widespread power outages in Anchorage and elsewhere?

The subject was front and center before a legislative meeting in Juneau last week.

The House Economic Development Committee was the forum for a debate on whether Kenai Peninsula and Cook Inlet gas, on which Anchorage depends, will be depleted before the aging electrical grid could be upgraded.

The problem is real. Eric Yould, executive director of the Alaska Power Association, posed this question:

"If we spend millions in the next few years upgrading the aging transmission lines and generators and have no gas to power the generators, then what?"

And this scary forecast came in a letter to the committee from Tony Izzo, president of Enstar Natural Gas Co.:

"Preliminary results from the Department of Energy show that as early as 2013 declining reserves in the Cook Inlet may not be enough to support home heating and power generation . . ."

And that, he added, could be the case even if the existing liquefied natural gas and fertilizer plants on the peninsula are closed and are no longer using big natural gas supplies.

A potential shortage of natural gas is far from the only threat.

Joe Griffith, CEO of Chugach Electric, said 22 generators power the entire electric grid that serves this area.

"Twenty of these," he said, "were built in the 1960s and have upwards of 200,000 hours on them. Just to replace the rotors in one of these generators costs over $2.5 million; to replace each generator would cost as much as $50 million each.

"Multiply that by 20 and you see the nature of the challenge."

Not only that, he said, "some of our transmission lines were built in 1958."

Are there alternative sources of power generation?

Not right away, in so far as committee members can determine.

Chugach Electric and Anchorage Municipal Light & Power are doing some investigative work on wind power, but the prospects are unclear.

Some suggest hydrogen power could be the salvation. The trouble is, the experts say, hydrogen power costs more to produce than it yields. Until better technology comes along, that's no lifesaver, however.

Jack Eckstrom, representing Evergreen, told the committee his company's plan to develop coal bed methane in the Matanuska Valley and other places in the state could offer an interim solution in a relatively short time.

According to Evergreen, coal bed methane reserves in Alaska might provide one-third to one-half of the 115 billion cubic feet of natural gas needed in the future.

That's the amount of natural gas that will be needed in just six to eight years, according to the experts.

The truth is that we're running out of time.

We don't have the answers we need, but we're going to keep looking.

One of the concerns is future financial stability of the various utilities.

To that end, we'll be holding additional hearings by the first part of March to examine actions by the Regulatory Commission of Alaska with respect to rates and operating margins.

Cheryll Heinze is a Republican member of the state House of Representatives from Anchorage.

The Anchorage Times
Editors: TOM BRENNAN, 264-8191; PAUL JENKINS, 264-8192; WILLIAM J. TOBIN, 264-8193.
Associate editor: JAN SINGYKE, 264-8107 • P.O. Box 100040, Anchorage, AK 99510 • FAX: 907-264-8194
• e-mail:AnchTimes@alaska.net

The Voice of the Times does not represent the views of the Anchorage Daily News. It is published under an agreement to preserve the separate editorial voice of the former Anchorage Times.

INFRASTRUCTURE

5.1) A Resolution Supporting the Authorization of a JAA for State Electric Infrastructure Assets

The Alaska Industrial Development and Export Authority/Alaska Energy Authority is the owner of the Bradley Lake Hydroelectric Project and Alaskan Intertie. These assets are currently managed and funded by the Railbelt utilities through the Intertie Operating Committee and the Bradley Lake Project Management Committee, respectively. The Railbelt utilities are made up of a combination of cooperatives and municipalities.

AIDEA has expressed an interest in divesting itself of these electrical projects to interested utilities in the Railbelt. It would be in the best interest of the Railbelt utilities to have common ownership of these electrical projects that will provide a funding mechanism for necessary maintenance, capital improvements and repair of these projects. The Joint Action Agency is a formal organization recognized by the State of Alaska that is particularly useful for organizations that include municipalities and cooperatives. Alaska Power Association strongly supports the authorization of a Joint Action Agency as a new entity to share ownership and manage assets that may be transferred from AIDEA/AEA.

5.2) A Resolution Urging Support for Development of Regional Electric Energy Projects

A stable and affordable electric infrastructure is vital to the economic stability of Alaska's communities and to their abilities to compete economically in national markets. The development of large projects, such as regional transmission inerties and capital intensive power projects that allow communities to realize economy of scale from such projects, are well beyond the financial capability of individual utilities and their ratepayers. In addition, many rural communities have no foreseeable opportunities to interconnect to a transmission system that will allow them to significantly lower electric rates. The economic health of these communities is very dependent on the rate relief that Power Cost Equalization helps to provide.

The State of Alaska has established a comprehensive Electric Energy Task Force to develop Railbelt and Rural Electric Energy Plans. Alaska Power Association (APA) strongly endorses this action by the State, and looks to the Governor and Legislature to provide the requisite appropriations needed to implement the regional infrastructure elements of the plan and to continue full funding of PCE.

ASSOCIATION

6.1) A Resolution Honoring the Memory of Representative Ramona Barnes

Ramona Barnes served 18 years in the Alaska State Legislature, representing the citizens of District 22 in Anchorage. During that time, she became familiar with the challenges of the electric utility industry and evolved into a staunch supporter of rural electric utilities in their overriding goal of supplying affordable, reliable electric power to their owner-members.

The Alaska Power Association Board of Directors and members will deeply miss Representative Barnes--her staunch support for the Railbelt energy fund, her compassionate support for the Power Cost Equalization fund for rural Alaska, and her tenacious dedication to her constituents throughout the entire state. She was the first female Speaker of the House; the first female to have held every leadership position in the Alaska Legislature, and the longest serving woman legislator in state history. Alaska Power Association expresses its deepest condolences to the family of Ms. Barnes and it remembers the legacy this great legislator left for all Alaskans.

CITY OF SEWARD
P.O. BOX 167
SEWARD, ALASKA 99664-0167

- Main Office (907) 224-4050
- Police (907) 224-3338
- Harbor (907) 224-3138
- Fire (907) 224-3445
- City Clerk (907) 224-4046
- Engineering (907) 224-4049
- Utilities (907) 224-4050
- Fax (907) 224-4038

March 8, 2004

Representative Tom Anderson, Chair
House Labor and Commerce
Alaska State Legislature
State Capitol (MS 3100)
Juneau, AK 99801-1182

Re: House Bill 453

Dear Representative Anderson;

Please accept this letter of opposition to House Bill 453 from the City of Seward, Alaska for the following reasons;

1. We have no objection and will encourage wherever we can the formation of joint action agencies (JAA's) to construct new generation;

2. We are definitely opposed to exempting JAA from RCA regulations. We've been told such action would have no effect on retail rates, but if wholesale rates (contracts) are unregulated, the JAA can charge what they wish and the rate to the purchasers will go up, forcing us to raise retail rates. We are certainly willing to pay a fair price, but not at the expense of supporting retail customers of the JAA;

3. If the City of Seward is not a member and participant of the JAA, then regulation by RCA is a necessity.

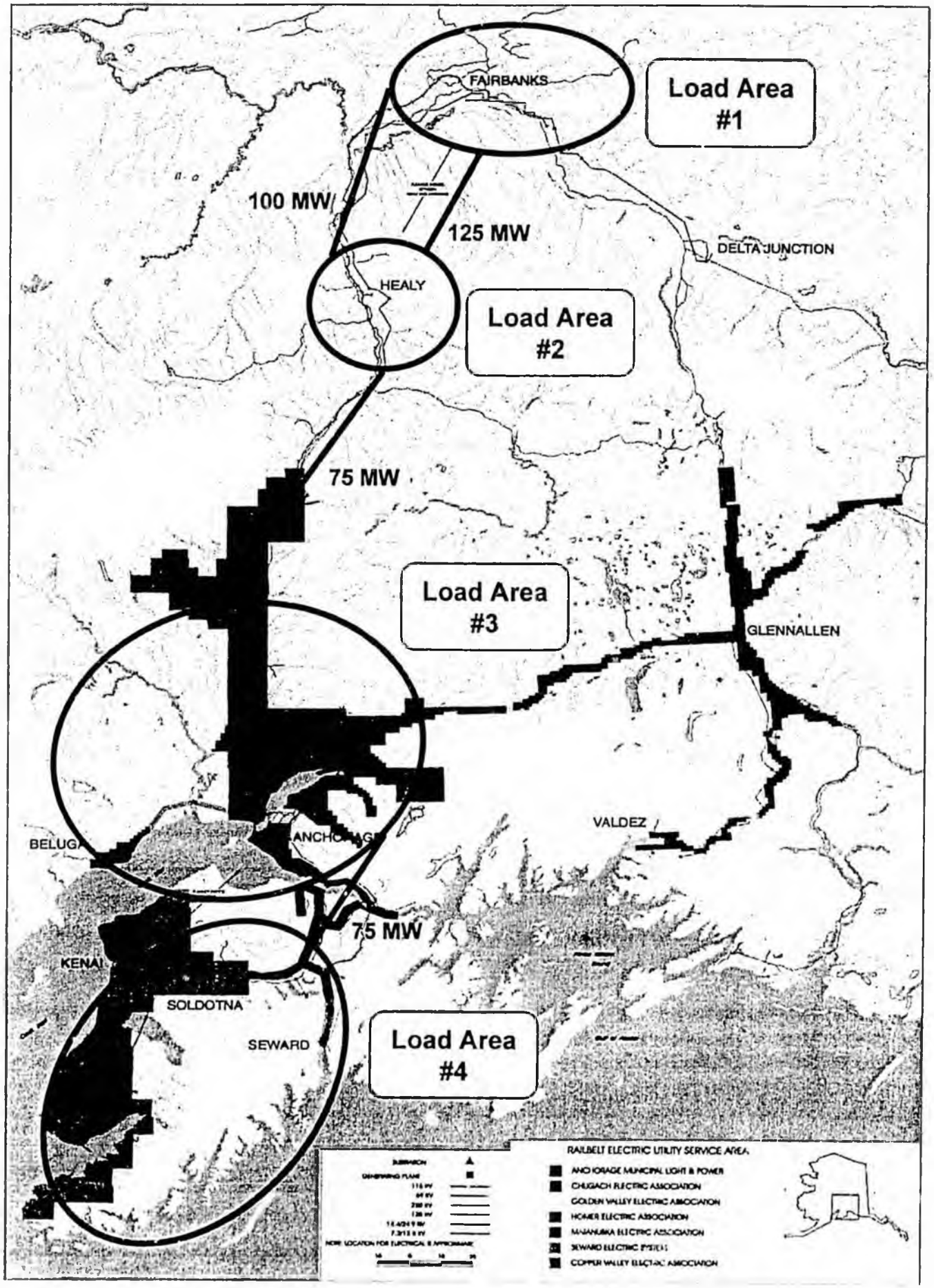
Thank you for considering our concerns regarding House Bill 453. If you have any further questions, please contact either myself and or Dave Calvert, Manager of the Seward Electric Utilities for further information.

Sincerely,
CITY OF SEWARD

Philip C. Shealy
City Manager

cc: Mayor and City Council, Kent Dawson, Dave Calvert.

Railbelt Energy Study



NAVIGATION

MENU

- Home
- Focus
- In this Issue
- Calendar
- Bulletin Board
- Movers & Shakers
- Business History
- Archive
- Around the World
- Legals & Classifieds
- Viewpoint
- Profile
- Cartoons
- Contact Us
- Advertise with us
- Subscribe
- About Us
- Submit Classifieds
- Oil & Gas

COLUMNS

- Wealthbuilders
- Tech Watch
- Fish Factor
- Law Page
- Travel Insight
- Philanthropy
- Property Wise

SPECIAL SECTIONS

- Top 25
- Top 40
- Book of Lists
- Wellness

WEATHER

-25° 12° 10° 19° 30° 37° 34° 39° 45° 39° 42°

Choose City

- Email Newsletter
- Palm Pilot Delivery
- Letter to the editor
- Comments

Business Calendar

Monday, February 23, 2004

Feb	M	T	W	T	F	S	S
	23	24	25	26			

in this issue

Web posted Monday, February 23, 2004

Energy group suggests single Railbelt operator

By Tim Bradner
Alaska Journal of Commerce

A state task force assigned to tackle a broad range of electric power generation issues in Alaska has issued its first report to the Legislature and is hard at work on a second report due in March.

Anchorage businessman Mike Barry, who chairs the Alaska Energy Policy Task Force, told the House Special Committee on Economic Development that the group reached consensus on a number of long-term issues affecting the Southcentral-Interior Alaska "Railbelt" power grid, but avoided several contentious short-term issues.

Eight representatives of Alaska power utilities, including several from the Railbelt, were named to the task force last year by Gov. Frank Murkowski along with Barry, who is also chairman of the state's Alaska Energy Authority.

Barry told legislators that the major long-term recommendation on which the group reached consensus in the first report was that a single operating entity should be formed among the Railbelt utilities to operate the grid as a single system.

an ad hoc arrangement for cooperation that exists now among the different utilities and the state. The Alaska Energy Authority owns

electric power assets like the Bradley Lake hydroelectric plant near Kachemak Bay and the aging electric intertie which transfers power from Southcentral to Interior Alaska.

Another recommendation by the task force is that the state and the Railbelt utilities address replacement of aging power generation and transmission facilities, some of which are nearing 50 years of age, Barry told the House committee.

The task force also urged the state to assist the utilities in renewing their aging skilled workforce by investing more funds in technical education and training. Many skilled workers in the electric power industry are nearing retirement and there are not enough young people entering training to replace them.

However, the task force avoided one pending power generation issue because there would be disagreement. That is what to do with the mothballed 50 Megawatt Healy Clean Coal Project, a new-technology coal power plant at Healy that is owned by the state.

The plant has been idle since late 1999 because of an ongoing disagreement between the state and Golden Valley Electric Association, the Interior Alaska utility which had agreed to operate and buy power from the plant.

Barry told the House committee that a single operating entity for the Railbelt grid could take responsibility for the system as a whole. The different utilities, such as GVEA in the Interior and Chugach Electric Association in the Southcentral region, now have responsibility for their own areas.

There are a number of cooperative agreements for power sharing among the utilties but the contracts differ, which is an inefficient arrangement.

"This is one power grid and we have to make sure it works," he said. "We need to have a centralized system, so that every time we have to finance a replacement or repair we don't get into a complex renegotiating of amendments to existing contracts."

"When that happens the utilities are tempted to try to gain advantages over each other, and the state may not have the expertise to broker these disputes," Barry said.

The utilities have the expertise to operate the grid on a day-to-day basis but it should be done by one entity, he said. A single operator organization could be done in several ways, but the utilities also have sharp differences among themselves over different ways of doing it.

Barry urged the Legislature to let the utilities work out the disagreement among themselves and make a recommendation for a single operator arrangement to the state because it will require legislation.

Some Railbelt utilities are now lobbying legislators to adopt their favored versions of single operator arrangements, but on behalf of the task force Barry warned against the Legislature imposing one or another type of single operator arrangement on the Railbelt utilities.

The task force is now working on a set of recommendations on power generation issues outside the Railbelt, including rural Alaska. That is due in March.

Rep. Cheryll Heinze, R-Anchorage, chairman of the House special committee, told Barry the task force should also consider sources of energy in its discussions, including the pending shortage of natural gas in Southcentral Alaska.

Another member of the committee, Rep. Harry Crawford, D-Anchorage, said he would like to see more discussion of renewable energy.

Barry said the task force will have more information on renewable energy in its second report in March. Renewable energy is important for several rural Alaska utilities, he said.

Final Report

Railbelt Energy Study

Ater Wynne LLP

January 15, 2004

R·W·BECK

EXECUTIVE SUMMARY

During June 2003, five of the six Railbelt utilities[1] agreed to jointly undertake a Railbelt Energy Study (RES). At the request of the utilities, the law firm Ater Wynne LLP contracted with the economic/engineering consulting firm R. W. Beck in August 2003 to perform the study. This report is a summary of the activities completed during the study, and the results of these activities.

Background and Objective

The participating utilities have several motives for conducting the RES:

- All of the thermal generating capacity in the Railbelt is more than 20 years old, and much of it is more than 30 years old. The utilities need to determine during the next several years whether to retire these units or make the investments in them required to extend their lives. If they decide to retire the units, they also need to decide what new generating capacity, if any, they should build to replace the units.
- During the next few years, several of the utilities may need to build new capacity to satisfy load growth.
- The utilities recognize that it may be both less costly and less risky to develop and operate new generating units jointly or collectively than to undertake these efforts separately.
- The utilities have several opportunities, such as restarting the Healy Clean Coal Project, constructing the Southern Intertie, and developing the Emma Creek Coal Project, that would provide benefits to (and impose costs on) more than one utility. As a result, the utilities recognize that decisions about these opportunities should reflect the joint or collective interests of the Railbelt utilities.

The objective of the RES is to identify the combination of generation and transmission (G&T) capital investments in the Railbelt through 2033 that 1) minimize future power supply costs and 2) maintain current levels of power supply reliability. The investments are to be identified taking into account uncertainty about future loads, fuel prices, and resource options, and assuming that the six Railbelt utilities act collectively. There are three important points to make about this objective:

- The RES is a *study*, not an Integrated Resource Plan (IRP). Each utility will still need to perform an IRP or Power Supply Plan, in order to identify appropriate

[1] The five participating utilities are Anchorage Municipal Light & Power (ML&P), Chugach Electric Association (Chugach), Golden Valley Electric Association (GVEA), Homer Electric Association (HEA), and Seward Electric System (SES). Matanuska Electric Association (MEA) was invited to participate but declined. Although MEA did not participate in the study, data for it has been included in the study, and the identified G&T capital investments reflect the need to serve its load.

The Alaska Energy Policy Task Force

Created by the 23rd Alaska Legislature

Legislative Resolve No. 24, 2003

Task Force Members

Mike Barry, Chair
AIDEA/Alaska Energy Authority
Chairman of the Board

H.A. Red Boucher
Vice Chair
Alaska Wireless Technology
Chugach Electric Association
Board Member

Tom Boutin
Alaska Department of Revenue
Deputy Commissioner

Dave Carlson
Southeast Conference
Intertie Coordinator

Wayne Carmony
Matanuska Electric Association
General Manager

Rick Eckert
Homer Electric Association
Interim General Manager

Steve Haagenson
Golden Valley Electric Association
President/Chief Executive Officer

Meera Kohler
Alaska Village Electric Cooperative
President/Chief Executive Officer

Robert Wilkinson
Copper Valley Electric Association
Chief Executive Officer

Staff Coordinators

Becky Gay, Legislative Staff
Speaker of the House Pete Kott
Senate President Gene Therriault
269-3024 *bgay@aidea.org*

Bernie Smith
AIDEA/Alaska Energy Authority
269-4643 *bsmith@aidea.org*

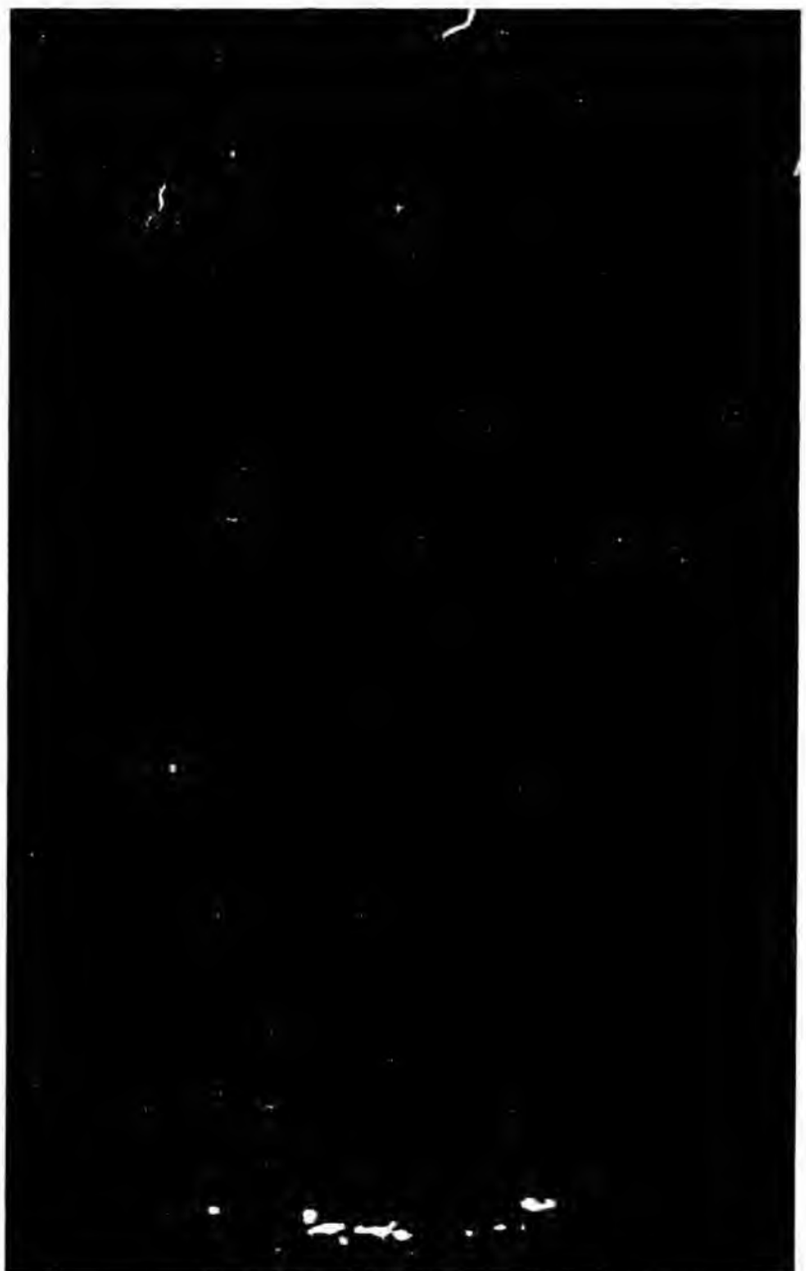


Photo by Yutaka Suzuki, AK Division of Tourism

Headquartered at AIDEA/Alaska Energy Authority
813 W. Northern Lights
Anchorage, AK 99503
907-269-3000
Fax: 269-3044
http://www.aidea.org/EnergyTaskForce.htm
In State toll free: 1-888-300-8534

Utilize Alaska's abundant renewable resources in the production of hydrogen.

Executive:

Convene a workshop to discuss the potential for Alaska's leadership in hydrogen production. Such a workshop could serve as an educational tool and a platform for discussion between public, university research and private sector individuals and organizations.

Direct the University of Alaska and executive agencies to inventory ideal locations for future renewable energy generation sites that could be used as a source of hydrogen for in-state use and export.

3. Energy Infrastructure

The Task Force's goals and strategies focused on matters including, but not limited to: (1) infrastructure; (2) transmission and distribution; and (3) economic efficiency. As the electrical system ages, increased concerns about reliability and stability and needs for technology-driven system improvements will be required. In addition, the long-range need for a hydrogen-based infrastructure to support fuel cell technologies provides yet another opportunity for expansion in energy infrastructure. There must exist within the State the capacity to deliver resources and energy to end-users, whether within or outside of the State's boundaries.

Stimulate private-sector participation in its energy infrastructure to allow greater energy export capability to meet state, regional, and national energy demands.

Executive:

Provide tax-exempt bonding to fund projects, much like the Bradley Lake Hydroelectric financing model, with the State retaining only the obligations that cannot be transferred to the participating utilities.

Through AIDEA/AEA, support and encourage the formation of a Railbelt unified operations model that would operate in a consolidated manner and allow the most Alaskans to benefit from projects funded through the use of tax exempt financing.

Work with Alaska's Congressional delegation to provide financing or economic incentives to promote energy infrastructure development.

Encourage Railbelt utilities to establish a unified system by providing incentives such as conduit financing for Railbelt infrastructure.

Encourage adequate transmission infrastructure to increase economic development activity.

Conduct an assessment to identify the State's energy infrastructure security needs.

Executive:

The RCA should include in their deliberations the issue of cyber-security.

Private Sector:

Continue in the joint planning process to identify the State's energy infrastructure needs.

Encourage adequate and secure transmission infrastructure to increase economic development activity.

Continue to promote adequate fuel delivery infrastructure.

Assess the potential for the development of a locality into a sustainable energy community that utilizes novel distributed and/or renewable energy systems for residences and commercial enterprises.

Executive:

Examine the potential for the development of an Alaska locality into a sustainable energy community.

Legislative:

Examine opportunities to provide support for the development of such a community.

Alaska regional transmission planners should work to become leaders in energy infrastructure development.

Private sector:

Establish energy infrastructure development projects that will promote the reliable transportation of electricity throughout Central and Interior Alaska, both on and off the Railbelt system, that meets the State's energy, environmental and economic needs.

Define and establish a unified system operator for the Railbelt.

4. Regulatory

Streamline all licensing, permitting, and regulatory processes of energy projects.

Executive:

Review agency practices regarding the licensing, permitting, and regulatory processes of energy projects. These agencies could also review the licensing, permitting, and regulatory processes of energy projects in other states so as to develop a study of best practices regarding these issues.

Establish and maintain regulatory processes that are consistent and have defined processing timelines and encourage utilities to maintain long-term financial health.

Legislative:

Enact appropriate legislation for the implementation of best practices regarding the licensing, permitting, and regulatory processes of energy projects.

Private sector:

Provide input to the Executive and Legislative Branches to implement best practices regarding licensing, permitting, and regulatory processes of energy projects.

C. Long-term Energy Needs

Findings

The Task Force adopted the definition of long-term as 20 years or more. The energy requirements of the Railbelt are expected to increase 39% over that time. Certain needs emerged from Task Force discussions and public testimony. Within the next 20 years, it was determined that Alaska needs to:

- **Create secure and reliable transmission between load centers**
- **Provide energy infrastructure for economic development**
- **Identify and evaluate long-term fuel sources**
- **Establish a unified system operation**
- **Connect new areas to the Railbelt grid**
- **Replace aging generation**
- **Replace an aging workforce**

D. Recommendations

Specific recommendations of how to fulfill future needs were as follows:

- Structure implementation of a unified Railbelt system operator.
- Support increased vocational trade schools, higher education and training of technical and professional utility career staff and management.
- State grants or financing should give priority to unified Railbelt system operation and expanding the grid along the road system, i.e., the "Roadbelt."
- Where common projects are identified as the most cost effective energy solutions, encourage financial risk sharing among utilities through a model similar to the Bradley Lake Project agreement.
- Increase the proportion of renewables in long-term fuel sources. Renewables include hydroelectric generation.
- Loop the existing Railbelt energy grid to improve system reliability and serve new markets. See map for details.
- Advance the physical and cyber security of the critical electrical infrastructure in Alaska.
- Strive to have nationally competitive electrical rates.

E. Long-term Railbelt Projects

For details see Appendix D.

III. STATE-OWNED RAILBELT ENERGY ASSETS

Findings

The Task Force supports the transfer of AIDEA/AEA electrical assets in a manner that recognizes existing contracts. Current state ownership of energy assets should be transferred to a Unified System Operator to support the cooperation of the utilities in that endeavor. The Task Force recommends the state should provide financing through AIDEA/AEA to assist development of future generation and transmission. Through AIDEA/AEA, the State owns three Railbelt energy assets, as follows:

A. The Bradley Lake Project

The Bradley Lake Project is located in south central Alaska at the southern end of the Kenai Peninsula. The project includes a 610-foot long, 125-foot high concrete-faced and rock-filled gravity dam, a 3.5-mile power tunnel and steel-lined penstock. The project transmits power to the state's main power grid via two parallel 20-mile transmission lines. The project, which cost approximately $328 million (including reserve fund balances), went into commercial operation in 1991. Homer Electric Association under contract with AEA now operates the project. Bradley Lake serves Alaska's Railbelt from Homer to Fairbanks as well as the Delta Junction area. The Bradley Lake Project Management Committee oversees operation and maintenance duties.

B. Alaska Intertie

The 170-mile transmission line that runs approximately between Willow and Healy is the state-owned portion of the 300-mile Anchorage to Fairbanks transmission system. It is rated at 345 kV and operates at 138 kV. The Intertie allows GVEA to purchase lower cost energy from Anchorage and the Kenai generated from natural gas and the Bradley Lake hydroelectric project. CEA and ML&P generate revenue from the sale of economy energy to GVEA. The Intertie Operating Committee oversees operations and maintenance duties.

C. Healy Clean Coal Project (HCCP)

The Healy Clean Coal Project grew out of a nationwide competition sponsored by the U.S. Department of Energy (DOE) to test new technologies aimed at solving the international problem of acid rain. Alaska was one of 48 applicants selected for 13 grants. The project is located adjacent to GVEA's existing Healy No. 1 power plant, which was constructed in 1967. General construction of the power plant began in May 1995 and was completed on November 21, 1997. A 90-day test of the power plant was completed in December 1999. HCCP has been idle since the completion of that test. After several engineering studies, AIDEA continues to pursue all options for getting HCCP into operation and selling power

IV. INDUSTRY AND /OR GOVERNMENT ACTIONS

Findings

To efficiently energize Alaska's economic development, the Task Force believes that the Railbelt utilities should develop a unified system operation. If there are legislative or regulatory issues, utilities should work cooperatively to determine actions needed to implement the unified system details. Different forms of unified systems operations may be used by the various utilities. The Task Force proposed the following examples.

A. Unified System Operations

Power Pooling:

Definition: "Two or more interconnected electric systems planned and operated to supply power in the most reliable and economical manner for their combined load requirements and maintenance program."
Source: Edison Electric Institute
Power pooling systems are usually set up in one of two ways; a member of the system takes on the role of the system operator or an independent operator is established. Power pools allow for better utilization of resources to meet the aggregated load. Better utilization of resources leads to lower production costs and more economical capital improvement plans. Power pools inherently share knowledge, which if transition to competition is imminent, will help smooth the process and automatically create a more level playing field.
Source: R.W. Beck Railbelt RES Scope of Work
The greatest benefit from a power pool assumes the utilities jointly meet capacity requirements and jointly dispatch as if they were one utility.

Joint Action Agency (JAA):

Defined in AS 42.45.300 as "Two or more public utilities may form a joint action agency for the purpose of participation in the design, construction, operation, and maintenance of a generating or transmission facility and to secure financing for carrying out the design, construction, operation, and maintenance of the facility. A JAA may request AIDEA to issue revenue bonds for projects of the agency. A joint action agency has the powers of a public utility under AS 42.05." The statute broadly defines "public utilities"—includes any corporation or cooperative that owns, operates, manages, or controls any plant, pipeline, or system for furnishing, by generation, transmission, or distribution, electrical service to the public.

Generation &Transmission Cooperative (G&T):

A G&T is a cooperative organization comprised of one or more utilities that plan, operate and maintain G&T facilities for the benefit of the member utility systems. The G&T governing board consists of members from each member utility. It is owned by several distribution utilities to provide for their power

supply needs, including in some cases ownership of generating plants and transmission lines. This is the method of unified operation that is most commonly employed by distribution cooperatives across the United States.

B. Other Tools

Integrated Resource Planning (IRP):

The National Energy Policy Act (NEPA - 1992) defined integrated resource planning and directed states to use that process as the starting point. "The term 'integrated resource planning' means a planning process for new energy resources that evaluates the full range of alternatives, including new generating capacity, power purchases, energy conservation and efficiency, cogeneration and district heating and cooling applications, and renewable energy resources, in order to provide adequate and reliable service to electric customers at the lowest system cost."

Title 42 of the Alaska statue authorizes the formation of a JAA (Joint Action Agency)

Joint Action Agency: Sec. 42.45.300

Two or more public utilities may form a joint action agency for the purpose of participation in the design, construction, operation, and maintenance of a generating or transmission facility and to secure financing for carrying out the design, construction, operation, and maintenance of the facility. A joint action agency may request the Alaska Industrial Development and Export Authority to issue revenue bonds for projects of the agency. A joint action agency has the powers of a public utility under AS 42.05

SEATTLE-NORTHWEST
SECURITIES CORPORATION

1420 Fifth Avenue
Seattle, WA 98101
206/628-2876 Fax: 206/3432103
425/391-6900 Fax: 425/391-1080

March 22, 2004

TO: Representative Cheryll Boren Heinze
907/~~269-0177~~
465 - 3834

FROM: Christine Hein Pihl

PAGES: 10, including cover

Attached are copies of the inserts from my remarks. I will send you complete copies of these reports in the next few days (if you need them sooner, please let me know).

Good luck today!

C

STANDARD & POOR'S | RATINGSDIRECT

Return to Regular Format

Research:

Public Finance Report Card: Public Power

Publication date: 21-Jan-2004

Credit Analyst: Peter V Murphy, New York (1) 212-438-2065; David Bodek, New York (1) 212-438-7969

Rating trends for the public power sector remain stable despite the increased risk and uncertainty in the overall U.S. power industry. Standard & Poor's Ratings Services has 235 ratings in the public power sector, with the overwhelming majority carrying investment-grade ratings, and only five ratings below investment-grade. Of the five ratings below investment-grade, four are California irrigation districts and water agencies whose bonds are rated 'B+' based on contracts with Pacific Gas and Electric Co. for the output of a specific power project. The other non-investment-grade-rated credit is Guam Power Authority, rated 'BB+/CreditWatch Negative'. The overall credit strength of the public power is further demonstrated by the rating distribution, with about 80% of credits rated at least 'A-' and 21% of ratings reaching the 'AA' category. The public power sector includes municipally owned electric utilities and combined, or multi-segment, utilities, as well as joint action agencies consisting of two or more participating utilities. Ratings are as of Jan. 20, 2004.

Since the last report card ("Public Finance Report Card: Public Power and Cooperatives", RatingsDirect, May 27, 2003), the sector has continued to experience overall credit stability, with only a handful of rating changes, despite ongoing industry turmoil on the investor-owned and merchant sectors. Aside from the sector's traditional strengths, the stability of the sector in the past year resulted from relatively low volatility in commodity prices for both fuel and power as compared with the prior three years, and from improved hedging activity that mitigated the impact of price swings. Rising power and fuel prices had resulted in weakening coverage and liquidity, and consequently, slight rating deterioration, in 2001 and 2002.

Traditional strengths of the sector that provide a solid credit foundation include the autonomy of public utilities' governing bodies in rate-setting and recovering costs (although there are exceptions, such as the requirement that Tennessee Valley Authority (TVA) distributors gain approval of TVA for rate increases above 2% and the state of Wisconsin, whose municipal electric utilities must file rate cases); the focus on core businesses and core mission to serve their customers; and for the most part, the absence of direct competition for retail customers. The absence of state or federal rate regulation enables these utilities to enact and implement rate increases or rate cuts quickly and as necessary in response to a changing cost or competitive structures, provided the willingness to do so exists. This is not often not the case for their investor-owned counterparts. Most public power utilities continue to operate as vertically integrated utilities and either own or have secured, through long-term contracts, sufficient generation to meet native-load demand, which is generally their main focus.

With regard to retail competition, where deregulation of the retail electric industry has moved forward, the enabling legislation has not required municipally owned utilities to compete directly for their native customers. Rather, these public utilities may choose open their service territories, a rare occurrence. As a result, the customer bases in the public sector have remained intact, which is very supportive of credit quality. However, in cases where public utilities' service territories have historically been multiply certified, the importance of being able to compete on price and on other measures has become heightened. Notable in this regard is Lubbock Power and Light (LP&L), the electric utility owned by the city of Lubbock, Texas. For over 80 years, LP&L has competed directly with an investor-owned utility (Southwest Public Service, or SPS, a unit of Xcel Energy Inc.) and typically held a strong market share. In the past year, however, due to an uncompetitive cost structure and competitive pressures that affected rate-making decisions, LP&L experienced operating losses and greatly reduced liquidity, and saw more than 5% of its customers switch to its direct competitor. Consequently, the rating was lowered to 'BBB-' from 'A+'. In contrast, Cleveland, Ohio also competes directly with an investor-owned utility but retains a rate advantage and has posted net gains in the number of meters. Cleveland's electric revenue bonds are rated 'A-'.

STANDARD & POOR'S UTILITIES

Publication date: 08-May-2003
Reprinted from RatingsDirect

Survey of State Regulators Reveals Focus on U.S. Utilities' Financial Strength

Credit Analyst: Richard W. Corright, Jr., New York (1) 212-438-7665

A recently completed survey of state regulators by RKS Research & Consulting on behalf of Standard & Poor's Ratings Services revealed significant shifts in regulator priorities since the previous survey of January 2001. The feedback from the interviews, which polled 47 different jurisdictions, placed financial issues as the most important consideration for regulators, followed by federal-state jurisdictional disputes, and generation and transmission resource adequacy. Other topics included reliability and power quality issues, service obligations, and subsidization of affiliate transactions. Regarding concerns over the next five to 10 years, respondents focused on jurisdictional clarity and resource adequacy, which would indicate that financial concerns are expected to dissipate in this timeframe. Two years ago, the primary issues noted by regulators were considerably different: the development of distributed generation and service reliability led the list, followed by transmission issues.

The responses indicate that utilities' financial profiles matter greatly to state regulators, at least in the short term. Regulators overwhelmingly stated that utilities need to maintain strong financial profiles. In fact, regulators highlighting this concern increased threefold, and more than a third expressed extreme concern for utilities' financial health, compared with less than 10% in 2001. Along with this position was the view by almost half of the respondents that utilities had weakened during the past three years, particularly those in the Midwest and the West. Reasons cited for this included the economic downturn, bad investment decisions, holding company/affiliate transactions, and the fallout from the California and Enron Corp. crises. However, about half of the Northeastern state regulators believe that utilities have actually strengthened reflecting the conversion of many utilities to basically lower-risk transmission and distribution companies. Not surprisingly, only half of all commissioners said they had as much confidence in the integrity of utility financial statements compared with a few years ago. Interestingly, a measurable number--17%--indicated a higher confidence level in financial statement quality; 26% have less confidence.

State regulators clearly expect to be more involved in monitoring utilities in their jurisdictions. However, while utilities' financial conditions and more specifically, their insulation from nonregulated activities, ranked first among the most pressing issues, opinion is evenly divided regarding whether current laws provide the appropriate enabling authority for regulators to ensure that utilities are not adversely affected by unregulated affiliates.

Other issues of note include:

- Deep jurisdictional disputes with the FERC over Standard Market Design (SMD). The majority consider SMD fatally flawed and that it will lead to wide inequities between high- and low-cost electricity regions. Respondents highlighted inflexibility, cost-shifting among states, and whether any compelling

STANDARD &POOR'S | RATINGSDIRECT

Return to Regular Format

Research:

Chugach Electric Association, AK Underlying Rating Placed on Watch Negative

Publication date: 28-Feb-2003

Credit Analyst: Leo Carrillo, San Francisco (1) 415-371-5077; Kathryn Mock Masterson, San Francisco (1) 415-371-5009

SAN FRANCISCO (Standard & Poor's) Feb. 28, 2003--Standard & Poor's Ratings Services said today it placed its 'A' underlying rating (SPUR) on Chugach Electric Association, Alaska's approximately $394 million in bonds outstanding on CreditWatch with negative implications partially due to the latest rate order from the Regulatory Commission of Alaska (RCA). The insured ratings on the bonds remain unaffected by the CreditWatch listing.

The latest RCA rate order is expected to reduce debt service coverage and could trigger a violation of Chugach's rate covenants. Standard & Poor's had already expressed concern that Chugach's coverage of interest was relatively weak for a utility with mostly non-amortizing debt and that lower coverage margins could result in lower ratings," said Leo Carrillo, credit analyst with Standard & Poor's. "In addition to substantially weakening debt service coverage, the RCA's rate order signals heightened regulatory and refinancing risk for the utility."

Chugach has petitioned the commission to reconsider its decision, which the RCA has partially granted. A final determination may come as early as the end of March 2003. If a sufficiently favorable order is not forthcoming, Standard & Poor's expects that it will downgrade the utility.

Chugach is an electric cooperative serving two-thirds of Alaska's population. It faces no competition from investor-owned utilities; its only meaningful competition is the municipal utility serving Anchorage, Anchorage Muncipal Light & Power.

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Fixed Income in the left navigation bar, select Credit Ratings Actions.

Chugach has approximately $394 million in bonds outstanding as of Dec. 31, 2002. The bonds are unsecured obligations of Chugach, supported by revenues from its wholesale and retail power sales operations. Permissive legal provisions exempt Chugach from maintaining a debt service reserve account on any of its unsecured debt.

Chugach's business profile score is a '4' on Standard & Poor's 10-point scale, with "1" being the highest score. Chugach is Alaska's largest electric utility, with 61,000 retail customers and approximately 50% of the state's total generating capacity in a region with no outside transmission access. Chugach serves a moderately urban and growing service territory, with retail sales accounting for 64.8% of revenues in 2001 and residential customers accounting for 32.9% of revenues. Chugach faces no competition from investor-owned utilities, and its only meaningful competition is the municipal utility serving Anchorage, Anchorage Municipal Light & Power (MLP). Although Chugach's rates, at 4.9 cents per kWh, are only slightly above the regional average, contentious relations with the utility's two largest wholesale customers continue to distract management. The two wholesale customers have a history of pursuing regulatory and legal action in an effort to suppress Chugach's wholesale rates.

Financial performance was weak in 2002, with margin for interest coverage based on audited financials of less than 1.1x. Financial margins and interest coverage have diminished over the past two years, relative to historical levels. MFI coverage averaged 1.3x from 1996 to 2000, before falling to 1.2x or less in 2001 and 2002. Net operating margins (after interest) averaged $7.3 million from 1996 to 2000, versus only $3.6 million in 2002.

Dis

The recent decline in financial margins and the relaxing by regulators of Chugach's coverage target raises concern regarding regulatory support for the maintenance of Chugach's historically strong financial profile. In January 2003, the RCA issued a rate order that reduced Chugach's target times interest earned ratio (TIER) coverage level to 1.30x from 1.35x, requiring a rate refund for overcollection in 2000 and 2001. Following an appeal by the utility, the RCA revised its rate order, reducing the cost of the rate refund from an estimated $7.1 million to $[illegible].6 million. Chugach is absorbing the cost of the refund through its cash reserves, which exceeded $7 million as of Dec. 31, 2002.

Chugach expects to achieve MFI coverage of around 1.2x in 2003. Beyond 2003, MFI coverage remains above 1.3x, based on assumptions of 3% rate increases in 2004 and 2006. The projections also assume that the RCA will pass through to customers any increases in interest cost associated with Chugach's variable interest rate debt. Standard & Poor's continues to regard the forecasted interest coverage as thin for a utility with mostly non-amortizing debt.

Debt is high, but manageable, with a total debt-to-capital ratio of 75% as of Dec. 31, 2002, although Standard & Poor's considers the debt structure itself to be aggressive. Chugach's heavy reliance on non-amortizing debt introduces a significant level of refinancing risk to an otherwise moderate debt profile. The use of variable rate debt contributes to interest rate risk, especially given the utility's dependence on regulatory approval for recovery of rising interest rate costs. Chugach's $60 million in variable-rate debt represents 15% of its overall debt burden. With increased refinancing and interest rate risk inherent in its new debt structure, Chugach's need for financial flexibility has increased.

Overall liquidity is adequate, but cash reserves remain low, given the utility's relatively aggressive financial profile. Total liquidity, including unrestricted cash and undrawn credit lines, amounted to $77.3 million, or 214 days' cash, as of Dec. 31, 2002. Chugach maintains over $70 million in lines of credit with CoBank and National Rural Utilities Co-op Finance Corp, against which over $50 million remained untapped as of fiscal year end 2002. Cash reserves have remained flat at historical levels, with unrestricted cash reserves of around $7.3 million, or 22 days of operating expense at fiscal year's end. Chugach does not maintain a debt service reserve fund, and has no plans to develop a sinking fund with which to prepay principal payments on its non-amortizing debt. Interest earnings from $7 million in cash reserves will do little to dampen rising interest rate costs on the utility's $60 million in variable-rate debt.

■ Outlook

The negative outlook reflects Standard and Poor's concern regarding Chugach's ability to achieve sound financial margins going forward. Rating stability will hinge on Chugach's future financial performance and evidence of a clear strategy for managing risks associated with the utility's non-

(F)

serving Anchorage, Anchorage Municipal Light & Power (ML&P).

Chugach is unlike other G&T cooperatives Standard & Poor's rates in both its unique strengths and the challenges it faces. Chugach differs in that half of its sales are to retail residential meters, whereas most G&Ts are wholesalers only. Standard & Poor's views this as a credit strength, as the margins from serving these customers can be greater than those derived from wholesale or commercial industrial sales. Furthermore, in the event of retail choice (which does not appear imminent in Alaska), residential customers are less likely to choose an alternate provider than industrial and commercial customers. Retail customers in 2001 consisted of 47% residential and 53% commercial and industrial. Distribution cooperatives, mainly Matanuska Electric Association (MEA) and Homer Electric Association (HEA), take the other half of Chugach's power.

Chugach differs further from other G&Ts in that it has only one all-requirements contract: it is with MEA and ends in 2014. Most other G&Ts sell their wholesale power through all-requirement contracts extending for the life of outstanding debt. MEA purchased about 52% of Chugach's wholesale power in 2001. The contract with HEA is a take-or-pay contract of 73MW and [illegible],000 megawatt-hours (MWh) annually (42% of the wholesale energy sold in 2001).

Chugach's relationship with MEA is strained as it is in litigation with MEA in rate cases and the courts. The Superior Court of Alaska recently granted summary judgment to Chugach on several claims MEA filed, though MEA intends to appeal these to the state's supreme court later in 2002. While these issues may be small in terms of potential monetary damages to Chugach, they serve to highlight the adversarial nature of the relationship and the potential for further acrimony in the years ahead, both of which serve to distract management focus.

(F)

Chugach's rates are set not by it but by the RCA, whereas many other G&Ts set their own. This distinction leads to the concern that regulators could set Chugach's rates such that its financial covenants are met and no more, though experience to date suggests that regulators are generally supportive of credit quality, ~~in [illegible] resistance to efforts by MEA to reduce Chugach's rates to the the minimum covenant requirement of 1.20x the MFI requirement.~~

The series 2002A term bond, like series 2001, is non-amortizing debt. Approximately 70% of Chugach's outstanding principal will mature in 2011 and 2012. Bullet maturities also expose bondholders to refinancing risk, which many other cooperatives do not face because of their amortizing debt.

Chugach's finances are distinguished by high MFI, debt service coverage, and equity ratios. These ratios are estimated (through November 2001) at 1.20 times (x), 1.73x, and 26%, respectively, down slightly from 1.35x, 1.73x, and 29% in 2000. The drop can be attributed to a warm first quarter in 2001, a delay in getting a rate increase from the RCA, increased labor rates, and the 2001 refinancing. Projections forecast continued high debt service coverage over the next five years, but mainly because most of the outstanding principal comes due in 2011 and 2012. Standard & Poor's will expect continued strong coverage ratios; Chugach's coverage of interest is actually somewhat thin for a utility with mostly non-amortizing debt. Therefore, degradation of coverage margins, even by small amounts, could result in lower ratings.

Chugach's business position is a '4' on a scale of 1-10, with '1' being the strongest. The score reflects the cooperative's operational, managerial, and financial strength, but also reflects the difficult relations with MEA and the legal difficulties in which it is embroiled.

Outlook

The stable outlook reflects expectations that Chugach will continue to receive regulatory support for MFI ratio consistent with an 'A' rating for a utility with non-amortizing debt, and that current litigation will not harm the cooperative's financial health. The outlook also reflects expectations that Chugach will manage the now-substantial refinancing risk it faces through market purchases of outstanding debt, accumulation of funds, maintenance of strong liquidity, or some combination of the above.

Management

A seven-member board elected at large from Chugach's retail membership oversees the cooperative.

(G) Chuck 206-343-2103

Position Paper
Regulatory Commission of Alaska

HB 453 – "An Act exempting from regulation under the Alaska Public Utilities Regulatory Act wholesale agreements for the sale of power by joint action agencies and contracts related to those agreement, and joint action agencies composed of public utilities of political subdivisions and utilities organized under the Electric and Telephone Cooperative Act."

The Regulatory Commission of Alaska is opposed to HB 453. This legislation holds the potential to exempt from regulatory oversight most new electrical generation in the Railbelt in future years. The only effect of HB 453 is to provide an exemption from all forms of regulatory oversight – this legislation does nothing to otherwise enhance the functioning of joint action agencies or define their operations. From the perspective of the RCA, HB 453 provides no tangible or measurable benefits to the consuming public while at the same time creates significant potential for the abuse of monopoly power in Alaska's most capital intensive industry. (G)

The principal joint action agency under Alaska law is the entity created to manage the "four-dam pool" assets which were built with direct state appropriations in the 1980's. This agency has functioned reasonably well, but this has been the case because of the unique circumstances which caused its formation. Underpinning the formation of the four-dam pool joint action agency was the fact that all of the assets which were and are subject to agency management were *already constructed* and that agreements were *already in place* for the purchase and sale of wholesale power from those projects. In summary, the State, with heavy Legislative involvement, determined that these investments were appropriate and that management under the joint action agency concept was the preferred course for the administration of these facilities. AS 42.05.431 (c) grants an exemption to the four-dam pool agency from RCA jurisdiction but that exemption is of limited duration.

Why does that matter?

In stark contrast, the exemption proposed in HB 453 would extend to an unknown number of new joint action agencies for an undefined number of projects which have not yet been planned, constructed, financed or operated. Further, the exemption would be of unlimited duration.

If exempt from RCA jurisdiction, new electrical generation facilities in the Railbelt constructed under the auspices of one or more new joint action agencies would not be subject to ANY independent review as to (1) their necessity or prudence; (2) the reasonableness of their operating expenses; or (3) the rates to be charged for power produced from these facilities. The RCA believes that a grant of such sweeping authority would be unprecedented in Alaska's history.

(G) what if they maintain a credit rating?

(H) Chris Pihl 206-343-2163

Fitch Downgrades Chugach Elec Assoc Bonds to 'A'; Credit Watch Neg

Fitch—NY—October 30, 2003: Fitch Ratings has downgraded Chugach Electric Association, Inc.'s (Chugach) $330 million in outstanding senior unsecured bonds from 'A+' to 'A', and placed the debt on Credit Watch Negative. The rating represents an underlying rating as the bonds are insured by MBIA Assurance Corp., whose financial strength is rated 'AAA' by Fitch. The downgrade reflects a more negative position on the part of the Regulatory Commission of Alaska (RCA) with regard to its regulatory oversight of Chugach, and the likely tighter projected financial protection measures as a result. Fitch expects to resolve the Credit Watch status over the next 6-8 weeks, pending a meeting with Chugach management to review in greater detail projected impacts of the RCA's 2003 rate orders.

(H)

Historically, Chugach has benefited from consistently solid financial performance, competitive electric retail rates, diversified customer base, and a favorable regulatory framework. In addition, long-term, firm natural gas supply contracts have helped support good operating generation assets and, along with two hydroelectric power purchase contracts, have met the needs of a moderately growing service territory. Financial performance had been very stable through 2001, with debt service coverage ranging from 1.50x-1.85x, and times interest earned ratio (TIER) at 1.35x or higher. Chugach's balance sheet was similarly solid, with equity-to-total capitalization in the 24%-26% range since 1997. Chugach's key concern had been the ongoing discontent among its wholesale customers, but their attempts to change Chugach's operations and/or acquire the utility have consistently failed.

Fitch Downgrades Chugach Elec Assoc Bonds to 'A-'; Stable Outlook

12 Dec 2003 4:23 PM (EST)

Fitch Ratings-New York-December 12, 2003: Fitch Ratings has downgraded Chugach Electric Association, Inc.'s (Chugach) $330 million in outstanding senior unsecured bonds to 'A-' from 'A', and has removed the Negative Rating Watch. Fitch has assigned a Stable Rating Outlook. The rating represents an underlying rating as the bonds are insured by MBIA Assurance Corp., whose financial strength is rated 'AAA' by Fitch. The downgrade reflects a negative stance taken by the Regulatory Commission of Alaska (RCA) toward Chugach in 2003 and tighter projected financial protection measures as a result. The rating downgrade and removal from Negative Rating Watch follows a recent meeting with management updating Chugach's financial projections and management's prospective business and rate strategy.

Historically, Chugach has benefited from consistently solid financial performance, competitive electric retail rates, diversified customer base, and a supportive regulatory framework. In addition, long-term, firm natural gas supply contracts have helped support solid operating generation assets and, along with two hydroelectric power purchase contracts, have met the needs of a moderately growing service territory. Financial performance had been very stable through 2001, with debt service coverage ranging from 1.50-1.85 times (x), and times interest earned ratio (TIER) at 1.35x or higher. Chugach's balance sheet was similarly solid, with equity-to-total capitalization in the 25%-29% range since 1990. Chugach's key concern had been the ongoing discontent among its wholesale customers, but their attempts to change Chugach's operations and/or acquire the utility have not been successful. Beginning in early 2003, a series of RCA rate orders ensued which were uncharacteristically negative for Chugach and eventually led to the credit rating downgrade. On July 1, 2001, Chugach filed a general rate case with the RCA seeking a 6.5% rate increase, or net margins of $11.9 million. The additional revenues were needed to help fund capital expenditures, meet rising operating expenses, and build equity to 30%. Chugach was also requesting an interim rate increase of 4%. After rendering two rate decisions, the RCA eventually approved an interim rate increase of 3.97% (effective Nov. 1, 2001), but the RCA's decisions quickly deteriorated for Chugach thereafter.

Following an updated rate case filing by Chugach on April 15, 2002, to reflect lower interests costs for refinancing, whereby Chugach requested a lower base rate increase (5.7%) than originally filed, the RCA rendered its initial decision (Rate Order No. 26). RCA Order No. 26 resolved certain issues in Chugach's favor, but the financial adjustments were by and large more heavily weighted against Chugach including: (1) reduction in overall TIER from 1.35x to 1.30x (a loss in margins of about $1.3 million), (2) requiring that capitalized interest be offset against interest expense includable in the revenue requirement, (3) lowering recoverable interest expense on variable rate securities, and (4) shifting a larger portion of margin burden on retail users by reducing the allowable TIER for wholesale customers to 1.10x from 1.15x. In addition, Chugach would have to refund the interim rate increase collected since implementation (approximately $1.8 million for 2001 and 2002).

Pursuant to Order No. 26, Chugach's financial performance fell below the 1.10x TIER requirement and resulted in a net loss of $2 million for 2002. If the Order remained as is, Chugach would not meet the 2003 TIER requirement as well. Chugach subsequently filed a motion to stay the Order (Feb. 13, 2003), which the RCA granted in part, and also filed a Petition for Reconsideration on Feb. 28, 2003. Several RCA orders followed which reversed and/or clarified Rate Order No. 26. Key changes to Order No. 26, which were generally positive for Chugach, included: recoverable variable rate debt interest expense was returned to 3.8% level, recovery of certain legal expenses was allowed, and approved retail rate increase of 3.5% and wholesale rate decrease of 7.8% (+0.8 million annually, in aggregate). Conversely, the RCA did not alter the lowering of overall TIER to 1.30x, the lowering of wholesale customers' TIER to 1.10x, and the requirement that capitalized interest be offset against interest expense includable

S&P

recoup defaulted payments from nondefaulting members. This can be accomplished through intrayear budget adjustments.

Despite the budgetary and ratemaking tools that are generally available to co-ops, as fuel and electricity prices rose sharply in recent years, net revenues coverage of debt obligations slipped at several G&T co-ops that were reluctant to adjust wholesale rates to preserve the financial cushion associated with excess margins. In turn, the degradation of the cushion eroded bondholder and lender protection at these co-ops. Affected co-ops included Hoosier Energy and Seminole Electric, whose 'A' ratings were assigned negative ratings outlooks. Hoosier later implemented a power-cost tracker to reduce its market exposure. Alabama Electric's rating was lowered to 'BBB+' as a result of degraded coverage margins that reflected increased costs and the burdens created by its investment in a propane business. Self-regulation and the ability to adjust rates can only provide value that translates into creditor protection if a utility's board demonstrates the will to exercise that authority by adjusting rates to preserve sound credit quality.

S&P Feb 2004

J.

In some cases, ratemaking flexibility has been constrained by outsiders. Regulatory oversight of ratemaking has proved to be a challenge for several rated and unrated co-ops. Over time, the inability of some G&T co-ops to fully recover costs through rates because of regulatory barriers has led to bankruptcies ~~of G&T and distribution co-ops~~ like Wabash Valley, Cajun Electric, and Vermont Electric Co-op. Regulation does not necessarily lead to such drastic results and many regulators have been supportive of the co-ops that are under their jurisdiction. Nevertheless, there is sufficient evidence of cases where regulation has had credit implications. For example, Chugach Electric's rating was lowered and the outlook remains negative following the regulator's reduction of the permitted margins for interest coverage that the utility could earn on its debt.

Questions often arise as to how to best measure a co-op's financial performance. The highly leveraged capital structures of G&T co-ops reflect their inability to access capital markets for equity. This makes it difficult to draw comparisons between a cooperative's financial metrics and the metrics used to gauge the performance of investor-owned utilities. Comparability with investor-owned utility metrics is further obscured by the predominant use of amortizing debt within the co-op sector, as compared with investor-owned utilities use of nonamortizing debt. Consequently, the financial analysis of co-op utilities largely tracks the rating methodology employed for municipal utilities and public power joint-action agencies that also rely on amortizing debt and lack access to equity capital markets. The analysis of a co-op such as Chugach Electric that heavily relies on nonamortizing debt with bullet maturities requires a hybrid analysis that incorporates elements derived from the rating methodology for both public power and investor-owned utilities. To achieve a given rating, Standard & Poor's expects a utility that uses a meaningful amount of nonamortizing debt to exhibit considerably stronger coverage of annual debt service than would be expected of a utility whose debt amortizes like a mortgage. Refinancing risk and capital market access are also factored into the analysis of utilities that use nonamortizing debt.

The amortizing debt of many co-ops is governed by mortgage indentures fashioned by the Rural Utilities Service of the U.S. Department of Agriculture. Under these indentures, the principal measure of financial performance is frequently a "margins-for-interest" (MFI) or "times-interest-earned" (TIER) ratio. It is Standard & Poor's view that these ratios do not adequately reflect a utility's financial capacity to cover amortizing principal and interest payments and do not paint a full picture of financial capacity and creditor protection. Consequently, Standard & Poor's does not limit its analysis to the MFI and TIER metrics.

Irrespective of whether a utility is legally bound to satisfy the requirements of an all-in-debt-service coverage test, Standard & Poor's examines each utility's financial capacity to produce excess coverage of principal and interest. Although the MFI and TIER tests are calculated with reference to a utility's income statement, Standard & Poor's analysis focuses on the income statement and the statement of cash flows. In calculating debt-service coverage, consideration is also given to fixed obligations that are not necessarily reflected on the balance sheet, including those related to capacity payments required under purchased-power agreements and long-term lease payments. However, payments that must be made pursuant to defeased lease agreements are viewed as mitigated by amounts held in escrow accounts dedicated to the payment of lease transaction obligations. Wabash Valley provides an example of a utility whose financial metrics were adjusted to impute debt and debt service as part of the analysis. Its income statement, cash flows, balance sheet, and financial ratios were adjusted to reflect the substantial fixed obligations that it has incurred under purchased-power agreements.

Table of Contents

Legislative Directive

In the first session of the 23rd Alaska State Legislature, the Energy Policy Task Force (EPTF) was established by concurrent resolution to:

1. Develop a long-term energy plan to efficiently enhance Alaska's economic future.

2. Review and analyze the state's current and long-term energy needs.

3. Consider how best to incorporate state-owned Railbelt energy assets as part of the solution for the Railbelt's current and long-term electrical needs.

4. Address elements of Alaska's long-term energy needs that can be solved through action on the part of industry and/or government actions, such as pooling and integrated resource planning.

Final findings regarding a Railbelt energy plan were to be reported to the legislature by December 31, 2003. Reports of task force findings for non-Railbelt areas shall be submitted by March 31, 2004.

I. A LONG-TERM ENERGY PLAN TO ENHANCE ALASKA'S ECONOMIC FUTURE

A. Vision Statement

Alaska holds a worldwide leadership role in energy supply, delivery and use solutions and environmental stewardship. Alaska will have reliable, economic, sustainable and secure power supplies for its citizens.

B. Mission Statement

Electricity is essential to meeting Alaska's economic, environmental, and educational development goals. The State will conduct its activities affecting energy in such a manner as to:

- Promote reliable and secure electric power systems
- Promote the lowest cost for consumers
- Stimulate the economy
- Provide employment opportunities for Alaskans
- Improve the quality of life for all Alaskans
- Promote workforce development, including training Alaskans, for Alaska's utility sector.
- Enhance the State's social, cultural, economic and environmental assets

C. Goals (Listed in no particular order)

- Promote unified operation of Railbelt generation and transmission system.
- Develop Alaska's position as a leader in competitively priced and reliably available electricity.
- Develop Alaska's electrical infrastructure while maintaining competitively priced energy.
- Ensure security of physical and cyber energy infrastructure.
- Promote research, development and demonstration of clean and renewable energy technologies.
- Promote conservation and energy efficiency across all of Alaska.
- Develop Alaska as a world leader in using and exporting competitively priced and reliably available fossil fuels
- Ensure standardized and consistent permitting and regulatory processes.
- Establish Alaska as a national leader in developing energy projects using its natural resources, including its workforce.

D. Recommendations

1. Workforce

Provide proper and focused workforce training to meet the challenges of 21st century energy industries.

Executive:

Perform an assessment of the opportunities for Alaska workers in the resource development and energy sectors and, based upon these opportunities, examine the deployment of a portion of its resources toward training and retraining of the workforce in these sectors.

Amend Department of Labor/Workforce Development (DOL/WD) regulations to facilitate the ability to develop training and internship programs with an emphasis on jobs for Alaskans.

Fund education to ensure that Alaska workers have the education and skills required to maintain energy's role in our economy.

Update certificate of fitness requirements for utility linemen to enhance workforce availability and better track the successful practices of the other 49 states.

Ensure that Alaska workforce regulatory practices conform to national practices.

Private Sector:

Work with the DOL/WD in its assessment of opportunities for the Alaska workforce in the energy and utility sectors.

Maximize internship programs that will allow entry into the Alaskan workforce.

Encourage development of new energy and energy related businesses in Alaska.

2. Energy Generation

A recent draft Railbelt Energy Study (RES) indicates that electric power generation needs of the Alaska could grow by 39 percent from 2008 to 2028. During that time, reliance on fossil fuels could grow by 90 percent, while emissions per kilowatt-hour of generation are reduced. The RES shows there is a surplus of power generation capacity on the Kenai Peninsula, with deficiencies projected in other areas of the Railbelt. Alaska must be active in its pursuit of developing new generation technologies to improve the efficiencies of present and future energy generation facilities and must be self-sufficient due to the lack of any electrical interconnections outside of Alaska

Assist the private sector in its efforts to develop energy generation capacity.

Executive:

Examine the ability of public bodies, including the Alaska Energy Authority (AEA), to assist the private sector in efforts to develop adequate energy generation capacity funded through conduit bonds and grants to keep the energy costs low for all Alaskans.

Utilize Alaska's abundant renewable resources in the production of hydrogen.

Executive:

Convene a workshop to discuss the potential for Alaska's leadership in hydrogen production. Such a workshop could serve as an educational tool and a platform for discussion between public, university research and private sector individuals and organizations.

Direct the University of Alaska and executive agencies to inventory ideal locations for future renewable energy generation sites that could be used as a source of hydrogen for in-state use and export.

3. Energy Infrastructure

The Task Force's goals and strategies focused on matters including, but not limited to: (1) infrastructure; (2) transmission and distribution; and (3) economic efficiency. As the electrical system ages, increased concerns about reliability and stability and needs for technology-driven system improvements will be required. In addition, the long-range need for a hydrogen-based infrastructure to support fuel cell technologies provides yet another opportunity for expansion in energy infrastructure. There must exist within the State the capacity to deliver resources and energy to end-users, whether within or outside of the State's boundaries.

Stimulate private-sector participation in its energy infrastructure to allow greater energy export capability to meet state, regional, and national energy demands.

Executive:

Provide tax-exempt bonding to fund projects, much like the Bradley Lake Hydroelectric financing model, with the State retaining only the obligations that cannot be transferred to the participating utilities.

Through AIDEA/AEA, support and encourage the formation of a Railbelt unified operations model that would operate in a consolidated manner and allow the most Alaskans to benefit from projects funded through the use of tax exempt financing.

Work with Alaska's Congressional delegation to provide financing or economic incentives to promote energy infrastructure development.

Encourage Railbelt utilities to establish a unified system by providing incentives such as conduit financing for Railbelt infrastructure.

Encourage adequate transmission infrastructure to increase economic development activity.

Conduct an assessment to identify the State's energy infrastructure security needs.

Executive:

The RCA should include in their deliberations the issue of cyber-security.

Private Sector:

Continue in the joint planning process to identify the State's energy infrastructure needs.

Encourage adequate and secure transmission infrastructure to increase economic development activity.

Continue to promote adequate fuel delivery infrastructure.

Assess the potential for the development of a locality into a sustainable energy community that utilizes novel distributed and/or renewable energy systems for residences and commercial enterprises.

Executive:

Examine the potential for the development of an Alaska locality into a sustainable energy community.

Legislative:

Examine opportunities to provide support for the development of such a community.

Alaska regional transmission planners should work to become leaders in energy infrastructure development.

Private sector:

Establish energy infrastructure development projects that will promote the reliable transportation of electricity throughout Central and Interior Alaska, both on and off the Railbelt system, that meets the State's energy, environmental and economic needs.

Define and establish a unified system operator for the Railbelt.

4. Regulatory

Streamline all licensing, permitting, and regulatory processes of energy projects.

Executive:

Review agency practices regarding the licensing, permitting, and regulatory processes of energy projects. These agencies could also review the licensing, permitting, and regulatory processes of energy projects in other states so as to develop a study of best practices regarding these issues.

Establish and maintain regulatory processes that are consistent and have defined processing timelines and encourage utilities to maintain long-term financial health.

Legislative:

Enact appropriate legislation for the implementation of best practices regarding the licensing, permitting, and regulatory processes of energy projects.

Private sector:

Provide input to the Executive and Legislative Branches to implement best practices regarding licensing, permitting, and regulatory processes of energy projects.

II. CURRENT AND LONG-TERM ENERGY NEEDS

A. Current Energy Needs

Findings

The electrical needs of the Railbelt are currently served by six utilities, consisting of four cooperatives and two municipal utilities. These are Golden Valley Electric Association (GVEA), Chugach Electric Association (CEA), Matanuska Electric Association (MEA), Homer Electric Association (HEA), Anchorage Municipal Light & Power (ML&P) and the City of Seward Electric System (SES). These utilities, along with state-owned assets, serve roughly 75% of Alaska's population and account for over 85% of the electricity generated in the state. The Railbelt grid, spanning from Homer to Fairbanks, is not connected to other parts of Alaska, to the grid in Canada nor to the 48 contiguous states. Power can neither be imported nor exported. Because it is unacceptable to come up short in arctic conditions, reserve requirements are higher than in the rest of the country.

Railbelt Generation: In 2002, total generating capacity was about 1,374 MW. Generation is fueled by natural gas (67%), coal (5%), hydro (15%), and fuel oil (13%.) All of the electricity is produced by the six utilities or purchased from the State (Bradley Lake hydro) or Aurora Energy, which is an investor-owned coal-fired plant in Fairbanks. The oldest thermal units were installed in the early 1960s. Most of the thermal generation is considered aged and may need to be replaced within the next decade or so. See Appendix E.

Railbelt Load: In 2002, total peak load was 721 MW. See Appendix E.

Railbelt Transmission: There are two main transmission interconnections in the Railbelt. The Anchorage to Fairbanks Intertie, a 300-mile transmission system that operates at 138kV, is composed of segments owned by MEA, CEA, AEA and GVEA. The other is the Anchorage to Kenai area transmission line, owned by HEA and CEA, and operated at 115kV. Transfer capacity on both lines is limited to approximately 70 MW. See Appendix E.

B. Current Railbelt Projects

For details see Appendix C. A road/rail map showing current loads and generation capacity, with transfer limitations noted between load centers, is available in a separate attachment file for this email friendly version. Dotted lines indicate transmission that are needed, but not built.

C. Long-term Energy Needs

Findings

The Task Force adopted the definition of long-term as 20 years or more. The energy requirements of the Railbelt are expected to increase 39% over that time. Certain needs emerged from Task Force discussions and public testimony. Within the next 20 years, it was determined that Alaska needs to:

- **Create secure and reliable transmission between load centers**
- **Provide energy infrastructure for economic development**
- **Identify and evaluate long-term fuel sources**
- **Establish a unified system operation**
- **Connect new areas to the Railbelt grid**
- **Replace aging generation**
- **Replace an aging workforce**

D. Recommendations

Specific recommendations of how to fulfill future needs were as follows:

- Structure implementation of a unified Railbelt system operator.
- Support increased vocational trade schools, higher education and training of technical and professional utility career staff and management.
- State grants or financing should give priority to unified Railbelt system operation and expanding the grid along the road system, i.e., the "Roadbelt."
- Where common projects are identified as the most cost effective energy solutions, encourage financial risk sharing among utilities through a model similar to the Bradley Lake Project agreement.
- Increase the proportion of renewables in long-term fuel sources. Renewables include hydroelectric generation.
- Loop the existing Railbelt energy grid to improve system reliability and serve new markets. See map for details.
- Advance the physical and cyber security of the critical electrical infrastructure in Alaska.
- Strive to have nationally competitive electrical rates.

E. Long-term Railbelt Projects

For details see Appendix D.

III. STATE-OWNED RAILBELT ENERGY ASSETS

Findings

The Task Force supports the transfer of AIDEA/AEA electrical assets in a manner that recognizes existing contracts. Current state ownership of energy assets should be transferred to a Unified System Operator to support the cooperation of the utilities in that endeavor. The Task Force recommends the state should provide financing through AIDEA/AEA to assist development of

future generation and transmission. Through AIDEA/AEA, the State owns three Railbelt energy assets, as follows:

A. The Bradley Lake Project

The Bradley Lake Project is located in south central Alaska at the southern end of the Kenai Peninsula. The project includes a 610-foot long, 125-foot high concrete-faced and rock-filled gravity dam, a 3.5-mile power tunnel and steel-lined penstock. The project transmits power to the state's main power grid via two parallel 20-mile transmission lines. The project, which cost approximately $328 million (including reserve fund balances), went into commercial operation in 1991. Homer Electric Association under contract with AEA now operates the project. Bradley Lake serves Alaska's Railbelt from Homer to Fairbanks as well as the Delta Junction area. The Bradley Lake Project Management Committee oversees operation and maintenance duties.

B. Alaska Intertie

The 170-mile transmission line that runs approximately between Willow and Healy is the state-owned portion of the 300-mile Anchorage to Fairbanks transmission system. It is rated at 345 kV and operates at 138 kV. The Intertie allows GVEA to purchase lower cost energy from Anchorage and the Kenai generated from natural gas and the Bradley Lake hydroelectric project. CEA and ML&P generate revenue from the sale of economy energy to GVEA. The Intertie Operating Committee oversees operations and maintenance duties.

C. Healy Clean Coal Project (HCCP)

The Healy Clean Coal Project grew out of a nationwide competition sponsored by the U.S. Department of Energy (DOE) to test new technologies aimed at solving the international problem of acid rain. Alaska was one of 48 applicants selected for 13 grants. The project is located adjacent to GVEA's existing Healy No. 1 power plant, which was constructed in 1967. General construction of the power plant began in May 1995 and was completed on November 21, 1997. A 90-day test of the power plant was completed in December 1999. HCCP has been idle since the completion of that test. Several engineering studies have been completed and AIDEA continues to pursue all options for getting HCCP into operation and selling power as soon as possible. AIDEA and GVEA Boards have mutually agreed to focus on getting the HCCP up and running.

D. Recommendations

- Provide Railbelt utilities the opportunity to obtain grants and tax-exempt financing for electrical infrastructure that provides the lowest cost of power to members and efficient operation.
- All other considerations being equal, projects should in general not be owned, operated or maintained by the State. The State should encourage Railbelt utilities to accept ownership of state-owned Railbelt

energy assets to reduce bureaucracy, thereby reducing state expenses and offering utilities the benefits of long-term ownership.

- Any divestiture of state-owned Railbelt energy assets should be consistent with the above.
- Future grants and financing should give priority to Railbelt projects endorsed by the Railbelt unified system operator.

IV. INDUSTRY AND /OR GOVERNMENT ACTIONS

Findings

To efficiently energize Alaska's economic development, the Task Force believes that the Railbelt utilities should develop a unified system operation. If there are legislative or regulatory issues, utilities should work cooperatively to determine actions needed to implement the unified system details. Different forms of unified systems operations may be used by the various utilities. The Task Force proposed the following examples.

A. Unified System Operations

Power Pooling:

Definition: "Two or more interconnected electric systems planned and operated to supply power in the most reliable and economical manner for their combined load requirements and maintenance program."
Source: Edison Electric Institute
Power pooling systems are usually set up in one of two ways; a member of the system takes on the role of the system operator or an independent operator is established. Power pools allow for better utilization of resources to meet the aggregated load. Better utilization of resources leads to lower production costs and more economical capital improvement plans. Power pools inherently share knowledge, which if transition to competition is imminent, will help smooth the process and automatically create a more level playing field.
Source: R.W. Beck Railbelt RES Scope of Work
The greatest benefit from a power pool assumes the utilities jointly meet capacity requirements and jointly dispatch as if they were one utility.

Joint Action Agency (JAA):

Defined in AS 42.45.300 as "Two or more public utilities may form a joint action agency for the purpose of participation in the design, construction, operation, and maintenance of a generating or transmission facility and to secure financing for carrying out the design, construction, operation, and maintenance of the facility. A JAA may request AIDEA to issue revenue bonds for projects of the agency. A joint action agency has the powers of a public utility under AS 42.05." The statute broadly defines "public utilities"—includes any corporation or cooperative that owns, operates, manages, or controls any plant, pipeline, or system for furnishing, by generation, transmission, or distribution, electrical service to the public.

Generation &Transmission Cooperative (G&T):
A G&T is a cooperative organization comprised of one or more utilities that plan, operate and maintain G&T facilities for the benefit of the member utility systems. The G&T governing board consists of members from each member utility. It is owned by several distribution utilities to provide for their power supply needs, including in some cases ownership of generating plants and transmission lines. This is the method of unified operation that is most commonly employed by distribution cooperatives across the United States.

B. Other Tools

Integrated Resource Planning (IRP):

The National Energy Policy Act (NEPA - 1992) defined integrated resource planning and directed states to use that process as the starting point. "The term 'integrated resource planning' means a planning process for new energy resources that evaluates the full range of alternatives, including new generating capacity, power purchases, energy conservation and efficiency, cogeneration and district heating and cooling applications, and renewable energy resources, in order to provide adequate and reliable service to electric customers at the lowest system cost."

V. OTHER TOPICS FOR FUTURE CONSIDERATION

Findings

The Task Force either touched on these subjects or found it did not have sufficient time to address these and form valid recommendations for the Legislature under the deadline given.

A. Critical Infrastructure Protection (CIP)

Homeland security efforts to list priority infrastructure includes the utility assets. Utility groups and representatives from associated sectors such as telecommunications must continue to cooperate to provide reliable power with due regard for changing demands of security.

B. Energy Efficiency, Conservation and the Environment

Efforts to use energy resources more efficiently can reduce energy costs and benefit the environment. Energy efficiency is broader than simple energy conservation, or eliminating unnecessary energy use. Efficiency involves achieving necessary goals, while minimizing energy requirements. Efficiency should not compromise comfort, performance or productivity, but rather meet those requirements through more proficient means. Environmental benefits are direct; if energy use is avoided, then the environmental impacts are avoided as well.

C. Emerging Energy and Environmental Technologies

Examine the establishment of public/private partnerships that benefit Alaska research institutions and commercial enterprises that engage in the commercialization of energy and environmental technologies.

D. Renewable Energy

Renewable power can be competitive. There are a number of technologies considered renewable and these include: hydroelectric, solar, biomass, geothermal, tidal and wind.

Solar, biomass, geothermal and tidal are in various stages of technological development and do not currently contribute, to a great extent, to the national energy supply. Solar at this time is expensive and because of Alaska's latitude isn't considered a likely candidate for large-scale energy production. There are some geothermal resources in the state. The closest geothermal site to the Railbelt is approximately 10 miles west of Chugach Electric's Beluga Power Plant. Tidal power is still early in its development and being studied as a potential resource in conjunction with a Knik Arm crossing. As with other technologies, tidal power is developing and it will be some time before it becomes a significant and competitive generation resource. However it is prudent for energy planners to continue to monitor the development of this technology.

Wind power is being studied as a potential renewable generation resource for the Railbelt. The technology is the beneficiary of more than 20 years of intense research and development. Large-scale wind projects are being installed across the country and around the world. These projects use large turbines and are installed on a scale that allows for the power to be priced competitively. Smaller turbines have been used for rural generation applications in the state and have been shown to be rugged and reliable. For Railbelt applications, larger turbines and projects would be required to achieve economies of scale and subsequently competitive pricing. CEA and ML&P is studying a large wind project on Fire Island.

Acknowledgements

Alaskan Command, Elmendorf AFB, Critical Infrastructure Protection (CIP)
Lt. Col. Bevan Orme
Julian Jensen

Alaska Conservation Foundation
Chris Rose

Alaska Natural Gas Development Authority (ANGDA)

Harold Heinze

Alaska Power Association (APA)
Eric Yould
T.C. Wilson

Chugach Electric Association (CEA)
Joe Griffith
John Cooley
Phil Steyer
Lee Thibert
Jeff Lipscomb

Denali Commission
Al Ewing

Homer Electric Association (HEA)
Myles Yerkes
Jim Cross

Matanuska Electric Association (MEA)
Tuckerman Babcock
Mike Pauley
Don Zoerb

Municipal Light & Power (Anchorage) (ML&P)
Jim Posey

Railbelt Energy Study (RES), Technical Working Group
Mark Fouts, Chair
Ron Moe, R.W. Beck

Representative Pete Kott, Speaker of the House
Representative John Harris

Senator Gene Therriault, Senate President
Senator Fred Dyson

Seward Electric
Dave Calvert

Glossary

Alaska Energy Authority (AEA) http://www.aidea.org/aea.htm
The Alaska Energy Authority was a state agency responsible for the administration of various state power projects and programs. The AEA was dissolved by State statute in 1993. Most of its rural programs moved to the Department of Community & Regional Affairs, Division of Energy. All existing projects, contracts, etc., remain with AEA under the guidance of the Alaska Industrial Development and Export Authority (AIDEA). Authority to construct or acquire new projects was repealed.

Alaska Industrial Development and Export Authority (AIDEA) http://www.aidea.org
The Alaska Industrial Development and Export Authority (AIDEA) is a State agency that assumed the functions of the dissolved AEA, with AIDEA's Board of Directors replacing the AEA Board.

Alaska Power Association (APA) http://www.areca.org
Statewide trade association for electric cooperatives. Formerly known as the Alaska Rural Electric Cooperative Association (ARECA).

Capacity
The maximum amount of power, normally expressed in megawatts, that a given system or subsystem can carry or produce at a particular moment, and is typically used to represent the real production capability rating of a generation or transmission system.

Cogeneration
The simultaneous production of power and thermal energy, such as burning natural gas to produce electricity and using the heat produced to create steam for industrial use.

Coincident Peak
When two or more systems or subsystems place demand on another system at the same time, it is referred to as a coincident peak. The term is used to describe energy demand at any time when these parties' needs coincide with each other. It does not to refer to a specific peak occurring during the time when both parties use the same energy source.

Combined Cycle (CC)
An electric generating technology in which additional electricity is produced from otherwise lost waste heat exiting from the gas turbines.

Combustion Turbine (CT)
A machine that generates rotary mechanical power from the energy of a stream of fluid.

Cooperative
A group organized to supply electricity to a specific area; a cooperatively owned electric utility. A non-profit utility owned by its members.

Demand
The rate, expressed in megawatts (MW), at which electric energy is delivered to or by a system, part of a system, or piece of equipment at a given instant, or averaged over a designated period of time.

Distributed Generation
This term generally refers to small-scale energy generation spread among several producers, but it can also refer broadly to any type of energy generation that is spread among multiple

producers. Distributed generation is most commonly used to insure that sufficient energy is available to meet peak demand. It may also be used as part of a fuels diversity program.

Distribution Line
A power line which delivers electricity throughout urban and rural areas. Typically between 2,300 and 25,000 volts.

Generation
The process of producing electric energy by transforming other forms of energy. It also refers to the amount of electric energy produced, expressed in megawatt-hours (MWh).

Generation and Transmission Company (G&T)
Term for a company that provides both energy production and facilities for transmitting energy to wholesale customers.

Gigawatt (GW)
A unit of measure equal to one billion watts or one thousand megawatts.

Integrated Resource Planning (IRP)
This term refers to a planning method that takes into account all resources available to or required to meet supply needs within an area or region that produce to the lowest possible cost.

Intertie
A tie permitting a flow of energy between the facilities of two electric systems.

Investor-Owned Utility
A utility owned privately (or by stockholders) and operated as a for-profit company.

Kilovolt (kV)
A unit of measurement of electrical force of pressure equal to 1,000 volts.

Kilowatt (kW)
A unit of power equal to 1,000 watts.

Kilowatt-Hour (kWh)
The most commonly used electrical measurement equal to 1,000 watts for one hour.

Load
The moment-to-moment measurement of power requirement in the entire system.

Megawatt (MW)
One thousand kilowatts or one million watts.

Peak Load, Peak Demand
These two terms are used interchangeably to denote the maximum power requirement of a system at a given time, or the amount of power required to supply customers at times when need is greatest. They can refer either to the load at a given moment (e.g. a specific time of day) or to averaged load over a given period of time (e.g. a specific day or hour of the day).

Railbelt Energy Study (RES)
Five utilities commissioned a study on the Railbelt. The purpose of the study is to identify the location and type of generation asset that satisfies future growth within the Railbelt.

Regulatory Commission of Alaska (RCA) http://www.state.ak.us/rca/

Formerly known as the Alaska Public Utility Commission. The RCA is the State's regulatory body overseeing utilities.

Roadbelt
That part of Alaska that is road-accessible, but not connected to the Railbelt grid, like Glennallen.

Transmission Line
A set of conductors, insulators, supporting structures, and associated equipment used to move large quantities of power at high voltage.

Volt
The unit of electrical measurement, which is similar to "pressure", that pushes current through a conductor.

Watt
A unit of electrical measurement used to determine the rate of energy delivered at some point. Watts = Voltage x Amperes

APPENDIX A
Process and Appointments

The Energy Policy Task Force (EPTF) convened its first meeting on Tuesday, September 23, at the AIDEA/AEA boardroom in Anchorage.

The Task Force consists of nine members. Chosen as proscribed in HCR 21, no legislators could serve, no utility could have more than one representative and at least one member on the EPTF was to be from a non-Railbelt electrical utility.

Governor Frank Murkowski appointed **Rick Eckert of Homer**, Interim General Manager of Homer Electric Association and **Wayne Carmony of Wasilla**, General Manager of Matanuska Electric Association.

Speaker of the House Pete Kott appointed **former Lt. Governor H.A. "Red" Boucher of Anchorage**, a board member of Chugach Electric Association and **Dave Carlson of Petersburg**, Intertie Coordinator of the Southeast Conference.

Senate President Gene Therriault appointed **Steve Haagenson of Fairbanks**, President and CEO of Golden Valley Electric Association and **Robert Wilkinson of Glennallen**, Chief Executive Officer of Copper Valley Electric Association. In accordance with the language of HCR21, **Meera Kohler of Anchorage**, President and CEO of Alaska Village Electric Cooperative, was also selected by the Senate President from a list of three names submitted by the minority leaders.

The Alaska Energy Authority (AEA) member is **Mike Barry of Anchorage**, Chairman of the AIDEA/AEA Board, who was also elected Chair of the EPTF. The Department of Revenue member is **Tom Boutin of Juneau**, Deputy Commissioner of Revenue.

Becky Gay, staff to **Representative John Harris**, provided coordination and legislative staff support through the Joint Leadership Offices of **Speaker of the House Pete Kott** and **Senate President Gene Therriault.** Bernie Smith, Project Manager at AIDEA/AEA and a former Regulatory Commissioner, provided research and regulatory guidance.

The Task Force was headquartered at AIDEA/AEA and held most of its meetings in Anchorage. The Task Force met every two weeks, with presentations by the all of the Railbelt utilities and others setting the stage for discussion. Interested public was encouraged to make both written and public comments. Presentations by federal and state agencies were incorporated. Long term was defined to be 20 years or more for purposes of this report. The Railbelt Energy Study (RES) currently being undertaken by five utilities has basic information that was received by the Task Force and will be completed early in 2004. A website was provided and kept current by AIDEA/AEA at www.aidea.org/EnergyTaskForce.htm.

Alaska Energy Policy Task Force Members

Chair: Mike Barry, Chairman of the Board
AIDEA/Alaska Energy Authority (AEA)
www.aidea.org

Vice Chair: H.A. Red Boucher, Alaska Wireless Technology
Board Member, Chugach Electric Association (CEA)
www.chugachelectric.com

Tom Boutin, Deputy Commissioner
State of Alaska-Department of Revenue
www.state.ak.us

Dave Carlson, Intertie Coordinator
Southeast Conference
www.seconference.org

Wayne Carmony, General Manager
Matanuska Electric Association (MEA)
www.matanuska.com

Rick Eckert, General Manager
Homer Electric Association (HEA)
www.homerelectric.com

Steve Haagenson, President/CEO
Golden Valley Electric Association (GVEA)
www.gvea.com

Meera Kohler, President/CEO
Alaska Village Electric Cooperative (AVEC)
www.avec.org

Robert Wilkinson, CEO
Copper Valley Electric Association (CVEA)
www.cvea.org

APPENDIX B
HCR 21 (Resolve 24)

BILL ID: HCR 21

00 SENATE CS FOR CS FOR HOUSE CONCURRENT RESOLUTION NO. 21(FIN)
01 Relating to establishing the Alaska Energy Policy Task Force.
02 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:
03 WHEREAS an adequate, reliable, reasonably priced, and safe supply of electric
04 energy is a basic necessity; and
05 WHEREAS other infrastructure elements such as water, wastewater, transportation,
06 and telecommunications systems are dependent on an adequate, reliable, reasonably priced,
07 and safe supply of energy; and
08 WHEREAS meaningful economic development and technological advancement
09 cannot occur in Alaska without an adequate, reliable, safe, and reasonably priced energy
10 supply; and
11 WHEREAS over 85 percent of the state's electrical consumption occurs in the
12 Railbelt; and
13 WHEREAS the needs of the non-Railbelt areas of the state include more electrical
14 infrastructure and less expensive power; and
15 WHEREAS it would be beneficial to examine how electricity is generated,
16 transmitted, and distributed in Alaska in order to meet the state's existing and future electrical
01 needs in the safest and most efficient manner; and
02 WHEREAS the financial resources of the state are limited;
03 BE IT RESOLVED that the Alaska State Legislature establishes the Alaska Energy
04 Policy Task Force to review and analyze the state's current and long-term energy needs; and
05 be it
06 FURTHER RESOLVED that the task force shall consider how best to incorporate
07 state-owned Railbelt energy assets as part of the solution for the Railbelt's current and long-
08 term electrical needs; and be it
09 FURTHER RESOLVED that the task force shall also address those elements of the
10 state's long-term energy needs that can be solved through action on the part of industry,
11 government, or both industry and government working together, such as through pooling and

integrated resource planning; and be it

FURTHER RESOLVED that the task force shall develop a long-term energy plan for Alaska that will efficiently enhance the state's economic future; and be it

FURTHER RESOLVED that the task force shall be composed of nine members as follows:

(1) one member from the directors of the Alaska Energy Authority, selected by the directors;

(2) the commissioner of revenue or the commissioner's designee;

(3) two members chosen by the governor who are not members of the legislature;

(4) three members chosen by the president of the senate who are not members of the legislature, one of whom must be from a list of three names proposed jointly by the minority leaders of the house of representatives and the senate, and the appointment from the list shall be made after consultation with the speaker of the house of representatives;

(5) two members chosen by the speaker of the house of representatives who are not members of the legislature; and be it

FURTHER RESOLVED that members shall be chosen in such a manner that a utility will not have more than one representative on the task force, but at least one member will be from a Railbelt electrical utility, and at least one member will be from a non-Railbelt electrical utility; and be it

FURTHER RESOLVED that the members of the task force shall select a chair from among themselves; and be it

FURTHER RESOLVED that task force members who are not state employees are entitled to per diem and travel expenses as for members of boards and commissions under AS 39.20.180; and be it

FURTHER RESOLVED that a staff member and other resources shall be provided to the task force, as necessary, by the legislature; and be it

FURTHER RESOLVED that the task force shall submit a report of its findings regarding a Railbelt energy plan to the legislature by December 31, 2003, and may make any interim reports on Railbelt energy issues it considers advisable; and be it

FURTHER RESOLVED that the task force shall submit reports of its finding regarding energy plans for areas of the state other than the Railbelt to the legislature by March 31, 2004, and may make any interim reports it considers advisable; and be it

FURTHER RESOLVED that the task force is terminated at 11:59 p.m. on April 15, 2004.

APPENDIX C
Current Railbelt Projects

- **Eklutna transmission line** replacement project: This $19,300,000 project is in the design phase.

- **Alaska Intertie Extension:** This project will upgrade and extend the Anchorage to Fairbanks power transmission Intertie to the Teeland substation.

- **Alaska Intertie:** Maintenance repair/replacements are required to address foundations problems and replace Static VAR Compensation (SVC) equipment. In addition, a long-term fix to the uneven snow-loading events should be evaluated.

- **Cooper Lake Hydro re-licensing:** Chugach's Cooper Lake Hydro, commissioned in the 1950's, was recently overhauled and upgraded and is currently in the process of a FERC license renewal application.

- **ML&P** is acquiring property for Plant III.

- **MEA** is preparing thermal generation plant site at Hollywood Road.

APPENDIX D
Long-term Railbelt Projects

- **Emma Creek Energy Project:** Usibelli Coal Mine Inc. has proposed a $421 million, 200MW power plant at its mine near Healy #2.
- **GVEA's North Pole Expansion (NPE) project:** Using combined-cycle technology to add a 57MW highly efficient gas combustion turbine at the existing 120MW North Pole power plant site (built in 1975), which is GVEA's largest generating facility. The new NPE project would entail installing a 43MW gas turbine equipped with a waste heat boiler on its exhaust stack. The boiler would produce steam to power a 14MW steam turbine.
- **Southern Intertie:** Proposed new construction of a 62-mile segment to increase reliability and to provide redundancy to the Quartz Creek transmission line.
- **Chugach:** Chugach's five year construction improvement plan includes a new South Anchorage bulk transmission station, and a 138kV transmission loop that ties the new Bulk station with International and University substations. In addition, load growth in the Airport and South-East Anchorage necessitate the addition of two new distribution substations. Chugach is currently performing an Integrated Resource Plan (IRP) to identify generation and transmission requirements over the next 25 years. Chugach is also looking at development of a wind-farm on Fire Island.
- **ML&P:** Plans for the long term future include developing a robust grid, integrated resource planning, reliable sources of natural gas, developing wind power and green pricing.
- **Bradley Lake Repairs:** Repair and upgrade of the Bradley Lake Hydroelectric Project's governor.
- **HCCP:** Healy Clean Coal Project (HCCP) retrofit.
- **Donlin Creek Exploration:** Construction of power supply for the potential Donlin Creek Mine in Western Alaska, Calista region and/or Bethel area.
- **Military Power Upgrades:** Retrofit of the military's various coal generation plants, in the Fairbanks area. A Greater Fairbanks Regional Energy Study of Military Installations for long-term heat and power at Ft. Wainwright, Clear, Eielson AFB, and Ft. Greeley. Missile defense system offers opportunities and requirements. Ft. Richardson and Elmendorf AFB are undertaking privatization efforts.
- **Copper Valley Intertie:** This Intertie has been proposed to link the Copper Valley area to the Railbelt Intertie system.

APPENDIX E
Current Energy Resources

Source: Railbelt Energy Study (RES) 2003 draft

2002 GENERATION

Thermal Resources

Owner	Name	Technology Category	Maximum Capacity (MW))
CEA	Beluga Unit 1	CT	19.6
CEA	Beluga Unit 2	CT	19.6
CEA	Beluga Unit 3	CT	64.8
CEA	Beluga Unit 5	CT	68.7
CEA	Beluga Unit 6/8	CC	109.0
CEA	Beluga Unit 7/8	CC	106.6
CEA	Bernice Lake 2	CT	19.0
CEA	Bernice Lake 3	CT	26.0
CEA	Bernice Lake 4	CT	22.5
CEA	International 1	CT	14.1
CEA	International 2	CT	14.1
CEA	International 3	CT	18.5
GVEA (Contract)	Aurora Chena	Steam	23.5
GVEA	Healy 1	Steam	25.0
GVEA	North Pole 1	CT	60.5
GVEA	North Pole 2	CT	60.5
HEA	Nikiski	CT	46.5
ML&P	ML&P Plant1 Unit 1	CT	16.2
ML&P	ML&P Plant1 Unit 2	CT	16.2
ML&P	ML&P Plant1 Unit 3	CT	19.5
ML&P	ML&P Plant1 Unit 4	CT	33.6
ML&P	ML&P Plant2 Unit 5&6 CC	CC	49.6
ML&P	ML&P Plant2 Unit 7&6 CC	CC	107.8
ML&P	ML&P Plant2 Unit 8	CT	85.0

Hydro Resources

Name	Maximum Capacity (MW)
Bradley Lake	120
Cooper Lake	20
Eklutna	40

CT = Combustion Turbine
CC= Combined Cycle

APPENDIX E, cont.
Current Energy Resources

Source: Railbelt Energy Study (RES) 11/2003 draft

2002 LOAD

	2002 Peak Load (MW)				
GVEA	CEA	ML&P	MEA	HEA	SES
179	227	145	114	95	10

The electrical needs of the Railbelt are served by six utilities; four cooperatives and two municipal utilities. Golden Valley Electric Association (GVEA), Chugach Electric Association (CEA), Matanuska Electric Association (MEA), Homer Electric Association (HEA), Anchorage Municipal Light & Power (ML&P) and City of Seward Electric System (SES).

2002 Transmission

Major Railbelt Transmission Lines

Name	From	To	Pole Miles	Capacity (kV)	Limit (MW)	Owned by	Operated by
Fairbanks	Fairbanks	Healy	103.2	138		GVEA	GVEA
Northern Intertie	Fairbanks	Healy	97	230		GVEA	GVEA
Alaska Intertie	Healy	Willow	170	345	75	AEA	IOC
Southern Intertie	Anchorage	Quartz Creek	90.4	115	75	CEA	CEA
Kenai Peninsula	Quartz Creek	Soldotna	~ 300	115		HEA	CEA
	Soldotna	Bradley Junction		115		HEA	CEA
	Bradley Junction	Homer		115		HEA	CEA
	Soldotna	Homer		115		HEA	CEA

The Alaska Intertie includes a 170-mile, 345 kV transmission line between Willow and Healy and voltage control devices at Teeland, Healy and Fairbanks. The line was build with State grant funds, went into operation in 1985 and is operated at 138 kV. All of the operating and maintenance costs of the Intertie are paid for by the utilities (83.5% from energy transfers and 16.5% from reserve sharing). The Intertie Operating Committee, set up by the Intertie Agreement among AEA, GVEA, CEA, ML&P and AEG&T (MEA & HEA), oversees the operation and maintenance of the line. The current agreement does not

provide a mechanism for financing capital repairs or improvements to the line. Certain repairs have been postponed for a lack of financing mechanism.

Chugach's single 115 kV transmission line, which has a stability-limited capacity of 75 MW, connects the Anchorage and Kenai areas. This line is over 50 years old and will require significant rebuilding to keep it in service. The limited capacity of these single lines limits the amount of generating reserves that may be shared between areas of the Railbelt.

GVEA recently completed construction of and energized the Battery Energy Storage System (BESS) and the Northern Intertie (a second line between Healy and Fairbanks) which reduced line losses, increased the transfer capacity and improved reliability. The line is rated at 230 kV and operates at 138 kV. This would allow energy from HCCP and GVEA's Unit 1, as well as energy transfers from Anchorage, to be simultaneously transferred to Fairbanks.

end

Bond Ratings – Fitch Ratings

- Downgraded from 'A' to 'A-'
  - Reflected negative stance taken by the RCA toward Chugach and tighter financial margins as a result
  - Noted Chugach's stable financial performance through 2001 including
    - Debt Service Coverage 1.50-1.85x
    - Times Interest Earned Ratio 1.35x or higher
    - Solid Equity Ratio 25%-29%

Bond Ratings – Standard & Poor's

- Downgraded from 'A' to 'A-'
  - Credit concerns
    - Reliance on regulatory approval of rates
    - Weak financial performance in 2002
    - Reliance on non-amortizing debt
  - Credit strengths
    - Solid equity capitalization of 25%

Bond Ratings – Moody's

- No change in A2 rating
  - Credit concerns
    - Recent pressure on the rating due to an unsupportive decision by the RCA
  - Credit strengths
    - Equity levels maintained at about 25%
    - Providing regular returns of capital to members

Bond Ratings - Regulation

- According to Standard & Poor's
  - "The regulation of public utilities is the defining element of the industry and is often the determining factor in the ratings of a utility"

COMMENTS ON RCA POSITION PAPER ON JAA REGULATORY EXEMPTION

With regard to the "stark contrast" between past unregulated new generation and the potential for new unregulated generation additions, it is interesting to note there were four major generation and transmission resource additions over the last 20 years. Three were not reviewed by regulators: Bradley Lake Hydroelectric generation station, the Alaska Intertie and the Northern Intertie. One was reviewed and approved by regulators: Healy Clean Coal Power Plant. The three unreviewed major power system improvements are a success. The one the Commission reviewed and approved is an abject failure.

It is not true that there would be no direct mechanism to control or question the sizing of proposed plant investments or their fuel sources. Actually the legislation is carefully crafted so that exemption from regulatory oversight is available only to owners of the JAA if the are either cooperatives or municipally-owned utilities. Unlike the RCA, the oversight this legislation envisions will be performed by representatives elected by the members of the JAA's owners.

The only way the JAA could work is if it has contracts in place between itself and its owners to support the projects it undertakes to own. These contracts would be voluntary. No one would have to buy power or other services from the JAA who did not want to. For this reason, it is also untrue that any and all expenses would be included in the wholesale rates to be charged to power distributors on a take it or leave it basis.

When did the legislature empower the RCA to "control or question" the sizing, cost, siting or fuel supply of projects before they are built?

Comments on RCA position paper on JAA regulatory exemption (HB 453)

1. Regulatory review of new generation has been the exception, not the rule.

Over the last 20 years there were four major generation and transmission resource additions in the Railbelt. Three were not reviewed by regulators: Bradley Lake Hydroelectric generation station, the Alaska Intertie and the Northern Intertie. All three are major power system improvements and are successful. The fourth was Healy Clean Coal Power Plant, so far an abject failure. The only other significant new generation during these years was the four generation projects associated with the Four Dam Pool and these were also exempted from regulatory review.

2. **Adequate oversight and safeguards exist without an additional layer of regulation.**

It is not true that there would be no direct mechanism to control or question the sizing of proposed plant investments or their fuel sources. The legislation is carefully crafted so that exemption from regulatory oversight is available only to owners of the JAA if they are either cooperatives or municipally-owned utilities. The oversight will be performed by representatives elected by the members of the JAA's owners.

3. **Contracts will provide additional protection and recourse to courts if necessary.**

All JAA projects and investments will be based on contracts between itself and the individual JAA member utilities. These contracts will specify the terms of the projects, each utilities rights and obligations, and provide for judicial enforcement of the contractual terms. These contracts would be voluntary, as is participation in the JAA. No utility would have to buy power or other services from the JAA unless its utility governing body chose to do so.

4. **RCA retail rate regulation of the individual utilities would remain.**

When did the legislature empower the RCA to "control or question" the sizing, cost, siting or fuel supply of projects before they are built? We do not believe the RCA has authority other than that given by the legislature and the legislature has not given this authority.

5. **The RCA would continue to regulate retail rates and any wholesale transactions between the JAA and utilities not a part of the JAA.**

Each expected JAA participant is and would continue to be regulated by the RCA for retail rates. The RCA would also continue to regulate wholesale transactions between JAA members or the JAA itself and utilities not part of the JAA.

6. **New generation is needed and unnecessary regulation will simply slow the process and increase the cost.**

The average age of generation is over 30 years. The utilities are in the best position to determine need and resource facility levels.

4/1/04

PATTON BOGGS LLP
ATTORNEYS AT LAW

601 West Fifth Avenue
Suite 700
Anchorage, Alaska 99501
907-263-6300

Facsimile 907-263-6345
www.pattonboggs.com

March 29, 2004

Kyle W. Parker
(907) 263-6330
kparker@pattonboggs.com

VIA FACSIMILE: (907) 465-3799

The Honorable John Harris
Co-Chair, House Finance Committee
State Capitol, Room 513
Juneau, Alaska 99801-1182

VIA FACSIMILE: (907) 465-3793

The Honorable Bill Williams
Co-Chair, House Finance Committee
State Capitol, Room 515
Juneau, Alaska 99801-1182

RE: CS HB 453 (L&C) – "An Act exempting from regulation under the Alaska Public Utilities Regulatory Act wholesale agreements for the sale of power by joint action agencies to public utilities that are parties to the agency agreement, including certain electric cooperatives, and contracts related to those agreements, and joint action agencies composed of public utilities of political subdivisions or utilities organized under the Electric and Telephone Cooperative Act or both."

Dear Chairmen Harris and Williams:

On Thursday, April 1, 2004, the House Finance Committee is scheduled to consider CS HB 453 (L&C). On behalf of Matanuska Electric Association ("MEA"), we have completed a review of HB 453 and associated memoranda prepared by Legal Services, and we write today to clarify several issues and convey our concerns regarding the effect of the proposed legislation.

It is our view that HB 453 could result in significant additional increases in the rates paid by all consumers of electric power in south-central Alaska and along the Railbelt to and including Fairbanks. As explained below, HB 453 would allow the members of a Joint Action Agency to undertake any project and incur any expense, and then pass those costs on to electric utility rate payers in the state, wholly without any independent review or oversight.

As written, HB 453 would allow interested utilities (both municipal and/or cooperative) to join together to establish a so-called "Joint Action Agency". Projects pursued by that Joint Action Agency would then be exempt from Regulatory Commission review and oversight. In effect, that would allow the Joint Action Agency to, among others things, design, site and build a new

electric power plant, and then establish, charge, and collect rates it deems necessary to recover the costs associated with construction of that new plant -- all without regulatory review or oversight.[1]

We agree that HB 453 would not exempt the individual utilities that are members of a Joint Action Agency from Regulatory Commission jurisdiction. *See generally* Legal Services memoranda dated February 27 and March 3, 2004 (attached). However, if HB 453 were enacted, no state agency would be empowered to review the wholesale rates charged for the purchase of power by the Joint Action Agency when determining whether the retail rates charged by those individual utilities to their customers are just and reasonable.

For example, Utility A and Utility B join together to create a Joint Action Agency. That Joint Action Agency then decides to contract for the construction of a new plant. At the time that new plant is ready to come on-line, the Joint Action Agency sets the wholesale rate it will charge its membership (Utilities A and B) for the purchase of power from that new plant. Utilities A and B then use that wholesale rate, as established by the Joint Action Agency (again, whose membership is Utilities A and B) as the basis for the rates they will then charge their customers (*e.g.*, the retail customers of Utilities A and B).

As written, the Regulatory Commission would have no authority to review the wholesale rate paid by Utilities A and B to the Joint Action Agency when determining whether the rates paid by the customers of Utilities A and B are just and reasonable. Under HB 453, there will be no independent review of whether the new plant constructed by the Joint Action Agency was necessary or prudent, a standard inquiry in any rate proceeding. There will be no review of whether the costs associated with construction of that new plant were reasonable, again a standard point of inquiry in any rate proceeding. Moreover, there would be no independent review of the operating cost component of the Joint Action Agencies wholesale rate to determine whether those costs are reasonable, prudent, or even related to the facility.

Rather, HB 453 would allow Utilities A and B, under the guise of a Joint Action Agency, to commit to the construction of a new plant (whether that plant is necessary to meet demand or not), pay any cost for the construction of that plant, decide what operating costs to recover (regardless of prudency or reasonableness), and then establish the wholesale rate it will charge its

[1] We note that HB 453 is not limited to new power projects developed by a Joint Action Agency. There is nothing in HB 453 to prevent a member of a Joint Action Agency from transferring existing assets to the Agency. As detailed in the example developed in the text above, under HB 453, investment decisions related to the maintenance of any assets transferred to a Joint Action Agency, as well as the costs associated with the operation of those assets, would also be exempt from Regulatory Commission review.

membership for the purchase of power from that plant -- all without ANY independent review or oversight. Such latitude in the area of providing utility service to the public, whether it be electric, telephone, water, etc., is unprecedented, and would leave electric utility ratepayers in Alaska open to substantial rate increases without any opportunity to achieve real rate relief in a regulatory proceeding.[2]

As a point of clarification, we also would like to address an issue raised in the Legal Services memorandum dated February 27, 2004 (attached). Representative Heinze, the sponsor of HB 453, asked Legal Service whether HB 453 would "affect existing contracts between individual utilities." Quoting Article I, Section 15, of the Alaska Constitution, Legal Services concludes that "[g]enerally a new law will not operate to modify existing contracts. . . . The legislature cannot retroactively change rights that are fixed under a contract." We do not disagree with that statement; however, we would like to point-out that the long-term power purchase agreements that are common among the various cooperative utilities operating in south-central Alaska would not necessarily protect the utilities purchasing power under those contracts from the cost increases likely to result from the creation of exempt Joint Action Agencies.

We are long-time counsel to MEA and are very familiar with the power purchase contract between MEA and Chugach Electric. That contract is an all requirements contract whereby MEA is obligated to purchase all of its power from Chugach Electric though 2014 (*i.e.*, MEA is a captive customer of Chugach Electric for the life of the contract). The MEA/Chugach Electric contract does not establish the rate MEA pays Chugach Electric for the purchase of power. Rather, the contract simply establishes the methodology for calculating the wholesale rate Chugach Electric charges MEA.

In other words, MEA's long-term power purchase agreement with Chugach Electric would not necessarily insulate MEA (and its membership) from an increase in power purchase costs were Chugach Electric to join a Joint Action Agency from which Chugach Electric then purchased power for resale to MEA. As in the example discussed above, were Chugach Electric to join a Joint Action Agency, MEA, as well as the approximately 70,000 Chugach Electric retail customers, would have no opportunity to question the reasonableness of the investment

---

[2] We question whether HB 453 is the appropriate vehicle for exempting electric utilities from Regulatory Commission review and oversight. As 42.05.711(h) and AS 42.05.712 establish the procedure for the member/owners of an electric cooperative (*i.e.*, Chugach Electric Association, Homer Electric Association, Golden Valley Electric Association, Matanuska Electric Association, etc.) to elect to exempt their cooperative from Regulatory Commission jurisdiction. If those utilities promoting passage of HB 453 are sincere about their stated interest in doing what is best for their member/owners, they should be direct about their intent with this effort and put it to a vote of their member/owners.

decisions or operating costs of the Joint Action Agency. Rather, in a rate proceeding at the Regulatory Commission, MEA (and Chugach Electric's other consumers of wholesale power, including its own retail customers) would be limited to reviewing Chugach Electric's general corporate administrative costs, and the costs related to any generation and transmission assets Chugach Electric retained in its own corporate name (*e.g.*, did not transfer to the Joint Action Agency).

Again, in our opinion, there is nothing in HB 453 that would bar a utility from transferring all or some of its existing generation and transmission assets to the Joint Action Agency, thus removing those assets, and all costs associated with the ownership and operation of those assets, from independent regulatory review and oversight. Nor do we see any safeguards against a partitioning of assets and costs to individual member utilities within the Joint Action Agency format. The end result of this proposed legislation, therefore, could well be that the largest component of the electric rates paid by the majority of south-central Alaska's consumers – the costs of power generation and transmission – would be beyond the scope of any regulatory protections, because all amounts paid by the member utilities of the Joint Action Agency in the form of the Joint Action Agency's wholesale rate would be exempt from Regulatory Commission review.

In closing, we note that electric utilities in Alaska enjoy a state-sanctioned monopoly in the form of exclusive service territories. In exchange for the state license to operate a monopoly, the state required that the various electric utilities submit themselves to state regulatory oversight so the state could ensure that the utilities were not abusing their exclusive license. Were the legislature to enact HB 453, the rate paying public would no longer enjoy the state's protection in the single most expensive area of providing electric service – power generation and transmission. On behalf of MEA, we urge you to reject HB 453.

Sincerely,

Kyle W. Parker

KWP/mw

cc: Mark Johnson, Chair Regulatory Commission of Alaska

Attachments

LEGAL SERVICES

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

(907) 465-3867 or 465-3450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM March 3, 2004

SUBJECT: Draft CSHB 453( ): parties to a joint action agency agreement and regulation by the RCA (Work Order No. 23-LS1601\D)

TO: Representative Cheryll Heinze
Attn: Jon Bittner

FROM: Barbara R. Craver BRC
Legislative Counsel

You have asked whether section 2 of draft CSHB 453( ), version D, makes the parties to a joint action agency agreement exempt from Regulatory Commission of Alaska (RCA) regulation. That bill section provides:

> * Sec. 2. AS 42.05.711(o) is amended to read:
>
> (o) A joint action agency established under AS 42.45.310 is exempt from regulation under this chapter, including the requirement to obtain a certificate of public convenience and necessity under AS 42.05.221, for the operation of, sale of power from, and other activities related to the power project the joint action agency purchases from the Alaska Energy Authority until the wholesale agreement and any related contract assigned by the authority becomes subject to review or approval by the commission under AS 42.05.431. The exemption provided by this subsection extends to repairs and improvements to the power project the joint action agency purchases from the authority but does not extend to any other power project or other activity of the joint action agency. A joint action agency established under AS 42.45.500 that is formed by public utilities owned by a political subdivision of the state or cooperatives organized under AS 10.25 or a combination of the two is exempt from regulation under this chapter, including the requirement to obtain a certificate of public convenience and necessity under AS 42.05.221.

The changes to AS 42.05.711(o) add a particular kind of joint action agency to that subsection and, for that particular kind of joint action agency, provide a complete exemption from RCA regulation. The exemption very clearly only applies to the

described joint action agency and does not also apply to the individual parties to the agreement which forms the joint action agency as a separate entity: "A joint action agency . . . is exempt from regulation under this chapter." Aside from the straightforward construction of the sentence, the singular verb "is" reinforces that the exemption is for the joint action agency only. Although it is my strong opinion that an additional sentence is not necessary, this sentence could be added to follow the last sentence added by section 2: The individual parties to the joint action agency agreement are not included in this exemption.

If I may be of further assistance, please advise.

BRC:mdr
04-085.mdr

LEGAL SERVICES

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

(907) 465-3867 or 465-3450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM February 27, 2004

SUBJECT: HB 453 and Joint Action Agencies (Work Order 23-LS1601\A)

TO: Representative Cheryll Heinze
Attn: Jon Bittner

FROM: Barbara R. Craver BRC
Legislative Counsel

You have asked for an legal opinion on two questions in regard to HB 453. The questions are:

1) Do the exemptions given to joint action agencies in this bill apply to the retail rates of the individual utilities and cooperatives who are members of the agency?

2) Will this bill affect existing contracts between individual utilities?

1. Do the exemptions given to joint action agencies in this bill apply to the retail rates of the individual utilities and cooperatives who are members of the agency?

No. Both sections of this bill apply exclusively to joint action agencies, which are separate legal entities from the members of the agency. Under AS 42.45.300, a joint action agency may only be formed "for the purpose of participation in the design, construction, operation, and maintenance of a generating or transmission facility". It is my understanding that generating and transmitting electricity does not include retail distribution, thus a joint action agency does not conduct retail sales. However, as legally separate entities, each member of the agency operating as a public utility or an electrical cooperative continues to be regulated as before in regard to its retail sales of power. This bill does not change that.

2. Will this bill affect existing contracts between individual utilities?
Generally a new law will not operate to modify existing contracts. In fact, if a law has that effect, it may be found to violate Article I, Section 15, of the Alaska Constitution which provides: ". . . no law impairing the obligation of contracts . . . shall be passed . . . ." The legislature cannot retroactively change rights that are fixed under a contract.

If I may be of further assistance, please advise.

BRC:med:mdr
04-240.med

-Historic
- A tool
- Misinformation abounds
- All non-profits

Written Comments

By Joe Griffith, CEO Chugach Electric Assoc,. Inc.

Testimony in favor of HB 453

Exempting economic regulation of wholesale agreements by joint action agencies to public utilities that are parties to the agency agreements.

Before
House Finance Committee
April 1, 2004 1:30 PM
CO-CHAIR Representative Harris and Representative Williams

- Chugach Electric supports House Bill 453
- House Bill 453 is simply a tool that the legislature can provide to joint action agencies to reduce regulatory uncertainty and reduce financing costs for future electrical infrastructure.
- The Railbelt Energy study identified that over 5 billion will be spent in the next 25 years on Railbelt electrical supply. This includes fuel, operations and maintenance expenses and the capital necessary to replace aging generation and meet new electrical demands. Five billion is a major contributor to Alaska's economic future.
- The Legislature has told the utilities that they should not count on the state providing grants for future infrastructure needs.
- House Bill 453 helps the utilities fill the gap without burdening the state with government subsidy and continued bureaucracy.
- The joint action agency is comprised of only cooperatives and municipal utilities. Representatives of the utilities will sit on the agencies board of directors.
- Member utilities will approve all power sales agreements between the JAA and the member utility. The addition of RCA oversight is not necessary as the utilities have a voice in the project operation, maintenance and cost recovery.
- A model that is working well today is the Bradley Lake Project; 4-Dam Pool.
- Bradley Lake has been a good example of utilities working together for the benefit of all. Cooperation; not regulation has been the key to this success.
- Governance of cooperatives and municipal utilities serve at the pleasure of the membership. The member/owners have the ability to change the governance if they don't agree with the reliability, price and service they receive from their utilities.
- Joint action agencies will be comprised of members who have common interest and share common goals. All will have a voice at the table and all will be free to make their own choices.
- Chugach, Golden Valley Electric, and Anchorage Municipal Light & Power are the initial members of the joint action agency. It is Chugach's desire to see the other utilities join as they see benefit in this process.
- As we have seen in the past, all of the utilities don't see eye to eye. We hope the joint action agency process will provide a better framework for future project development.
- Supporting HB 453 will help maintain low-cost reliable power by giving utilities the tools they need to attract low-cost financing to build Alaska's future electrical infrastructure.

ACTIVE MEMBERS

ARECA Active Members

Rural electric cooperative corporations, municipally-owned electric utilities, regional electric authorities, or joint action agencies organized under the laws of the State of Alaska with annual sales of at least 800 mwh.

- Alaska Electric & Energy Cooperative (AEEC)
- Alaska Electric Generation and Transmission Cooperative, Inc. (AEG&T)
- Alaska Village Electric Cooperative, Inc. (AVEC)
- Anchorage Municipal Light & Power (ML&P)
- Barrow Utilities & Electric Cooperative, Inc. (BUECI)
- Chugach Electric Association (Chugach)
- Copper Valley Electric Association, Inc. (CVEA)
- Cordova Electric Cooperative, Inc. (CEC)
- Four Dam Pool Power Agency (FDPPA)
- Galena, City of (Galena)
- Golden Valley Electric Association, Inc. (GVEA)
- Homer Electric Association, Inc. (HEA)
- INN Electric Cooperative, Inc. (INN)
- Kodiak Electric Association, Inc. (KEA)
- Kotzebue Electric Association, Inc. (KOTZ)
- Levelock Electric Cooperative, Inc. (LEC)
- Middle Kuskokwim Electric Cooperative, Inc. (MKEC)
- Naknek Electric Association, Inc. (NEA)
- Nome Joint Utility System (NJUS)
- North Slope Borough Power & Light (NSBPL)
- Nushagak Cooperative, Inc. (NUS)
- ~~[illegible]~~
- Seward, City of Light & Power Division (SL&P)
- Thomas Bay Power Authority (TBPA) Inside Passage Elec. Coop (IPEC)
- ~~Tlingit-Haida Regional Electrical Authority (TTREA)~~
- Unalakleet Valley Electric Cooperative (UVEC)
- Yakutat Power, Inc. (YPI)

26

CONTRIBUTING MEMBERS

ASSOCIATE MEMBERS

March 26, 2004

To: The Honorable Frank Murkowski
Governor
State of Alaska

The Honorable Gene Therriault
President, Alaska State Senate
Alaska State Legislature

The Honorable Pete Kott
Speaker House of Representatives
Alaska State Legislature

We the undersigned support using $68 million in grants for a group of projects that will improve electrical energy infrastructure for Alaskans throughout the Railbelt and in the Copper River basin. The utilities serving these customers are all either not-for-profit member owned cooperatives or municipal systems. The Railbelt Energy Fund is the source of the monies for the grants. Our proposal is for the following package of projects:

- $16 million to AIDEA/AEA for improvements to the Alaska Intertie
- $15.5 million to Matanuska Electric Association for transmission and distribution work
- $22 million to Chugach Electric Association to rebuild portions of its transmission line between Anchorage and Cooper Landing
- $9 million to Homer Electric Association to rebuild portions of its transmission line between Cooper Landing and Soldotna
- $1.5 million to the City of Seward to construct a transmission line
- $4 million to Copper Valley Electric Association for system projects

Additional project information is contained in the attached document.

We respectfully urge your support for this package proposal.

Steve Haagenson, President & CEO
Golden Valley Electric Association

Brad Janorschke, General Manager
Homer Electric Association

Wayne Carmony, General Manager
Matanuska Electric Association

Dave Calvert, Utility Manager
City of Seward

James Posey, General Manager
Anchorage Municipal Light & Power

Robert Wilkinson, CEO
Copper Valley Electric Association

Evan J. Griffith, CEO
Chugach Electric Association

Testimony of Christine Pihl (*Seattle Northwest Securities*)
Before the House Labor and Commerce Committee/

Given the importance that reliable and affordable electricity plays in our lives, it is in the public interest to insure that electric utilities are of sound financial health and have access to capital at cost-effective rates.

A utility's credit rating is a proxy for its cost of borrowing. Electric utilities, particularly those with generation and transmission assets, rely heavily on long-term borrowing to finance projects.

Credit ratings by national rating agencies provide an independent opinion on the financial health/position of a utility, particularly in comparison to other utilities.

The regulatory environment is one of several key factors evaluated by rating agencies to assess the credit worthiness of a utility.

For example, being regulated is viewed as constraining a utility's ability to respond to changes in financial conditions. If a utility is not free to address these issues, and a regulator has oversight, a rating analyst cannot be certain that the utilities financial goals, policies or projections will come to fruition.

If there is a history of favorable regulatory treatment, the effects of regulation can be somewhat muted.

In a situation where the regulatory body has a history of being neutral, the threat of regulatory interference may be somewhat lessened but its potential effect is still acknowledged.

The most difficult situation is that where there is a precedent of negative regulatory treatment. This creates a great deal of

uncertainty as to the financial future of a utility to existing and potential lenders, despite solid planning, clear financial strategy and goals and the desire to maintain a favorable credit rating. The regulatory environment can undermine all of this.

A recent example of this is the downgrading of Chugach Electric, in 2003 by the credit rating agencies. Negative regulatory treatment was sited by both agencies as the reason for the downgrades.

This is in sharp contrast to S&P's observations on the RCA's support as indicated in their write up from January 2002:

As is evident from these reports, the actions and interactions of the RCA directly impact the credit rating and hence the cost of capital that Chugach pays.

As the RCA position paper points out, the electric utility business is the most capital-intensive industry in Alaska. With Chugach supplying power to 2/3rds of Alaska and with ML&P supplying a large portion of the remainder, all of Alaska's electric consumers benefit from these public utilities having strong credit ratings to facilitate cost-effective financing of these large capital expenditures. To the extent that a regulatory body takes action to cause a decrease in financial stability or creates an unfavorable regulatory environment, it impacts all ratepayers' in the Railbelt.

Furthermore, as it becomes more evident that State regulators have increasing interest in financial profiles, to the extent that Alaska's regulatory environment does not support this thinking creates an even greater red flag for the rating agencies.

Everything that I have said here and attributed to S&P is echoed by Fitch Ratings, another leading independent provider of credit ratings. Fitch also took ratings action with respect to Chugach in

2003 with a two-notch downgrade (Oct 03/Dec 03) from A+ to A-, again largely attributable to regulatory action and the effects thereof.

You have the complete reports before you.

In Alaska, regulation is costing ratepayers due to higher costs of capital. Nationally, the regulatory environment has been cited as a constraint to financial flexibility:

CONCLUSIONS

Regulatory oversight is viewed as a constraint to financial flexibility and timely responsiveness in what has become an evolving, dynamic energy marketplace.

A negative regulatory environment casts a long shadow over the credit quality of those bodies it regulates.

A lower credit rating means higher borrowing costs, which translates into higher rates for ratepayers.

> A credit rating below A- will cost ratepayers substantially more.

By and large around the nation, public utilities are not subject to the state regulatory oversight but rather are left to oversight by elected boards, members, or customers and customer representatives, all of whom have a direct vested interest in the financial stability and strength of the utility.

It is incumbent upon the regulatory body to be cognizant of the capital market ramifications and credit rating agency responses to its actions, as they are scrutinized carefully by these parties and directly affect the cost of capital for these capital-intensive utilities.

Subjecting the new Railbelt JAA to state regulatory oversight will cost electricity consumers in the Railbelt in the form of higher energy bills.

Alaska State Legislature
HOUSE OF REPRESENTATIVES

Official Business

State Capitol
Juneau, AK 99801-1182

Dear Representative Williams, Co-Chair Finance: 04/21/04

We represent consumers of Matanuska Electric Association. Our electric utility is the oldest, fastest growing, second largest electric cooperative in Alaska. MEA has also earned a reputation for efficiency and low rates. MEA is subject to a 25 year all requirements wholesale power contract with Chugach Electric Association in Anchorage. The contract expires December 31, 2014.

Currently, generation and transmission cost from Chugach Electric make upjust over 60 percent of the bill every MEA member pays for power. HB453would create a new standard for some or all of Chugach generation and transmission cost. HB453 would make a radical change in State law to exempt Joint Action Agencies from regulation by the consumer protection agency, the Regulatory Commission of Alaska.

MEA would be at the mercy of whatever price the Joint Action Agency charged Chugach Electric for generation and transmission.The Energy Policy Task Force did not recommend this change in state law in their Railbelt report filed with the Legislature this year. None of the utilities seeking this radical change in state law asked the Energy Policy Task Force to recommend exempting generation and transmission from consumer protection regulation. HB453 is premature and the issues involved should be considered at length, not pushed through over the objections of the Regulatory Commission of Alaska, Homer Electric Association, the City of Seward and Matanuska Electric Association.

We respectfully request that you join us in opposing HB453.

Sincerely,

Rep. Carl Gatto

Rep. Nancy Dahlstrom

Rep. Beverly Masek

Rep. Vic Kohring

Rep. Bill Stoltze

Rep. John Harris

Sen. Fred Dyson

Sen. Lyda Green

Sen. Scott Ogan

Speaker Pete Kott

SESSION
State Capitol, Room 416
Juneau, Alaska 99801-1182
(907) 465-4930 Tel
(907) 465-3834 Fax

INTERIM
716 W. Fourth Ave.
Anchorage, Alaska 99501-2133
Tel (907) 269-0174
Fax (907) 269-0177

Alaska State Legislature
REPRESENTATIVE CHERYLL BOREN HEINZE
Chair: Economic Development; International Trade & Tourism

April 13th 2004

To: Chair Williams — Chair Harris

CC: Vice-Chair Meyer, Representative Fate, Representative Hawker, Representative Croft, Representative Joule, Representative Chenault, Representative Foster, Representative Stoltze, Representative Moses

From: Representative Heinze

Re: Legislative Legal Memo regarding the RCA's authority under CSHB 453 (L&C).

In the last hearing in Finance on HB 453, Representative Hawker asked if the RCA would be able to "pierce the corporate veil" in regulating rates.

MEA had asserted that Chugach/ML&P/Golden Valley could shift their generation and transmission assets to a JAA and then sell back to themselves at an inflated price *without regulatory oversight*, thus causing rates to go up without an adequate check and balance. This assertion was presented in a letter from Patton Boggs on behalf of MEA.

The Alaska State Legislature's Legal Department categorically refutes MEA's argument (see attached memo) that the utilities could sell wholesale power effectively *without regulatory oversight.*

Current statutes give RCA the explicit authority to consider "contracts affecting" the rates a utility charges another utility for power.

SESSION
State Capitol, Room 416
Juneau, Alaska 99801-1182
(907) 465-4930 Tel
(907) 465-3834 Fax

INTERIM
716 W. Fourth Ave.
Anchorage, Alaska 99501-2133
Tel (907) 269-0174
Fax (907) 269-0177

Alaska State Legislature
REPRESENTATIVE CHERYLL BOREN HEINZE
Chair: Economic Development; International Trade & Tourism

Further, since my bill would limit the exemption from regulation to wholesale agreements between a JAA and its members, the RCA would retain the authority to regulate wholesale agreements between utilities outside the JAA.

CSHB 453 (L&C) provides a narrow and needed exemption similar to the one provided to the four-dam pool, without materially affecting the RCA's ability to regulate rates in Alaska.

If you have any further questions, please feel free to contact me at any time.

Thank you,

Cheryll

Representative Heinze

Web Site: www.akrepublicans.org/heinze/ • E-mail: Representative_Cheryll_Heinze@legis.state.ak.us

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

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM April 9, 2004

SUBJECT: Parameters of the exemption from Regulatory Commission of Alaska oversight given to joint action agencies in CSHB 453(L&C), (Work Order No. 23-LS1601\H)

TO: Representative Cheryll Boren Heinze
Attn: Mike Pawlowski

FROM: Barbara R. Craver BRC
Legislative Counsel

In your April 2 communication, you have asked

1) "would the RCA [Regulatory Commission of Alaska] have the authority to pierce the corporate veil in regulating the wholesale contracts between utilities as they are affected by the unregulated contracts conducted with a JAA [joint action agency] exempted by CSHB 453 (L&C)?"; and

2) "under CSHB 453(L&C), would the RCA maintain regulatory authority over the utilities as they exist outside of the JAA?"

Question 1

Transmitted with the two questions you have asked was a copy of Kyle Parker's March 29 letter to the House Finance Committee co-chairs. Mr. Parker voices objection to the bill because, from his reading, it appears to allow utilities to transfer key assets to a joint action agency, "thus removing those assets, and all costs associated with the ownership and operation of those assets, from independent regulatory review and oversight." His explanation includes a hypothetical involving a pair of utilities, A and B, that join together to create a joint action agency.

Let me borrow Mr. Parker's hypothetical. Consider that Utility A[1] and Utility B[2] have entered into a wholesale power agreement. Utility B is a member of BXJAA, a joint

---

[1] Utility A is a public utility that sells electricity to consumers. Utility A is an electric cooperative organized under AS 10.25. It buys power under an "all requirements contract" from Utility B, another electric cooperative organized under AS 10.25. The requirements contract does not set the price of wholesale power, but provides a methodology to calculate the rate charged by B to A.

[2] Utility B is a public utility that sells electricity to consumers and also generates power which it sells wholesale to various other utilities. At the same time, utility B is a member

action agency, and BXJAA sells wholesale power back to Utility B. Under this hypothesis, may the RCA examine B's power costs, including B's cost of buying power from BXJAA, in order to determine whether the A-B contract rates are "just and reasonable" to protect A's retail customers?

RCA review of wholesale power agreements. Under existing law, specifically AS 42.05.431(b), the wholesale power agreement between Utility A and Utility B is subject to advance approval of the RCA. However, AS 42.05.431(c)(2), added by section 1 of CSHB 453(L&C), provides that the wholesale power agreement between Utility B and the joint action agency of which it is a member, BXJAA, is "not subject to review or approval by the commission."[3]

RCA authority in setting regulated rates
This bill does not change the RCA's authority to set "just and reasonable" rates under AS 24.50.341(a). That subsection grants very broad review powers in regard to regulated services. "When the commission . . . finds that a . . . contract affecting [a rate subject to RCA regulation] . . . is unjust, unreasonable, unduly discriminatory or preferential, the commission shall determine a just and reasonable rate . . . to be observed or allowed and shall establish it by order. So while the RCA has no authority over the B-BXJAA contract, it may consider the effect of that contract on the A-B contract and the effect on A's retail customers. The RCA may look at the wholesale power rate set by B in the A-B contract and B's costs and any "contract affecting" the rate charged. This would seem to encompass B's whole operation, beyond the wholesale power agreement with BXJAA.

Covenants under AS 42.05.431(a). The RCA is directed under AS 42.05.431(a) to consider certain covenants made by utilities when setting rates:

> . . . A municipality may covenant with bond purchasers regarding rates of a municipally owned utility, and the covenant is valid and enforceable and is considered to be a contract with the holders from time to time of the bonds. The financial covenants contained in mortgages and other debt instruments of cooperative utilities organized under AS 10.25 are also valid and enforceable, and rates set by the commission must be adequate to meet those covenants. . . . .

---

of BXJAA, a joint action agency formed under AS 42.45.300. The members of this JAA are utility B and utility X. This JAA is composed of public utilities owned by a political subdivision of the state cooperatives organized under AS 10.25, or by a combination of the two.

[3] The initial phrase of AS 42.05.431(c) is "notwithstanding (b) of this section," which means that the wholesale power agreement between B and BXJAA is not subject to RCA review and approval under (b).

(emphasis added.) The court found that this section required that the RCA set rates so as to assure that the existing bond covenants of a municipality could be met. Alaska Pub. Utils. Comm'n v. Municipality of Anchorage, 555 P.2d 262 (Alaska 1976).

Would the RCA also be required to assure that the rate that A pays B in the A-B contract is adequate to allow B to pay the rate agreed to in the B-BXJAA contract[4]? While the covenants in (c)(3) are different kinds of covenants than the municipal bonds mentioned in (a), the same "valid and enforceable" language is used. There is no reason for that language except to mean that the RCA cannot disregard the covenant. In regard to bond covenant, it has been held that AS 42.05.431 "specifically provides that the covenants are 'valid and enforceable'." Id. at 267. The validity of the bond covenants thus requires the Commission to respect the provisions of the covenants, and insure that they will not be breached." Id.

Power of the commission to set rates; validated costs. The general purpose of AS 42.05.431 is to authorize the RCA to set rates that are "just and reasonable." AS 42.05.431(a).[5] However, one provision of that section, AS 42.05.431(e),[6] not amended by CSHB 453(L&C), currently provides that the RCA must allow "validated

---

[4] ". . . a wholesale agreement or related contract described in (1) or (2) of this subsection may contain a covenant for the public utility to establish, charge, and collect rates sufficient to meet its obligations under the contract; the rate covenant is valid and enforceable." AS 42.05.431(c)(3).

[5] AS 42.05.431(a):

> When the commission, after an investigation and hearing, finds that a rate demanded, observed, charged, or collected by a public utility for a service subject to the jurisdiction of the commission, or that a classification, rule, regulation, practice, or contract affecting the rate, is unjust, unreasonable, unduly discriminatory or preferential, the commission shall determine a just and reasonable rate, classification, rule, regulation, practice, or contract to be observed or allowed and shall establish it by order. . . . .

[6] AS 42.05.431(e):

> Validated costs incurred by a utility in connection with the related contracts described in (c)(1) of this section must be allowed in the rates charged by the utility. In this subsection, "validated costs" are the actual costs that a utility uses, under the formula set out in related contracts described in (c) of this section, to establish rates, charges for services and rights, and the payment of charges for services and rights. This subsection does not grant the commission jurisdiction to alter or amend the formula set out in those related contracts.

[power sales contract] costs . . . in the rates[7] charged by the utility." The operation of the exception is limited: only the Four Dam Pool[8] wholesale power sales contract costs are required to be taken as a given, or as a "validated cost," so the RCA must approve a rate that allows for the wholesale power costs of the Four Dam Pool without alteration. CSHB 453(L&C) does not propose a change or amendment to AS 42.05.431(e) that would add the wholesale contracts in the new (c)(2) as "validated costs" not subject to RCA alteration.

Because AS 42.05.431(e) does not specifically include the "new JAAs" of (c)(2) within the Four Dam Pool "validated costs" exemption, I don't think that RCA would be required to accept the wholesale power sales contract costs and provide for these costs without examination when reviewing a wholesale rate under AS 42.05.431(b). I reach this conclusion on an application of the principle that the legislature's decision not to extend the "validated costs" exemption is intentional, not an oversight, and that the review and approval of these costs when considering the rate is consistent with the narrow application of the exclusion and consistent with the general obligation of the RCA under AS 42.05.431. In the hypothetical developed in this memo, that would mean that the RCA, when reviewing the wholesale power agreement between Utility A and Utility B, would not be required to accept B's costs under the B - BXJAA contract without question; the commission could review and pass upon the justness of the rates that incorporate those costs. However, the RCA could not alter the terms of the B-BXJAA wholesale power agreement.

So, while CSHB 453(L&C) insulates the wholesale power agreements between B and BXJAA from RCA review, the RCA maintains its ability to look at the "big picture" in reviewing the rates set in the A-B contract, while still being required to respect the provisions of the B-BXJAA contract.

*

Question 2

CSHB 453(L&C) does not change my previous analysis, which is that the bill's amendments to AS 42.05.711(o) very clearly only apply to the described joint action agency and do not also apply to the individual parties to the agreement which form the joint action agency as a separate entity: "**A joint action agency . . . is exempt from regulation under this chapter.** Aside from the straightforward construction of the

---

[7] The term "rate" is defined at AS 42.05.990(5) as including "each rate, toll, fare, rental, charge, or other form of compensation demanded, observed, charged, or collected by a public utility for its services." I am assuming that AS 42.05.431(e) thus refers to wholesale rates as well as retail tariffs, as the term "tariff," also defined at (7) of that section, refers specifically to compensation for service to the public.

[8] The Four Dam Pool is the joint action agency formed under AS 42.05.310.

sentence, the singular verb "is" reinforces that the exemption is for the described joint action agency only.

*

My analysis in this memo is based primarily on statutory construction. The regulation of public utilities is one which requires expertise and practical knowledge of the regulated entities as well as the goals of regulation. Thank you for sharing the opinions provided by others working in this area.

If I may be of further assistance, please advise.

BRC:med:lmb:mdr
04-101.lmb

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: G. Nanette Thompson, Chair
Bernie Smith
Patricia M. DeMarco
Will Abbott
James S. Strandberg

In the Matter of Regulations Defining the Future Market Structure of Alaska's Electric Industry

R-97-10

ORDER NO. 8

ORDER TABLING ELECTRIC MARKET STRUCTURE ISSUES AND CLOSING DOCKET

BY THE COMMISSION:

Summary

Through hearings and extensive comments from interested persons, we have examined the electric market structure study that we commissioned jointly with the Legislature. The Commission Staff (Staff) proposed an analysis of Railbelt electric contracts with input from concerned persons. After consideration of all the collected information and noting the guidance from the Legislature, we decide to defer any further consideration of retail electric utility restructuring and competition in Alaska. Projections of any potential benefits are too speculative at this time. Important factors such as natural gas supply, power transmission capacity, and technological improvements may significantly change the dynamics for future competition. We take no action now other than continuing to monitor the regulated Railbelt electric market. We close this Docket.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Background

We opened this Docket to "determine the appropriate roles for competition and regulation in Alaska's electric industry and implement the actions and changes the Commission finds appropriate."[1] Together with the Alaska State Legislature,[2] we selected the firm of CH2M Hill to prepare a "Study of Electric Utility Restructuring in Alaska" (the Study). CH2M Hill submitted a draft of the Study on April 4, 1999.

We released the Study for comment.[3] All Railbelt electric utilities[4] submitted comments, as did Kodiak Electric Association, Inc. (KEA); Copper Valley Electric Association, Inc. (CVEA); and the Alaska Rural Electric Cooperative

---

[1]Order R-97-10(1), dated April 30, 1999 (hereinafter Order No. 1), p. 1.

[2]The Legislative Joint Committee on Electric Utility Restructuring, a special committee of the Alaska State Legislature, heard testimony in two separate sessions during the 1999 and 2000 sessions. The Committee also issued two letters stating that electric utility restructuring is a public policy question that the Legislature should decide. (Letter from Representative Bill Hudson, Chair, House Utilities Restructuring Committee *et al.*, dated May 7, 1999, to the Alaska Public Utilities Commission, and letter from Representative Bill Hudson, Chair, House Utilities Restructuring Committee, *et al.*, dated April 20, 2000, to Governor Tony Knowles.)

[3]*See* Order No. 1.

[4]By the "Railbelt utilities" we mean the interconnected utilities of Chugach Electric Association, Inc. (Chugach); Golden Valley Electric Association, Inc. (GVEA); Homer Electric Association, Inc. (HEA); Matanuska Electric Association, Inc. (MEA); and the Municipality of Anchorage d/b/a Municipal Light & Power Department (ML&P). Alaska Electric Generation and Transmission Cooperative, Inc., is a wholesale supplier to HEA and MEA. The City of Seward's electric system is a nonregulated municipal utility included within the Railbelt interconnection.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Association, Inc. (ARECA).[5] Generally, all commentors supported CH2M Hill's recommendation that electric restructuring must be approached with caution and only after thorough analysis of all of the potential risks and benefits.

ARECA commented that the Study presented a useful and informative description of the primary issues that policymakers must address when deciding whether to pursue electric restructuring in Alaska. HEA believed it is unclear that competition is appropriate for Alaska but stated that we should emphasize and further study market power and the status of wholesale power contracts. HEA stated the Study did not address how the existing wholesale contract would be affected by competition. HEA asserted the effects of those wholesale contracts must be evaluated in any approach to competition.

GVEA stated Alaska should not base its electric industry market structure policies on the conclusions set forth in the Study. GVEA asserted the Study did not address the uniqueness of Alaska or the level of success the electric industry in Alaska has achieved in providing low-cost power to consumers. GVEA further asserted that the Study did not provide a sound basis with which to move forward on efforts to promote different forms of competition. GVEA concluded that the expenditure of millions of dollars is unwarranted based on a study that shows, at best, marginal benefits and does not address the true cost of implementing the proposed alternative to the current system.

ML&P asserted that no quantitative analysis has yet been performed that demonstrates the existence of net positive benefits to consumers from restructuring.

[5]Order No. 1 set a closing date of May 28, 1999, for comments on the Study, and required peer reviews of the document. Orders R-97-10(2), dated June 4, 1999; R-97-10(3), dated June 21, 1999; and R-97-10(4), dated June 21, 1999, extended the comment deadline.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

CVEA stressed that the concerns of rural Alaska were not addressed adequately by the Study. CVEA pointed out that Alaskan utilities, notably most cooperatives, are changing the way they do business under the threat of competition. Because of this threat, CVEA asserted some discussion on this issue would be beneficial.

KEA pointed out that the study failed to discuss mid-size rural utilities, which are larger than "bush" utilities but not interconnected. A good portion of these utilities' total customer load consists of large industrial customers. Many are connected to the Four Dam Pool.[6] KEA also pointed out that competition for these large industrial loads would have substantial, negative consequences on the residential ratepayers.

The Study's authors made several presentations to the Legislative Joint Committee and to us to explain their analysis and conclusions. The final version of the Study, dated June 30, 1999, was submitted to us on July 6, 1999.

The Study considers retail electricity competition within what has become the standard framework for restructuring the industry. In this model, a centralized, nonprofit power exchange purchases electricity from generators and then sells the power to those who will ultimately market it to retail consumers. Transmission and distribution service continues to be regulated in the traditional manner. This restructuring template leaves open whether bilateral contracts between generators and marketers would be permitted, alongside sales to the central exchange.

Chugach, like most commentors on the Study, opposed creating a centralized power exchange. However, Chugach was alone among commentors in

[6]During the 1980s, four of Alaska's hydroelectric projects, Swan Lake, Terror Lake, Solomon Gulch and Tyee Lake were combined into one unit called the Four Dam Pool. These hydroelectric facilities are located in Petersburg-Wrangell, Kodiak, Valdez, and Ketchikan.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

encouraging the Commission to move rapidly towards retail competition. An outline of Chugach's favored approach was appended to its comments to us[7] without elaboration. Instead, Chugach suggested that we initiate informal round-table discussions to develop a procedural timeline for addressing issues that we believe are worthy of further consideration.[8]

The Study proposed three different policy "packages" or paths the state can travel regarding future retail electric market structure:

- work within the current regulatory scheme to improve efficiency;
- move aggressively towards an open market in electricity with minimal regulatory oversight; or
- move more slowly but deliberately towards a competitive market but with considerable regulatory and legislative involvement at regular intervals.

The Study assumes the second and third paths would both yield the same competitive market structure but over a different time period and with a different level of regulatory oversight. Possible benefits and costs of restructuring the electricity market along the latter two paths are modeled.[9] Projected net benefits up to year 2017 range from $25 million to $250 million, with stranded costs of $35 million to $200 million. Estimated costs to consumers from the exercise of market power go as

[7] *See* Appendix A to Chugach's Comments, dated June 1, 1999.

[8] Chugach Comments, p. 2.

[9] Modeling was generally over the period 1996-2017.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

high as $350 million. The wide range in possible net benefits is the result of uncertainty surrounding the future evolution of market structures.[10]

The Study included a "roadmap" for restructuring, including four discrete phases of transition:[11]

Restructuring Regulation – Conducting rulemaking, integrating agency activities, reviewing rate regulations to allow aggregation.

Preparing for Competition – Conducting cost studies, resource planning and acquisition processes; studying and designing a market for commodity energy.

Implementing – Unbundling rates; developing market power rules, reliability standards, pro forma tariffs, and governance rules; transferring operations to central dispatch authority; considering contract reformation; developing stranded-cost mitigation plan.

Start Up – Launching power exchange and Independent System Operator, initiating market power oversight and enforcement.

The Study assumes significant input from the Legislature in the Restructuring Regulation phase and the Preparing for Competition phase, including statements of legislative intent, general legislative authorizations, legislative mandates, and appropriation of funds and tax legislation.

While the Study concludes that this is the appropriate time to begin preparing for competition in the electric utility industry, the Study excludes rural Alaska

[10]Executive Summary, p. ES-20.

[11]Executive Summary, Table ES-1.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

from consideration for competitive market restructuring. Focusing on the Railbelt, the Study suggests a limited regulatory reform agenda aimed at maximizing the potential for market success and seizing short-term benefits available through the introduction of market-informed changes. The Study concludes that the Railbelt region is not yet ready for implementation of fully deregulated competition but recommends a gradual approach to restructuring.[12]

To help define the Railbelt market structure, we required Staff to assemble a summary of railbelt bilateral contracts. We released for comment a Staff work paper dated November 20, 2000, that summarizes existing Railbelt contracts for fuel, wholesale electric power, and transmission service (Contract Summary).[13] Comments were helpful in clarifying the wholesale power contract structure. We have incorporated industry comments in the Contract Summary, and the revised document has been used to address the existing bilateral contracts in Railbelt electrical structure, which was not detailed in the Study.

At our direction, Staff reviewed the Study, and on June 1, 2001, submitted its analysis and recommendation (Report). We released Staff's Report for a thirty-day period to afford all interested persons an opportunity to review it and file comments. (See Order R-97-10(7), dated June 22, 2001.) Numerous comments were timely filed in response to Staff's Report. In general, the comments supported Staff's analysis and recommendations although CH2M Hill voiced its objections to Staff's conclusions.

[12]Executive Summary, p. ES-20.

[13]*See* Order R-97-10(5), dated November 27, 2000.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

At the August 15, 2001, public meeting, we considered the comments received in response to Staff's Report. At that meeting, we determined that these additional comments do not change our view that the overall record in this Docket supports the motion that was passed at the June 20, 2001, public meeting. At the June 20, 2001, meeting, we moved to adopt a conclusion that there is insufficient evidence in the record to justify initiating retail electric competition for any area of Alaska and closed the Docket.

Discussion

The Legislature has asserted that electric utility restructuring is an important public policy question that it should decide. We acknowledge the Legislature's leading role in determining such important public policy. But, as a commission, we have expertise in engineering, economic, and regulatory policy to contribute. We also have a record, developed in this Docket, including the Study, the Contract Summary, comments in our public meetings, the Staff Report, and briefings from the participating entities. This Order states our reasons for concluding that it is not appropriate at this time to initiate regulatory changes to promote retail electric competition in the electricity market.

As a starting point, we believe it is appropriate for us to initiate electric utility restructuring only if we are convinced it is in the public interest. The public interest is a flexible concept that we tailor to the unique conditions of Alaska's electric market. We must find: first, that ratepayers will not be harmed and in fact will reap benefits; second, rates will be truly competitive and no entity will have market control; and, third, reliability and quality of service will remain high.

The Study indicates that while retail competition is inevitable for Alaska, we should pursue competitive market restructuring only after further, more careful

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

modeling work.[14] We disagree that retail competition is inevitable. Alaska faces neither legal nor economic pressures experienced by other States. Alaska is different from the contiguous Lower 48 states because, without interconnection to another state's energy transmission grid, Alaska does not need to respond to the actions of its neighbors. Also, many Lower 48 utilities have a large percentage of their power consumption load from industrial and large commercial customers. In contrast, large industrial and commercial users comprise less than two percent of the Alaskan Railbelt load. Most customers receiving service are residential and small business consumers. National data suggests that these kinds of customers benefit the least from retail electric competition.[15]

The Study projects potential savings from retail competition of $41 million over the 20-year modeling time horizon. However, we find the model does not address:

---

[14]The Study states:

> Though it seems to proceed in fits and starts, the march of restructuring appears generally steady. This sets up a fundamental policy question for decision-makers in Alaska. On the one hand, the longer Alaska waits to move into restructuring, the better the base of knowledge and the experience from which to draw. On the other hand, delay may compromise Alaska's ability, and the ability of its electric industry, to harvest the potential benefits of a more competitively structured industry . . . . That is, Alaska policy makers can come to terms with <u>how</u> to accomplish electric utility restructuring in a manner that best serves the interests of the people and the State, while recognizing that there will continue to be debate about <u>when</u> restructuring should occur.

Executive Summary, p. ES-3.

[15]Fran Sevel, *The Consumer Response to Public Utility Competition*, National Regulatory Research Institute (June 2001).

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

- the myriad long-term contracts for fuel and service that would need to be divested to create competitive markets;
- ownership of the Railbelt utilities: all are either member-owned cooperatives or municipalities; they are not investor-owned;[16] and
- the lack of transmission infrastructure and the concentrated ownership of generation resources, which could seriously impede competitive market formation.

Therefore, we find that, without additional detail considering unique Alaska factors such as these, the Study's modeling work is not sufficient to rely on.[17]

Utility Business and Infrastructure

Alaska's Railbelt utilities have secured a series of long-term contracts for both fuel and wholesale power. Some of these contracts will continue through the year 2014. If left in place, the contracts would limit the scope of competition and largely predetermine competitive market outcomes. Therefore, to capture the efficiency benefits that retail competition might theoretically offer, the contracts would need to be renegotiated. However, renegotiations of the existing contracts could be harmful and expensive. We believe these contracts have served Railbelt utilities and their customers well within the present context; they only pose difficulties in the context of a short-term competitive regime.

[16]Aurora Energy, LLC (Aurora), located in Fairbanks, is the lone exception. Aurora supplies a very small fraction of overall Railbelt supply.

[17]It should be noted that the Study authors did recommend "retail simulation modeling as a part of the decision to move to a full retail competition pilot or retail competition." Executive Summary, p. ES-4.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Railbelt power companies are primarily member-owner cooperatives or municipally owned. This also contrasts with the situation in the Lower 48 where investor-owned utilities are the predominant service providers. Cooperatives and municipally owned utilities enjoy low cost sources of debt and are tax exempt. However, both cooperatives and municipally owned utilities have limitations on the amount of power they can sell to nonmembers if they are to maintain these advantages.[18] Accordingly, a transition to retail competition might require these utilities to convert to investor-owned business structures that would have higher costs of debt and greater tax burdens.

We question whether the Railbelt boasts sufficient redundancy and scale of both infrastructure and demand to facilitate competitive markets in the near- to medium-term. Implementing a competitive market place requires a minimum number of providers that can compete to provide power on an equal basis. The Railbelt does not appear to meet this minimum threshold. At present, two providers in the Anchorage vicinity, Chugach and ML&P, generate over 85 percent of the electricity consumed in the Railbelt. Chugach by itself provides over 60 percent of the Railbelt's needs.[19] GVEA is largely responsible for the generation that is north of the Alaska

[18]Cooperatives that enjoy tax-exempt status may not derive more than 15 percent of their income from non-members; *see* 26 U.S.C. § 501(c)(12)(B) (1999). Although strictures have been somewhat relaxed by a temporary IRS rule, many types of commercial sales may violate the terms of the tax-exempt bonds of municipally-owned utilities; *see* 26 U.S.C. § 142(f) (1999).

[19]*See* The Black and Veatch "Power Pooling / Central Dispatch Planning Study," October 1998, Docket U-97-140.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Range. It purchases some power from a private power producer[20] in the Fairbanks area.

Likewise, the Railbelt infrastructure for power transmission is neither extensive nor robust. Existing transmission constraints increase the possibilities that a major power producer would wield market power if a competitive regime were imposed. While the transmission backbone of the Railbelt system connects all users together in the same network, there are serious capacity issues. There are no duplicative transmission routes between major population centers. Moreover, it is unclear whether the transmission line between Fairbanks and Anchorage could be used to provide firm power. Similar transmission constraints exist to the Kenai Peninsula.

The limitations on sales to nonmembers faced by the cooperatives, the location of generation facilities, and the inadequate transmission grid make creation of an Alaskan competitive market an extremely difficult and expensive proposition. We conclude that implementing retail competition in a way that creates a level playing field and effectively fosters competitive outcomes would require at least the following changes to the Railbelt:

- restructuring of long-term fuel supply and power supply contracts;
- upgrading of transmission lines both for reliability and capacity;
- increasing the number of power producer companies in the power supply market to guard against market power abuse; and

[20]Aurora Energy, LLC, operates a 27-mw coal fired power plant in Fairbanks, Alaska.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

- modifying the current restrictions on member-owned cooperatives and municipal utilities that limit their ability to sell power to non-members.

We conclude that these barriers, both practical and economical, are sufficient to strip away any potential for retail competition to confer benefits on ratepayers in the near- to medium-term.

Restructuring of Fuel and Power Supply Contracts

We have no evidence of the cost of buying out or dissolving the existing long-term supply contracts. These contracts inhibit the operation of a workably competitive market. However, these contracts have provided economic efficiencies and stability in Alaska's energy market. The scale of demand and supply in the Railbelt may not be sufficient to justify the expense and disruption to the existing market that would be necessary to eliminate the long-term supply contracts and replace them with an open exchange.[21]

Upgrading the Transmission Lines both for Reliability and Capacity

There are no known cost estimates to make the present network adequate and reliable for the operation of a competitive retail power market.[22] The

[21]Our authority to approve long-term power supply contracts is set out in AS 42.05.431(b). Once we have approved such a contract, we can then modify it only for rates purposes. The Legislature would need to modify this statute before we could terminate such contracts or revoke our authority to review such contracts altogether.

[22]The Study at p. 11.3 notes that present transmission constraints are considered. However, the constraints may lead to market-power abuse, which the Study did not assume to occur in base cases. Such market-power abuse is alleged to be occurring in California, which is similarly transmission constrained. We do not consider the present transmission infrastructure adequate to facilitate efficient markets.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

present transmission link is capacity-constrained[23] and does not have the ability to transmit firm power, which we feel is necessary for retail competition to flourish. Further, these transmission constraints only serve to exacerbate problems of market power.[24]

Increasing the Number of Power Producer Companies

To combat the problems of market concentration, the Study suggested the possible creation of a BTU[25] market, in which both electricity and natural gas is traded.[26] However, natural gas supply is not amenable to being allocated through liquid markets; virtually all Cook Inlet gas is already committed to long-term contracts for electricity, heating, or export. Therefore, creation of such a market presently appears impractical. The Study also introduced the idea of reducing the size of contracts traded in a competitive power exchange to only 500 kilowatt-hour.[27] However, trading in smaller units would not reduce the concentration, and hence market power, of those who initially own those tradable units.

Short of forced divestiture of generation assets, we see no way to reduce the concentration of generation assets in the Railbelt for the foreseeable future. It is not clear that such divestiture would be either practical or economical, compared to maintaining the status quo. Given the small population and relatively slow growth of the interconnected Railbelt, the problem of producer concentration and market power make an efficient retail power market unattainable.

---

[23]The Study, p. 11.3.

[24]*See* Tables 9 and 10 of the Study, p. 11.11.

[25]British Thermal Unit.

[26]The Study, p. 2.6.

[27]The Study, p. 2.5.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Business Structure Conversions

It is expected that because of prohibitions on the sale of power to non-members, and other debt covenants, both cooperatives and municipally owned utilities would need to change to alternate business structures to be able to participate in retail power marketing. Railbelt cooperatives and municipally owned utilities now enjoy sources of debt that have low cost, and the entities are tax exempt. Conversion away from current structures would entail higher costs of debt and a greater tax burden.

Chugach Proposal

We deal with Chugach's proposal to implement competition, included in its June 1, 1999, filing as Appendix A. Strictly speaking, Chugach did not present a proposal for retail restructuring to us. It offered a recommendation that we quickly move towards retail competition and suggested that Chugach convene informal discussions with interested persons to address the major questions it believed needed to be resolved. However, Chugach did append to its comments a presentation that it made to the Legislature on retail competition.

The essence of the Chugach proposal is to impose price-cap regulation on retail customers, and to deregulate sales to large commercial customers. It also suggests fully deregulating wholesale transactions (but with the proviso that existing wholesale contracts remain in effect). The experiment would be allowed to run two to three years, and a blue-ribbon panel would then recommend reversing, modifying, or continuing the measures. Chugach asserts that its proposal protects small customers, protects against the misuse of monopoly facilities, and is both safe and simple.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

The skeleton presentation offered to us raises more questions than it answers.[28] The lack of detail makes critical analysis difficult since there are so many unresolved issues. We have accordingly confined our discussion of retail competition to the institutional structure envisioned by the Study.

That said, there is no concrete indication that the retail competition as envisioned by the Chugach proposal will confer benefits to most Railbelt customers. It is not obvious that it is either simple or safe. Absent direction from the Legislature, we see no pressing need to "do it now," as Chugach suggests.

Conclusion

The CH2M Hill Study has provided generalized modeling and analysis conclusions that have been helpful in our decision. While the Study's modeling did not yield firm monetary costs and benefits, it did focus important market issues and constraints that we discussed above.

Having considered the issues highlighted by the Study and all the additional information we gathered, we find there is insufficient evidence in the record showing that retail electric competition is in the public interest for any area of Alaska. There is no compelling evidence that rates can be lowered. Retail competition would require extensive investment to create a well-functioning power market; it might also require significant divestiture of Railbelt utility assets, both contractual and physical.

[28]Chugach's proposal is contained on six Power Point slides of the Appendix that it attached to its Comments.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

The transition to competition from the present regulated environment would expose ratepayers to significant risk.

Without convincing evidence of benefits, we will continue to monitor the dynamics that will influence policy, specifically the natural gas supply and improvements to power transmission up and down the Railbelt. Should the Legislature again take up policy concerning electric utility restructuring, we will assist it to achieve the greatest public benefit.

Allocating Costs

With the above determinations, all other substantive and procedural matters in this proceeding have been disposed of with the exception of the allocation of costs in accordance with AS 42.05.651 and 3 AAC 48.157. Inasmuch as this is a rulemaking proceeding, the allocable costs will be borne by the Commission. Therefore, this Docket should be closed.

ORDER

THE COMMISSION FURTHER ORDERS:

1. No action will be taken on implementation of retail electric competition for Alaska at this time.

2. The allocable costs of this proceeding will be borne by the Commission.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

3. Docket R-97-10 is closed.

DATED AND EFFECTIVE at Anchorage, Alaska, this 28th day of September, 2001.

BY DIRECTION OF THE COMMISSION

(S E A L)

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Fitch Downgrades Chugach Elec Assoc Bonds to 'A-'; Stable Outlook

12 Dec 2003 4:23 PM (EST)

Fitch Ratings-New York-December 12, 2003: Fitch Ratings has downgraded Chugach Electric Association, Inc.'s (Chugach) $330 million in outstanding senior unsecured bonds to 'A-' from 'A', and has removed the Negative Rating Watch. Fitch has assigned a Stable Rating Outlook. The rating represents an underlying rating as the bonds are insured by MBIA Assurance Corp., whose financial strength is rated 'AAA' by Fitch. The downgrade reflects a negative stance taken by the Regulatory Commission of Alaska (RCA) toward Chugach in 2003 and tighter projected financial protection measures as a result. The rating downgrade and removal from Negative Rating Watch follows a recent meeting with management updating Chugach's financial projections and management's prospective business and rate strategy.

Historically, Chugach has benefited from consistently solid financial performance, competitive electric retail rates, diversified customer base, and a supportive regulatory framework. In addition, long-term, firm natural gas supply contracts have helped support solid operating generation assets and, along with two hydroelectric power purchase contracts, have met the needs of a moderately growing service territory. Financial performance had been very stable through 2001, with debt service coverage ranging from 1.50-1.85 times (x), and times interest earned ratio (TIER) at 1.35x or higher. Chugach's balance sheet was similarly solid, with equity-to-total capitalization in the 25%-29% range since 1996. Chugach's key concern had been the ongoing discontent among its wholesale customers, but their attempts to change Chugach's operations and/or acquire the utility have not been successful. Beginning in early 2003, a series of RCA rate orders ensued which were uncharacteristically negative for Chugach, and eventually led to the credit rating downgrade. On July 10, 2001, Chugach filed a general rate case with the RCA seeking a 6.5% rate increase, or net margins of $11.9 million. The additional revenues were needed to help fund capital expenditures, meet rising operating expenses, and build equity to 30%. Chugach was also requesting an interim rate increase of 4%. After rendering two rate decisions, the RCA eventually approved an interim rate increase of 3.97% (effective Nov. 1, 2001), but the RCA's decisions quickly deteriorated for Chugach thereafter.

Following an updated rate case filing by Chugach on April 15, 2002, to reflect lower interests costs for refinancing, whereby Chugach requested a lower base rate increase (5.7%) than originally filed, the RCA rendered its initial decision (Rate Order No. 26). RCA Order No. 26 resolved certain issues in Chugach's favor, but the financial adjustments were by and large more heavily weighted against Chugach including: (1) reduction in overall TIER from 1.35x to 1.30x (a loss in margins of about $1.3 million), (2) requiring that capitalized interest be offset against interest expense includable in the revenue requirement, (3) lowering recoverable interest expense on variable rate securities, and (4) shifting a larger portion of margin burden on retail users by reducing the allowable TIER for wholesale customers to 1.10x from 1.15x. In addition, Chugach would have to refund the interim rate increase collected since implementation (approximately $1.8 million for 2001 and 2002).

Pursuant to Order No. 26, Chugach's financial performance fell below the 1.10x TIER requirement and resulted in a net loss of $2 million for 2002. If the Order remained as is, Chugach would not meet the 2003 TIER requirement as well. Chugach subsequently filed a motion to stay the Order (Feb. 13, 2003), which the RCA granted in part, and also filed a Petition for Reconsideration on Feb. 28, 2003. Several RCA orders followed which reversed and/or clarified Rate Order No. 26. Key changes to Order No. 26, which were generally positive for Chugach, included: recoverable variable rate debt interest expense was returned to 3.8% level, recovery of certain legal expenses was allowed, and approved retail rate increase of 3.5% and wholesale rate decrease of 7.9% (+0.8 million annually, in aggregate). Conversely, the RCA did not alter the lowering of overall TIER to 1.30x, the lowering of wholesale customers' TIER to 1.10x, and the requirement that capitalized interest be offset against interest expense includable

in the revenue requirement. The RCA's approved final rates on November 7, 2003, and Chugach does not plan to file any new rate requests with the RCA for sometime.

On a net basis, Chugach is projecting net margins of $8.0 million for 2003, and approximately $6 million per year through 2006. (Based on the 2003-2007 Business Plan projections) TIER is estimated at 1.34x for 2003, and 1.20x-1.25x for 2004-2006 (Based on current financial projections contained in the 2003-2007 Business Plan). Equity to total capitalization is projected to be rise from 25% currently to 28% by 2006. Actual equity levels will vary, however, depending upon annual operating results, capital expenditure levels and patronage capital distributions. (Currently, a 2004-2008 Business Plan is being developed). For 2003, patronage capital distributions are zero, due to lack of net margins generated in the prior year.

There are three new commissioners (and new associated staff) among the 5-member appointed RCA. As a result, given the untested and uncertain direction of the new members of the RCA, the regulatory risk remains a concern. Partially offsetting this risk are the following factors: Based on current financial projections, Chugach should not need rate relief until 2006, Chugach is working with RCA and the legislature to address the power supply issues facing the state. While Chugach has the option under Alaska statute to request its members' approval to eliminate regulation by the RCA, Fitch believes this may be very challenging. Lastly, while Chugach's financial performance ratios are reasonable and not out-of-line with straight 'A' level cooperatives, the regulatory uncertainty and certain ongoing wholesale customer discontent brings the rating down to the 'A-' level, with a Stable Outlook.

Chugach is the largest electric utility provider in Alaska, serving either directly or through wholesale sales roughly two thirds of all electric customers in the state, or approximately 175,000 users.

Contact: Lina Santoro +1-212-908-0522 or Alan Spen +1-212-908-0594, New York.

STANDARD &POOR'S	RATINGSDIRECT

Research:

Return to Regular Format

Summary: Chugach Elec Assoc, AK; Utility, Wholesale Electric

Publication date: 08-Aug-2003

Credit Analyst: Leo Carrillo, San Francisco (1) 415-371-5077; Swami Venkataraman, San Francisco (1) 415-371-5071

Credit Profile

DOWNGRADED, OFF CREDITWATCH	To	From
$120.000 mil. Chugach Elec Assoc new bnds ser 2002A dtd 02/01/2002 due 02/01/2012	AAA/A-(SPUR)	A
$60.000 mil. Chugach Elec Assoc new bnds ser 2002B dtd 02/01/2002 due 02/01/2012	AAA/A-(SPUR)	A
$150.000 mil. Chugach Elec Assoc 1st lien rev bnds ser 2001A dtd 04/17/2001 due 03/15/2011	AAA/A-(SPUR)	A
OUTLOOK:	NEGATIVE	

Rationale

Standard & Poor's Ratings Services has removed from CreditWatch and lowered the underlying ratings on Chugach Electric Association, Alaska's revenue bonds to 'A-' from 'A', based on a recent decline in financial margins, the decision by regulators to lower its interest coverage target for the utility, and challenges associated with Chugach's exceptionally large amount of non-amortizing debt. The insured ratings on the bonds remain unaffected by the downgrade.

The underlying ratings on Chugach Electric Association, Alaska's revenue bonds are based on the following credit concerns:

- A reliance on regulatory approval of rates and the implications for credit quality of the Regulatory Commission of Alaska's (RCA) recent decision to reduce its interest coverage target for the utility;
- Weak financial performance in 2002, with a margin for interest (MFI) ratio of less than 1.1x versus 1.20x in 2001; and
- Heavy reliance on non-amortizing debt, with 70% of total outstanding principal due in 2011 and 2012.

Credit strengths include:

- Chugach's dominant market position, competitive rates, and relatively diverse service territory near Anchorage, Alaska;
- Chugach's dominant market position, competitive rates, and relatively diverse service territory near Anchorage, Alaska;
- The RCA's historic support for a quarterly-reset fuel cost adjustment charge, and statutory rate-setting controls that require compliance with Chugach's bond covenants; and
- Solid equity capitalization, accounting for 23% of assets as of Dec. 31, 2002, with no current plans for long-term debt issuance, apart from refundings.

Chugach Electric Association (Chugach) is a vertically integrated electric cooperative that provides electricity through its retail and wholesale operations to roughly two-thirds of Alaska's population, around Anchorage, the Kenai Peninsula, and the "Railbelt" corridor between Anchorage and Fairbanks.

Chugach has approximately $394 million in bonds outstanding as of Dec. 31, 2002. The bonds are unsecured obligations of Chugach, supported by revenues from its wholesale and retail power sales operations. Permissive legal provisions exempt Chugach from maintaining a debt service reserve account on any of its unsecured debt.

Chugach's business profile score is a '4' on Standard & Poor's 10-point scale, with "1" being the highest score. Chugach is Alaska's largest electric utility, with 61,000 retail customers and approximately 50% of the state's total generating capacity in a region with no outside transmission access. Chugach serves a moderately urban and growing service territory, with retail sales accounting for 64.8% of revenues in 2001 and residential customers accounting for 32.9% of revenues. Chugach faces no competition from investor-owned utilities, and its only meaningful competition is the municipal utility serving Anchorage, Anchorage Municipal Light & Power (MLP). Although Chugach's rates, at 4.9 cents per kWh, are only slightly above the regional average, contentious relations with the utility's two largest wholesale customers continue to distract management. The two wholesale customers have a history of pursuing regulatory and legal action in an effort to suppress Chugach's wholesale rates.

Financial performance was weak in 2002, with margin for interest coverage based on audited financials of less than 1.1x. Financial margins and interest coverage have diminished over the past two years, relative to historical levels. MFI coverage averaged 1.3x from 1996 to 2000, before falling to 1.2x or less in 2001 and 2002. Net operating margins (after interest) averaged $7.3 million from 1996 to 2000, versus only $3.6 million in 2002.

The recent decline in financial margins and the relaxing by regulators of Chugach's coverage target raises concern regarding regulatory support for the maintenance of Chugach's historically strong financial profile. In January 2003, the RCA issued a rate order that reduced Chugach's target times interest earned ratio (TIER) coverage level to 1.30x from 1.35x, requiring a rate refund for overcollection in 2000 and 2001. Following an appeal by the utility, the RCA revised its rate order, reducing the cost of the rate refund from an estimated $7.1 million to $1.6 million. Chugach is absorbing the cost of the refund through its cash reserves, which exceeded $7 million as of Dec. 31, 2002.

Chugach expects to achieve MFI coverage of around 1.2x in 2003. Beyond 2003, MFI coverage remains above 1.3x, based on assumptions of 3% rate increases in 2004 and 2005. The projections also assume that the RCA will pass through to customers any increases in interest cost associated with Chugach's variable interest rate debt. Standard & Poor's continues to regard the forecasted interest coverage as thin for a utility with mostly non-amortizing debt.

Debt is high, but manageable, with a total debt-to-capital ratio of 75% as of Dec. 31, 2002, although Standard & Poor's considers the debt structure itself to be aggressive. Chugach's heavy reliance on non-amortizing debt introduces a significant level of refinancing risk to an otherwise moderate debt profile. The use of variable rate debt contributes to interest rate risk, especially given the utility's dependence on regulatory approval for recovery of rising interest rate costs. Chugach's $60 million in variable-rate debt represents 15% of its overall debt burden. With increased refinancing and interest rate risk inherent in its new debt structure, Chugach's need for financial flexibility has increased.

Overall liquidity is adequate, but cash reserves remain low, given the utility's relatively aggressive financial profile. Total liquidity, including unrestricted cash and undrawn credit lines, amounted to $77.3 million, or 214 days' cash, as of Dec. 31, 2002. Chugach maintains over $70 million in lines of credit with CoBank and National Rural Utilities Co-op Finance Corp, against which over $50 million remained untapped as of fiscal year end 2002. Cash reserves have remained flat at historical levels, with unrestricted cash reserves of around $7.3 million, or 22 days of operating expense at fiscal year's end. Chugach does not maintain a debt service reserve fund, and has no plans to develop a sinking fund with which to prepay principal payments on its non-amortizing debt. Interest earnings from $7 million in cash reserves will do little to dampen rising interest rate costs on the utility's $60 million in variable-rate debt.

Outlook

The negative outlook reflects Standard and Poor's concern regarding Chugach's ability to achieve sound financial margins going forward. Rating stability will hinge on Chugach's future financial performance and evidence of a clear strategy for managing risks associated with the utility's non-

amortizing and variable-rate debt. Management plans to address these risks in its revised debt management policy, due for release in early 2004. Sound debt management policies could include: limiting growth in the utility's debt burden, periodic market purchases of outstanding debt, accumulation of debt amortization funds, and maintenance of strong liquidity. However, even with sound policies, chronically weak coverage margins could result in lower ratings.

STANDARD &POOR'S | RATINGSDIRECT

Return to Regular Format

Research:

Chugach Electric Association, AK Underlying Rating Placed on Watch Negative

Publication date: 28-Feb-2003

Credit Analyst: Leo Carrillo, San Francisco (1) 415-371-5077; Kathryn Mock Masterson, San Francisco (1) 415-371-5009

SAN FRANCISCO (Standard & Poor's) Feb. 28, 2003--Standard & Poor's Ratings Services said today it placed its 'A' underlying rating (SPUR) on Chugach Electric Association, Alaska's approximately $394 million in bonds outstanding on CreditWatch with negative implications partially due to the latest rate order from the Regulatory Commission of Alaska (RCA). The insured ratings on the bonds remain unaffected by the CreditWatch listing.

"The latest RCA rate order is expected to reduce debt service coverage and could trigger a violation of Chugach's rate covenants. Standard & Poor's had already expressed concern that Chugach's coverage of interest was relatively weak for a utility with mostly non-amortizing debt and that lower coverage margins could result in lower ratings," said Leo Carrillo, credit analyst with Standard & Poor's. "In addition to substantially weakening debt service coverage, the RCA's rate order signals heightened regulatory and refinancing risk for the utility."

Chugach has petitioned the commission to reconsider its decision, which the RCA has partially granted. A final determination may come as early as the end of March 2003. If a sufficiently favorable order is not forthcoming, Standard & Poor's expects that it will downgrade the utility.

Chugach is an electric cooperative serving two-thirds of Alaska's population. It faces no competition from investor-owned utilities; its only meaningful competition is the municipal utility serving Anchorage, Anchorage Muncipal Light & Power.

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Fixed Income in the left navigation bar, select Credit Ratings Actions.

The McGraw-Hill Companies

STANDARD &POOR'S | RATINGSDIRECT

Return to Regular Format

Research:

Chugach Electric Association, Alaska; Utility, Wholesale Electric

Publication date: 24-Jan-2002

Credit Analyst: Christopher C Loop, CFA, San Francisco (1) 415-371-5003; Swami Venkataraman, San Francisco (1) 415-371-5071

Credit Profile

$60 mil muni debt muni issue ser 2002B due 2012	A
Sale date: 29-JAN-2002	
$120 mil muni debt muni issue ser 2002A due 2012	A
Sale date: 29-JAN-2002	
AFFIRMED	
$194.139 mil. Chugach Elec Assoc	A
$150.000 mil. Chugach Elec Assoc 1st lien rev bnds ser 2001A dtd 04/17/2001 due 03/15/2011	AAA/A(SPUR)
OUTLOOK:	STABLE

Rationale

The 'A' rating on Chugach Electric Association, Alaska's revenue bonds reflects:

- Solid finances, including a strong margin for interest (MFI) ratio (a times interest earned ratio-like statistic) and equity as a percent of assets at 23%;
- A dominant market position, with approximately 50% of the total capacity in the railbelt region;
- Low likelihood of deregulation in the near term and, since the electric system is geographically isolated, little chance of competition from other parts of the state or from Canada; and
- A substantial (49% of total kilowatt-hour (kWh) sales in 2001 and 64% of revenues) retail sector.

These strengths are offset by the following weaknesses:

- Heightened use of bullet maturities, meaning increased refinancing risk, since 72% of outstanding principal is due in 2011 and 2012;
- Contentious relations with its two largest wholesale customers, which accounted for 48% of energy sales in 2001;
- Only one all-requirements contract customer, ending in 2014, before the anticipated retirement of currently outstanding debt obligations as well as the ultimate maturity of debt obligations that are anticipated to be rolled over in 2011 and 2012; and
- Reliance on the Regulatory Commission of Alaska (RCA) to approve rates--many generation and transmission cooperatives (G&Ts) have the authority to set their own rates.

Offsetting this concern is the support the RCA has lent Chugach by allowing it rates that achieve higher levels of coverage than required by its covenants.

The net revenues that Chugach derives from energy sales secure the bonds. Chugach is an electric cooperative serving two-thirds of the population of Alaska, mainly around Anchorage, the Kenai Peninsula, and, through an economy energy wholesale customer, north to Fairbanks. Chugach faces no competition from investor-owned utilities; its only meaningful competition is the municipal utility

serving Anchorage, Anchorage Municipal Light & Power (ML&P).

Chugach is unlike other G&T cooperatives Standard & Poor's rates in both its unique strengths and the challenges it faces. Chugach differs in that half of its sales are to retail residential meters, whereas most G&Ts are wholesalers only. Standard & Poor's views this as a credit strength, as the margins from serving these customers can be greater than those derived from wholesale or commercial industrial sales. Furthermore, in the event of retail choice (which does not appear imminent in Alaska), residential customers are less likely to choose an alternate provider than industrial and commercial customers. Retail customers in 2001 consisted of 47% residential and 53% commercial and industrial. Distribution cooperatives, mainly Matanuska Electric Association (MEA) and Homer Electric Association (HEA), take the other half of Chugach's power.

Chugach differs further from other G&Ts in that it has only one all-requirements contract: it is with MEA and ends in 2014. Most other G&Ts sell their wholesale power through all-requirement contracts extending for the life of outstanding debt. MEA purchased about 52% of Chugach's wholesale power in 2001. The contract with HEA is a take-or-pay contract of 73MW and 350,000 megawatt-hours (MWh) annually (42% of the wholesale energy sold in 2001).

Chugach's relationship with MEA is strained as it is in litigation with MEA in rate cases and the courts. The Superior Court of Alaska recently granted summary judgment to Chugach on several claims MEA filed, though MEA intends to appeal these to the state's supreme court later in 2002. While these issues may be small in terms of potential monetary damages to Chugach, they serve to highlight the adversarial nature of the relationship and the potential for further acrimony in the years ahead, both of which serve to distract management focus.

Chugach's rates are set not by it but by the RCA, whereas many other G&Ts set their own. This distinction leads to the concern that regulators could set Chugach's rates such that its financial covenants are met and no more, though experience to date suggests that regulators are generally supportive of credit quality, including past resistance to efforts by MEA to reduce Chugach's rates to the then-minimum covenant requirement of 1.20x the MFI requirement.

The series 2002A term bond, like series 2001, is non-amortizing debt. Approximately 70% of Chugach's outstanding principal will mature in 2011 and 2012. Bullet maturities also expose bondholders to refinancing risk, which many other cooperatives do not face because of their amortizing debt.

Chugach's finances are distinguished by high MFI, debt service coverage, and equity ratios. These ratios are estimated (through November 2001) at 1.20 times (x), 1.73x, and 26%, respectively, down slightly from 1.35x, 1.73x, and 29% in 2000. The drop can be attributed to a warm first quarter in 2001, a delay in getting a rate increase from the RCA, increased labor rates, and the 2001 refinancing. Projections forecast continued high debt service coverage over the next five years, but mainly because most of the outstanding principal comes due in 2011 and 2012. Standard & Poor's will expect continued strong coverage ratios; Chugach's coverage of interest is actually somewhat thin for a utility with mostly non-amortizing debt. Therefore, degradation of coverage margins, even by small amounts, could result in lower ratings.

Chugach's business position is a '4' on a scale of 1-10, with '1' being the strongest. The score reflects the cooperative's operational, managerial, and financial strength, but also reflects the difficult relations with MEA and the legal difficulties in which it is embroiled.

Outlook

The stable outlook reflects expectations that Chugach will continue to receive regulatory support for an MFI ratio consistent with an 'A' rating for a utility with non-amortizing debt, and that current litigation will not harm the cooperative's financial health. The outlook also reflects expectations that Chugach will manage the now-substantial refinancing risk it faces through market purchases of outstanding debt, accumulation of funds, maintenance of strong liquidity, or some combination of the above.

Management

A seven-member board elected at large from Chugach's retail membership oversees the cooperative.

Elections are staggered, and members serve three-year terms. Chugach does sell on a wholesale basis to distribution cooperatives, but these customers do not have a seat on the board and have limited influence in Chugach's operations. The wholesale members have a vote in general affairs, but their vote--though they purchase considerably more energy--is a single vote, just as each of the approximately 59,700 retail customers have only one vote.

The board may convene at any time to review rates and may initiate a base rate change at any meeting, though the RCA must approve the change. In practice, fuel surcharge adjustments have been on a quarterly basis. Chugach's base rates have not been increased since 1994 but, on a quarterly basis, the utility has adjusted fuel costs and chugach has never been denied the rates it sought to be set for adjusted fuel costs. Chugach's fuel prices under its contracts are adjusted based on three indices, which incorporate a natural gas component, a crude oil component, and a home heating oil component.

Chugach benefits from strong, forward-looking leadership. Management prepares annually a power requirements study, a rolling five-year business plan, and a construction plan. Chugach conducts quarterly surveys to monitor customer satisfaction. Even so, acrimonious relations with MEA, with seemingly little prospect for improvement, continue to distract Chugach. Most recently, in November 2001, the state's superior court granted summary judgment to Chugach on several important outstanding legal issues, though MEA intends to appeal the judgment to the state supreme court as soon as a final matter regarding the process by which Chugach internally determines rates is decided, perhaps in April 2002. These issues will probably not have much impact on Chugach's finances or operations, but they do divert management attention.

MEA's all-requirements contract with Chugach ends in 2014, but MEA must give notice as to whether it would like to continue the contract in 2007. Although relations are poor, Chugach, MEA, and HEA (with which relations in the past have also been somewhat difficult), in fact, need each other: MEA and HEA can only obtain sufficient capacity for their load from Chugach, and Chugach needs the sales it makes to the other two utilities to spread its costs of service over a wider base.

Standard & Poor's notes that should MEA not renew its contract with Chugach and should Chugach refinance its 2011 and 2012 bullet maturities, a large portion of Chugach's sales would be, in effect, merchant, since they would not be under contract. Chugach's only all-requirements contract is with MEA; all-requirements contracts are a traditional strength of cooperative (G&T) systems.

Standard & Poor's believes that the more worrying disputes between Chugach and its wholesale customers are MEA's and HEA's appeal of test years 1998 and 2000. A test year is a full calendar year used as a basis for setting electric rates. The three cooperatives signed an agreement in 1996 in the hopes of avoiding conflict and providing rate stability. The agreement has clearly broken down, and both 1998 and 2000 are before the RCA for adjudication. The RCA issued an order for the 1997 test year, which ruled that Chugach make rebates of less than $1 million. While HEA is not contesting the order, MEA may appeal it through judicial channels. A decision against Chugach on the 1998 test year would require Chugach to offer credits or make refunds to customers. Because one year's rates serves as the basis for the next, a decision against Chugach in the 1998 case could snowball into larger credits or repayments over successive years. No decision has been reached on either the 1998 or the 2000 test year case. The 2000 test year case could take years to decide. In the meantime, Chugach is allowed to charge what is known as interim refundable rates, reflecting the fact that Chugach may have to offer credits should decisions move against it. Chugach has made no provisions for the possibility that these cases could go against it.

■ Business Profile

Chugach's business profile score of '4' reflects:

- A dominant position within the state as the largest electric utility;
- The presence of the generally higher margin distribution business, which offers Chugach not only better margins but some protection should deregulation occur;
- Lack of movement toward deregulation in Alaska; and
- The favorable operational profile of Chugach's generation assets.

These favorable characteristics are somewhat offset by the legal issues with which management grapples, described above, with its main wholesale customer.

Regulation

Recent events in California have derailed deregulatory efforts in Alaska. Chugach was one of the few proponents of retail choice, with none of the other local utilities or trade organizations supporting the effort. Until such time that deregulation occurs, utilities in Alaska serve their own service territories exclusively.

Chugach is nonetheless pursuing a legal route to try to introduce deregulation. Drawing upon anti-trust law, Chugach has argued before the state supreme court that service areas are not exclusive. Were Chugach to win this case, the result would be to overturn the underpinnings of regulation in Alaska. This case has been briefed and a ruling is expected later in 2002.

The RCA is the primary regulator for Chugach and approves all requests for rate increases, including those for fuel adders. While Chugach is allowed to institute quarterly fuel adders with concurrence from the RCA, Chugach has never been denied the RCA's formal approval. The RCA almost always delivers its decision within the 45 days allotted for the process.

The RCA has demonstrated a fair degree of regulatory support for Chugach. While state law requires that the RCA approve rate levels to meet the cooperative's financial covenants (including the MFI covenant), the RCA has discretion on authorizing rates at higher levels. In practice, though, the RCA has recognized the need for financial strength and granted rates to allow Chugach to set rates at a times interest earned ratio (TIER) of 1.35x when its covenant was 1.20x. This history alleviates some of Standard & Poor's concerns that, with the lower threshold of 1.10x, the RCA may lower allowed rates. Furthermore, MEA has proposed in the past that Chugach's rates be reduced to meet only the minimal covenant-required MFI ratio, but the RCA has ignored the proposal. In fact, Chugach has applied for a permanent base rate increase of 6.5%, sufficient to generate a 1.44x MFI using a proposed rate of return method of calculation. A hearing on the increase is scheduled for August 2002 with the final order expected during the fourth quarter of 2002.

Additional evidence of regulatory support can be found in recent interim base-rate increases the RCA granted. The RCA granted a 1.6% increase in September 2001 and, after further deliberation, increased it to 3.97% two months later, very close to the 4% Chugach had originally requested.

Finances

Chugach's finances are bolstered by the significant distribution market it serves and the rates the RCA allows in order to meet a 1.35x target TIER. Highlights of the utility's finances include:

- A high MFI, over 1.25 for the past five years, though slightly lower in 2001, at 1.20x, because of a warmer January and higher interest, depreciation, and labor costs;
- A better than 23% ratio of equity-to-assets; and
- Good liquidity, with a current ratio generally over 1.0x through 2006 and, when accounts receivable from distribution customers are included, days' cash-on-hand equals more than 60 days.

Chugach benefits from serving a higher margin retail distribution sector. The G&T side is allowed a TIER of 1.15x, meaning that the distribution side is required to make up the difference to meet the RCA-allowed 1.35x amount. This aspect of Chugach is a distinct strength and sets it apart from other G&T cooperatives. The retail component was 49% of energy sales through November 2001, with 47% of this to residences and 53% to commercial businesses. Wholesale power and economy energy constitute the remainder of total energy sales. In terms of revenues, retail sales are 64% of total revenues and wholesale plus economy sales are 36%.

Standard & Poor's has reviewed Chugach's projections and finds them reasonable. Key assumptions include the expectation that MEA will continue to purchase all its requirements from Chugach, despite

an option to convert to a net requirements customer by giving five years' notice. As discussed above, it does not appear likely that MEA would find an economical replacement source for its needs. Load growth is expected to occur at an overall compounded rate of 2.1%, with the retail sector increasing at 1.6% and the wholesale at 2.6%. The result is that the projections anticipate a continuation of the trend of high MFI and equity. MFI is projected at 1.25 in 2002 and beyond, and equity is projected to increase to over 26%. These ratios are strong for the cooperative G&T sector. Debt service coverage is very high at over 2.0x, but this is because nearly all of Chugach's debt is non-amortizing. Projected funds from operations coverage of interest is much lower, ranging from 1.40x to 1.70x over the next five years, and is actually somewhat thin for a utility with largely non-amortizing debt, as described below.

Chugach Electric Association, Alaska's Ratios						
	1996	1997	1998	1999	2000	Through November 2001
Equity/assets (%)	21.7	22.5	23.7	23.6	23.9	23.6
Equity/capitalization (%)	25.3	25.9	27.2	26.7	29.2	26.3
Current ratio (x)	1.07	1.34	1.12	1.21	0.53	1.05
Debt/equity (x)	3.27	3.13	2.93	2.95	2.59	2.95
Accounts receivable/operating revenues (%)	11.4	16.7	12.2	12.6	14.0	12.0
Cash/operating expense (%)	6.8	5.7	2.6	4.5	1.6	3.2
Days' cash	25	21	10	17	6	12
Receivables collections period (days)	42	61	44	46	51	44

Debt and Debt Structure

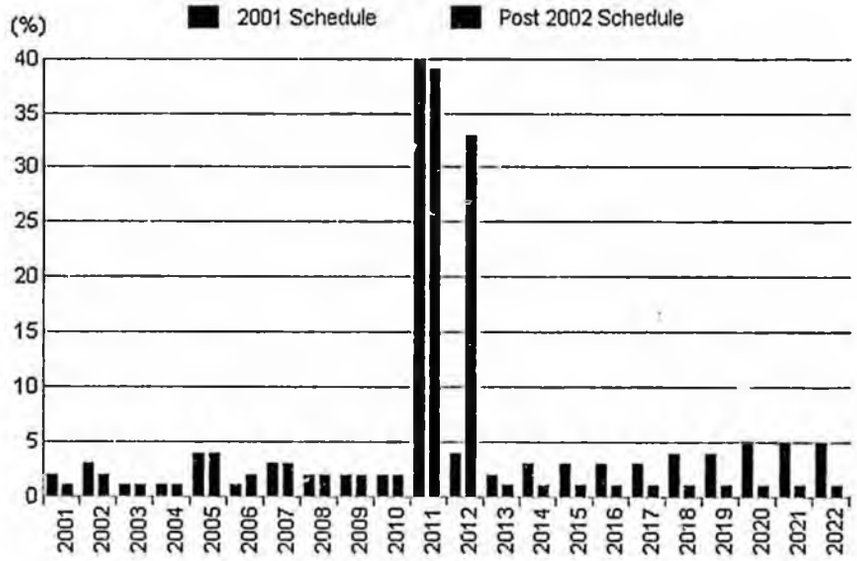
One of Chugach's strengths is that it will fund virtually all of its capital expenditures through internally generated cash after the issuance of series 2002. Available cash more than covers anticipated capital expenditure from 2003 to 2006. Capital expenditures average about $30 million per year, fairly evenly apportioned between distribution, generation, and transmission projects. The largest projects are for work on the Beluga 6 and 7 units and a contribution toward the Southern Intertie and South Anchorage transmission project. Chugach does not expect to need a meaningful amount of new capacity until after 2010, and even then it could curtail its interruptible or economy sales or even dip into its 30% reserve requirement.

The cooperative's overall debt structure changes substantially with the issuance of series 2002, continuing a trend toward greater reliance on bullet maturities and the refinancing risk they present, and away from a traditional amortization structure. The issuance of the $150 million series 2001 introduced refinancing concerns when, with its issuance, 40% of total principal then outstanding matured in 2011. Series 2002A exacerbates this concern in that it is a $120 million bullet due in 2012, resulting in 39% of total outstanding debt due in 2011 and 33% in 2012. Even so, it is important to note that Chugach's debt service schedule after the issuance of series 2002 remains virtually the same through 2010 as it was after the issuance of series 2001.

No other cooperative has assumed refinancing risk to the degree that Chugach does with its series 2001 and 2002 bonds. Standard & Poor's does not take rating action at this time to reflect the increased risk because of Chugach's historically strong finances, access to credit markets (including lines of credit from institutions dedicated to serving the cooperative sector), the remoteness of the need to refinance (nine years), and the fact that Chugach includes depreciation in its rates, suggesting that over the course of the decade to come, the cooperative could generate sufficient cash to repay the bullet if it chose to do so.

The issuance of series 2002 releases Chugach from its existing indenture and allows the amended and restated indenture dated April 1, 2001, to take effect. Please refer to the March 9, 2001 analysis on Ratings Direct on Chugach for a full review of the implications of the amended and restated indenture.

Chugach's Amortization Schedule



STANDARD &POOR'S | RATINGSDIRECT

Return to Regular Format

Research:

Update on U.S. Electric Cooperative Sector Ratings

Publication date: 19-Feb-2004
Credit Analyst: David Bodek, New York (1) 212-438-7969

Standard & Poor's Ratings Services maintains published ratings on about one-third of America's electric generation and transmission (G&T) cooperatives. The wholesale electricity generated and procured by these utilities serves the energy needs of their member distribution cooperatives' retail customers. All of the G&T co-ops rated by Standard & Poor's have investment-grade ratings (see table). More than half of the ratings assigned by Standard & Poor's to G&T co-ops are in the 'A' rating category. The weakest rating currently assigned to a G&T cooperative is 'BBB' and the strongest is 'AA'. This ratings distribution reflects operational and financial profiles and business strategies that have largely insulated these utilities from some of the extreme volatility that has plagued many energy companies in recent years.

U.S. Electric Co-op Ratings		
	Rating	Outlook
Associated Electric Co-op Inc.	AA	Stable
Central Electric Power Co-op Inc.	AA	Stable
Georgia Transmission Corp.	AA	Negative
Dairyland Power Co-op	AA-	Stable
Arkansas Electric Co-op Corp.	AA-	Stable
Buckeye Power Inc.	A+	Stable
Old Dominion Electric Co-op	A+	Stable
Basin Electric Power Co-op	A+	Stable
Central Iowa Power	A	Stable
Oglethorpe Power Co-op	A	Stable
Seminole Electric Co-op	A	Negative
Tri-state Generating & Transmission Assoc.	A	Stable
Hoosier Energy Rural Electric Co-op Inc.	A	Negative
Wabash Valley Power Inc.	A-	Stable
Brazos Electric, TX	A-	Stable
Chugach Electric Assoc.	A-	Negative
Alabama Electric Co-op Inc.	BBB+	Stable
Western Farmer's Electric Co-op	BBB+	Stable
Great River Energy	BBB	Developing

G&T co-ops were created through the pooled efforts of electric distribution cooperatives. By banding together to build G&T assets to serve the amalgamated load of a group of utilities, distribution co-ops have achieved economies of scale that would likely have eluded them if they had each separately built the generation or transmission assets needed to meet their custo[illegible] needs or individually negotiated agreements for the purchase of generation and transmission services.

Although some cooperatives have seen a portion of their rural service territories transformed into prosperous suburbs of major metropolitan areas, for the most part electric co-ops serve far-flung, sparsely populated areas that exhibit below-average income levels. Many G&T cooperatives' credit ratings transcend the weak demographic profiles exhibited by the retail distribution systems that form the backbone of their revenue streams. Moreover, the G&T ratings tend to eclipse the ratings assigned to investor-owned utilities.

Several factors explain the differences in credit quality between G&T cooperatives and investor-owned utilities. Some of the leading reasons are:

- Absent a severe economic dislocation in a G&T's service territory that either results in customer migration or renders customers unable to afford electric service, the requirements contracts between a G&T and its members should provide a secure revenue stream that supports trade and debt obligations if the requirements contract, as is most often the case, mirrors the term of the utility's debt;
- Revenue stream stability is also reflective of usage patterns and low customer density that tend to make electric cooperative loads unattractive to competitive suppliers;
- Unlike investor-owned utilities, many distribution and G&T cooperatives have autonomous rate-setting authority and are free from regulatory oversight, including the delays and political vagaries associated with rate regulation;
- Ratemaking authority empowers cooperative utilities to implement timely cost recovery in response to volatile fuel and electricity markets;
- Co-ops benefit from access to low-cost, amortizing debt available from the federal government and cooperative lending institutions;
- It is rare for co-ops to pursue noncore businesses to enhance revenues because the cooperative ownership structure removes the profit motive that influences investor-owned companies' business strategies; and
- There is an element of positive self-selection among those cooperatives that use credit ratings.

These attributes that are common to co-ops with sound credit quality were distilled using the analytical framework employed by Standard & Poor's in its evaluation of all electric utilities, including electric cooperatives. Standard & Poor's analytical evaluation of utilities, regardless of ownership structure, focuses heavily on qualitative factors that define the strength of the financial performance that a utility must demonstrate to support a given rating. The quantitative assessment of all utilities is predicated on the qualitative analysis of six principal areas:

- The utility's operational profile;
- An examination of the markets served by the utility;
- The utility's competitive posture;
- An examination of the regulatory environment where the utility operates, including the ratemaking flexibility available to the utility;
- The strengths that the management team brings to the table; and
- The strength of the bondholder or lender protections provided by the bond indenture or other financing documents.

The application of these principles has by and large translated into sound credit quality for rated co-ops. However, the positive characteristics that are shared by many cooperatives are not ubiquitous. Over time, Standard & Poor's has lowered the ratings of a number of G&T co-ops and assigned negative outlooks to the ratings of others. These rating actions were taken in response to eroded creditor protections and were attributable to different causes.

Several utilities' credit ratings were reassessed because of weakening or weakened debt-service coverage. Bondholder and lender protection are closely linked to the capacity of the revenue stream to consistently provide excess coverage of amortizing debt service. Co-ops tend to exhibit margins that are narrower than those of vertically integrated utilities with similar ratings. Therefore, an erosion of coverage can have a pronounced effect on credit quality.

Standard & Poor's traditionally has correlated co-ops' modest excess coverage with sound ratings because of the autonomy that permits them to quickly adjust rates in response to deviations from projected levels of revenues and expenses, as well as the benefits provided by the breadth of their customer bases. The G&Ts rated by Standard & Poor's serve either directly or indirectly an average of 28 distribution cooperatives. This level of diversity is viewed as protective of creditors. It is Standard & Poor's opinion that the risk of multiple simultaneous defaults among a diverse pool of distribution co-ops is slim. Importantly, should a distribution co-op fail to discharge its financial obligations to the G&T, the G&T typically can

recoup defaulted payments from nondefaulting members. This can be accomplished through intrayear budget adjustments.

Despite the budgetary and ratemaking tools that are generally available to co-ops, as fuel and electricity prices rose sharply in recent years, net revenues coverage of debt obligations slipped at several G&T co-ops that were reluctant to adjust wholesale rates to preserve the financial cushion associated with excess margins. In turn, the degradation of the cushion eroded bondholder and lender protection at these co-ops. Affected co-ops included Hoosier Energy and Seminole Electric, whose 'A' ratings were assigned negative ratings outlooks. Hoosier later implemented a power-cost tracker to reduce its market exposure. Alabama Electric's rating was lowered to 'BBB+' as a result of degraded coverage margins that reflected increased costs and the burdens created by its investment in a propane business. Self-regulation and the ability to adjust rates can only provide value that translates into creditor protection if a utility's board demonstrates the will to exercise that authority by adjusting rates to preserve sound credit quality.

In some cases, ratemaking flexibility has been constrained by outsiders. Regulatory oversight of ratemaking has proved to be a challenge for several rated and unrated co-ops. Over time, the inability of some G&T co-ops to fully recover costs through rates because of regulatory barriers has led to bankruptcies of G&T and distribution co-ops like Wabash Valley, Cajun Electric, and Vermont Electric Co-op. Regulation does not necessarily lead to such drastic results and many regulators have been supportive of the co-ops that are under their jurisdiction. Nevertheless, there is sufficient evidence of cases where regulation has had credit implications. For example, Chugach Electric's rating was lowered and the outlook remains negative following the regulator's reduction of the permitted margins for interest coverage that the utility could earn on its debt.

Questions often arise as to how to best measure a co-op's financial performance. The highly leveraged capital structures of G&T co-ops reflect their inability to access capital markets for equity. This makes it difficult to draw comparisons between a cooperative's financial metrics and the metrics used to gauge the performance of investor-owned utilities. Comparability with investor-owned utility metrics is further obscured by the predominant use of amortizing debt within the co-op sector, as compared with investor-owned utilities use of nonamortizing debt. Consequently, the financial analysis of co-op utilities largely tracks the rating methodology employed for municipal utilities and public power joint-action agencies that also rely on amortizing debt and lack access to equity capital markets. The analysis of a co-op such as Chugach Electric that heavily relies on nonamortizing debt with bullet maturities requires a hybrid analysis that incorporates elements derived from the rating methodology for both public power and investor-owned utilities. To achieve a given rating, Standard & Poor's expects a utility that uses a meaningful amount of nonamortizing debt to exhibit considerably stronger coverage of annual debt service than would be expected of a utility whose debt amortizes like a mortgage. Refinancing risk and capital market access are also factored into the analysis of utilities that use nonamortizing debt.

The amortizing debt of many co-ops is governed by mortgage indentures fashioned by the Rural Utilities Service of the U.S. Department of Agriculture. Under these indentures, the principal measure of financial performance is frequently a "margins-for-interest" (MFI) or "times-interest-earned" (TIER) ratio. It is Standard & Poor's view that these ratios do not adequately reflect a utility's financial capacity to cover amortizing principal and interest payments and do not paint a full picture of financial capacity and creditor protection. Consequently, Standard & Poor's does not limit its analysis to the MFI and TIER metrics.

Irrespective of whether a utility is legally bound to satisfy the requirements of an all-in debt-service coverage test, Standard & Poor's examines each utility's financial capacity to produce excess coverage of principal and interest. Although the MFI and TIER tests are calculated with reference to a utility's income statement, Standard & Poor's analysis focuses on the income statement and the statement of cash flows. In calculating debt-service coverage, consideration is also given to fixed obligations that are not necessarily reflected on the balance sheet, including those related to capacity payments required under purchased-power agreements and long-term lease payments. However, payments that must be made pursuant to defeased lease agreements are viewed as mitigated by amounts held in escrow accounts dedicated to the payment of lease transaction obligations. Wabash Valley provides an example of a utility whose financial metrics were adjusted to impute debt and debt service as part of the analysis. Its income statement, cash flows, balance sheet, and financial ratios were adjusted to reflect the substantial fixed obligations that it has incurred under purchased-power agreements.

Western Farmer's Electric Co-op exemplifies the need for an analysis of coverage of total debt service and the shortcomings of reliance on MFI and TIER tests. In the 1970s, Western Farmers purchased an interest in a proposed nuclear power plant, the Black Fox Station. The purchase was debt financed. Upon the plant's 1982 cancellation, Western Farmers' investment was lost, but acquisition debt balances remained on its balance sheet for many years. That debt has been extinguished. The plant's cancellation left Western Farmers without a depreciable asset, which had implications for financial metrics until the Black Fox debt matured.

Depreciation expense is the budgetary vehicle that co-ops use for recovering amortizing principal in wholesale rates. In the years following Black Fox's cancellation, Western Farmers established wholesale rates and budgets based on its projected income statement. In the absence of a Black Fox depreciable asset, depreciation expense failed to serve as a proxy for the Black Fox component of Western Farmers' overall debt amortization. Depreciation expense reflected the debt-service requirements associated with the capitalization of Western Farmers' investments other than Black Fox. Revenue requirements calculated with reference to projected income statement operating and depreciation expenses repeatedly satisfied Western Farmers' interest coverage test, even though the income statement-based budget did not give effect to the cash flow necessary to amortize Black Fox debt. As a result, operating cash flow provided weak coverage of total amortizing debt. Standard & Poor's examination of all-in debt service was an important element of the 'BBB+' rating assigned to Western Farmers.

The factors cited in this article reflect some of the principal considerations that are incorporated in Standard & Poor's credit analysis of electric G&T cooperatives. While not an exhaustive review of all factors that influence co-ops' credit quality, the goal has been to provide insights into fundamental elements of Standard & Poor's ratings criteria for electric co-ops. From time to time, Standard & Poor's will communicate its views on the cooperative sector to further elucidate our ratings methodology for the benefit of those who engage Standard & Poor's to provide ratings on co-ops as well as for those who rely on Standard & Poor's electric co-op ratings when doing business with or investing in electric cooperatives.

STANDARD &POOR'S | RATINGSDIRECT

Return to Regular Format

Research:

Public Finance Report Card: Public Power

Publication date: 21-Jan-2004

Credit Analyst: Peter V Murphy, New York (1) 212-438-2065; David Bodek, New York (1) 212-438-7969

Rating trends for the public power sector remain stable despite the increased risk and uncertainty in the overall U.S. power industry. Standard & Poor's Ratings Services has 235 ratings in the public power sector, with the overwhelming majority carrying investment-grade ratings, and only five ratings below investment-grade. Of the five ratings below investment-grade, four are California irrigation districts and water agencies whose bonds are rated 'B+' based on contracts with Pacific Gas and Electric Co. for the output of a specific power project. The other non-investment-grade-rated credit is Guam Power Authority, rated 'BB+/CreditWatch Negative'. The overall credit strength of the public power is further demonstrated by the rating distribution, with about 80% of credits rated at least 'A-' and 21% of ratings reaching the 'AA' category. The public power sector includes municipally owned electric utilities and combined, or multi-segment, utilities, as well as joint action agencies consisting of two or more participating utilities. Ratings are as of Jan. 20, 2004.

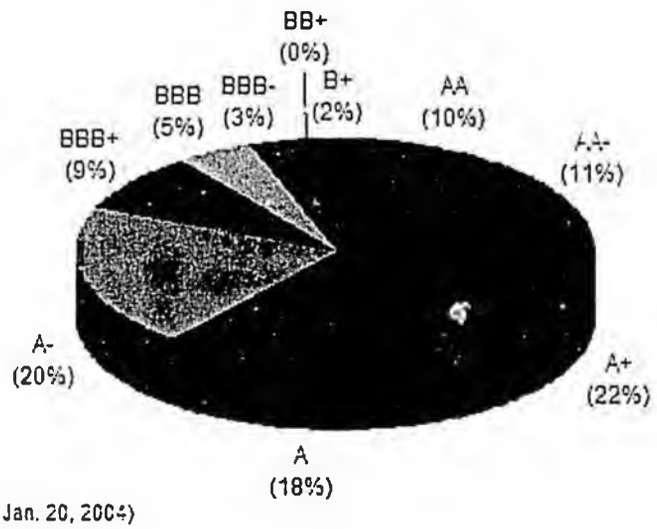
Since the last report card, ("Public Finance Report Card: Public Power and Cooperatives", RatingsDirect, May 27, 2003), the sector has continued to experience overall credit stability, with only a handful of rating changes, despite ongoing industry turmoil on the investor-owned and merchant sectors. Aside from the sector's traditional strengths, the stability of the sector in the past year resulted from relatively low volatility in commodity prices for both fuel and power as compared with the prior three years, and from improved hedging activity that mitigated the impact of price swings. Rising power and fuel prices had resulted in weakening coverage and liquidity, and consequently, slight rating deterioration, in 2001 and 2002.

Traditional strengths of the sector that provide a solid credit foundation include the autonomy of public utilities' governing bodies in rate-setting and recovering costs (although there are exceptions, such as the requirement that Tennessee Valley Authority (TVA) distributors gain approval of TVA for rate increases above 2% and the state of Wisconsin, whose municipal electric utilities must file rate cases); the focus on core businesses and core mission to serve their customers; and for the most part, the absence of direct competition for retail customers. The absence of state or federal rate regulation enables these utilities to enact and implement rate increases or rate cuts quickly and as necessary in response to a changing cost or competitive structures, provided the willingness to do so exists. This is most often not the case for their investor-owned counterparts. Most public power utilities continue to operate as vertically integrated utilities and either own or have secured, through long-term contracts, sufficient generation to meet native-load demand, which is generally their main focus.

With regard to retail competition, where deregulation of the retail electric industry has moved forward, the enabling legislation has not required municipally owned utilities to compete directly for their native customers. Rather, these public utilities may choose open their service territories, a rare occurrence. As a result, the customer bases in the public sector have remained intact, which is very supportive of credit quality. However, in cases where public utilities' service territories have historically been multiply certified, the importance of being able to compete on price and on other measures has become heightened. Notable in this regard is Lubbock Power and Light (LP&L), the electric utility owned by the city of Lubbock, Texas. For over 80 years, LP&L has competed directly with an investor-owned utility (Southwest Public Service, or SPS, a unit of Xcel Energy Inc.) and typically held a strong market share. In the past year, however, due to an uncompetitive cost structure and competitive pressures that affected rate-making decisions, LP&L experienced operating losses and greatly reduced liquidity, and saw more than 5% of its customers switch to its direct competitor. Consequently, the rating was lowered to 'BBB-' from 'A+'. In contrast, Cleveland, Ohio, also competes directly with an investor-owned utility but retains a rate advantage and has posted net gains in the number of meters. Cleveland's electric revenue bonds are rated 'A-'.

Chart 1

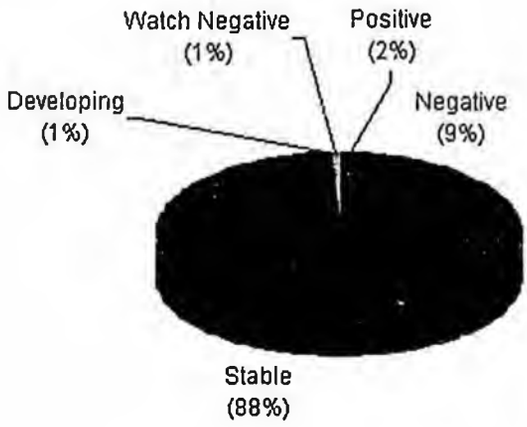
Public Power Ratings Distribution



(As of Jan. 20, 2004)

Chart 2

Public Power Outlook Distribution



Key Issues

Despite these inherent strengths and the sector's stable credit profile, public power faces heightened risks through its required interaction with the wider industry. Exposure to counterparty risk, even through a limited dependence on wholesale purchases; uncertainty over the future of transmission capacity and availability; and asset and fuel diversification continue to pressure many public power entities to maintain liquidity and establish flexible rate structures with energy or fuel adjustment

mechanisms.

The sector continues to watch carefully and participate actively in the evolving debate regarding federal restructuring of transmission. Public power is concerned that changes implemented at the federal level could result in cost increases and operational uncertainty if firm transmission rights are not retained.

Despite surplus capacity in the industry, public utilities continue to plan and build additional generation to accommodate growing demand and to avoid exposure to the often volatile wholesale markets at a time when other energy companies are still faced with liquidity concerns, over-leveraged balance sheets, and limited access to capital from the equity markets. This drive toward local generation tends to be regionalized. In California, public power entities such as Turlock Irrigation District (Walnut Energy Center), Modesto Irrigation District (Ripon Generation Station), and certain members of Southern California Public Power Authority (Magnolia Project) are at various stages of development of gas-fired generation. While these moves will result in decreased exposure to often volatile wholesale power markets, these utilities are consequently increasing their exposure to natural gas price volatility. In the Midwest, the Municipal Energy Agency of Nebraska, Lincoln Electric, Neb., and others are issuing debt to finance their investments in new coal-fired capacity.

Table 1 Public Power Ratings

Arranged Alphabetically by State

Utility	State	Rating & Outlook	Business profile	Analyst	Comments
Anchorage Municipal Light & Power	AK	A/Stable	4	Paul Dyson	Moderate rates, with rate increases in 2002 and 2003, a large commercial base, and large owned generation capability characterize this consistently solid financial performer. Overall debt service coverage was 1.56x in 2002. The utility acquired in 1998 a partial ownership stake in the Beluga gas field. Diversification of local economy has dampened effects of recession.
Huntsville Electric	AL	AA/Stable	2	Peter Murphy	Growth in Huntsville electric system's service territory will require significant investment in the system's distribution infrastructure. However, with a relatively low rates and low debt burden, the system has a large measure of financial flexibility. The evolution of Huntsville's relationship with the Tennessee Valley Authority (TVA) also has rating implications.
Arizona Power Authority	AZ	AA/Stable	2	Anne Selling	The ability of the Hoover Dam to produce low-cost hydropower under a variety of water conditions, combined with the operational reliability associated with the plant's sound operational performance and reliability, is supportive of strong credit quality.
Mesa	AZ	A+/Stable	4	Markela Soward	Mesa, a five-system combined utility, demonstrates very strong coverage, typically exceeding 3x. Cash at year-end remains low at about $8 million, or 27 days' worth of operating expenses, which is due transfers (ranging from $24 million to $50 million) from these systems into the city's general fund. Rates remain competitive, with modest increases anticipated in the near- to medium-term. The competitive rates give each system flexibility to increase rates if necessary. The customer base remains diverse and is mainly made up of residential customers.
Salt River Project	AZ	AA/Stable	3	Anne Selling	Salt River Projects's (SRP) rating reflects a stable, diverse, and low-cost generation portfolio. Debt service coverage ratios are expected to drop as low as 1.8x during the next three years, which is below SRP's past strong coverages, which, over the last five years have often exceeded 3x but are still in line with a 'AA' rating. The drivers of the lower coverage levels include proactive efforts by the utility to accelerate debt repayment as well as higher production costs largely, in the form of rising natural gas costs and weaker wholesale sales. In October 2003, SRP closed the sale of the Desert Basin plant, a 575 MW combined cycle plant formerly owned by Reliant. In December 2003, SRP issued $300.0 million of certificates of participation (COPs) as long-term financing for the asset.
					The system has been able to sustain its credit quality

Alameda Power & Telecom	CA	A-/Stable	4	Markela Soward	given its solid financial position which has been aided by a proactive and responsive management team. Management entered into fixed-priced, long term purchased power contracts to provide rate stability. Rates are average reflective of the system's participation in high cost projects with a sizable high level of off-balance sheet debt associated with Northern California Power Agency projects. The system expects need to continue addressing its fixed costs and competitive issues in order to stabilize costs and rates while sustaining its operational, financial, and rate flexibility.
Anaheim Electric System	CA	A+/Positive	4	Peter Murphy	The success of Anaheim's plan to acquire new generation and repower existing assets to reduce the system's exposure to market purchases is critical to the rating over the next two to three years and is the basis of the rating's positive outlook.
Burbank Electric & Water	CA	A+/Stable	4	Paul Dyson	Despite cash flow in fiscal 2002 that was insufficient to meet debt service due to higher-than-anticipated purchased-power costs, the outlook remains stable. The utility used funds from its rate stabilization fund to cover debt service in 2002. Higher power costs resulted from a conversion of an existing contract, and its debt burden doubled from 37% debt-to-capitalization in 2001 to 60% in 2002. However, Burbank Electric & Water's construction of a 47 MW gas-fired combustion turbine, completed in 2002, along with it participation in Southern California Public Power Agency's Magnolia Project, should reduce the need to purchase peaking requirements from the wholesale market, allowing a return to a healthy cash flow position in 2003, with over 2.7x coverage projected, appropriate to the 'A+' rating.
California Department of Water Resources	CA	BBB+/Watch Negative	N/A	David Bodek	The rating principally reflects the bondholder protection provided by the Department of Water Resources (DWR) financing's legal framework, which mitigates many of the political risks and power market uncertainties associated with DWR's power program. The legal framework is characterized by significant reserves and requirements that the DWR, in concert with the California Public Utility Commission (CPUC), act to adjust retail rates in a timely manner should the power program's costs rise above projected levels. California's investor-owned utilities have assumed responsibility for procuring residual net short power for 2003. The utilities have also assumed operational responsibility for dispatching DWR's above-market contracts.
Glendale Electric	CA	A+/Stable	4	Peter Murphy	Despite high rates, Glendale's electric system has a strong financial position, including a large stranded investment reserve, which insulates it from a variety of financial risks. The system's key challenge will be to repower its existing generation assets successfully, which includes its stake in Southern California Public Power Authority (SCPPA) gas-fired Magnolia Project, which should be online in 2005. Glendale's prudent risk management strategy reduces its otherwise sizeable power market exposure.
Imperial Irrigation District	CA	A+/Stable	4	Paul Dyson	Serving over 108,000 electric customers in Imperial and Riverside counties, Imperial Irrigation District (IID) has a diverse generation resource mix and firm transmission access. Responsiveness of management demonstrated by modest annual rate increase in each of the last five years in response to gradually increasing costs is expected to continue to provide solid margins, with coverage in 2002 at 4.67x. Despite rate increases, the district maintains competitive rates that are below state and local averages for residential and commercial customers. The stable outlook reflects the expectation that IID will maintain its current financial health and its debt service coverage policy of no less than 1.70x.
Lodi Electric	CA	BBB+/Stable	5	Peter Murphy	Rate increases have enabled Lodi Electric to recoup losses incurred in fiscal 2001 and 2002 on power purchases and the buyout of a long-term above-market power contract. Due to the losses, the system's financial cushion has been depleted below management's target level. The system's cash-depleted position makes Lodi Electric more vulnerable to unpredictable adverse market

					or operational events, making restoration of stronger cash balances critical.
Los Angeles Dept. of Water & Power (Electric System)	CA	AA-/Stable	4	David Bodek	Los Angeles Dept. of Water & Power (LADWP) has made significant progress in reducing debt and operating expenses in recent years and expects that the utility's capital needs can be funded from monies from operations, assuming that retail rates are maintained at current levels. Preservation of the rating hinges on ongoing resilience to the political environment in California that has raised questions about all who participated in the state's wholesale markets in 2000 and 2001.
Modesto Irrigation District	CA	A+/Stable	3	Markela Soward	The Modesto Irrigation District (MID) is in the process of securing permits so that a 95MW gas fired plant (Ripon Generation Station) may be constructed (current projected completion date is April 2005). MID continues to implement necessary rate increases, with a board-approved rate increase for fiscal 2004 of 8%. Cash reserves remains strong, at an estimated $165 million, or 341 days' of operating expenses for unaudited fiscal 2003. These reserves are anticipated to increase as the district reiumburses a portion of its cash reserves with an estimated bond financing. Concerns continue to exist from MID's increasing debt burden, which has a high debt-to-capital ratio of 68%.
M-S-R Power Agency	CA	A+/Stable	5	Peter Murphy	M-S-R Power Agency's rating is based on the ratings of its two largest participants, Modesto Irrigation District and Silicon Valley Power (SVP). The agency owns a share of San Juan coal-fired unit #4 in New Mexico under a take-or-pay contract.
Northern California Power Agency-Geothermal Project	CA	BBB+/Stable	5	Peter Murphy	The geothermal project consists two generating units with annual output of approximately 140 MW. Plant output is projected to decline by about half in the next 20 years, although as project debt is repaid rapidly, project economics should not deteriorate. The project provides baseload power to 11 participants, the largest of which is SVP, Calif. The rating is based on the credit quality of the participants because of their unconditional obligation to pay project costs whether or not the project is operational.
Northern California Power Agency-Combustion Turbine No.1	CA	BBB+/Stable	5	Peter Murphy	The combustion turbine project consists of five 25 MW combustion turbines that provide peaking capacity to eight participants, the largest of which is Lodi, Calif. ('BBB+/Stable'). The rating is based on the credit quality of the participants, because of their unconditional obligation to pay project costs whether or not the project is operational.
Northern California Power Agency-Hydroelectric Project	CA	A-/Stable	4	Peter Murphy	The hydroelectric project is a 248 MW project that provides baseload power to 11 members, the largest of which is SVP, Calif. The rating is based on the credit quality of the participants because of their unconditional obligation to pay project costs whether or not the project is operational, and to make limited (25%) step-up payments in case other participatants default.
Palo Alto Combined Utility (sub lien)	CA	AA-/Stable	3	Markela Soward	Joint financing for the independent water and gas systems earned a high investment-grade rating due to strong projected coverage and significant reserves for both the water and gas systems.
Pasadena Electric	CA	A+/Stable	4	Peter Murphy	A large stranded cost reserve fund and a flexible fuel cost pass-through policy should insulate Pasadena Electric from its market exposure, high fixed costs related to off-balance sheet obligations, and the pressure to reduce rates. Longer-term risks are linked to load growth, rehabilitation of the distribution system, and the need to plan for the acquisition of power supply and transmission to offset these risks.
					The utility is characterized by a strong, diverse, and stable service territory covering over 96,000 customers and declining costs in purchased power contracts that account for 42% of supply. The utility's movement toward reduction of the system's exposure to power supply markets via additional local generation for power supply needs is a positive trend, although the recent construction of this new 40 MW peaking generation project, and two

Riverside Electric	CA	A+/Stable	4	Paul Dyson	additional 50MW peaking facilities planned, could manifest operational challenges to a relatively inexperienced utility. Annual rate increases from 2002 to 2004 will allow the utility to rebuild reserves while increasing system reliability. Strong senior debt service coverage of 2.04x is offset by marginal combined coverage of both senior debt service and transfers out to the general fund of 1.08x and coverage of all fixed charges of 1.01x.
Roseville	CA	A/Stable	4	Peter Murphy	Roseville's very strong cash reserves, held in the rate stabilization fund, and strong coverage levels insulate Roseville against the near-term risks associated with a somewhat concentrated customer base. Implementation of Roseville's plan to shift toward owned generation from market purchases introduces some longer-term risk.
Sacramento Municipal Utility District	CA	A/Stable	4	Swami Venkataraman	A revamped business strategy that focuses on ownership of assets, a long-term fuel procurement policy that targets stability of gas costs partly through ownership of reserves, a new strategic financial plan that targets a 20% equity-to-capitalization ratio by 2007 and improved coverage ratios should provide credit stability.
Silicon Valley Power (City of Santa Clara) Subordinate Lien	CA	A/Stable	4	Leo Carrillo	SVP is expected to continue to maintain significant cash reserves to offset above-market contracts, additional cost pressures, industrial customer concentration risk, and future capital needs. SVP has not terminated its purchase power contract with Enron and deliveries have not been made under the above market-priced contract for the past two years. Assignment of this contract to another supplier will place financial pressure on the utility because load has decreased since the contract was signed and the additional power is not needed to serve native load. SVP's native load demand should return to a balance with its resources as the economy grows and its WAPA contract lapses, reducing the surplus energy that must currently be sold into the market. The utility officially broke ground on its new Pico Generating Station, a 147 MW combined cycle generating turbine located within city limits.
Southern California Public Power Authority - - STS (working lien)	CA	A+/Stable	4	Peter Murphy	Five of the six participants are rated 'A+' (Anaheim, Riverside, Burbank, Pasadena, and Glendale). The sixth, Los Angeles Department of Water & Power, is rated 'AA-' and accounts for 59.5% of the project, a 500 kv transmission line running 488 miles from the Intermountain Power Project to a convertor station in southern California.
Southern California Public Power Authority (Hoover Project)	CA	AA-/Stable	2	Peter Murphy	Anaheim, Burbank, and Riverside, each rated 'A+', combine for 91% of SCPPA's 94 MW entitlement of the Hoover Dam's capacity resulting from an uprating of nameplate capacity through efficiency improvements.
Southern California Public Power Authority (Magnolia Project)	CA	A+/Stable	4	Peter Murphy	The rating is based on the credit quality of the four 'A+' rated members (Burbank, Glendale, Anaheim, and Pasadena). The project is a 242 MW gas-fired plant that is projected to be operational by spring 2005. Take-or-pay contracts, with limited step-up provisions, support the rating.
Southern California Public Power Authority (Palo Verde Project)	CA	A+/Stable	6	Peter Murphy	The Authority's 5.9% interest in the Palo Verde Nuclear Generating Station is shared by 10 participants, including LADWP (67%). Debt benefitting from a closed senior lien is rated 'AA-'.
Southern California Public Power Authority (San Juan Project)	CA	A+/Stable	4	Peter Murphy	Glendale and Imperial Irrigation District, both rated 'A+', are this project's largest and most highly-rated participants. SCPPA has a 208 MW share, or 41.8%, of San Juan's unit 3.
Turlock Irrigation District	CA	A+/Stable	4	Markela Soward	The Turlock Irrigation District's (TID) financial position remains strong. TID is in the process of securing permits for the construction of a 250 MW combined cycle gas fired plant, the Walnut Energy Center. TID's current plans are to use all power generated from the plant for its own uses, with the possibility of reselling small portions of the excess power in the open market. The anticipated completion date is December 2005. Audited coverage for

					fiscal 2002 remains adequate at 1.58x, with a projected coverage for fiscal 2003 at 1.98x. Cash reserves are anticipated to remain solid at approximately $71 million or 203 days of operating expenses.
Colorado Springs	CO	AA/Stable	3	Peter Murphy	Strong financial performance and management's ability to handle its substantial capital needs drive the rating on Colorado Springs Utilities' combined water, sewer, gas, and electric system. Future capital needs are substantial and are driven by both the growth of the service area and by long-term water and power supply challenges.
Platte River Power Authority	CO	AA-/Positive	3	Peter Murphy	Platte River Power Authority's efficient, low-cost generating resources should continue to support strong financial performance and provide a buffer against industry volatility. The authority's four member cities' growth trends should continue to be supportive of credit quality. The positive outlook reflects Standard & Poor's expectation that the financial profile will continue to improve to levels in line with those of a higher rating.
Gainesville Regional Utility	FL	AA/Stable	3	Jodi Hecht	Changes to the 2003 indenture, which should be finalized by the end of the year, slightly weaken bondholder protection. However, operating procedures to maintain strong liquidity offset concerns regarding the elimination of a debt service reserve fund. Debt service coverage remains sound at over 2.7x and Gainesvill Regional Utility continues to draw down the reserve fund as budgeted to support rates. Management is in the process of addressing and financing future load growth and related capacity shortfalls expected in 2010.
Jacksonville Electric Authority	FL	AA/Negative, AA-/Negative Junior Lien	3	Jeff Panger	Jacksonville Electric Authority's (JEA) coverage of debt service and fixed charges has dwindled in recent years, as management has focused on creating expense side savings rather than raising rates to rebuild margins. Such focus has improved coverage somewhat, but not to levels consistent with the current rating. The rating will likely be lowered if JEA is unable to produce additional cost savings leading to improved coverage for 2003 or institute a rate increase by the end of the current fiscal year. Management has indicated that it does not anticpate raising rates in the near future unless warranted by inflationary pressures.
Lakeland Energy System	FL	AA-/Stable	3	Jeff Panger	Lakeland Energy System has experienced financial losses associated with a unprofitable power sales contract to supply Florida Municipal Power Agency (FMPA) with 50 MW/year through 2010 from its gas fired combined cycle unit 5 . The contract requires FMPA to pay Lakeland a fixed price for the power and does not include fuel cost pass-throughs. Solid coverage levels and actions to reduce other costs give some short-term comfort as to the utility's ability to absorb the losses as Lakeland pursues restructuring of the contract.
Orlando Utilities Commission	FL	AA/Stable	3	Jeff Panger	In October 2003, Orlando Utilities Commission (OUC) achieved bondholder consent of its general resolution, which, among other provisions, called for all outstanding and future bonds to rank pari passu. Although security for the current senior-lien bondholders will be diluted somewhat under the new general resolution, Standard & Poor's believes that OUC's solid financial operations support a 'AA' rating on all outstanding bonds, and as such raised its rating on the current subordinate-lien bonds to 'AA' from 'AA-. Key to the rating is Orlando's strong financial profile, diverse fuel mix, favorable rates, and strong service area. However, the service area economy is highly influenced by tourism, which is subject to downturn or disruption to the historic travel patterns.
Tallahassee Electric Energy System	FL	AA/Stable	4	Jeff Panger	Progress in reducing the city of Tallahassee's reliance on electric system transfers to support general operations has helped the Tallahassee Electric Energy System to maintain a solid financial profile. Coverage levels are expected to decline over the next few years as fund balances are used to underwrite rate relief. Meanwhile challenges posed by a reliance on gas fired-generation, short-term gas contracts, and spot purchases exposes the utility to potential expense volatility.
					This joint-action agency's rating was affirmed in

Municipal Electric Authority of Georgia	GA	A+/Stable	4	Leo Carrillo	December on the strength of Municipal Electric Authority of Georgia's (MEAG) take-or-pay contracts with its members and on the significant financial flexibility provided by MEAG's Municipal Competitive Trust (MCT). Reserves in the MCT are expected to be sufficient to mitigate MEAG's heavy debt and above-market production costs in a competitive environment. The members' cumulative MCT money currently totals more than $620 million and is expected to increase to more than $800 million by 2008, MEAG's conservative forecast for implementation of retail competition in the state. MEAG's wholesale rates are expected to remain flat at about 5 cents per kilowatt hour (KWh) until 2006, when environmental compliance costs are expected to drive up costs to about 5.5 cents.
Guam Power Authority	Guam	BB+/Creditwatch Negative	5	Leo Carrillo	Standard & Poor's lowered Guam Power Authority's (GPA) rating to 'BB+' in July, while maintaining the ratings on Credit Watch with negative implications due to financial pressures associated with recent typhoon damage, diminished liquidity, weak cash flow coverage projected for 2003, the absence of rate relief and uncertainty regarding the retirement of a large receivables burden created by payment delinquencies of governmental agency customers. GPA is working to restore its financial profile by aggressively reducing payment delinquency, pursuing FEMA (Federal Emergency Management Agency) disaster aid and seeking immediate payment by Government of Guam agencies for past due balances.
Springfield Electric	IL	A+/Stable	4	Peter Murphy	Springfield Electric's rating was raised in 2001 to 'A+' after it had recovered from substantial trading losses incurred in 1998. In 2002, the city paid $18.1 million to alter its power marketing contract with Reliant Energy so that the city would retain the bulk of the profits of its excess energy sales. While wholesale profits should increase, the uncertainty of wholesale power markets is a key risk. Springfield must continue to manage its surplus power supply.
Indiana Municipal Power Agency	IN	A+/Stable	3	Leo Carrillo	Standard & Poor's is monitoring Indiana Municipal Power Agency's (IMPA) financial performance, after the utility's cash flow coverage fell to around 1x in 2002, versus the 1.125x board target. Liquidity continues to be healthy, with three-months' unrestricted cash available and a rate stabilization fund maintained at around $28 million.
Wyandotte County Unified Government Board of Public Utilities	KS	A+/Stable	4	Peter Murphy	Wyandotte County's combined water and electric system rating is dominated by the electric system (84% of operating revenues). Management is expected to combat near-term growth pressures through rate adjustments that should restore the system's liquidity levels. The system's mix of owned and contracted power supply should be sufficient over the intermediate term.
Massachusetts Municipal Wholesale Electric Co. (Wyman Project)	MA	BBB+/Stable	5	Dimitri Nikas	The stability of the several Massachusetts Municipal Wholesale Electric Co. (MMWEC) projects is a function of the ability of MMWEC to charge rates that are sufficient to recover not only debt service but also stranded costs and a preponderance of mid-investment-grade evaluations on the members' light departments, which are responsible for debt service. The modest disparity of the projects' ratings reflect the credit quality of the individual light departments.
Massachusetts Municipal Wholesale Electric Co. (Nuclear Project #4)	MA	BBB+/Stable	5	Dimitri Nikas	See Massachusetts Municipal Wholesale Electric Co. (Wyman Project)
Massachusetts Municipal Wholesale Electric Co. (Nuclear Project #5)	MA	A-/Stable	4	Dimitri Nikas	See Massachusetts Municipal Wholesale Electric Co. (Wyman Project)
Massachusetts Municipal					See Massachusetts Municipal Wholesale Electric Co.

Wholesale Electric Co. (Project 6)	MA	BBB+/Stable	5	Dimitri Nikas	(Wyman Project)
Massachusetts Municipal Wholesale Electric Co. (Stony Brook Intermediate)	MA	A-/Stable	4	Dimitri Nikas	See Massachusetts Municipal Wholesale Electric Co. (Wyman Project)
Massachusetts Municipal Wholesale Electric Co. (Stony Brook Peaking)	MA	A-/Stable	4	Dimitri Nikas	See Massachusetts Municipal Wholesale Electric Co. (Wyman Project)
Massachusetts Municipal Wholesale Electric Co. (Nuclear Mix #1)	MA	A-/Stable	4	Dimitri Nikas	See Massachusetts Municipal Wholesale Electric Co. (Wyman Project)
Massachusetts Municipal Wholesale Electric Co. (Nuclear Project #3)	MA	BBB+/Stable	5	Dimitri Nikas	See Massachusetts Municipal Wholesale Electric Co. (Wyman Project)
Lansing Board of Water Power and Light	MI	AA-/Stable	4	Susan Knutson	Lansing Board of Water Power and Light's (Lansing BWL) rating was downgraded in August 2003 to 'AA-' from 'AA' due to financial pressures associated with the system's chilled water utility. The electric system's customer base is concentrated, with General Motors a concentrated user at 14% of electric revenues. The system's finances remain strong with 4x debt service coverage and total fixed charge coverage of 1.74x.
Michigan Public Power Agency (Belle River)	MI	AA/Stable	4	Susan Knutson	The Belle River project maintains exceptionally strong cash reserves equal to four years of debt service. The 25% step-up provisions, along with the very strong credit profiles of the two largest participants, mitigate participant concentration. Belle River has excess transmission capacity and does not expect need for additional base load until after 2007.
Michigan South Central Power Agency	MI	BBB/Stable	5	Susan Knutson	The 'BBB' rating reflects the credit quality of the agency's members. The agency's high fixed costs, high members rates, and the members' dependence on industrial customers for a substantial portion of their revenues will continue to preclude a higher rating. The financial reserves held at the agency provides stability to the rating.
Northern Municipal Power Agency	MN	A/Stable	3	Swami Venkataraman, MN	The agency's creditworthiness is a function of strong long-term all-requirements contracts with its 12 participants, extremely low-cost coal and hydro power resources, wholesale rates that are much lower than state and regional averages, and the benefits from the coordination agreement with Minnkota Power Cooperative. This agreement essentially combines the two into one electric system from both an operational and financial perspective. Minnkota serves as a backstop for all of Northern Municipal Power Agency's revenue requirements in excess of member revenues.
Southern Minnesota Municipal Power Agency	MN	A+/Stable	4	Susan Knutson	Southern Minnesota Municipal Power Agency (SMMPA) member contracts extend through 2030, and members must give seven years' notice if they opt to seek other sources of supply. SMMPA's largest member, Rochester, has a fixed energy requirement of 216 MW. There is a cost-adjustment clause in place to protect the agency from volatile fuel and purchased power costs.
Columbia Water and Electric System	MO	AA/Stable	4	Susan Knutson	Columbia Water and Electric System's negative outlook cites declining coverage of fixed charges and projections of further declines in coverage levels, with no plans to enhance revenues to address the declines. The system is reliant on purchased power, with three separate base-load contracts, one expiring in 2004. Coverage of direct debt remains strong and liquidity has improved, with a

					strong 177 days' cash when including the renewal and replacement fund.
Springfield Utilites	MO	AA/Stable	3	Susan Knutson	Springfield Utilites is planning to building 300 MW of new coal-fired generation later in 2004. The additional base load has a preliminary estimated cost of $600.0 million, and the related revenue bonds require a simple majority approval of voters under Missouri law. The system remains very competitive and has some of the lowest rates in the state. Currently debt service coverage exceeds 5x and liquidity has grown in anticipation of the project. There will be rate increases associated with the new generation, currently proposed to be 4% per year for the next four years.
North Carolina Eastern Municipal Power Agency	NC	BBB/Stable	6	Jeanny Silva	Eastern's high debt burden a[illegible]bove-average wholesale rates are somewhat miligated [illegible]e agency's strong take-or-pay contracts, which con[illegible]tually obligate member cities to pay agency debt service and the financial oversight and political support provided by the Local Government Commission of North Carolina (LGC). Eastern recently renewed its supplemental power agreement with Carolina Power & Light (CP&L), which will provide North Carolina Eastern Municipal Power Agency (NCEMPA) with adequate power supplies through 2009 and should provide NCEMPA with additional cost savings.
North Carolina Municipal Power Agency No. 1	NC	BBB+/Stable	5	Jeanny Silva	North Carolina Municipal Power Agency (NCMPA) continues to take measures to improve its cost structure. It is currently negotiating certain modifications to an interconnection agreement wiith Duke Energy while negotiating a new more favorable arrangement with Southern Power. The contract arrangements should help the agency to contain its above-average wholesale rates.
Lincoln Electric System	NE	AA/Stable	2	Swami Venkataraman	Lincoln Electric System (LES) announced the acquisition of of a 100 MW stake in the Council Bluffs unit #4 coal plant being built by Mid American Energy. The business profile is exceptionally strong for a vertically integrated utility, and continued stable financial performance is expected.
Municipal Energy Agency of Nebraska	NE	A-/Stable	5	Peter Murphy	Municipal Energy Agency of Nebraska's (MEAN) participation in the Council Bluffs Unit #4 coal-fired facility represents a shift into acquiring generation assets. The lack of competitive threats in Nebraska for the foreseeable future is key to the rating.
Nebraska Public Power District	NE	A/Negative	4	Swami Venkataraman	Nebraska Public Power District's (NPPD) Cooper Nuclear Station is expected to emerge out of "repetitively degraded" status by the first quarter of 2004. The decision to sign a management contract for Cooper with Entergy is a positive development. Key credit issues include the need to secure reasonable power sales contracts for Cooper beyond 2004 and to maintain financial performance in the face of additional borrowings for the new Beatrice Gas Station and the recently announced acquisition of 150 MW from Omaha Public Power District's (OPPD) Nebraska City #2 coal unit.
Omaha Public Power District	NE	AA/Stable	3	Swami Venkataraman	Stable financial performance is expected to continue at this low-risk utility in the all-public power state of Nebraska. OPPD announced the construction of the potentially 600 MW Nebraska City #2 coal station, with its own requirement limited to 300 MW. OPPD is expected to structure the additional capacity with no impact on its own credit rating.
Long Island Power Authority	NY	A-/ Neg	4	Terry Pratt	In June 2003, Suffolk ratepayers began to pay a surcharge related to the Shoreham plant that will be approximately 2.8% per year through 2029. The surcharge will be used to cover debt service on the Shoreham-related bonds and improves Long Island Power Authority's (LIPA) financial position. LIPA's contract capacity grew in 2003 with the addition of 55 MW at FPL Jamaica Bay and 52 MW at Greenport. The negative outlook reflects CFO turnover, lack of a long-term supply program, and potential acquisition of the Keyspan generation assets.
					The outlook for New York Power Authority (NYPA) remains stable due to maintenance of strong coverage

New York State Power Authority	NY	AA-/Stable	5	Dimitri Nikas	levels, resolution of the litigation surrounding the Power Now! assets in New York City, and prospects for an improved hydrology environment going into 2003. NYPA's senior debt coverage in 2002 was 2.2x without the Entergy payment and 2.9x with the Entergy payment.NYPA is forecasting coverages above 1.8x from 2003-2007, excluding the annual $118 million Entergy payment.
Cleveland Public Power System	OH	A-/Stable	4	Jeff Panger	Cleveland Public Power System (CPP) continues to maintain its rate advantage and post net meter gains from Cleveland Electric Illuminating Co., with which it directly competes on a door to door basis. However, CPP's rate advantage has declined over the past several years, and with the expiration of one-third of purchased power contracts, CPP will continue to be challenged to maintain its competitive position.
Ohio Municipal Electric Generating Agency (Belleville Hydro Project)	OH	BBB+/Stable	5	Jeff Panger	American Municipal Power-Ohio's diverse member base provides support to credit quality, but contract structure introduces risk due to the presence of some weak members. Additional project operating history and oversight of members has mitigated concern regarding the limited step-up and a number of members that are of weaker credit quality, resulting in a rating upgrade in October 2003. Stable water flows continue to mitigate concern regarding the run-of-the-river nature of the project.
Grand River Dam Authority	OK	BBB+/Stable	6	Jeanny Silva	Short-term off-system contracts accounting for approximately 30% of operating income expose the Grand River Dam Authority (GRDA) to merchant risks over the intermediate term. These risks are tempered by the GRDA's proven ability to add new contracts and extend existing ones, most recently with the extension of the Stillwater contract, which extends through 2011-2013. GRDA's liquidity position continues to be strong, with about 150 days cash on hand. Performance for the last 12 months ending September 2003 was significantly up, as compared to the same period last year, largely because of higher weather-related (peaking) demand and growth at some of the GRDA's municipal customers.
Oklahoma Municipal Power Authority	OK	A/Stable	4	Jeanny Silva	The Oklahoma Municipal Power Authority faces uncertainty regarding its transmission arrangements with Oklahoma Gas & Electric (OG&E) and the degree to which it will need to contribute to capital expenditures designed to improve the reliability of transmission assets in the southwest region of its service area. The Oklahoma Municipal Power Authority should continue to meet cashflow adequacy measures commensurate with its 'A' rating provided that its debt levels and transmission costs do not materially increase beyond current projections.
Bonneville Power Administration	OR	AA-/Negative	5	Swami Venkataraman	The implementation of the Safety Net CRAC starting Oct. 1, 2003, as intended by the mechanism, removes concern about the use of savings from a debt optimization program ($315 million in fiscal 2003) to offset the need for additional rate increases. Bonneville Power Administration (BPA) is expected to end its fiscal 2003 with a much improved liquidity position. However, BPA remains significantly dependent on hydro conditions and wholesale power prices over the next three years until the next rate period. The risk of unfavorable market conditions depleting liquidity remains. Further rate hikes to customers, if required, will be politically difficult.
Eugene Water & Electric Board (Electric System)	OR	AA-/Negative	4	Paul Dyson	As did many northwestern utilities, Eugene Water & Electric Board (EWEB) experienced higher-than-anticipated purchased power costs during the drought and energy market volatility of 2001. The system's almost complete dependence on hydrological sources for its power and recent local adverse hydrological and market conditions have also challenged the utility's financial performance. The negative outlook reflects EWEB's increased risk profile, including increased reliance on off-system sales to meet rapidly escalating debt service payments that will double over the 2002-2007 period, as well as EWEB's reduced rate-setting flexibility, given recent large rate increases. Cost pass-thoughs from Bonneville appear to be diminishing somewhat in the near

					term, and this should allow the utility to improve overall operations and financial performance.
Puerto Rico Electric Power Authority	PR	A-/Stable	2	Jeff Wolinsky	Rating stability centers on Puerto Rico Electric Power Authority's (PREPA) ability to maintain a stable financial profile and to continue to make progress on its large and much needed capital program. PREPA's projected minimum debt service coverage ratios remain sound at about 1.53x, which are slightly lower than historical levels. Minimum fixed-charge coverage, which includes a portion of the payments under the power purchase agreements, will be adequate, but at the lower level of 1.47x.
Piedmont Municipal Power Agency	SC	BBB-/Negative	6	Dimitri Nikas	Piedmont Municipal Power Agency has successfully arranged for replacement supplemental and backup sources of energy after its interconnection agreement with Duke expires in 2006, arresting any concerns that the financial and business profiles could be adversely affected. The outlook was revised to stable to reflect this event.
South Carolina Public Service Authority	SC	AA-/Stable	3	Dimitri Nikas	The combination of efficient low-cost generation, lack of deregulation efforts, and diverse customer base provide support to credit quality. Furthermore, Santee Cooper's prudent management and strong financial profile, including substantial liquidity, ensure a stable outlook.
Chattanooga Electric Power Board	TN	AA/Stable	2	Ted Chapman	Chattanooga Electric Power Board's (Chattanooga EPB) front-loaded debt service and strong overall electric system coverage are part of Chattanooga EPB's efforts to remain competitive and retain a large industrial customer base in the event the TVA service area were to restructure to allow retail competition. Chattanooga EPB's telecommunication venture, while a small portion of total system revenues, reached break-even status in 2002, ahead of schedule, limiting the risk to the electric system.
Knoxville Utilities Board	TN	AA/Stable	2	Ted Chapman	Knoxville regularly exceeds internal debt service of at least 3x. There is some risk associated with above-average amount of variable-rate debt, but moderated with rapid maturity by 2004. Benefits from reduced operating risk from its status as a TVA all-requirements customer.
Memphis Light Gas and Water	TN	AA/Stable	2	Ted Chapman	A recently completed first-of-its-kind $1.5 billion debt-financed prepaid purchased power agreement (transaction rated 'AA-'/stable) with the TVA is expected to save Memphis Light Gas and Water a net $13 million per year for the next 15 years. The transaction introduces a significant fixed-cost component that has been introduced by shifting a portion of the all-requirements power supply to debt service.
Nashville Electric Service (Nashville & Davidson County)	TN	AA/Stable	3	Peter Murphy	Nashville Electric Service's manageable capital plan addresses the distibution-only system's growth and reliability needs. TVA continues to provide a reliable and reasonably priced power supply on a take-and-pay basis, which limits Nashville Electric Service's exposure to TVA's high debt burden. The system's expected modest customer growth and relatively low rates should result in continued good coverage levels, consistent with its rating level.
Austin Combined Utility (senior lien)	TX	A/Positive	4	Ted Chapman	A recent unplanned outage at one of the South Texas Project nuclear units forced the utility to purchase power from the market to replace the temporarily lost portion of their generation portfolio, but the cost for replacement power was manageable. Austin closed this lien after having separated the electric system and the water and sewer systems' net revenue pledges in 2000. The utility continues efforts to restructure debt and separate business lines, which could improve competitiveness in an open-market scenario. It recently completed a comprehensive risk management policy applicable to finances, operations, and day-to-day policies and procedures.
Brownsville Utilities System	TX	BBB+/Stable	5	Peter Murphy	The key challenges facing Brownsville Utilities System's operations include the need for reliable power and fresh water supplies to serve its growing customer demand while maintaining competitive rates. Brownsville Utilities System is already subject to direct competition in some of its electric service area, and thus its recently adopted rate

					increases across all three business segments (electric, water, and sewer) over the next four years should fund system growth while maintaining liquidity and coverage levels.
Denton Combined Utility	TX	A+/Stable	4	Peter Murphy	Denton Combined Utility's electric system provides three-fourths of the operating revenue of the combined water, sewer, and electric utility. The performance of Texas Municipal Power Agency's (TMPA) Gibbons Creek plant, which provides about two-thirds of the city's energy is critical to the rating. Other challenges include exposure to market forces for the city's growing load, as well as infrastructure needs in all three systems that have driven rising debt levels. Denton Combined Utility's liquidity is strong but may decline as rate stabilization reserves are depleted to offset TMPA's high fixed costs over the next decade.
Garland Combined Utility	TX	A+/Stable	4	Ted Chapman	Although Garland Combined Utility has recently acquired additional generation assets, it remains dependent upon Texas Municipal Power Authority's high-cost coal-based power for the majority of its load requirements. Substantial off-balance sheet debt associated with TMPA remains a manageable challenge. Garland does not plan to opt-in to the competitive retail market within ERCOT.
Lower Colorado River Authority Transmission Services Corp.	TX	A/Stable	3	Anne Selting	The transmission business is highly dependent on regulatory approval of cost recovery for new transmission projects. Transmission Services Corp. (TSC) is embarking on a $1.3 billion transmission investment plan (2004-2008) that is will be 96% debt-financed and which could expose Lower Colorado River Authority (LCRA) to regulatory disallowance or timing delays that could stress cash flows. To date, regulatory treatment has been favorable, and the rating reflects the expectation that the regulatory process will be sufficient to provide LCRA TSC with sufficient revenues to maintain a minimum of 1.25x debt service coverage each year and that liquidity levels will remain sufficient to support a substantial capital plan.
Lower Colorado River Authority	TX	A/Stable	4	Anne Selting	LCRA has a diverse resource mix that provides favorably priced energy to LCRA's 42 wholesale customers. The resource mix is expected to contribute to a stable revenue stream, despite a newly deregulated retail market in ERCOT. LCRA announced in December 2003 its proposed acquisition of Calpine Corp.'s 50% interest in the Lost Pines Power Project, a 545 MW combined-cycle power plant. LCRA owns the other 50% interest in the plant through its affiliate, GenTex. The purchase includes a one-year agreement that allows Calpine to call up to 250 MW. LCRA is expected to close the sale in January 2004 and will debt-finance the majority of the purchase. Debt-service coverage is not expected to materially change as a result of the purchase, and is forecast to be 1.3x in 2004.
Lubbock Power and Light	TX	BBB-/Negative	7	Peter Murphy	Lubbock Power and Light is unique among public power entities in that in 80% of its service area it faces direct competition from Southwestern Public Service, a unit of Xcel Energy. The city must restore its competitive position and stem customer losses and restore its profitability to remain viable. Lubbock must also successfully implement a plan regarding its power supply portfolio and must continue to recover costs on a timely basis via its fuel cost recovery mechanism.
New Braunfels	TX	A+/stable	5	Ted Chapman	This combined electric, water, and sewer utility is located in a high-growth corridor between San Antonio and Austin, helping the largely residential customer base to grow and diversify. Manageable growth, single certification of the electric service area to the city, and a favorable take-and-pay agreement for wholesale power with LCRA have allowed NBU to maintain debt service coverage generally in excess of 4x and strong system liquidity. While the system does have additional debt plans over the next five years, no financing needs are projected for the electric system.
					Sam Rayburn Municipal Power Agency restructured its outstanding debt in 2002 in conjunction with the sale of its generation asset to Entergy in return for a long-term, fixed-rate purchased power contract. The agency's debt is

Sam Rayburn Municipal Power Agency	TX	BBB-/Stable	6	Ted Chapman	secured by an unconditional commitment to pay by three Texas municipal electric systems (Jasper, Liberty, and Livingston) that include an unlimited step-up obligation. The three municipal electric systems have rate structures that are designed to cover the high fixed costs of the Sam Rayburn debt, and all are experiencing moderate to strong system growth. All three cities are located outside of the ERCOT region and retail choice is not an option at this time. Although power supply is 100% dependent on delivery and performance by Entergy, the contract is no longer plant-specific, reducing the single-asset risk.
San Antonio Electric and Gas	TX	AA+/Stable	2	Arloen Spangler	The ratings reflect San Antonio's continued ability and success at providing low-cost rates to customers, managing a diverse resource portfolio, and hedging commodity price risk on behalf of its customers while maintaining a strong financial profile. The rating anticipates a continued strong financial profile and legal protections for bondholders.
Texas Municipal Power Agency	TX	A+/Stable	5	Ted Chapman	TMPA's four participants (Denton, Garland, Greenville, and Bryan, Texas) are unconditionally obligated to pay the costs of TMPA with an unlimited step-up provision. Operations at the Gibbons Creek coal-fired plant are now strong, and the additional transmission revenues that TMPA began receiving in 2000 as a result of the deregulated ERCOT market have helped buy down the high fixed costs of the agency. Members are not planning to opt-in to the competitive Texas market and are expected to be able to support the above average cost of power from TMPA as part of their overall generation resources. Near-term challenges include a possible investment in expanded rail delivery capacity at Gibbons.
Virgin Islands Water and Power Authority	USVI	BBB-/Stable	5	Jeff Wolinsky	Rating stability centers on Virgin Islands Water and Power Authority's (WAPA) ability to maintain a stable financial profile while making progress on its capital program. Over time, the rating could be raised, as the large capital program is completed and operations improve. However, the regulatory oversight and tourism-based economy will likely limit the rating to the 'BBB" category.
Intermountain Power Agency	UT	A+/Stable	4	Markela Soward	Intermountain Power Agency (IPA) continues to benefit from efficient operations, with its two coal-fired units running at an availability of 93% in 2002, compared to the industry average of 74%. These strengths are tempered by substantial fixed costs associated with about $3.2 billion of debt and high fuel costs. Debt service continues to represent nearly two-thirds of revenue requirements at 2.88 cents/kWh and translates into debt service payments that account for 55% of IPA's total revenue requirement.
Utah Associated Municipal Power Systems (Craig Mona Project)	UT	A-/Stable	4	Markela Soward	The downgrade to the transmission project rating in 2002 reflects the deterioration in credit quality of the largest participants in the project. A number of the Utah municipal electric systems struggled to meet load growth through power purchases at a time when market price volatility has been substantial. The stable outlook reflects Standard & Poor's expectations that recent rate increases and decreased exposure to purchases in the open market will stabilize the financial well being of the participants in the transmission project.
Benton County Public Utility District No. 1	WA	BBB+/Stable	5	Paul Dyson	Benton County Public Utility District has had recent success in meeting relatively high wholesale sales projections necessary to achieve healthy margins and debt service coverage, and its forecasts show less dependence on such sales to meet future debt obligations. In addition, the utility has made proactive management steps that will likely improve financial performance, including an acceleration of a future 2004 rate increase into 2003, a new power cost adjustment mechanism, strengthened financial policies and risk management techniques, and a material change towards conservatism in its forecasts, which, nonetheless, continue to show good financial margins and coverage.
Chelan County Pub Utility District No. 1 (Chelan	WA	AA/Stable	2	Leo Carrillo	The ratings on Chelan County's revenue bonds reflect very low production costs, averaging two cents per KWh, retail rates that are among the lowest in the U.S., consistently strong financial performance, and a strong,

Hydroelectric Consolidated System)					liquid balance sheet with enough cash on hand to meet all planned capital expenditures and to protect against contingencies.
Chelan County Public Utility Distric No. 1 (Rocky Reach Hydroelectric System)	WA	AA/Stable	2	Leo Carrillo	See Chelan County Public Utility Distric No. 1 (Rocky Reach Hydroelectric System)
Chelan County Public Utility District No. 1 (Rock Island Hydroelectric System)	WA	AA/Stable	2	Leo Carrillo	See Chelan County Public Utility Distric No. 1 (Rocky Reach Hydroelectric System)
Clark County Public Utility District	WA	A/Stable	4	Markela Soward	Clark Public Utility District's (CPUD) higher priced gas contracts will expire over the first quarter of 2004, leaving CPUD with the possibility of negotiating newer, potentially cheaper contracts going forward. However, to date CPUD has only secured by 80% of its gas requirements for fiscal 2004, with no contacts secured for fiscal 2005. CPUD's power resource mix will adjust slightly starting in fiscal 2004, with a few long-term power contracts expiring. As a result, CPUD's gas-fired plant, The River Road Generating Plant, will account for 39% of its overall power mix, a 4% increase from fiscal 2003. Cash flow debt service remains improved for fiscal 2004, with coverage hovering around 1.51x. A 5% rate increase was implemented in 2003, which has helped improve coverage and the increased costs associated with purchased power from Bonneville Power Administration under the cost-recovery adjustment clause (CRAC).
Cowlitz County Public Utility District	WA	A-/Negative	4	Markela Soward	Cowlitz County Public Utility District was placed on negative outlook in March 2003 due to severe damage to its dam, leaving it somewhat reliant upon spot-market purchases for substitute power, coupled with already low unrestricted reserve levels. This left the district with less of a financial cushion should other unplanned future costs occur. The Cowlitz County PUD remains committed to increasing rates and as of Oct. 15, 2003, had just recently passed a 4.5% rate increase. The rate increase was slightly less than the projected rate increase of 10%-12% estimated earlier in the year. In the first quarter of calendar 2004 the district will most likely issue bonded debt to fund the reconstruction of Swift No. 2.
Douglas County Public Utility District #1 (Wells Project)	WA	AA/Stable	2	Leo Carrillo	Very low production costs of about 10 mills per kWh and favorable environmental attributes make for one of the most competitive hydroelectric resources in the Pacific Northwest. Single-asset risk is the only major credit concern underlying the 'AA' rating.
Douglas County Public Utility District No. 1	WA	AA-/Stable	3	Leo Carrillo	The district's very strong financial profile and conservative budgeting policies complement a strong business profile characterized by very low retail rates, an efficient and very low-cost generating resource in the Wells Project, a largely residential retail base. These credit strengths easily overcome potential concerns regarding the small, agriculture-based local economy, potential relicensing costs at the Wells Project, or capital requirements for buildout of the district's telecommunications system. Unrestricted cash of $25 million exeeds outstanding debt of $19 million. Levelized debt service coverage is projected to exceed 2x, even under the conservative assumption of very low streamflow and cost based rates.
Franklin County Public Utility District	WA	BBB/Stable	5	Paul Dyson	Significant operating losses in 2002 demonstrated heightened risk due to recent transition to generation ownership, dependence on off-system sales revenues of surplus hydro power, and exposure to Bonneville price increases. Management's adherence to aggressive wholesale revenue forecasts is still a credit concern. Strengths include management's recent implementation of an 11.5% rate surcharge in January 2003 and the district's recent success in meeting somewhat aggressive off-system sales for resale targets for 2003 to date (unaudited). In spite of these positive factors, the district's financial performance could be impaired as a result of its

					total dependence on gas and hydrological power resources, which are volatile in nature in terms of both availability and price. The utility's debt service coverage policy of 1.6x contributes to the strength and stability of the rating.
Grant County Public Utility District No. 2 (Electric System)	WA	A+/Negative	4	Leo Carrillo	Weak cash flow coverage prompted Standard & Poor's to revise in January 2003 its outlook to negative on the rating for Grant County's distribution system, after the district chose to rely exclusively on power cost deferrals to recover unusually high power costs in those years. The district imposed a rate increase of 4% in April 2003 and plans another for 2004. Although Standard & Poor's is concerned with the utility's financial profile and rate-setting responsiveness, Grant County's credit quality remains strong, helped in large part by the very low production costs of below $13 per megawatt-hour at the district's two hydroelectric projects, a return to Bonneville Power Administration for the district's full residential amount in a shaped-block product, and residential rates that are among the lowest in the nation.
Grant County Public Utility District No. 2 (Priest Rapids)	WA	AA-/Stable	2	Leo Carrillo	Very low project costs of $6.24 per megawatt-hour (MWh) at Wanapum and $8.11/MWh at Priest Rapids enable Grant County PUD to offer extremely competitive cost-based power in the current western electric markets. It is expected to continue to be supportive of strong credit quality. Unconditional power-purchase contracts with 12 (Priest Rapids) and nine (Wanapum) purchasers for 63.5% of each project's output through Oct. 31, 2005, and Oct. 31, 2009, respectively, with the remaining 36.5% reserved for sale to the district's electric system provide long-term stability. Costs continue to be passed directly through to participants based on their percentage share.
Grant County Public Utility District No. 2 (Wanapum)	WA	AA-/Stable	2	Leo Carrillo	See Grant County Public Utility District No. 2 (Priest Rapids)
Grays Harbor County Public Utility District No. 1	WA	A-/Stable	4	Markela Soward	Grays Harbor County Public Utility District is similar to sister PUDs Benton and Franklin, but key differences enabled rating to remain in the 'A' category. Grays Harbor County PUD also acquired a participation in Bonneville hydro generation assets, with the intention of subsidizing rates with profits from off-system sales, which failed to materialize in 2002. In response to resulting operating loss, Grays Harbor County PUD drastically reduced forecasted margins from off-system sales. Conservative forecasting increases likelihood district will achieve sound coverage going forward.
Seattle City Light	WA	A/Negative	4	Leo Carrillo	Seattle City Light (SCL) continues to face financial pressure as it digs itself out of the financial hole created by exceptionally high purchased-power costs in 2001 and lower-than-anticipated wholesale revenues in 2002. Although operations remain solid, and SCL is in resource balance at critical water levels, the utility will have seriously constrained liquidity through 2004. Although generating positive cash flow, all excess revenues will be used to repay short-term borrowing, expected to occur in mid-2004. The negative outlook reflects the downside potential of the rating if SCL's recovery to a cash flow positive financial position is delayed substantially beyond fiscal 2004. Delays could be caused by variable water conditions, low wholesale market prices, additional rate increases from Bonneville that are not passed through to retail customers, or unexpected capital needs.
Snohomish County Public Utility District No. 1	WA	A+/Stable	4	Markela Soward	Snohomish County Public Utility District continues to retain its solid financial profile. Current emphasis is to bring rates down while continuing to fund a significant share of capital needs from operating revenues to reduce the utility's overall debt burden. Snohomish County PUD is considering several options to help cover a shortfall that is materializing for its current fiscal 2004 year. The shortfall does not include the pending increases in the CRACs under Bonneville because Snohomish is a block and slice customer.
					Management's sound financial policies, as shown by the early implementation of a 50% rate surcharge during the

Tacoma Light & Power	WA	A+/Stable	4	Anne Selting	western energy crisis and a 100% pass-through of Bonneville Power Administration's (BPA, 'AA-/Negative') 48% rate increase in October 2001, served to quickly restore Tacoma's financial health following the Western energy crisis. The decision to sign a five-year contract with BPA using the block product instead of the SLICE product insulates Tacoma from hydro risks and reduces its reliance on wholesale revenues to meet debt service coverage. The stable outlook reflects the rapid recovery from financial challenges associated with the 2001 power crisis and an expectation that cash flow at the utility will return to historically strong levels by the end of fiscal 2002.
Wisconsin Public Power Inc.	WI	A/Stable	4	Jeff Panger	Wisconsin Public Power Inc.'s (WPPI) rating and outlook are bolstered by the strength of its all-requirements power supply contracts with 37 members, low rates and automatic pass-through adjustments, and solid liquidity, all of which serves to insulate WPPI from pressures associated with a reliance on purchased power and a retail level base that is highly concentrated in paper product manufacturing. Through the third quarter of fiscal 2003 year-over-year operating income has declined 10%, as fuel and purchased power expense has increased on a unit basis, but volume purchased was lower in response to decline in demand, driven by generally cooler weather and weakened economic conditions.
Wyoming Municipal Power Agency	WY	A-/Stable	4	Peter Murphy	Wyoming Municipal Power Agency's (WMPA) competive cost structure and its all-requirements members' stable customer bases should enable the agency to maintain its sound financial results.

Table 2 CreditWatch

Issuer	Rating	Implications	Date	Reason
Guam Power Authority, Guam	BB+	Negative	2/5/2003	Concerns regarding immediate liquidity and financial condition.
California Department of Water Resources, Calif.	BBB+	Negative	5/15/2003	Reduction in indenture-required funds and Western Area Power Administration payments.

Table 3 Outlook Changes

Issuer	To	From	Date	Reason
Benton County PUD #1, Wash.	Stable	Negative	10/30/2003	Reduced reliance on off-system power sales to meet financial targets.
Lubbock, Texas	Negative	Stable	8/22/2003	Deteriorating financial and competitive position.
West Texas Municipal Power Agency, Texas	Negative	Stable	8/22/2003	Downgrade of dominant member, Lubbock, Texas.
Franklin County PUD, Wash.	Stable	Negative	6/13/2003	Revenue enhancements and reduced reliance on off-system sales in financial forecast.

Notes: Ratings are from May 31, 2003 to Jan. 20, 2004. PUD -- Public Utility District.

Table 4 Rating Changes

Issuer	To	From	Date	Reason
Benton County PUD #1, Wash.	BBB+	BBB	10/30/03	Revenue enhancements and increased conservatism in budgeting.
Ohio Municipal Electric Generating Agency, Ohio	BBB+	BBB	10/27/03	Positive project operating history.
Orlando Utilities Commission, Fla. (junior lien only)	AA	AA-	10/02/03	Combining of subordinate and senior liens.
Lansing Board of Water & Light, Mich.	AA-	AA	08/22/03	Losses in chilled water unit reduced financial flexibility through extension of debt maturities.
Lubbock, Texas	BBB-	A+	08/22/03	Deteriorating financial and competitive position.
West Texas Municipal Power Agency, Texas	BBB-	A+	08/22/03	Downgrade of dominant member, Lubbock, Texas.

Guam Power Authority, Guam	BB+	BBB	07/16/03	Financial pressures associated with widespread typhoon damage, diminished cash flow coverage, and weakened liquidity.
Granbury, Texas	A	A-	06/17/03	Improved financial performance and customer growth.
Northern California Power Agency (Geothermal Project), Calif.	BBB+	A-	01/20/04	Reduced credit quality of project participants.
Northern California Power Agency (Combustion Turbine Project #1), Calif.	BBB+	A-	01/20/04	Reduced credit quality of project participants.
Notes: Ratings are from May 31, 2003 to Jan. 20, 2004. PUD -- Public Utility District.				

Table 5 Previously Published Public Power Articles	
Nov. 12, 2002	Public Finance Criteria: Public Power
Oct. 9, 2003	Credit Implications of Public Power Utilities' Power Purchases
Nov. 11, 2003	Prepurchased Power and its Implications for Public Power Ratings
May 20, 2003	Maximizing Public Power Rating Potential
May 27, 2003	Public Finance Report Card: Public Power and Cooperatives

Table 6 Contact Information			
Credit analyst	Location	Phone	E-mail
David Bodek, Director	New York	1 (212) 438-7969	david_bodek@standardandpoors.com
Leo Carrillo, Associate	San Francisco	1 (415) 371-5077	leo_carrillo@standardandpoors.com
Ted Chapman, Associate Director	Dallas	1 (214) 871-1401	theodore_chapman@standardandpoors.com
Paul Dyson, Associate	San Francisco	1 (415) 371-5079	paul_dyson@standardandpoors.com
Jodi Hecht, Director	New York	1 (212) 438-2019	jodi_hecht@standardandpoors.com
Susan Knutson, Associate Director	Chicago	1 (312) 233-7017	susan_knutson@standardandpoors.com
Michael Messer, Associate	New York	1 (212) 438-1618	michael_messer@standardandpoors.com
Peter V. Murphy, Director	New York	1 (212) 438-2065	peter_murphy@standardandpoors.com
Dimitri Nikas, Associate Director	New York	1 (212) 438-7807	dimitri_nikas@standardandpoors.com
Jeff Panger, Director	New York	1 (212) 438-2076	jeff_panger@standardandpoors.com
Aneesh Prabhu, Associate Director	New York	1 (212) 438-1285	aneesh_prabhu@standardandpoors.com
Terry Pratt, Director	New York	1 (212) 438-2080	terry_pratt@standardandpoors.com
Anne Selting, Associate Director	San Francisco	1 (415) 371-5009	anne_selting@standardandpoors.com
Jeanny Silva, Associate	New York	1 (212) 439-1776	jeanny_silva@standardandpoors.com
Markela Soward, Associate Director	San Francisco	1 (415) 371-5006	markela_soward@standardandpoors.com
Arleen Spangler, Director	New York	1 (212) 438-2098	arleen_spangler@standardandpoors.com
Swami Venkataraman, Associate Director	San Francisco	1 (415) 371-5071	swami_venkataraman@standardandpoors.com

SESSION
State Capitol, Room 416
Juneau, Alaska 99801-1182
(907) 465-4930 Tel
(907) 465-3834 Fax

INTERIM
716 W. Fourth Ave.
Anchorage, Alaska 99501-2133
Tel (907) 269-0174
Fax (907) 269-0177

Alaska State Legislature
REPRESENTATIVE CHERYLL BOREN HEINZE
Chair: Economic Development; International Trade & Tourism

Existing Law regarding the RCA's Authority to consider costs in determining just and reasonable rates.

Sec. 42.05.431. **Power of commission to fix rates.**

(a) When the commission, after an investigation and hearing, finds that a rate demanded, observed, charged, or collected by a public utility for a service subject to the jurisdiction of the commission, or that a classification, rule, regulation, practice, **or contract affecting the rate**, is unjust, unreasonable, unduly discriminatory or preferential, the commission shall determine a just and reasonable rate, classification, rule, regulation, practice, or contract to be observed or allowed and shall establish it by order.....

[*42.05.431 (a) specifies that the RCA does indeed have the authority to evaluate the costs asserted in the Patton Boggs letter. The RCA would not, under HB 453 have the ability to consider the internal wholesale relationship formed between a JAA and its member utilities. However, a new or existing contract between a utility which is not a member of the JAA and a utility which is a member of the JAA would still be subject to review under AS 42.05.431*]

(b) A wholesale power agreement between public utilities is subject to advance approval of the commission. After a wholesale power agreement is in effect, the commission may not invalidate any purchase or sale obligation under the agreement. However, if the commission finds that rates set in accordance with the agreement are not just and reasonable, the commission may order the parties to negotiate an amendment to the agreement and if the parties fail to agree, **to use the dispute resolution procedures contained in the contract.**

[*42.05.431 (b) recognizes the primacy of contracts in disputes over rates.*]

Testimony of Christine Pihl (*Seattle Northwest Securities*)
Before the House Labor and Commerce Committee/

Given the importance that reliable and affordable electricity plays in our lives, it is in the public interest to insure that electric utilities are of sound financial health and have access to capital at cost-effective rates.

A utility's credit rating is a proxy for its cost of borrowing. Electric utilities, particularly those with generation and transmission assets, rely heavily on long-term borrowing to finance projects.

Credit ratings by national rating agencies provide an independent opinion on the financial health/position of a utility, particularly in comparison to other utilities.

The regulatory environment is one of several key factors evaluated by rating agencies to assess the credit worthiness of a utility.

For example, being regulated is viewed as constraining a utility's ability to respond to changes in financial conditions. If a utility is not free to address these issues, and a regulator has oversight, a rating analyst cannot be certain that the utilities financial goals, policies or projections will come to fruition.

If there is a history of favorable regulatory treatment, the effects of regulation can be somewhat muted.

In a situation where the regulatory body has a history of being neutral, the threat of regulatory interference may be somewhat lessened but its potential effect is still acknowledged.

The most difficult situation is that where there is a precedent of negative regulatory treatment. This creates a great deal of

uncertainty as to the financial future of a utility to existing and potential lenders, despite solid planning, clear financial strategy and goals and the desire to maintain a favorable credit rating. The regulatory environment can undermine all of this.

A recent example of this is the downgrading of Chugach Electric, in 2003 by the credit rating agencies. Negative regulatory treatment was sited by both agencies as the reason for the downgrades.

This is in sharp contrast to S&P's observations on the RCA's support as indicated in their write up from January 2002:

As is evident from these reports, the actions and interactions of the RCA directly impact the credit rating and hence the cost of capital that Chugach pays.

As the RCA position paper points out, the electric utility business is the most capital-intensive industry in Alaska. With Chugach supplying power to 2/3rds of Alaska and with ML&P supplying a large portion of the remainder, all of Alaska's electric consumers benefit from these public utilities having strong credit ratings to facilitate cost-effective financing of these large capital expenditures. To the extent that a regulatory body takes action to cause a decrease in financial stability or creates an unfavorable regulatory environment, it impacts all ratepayers' in the Railbelt.

Furthermore, as it becomes more evident that State regulators have increasing interest in financial profiles, to the extent that Alaska's regulatory environment does not support this thinking creates an even greater red flag for the rating agencies.

Everything that I have said here and attributed to S&P is echoed by Fitch Ratings, another leading independent provider of credit ratings. Fitch also took ratings action with respect to Chugach in

2003 with a two-notch downgrade (Oct 03/Dec 03) from A+ to A-, again largely attributable to regulatory action and the effects thereof.

You have the complete reports before you.

In Alaska, regulation is costing ratepayers due to higher costs of capital. Nationally, the regulatory environment has been cited as a constraint to financial flexibility:

CONCLUSIONS

Regulatory oversight is viewed as a constraint to financial flexibility and timely responsiveness in what has become an evolving, dynamic energy marketplace.

A negative regulatory environment casts a long shadow over the credit quality of those bodies it regulates.

A lower credit rating means higher borrowing costs, which translates into higher rates for ratepayers.

> A credit rating below A- will cost ratepayers substantially more.

By and large around the nation, public utilities are not subject to the state regulatory oversight but rather are left to oversight by elected boards, members, or customers and customer representatives, all of whom have a direct vested interest in the financial stability and strength of the utility.

It is incumbent upon the regulatory body to be cognizant of the capital market ramifications and credit rating agency responses to its actions, as they are scrutinized carefully by these parties and directly affect the cost of capital for these capital-intensive utilities.

Subjecting the new Railbelt JAA to state regulatory oversight will cost electricity consumers in the Railbelt in the form of higher energy bills.

CHUGACH ELECTRIC

2003 Ratings

Moody's Investors
Service

Moody's Investors Service
Global Credit Research

Fundamental Credit Research
Opinion Update
Published 27 Feb 2003

CHUGACH ELECTRIC ASSOCIATION, INC

Anchorage, Alaska, United States

Ratings

Category	Moody's Rating
First Mortgage Bonds	A2
Bkd Senior Secured	Aaa

Contacts

Analyst	Phone
Kevin G. Rose/New York	1.212.553.1653
James Hempstead/New York	
John Diaz/New York	

Opinion

Rating Rationale

Chugach's Aaa rating on its bonds reflects the insurance policy provided by MBIA Insurance Corporation, providing for the payment of principal and interest when due. The A2 underlying rating for these bonds has come under some pressure recently due to an unsupportive decision by the Regulatory Commission of Alaska (RCA) in the co-op's recently concluded rate case. This rate case outcome is in contrast to largely supportive regulatory treatment provided to Chugach in the recent past. Chugach's standalone credit fundamentals still benefit from its dominance in the Alaskan market, its low-risk operating profile, and generally conservative financial strategies. We also note that although some 30% of Chugach's total revenues come from two customers, these customers have signed either a take and pay or partial requirements contract with the co-op.

We note that although Chugach is a small co-op, it is still the largest power provider in Alaska, serving over two-thirds of the Railbelt and owning a majority of the transmission assets in Southcentral Alaska. Most of the co-op's generating capacity comes from gas-fired plants that are near the wellhead, making fuel costs more affordable. Although certain fuel costs are cyclical, Chugach has typically managed other costs and relied on increases in sales to minimize the need for rate increases. Also, equity levels have been maintained at about 25%, while providing regular returns of capital to members. Lastly, any efforts to establish electric competition in Alaska are effectively at a standstill.

Recent Developments

Chugach's request for a 5.7% rate increase and a change in the rate setting methodology were denied in an order issued by the RCA on 2/6/03. Preliminarily, Chugach estimates revenue refunds required by the rate decision would cause an operating loss of about $2MM for fiscal 12/31/02, causing a shortfall in meeting the required 1.1 interest coverage under the Rate Covenant in Chugach's bond indenture. Furthermore, Chugach would need to achieve cost savings or otherwise compensate for the rate reduction to restore compliance with the Rate Covenant in 2003. Importantly, noncompliance with the Rate Covenant interest coverage test is not

cause for acceleration of the obligations. Also, we note that on 2/18/03, the RCA agreed to stay some aspects of the order, including any change in rates, pending the outcome of Chugach's planned filing of a motion for reconsideration of the order on or before 2/28/03.

Rating Outlook - Stable

The outlook for the Aaa rating is stable as the bond insurance policy stands behind repayment of the obligations. We will continue to monitor the pressure on Chugach's underlying rating. The extent of relief will depend in part on the degree to which Chugach can be successful in obtaining a more supportive outcome through a planned filing of a motion for reconsideration of the 2/6/03 rate order.

Standard & Poors

STANDARD &POOR'S PUBLIC FINANCE

Publication date: 08-Aug-2003
Reprinted from RatingsDirect

Chugach Electric Association; Utility, Wholesale Electric

Credit Analysts: Leo Carrillo, San Francisco (1) 415-371-5077; Swami Venkataraman, San Francisco (1) 415-371-5071

Credit Profile

DOWNGRADED, OFF CREDITWATCH
To
AAA/A-(SPUR)
From A
$120.000 mil. Chugach Elec Assoc new bnds ser 2002A dtd 02/01/2002 due 02/01/2012
AAA/A-(SPUR)
A

$60.000 mil. Chugach Elec Assoc new bnds ser 2002B dtd 02/01/2002 due 02/01/2012
AAA/A-(SPUR)
A

$150.000 mil. Chugach Elec Assoc 1st lien rev bnds ser 2001A dtd 04/17/2001 due 03/15/2011
AAA/A-(SPUR)
A

OUTLOOK:
NEGATIVE

Rationale

Standard & Poor's Ratings Services has removed from CreditWatch and lowered the underlying ratings on Chugach Electric Association, Alaska's revenue bonds to 'A-' from 'A', based on a recent decline in financial margins, the decision by regulators to lower its interest coverage target for the utility, and challenges associated with Chugach's exceptionally large amount of non-amortizing debt. The insured ratings on the bonds remain unaffected by the downgrade.

The underlying ratings on Chugach Electric Association, Alaska's revenue bonds are based on the following credit concerns:

- A reliance on regulatory approval of rates and the implications for credit quality of the Regulatory Commission of Alaska's (RCA) recent decision to reduce its interest coverage target for the utility;
- Weak financial performance in 2002, with a margin for interest (MFI) ratio of less than 1.1x versus 1.20x in 2001; and
- Heavy reliance on non-amortizing debt, with 70% of total outstanding principal due in 2011 and 2012.

Credit strengths include:

- Chugach's dominant market position, competitive rates, and relatively diverse service territory near Anchorage, Alaska;
- Chugach's dominant market position, competitive rates, and relatively diverse service territory near Anchorage, Alaska;
- The RCA's historic support for a quarterly-reset fuel cost adjustment charge, and statutory rate-setting controls that require compliance with Chugach's bond covenants; and
- Solid equity capitalization, accounting for 23% of assets as of Dec. 31, 2002, with no current plans for long-term debt issuance, apart from refundings.

Chugach Electric Association (Chugach) is a vertically integrated electric cooperative that provides electricity through its retail and wholesale operations to roughly two-thirds of Alaska's population, around Anchorage, the Kenai Peninsula, and the "Railbelt" corridor between Anchorage and Fairbanks. Chugach has approximately $394 million in bonds outstanding as of Dec. 31, 2002. The bonds are unsecured obligations of Chugach, supported by revenues from its wholesale and retail power sales operations. Permissive legal provisions exempt Chugach from maintaining a debt service reserve account on any of its unsecured debt.

Chugach's business profile score is a '4' on Standard & Poor's 10-point scale, with "1" being the highest score. Chugach is Alaska's largest electric utility, with 61,000 retail customers and approximately 50% of the state's total generating capacity in a region with no outside transmission access. Chugach serves a moderately urban and growing service territory, with retail sales accounting for 64.8% of revenues in 2001 and residential customers accounting for 32.9% of revenues. Chugach faces no competition from investor-owned utilities, and its only meaningful competition is the municipal utility serving Anchorage, Anchorage Municipal Light & Power (MLP). Although Chugach's rates, at 4.9 cents per kWh, are only slightly above the regional average, contentious relations with the utility's two largest wholesale customers continue to distract management. The two wholesale customers have a history of pursuing regulatory and legal action in an effort to suppress Chugach's wholesale rates.

Financial performance was weak in 2002, with margin for interest coverage based on audited financials of less than 1.1x. Financial margins and interest coverage have diminished over the past two years, relative to historical levels. MFI coverage averaged 1.3x from 1996 to 2000, before falling to 1.2x or less in 2001 and 2002. Net operating margins (after interest) averaged $7.3 million from 1996 to 2000, versus only $3.6 million in 2002.

The recent decline in financial margins and the relaxing by regulators of Chugach's coverage target raises concern regarding regulatory support for the maintenance of Chugach's historically strong financial profile. In January 2003, the RCA issued a rate order that reduced Chugach's target times interest earned ratio (TIER) coverage level to 1.30x from 1.35x, requiring a rate refund for overcollection in 2000 and 2001. Following an appeal by the utility, the RCA revised its rate order, reducing the cost of the rate refund from an estimated $7.1 million to $1.6 million. Chugach is absorbing the cost of the refund through its cash reserves, which exceeded $7 million as of Dec. 31, 2002.

Chugach expects to achieve MFI coverage of around 1.2x in 2003. Beyond 2003, MFI coverage remains above 1.3x, based on assumptions of 3% rate increases in 2004 and 2006. The projections also assume that the RCA will pass through to customers any increases in interest cost associated with Chugach's variable interest rate debt. Standard & Poor's continues to regard the forecasted interest coverage as thin for a utility with mostly non-amortizing debt.

Debt is high, but manageable, with a total debt-to-capital ratio of 75% as of Dec. 31, 2002, although Standard & Poor's considers the debt structure itself to be aggressive. Chugach's heavy reliance on non-amortizing debt introduces a significant level of refinancing risk to an otherwise moderate debt profile. The use of variable rate debt contributes to interest rate risk, especially given the utility's dependence on regulatory approval for recovery of rising interest rate costs. Chugach's $60 million in variable-rate debt represents 15% of its overall debt burden. With increased refinancing and interest rate risk inherent in its new debt structure, Chugach's need for financial flexibility has increased.

Overall liquidity is adequate, but cash reserves remain low, given the utility's

relatively aggressive financial profile. Total liquidity, including unrestricted cash and undrawn credit lines, amounted to $77.3 million, or 214 days' cash, as of Dec. 31, 2002. Chugach maintains over $70 million in lines of credit with CoBank and National Rural Utilities Co-op Finance Corp, against which over $50 million remained untapped as of fiscal year end 2002. Cash reserves have remained flat at historical levels, with unrestricted cash reserves of around $7.3 million, or 22 days of operating expense at fiscal year's end. Chugach does not maintain a debt service reserve fund, and has no plans to develop a sinking fund with which to prepay principal payments on its non-amortizing debt. Interest earnings from $7 million in cash reserves will do little to dampen rising interest rate costs on the utility's $60 million in variable-rate debt.

Outlook

The negative outlook reflects Standard and Poor's concern regarding Chugach's ability to achieve sound financial margins going forward. Rating stability will hinge on Chugach's future financial performance and evidence of a clear strategy for managing risks associated with the utility's non-amortizing and variable-rate debt. Management plans to address these risks in its revised debt management policy, due for release in early 2004. Sound deot management policies could include: limiting growth in the utility's debt burden, periodic market purchases of outstanding debt, accumulation of debt amortization funds, and maintenance of strong liquidity. However, even with sound policies, chronically weak coverage margins could result in lower ratings.

Regulation

The RCA retains oversight authority over Chugach's rates, including fuel adders, whereas many other generation and transmission cooperatives (G&Ts) set their own rates. While state law requires that the RCA approve rate levels sufficient to meet Chugach's debt covenants (including the MFI covenant), the RCA has the authority to set rates at higher levels.

Standard & Poor's cited the RCA's historical regulatory support as a key credit factor in affirming the utility's rating at the time of Chugach's debt restructuring in 2001, which reduced the utility's rate covenant to 1.1x from 1.2x, and converted its debt obligations from mortgage to unsecured debt. By that time, the RCA had historically demonstrated a fair degree of regulatory support for Chugach through its rate-setting policies and its adopted rates. The RCA has consistently adjusted Chugach's rates to meet or exceed its target TIER of 1.35x, rebuffing repeated appeals by the utility's wholesale customers to reduce financial margins down to Chugach's previous 1.2x MFI interest coverage rate covenant. The RCA again demonstrated its regulatory support in November 2001, when it granted Chugach an additional 2.37% interim refundable rate increase in addition to the 1.6% interim base-rate increase awarded two months later. The two rate increases totaled 3.97%, just under the 4.0% rate increase that Chugach originally requested.

However, recent regulatory action by the RCA suggests that its support for Chugach's credit quality has declined. The revised RCA rate order reduces Chugach's target TIER coverage level to 1.30x from 1.35x and requires that Chugach refund to ratepayers approximately $1.6 million for overcollection in 2001 and 2002. The last round of ratepayer refunds occurred in 2000, when

the RCA ordered Chugach to refund $1.9 million in relation to the 1996 test year filing and $1 million in relation to the 1997 test year filing.

Standard & Poor's is also concerned that, in adjusting Chugach's rates, the RCA may be relying on financial metrics that do not take into account the challenges of servicing Chugach's largely non-amortizing debt burden. Since the restructuring of the utility's debt in 2000 and 2001, the RCA has adhered to its traditional interest coverage metrics. However, the conversion of Chugach's debt to largely non-amortizing debt naturally boosts the utility's coverage ratios, due to the shifting of principal payments over many years to principal payments in only a few years. As a result, TIER and MFI ratios may be misleading indicators of financial performance.

Despite the trend toward weakening margins, several favorable regulatory support mechanisms and policies remain in place. Foremost is the RCA's ongoing support for Chugach's fuel surcharge adjustment factor. The RCA granted Chugach this surcharge, reset quarterly, to address the utility's fuel risk. Under its fuel supply contracts, Chugach's fuel prices are adjusted based on three indices, incorporating a natural gas component, a crude oil component, and a home-heating oil component. To date, the RCA has not denied Chugach the rates it sought to be set for adjusted fuel costs, and the agency usually issues its decision on fuel adders within the allotted 45-day deadline.

Management

A seven-member board of directors, elected at large from Chugach's retail membership, oversees the cooperative. Elections are staggered, and members serve three-year terms. Chugach does sells wholesale electricity to several distribution cooperatives, but these customers have limited influence on the rate-setting or governance of Chugach. The wholesale members do not have a seat on the utility's board of directors and wield only a single vote a piece, with no more weight than those of any of Chugach's 61,000 retail customers. The board may convene at any time to review rates and may initiate a base rate change at any meeting, though the RCA must approve the change.

Competitive Position

Chugach faces very little competition in its generation, transmission or distribution services. There are no investor-owned utilities within its service area, and the service area is not interconnected with the rest of the state. The energy needs of Chugach's wholesale customers far outstrip their own generating resources. The only meaningful competition Chugach faces is the municipal utility serving Anchorage, Alaska, MLP. Chugach's rates are average relative to other providers in the area, but slightly higher than MLP's. In 2003, Chugach's average residential rate of 10.6 cents per kWh was about 9% higher than MLP's. The gap between commercial rates was even narrower, with Chugach's 8.0 cents per kWh rate only 3% higher than MLP's rate.

Markets

Chugach serves a relatively urban service area in the Kenai Peninsula, the suburbs of Anchorage, and, through its economy energy customer, Golden Valley Electric Association (GVEA), an area south of Fairbanks. Alaska and

Chugach's service territory is heavily dependent on primary commodity products, particularly the price of a barrel of oil. The state government receives a large portion of its general fund revenues from petroleum taxes and royalties. This reliance is tempered somewhat by the substantial federal government presence. There are several large military bases in Alaska, and the administration of the approximately 60% of Alaskan land set aside as parks or other protected spaces demands considerable personnel. The diversity of Anchorage's economic base compares favorably with that of other Alaskan cities. Anchorage is the headquarters for development and production of petroleum resources in the North Slope and the Cook Inlet. Anchorage also hosts about two-thirds of the tourists visiting the state. Per capita income in Anchorage is about 130% of the national average, but the cost of living is also higher.

Chugach's markets are divided among its retail and wholesale operations in a manner that sets it apart from most G&T cooperatives. Half of its sales are to retail residential meters, whereas most G&Ts sell to distribution cooperatives only. Chugach sells the remaining half of its power to three wholesale cooperatives, mainly MEA, Homer Electric Association (HEA), and Seward Electric System (SES).

Chugach's retail operation accounted for about 48% of both sales and revenues in 2002. Chugach's retail operations can be characterized by a lack of concentration both in terms of energy sales and revenues derived. The largest customer, the City of Anchorage, accounted for 2.1% of revenues and 1.1% of sales in 2002. Chugach has a meter per line mile ratio of over 150, which is high relative to those of most cooperatives. Retail revenues were roughly split between residential and commercial meters at 33% and 32%, respectively, of total revenues in 2002. Chugach has no large industrial customers.

Wholesale energy sales totaled approximately 52% of total sales in 2002. MEA and HEA are the two largest offtakers, at 22% and 19%, respectively. The contracts with MEA and HEA extend until 2014. Chugach also makes what it calls "economy" (or non-firm) energy sales to GVEA, which serves about 36,000 meters. Chugach has a contract to furnish economy energy to GVEA through 2008. Power to GVEA is not included in Chugach's forecasts due to its interruptible nature. Chugach has only one all-requirements wholesale power customer, whereas most other G&Ts sell their wholesale power exclusively through all-requirement contracts extending for the life of outstanding debt.

Operations

Chugach is the dominant electric utility in the State of Alaska, and owns or purchases 654 MW out of the "Railbelt" region's total of approximately 1,200 MW. Chugach also operates 402 miles of transmission line, 1,590 miles of distribution line, and owns or contractually operates 467 MW of capacity. Chugach's generation consists of numerous small turbines and plants, which generally exhibit strong availability factors. The Beluga Station, a 326 MW gas-fired station composed of seven turbines, is the largest generating station in Alaska and Chugach's most important generating asset; it accounts for 62% of Chugach's total capacity. System peak was 415 MW in 2002. Chugach plans for a 30% reserve, double that Standard & Poor's usually

sees, due to its isolated location. Current capacity is expected to be sufficient until 2009 or 2010.

The cooperative's power supply portfolio is heavily weighted toward gas-fired generation (around 90%), with hydroelectric resources contributing the remainder. Chugach has long-term contracts for its natural gas supply through what is known as the Beluga producers (which operate the Beluga gas field, on top of which the Beluga unit is located) and Marathon Oil. Chugach predicts that, given its current gas consumption, its contractual allocation of gas production will be exhausted by 2012 in the case of the Beluga Producers and 2008 with Marathon. Current pricing is based on a flat fee plus tracking indices that match those it files with the RCA, thus effectively passing on fuel costs to end customers. In roughly 2008 (projected based on current consumption), the fuel-pricing mechanism will shift to one that is entirely market based. Before that time, Chugach hopes to renegotiate its pricing with the producers to insulate itself from some of the volatility associated with the natural gas market.

Fitch

Fitch Downgrades Chugach Elec Assoc Bonds to 'A-'; Stable Outlk

Fitch Ratings–New York–December 12, 2003: Fitch Ratings has downgraded Chugach Electric Association, Inc.'s (Chugach) $330 million in outstanding senior unsecured bonds to 'A-' from 'A', and has removed the Negative Rating Watch. Fitch has assigned a Stable credit outlook. The rating represents an underlying rating as the bonds are insured by MBIA Assurance Corp., whose financial strength is rated 'AAA' by Fitch. The downgrade reflects a negative stance taken by the Regulatory Commission of Alaska (RCA) toward Chugach in 2003 and tighter projected financial protection measures as a result. The rating downgrade and removal from Negative Rating Watch follows a recent meeting with management updating Chugach's financial projections and management's prospective business and rate strategy.

Historically, Chugach has benefited from consistently solid financial performance, competitive electric retail rates, diversified customer base, and a supportive regulatory framework. In addition, long-term, firm natural gas supply contracts have helped support solid operating generation assets and, along with two hydroelectric power purchase contracts, have met the needs of a moderately growing service territory. Financial performance had been very stable through 2001, with debt service coverage ranging from 1.50-1.85 times (x), and times interest earned ratio (TIER) at 1.35x or higher. Chugach's balance sheet was similarly solid, with equity-to-total capitalization in the 25%-29% range since 1996. Chugach's key concern had been the ongoing discontent among its wholesale customers, but their attempts to change Chugach's operations and/or acquire the utility have not been successful.

Beginning in early 2003, a series of RCA rate orders ensued which were uncharacteristically negative for Chugach, and eventually led to the credit rating downgrade. On July 10, 2001, Chugach filed a general rate case with the RCA seeking a 6.5% rate increase, or net margins of $11.9 million. The additional revenues were needed to help fund capital expenditures, meet rising operating expenses, and build equity to 30%. Chugach was also requesting an interim rate increase of 4%. After rendering two rate decisions, the RCA eventually approved an interim rate increase of 3.97% (effective Nov. 1, 2001), but the RCA's decisions quickly deteriorated for Chugach thereafter.

Following an updated rate case filing by Chugach on April 15, 2002, whereby Chugach requested a lower base rate increase (5.7%) than originally filed, the RCA rendered its initial decision (Rate Order No. 26). RCA Order No. 26 resolved certain issues in Chugach's favor, but the financial adjustments were by and large more heavily weighted against Chugach including: (1) reduction in overall TIER from 1.35x to 1.30x (a loss in margins of about $1.3 million), (2) disallowance of capitalized interest as interest expense, (3) lowering recoverable interest expense on variable rate securities, and (4) shifting a larger portion of revenue requirement on retail users by reducing the allowable TIER for wholesale customers to 1.10x from 1.15x. In addition, Chugach would have to refund the interim rate increase collected since implementation (approximately $--- million for 2001 and 2002).

Pursuant to Order No. 26, Chugach's financial performance fell below the 1.10x TIER requirement and resulted in a net loss of $2 million for 2002. If the Order remained as is, Chugach would not meet the 2003 TIER requirement as well. Chugach subsequently filed a motion to stay the Order (Feb. 13, 2003), which the RCA granted in part, and also filed a Petition for Reconsideration on Feb. 28, 2003. Several RCA orders followed which reversed and/or clarified Rate Order No. 26. Key changes to Order No. 26, which were generally positive for Chugach, included: recoverable variable rate debt interest expense was returned to 3.8% level, recovery of certain legal expenses was allowed, and approved retail rate increase of 3.5% and wholesale rate decrease of 7.9% (+0.8 million annually, in aggregate). Conversely, the RCA did not alter the lowering of overall TIER to 1.30x, the lowering of wholesale customers' TIER to 1.10x, and disallowance of capitalized interest as interest expense. The RCA's final rate order was rendered Sept. 18, 2003, and Chugach does not plan to file any new rate requests with the RCA for sometime.

Consequently, on a net basis, Chugach is projecting net margins of $8.0 million for 2003, and approximately $6 million per year through 2006. TIER is estimated at 1.34x for 2003, and 1.20-1.25x for 2004-2006. Equity to total capitalization is projected to be rise from 25% currently to 28% by 2006. Actual equity levels will vary, however, depending upon annual operating results, capital

expenditure levels and patronage capital distributions. For 2003, patronage capital distributions are zero, due to lack of net margins generated in the prior year.

While the Chugach rate case is now closed, there are three new commissioners (and new associated staff) among the 5-member appointed RCA. As a result, given the untested and uncertain direction of the new members of the RCA, the regulatory risk remains a concern. Partially offsetting this risk are the following factors: Chugach should not need rate relief until 2006, Chugach is working with RCA and the legislature to address the power supply issues facing the state, and Chugach has the option to request its members' approval to eliminate regulation by the RCA. Lastly, while Chugach's financial performance ratios are reasonable and not out-of-line with straight 'A' level cooperatives, the regulatory uncertainty and certain ongoing wholesale customer discontent brings the rating down to the 'A-' level, with a Stable Outlook.

Chugach is the largest electric utility provider in Alaska, serving either directly or through wholesale sales roughly two-thirds of all electric customers in the state, or approximately 175,000 users.

Contacts: Lina Santoro +1-212-908-0522 or Alan Spen +1-212-908-0594, New York.