HB

127

LAW OFFICES
GROSS & BURKE
A PROFESSIONAL CORPORATION
424 NORTH FRANKLIN STREET
JUNEAU, ALASKA 99801

AVRUM M. GROSS
SUSAN A. BURKE

(907) 586-2777

February 22, 1984

MEMORANDUM

TO: Senate Transportation Committee

FROM: Gross & Burke

RE: Organization of Public Corporation to Operate the Alaska Railroad

At your request, we have reviewed the drafts of SB 10 and SB 352, with a view toward determining the extent to which those bills create a valid legal structure to operate the Alaska Railroad after its proposed purchase. Initially, we were asked whether the legislature had the power to require that gubernatorial appointments to the governing authority[1] of the railroad be confirmed by the legislature. Both SB 352 and SB 10 presently require confirmation of executive appointments. At a second committee hearing we were requested to advise you of the minimum number of executive branch controls which must be placed on any entity created by law to operate the railroad to insure that the entity would be a part of the executive branch and, therefore, constitutionally sound. We shall answer the questions in the order posed.

SB 10 and SB 352 both provide that appointments made by the Governor be confirmed by the legislature in joint session.

1/ SB 10 speaks of an "Authority" while SB 352 creates a similar organization but describes it as the "Railroad Corporation." Purely for the purposes of simplicity, we will refer to the basic organizational structure at issue here as an "Authority."

We assume that if a similar section remains in a bill, which passes the legislature, the Governor will probably choose to submit the names of his appointees for confirmation just as he submits his appointees to a host of other boards and commissions in state government. It is our opinion, however, that should an occasion arise when the Governor decides not to submit a name or names for confirmation, the legislature would have no legal right to insist he do so.

Our conclusion is based both on the words of the Alaska Constitution and a decision of the Alaska Supreme Court. The constitution provides in Art. III, sec. 25 that:

> The head of each principal department shall be a single executive unless otherwise provided by law. He shall be appointed by the Governor, subject to confirmation by a majority of the members of the legislature in joint session . . .

Sec. 26 of the same article states that:

> When a board or commission is at the head of a principal department or a regulatory or quasi-judicial agency, its members shall be appointed by the Governor subject to confirmation by a majority of the members of the legislature in joint session . . .

The wording of the constitution is clear on its face. The legislature may confirm the heads of all departments, whether they are single executive officers or a board. The legislature may also confirm boards or commissions which are "regulatory or quasi-judicial" agencies. A regulatory authority is, as it implies, one whose basic function is to regulate a particular public activity. The Fish and Game Board is a classic example of such a regulatory board. A quasi-judicial

agency is one in which individual rights are adjudicated. An example of such a board would be the Public Utilities Commission, where contested proceedings determine rates.

The Railroad Authority as established in SB 352 or SB 10 fits under none of these definitions. It is not at the head of a department[2/] nor is it a quasi-judicial or regulatory agency. Under the constitution, then, the legislature has no power to confirm executive appointments to the Authority, unless the legislature can add to the powers of confirmation which are granted in the constitution.

The legislature attempted to do just that in 1975 when it passed a statute authorizing confirmation of a whole list of lesser executive branch officials, including deputy commissioners and certain division directors. The Alaska Supreme Court held that the statute granting the legislature the additional confirmation power was unconstitutional. Bradner v. Hammond, 553 P.2d 1 (Ak. 1976) In the Supreme Court's view, the power to appoint to positions in the executive branch is a power reserved to the Governor under the doctrine of separation of power, except as the constitution permits the legislature to participate in the process through confirmation. If the constitution does not specifically

2/ We recognize that SB 352 provides, "The corporation shall be considered a principal department only for the purposes of Art. III, sec. 26, Constitution of the State of Alaska." (emphasis added) In our view, however, the courts would almost certainly view this purely nominal designation as one purely of form, since the bill does not actually establish a new department with the kinds of gubernatorial controls normally associated with a principal department of state government. This issue of gubernatorial controls is addressed in detail later in this memorandum.

authorize confirmation, there is no legal power to do so and the Governor's power of appointment can not be subjected to confirmation by the legislature. Put another way, the Bradner case holds that the constitution states the outer limits of legislative powers of confirmation; the legislature may not expand that power by statute. While neither SB 10 or SB 352, as presently structured, would withstand constitutional challenge on the issue of confirmation, there are options available to the legislature which would provide a valid legal basis for the confirmation of appointments. We will set these options out briefly for your consideration.

The first and most obvious manner for the legislature to obtain confirmation power is to pass a joint resolution placing before the voters a constitutional amendment that would specifically authorize the legislature to confirm appointments to the Railroad Authority. This amendment could be placed before the voters during this year's election. If the amendment passed, the first appointees of the Governor to the authority or commission would be constitutionally subject to confirmation; if it did not pass, the situation would remain as it is today -- confirmation if and when the Governor chooses to submit the names. We should note that following the Bradner case a constitutional amendment granting broad additional confirmation powers to the legislature was put before the voters and failed, but whether that would be the fate of a more narrowly drawn provision would be difficult to predict.

The second option to insure confirmation would be to create an entirely new department of state government, which would be headed by the Railroad Authority. The sole purpose that new department would be to the railroad. In such an instance, the Authority would be at the head of a department and under Art. III, sec. 26 of the Alaska Constitution, the members of the Authority, would be subject to confirmation. There are, however, certain serious problems which might result from this approach. One of the basic purposes of the present bills creating an independent public corporation or authority (located nominally within a department) is to permit the Railroad Authority to raise money for operations without involving the general credit of the state. If, however, the authority which manages the railroad is a full department of state government there is some real question about its ability to successfully perform this fundraising activity without the involvement of state credit. Art. IX, sec. 8 of the constitution provides that no state debt may be incurred unless (1) it is authorized by law; (2) is for capital improvements; and (3) is ratified by the voters. Sec. XI of the same article provides that the restrictions of sec. 8 do not apply to debts incurred through revenue bonds issued by public corporations or public enterprises of the state when the only security is the revenue of the enterprise or the corporation. Whether or not an entire department of state government can be made a "public corporation" or whether

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or not the entire activity of a department of state government would qualify as a "public enterprise" are questions that have never been decided in this state by any court. While the committee can certainly receive advice from legal counsel as to the possible or probable outcome of litigation on these subjects, it would at best be an educated guess. The result might well be that in order to obtain confirmation powers the committee would create a department which, in the end, might be subject to the same bonding restrictions applicable to all other departments of state government. I gather there is no disagreement within the committee that such a result would be highly undesirable. We cannot recommend this method of insuring confirmation powers because the risks are simply to great -- the legislature would be in totally unchartered waters and the magnitude of the questions involved is simply to great to accept that degree of risk.

Having discussed the issue of confirmation, we now move to the second issue posed by the committee. Specifically, that question involves the extent to which a public corporation may be established independently of the authority of executive branch and yet be a part of that branch of government. Art. III, sec. 22 of our constitution requires that all agencies of state government and their respective functions shall be allocated within no more than 20 principal departments.

The only exceptions provided are for "regulatory, quasi-judicial, and temporary agencies." As we view the functions of the operation of the Railroad -- whatever form of entity is chosen -- those functions are not primarily "regulatory" or " quasi-judicial." Further, the railroad operation would not necessarily be "temporary." Although conceivably the railroad could be sold or leased at some point in the future to a private corporation, the existence of the operating entity could well be permanent.

We think it is clear that the Alaska Supreme Court would view the Railroad Authority as performing operational or executive functions and would, therefore, require that the Authority be either a separate principal department or located within one of the already established principal departments. We have already reviewed the problems that would be created if the Railroad Authority would be made the head of an entirely separate principal department. Therefore, we are left with the conclusion that the only other constitutionally sound option is to place the governing board or authority within an existing department of state government.

Simply stated, then, the legal issue you have asked reduces itself to this. On the one hand, the legislature seeks to create an "independent" authority -- one which has financial and political autonomy and is not subject to direct gubernatorial control. On the other hand, the constitution

requires that all executive or managerial functions be a part of the executive branch, which, in turn, is under the supervision and control of the Governor. What then are the limits -- how much gubernatorial control is required to make the "independent" authority a constitutionally valid part of state government?

The cases that the Alaska Supreme Court has reviewed concerning the requirements of Art. III, sec. 22 make it clear that more than mere nominal placement of an independent corporate entity within a department in the executive branch is required. For example, in De Armond v. Alaska State Development Corporation, 376 P.2d 717 (Alaska 1962), it was claimed that the legislation creating the Alaska State Development Corporation was unconstitutional because it sought to create an independent agency that was nominally within the Department of Commerce, but which the challengers claimed was not in actuality within that department. The Alaska Supreme Court rejected this contention and upheld the constitutionality of the Development Corporation. In doing so, the court enumerated a number of features contained in the enabling legislation for the corporation, which demonstrated sufficient ties with the Department of Commerce to justify the conclusion that the corporation was (at least for constitutional purposes) truly within the Department of Commerce.

The factors that the court cited were as follows:

(1) the Commissioner of Commerce had a permanent seat on the board of directors and thus had "considerable influence" on the board;

(2) the other six members of the board were appointed by the Governor, and served at his pleasure;

(3) the board was required to submit comprehensive annual reports to the Governor and legislature;

(4) the financial records were to be audited annually by the legislative auditor; and

(5) the state's bank examiner was required to examine the corporation's records each year.

Additionally, although the court did not make clear what significance this fact had, it noted that the corporation was "temporary" and could be dissolved by a majority vote of the board subject to legislative approval.

Four years later, the court reviewed a similar challenge to the constitutionality of the Alaska State Mortgage Association; i.e. that it was only a nominal rather than a legitimate part of the department of state government in which it had been placed. Walker v. Alaska State Mortgage Association, 416 P.2d 245 (Alaska 1966). The court, however, noted that the mortgage association legislation contained most of the same features which it had cited in De Armond to support its conclusion that the development corporation was properly established within a department of state government. Like

the development corporation in De Armond, the mortgage association members were appointed by the Governor and served at his pleasure. The commissioner of Commerce had a permanent seat on the board of the association. Additionally, the court noted that as further evidence of gubernatorial control, the mortgage association was required to submit detailed annual reports to the Governor and legislature, the financial records were subject to an annual legislative audit, and certified copies of the minutes of every meeting of the association were required to be sent to the Governor.

Neither of these decisions, unfortunately, provide any guidance on the question of the minimum number of factors that will be required in order to meet the constitutional requirements of executive supervision or control. In both cases, however, the court seemed to emphasize two factors over and above all the others. The first was that board members served at the pleasure of the Governor. The second was that the Commissioner of the department within which these independent entities were located served on the board and was a full voting member. These two features were emphasized by the court to demonstrate that the Governor exercised at least partial control over the activities of the board. The court, for instance, noted that while the commissioner was only a single member of a multi-member board his position as a cabinet member would give him

substantial influence. The court further emphasized that the Governor was in a position to exercise influence on an otherwise independent board through the fact if there were a real disagreement in policy, he could exert control over the board members through his ultimate power to reove them. The court, in Walker, cited with approval language from the Superior Court decision in the case to this effect:

> If the Governor is dissatisfied with the executive director in either his capacity as a member of the Alaska State Housing Authority or the Alaska State Mortgage Association, he can assert his authority over the board members to effect the director's removal, and should they disregard his wishes, his alternative is to appoint members to the board who will appoint an executive director satisfactory to the Governor.

Walker, at 250 n.19.

At the same time, the court recognized that there may be important and legitimate reasons for the legislature to insulate a board or authority from direct gubernatorial influence over particular decisions. In the courts words:

> It is true that the Commissioner of Commerce can not dictate the decisions of the Board. Nor can any other state official . . . . It is quite apparent that the legislature intended the board to be free from outside control in making decisions on particular loans.

De Armond, at 724 (emphasis added).

Nonetheless, it is clear from the decisions that there are limits to the degree of insulation that the court will

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tolerate and still uphold the constitutionality of the placement of the independent corporation nominally within a department of state government.

Accordingly, it is our view that to insure constitutionality of this bill the legislature should, at an absolute minimum:

1. create an independent authority which is part of an enumerated department of state government;

2. provide that the board for the public corporation or authority be comprised of persons appointed by the Governor and who serve at his pleasure;[3/] and

3. that the commissioner of the department in which the authority is placed serve as a voting member of the board.

3/ There is a secondary, but perhaps no less important, reason why the appointees to the governing body of the railroad should serve at the Governor's pleasure. As a constitutional matter, there is a serious question as to whether any appointee of the executiv branch with the exception of those who serve in regulatory or quasi-judicial positions can be subject to any other restrictions but that they serve at the Governor's pleasure. The U.S. Supreme Court has interpreted that under the federal constitution, if an office is "executive" in nature, legislative efforts to restrict the president's power to remove an official are invalid. Myers v. United States, 272 U.S. 178. That opinion has been modified slightly in Humphries Executor v. United States, 295 U.S. 602, as the court held that a member of the Federal Trade Commission could have his term set by Congress and be insulated from removal by the president, but the court was clear to limit its opinion to quasi-legislative or judicial agencies, i.e. those that were actually passing regulations or resolving legal disputes as their prime function. The Railroad Authority would fall in neither of these categories, but would be within a traditional executive agency structure.

We raise this issue because we can be reasonably sure that the content of this bill will be litigated in the courts, if there is any reasonable basis to do so. The appointment of commissioners to the Railroad Authority who serve at the Governor's pleasure would reduce the possibility of legal attack on yet another basis.

It would be advisable, as well, to include at least some of the kinds of provisions (such as the annual reports to the Governor and legislative audits) which the court in De Armond cited as significant, although these may not be essential. Beyond that, the legislature may, in our view, limit the application of acts such as the Executive Budget Act, Administrative Procedures Act and others which impact most executive branch agencies, but are not, in our view, critical to upholding the constitutionality of this public corporation structure.

AMG/SAB/yw

Alaska Railroad Corporation

P.O. BOX 107500 ANCHORAGE, ALASKA 99510-7500
327 W. SHIP CREEK AVENUE, ANCHORAGE, ALASKA 99501

To: The Honorable Peggy Wilson
Chair, House Transportation Committee
From: Phyllis Johnson, ARRC VP/General Counsel
Regarding: HB 127 - Question regarding Alaska Railroad Transfer Act Provision for Retaining Railroad Revenues
Date: March 16, 2009

I understand that a question arose during last week's House Transportation Committee hearing on HB 127 regarding certain language in the federal Alaska Railroad Transfer Act (ARTA), 45 U.S.C. 1201 et seq. That statute contains the following provision regarding the revenues generated by the railroad:

> Revenues generated by the State-owned railroad, including any amount appropriated or otherwise made available to the State-owned railroad, shall be retained and managed by the State-owned railroad for railroad and related purposes. *[45 U.S.C. 1207(a)(5)]*

A committee member asked what legal memoranda or opinions might exist regarding the interpretation of this provision. To the best of my knowledge and that of my staff, there are none. The language is straightforward and we have never had occasion to address this question.

Unfortunately, there is little guidance in the form of legislative history either. The Senate Committee Report dated June 22, 1982 for an earlier draft of the transfer legislation contains the following statement:

> Subsection (a) *[this draft was organized differently from the version that eventually passed]* specifies that the state-owned railroad shall retain and manage its own revenues. The purpose of this provision is to avoid the need for annual appropriations by the State for the railroad. [*Senate Committee on Commerce, Science, and Transportation, Report to Accompany S.1500, Alaska Railroad Transfer Act, Report No. 97-479, at p. 20]*

Thank you for the opportunity to provide information on this subject.

COMMENTS ON HB 127
Executive Summary
Submitted by the Alaska Railroad Corporation (ARRC)

Reasons why placing ARRC under the Executive Budget Act (EBA) is a bad idea:

- **Will cause ARRC to lose the flexibility needed to respond to business opportunities. Changes in railroad business require the ability to respond quickly with capital investment and/or operating increases when customers or circumstances demand it, a condition no other state entity such as AHFC or AIDEA must contend with. The proposed bill will make it very difficult to respond to market opportunities in a timely fashion.**

- **Will cause concerns by ARRC's major customers/lenders (e.g. Flint Hills, Usibelli Coal Mine, Lynden, TOTE, Princess, Holland America, Wells Fargo Bank) as to its ability to perform under existing long term contracts. Passage of this bill may also constitute an impairment of contract rights in violation of Article I, Section 15 of the Alaska Constitution. ARRC's existing agreements do not contain language conditioning ARRC's duty to perform on its receipt of sufficient appropriations from the legislature, as is the case in a typical state contract.**

- **ARRC's current fiscal year is the calendar year. Its business is highly seasonal, and moving to the state fiscal year would split the business season, something no prudent business person would do.**

- **By assuming substantial actual control over the financial and legal obligations of ARRC, the state may subject itself to full liability for ARRC's operations. The more control you assert over an entity, the more likely it is that you will be held responsible when things go wrong.**

- **May violate the federal Alaska Railroad Transfer Act (ARTA) which specifically provides that ARRC is to retain control of its funds. This provision was inserted in ARTA to prevent the state from repeating the mistakes that caused the federally owned railroad to lose money in almost every year of its 60-year history. A major reason that the federal railroad lost money was that all of its funds had to be appropriated under the federal budget process which deprived the railroad of the flexibility needed to respond quickly to business opportunities and prevented it from obtaining needed capital to maintain or improve service.**

- **EBA process adds time and cost without adding value.**

- **Bill seeks to fix something that is not broken. Putting ARRC under the EBA has been brought up numerous times by various parties since ARRC's creation. In each instance, the current "business" model was determined to be the superior choice.**

DETAILED COMMENTS ON HB 127

Submitted by the Alaska Railroad Corporation (ARRC)

Loss of Flexibility Needed to React to Business Changes

- **Changes in railroad business require the ability to respond quickly with capital investment and/or operating increases.**

Unlike other public corporations such as AHFC and AIDEA, which are not primarily operating entities, ARRC operates a multifaceted freight and passenger transportation and real estate business that require it to be responsive to the needs of Alaska citizens and businesses in order to be successful. The railroad industry in America is engaged in a capital intensive business that has experienced significant changes in customers' requirements, and therefore significant changes in its infrastructure, equipment and technology. Quick action is often required to respond to customers' needs and to seize business opportunities. For ARRC, this translates into the need for the flexibility to make business decisions unencumbered by rigid yearly appropriation schedules. For example, a decision to acquire new high capacity hopper cars was made during negotiations regarding export coal, in order to make ARRC's coal customer more competitive in the world markets, as well as improve service to other customers. Because this occurred during the middle of a fiscal year, it would have been difficult if not impossible to respond in a timely manner had it been necessary to seek administrative and legislative approval.

Effect on Borrowing and Contracts

- **The proposed bill may impair ARRC's ability to perform its legal obligations under long term contracts and loan agreements.**

The proposed bill does not address several legal problems that may arise if ARRC is subjected to the EBA. First, ARRC has been operating as a business for the past 24 years and has incurred legal obligations under existing long term contracts to provide a wide variety of transportation services to customers under constantly changing market conditions. ARRC also has several long term loan agreements that require ARRC to make periodic interest and principal payments. None of these agreements contains language conditioning ARRC's duty to perform on its receipt of sufficient appropriations from the legislature, as is the case in a typical state contract. Even if ARRC retains all its revenues, if it cannot expend them except in strict accordance with a legislatively approved annual budget, our existing customers/lenders may have valid concerns about its continuing ability to perform as their contracts require and may assert that their contract rights have been impaired in violation of Article I, Section 15 of the Alaska Constitution.

Second, putting ARRC under the EBA may create a risk that ARRC's existing long term debt could be called. All of ARRC's loan agreements contain provisions that allow the lender to declare a default and/or accelerate the loan if, as a result of changed circumstances, the lender deems itself insecure. Our lenders may have a legitimate reason to be concerned about ARRC's ability to repay their loans if the corporation is subjected to the EBA because there is little ARRC can do to assure them that the Legislature will

appropriate enough money to ARRC to make the payments required on their loans.

Third, ARRC must sometimes borrow funds to enable it to fulfill its contract obligations. While this bill leaves intact several provisions regarding borrowing by ARRC, placing the corporation under the EBA may jeopardize the borrowing ability of the corporation. It may be difficult for ARRC to assure its creditors that the legislature will appropriate sufficient money, or approve line entries in its budget, to pay the debt service on their loans.

Fourth, even if ARRC can overcome the non-appropriation risk, borrowing will likely be more costly. ARRC is able to borrow money at a lower interest rate than other tax exempt entities such as the State because ARRC currently meets the definition of a "small debt issuer" under Section 235 of the Internal Revenue Code. This provision allows banks to deduct approximately 80% of their carrying costs on loans to ARRC, which has in the past resulted in an interest rate that is 80-100 basis points lower than the usual tax exempt rate. If ARRC is subjected to the EBA, its finances would no longer be considered separate from the State's and it will no longer qualify for this important benefit. As a result, ARRC's cost of borrowing could increase markedly.

In short, subjecting ARRC to the EBA will limit ARRC's ability to enter into future long term contracts with its customers and lenders because every agreement it negotiates will have to have the caveat at the end "SUBJECT TO LEGISLATIVE APPROPRIATION." If we cannot assure our customers that we will have the funds and the authority to spend them to perform the services they require, they are likely to go elsewhere.

Effect of State Fiscal Year

- **ARRC's business is highly seasonal, and moving to the state fiscal year would split the business season.**

Business activity in Alaska is highly seasonal. Subjecting ARRC to the EBA will require it to change from its current calendar year as fiscal year, to the state fiscal year that ends on June 30. While there does not appear to be a specific mandate to this effect, the requirement to participate in the governor's budgeting process and seek legislative approvals will necessitate such a change. Prudent businesses close their fiscal year at the end of a business cycle, not during its busiest time. The railroad's "busy season" ends around November 1, and the calendar year is therefore the most appropriate fiscal year for ARRC. Not only would the state fiscal year artificially bifurcate the business year, but it would require the corporation to spend considerable time participating in the budgeting process at the same time it is gearing up to expand operations in May. This is not an efficient use of resources.

Effect on Liability

- **By assuming substantial actual control over the financial and legal obligations of ARRC, the State will likely subject itself to full liability for ARRC's operations.**

A major purpose of setting up an "enterprise fund" such as ARRC is to shield the State from liability in the event the enterprise goes under or incurs a catastrophic liability. ARRC has been a defendant in numerous lawsuits since its creation, and the State of Alaska has never been made a party as a result of ARRC's actions, nor called upon to answer in damages in any of these cases. Obviously, the language of AS 42.40.500 and the arm's length nature of the corporation's past relationship with the State have had the intended effect and spared the State these liabilities. This is not likely to continue once the State injects itself so substantially into the railroad's business decision-making process. Simply put, the more control you exercise over an entity, the more likely you are to become liable for the entity's obligations.

Violation of Alaska Railroad Transfer Act, 45 USC 1201 et seq. (ARTA)

- **The Transfer Act specifically requires that ARRC retain control of its funds and budget. The federal government could raise this violation of ARTA as a breach in its contract with the State of Alaska transferring the railroad.**

Section 1207 of ARTA mandates that the revenues generated by ARRC be "retained and managed by the State-owned railroad for railroad and related purposes". This provision was inserted in ARTA to prevent the state from repeating the mistakes that caused the federally owned railroad to lose money in almost every year of its 60 year history. A major reason that the federal railroad lost money was that all of its funds had to be appropriated under the federal budget process which deprived the railroad of the flexibility needed to respond quickly to business opportunities and prevented it from obtaining needed capital to maintain or improve service.

This bill could infringe on that "management" right in several respects. For example, inclusion of ARRC under the EBA could have the effect of prohibiting the corporation from hiring additional employees or expending any money or incurring other obligations unless these items were included in an operations plan approved by OMB, which must in turn comport with a budget approved by the legislature. See AS 37.07.080(d). If ARRC receives excess funds from its operations (beyond what is expected and accounted for in its approved budget), it must convince the administration to propose a revision to the Legislative Budget & Audit Committee and possibly wait 45 days before expending the money. See AS 37.07.080(h). Not only does this run afoul of "management" rights provided in ARTA, but it also provides another example of the potential loss of business if ARRC is brought under the EBA. One can foresee a multitude of business opportunities or potential employees that will not wait the time required to obtain such approvals and, accordingly, be lost to the corporation.

As noted below, there does not appear to be any requirement that all of the money generated by ARRC be paid into the state treasury. However, in light of the "appropriation" language used in the bill, the bill's intent is not entirely clear. If the design is for ARRC revenues either (1) to be "state funds" which are then appropriated back to the corporation or (2) to be held by the corporation but only expended pursuant to an approved budget, then the corporation no longer has the "management" rights required by Section 1207 of ARTA. In addition, if all of ARRC's revenues are not either appropriated back to the corporation or approved to be used in the corporation's budget, part of ARRC's revenue could be used to

fund a program or project that is totally unrelated to the railroad. This too would violate the mandate of ARTA Section 1207.

EBA Process Adds Time and Cost Without Adding Value

- **Participating in the budgeting process as proposed will substantially increase the costs of doing business. It is unreasonable to expect the customers to bear this additional cost.**

Subjecting ARRC to the EBA will add an unnecessary layer of expense and time consuming government bureaucracy to what is currently a profitable and self-sustaining asset. Numerous provisions throughout the EBA impose procedures with considerably different focus and detail than ARRC currently develops, such as the "agency program," "financial plan" and "operations plan." In addition, involvement of additional layers of governmental agencies (OMB, LB&A, etc.) to business sector decision-making will delay the process and therefore result in less flexibility to react to business climate changes. All of these add significant costs to ARRC's operations without adding any value. These costs will ultimately be paid by railroad customers or, worse still, by the corporation in the form of lost opportunity.

Inconsistency of Approach

- **The inconsistencies found in the bill illustrate the difficulty in separating the financial management of the corporation from the operational management left to ARRC.**

The bill expressly subjects ARRC's revenues to legislative control by making the corporation subject to the EBA. Yet, it does not change the primary legislative purposes embedded throughout the Alaska Railroad Corporation Act that require the corporation (1) to be exclusively responsible for management of the financial and legal obligations of the Alaska Railroad, (2) to carry out its responsibilities on a "self-sustaining basis," and (3) to provide for the "prudent operation of the railroad according to sound business management practices." The bill requires ARRC to "request, in accordance with AS 37.07, appropriations from the legislature to carry out the provisions of this chapter". Under this bill, ARRC will have to seek an annual appropriation for all expenditures of the corporation, with all the accompanying budget, operations plan and other documents that are generated in the governor's budgeting process. However, the EBA itself does not require ARRC revenues to be paid into the general governmental treasury[1/] and it is unclear whether the bill contemplates this result. If ARRC is to retain its receipts, it is inconsistent to require the corporation to seek appropriations for operating and other expenditures.

[1/] Another section of the Public Finance title, AS 37.05.146, provides that ARRC receipts are not general fund receipts. Without any other section of that title being made applicable to ARRC, there is apparently no requirement that corporation funds be paid over to the state treasury.

Conclusion: HB 127 Seeks to Fix Something That is Not Broken

The most perplexing issue about HB 127 is that the impetus for the bill isn't coming from the citizens or businesses served by the railroad, or from the communities being served. Nor is it supported by any research or studies such as those provided by the Harvard Business School and University of Alaska Institute for Social and Economic Research that led the 13th Legislature to adopt the current business model that exempts ARRC from the EBA. The railroad as it exists today has provided Alaska with the best of all possible worlds-- the State owns the asset but has none of the liability associated with its operations, the railroad pays its own way as well as making a profit, and it operates an essential transportation service without any burden on the taxpayers. In short, the Alaska Railroad is working just fine as it is currently structured. It makes no sense to make so sweeping a change without any demonstrable reason.

HB 127 COMMENTARY

IS IT TIME TO RESTRUCTURE THE ALASKA RAILROAD CORPORATION?

HB 127 seeks to make a fundamental change in the operation of Alaska Railroad Corporation (ARRC) despite the fact that the current operational structure has worked very well for the past 24 years and has produced substantial benefits for the State of Alaska since the State acquired the Alaska Railroad from the Federal Government in 1985. In ARRC as currently formulated, the State has a well-run, self-sustaining transportation instrumentality that provides safe, economical, and efficient transportation to residents, businesses, visitors, and military installations in the State. In the past 24 years since transfer, ARRC has been profitable for 20 of those years, made hundreds of millions of dollars in capital improvements to the railroad's track infrastructure, facilities and railcar/locomotive fleet and has grown to have an asset value approaching $1 billion. All of this was accomplished without ongoing State appropriations.

The enormous success of the present ARRC model did not occur by accident. Rather, it was the result of an essential policy decision made by the decision makers within the State of Alaska after several years of studies, debate, discussions and careful consideration as to the type of entity that would operate the railroad under state ownership.

Alaska Railroad Perspective: Government Agency or Business?

During the 60 years prior to the transfer of the Alaska Railroad to the State in 1985, the Federal Government operated the railroad primarily from a governmental perspective as a typical, inefficient federal bureaucracy within the Federal Railroad Administration (FRA) that required yearly injections of tax payer dollars to meet its operating and capital expenses. Historically, the role of the railroad was subject to considerable confusion. At various times it was a frontier development tool, a part of the national defense system, a vehicle for implementing federal policies, a resource recovery mechanism, a repository for surplus federal material, a means of social service delivery and, on occasion, a market place railroad. The lack of a clear set of goals placed a severe limitation on the railroad's ability to satisfy any one of these purposes adequately. As a consequence, except for a few years during World War II and the pipeline construction, the Alaska Railroad lost money every year.

Moreover, because the Alaska Railroad was subject to the federal capital budget/appropriation process, it was never able to obtain sufficient capital money to fund such necessary items as annual cross-tie replacement, track surfacing, major equipment repair/refurbishing, new equipment acquisitions, building repair, etc. The Federal Government always seemed to have better, more politically motivated things to do with its money. As a result of the lack of capital investment, the physical plant of the railroad deteriorated, operating expenses increased and service levels declined.

At the time of transfer, there was an estimated $100,000,000 in deferred maintenance associated with the property.

By 1979, it became apparent that the Alaska Railroad had become a fiscal and political liability for the FRA and it approached the State of Alaska with a proposal to transfer the railroad to the State. The State responded that while it regarded the railroad as an integral part of Alaska's transportation infrastructure, it was hesitant to involve itself directly in the operation of the railroad which had historically operated at significant annual losses. In 1980, the State commenced an in-depth assessment of the multitude of issues related to the transfer proposal. It retained experts to advise it and commissioned reports and studies to be prepared as to what would be the best organizational alternative for the Alaska Railroad under state ownership, one that would not perpetuate the financial failures of the federally owned railroad.

With this goal in mind and based upon input from several experts, the State made the critical policy decision that a state owned railroad had to be governed by a business orientation rather than a government agency perspective in order to prevent the railroad from becoming entrenched as another state bureaucracy. Based upon studies prepared by such entities as the Harvard Business School and the University of Alaska Institute of Social and Economic Research, the State decision makers determined that each potential organizational structure should be measured by the extent to which it satisfied the following criteria:

1. Freedom from—and equal legal standing with—government to take advantage of management and market opportunities.

2. Ability to access and obtain private and public capital funds.

3. Management freedom for the railroad's operational decisions within established policies.

4. Clear-cut lines of management responsibility and accountability for decisions which are made.

5. Marketing freedom within established policies and budgetary constraints.

6. Clear decision-making authority without a cumbersome and bureaucratic process.

7. Management capability to make long-term commitments within established policies.

8. Management freedom to negotiate solutions to problems and to take advantage of service opportunities.

9. Industrial development capability on railroad land.

10. Performance-based personnel management including the direct ability to hire, fire, promote, train, supervise and direct required railroad employees.

11. Ability to provide financial and other incentives for performance.

Using the above criteria, the 13th Alaska Legislature determined that the organizational structure that would provide the best chance for a viable state owned railroad was a public corporation that (1) would be exclusively responsible for the management of the financial and legal operations of the Alaska Railroad, (2) would have the ability to raise capital from the private sector, (3) would carry out its responsibilities on a self-sustaining basis, and (4) would provide for prudent operation of the railroad according to sound business management practices, i.e. the Alaska Railroad Corporation as it is currently structured under AS 42.40. The 13th Alaska Legislature specifically exempted ARRC from the Executive Budget Act in order to satisfy the abovementioned organization criteria and to assure that the railroad would have the flexibility to operate from a business perspective.

Proposed HB 127 seeks to place ARRC under the Executive Budget Act. If adopted, this legislation will turn the railroad into a line agency of the State that will be unable to respond quickly to business opportunities and may even have to compete for state operating and capital funds with other agencies. This organizational structure was expressly rejected by the 13th Legislature because the same limitations and problems encountered by the Alaska Railroad as a federal agency would also be present with the railroad as a state agency.

The in-depth assessment of the Alaska Railroad conducted during the five years before transfer determined that the majority of the federally owned railroad's financial problems were due to the requirement that the railroad follow federal budgeting procedures rather than allowing its management to develop operating and capital programs on the same basis as a privately owned railroad. Specifically, the federal budget procedures requirement caused the following problems:

1. Obtaining needed capital appropriations was difficult and usually political, providing the Alaska Railroad with little assurance that required funds would be available when needed. The funding by appropriation mechanism made it impossible for the railroad to realistically plan and budget for more than a year in advance. The lack of needed capital also caused the railroad's physical plant to deteriorate, which increased operating costs and made it more difficult for the railroad to compete for new business.

2. Eliminated the flexibility management needed to take advantage of new business opportunities. Alaska's economic activity is dynamic, which means that rail service needs the ability to change frequently during a fiscal year. Under the funding by appropriation mechanism, the federally owned railroad lost numerous business opportunities because, needing congressional

appropriations, it could not make business commitments quickly enough to meet the potential customer's needs.

3. Compliance with the bureaucratic federal budget procedures created an expensive and time consuming burden on the Alaska Railroad. The railroad was required to spend time trying to force its operation into a format that was designed for federal agencies. This resulted in a substantial amount of nonproductive time being expended in preparing reports, budget submittals, etc. that had no significant management value.

Considerable State Oversight Exists in Current Business Model

Although the exemption of ARRC from the Executive Budget Act solved the major problems that plagued the federally owned railroad, the 13th Legislature nonetheless recognized that because the railroad was publicly owned, it was important to maintain significant State oversight over ARRC's operation and management practices. This oversight is accomplished by the following requirements:

1. The ARRC Board of Directors is responsible for providing an annual report of the operations and financial condition of the corporation to the Governor, making it available to the legislature as well.

2. The ARRC Board of Directors is responsible for initiating both a financial and performance audit each year. As required by statute, the financial audit is performed by an independent certified public accountant. Copies are provided to the Governor and the Legislature each year. In addition, a recognized railroad management expert conducts the annual performance audit to ensure ARRC is managed and operated effectively and efficiently.

3. ARRC must file an oversight report with the Legislature and Governor before it undertakes expansion, reduction, or diversification of train services that represents a significant and permanent change in service level.

4. Legislative approval is required for certain corporate actions, such as disposing of the Railroad's entire interest in land, leasing land for longer than 55 years, or selling tax exempt bonds.

5. The Legislative Budget and Audit Committee regularly reviews ARRC's operation and management practices.

6. ARRC's procurement procedures are required to be substantially equivalent to state procurement requirements.

7. ARRC employees and directors are subject to the Executive Branch Ethics Act.

8. The Commissioners of the Alaska Department of Transportation and Public Facilities and the Department of Commerce, Community and Economic Development both serve on ARRC's board of directors.

9. ARRC's spill prevention and response plans are filed with and regulated by the state. ARRC is required by state law to show sufficient financial responsibility to respond to spills.

10. ARRC must provide public notice before entering into leases or other disposals of an interest in land.

Conclusion

The rationale for exempting ARRC from the Executive Budget Act is as valid today as it was 24 years ago. In exempting ARRC from the Executive Budget Act, the 13th Legislature understood the need for the state-owned railroad to operate as an independent business, free from political concerns and the unnecessary cost of bureaucratic attachments. They understood that railroad business, safety, and environmental decisions have to be made based on the facts and merits of the situation, and not unnecessarily biased or encumbered by political considerations. They understood that dependence on appropriations from the State would automatically slow down day-to-day decision-making in a very complex and dynamic transportation business where customers depend on the railroad's ability to respond quickly to market demands.

In short, the ARRC business model, as it exists today, works very well and, as a result, ARRC has never requested State dollars for its operation. We firmly believe that the Legislature should be proud that this business is providing a valuable service to Alaska's economy, satisfying its customers, and paying its own way. The Alaska Legislature should not undermine ARRC's continuing viability by injecting the Executive Budget Act into its operations. ARRC needs to be at the very top of its game if it is to someday support a new pipeline, Department of Defense development, growing tourist numbers, a future need for commuter rail support, and/or expansion into Canada or ultimately north beyond Fairbanks. HB 127 threatens that readiness to take on growth and development within the state, a hallmark of ARRC's history and track record.

Rebecca Rooney

From: Wendy Lindskoog [LINDSKOOGW@akrr.com]
Sent: Friday, March 06, 2009 5:41 PM
To: Rep. Peggy Wilson
Cc: Patrick Gamble
Subject: Pat Gamble's letter to Rep. Stoltze
Attachments: Representativr Stoltze March 6, 2009.pdf

Representative Wilson: I hope this e-mail finds your husband doing well. Mr. Gamble asked that I forward you a copy of the letter we sent to Representative Bill Stoltze. Mr. Gamble is hoping to provide his testimony on HB 127 in person on March 17th. We will both be in town that day for a Senate Finance hearing as well. He will also try to call in to the hearing on March 12th if his schedule allows. I have asked your staff to provide me the call in number. See you in Juneau soon,

Wendy Lindskoog
Assistant Vice President Corporate Affairs
907-265-2498
lindskoogw@akrr.com

AT&T 20.63

Executive Office
Telephone: 907-265-2403
Facsimile: 907-265-2312

March 6, 2009

The Honorable Bill Stoltze
Representative
State Capitol, Room 515
Juneau, AK 99801

Dear Representative Stoltze:

Your staff probably mentioned that I called Wednesday to be sure I clearly understood your rationale for introducing House Bill 127 which places the Alaska Railroad under the Executive Budget Act. Another reason for my phone call was to express concern about the scheduled hearing in House Transportation regarding this bill on March 12, 2009, a day I am unable to attend.

I will be in Washington D.C. from March 9th through the 13th meeting with various governmental agencies including the Department of Defense, Federal Railroad Administration, and the Corps of Engineers, as well as all three members of our Congressional Delegation. Since it was our understanding that the Juneau hearing for HB 127 would likely occur on March 17th, I had arranged my appointment schedule accordingly. Under normal circumstances I am happy to rearrange my calendar to accommodate hearing changes in Juneau. Unfortunately, I cannot reschedule this particular trip to Washington D.C.

As I am sure you have already determined, placing the Alaska Railroad under the Executive Budget Act would fundamentally change the way the railroad was intended to operate by the legislature that approved the Corporation Act (AS 42.40). It would entail a careful and comprehensive rewrite of the Act in order to make very clear the way in which the Executive Budget Act would enhance the existing Railroad model and make it a better operating business enterprise of the State. I think we could all agree that is not a trivial matter to be dealt with in haste. Which brings me to my point.

327 W. Ship Creek Avenue
Anchorage, Alaska 99501

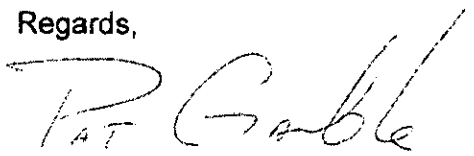
MAILING ADDRESS
P.O. Box 107500 Anchorage, Alaska, 99510-7500

TEL 907.265.2300 FAX 907.265.2416
AlaskaRailroad.com

Representing the Alaska Railroad as its President and CEO, I feel strongly that I need to attend this major State policy discussion in person before the House Transportation committee and future committees the bill may be scheduled in. I believe it is imperative during the legislative hearings to dialogue face to face with legislators on this important matter, rather than by teleconference. I have requested that the House Transportation Committee Chair consider rescheduling this bill for March 17th, or a future date, in recognition of the value our personal dialogue would bring to these landmark deliberations. I would appreciate your support in this request.

It is my hope that we can assist your efforts to examine this proposition. Once they are presented my staff and I are standing by to address your specific concerns.

Regards,



Patrick K. Gamble
President and CEO

Rebecca Rooney

From: Rep. Bill Stoltze
Sent: Monday, March 09, 2009 11:37 AM
To: Patrick Gamble
Cc: Rep. Peggy Wilson
Subject: RE: PDF

Mr. Gamble.

I understand your interest in delaying this legislation. I am sorry it took you so long to try to contact me directly I have certainly received NUMEROUS messages and contacts from individuals who were contacted by members of your organization (just about every route but the direct one- calling me!) The most casual observor can note that you have no shortage of high level railroad officials who can participate in the first meeting, in the first committee of referral on what will be the 52nd day of the 90 day session. The call on scheduling is certainly up to Chair Wilson, but I favor having the 1st hearing at the earliest date possible

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From: Patrick Gamble [Gamblep@akrr.com]
Sent: Friday, March 06, 2009 5:45 PM
To: Rep. Bill Stoltze
Subject: PDF