(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.

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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

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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:

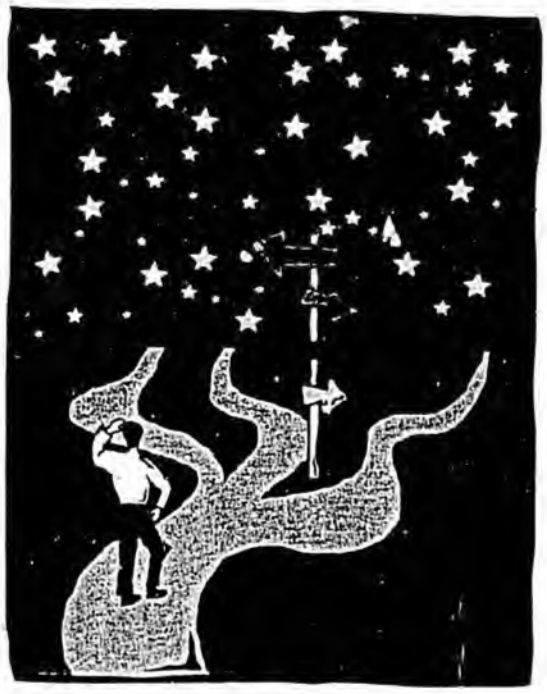
1. Develop a long-term energy plan to efficiently enhance Alaska's economic future.

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.

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Senator Fred Dyson

Seward Electric
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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

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March 29, 2004

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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
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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

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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.

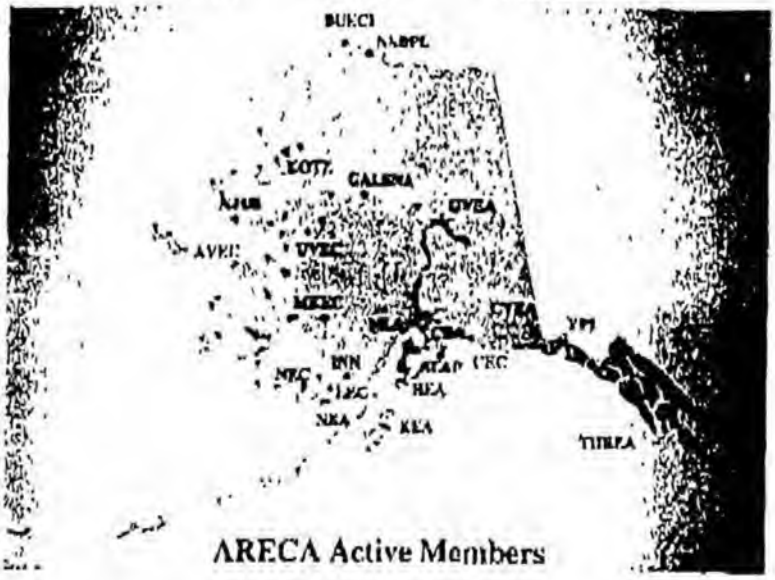
Testimony in favor of HB 453

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

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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.

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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

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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

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[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

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[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

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[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
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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.

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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.

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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.

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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.

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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.

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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

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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:

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[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).

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- 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.

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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.

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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.

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- 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.

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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.

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[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.

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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.

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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.

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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.

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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)

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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.

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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.

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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

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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